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Limited Liability Companies in Kentucky: Applications & New Topics for the LLC

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Limited Liability Companies in Kentucky

Applications & New Topics for the LLC

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LIMITED LIABILITY COMPANIES IN KENTUCKY
Applications & New Topics For The LLC

TABLE OF CONTENTS

BATTLE OF THE CLOSELY-HELD BUSINESS ENTITIES OF CHOICE:
S CORPORATIONS VERSUS LLCs IN THE POST CHECK-THE-BOX ERA

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BATTLE OF THE CLOSELY-HELD BUSINESS ENTITIES OF CHOICE:
S Corporations versus LLCs in the Post Check-The-Box Era

TABLE OF CONTENTS

CHOICE OF BUSINESS ENTITY
S Corporations Versus The Limited Liability Company

I. General Philosophy Of Choice Between The S Corporation And The Limited Liability Company.

- Under what circumstances do you use one or the other
- Panel member's basic choice and reasons for that choice
- Consideration of other choices: C corporations; limited partnerships; REITS; etc.

II. Panel Discussion Topics Relating To Choice Of Entity:

A. Ease and cost of formation.

B. Capital raising through corporations vs. LLCs (*e.g.*, S corporation use of ESOPs).

C. Management issues (*e.g.*, structure, delegation, standard of conduct, agency).

D. Self-employment tax issues.

E. Contributions/distributions of appreciated property/wrongful distributions.

F. Problems with S corporations relating to the identity/characteristics of owners.

G. Uses of qualified S corporation subs and single-member LLCs.

H. Estate planning issues: use of family LLCs; limitations on S corporations (*e.g.*, types of trusts). Use of GRATs for S corporation stock.

I. Legal/regulatory issues: Kentucky Supreme Court Rule on attorney practice through PSCs and PLLCs; statutory limitations on use of LLCs (KRS 287.030(2) (banks) and KRS 304.3-070(1) (insurance companies).

J. Liability shield: piercing the corporate versus LLC veil.

K. Participation in tax-free reorganizations: step transaction issue for LLCs; business entity merger and conversion statutes.

L. State tax issues (*i.e.*, income, license, sales taxes, nonresident issues).

M. LLC's ability to use special allocations; S corporation's limits on classes of equity.

N. Compensation planning through S corporations versus LLCs: incentive stock options; equity-based compensation issue; employee versus member issue.

O. Advantages of C corporations versus the LLC and S corporation.

P. Advantages of limited partnership versus the LLC and S corporation.

Q. Exempt organization issues.

R. Check-the-box issues.

S. Securities law issues.

CHOICE OF ENTITY—INCOME TAX CONSIDERATIONS
by
Charles J. Lavelle and Charles Fassler

In examining the income tax considerations in choosing an entity, the first decision is whether to select an entity with corporate tax patterns or a pass through entity. An entity taxed as a corporation will pay tax at the entity level; the owners will generally not pay any tax on the corporation's undistributed earnings, but will normally pay tax on distributions from the corporation. A pass through entity does not generally pay tax at the entity level; however, the owners will generally report the entity's income, gain and loss on their individual returns in the year earned.

C corporations are taxed as corporations, as are public limited partnerships and entities (such as business trusts or other associations) that elect to be treated as corporations under the check-the-box regulations. They are called C corporations because they are chiefly governed by Subchapter C of Chapter 1 of Subtitle A of the IRC.

S corporations, general partnerships, limited partnerships, LLPs and LLCs, unless they elect otherwise, are pass through entities. Most taxpayers will want their LLCs to be taxed as partnerships; accordingly, unless otherwise indicated, we will assume that the LLC will be taxed as a partnership.

We will address the typical situation of several owners conducting a business and not discuss publicly traded entities. We will generally not discuss an affiliated group of corporations that file a consolidated return. The special taxation of trusts and estates, foreign entities operating in the United States, insurance companies, real estate investment trusts, foreign sales corporations and other special entities are also beyond the scope of this section.

<u>Overview of Tax Aspects of Choice of Entity</u>

Before concentrating on the details, this paragraph discusses the broad tax considerations in selecting an entity. Depending on the entity selected, there may be markedly different tax treatment to the entity and the owners relating to: contributions to the entity; basis in the entity's assets and the entity's ownership interests; operations at a profit or a loss; recognition and utilization of losses; distributions by the entity; dispositions of ownership interests, etc. These are discussed below for each entity in detail.

In the broadest terms, a C corporation pays tax on its income and the shareholders pay tax on the C corporation's after-tax earnings when they are distributed to the shareholders. Also, in broad terms, the owners of general partnerships, limited partnerships, S corporations, LLPs and LLCs pay personal tax on the earnings of these entities as they are earned; these entities generally do not pay an entity level income tax. Beyond these very general statements, there can be very different tax consequences among the various entities on the wide variety of transactions involved in the establishment, operation and liquidation of a business entity.

In most circumstances, organizing the business is tax-free, although there are circumstances when tax will result at the business' creation. The entity's bases in the contributed assets and the owners' bases in their entity interests may vary depending on the entity. While C corporations are generally permitted to pay a tax on income and retain the earnings, there are limits which ultimately compel distributions. The taxability of distributions varies widely depending on the circumstances and the entity involved. The ability to recognize and utilize losses also depends on the circumstances and the entity. Depending on the facts and the entity, periodic distributions may be taxable or nontaxable, capital or ordinary. Finally with some entities, even liquidating distributions of property may not result in a final tax reckoning; that may await a cashing out of the property received.

Thus, while each of the pass through entities will ultimately impose approximately the same amount of income tax on the same amount of income, careful selection and planning may create such a significant disparity among the entities as to when the taxes must be paid, that one form is superior to the others.

Further, if the owners are individuals, some of that deferral can become permanent because of the step up in basis to fair market value upon death. Because each business has unique circumstances, there is no single answer to which entity should be selected; and, because LLCs are relatively new, certain of the issues have not been resolved. However, in many respects LLCs combine most of the advantages of the various entities, without some of the disadvantages that some of the entities have.

Corporate Income Tax Rates

The tax rates of a C corporation are as follows (IRC § 11):

- 15% for taxable income through $50,000
- 25% for taxable income between $50,001 through $75,000
- 34% for taxable income between $75,001 through $10,000,000 plus 5% of taxable income between $100,001 through $335,000
- 35% for taxable income above $10,000,000 plus 3% of taxable income between $15,000,000 and $18,333,333

Capital gains are taxed at the same rates as ordinary income, not to exceed 35 percent. IRC § 1201. Personal service corporations are taxed at a uniform 35 percent rate on all taxable income. IRC § 11(b)(2). The alternative minimum tax is imposed to the extent that 20 percent of alternative minimum taxable income exceeds the regular tax; in computing alternative minimum taxable income, the corporation is entitled to an exemption of $40,000, which phases out at the rate of 25 percent of the amount by which the alternative minimum taxable income exceeds $150,000. Alternative minimum taxable income is computed by modifying taxable income for certain tax preferences and adjustments. The purpose of the alternative minimum tax is to require each corporation to pay a minimum amount of tax, even if it would not have any tax liability under the regular tax.

An environmental tax equal to .12 percent is imposed on so much of the alternative minimum taxable income (without taking into account the alternative minimum tax net operating loss or the environmental tax) as exceeds $2,000,000. IRC § 59A. C corporations are also generally subject to an accumulated earnings tax, if they are formed or availed of for the purpose of avoiding tax at the shareholder level by accumulating profits rather than distributing them. The accumulated earnings tax is equal to 39.6 percent of the corporation's accumulated taxable income. IRC §§ 531-537. A personal holding company tax is imposed upon personal holding companies equal to 39.6 percent of undistributed personal holding company income. IRC §§ 541-565. The tax is generally imposed on closely held corporations (where 50 percent of the value of the stock is directly or indirectly owned by five or fewer individuals) that earn too great a portion of their income from personal holding company income (such as dividends, interest, certain royalties, certain rents, etc.) and do not distribute sufficient dividends IRC § 542(a). Closely held C corporations are subject to the at risk and passive activity loss rules described *supra* IRC §§ 465(a)(1)(B) and 469(a)(2)(B).

Individual Income Tax Rates

The individual income tax rates generally consist of five graduated rates: 15 percent, 28 percent, 31 percent, 36 percent and 39.6 percent. The levels at which the income tax rates change differ for married taxpayers filing jointly; married taxpayers filing separately; heads of households; and single taxpayers. The brackets are adjusted annually for inflation. For 1998, the rates for each category were imposed on the following amounts of taxable income:

	Married Filing Joint	Head of Household	Unmarried Individuals	Married Filing Separately
15%	0 to $42,350	0 to $33,950	0 to $25,350	0 to $21,175
28%	$42,351 to $102,300	$33,951 to $87,700	$25,351 to $61,400	$21,176 to $41,150
31%	$102,301 to $155,950	$87,701 to $142,000	$61,401 to $128,100	$51,151 to $77,975
36%	$155951 to $278,450	$142,001 to $278,450	$128,101 to $278,450	$77,976 to $139,225
39.6%	above $278,450	above $278,450	above $278,450	above $139,225

Most long-term capital gains are taxable at no more than 20 percent. IRC § 1(h).

The alternative minimum tax discussed above for corporations also applies to individuals, although some of the preferences and adjustments differ from those applicable to corporations. IRC §§ 55-59. The alternative minimum taxable income in excess of an exemption amount is taxed at a 26 percent rate on the first $175,000 and a 28 percent rate above that. The $45,000 exemption amount used in computing alternative minimum taxable income for joint returns or surviving spouses is phased out beginning at alternative minimum taxable income of $150,000. The exemption amount and phase out levels are different for single taxpayers and married taxpayers filing separately.

Taxation of C Corporations

C corporations pay a tax on their taxable income at the rates set forth *supra*. Corporations that are members of an affiliated group and file a consolidated return pay a single tax at those rates. As noted above, individual shareholders do not include any of the income or loss of C corporations in their individual returns.

Taxation of Contributions to C Corporations

Under IRC § 351, when shareholders contribute property to a C corporation solely in exchange for stock of that corporation, there generally is no gain or loss to the shareholders, if, after the exchange, the contributing shareholders own 80 percent of the stock of the corporation. There is an exception to nonrecognition treatment in the case of an investment company. IRC § 351(e)(1). If the provisions of IRC § 351 are met, then the shareholders will have a basis in their stock equal to the basis in the property contributed; the corporation will receive bases in the assets received equal to their bases in the shareholders' hands.

If the transferors also receive "boot" (money or property in addition to stock), they recognize gain (but not loss) to the extent of the money and fair market value of the property. The basis in the stock is reduced by the money and value of property received and increased by the gain recognized. IRC § 358. If the shareholder receives stock for services, the stockholder has income taxable under IRC § 83.

If the requirements of IRC § 351 are not met, then the transferors generally recognize gain or loss equal to the difference between the value of the stock received and the basis in the assets contributed; however, the loss may be disallowed under IRC § 267, for any transferor treated as owning more than 50 percent of the stock of the corporation after application of the attribution rules. The corporation has a basis in the assets received equal to the fair market value of the stock exchanged. B. Bittker and J. Eustice, Federal Income Taxation of Corporations and Shareholders, ¶ 3.12[4] at 3-63 n. 286 (6th ed. 1994). However, the corporation does not recognize gain or loss on issuance of stock for property. IRC § 1032.

There are often liabilities assumed by the corporation in an incorporation. With two exceptions, a transaction otherwise qualifying under IRC § 351 will remain tax-free to the transferor even if the corporation assumes the transferor's liabilities, or takes property subject to a liability. IRC § 357(a). The two exceptions are (1) if the liabilities exceed the total bases of the properties transferred, then gain is recognized to the transferor equal to such excess (IRC § 357(c)), and (2) if the principal purpose of a liability was either not a bona fide business purpose or was to avoid Federal income tax, then all of the liabilities will be treated as money received by the taxpayer in the exchange (IRC § 357(b)).

Basis in C Corporation Stock

A shareholder has a basis in his or her stock equal to the basis determined for his or her stock as set forth *supra*. This basis is unaffected by the operating income or loss of the corporation. The basis is reduced if the C corporation's distributions are nontaxable to the shareholder, as set forth *supra*. If the shareholder lends money to the C corporation, the shareholder has a basis in the debt equal to the amount loaned.

Taxation of C Corporation Distributions

A corporation that distributes money or property to its shareholders in respect of their stock does not receive a deduction. If property is distributed, the corporation recognizes income (but not loss) equal to the amount by which the value of the property exceeds the corporation's basis in it. IRC § 311(b)(1). The corporation's earnings and profits are increased by the amount of the excess of the fair market value of such property over its basis for determining earnings and profits, and reduced by the fair market value of such property. IRC §§ 312(a)(3) and (b). If the property's basis exceeds its value, the earnings and profits are reduced by the adjusted basis of the property. IRC § 312(a)(3). A distribution is taxed as a dividend to the individual shareholder, if the corporation has either accumulated earnings and profits or earnings and profits during the year of distribution, computed at the end of the year. IRC §§ 301(c) and 316. To the extent the distributing corporation does not have such earnings and profits, then the distributions are nontaxable returns of capital to the extent of basis, then capital gain distributions thereafter. IRC § 301(c).

If the distribution is in redemption of shares, it will be treated as described in the preceding sentence (generally as ordinary income without reduction for the basis of the redeemed shares under IRC § 301(c)), unless it is treated as a payment in exchange for stock under IRC § 302(b). IRC § 302(b) will apply if any of four criteria are met: (1) the redemption is not essentially equivalent to a dividend; (2) after the redemption, the shareholder has less than 50 percent of the stock and less than 80 percent of the percentage of the stock the stockholder previously held; (3) the redemption terminates the shareholder's interest in the corporation; or (4) it is in partial liquidation of a noncorporate shareholder's interest. Each of these categories has additional rules and require that attribution rules apply.

If a corporation liquidates, it will generally recognize gain or loss as if it had sold all its property to its shareholders at fair market value. IRC § 336(a). There are limitations on the loss if the distribution is non pro rata or if the property was received under IRC § 351 within five years of the distribution. IRC § 336(d). The taxation of the liquidating corporation was instituted in the Tax Reform Act of 1986. Before that, such liquidations were not taxable under IRC § 336; the nontaxability codified the decision in General Utilities & Operating Co. v. Helvering, 296 U.S. 200 (1935). The adoption of corporate level tax in 1986 is generally referred to as the repeal of the General Utilities doctrine.

Taxation on Dispositions of C Corporation Stock

Shareholders recognize losses on their stock when shares are sold for less than their basis or if the shares become worthless. IRC §§ 165(g)(1) and (2). The losses are capital losses and will be long or short term depending upon whether the holding period is more or less than one year. Worthless stock is treated as sold on the last day of the year. Under IRC § 1244, up to $50,000 ($100,000 for married taxpayers filing jointly) of such loss on stock in small corporations may be deducted as an ordinary loss. Among other limitations, such stock must have been issued by the corporation to the shareholder in exchange for money or property; the corporation must be in an active business and may not have paid or contributed capital exceeding $1,000,000. The gain on the sale of stock may be treated as ordinary income under certain circumstances. *See, e.g.*, IRC §§ 306 and 341 (relating to collapsible corporations).

Under certain circumstances, a shareholder may exclude up to 50 percent of the gain from the sale of shares of "qualified small business stock" held for more than five years. IRC § 1202. "Qualified small business stock" is generally C corporation stock issued after August 10, 1993, by a corporation meeting size limitations and conducting an active business, which was acquired at the time the corporation initially issued the stock for money or property (other than stock). The stock of a small business investment company under section 301(d) of the Small Business Investment Act of 1958 will meet the active business requirement. IRC § 1202 describes the additional rules applicable to this exclusion.

A taxpayer may defer gain on the sale of publicly traded stock, if he or she reinvests the proceeds into a specialized small business investment company under section 301(d) of the Small Business Investment Act of 1958 within 60 days. IRC § 1044. The deferred gain is limited to $50,000 per year, not to exceed $500,000 for a lifetime for individuals and $250,000 per year, $1,000,000 in total, for C corporations.

Shareholders will generally be able to receive, tax-free, stock in a corporation which is part of a reorganization under IRC § 368 or distributions of stock of a controlled corporation under IRC § 355 (such as spin-offs, split-offs and split-ups). The general tax-free character of many of these transactions may be retained, even if property is distributed in addition to the stock, but the property will be taxed under IRC § 356(a).

Compensation of C Corporation Shareholders

Salaries paid to C corporation shareholder employees are deductible by the corporation if they are reasonable for the services rendered; they are includable in the income of the shareholder. By being deductible to the corporation, the payments escape the two levels of tax generally applicable to payments to C corporation shareholders. For this reason, the IRS has often challenged the deductibility of compensation paid to shareholders. It is extremely difficult to generalize in this area because the cases are so fact specific. Some corporations paying large salaries have been successful, while others (even those with a large proportion of professional income) have not. *Compare, e.g.*, Home Interiors & Gifts, Inc. v. Commissioner, 73 T.C. 1142 (1980) with Richlands Medical Association v. Commissioner, T.C. Memo 1990-660 (1990), *aff'd* without published opinion, 953 F.2d 639 (4th Cir. 1992). This issue is avoided completely if a pass through entity is used. Similarly, the $1,000,000 cap on compensation under IRC § 162(m) is only applicable to publicly traded corporations.

The opposite issue arises for S corporations. The shareholders will pay income tax on their distributive share of income plus their salary. However, only the salary is subject to social security tax; there is no self-employment tax on their distributive share of income. Rev. Rul. 59-221, 1959-1 C.B. 225. The IRS has ruled that an S corporation may not pay an unreasonably low salary in order to avoid the self-employment tax. Rev. Rul. 74-44, 1974-1 C.B. 287.

S Corporations and Their Limitations

If a corporation meets certain qualifications, it and its shareholders may elect under Subchapter S of Chapter 1 of Subtitle A of the IRC to have the corporation generally taxed as a pass through entity, with no tax at the corporate level, and with the gain or loss passed through to the shareholders. Initially there were very stringent restrictions on S corporations. While these limitations have been relaxed over time, they can still pose a substantial burden on some entities.

S corporations may only have 75 shareholders. IRC § 1361(b)(1)(A). Each of the shareholders must be an individual, estate or certain specified trusts, including a "qualified subchapter S trust" ("QSST") and an "electing small business trust" ("ESBT"), and certain tax-exempt entities. IRC §§ 1361(b)(1)(B), (c)(2), (c)(6), (d)(1) and (e). Thus, an S corporation may not have a shareholder that is a corporation (unless the corporation is an S corporation, owns all of the stock of the S corporation and makes a qualified subchapter S subsidiary election for the subsidiary), partnership or trusts other than the permitted trusts. Further, nonresident aliens may not be shareholders of S corporations. IRC § 1361(b)(1)(C). A husband and a wife are treated as one shareholder for purposes of counting the number of shareholders. IRC § 1361(c)(1).

In a reversal of policy, the IRS has approved a strategy that may effectively relax the 75 shareholder limitation. Rev. Rul. 94-43, 1994-2 C.B. 198, reconsidered and revoked Rev. Rul. 77-220, 1977-1 C.B. 263, a ruling involving thirty individuals who formed three identical S corporations, each of which had ten different shareholders; the three S corporations formed a partnership to conduct a single business. The principal purpose for forming three corporations instead of one was to avoid the then ten shareholder limitation of S corporations. The IRS ruled in Rev. Rul. 77-220 that the S corporation elections were invalid because the three corporations would be treated as one for purposes of the S corporation election. Rev. Rul. 94-43 revoked Rev. Rul. 77-220 stating that the shareholder limit is to obtain administrative simplicity in the corporation's affairs. Because administrative simplicity is not undermined by being a partner with other S corporations, the S corporation election should be respected.

S corporations must be domestic corporations and cannot be financial institutions that use the reserve method for computing bad debts, insurance companies or certain other special corporations. An S corporation election by a corporation which was previously a C corporation and which has C corporation earnings and profits will terminate if more than 25 percent of the corporation's gross receipts are from passive sources for three consecutive profitable years, if at the end of each of those years, the corporation had C corporation earnings and profits. IRC § 1362(d)(3).

An S corporation may only have a single class of stock. Thus all stock must be identical in income, distribution and liquidation rights. However, the shares may differ in voting rights without constituting a second class of stock. IRC § 1361(c)(4). This means that income, loss and distributions are allocated in exact proportion to stock ownership. Unlike partnerships, S corporations may not make any special allocations. It also means that taxpayers must assure themselves that purported debt is not reclassified as equity. There is a safe harbor for nonconvertible debt with noncontingent interest. IRC § 1361(c)(5).

Taxation of Contributions to S Corporations; Basis

The tax consequences of a contribution of property to an S corporation in exchange for stock are similar to those for a C corporation. When the shareholder of an S corporation contributes property to the S corporation in exchange for stock qualifying under IRC § 351, he or she has no gain or loss on the transfer; the S corporation has no gain or loss; the shareholder takes a basis in such stock equal to the amount of money and basis of property contributed and the corporation has a basis in the contributed assets equal to their bases in the contributor's hands.

A shareholder's basis in stock is generally increased by income passed through to the shareholder, realized gains on the contribution, contributions to capital, and depletion deductions in excess of the property's basis; and is decreased by losses passed through to the shareholder, by nontaxable distributions to the shareholder, by nondeductible, noncapital expenses and by certain depletion. IRC § 1367(a).

Allocation of Income, Gain, Loss, Deduction and Credit by an S Corporation

An S corporation passes through its income, gain, loss, deduction and credit to its shareholders in direct proportion to their stockholdings; however, if a family S corporation is involved and a family member provides services or capital to the corporation without compensation, the IRS can reallocate to reflect the value of the services and capital. IRC § 1366(e). Income is reported by shareholders with the same character as in the hands of the S corporation. Losses (with the same character as in the hands as the S corporation) are passed through to the shareholders, but the shareholder's ability to currently deduct the losses is subject to three limitations: (1) basis; (2) at risk; and (3) passive activity.

Limitations on a Shareholder's Ability to Deduct S Corporation Losses

A shareholder cannot deduct losses which exceed his or her basis; any excess is carried over into the first subsequent year where there is sufficient basis. IRC § 1366(d). Basis for this purpose includes the shareholder's basis in both stock and loans from the shareholder to the corporation. IRC § 1366(d)(1). Thus, a shareholder may deduct losses from operations against not only the shareholder's equity investment, but also the shareholder's debt. This is contrasted with a partnership where a partner may deduct losses against not only the equity basis, but also a portion of all the partnership's debts, not solely the debts by the partnership to that partner. A shareholder cannot generally receive basis for S corporation debts to others, even if the shareholder guarantees them. Perry v. Commissioner, 47 T.C. 159 (1966), *aff'd on other issue* 392 F.2d 458 (8th Cir. 1968); *cf.* Selfe v. United States, 778 F.2d 769 (11th Cir. 1985). *See infra.*

IRC §§ 465(a) and (b) limit an S corporation shareholder's ability to deduct losses from the corporation to the amount the shareholder has "at risk": the shareholder's investment, debts relating to the activity on which the shareholder is personally liable or has pledged property other than stock in the borrower, and his or her share of qualified nonrecourse financing. Qualified nonrecourse financing means a nonrecourse mortgage on real estate used in an activity of holding real property and generally borrowed from a bank, other commercial lender or government.

If the taxpayer has sufficient basis to deduct the loss and is at risk with respect to the activity, then the passive activity loss rules of IRC § 469 must be applied. Treas. Reg. § 1.469-2T(d)(6). The passive activity rules permit deductions of losses in ongoing passive activities only against passive activity income. Portfolio income, such as interest and dividends, is not passive income. Passive losses may not be deducted against active trade or business income. Disallowed losses may be carried over and, if not used before, may be deducted when the taxpayer disposes of his or her entire interest in the activity. An activity is not passive if the taxpayer materially participates in it. Material participation requires that the taxpayer participation be regular, continuous and substantial. IRC § 469(h). The regulations contain seven alternative tests, satisfaction of any one of which will constitute material participation: (1) more than 500 hours of participation; (2) the taxpayer and spouse perform substantially all of the participation anyone has in the activity; (3) the taxpayer participates more than anyone else and more than 200 hours; (4) the taxpayer significantly, but not materially, participates in a number of activities, for a total of more than 500 hours; (5) material participation in five of the last ten years; (6) material participation in any three prior years in a personal service activity; and (7) regular, continuous and substantial involvement under a facts and circumstances test. Treas. Reg. § 1.469-5T.

Rental activities are always passive activities, except for rental real estate. Rental real estate activities will not be treated as per se passive for an individual devoting more than 750 hours to real property trades or businesses in which he or she materially participates and more than half of his or her services are for such trades or businesses. One's activities as an employee are not counted towards this test, unless the employee is at least a five percent owner of the employer. If the 50 percent and 750 hours tests are met, then each interest of the taxpayer in rental real estate will be treated as a separate activity, unless the taxpayer elects to aggregate them. Further, for all years, if a taxpayer actively participates in rental real estate, then up to $25,000 of losses are allowable, reduced by 50 percent of the amount by which the taxpayer's adjusted gross income exceeds $100,000. Both the $25,000 and $100,000 limits are halved if filing separately. *See* IRC § 469(i) for additional rules.

Taxation of S Corporation Distributions

An S corporation generally recognizes gain on the distribution of appreciated property equal to the difference between the fair market value of the property and its basis. This is true whether the distribution is as a result of a dividend, a partial liquidation or complete liquidation, but not in the case of a reorganization or spin-off. IRC §§ 311, 336, 354 and 355.

The taxation to the S corporation shareholder of distributions involves the accumulated adjustment account ("AAA") and the determination of whether the S corporation has C corporation earnings and profits.

If the S corporation has no C corporation earnings and profits, distributions are nontaxable to the extent of stock basis and capital gain thereafter. IRC § 1368(b). If the S corporation has C corporation earnings and profits, then the distribution will be treated in the same manner as set forth in the previous sentence, but only to the extent of the AAA. IRC § 1368(c)(1). The AAA generally reflects the amount of undistributed profits which shareholders have previously reported in their tax returns, and is a corporate level account, not a shareholder account. IRC § 1368(e)(1). Any distributions that are in excess of AAA are treated as dividends to the extent of C corporation earnings and profits; thereafter, they are nontaxable to the extent of any remaining stock basis and then capital gain. IRC §§ 1368(c)(2) and (3). An S corporation will not create earnings and profits while it is an S corporation (IRC § 1371(c)(1)), but it may have earnings and profits for a number of reasons, including the fact it was previously a C corporation or a C corporation merged into the S corporation.

Taxes Imposed at the S Corporation Level

While an S corporation generally pays no tax, there are circumstances where S corporations must pay income tax at the corporate level. First, S corporations must pay tax at regular income rates, on certain net passive income if the corporation has C corporation earnings and profits at year end and if more than 25 percent of its gross receipts are from passive investment income. IRC § 1375. The tax is imposed on the result obtained by multiplying the net passive income by a fraction, the numerator of which is the amount of passive investment income that exceeds 25 percent of gross receipts and the denominator of which is the year's passive investment income. The IRS can waive this tax if the taxpayer believed in good faith it had no C corporation earnings and profits at the close of the year and distributed them reasonably quickly after it determined they did exist. IRC § 1375(d). Secondly, if a C corporation converts to an S corporation and has net unrealized appreciation on the date of conversion, then the S corporation pays tax at corporate rates on the realization of any such net built-in gains during the next ten years. IRC § 1374. Thirdly, it may be subject to investment tax credit recapture under IRC § 1371(d)(2). Fourthly, if a C corporation converts to an S corporation, there will be a tax on recapture of any LIFO (last-in first-out) inventory reserve, spread over four years. IRC § 1363(d). The first three items are subject to corporate estimated tax payments. IRC § 6655(g)(4).

Taxation of Partnerships

There is no income taxation at the partnership level, whether it be a general partnership or a limited partnership. In a partnership, the income, gains, losses, deductions and credits of the partnership generally are passed through to the partners. Unlike S corporations, there are generally no limits on the identity of the partners, the permissible sources of revenues or the method of conducting business. Partnerships must have at least two partners. Limited partnerships must have at least one general partner. The general partner of a limited partnership may be a corporation which would result in all of the ultimate owners having limited liability.

Taxation of Contributions to Partnerships

Generally, no gain or loss is recognized to a partnership or any of its partners upon the contribution of property to a partnership in exchange for an interest in the partnership, assuming the partnership is not an investment company. IRC § 721(a). This contrasts with the incorporation of, or transfer to, a corporation under IRC § 351, which requires that the transferors must hold 80 percent of the stock after the transfer in order to qualify for nonrecognition treatment. If the partnership assumes liabilities, or takes property subject to liabilities, the contributing partner will recognize income if these liabilities exceed the partner's portion of the partnership's liabilities, plus the basis of the property contributed by that partner. IRC §§ 723 and 752. The partner receives a basis in the partnership interest equal to the money and the adjusted bases in the contributed property less any decrease in the partner's share in liabilities associated therewith. IRC §§ 705, 722 and 752. The partnership has a basis in the assets equal to the basis the partner had before the contribution. IRC § 723. If the partnership makes a distribution to a partner that contributes property to the partnership, the contribution will be treated as a sale if that is the substance of the transaction. IRC § 707(a)(2)(B).

The IRS has clarified an issue that had generated much controversy: What is the consequence to a partner of receiving a partnership interest in exchange for services? The traditional view had been that granting a capital interest was taxable, but granting a profits interest was not taxable. Thus, assume Partner A contributes $100 in cash and Partner B contributes services and they agree to split profits and losses equally, but A gets his initial capital back upon liquidation. Since B has no interest in the original capital if the partnership is liquidated, and B only builds up equity from undistributed profits, B would have no income upon the receipt of the profits interest. This is the approach taken in Rev. Proc. 93-27, 1993-2 C.B. 343, unless the profits interest is a substantially certain and predictable income stream, is disposed of within two years of receipt or is a limited partnership interest in a publicly traded partnership. Prior case law is illustrated by Campbell v. Commissioner, 943 F.2d 815 (8th Cir. 1991), *aff'g in part, rev'g in part,* T.C. Memo 1990-162 (1990); St. John v. United States, 84-1 USTC ¶ 9158 (C.D. Ill. 1983); and Diamond v. Commissioner, 56 T.C. 530 (1971), *aff'd* 492 F.2d. 286 (7th Cir. 1974).

Basis in Partnerships

The taxpayer's basis in the partnership interest includes the basis received upon the contribution of property (IRC § 722), plus basis in interests acquired from others (IRC § 742), income passed through to the partner (both taxable and nontaxable) and the excess of depletion over the property's basis; less distributions, losses passed through to the partner and certain depletion. IRC § 705. An increase in a partner's share of the partnership's liabilities is treated as a contribution to capital, thus increasing the partner's basis. IRC § 752(a). A decrease in a partner's share of the partnership liabilities is treated as a distribution of cash, thus decreasing the partner's basis. IRC § 752(b). If the loan is recourse, *i.e.*, at least one partner or related party is personally liable for it, then there is allocated to each partner the portion of the loan with respect to which the partner or related party bears the economic risk of loss. Treas. Reg. §§ 1.752-1(a)(1) and 1.752-2. A limited partner will only share in recourse liabilities to the extent the partner is obligated, directly or indirectly, to pay the liability. Treas. Reg. § 1.752-2. Thus, in a typical limited partnership, only general partners will normally be allocated liabilities, unless they are nonrecourse liabilities. A nonrecourse liability is one where no partner or related party bears the economic risk of loss. Treas. Reg. § 1.752-1(a)(2). If the partnership incurs a nonrecourse debt, but a partner guarantees the debt, then the debt is treated as a recourse loan and generally all the basis attributable to such debt is allocated to the guarantor.

Nonrecourse liabilities are allocated to the partner in the following manner: first, equal to his or her share of minimum gain under the § 704(b) regulations, secondly, equal to the partner's share of gain allocable under IRC § 704(c) (special allocation of gain or loss on contributed property) and finally, in accordance with the partner's profits interest (where the partnership agreement provides for different profit sharing allocations, the partners generally may choose which one to use). Treas. Reg. § 1.752-3(a). Thus, if a limited partnership borrows money on a nonrecourse basis and no partner or related party guarantees such debt, then the limited partners will have basis associated with a portion of the liabilities.

Allocations of Income, Gain, Loss, Deduction and Credit by Partnerships

The partners have wide discretion in allocating the income, gain, loss, deduction and credit in the partnership agreement, subject to certain restrictions. IRC § 704(a). If a partner contributes property to the partnership that has a value different than its basis, then, under IRC § 704(c)(1)(A), the depreciation, gain or loss will be shared among the partners to take that into account. Thus, if the property were sold the next day, all the gain would be allocated to the contributing partner. If there is a contribution of property by a partner and that property is distributed to another partner within seven years, the contributing partner will generally be allocated the gain or loss to the extent of the gain or loss at the time of contribution. IRC § 704(c)(1)(B). If a contributing partner receives a distribution within seven years of the contribution, then the contributing partner will be subject to tax to the extent of the precontribution gain. IRC § 737.

The general rule is that the parties have great flexibility in allocating income, gain, loss, deduction or credit, or any item of any of these, among the partners, so long as the allocation has "substantial economic effect." IRC § 704(b). The allocation of income does not have to be on the same basis as loss, nor need it remain static; for instance, a partner may be allocated 1 percent of losses and 20 percent of the income until certain events occur, then 50 percent of the income. To have economic effect, the partnership agreement must provide that: (1) the partners must maintain capital accounts in the manner set forth in the § 704 regulations; (2) liquidating distributions must be made in accordance with the capital accounts; and (3) partners must either (i) be obligated to make-up deficits in capital accounts, or (ii) have a qualified income offset provision as provided in § 704 regulations. Treas. Reg. § 1.704-1(b)(2)(ii). The guiding principle of these allocations is that the person who is allocated losses must ultimately bear the economic burden of those losses; *i.e.*, if one is allocated $1 of loss, that person will get $1 less in money upon the final liquidation of the partnership. Thus, if one had invested $1,000 in a partnership that has sold all its assets and is about to distribute cash, and over the term of the partnership that partner had been allocated $990 of losses on a net basis, then the partner would only receive $10 of the final distribution.

The allocations must be substantial, in that the allocations will substantially affect the dollars received by the partners independent of tax consequences. Treas. Reg. § 1.704-1(b)(iii).

If there are nonrecourse liabilities and the prior losses and deductions have reduced the basis of the asset below the amount of the nonrecourse debt, then an additional set of rules apply. This is done because if the property were sold for its basis, no one will economically bear the forgiven debt (*i.e.*, the amount of debt the lender will not collect because it is nonrecourse.) Accordingly, no such allocation can have economic effect. The regulations permit allocations of nonrecourse debt if (1) the provisions of Treas. Reg. § 1.704-1(b)(2) (discussed two paragraphs above) are met; (2) they are made in a manner reasonably consistent with the allocations that do have substantial economic effect; (3) the agreement provides a minimum gain chargeback provision, which generally means that the persons to whom the nonrecourse deductions were allocated will be allocated an equal amount of income; and (4) the other material allocations and capital adjustments are recognized. Treas. Reg. § 1.704-2(e).

IRC § 704(e) imposes family partnership rules designed to reallocate income within a family partnership from those who own the title to the interests to those to whom the income should really be allocated. *See* Treas. Reg. § 1.704-1(e).

Limitations on Partner's Ability to Deduct Partnership Losses

As with S corporations, there are three limitations on the ability to deduct losses allocated to the partner by the partnership: (1) basis; (2) at risk rules; and (3) passive activity loss rules. A partner has a basis in the partnership interest described *supra*. A partner may not deduct losses allocated in excess of basis remaining at the end of the taxable year. Any unused losses may be carried over until the taxpayer has basis in the partnership at a taxable year end. IRC § 704(d).

The taxpayer must also avoid the at risk limitations. In order for a taxpayer to be able to deduct a loss allocated by a partnership, the taxpayer must be at risk; *i.e.*, the taxpayer must ultimately bear the loss. The at risk limitation amount equals the amount contributed plus the amounts borrowed with respect to the activity. Amounts borrowed include not only debts for which the partner is personally liable, but also debts for which property not used in the activity is pledged (up to the property's fair market value.) In addition, a partner is also deemed at risk for the partner's share of "qualified nonrecourse financing." Qualified nonrecourse financing is generally nonrecourse debt that is not guaranteed, which is attributable to a real estate activity and which was borrowed from a lender that is in the business of lending money.

Even if a partner has sufficient basis and amounts at risk to take a loss, there are additional limitations if the partner is a passive investor. To avoid the application of the passive activity limitations, the partner must materially participate in the enterprise. As described *supra*, material participation must be regular, continuous and substantial. There are seven specific tests that may be met to meet the material participation standard. The same rules apply to general partners that apply to S corporation shareholders. However, under IRC § 469(h), no limited partner can materially participate with respect to his or her limited partnership interest, except as provided in the regulations. The regulations provide that a limited partner will be treated as materially participating if he or she meets any of the tests under Treas. Reg. §§ 1.469-9 5T(a)(1), (5) or (6). Treas. Reg. § 1.469-5T(e)(2). These three tests are: (1) more than 500 hours of participation; (5) material participation in five of the last ten years; and (6) material participation in any three prior years in a personal service activity. Treas. Reg. §§ 1.469-5T(a)(1),(5) and (6), respectively. Rental activities are generally presumed to be passive, but a partner will be deemed to materially participate in rental real estate if (a) more than one-half of the taxpayer's services are performed in real property trades or businesses in which the taxpayer materially participates and (b) those trades or businesses account for at least 750 hours. As explained in more detail *supra*, if the taxpayer actively participates, the taxpayer may deduct up to $25,000 (one-half that amount if married filing separately) of the losses in any taxable year, subject to a phase out.

Taxation of Partnership Distributions

Distributions reduce basis by the amount of money distributed and the partnership's basis in the property; however, if the distribution of property other than cash would exceed the taxpayer's basis in the partnership, then the distributed property takes the taxpayer's basis in the partnership and the partner's basis in the partnership is eliminated. IRC § 732. No gain or loss is recognized to the partnership on a distribution, unless there is a disproportionate distribution of unrealized receivables or substantially appreciated inventory. IRC §§ 731(b) and 751(b). The partnership may elect under IRC § 754 to adjust the basis of partnership property as set forth in IRC § 734. Generally, no gain or loss is recognized to the partners on a distribution unless a distribution of money exceeds the partner's remaining basis, in which case the excess is income to the partner. IRC §§ 731(a)(1), 735 and 751. No loss is recognized to the partner upon any distribution, except upon liquidation where only cash, unrealized receivables and substantially appreciated inventory are distributed. IRC § 731(a)(2).

Partnership Termination

If 50 percent or more of the total interest in partnership capital and profits are sold or exchanged within a 12 month period, the partnership will be treated as terminated for Federal income tax purposes. IRC § 708(b)(1).

Abusive Partnerships

In December, 1994, the Treasury issued Treas. Reg. § 1.701-2 which provides that the IRS may disregard a transaction if a partnership is formed with a principal purpose of substantially reducing the present value of the partners' aggregate federal tax liability in a manner inconsistent with the intent of subchapter K [the IRC's partnership provisions], even if the literal language of the IRC or Treasury Regulations are complied with. The IRS has stated that this is designed to be used in only rare circumstances and only with respect to public partnerships that present truly abusive situations, but its language is broader. To date, there is no authority interpreting this regulation. Where an LLC is treated as a partnership, this regulation would apply to it.

Additional Considerations

The previous paragraphs in this section discussed some of the major tax consequences of selecting and operating an enterprise as a C corporation, S corporation or partnership (general or limited). In addition there are additional consequences which may have more limited application, but which are critical to those affected.

Introduction to the Taxation of LLCs

Having discussed the tax consequences of operating as a C corporation, S corporation and partnership (both general and limited), it is time to consider the LLC. LLCs were created to simultaneously achieve three goals: (1) obtain limited liability for the members; (2) obtain pass through tax treatment; and (3) avoid the limitations of operating as an S corporation or a limited partnership.

There are numerous non-tax considerations involved in selecting an entity. One major advantage is that members of an LLC are not liable for the debts or obligations of the LLC, except for each member's liability for his or her own acts or omissions. Both C corporations and S corporations fully accomplish this goal. A limited partnership partially accomplishes this goal: the limited partners have limited liability, the general partners do not.

The second consideration is that in addition to limited liability, the owners often wish for pass through tax treatment; *i.e.*, the entity pays no tax and the owners include the entity's gain or loss in the owners' respective tax returns. The S corporation, general partnership and limited partnership accomplish pass through treatment. Accordingly, the only entities that accomplish both goals are an S corporation and, to a more limited extent, a limited partnership.

The S corporation and limited partnership each have limitations, which are discussed above; for instance, the S corporation has no ability to specially allocate gain and loss and has a number of limitations on the scope and method of operation and the identity and number of owners. Maintaining a fully liable general partner, even if it is a corporation, is a disadvantage of the limited partnership not present in the LLC, as is the fact that limited partners may not control the limited partnership without jeopardizing their limited liability. Further, as detailed in paragraph 8.4, members of an LLC will generally be able to include their portion of all the LLC's liabilities in the basis of their interest in the LLC, while limited partners are unable to include any of such liabilities in their basis in their limited partnership interests unless the general partners (and all other partners) have no liability for them or that limited partner has guaranteed such liabilities.

Comparison of LLCs and C Corporations

As set forth above in detail, C corporations generally require the payment of tax on two levels in order to get the corporation's earnings into the hands of its shareholders. This is often a significant deterrent to the use of a C corporation. The most crucial determinant in the selection of the entity is often whether to select a pass through entity or an entity taxed as a corporation. Because most taxpayers operating a small business want pass through treatment, a C corporation is often not selected. There are, however, a number of areas in which a C corporation would be superior to an LLC, and there are circumstances under which the C corporation should be the entity of choice.

The individual tax rates are generally higher than corporate rates, so if there is a limited amount of profit in the business and the owners do not need a return on their investment, nor money from the business other than from their salaries, a C corporation will often result in a lower tax liability. If one desires to reinvest all of the entity's earnings into the business and not take out more than a reasonable amount of compensation for his or her work, then a C corporation may be the most desirable choice. If, however, the corporation is a professional service corporation ("PSC"), the individual rates may not be higher than those of the corporation because the PSC carries a uniform 35 percent rate, which is not graduated. PSCs will often pay a large percentage of the pre-compensation earnings as compensation.

There are additional areas in which the C corporation receives better tax results than an LLC (and other entities.) For instance, loans from a qualified pension and profit sharing plan of a C corporation to a shareholder/employee are often exempted from being prohibited transactions. However, those exemptions do not apply to loans to a more than 5 percent shareholder in an S corporation or to a partner who owns more than 10 percent of the capital interests or profits interests, and thus those loans would be prohibited transactions under IRC § 4975(d).

A C corporation may generally select any calendar or fiscal year that ends on the last day of a month (or may elect a 52/53 week year.) IRC § 441. Under IRC § 441(i), C corporations that are PSCs must generally use a calendar year unless the corporation establishes, to the IRS' satisfaction, a business purpose for another fiscal year. The PSC may also elect a September 30, October 31 or November 30 fiscal year, but, if so, the PSC is prohibited from manipulating the timing of deducting payments made by the PSC and includible in the income of the shareholder. IRC §§ 280H and 444. S corporations must generally select the calendar year and partnerships must generally select the fiscal year of their majority owners. IRC §§ 706(b) and 1378. Partnerships or S corporations may elect to have a September 30, October 31 or November 30 fiscal year, if the entities pay an additional amount to reflect the benefit of the deferral received by using the earlier year end. IRC §§ 444(c)(1) and 7519. An S corporation or partnership may select any fiscal year if the IRS is satisfied that there is a good business purpose.

A C corporation may deduct 100 percent of health insurance premiums (and such premiums need not be included in the employee's income). Employee-partners and S corporation shareholders are limited in the amount of their health insurance premiums which they may deduct. The percentage (which is 60% in 1999) increases until 2003, when they become fully deductible.

Life insurance premiums for up to $50,000 of nondiscriminatory group term life insurance are excludible for employee-shareholders of C corporations. IRC § 79. This exclusion does not apply to self-employed individuals, which would presumably include partners. Treas. Reg. §§ 1.79-0 and 31.3401(c)-1. Thus, the exclusion would not apply to members of an LLC.

Cancellation of indebtedness income is excludible from gross income if, among other things, it is subject to the bankruptcy or insolvency exception. IRC §§ 108(a)(1)(A) and (B). The insolvency exception is limited to the amount of insolvency, which is tested at the entity level for C corporations and S corporations, but at the partner level for partnerships. There is no current authority as to whether the amount of insolvency will be tested at the member level or the LLC level in the case of an LLC, but it appears fairly certain that it will be at the member level.

Although there is nothing definitive, the commentators generally assume that members of an LLC will not be able to participate in cafeteria plans and will not be eligible for the $5,000 death benefit exclusion of IRC § 101(b)(3).

A C corporation is generally not subject to the passive loss rules, except where (i) it is a personal service corporation or (ii) five or fewer individuals own more than 50 percent of the value of the corporation.

A single shareholder may own a C corporation or an S corporation, and since July 15, 1998, a single person may be the sole member of a Kentucky LLC. *See* KRS 275.015(8). If an LLC only has a single member, it may be taxed as a C corporation, an S corporation or as a disregarded entity. Treas. Reg. § 301.7701-2(c)(2)(i). An LLC which is a disregarded entity is treated as a sole proprietorship if it is owned by an individual and as a branch or a division if it is owned by an entity. An LLC is the only entity (with the exception of a qualified subchapter S subsidiary and special REIT subsidiaries) which can be treated as a disregarded entity. The ability to be treated as a disregarded entity has a number of benefits. First, if owned by an individual, it enables the individual to obtain limited liability while still not being required to file a separate return for an entity. In the case of an LLC owned by an entity, it enables the separation of assets for liability purposes, while still being able to consolidate the activities of the owner and the LLC, but without being subject to the extremely complex consolidated return regulations.

Differences Between S Corporations and LLCs

As noted supra, S corporations have significant limitations on the number and identity of the owners (75 individuals, certain trusts, no nonresident aliens); scope of operations (not passive if there are C corporation earnings and profits); and capital structure (only a single class of stock.) LLCs (and other entities taxed as partnerships) have none of these restrictions, except that entities otherwise taxable as partnerships will be taxed as corporations if they are publicly traded. IRC § 7704. Partnerships must have more than one partner. Individuals, including non-resident aliens, C corporations, S corporations, general partnerships, limited partnerships, trusts, estates, LLPs and LLCs may all be members of LLCs. LLCs do not have passive income limitations. Somewhat because of these limitations, it is easier for an S corporation to fail to qualify as an S corporation, although the IRS can waive an inadvertent termination. IRC § 1362(f). On the other hand, unless an LLC affirmatively elects to be treated as a corporation, it will be treated as a partnership (assuming it has at least 2 members).

S corporations may only have a single class of stock: each share receives the same distributive share of income, gain and loss. LLCs (and other entities taxed as partnerships) may have special allocations of income, gain, loss, deduction or credit which have no relationship to equity ownership, so long as they have substantial economic effect. Thus, S corporations lack the tremendous flexibility in sharing the economic consequences among owners that the LLCs (and other entities taxed as partnerships) have. In addition to the fact that the owners in an LLC can voluntarily choose an allocation that differs from ownership interests, there are IRC provisions that may require a difference between S corporation and partnership allocations. If a member contributes appreciated property to an LLC (or other entities taxed as partnerships), the inherent gain (and depreciation) must be allocated to take into account the difference between basis and value; there is no, and can be no, special allocation of this gain in an S corporation. IRC § 704(c)(1). LLCs may have different tiers of ownership while the only differentiation among S corporation shares is that there may be differences in voting rights.

Contributions of appreciated property will be taxable if made to an S corporation, unless all transferors as a group own 80 percent of the stock immediately after the transfer; there is no similar rule with LLCs. Both S corporation shareholders and LLC members may deduct losses up to their basis, at risk amounts and are subject to the passive activity loss rules. For purposes of computing basis for deducting losses, a member of an LLC includes in basis a proportionate part of all of the liabilities of the LLC, in addition to the amount contributed for the ownership interest; while an S corporation shareholder's basis for loss limitation purposes is the stock basis plus loans made by that shareholder to the corporation. An S corporation shareholder does not receive any basis for debts owed by the corporation to others.

Gain is normally recognized by the corporation if there is a distribution of appreciated property by an S corporation, but not by an LLC distributing appreciated property. Similarly, liquidations will generate gain for an S corporation shareholder, but not always for an LLC member. S corporations are sometimes subject to tax at the corporate level, while LLCs never are.

Under IRC § 754, the basis of LLC assets may be adjusted under two circumstances: if a member purchases an appreciated LLC interest, the LLC will be able to increase the basis in its assets that are attributable to that interest. A similar increase applies under the election if gain is recognized on the distribution of property to a partner. There is no similar election for S corporations.

It is uncertain if an LLC member's distributive share of income is subject to self-employment tax. It is clear that an S corporation shareholder's distributive share is not subject to self-employment tax, but salary is. Further, there is some question whether an LLC may use the cash method of accounting, although it is clear that an S corporation that otherwise qualifies may do so.

Comparison Between LLCs and Partnerships

An LLC having more than one member may be taxed either as a corporation or as a partnership. Most LLCs will seek partnership treatment. However, as alluded to above, the treatment of general partnerships is sometimes different than limited partnerships and the treatment of their respective owners also differs. There is no uniform treatment of LLCs as either general partnerships or limited partnerships or members of an LLC as either general partners or limited partners.

ADDENDUM

A. 26 C.F.R. § 1.1402(a)-2

B. R & R Marketing, LLC v. Brown-Forman Corporation, 704 A.2d 1327 (N.J.Super.A.D. 1998).

income derived by an individual from a trade or business. See section 707(c) and the regulations thereunder, relating to guaranteed payments to a member of a partnership for services or the use of capital. See also section 706(a) and the regulations thereunder, relating to the taxable year of the partner in which such guaranteed payments are to be included in computing taxable income.

(c) Gross income derived by an individual from a trade or business includes gross income received (in the case of an individual reporting income on the cash receipts and disbursements method) or accrued (in the case of an individual reporting income on the accrual method) in the taxable year from a trade or business even though such income may be attributable in whole or in part to services rendered or other acts performed in a prior taxable year as to which the individual was not subject to the tax on self-employment income. [Reg. § 1.1402(a)-1.]

☐ [*T.D.* 6196, 8-13-56. *Amended by T.D.* 6691, 12-2-63, *and T.D.* 7333, 12-19-74.]

[Reg. § 1.1402(a)-2]

§ 1.1402(a)-2. **Computation of net earnings from self-employment.**—(a) *General rule.* In general, the gross income and deductions of an individual attributable to a trade or business (including a trade or business conducted by an employee referred to in paragraphs (b), (c), (d), or (e) of § 1.1402(c)-3), for the purpose of ascertaining his net earnings from self-employment, are to be determined by reference to the provisions of law and regulations applicable with respect to the taxes imposed by sections 1 and 3. Thus, if an individual uses the accrual method of accounting in computing taxable income from a trade or business for the purpose of the tax imposed by section 1 or 3, he must use the same method in determining net earnings from self-employment. Likewise, if a taxpayer engaged in a trade or business of selling property on the installment plan elects, under the provisions of section 453, to use the installment method in computing income for purposes of the tax under section 1 or 3, he must use the same method in determining net earnings from self-employment. Income which is excludable from gross income under any provision of subtitle A of the Internal Revenue Code is not taken into account in determining net earnings from self-employment except as otherwise provided in § 1.1402(a)-9, relating to certain residents of Puerto Rico, in § 1.1402(a)-11, relating to ministers or members of religious orders, and in § 1.1402(a)-12, relating to the term "possession of the United States" as used for purposes of the tax on self-employment income. Thus, in the case of a citizen of the United States conducting, in a foreign country, a trade or business in which both personal services and capital are material income-producing factors, any part of the income therefrom which is excluded from gross income as earned income under the provisions of section 911 and the regulations thereunder is not taken into account in determining net earnings from self-employment.

(b) *Trade or business carried on.* The trade or business must be carried on by the individual, either personally or through agents or employees. Accordingly, income derived from a trade or business carried on by an estate or trust is not included in determining the net earnings from self-employment of the individual beneficiaries of such estate or trust.

(c) *Aggregate net earnings.* Where an individual is engaged in more than one trade or business within the meaning of section 1402(c) and § 1.1402(c)-1, his net earnings from self-employment consist of the aggregate of the net income and losses (computed subject to the special rules provided in §§ 1.1402(a)-1 to 1.1402(a)-17, inclusive) of all such trades or businesses carried on by him. Thus, a loss sustained in one trade or business carried on by an individual will operate to offset the income derived by him from another trade or business.

(d) *Partnerships.* The net earnings from self-employment of an individual include, in addition to the earnings from a trade or business carried on by him, his distributive share of the income or loss, described in section 702(a)(9), from any trade or business carried on by each partnership of which he is a member. An individual's distributive share of such income or loss of a partnership shall be determined as provided in section 704, subject to the special rules set forth in section 1402(a) and in §§ 1.1402(a)-1 to 1.1402(a)-17, inclusive, and to the exclusions provided in section 1402(c) and §§ 1.1402(c)-2 to 1.1402(c)-7, inclusive. For provisions relating to the computation of the taxable income of a partnership, see section 703.

(e) *Different taxable years.* If the taxable year of a partner differs from that of the partnership, the partner shall include, in computing net earnings from self-employment, his distributive share of the income or loss, described in section 702(a)(9), of the partnership for its taxable year ending with or within the taxable year of the partner. For the special rule in case of the termination of a partner's taxable year as result of death, see §§ 1.1402(f) and 1.1402(f)-1.

(f) *Meaning of partnerships.* For the purpose of determining net earnings from self-employment, a partnership is one which is recognized as such for income tax purposes. For income tax purposes, the term "partnership" includes not only a partnership as known at common law, but, also, a syndicate, group, pool, joint venture, or other unincorporated organization which carries on any trade or business, financial operation, or venture, and which is not, within the meaning of the Code, a trust, estate, or a corporation. An organization described in the preceding sentence shall be treated as a partnership for purposes of the tax on self-employment income even though such organization has elected, pursuant to section 1361 and the regulations thereunder, to be taxed as a domestic corporation.

(g) *Nature of partnership interest.* The net earnings from self-employment of a partner include his distributive share of the income or loss, described in section 702(a)(9), of the partnership of which he is a member, irrespective of the nature of his membership. Thus, in determining his net earnings from self-employment, a limited or inactive partner includes his distributive share of such partnership income or loss. In the case of a partner who is a member of a partnership with respect to which an election has been made pursuant to section 1361 and the regulations thereunder to be taxed as a domestic corporation, net earnings from self-employment include his distributive share of the income or loss, described in section 702(a)(9), from the trade or business carried on by the partnership computed without regard to the fact that the partnership has elected to be taxed as a domestic corporation.

(h) *Proprietorship taxed as domestic corporation.* A proprietor of an unincorporated business enterprise with respect to which an election has been made pursuant to section 1361 and the regulations thereunder to be taxed as a domestic corporation shall compute his net earnings from self-employment without regard to the fact that such election has been made. [Reg. § 1.1402(a)-2.]

☐ [*T.D.* 6691, 12-2-63. *Amended by T.D.* 7333, 12-19-74.]

[Reg. § 1.1402(a)-3]

§ 1.1402(a)-3. **Special rules for computing net earnings from self-employment.**—For the purpose of computing net earnings from self-employment, the gross income derived by an individual from a trade or business carried on by him, the allowable deductions attributable to such trade or business, and the individual's distributive share of the income or loss, described in section 702(a)(9), from any trade or business carried on by a partnership of which he is a member shall be computed in accordance with the special rules set forth in §§ 1.1402(a)-4 to 1.1402(a)-17, inclusive. [Reg. § 1.1402(a)-3.]

☐ [*T.D.* 6691, 12-2-63. *Amended by T.D.* 7710, 7-28-80.]

[Reg. § 1.1402(a)-4]

§ 1.1402(a)-4. **Rentals from real estate.**—(a) *In general.* Rentals from real estate and from personal property leased with the real estate (including such rentals paid in crop shares) and the deductions attributable thereto, unless such rentals are received by an individual in the course of a trade or business as a real-estate dealer, are excluded. Whether or not an individual is engaged in the trade or business of a real-estate dealer is determined by the application of the principles followed in respect of the taxes imposed by sections 1 and 3. In general, an individual who is engaged in the business of selling real estate to customers with a view to the gains and profits that may be derived from such sales is a real-estate dealer. On the other hand, an individual who merely holds real estate for investment or speculation and receives rentals therefrom is not considered a real-estate dealer. Where a real-estate dealer holds real estate for investment or speculation in addition to real estate held for sale to customers in the ordinary course of his trade or business as a real-estate dealer, only the rentals from the real estate held for sale to customers in the ordinary course of his trade or business as a real-estate dealer, and the deductions attributable thereto, are included in determining net earnings from self-employment; the rentals from the real estate held for investment or speculation, and the deductions attributable thereto, are excluded. Rentals paid in crop shares include income derived by an owner or lessee of land under an agreement entered into with another person pursuant to which such other person undertakes to produce a crop or livestock on such land and pursuant to which (1) the crop or livestock, or the proceeds thereof, are to be divided between such owner or lessee and such other person, and (2) the share of the owner or lessee depends on the amount of the crop or livestock produced. See, however, paragraph (b) of this section.

(b) *Special rule for "includible farm rental income"*—(1) *In general.* Notwithstanding the rules set forth in paragraph (a) of this section, there shall be included in determining net earnings from self-employment for taxable years ending after 1955 any income derived by an owner or tenant of land, if the following requirements are met with respect to such income:

(i) The income is derived under an arrangement between the owner or tenant of land and another person which provides that such other person shall produce agricultural or horticultural commodities on such land, and that there

DESIGNATION AND TREATMENT OF EMPOWERMENT ZONES, ENTERPRISE COMMUNITIES, AND RURAL DEVELOPMENT INVESTMENT AREAS

Qualified Zone Academy Bonds: Tax Treatment

Qualified Zone Academy Bonds: Federal Income Tax Treatment.—Reg. § 1.1397E-1, relating to the federal income tax treatment of qualified zone academy bonds, is proposed (published in the Federal Register on January 7, 1998) (REG-119449-97).

☐ Par. 2. Section 1.1397E-1 is added to read as follows:

§ 1.1397E-1. Qualified zone academy bonds.

[The text of this proposed section is the same as the text of § 1.1397E-1T as added by T.D. 8755.]

TAX ON SELF-EMPLOYMENT INCOME

Self-Employment Tax: Limited Partner: Definition

Self-Employment Tax: Limited Partner: Definition.—Amendments to Reg. § 1.1402(a)-2, relating to the self-employment tax imposed under Code Sec. 1402, are proposed (published in the Federal Register on January 13, 1997) (REG-209824-96).

☐ Par. 2. Section 1.1402(a)-2 is amended by:

1. Revising the first sentence of paragraph (d).

2. Removing the reference "section 702(a)(9)" in the first sentence of paragraph (e) and adding "section 702(a)(8)" in its place.

3. Revising the last sentence of paragraph (f).

4. Revising paragraphs (g) and (h).

5. Adding new paragraphs (i) and (j).

The revisions and additions read as follows:

§ 1.1402(a)-2. Computation of net earnings from self-employment.

* * * * *

(d) * * * Except as otherwise provided in section 1402(a) and paragraph (g) of this section, an individual's net earnings from self-employment include the individual's distributive share (whether or not distributed) of income or loss described in section 702(a)(8) from any trade or business carried on by each partnership of which the individual is a partner. * * *

* * * * *

(f) * * * For rules governing the classification of an organization as a partnership or otherwise, see §§ 301.7701-1, 301.7701-2, and 301.7701-3 of this chapter.

(g) *Distributive share of limited partner.* An individual's net earnings from self-employment do not include the individual's distributive share of income or loss as a limited partner described in paragraph (h) of this section. However, guaranteed payments described in section 707(c) made to the individual for services actually rendered to or on behalf of the partnership engaged in a trade or business are included in the individual's net earnings from self-employment.

(h) *Definition of limited partner*—(1) *In general.* Solely for purposes of section 1402(a)(13) and paragraph (g) of this section, an individual is considered to be a limited partner to the extent provided in paragraphs (h)(2), (h)(3), (h)(4), and (h)(5) of this section.

(2) *Limited partner.* An individual is treated as a limited partner under this paragraph (h)(2) unless the individual—

(i) Has personal liability (as defined in § 301.7701-3(b)(2)(ii) of this chapter for the debts of or claims against the partnership by reason of being a partner;

(ii) Has authority (under the law of the jurisdiction in which the partnership is formed) to contract on behalf of the partnership; or

(iii) Participates in the partnership's trade or business for more than 500 hours during the partnership's taxable year.

(3) *Exception for holders of more than one class of interest.* An individual holding more than one class of interest in the partnership who is not treated as a limited partner under paragraph (h)(2) of this section is treated as a limited partner under this paragraph (h)(3) with respect to a specific class of partnership interest held by such

individual if, immediately after the individual acquires that class of interest—

(i) Limited partners within the meaning of paragraph (h)(2) of this section own a substantial, continuing interest in that specific class of partnership interest; and,

(ii) The individual's rights and obligations with respect to that specific class of interest are identical to the rights and obligations of that specific class of partnership interest held by the limited partners described in paragraph (h)(3)(i) of this section.

(4) *Exception for holders of only one class of interest.* An individual who is not treated as a limited partner under paragraph (h)(2) of this section solely because that individual participates in the partnership's trade or business for more than 500 hours during the partnership's taxable year is treated as a limited partner under this paragraph (h)(4) with respect to the individual's partnership interest if, immediately after the individual acquires that interest—

(i) Limited partners within the meaning of paragraph (h)(2) of this section own a substantial, continuing interest in that specific class of partnership interest; and

(ii) The individual's rights and obligations with respect to the specific class of interest are identical to the rights and obligations of the specific class of partnership interest held by the limited partners described in paragraph (h)(4)(i) of this section.

(5) *Exception for service partners in service partnerships.* An individual who is a service partner in a service partnership may not be a limited partner under paragraphs (h)(2), (h)(3), or (h)(4) of this section.

(6) *Additional definitions.* Solely for purposes of this paragraph (h)—

(i) A *class of interest* is an interest that grants the holder specific rights and obligations. If a holder's rights and obligations from an interest are different from another holder's rights and obligations, each holder's interest belongs to a separate class of interest. An individual may hold more than one class of interest in the same partnership provided that each class grants the individual different rights or obligations. The existence of a guaranteed payment described in section 707(c) made to an individual for services rendered to or on behalf of a partnership, however, is not a factor in determining the rights and obligations of a class of interest.

(ii) A *service partner* is a partner who provides services to or on behalf of the service partnership's trade or business. A partner is not considered to be a service partner if that partner only provides a de minimis amount of services to or on behalf of the partnership.

(iii) A *service partnership* is a partnership substantially all the activities of which involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, or consulting.

(iv) A *substantial interest in a class of interest* is determined based on all of the relevant facts and circumstances. In all cases, however, ownership of 20 percent or more of a specific class of interest is considered substantial.

(i) *Example.* The following example illustrates the principles of paragraphs (g) and (h) of this section:

Example. (i) A, B, and C form LLC, a limited liability company, under the laws of State to engage in a business that is not a service partnership described in paragraph (h)(6)(iii) of this section. LLC, classified as a partnership for federal tax purposes, allocates all items of income, deduction, and credit of LLC to A, B, and C in proportion to their ownership of LLC. A and C each contribute $1x for one LLC unit. B contributes $2x for two LLC units. Each LLC unit entitles its holder to receive 25 percent of LLC's tax items, including profits. A does not perform services for LLC; however, each year B receives a guaranteed payment of $6x for 600 hours of services rendered to LLC and C receives a guaranteed payment of $10x for 1000 hours of services rendered to LLC. C also is elected LLC's manager. Under State's law, C has the authority to contract on behalf of LLC.

(ii) *Application of general rule of paragraph (h)(2) of this section.* A is treated as a limited partner in LLC under paragraph (h)(2) of this section because A is not liable personally for debts of or claims against LLC, A does not have authority to contract for LLC under State's law, and A does not participate in LLC's trade or business for more than 500 hours during the taxable year. Therefore, A's distributive share attributable to A's LLC unit is excluded from A's net earnings from self-employment under section 1402(a)(13).

(iii) *Distributive share not included in net earnings from self-employment under paragraph (h)(4) of this section.* B's guaranteed payment of $6x is included in B's net earnings from self-employment under section 1402(a)(13). B is not treated as a limited partner under paragraph (h)(2) of this section because, although B is not liable for debts of or claims against LLC and B does not have authority to contract for LLC under State's law, B does participates in LLC's trade or business for more than 500 hours during the taxable year. Further, B is not treated as a limited partner under paragraph (h)(3) of this section because B does not hold more than one class of interest in LLC. However, B is treated as a limited partner under paragraph (h)(4) of this section because B is not treated as a limited partner under paragraph (h)(2) of this section solely because B participated in LLC's business for more than 500 hours and because A is a limited partner under paragraph (h)(2) of this section who owns a substantial interest with rights and obligations that are identical to B's rights and obligations. In this example, B's distributive share is deemed to be a return on B's investment in LLC and not remuneration for B's service to LLC. Thus, B's distributive share attributable to B's two LLC units is not net earnings from self-employment under section 1402(a)(13).

(iv) *Distributive share included in net earnings from self-employment.* C's guaranteed payment of $10x is included in C's net earnings from self-employment under section 1402(a). In addition, C's distributive share attributable to C's LLC unit also is net earnings from self-employment under section 1402(a) because C is not a limited partner under paragraphs (h)(2), (h)(3), or (h)(4) of this section. C is not treated as a limited partner under paragraph (h)(2) of this section because C has the authority under State's law to enter into a binding contract on behalf of LLC and because C participates in LLC's trade or business for more than 500 hours during the taxable year. Further, C is not treated as a limited partner under paragraph (h)(3) of this section because C does not hold more than one class of interest in LLC. Finally, C is not treated as a limited partner under paragraph (h)(4) of this section because C has the power to bind LLC. Thus, C's guaranteed payment and distributive share both are included in C's net earnings from self-employment under section 1402(a).

(j) *Effective date.* Paragraphs (d), (e), (f), (g), (h), and (i) are applicable beginning with the individual's first taxable year beginning on or after the date this section is published as a final regulation in the Federal Register.

WITHHOLDING OF TAX ON NONRESIDENT ALIENS AND FOREIGN CORPORATIONS

Withholding: Nonresident Aliens: Form W-8: Electronic Transmission

Withholding: Nonresident Aliens: Form W-8: Electronic Transmission.—Amendments to Reg. § 1.1441-1, relating to the establishment by withholding agents and payors of an electronic system for use by beneficial owners or payees in furnishing Form W-8 (Certificate of Foreign Status), are proposed (published in the Federal Register on October 14, 1997) (REG-107872-97).

☐ Par. 2. In § 1.1441-1, paragraph (e)(4)(iv) is revised to read as follows:

§ 1.1441-1. Requirement for the deduction and withholding of tax on payments to foreign persons.

* * * * *

(e) * * *

(4) * * *

(iv) *Electronic transmission of information*—(A) *In general.* A withholding agent may establish a system for beneficial owners or payees to furnish electronically Forms W-8 (or such other form as the Internal Revenue Service may prescribe). The system also may enable the withholding agent to electronically transmit Forms W-8 to another person. The system must meet the requirements described in paragraph (e)(4)(iv)(B) of this section.

(B) *Requirements*—(1) *In general.* The electronic system must ensure that the information received is the information sent, and must document all occasions of user access that result in the submission, renewal, or modification of a Form W-8. In addition, the design and operation of the electronic system, including access procedures, must make it reasonably certain that the person accessing the system and furnishing Form W-8 is the person named in the form.

(2) *Same information as paper Form W-8.* The electronic transmission must provide the withholding agent or payor with exactly the same information as the paper Form W-8.

(3) *Perjury statement and signature requirements.* The electronic transmission must be signed by way of an electronic signature by the person whose name is on the Form W-8 and the signature must be under penalties of perjury in the manner described in this paragraph (e)(4)(iv)(B)(3).

(i) *Perjury statement.* The perjury statement must contain the language that appears on the paper Form W-8. The electronic system must inform the person whose name is on the Form W-8 that the person must make the declaration contained in the perjury statement and that the declaration is made by signing the Form W-8. The instructions and the language of the perjury statement must immediately follow

307 N.J.Super. 474

474 **R & R MARKETING, L.L.C., Royal Distributors and Importers, Ltd., Inc., and Reitman Industries, Inc., Petitioners-Appellants,**

v.

BROWN-FORMAN CORPORATION, Respondent-Respondent.

Superior Court of New Jersey,
Appellate Division.

Argued Nov. 12, 1997.
Decided Jan. 27, 1998.

Authorized liquor wholesalers appealed decision of Department of Law and Public Safety, Division of Alcoholic Beverage Control, upholding refusal of supplier to sell to them after they incorporated under Limited Liability Company Act. The Superior Court, Appellate Division, Kleiner, J.A.D., held as matter of first impression that incorporation of wholesalers under Act did not deprive them of protection of wholesaler anti-discrimination statute.

Reversed.

1. Administrative Law and Procedure ⟹763

Generally, on appeal from administrative decision, Appellate Division will not upset ultimate determination of agency, unless it was arbitrary, capricious, or unreasonable, or violated legislative policies expressed or implied in act governing the agency.

2. Administrative Law and Procedure ⟹784.1, 787

When error in fact-finding of administrative agency is alleged, court gives due regard to ability of factfinder to judge credibility and, where agency's expertise is factor, to that expertise.

475 **3. Administrative Law and Procedure ⟹796**

Statutes ⟹219(1)

When asked to review agency's interpretation of statute or strictly legal decision, Appellate Division respects agency's expertise, but is not bound by it; interpretation of statutes is judicial, not administrative, function.

4. Intoxicating Liquors ⟹124

Incorporation of two authorized liquor wholesalers under Limited Liability Company Act did not deprive them of protection of wholesaler anti-discrimination statute which prohibits discrimination in sale of nationally advertised brand of alcoholic beverage to duly licensed wholesalers, even though limited liability company included transportation company to deliver products for wholesalers; wholesalers transferred their authorizations by operating, transfer, and assignment agreements and maintained complete control of their respective sales forces, and formation of the company did not dissipate supplier's control of its distribution system. N.J.S.A. 33:1-93.6, 42:2B-1 et seq.

Frederick E. Gerson, Florham Park, for petitioners-appellants (D'Alessandro, Jacovino & Gerson, attorneys; Mr. Gerson and Edward G. D'Alessandro, on the brief).

Ross A. Lewin, Princeton, for respondent-respondent (Jamieson, Moore, Peskin & Spicer, attorneys; Mr. Lewin, of counsel and on the brief; Michael G. Petrone and David F. Swerdlow, on the brief).

Analisa Sama Holmes, for amicus curiae New Jersey Department of Law and Public Safety, the New Jersey Division of Alcoholic Beverage Control (Peter Verniero, Attorney General; Ms. Holmes, Deputy Attorney General, of counsel and on the brief).

Before Judges LONG, KLEINER and KIMMELMAN.

The opinion of the court was delivered by

476 KLEINER, J.A.D.

This case of first impression requires us to interpret *N.J.S.A.* 33:1-93.6, New Jersey's wholesaler anti-discrimination statute, as it may affect licensed liquor wholesalers who have been authorized to distribute liquor supplier's products, and who elect to incorporate under the Limited Liability Company Act, *N.J.S.A.* 42:2B-1 *et seq.* (the Act).

To more fully define the parameters of the issues presented on this appeal from a decision of the Director of the Division of Alcoholic Beverage Control, we must first analyze the factual background predating a decision by petitioners Royal Distributors and Importers, LTD., Inc. (Royal), and Reitman Industries, Inc. (Reitman), to form a limited liability company.

For over twenty years Royal and Reitman were wholesalers, each authorized by Brown-Forman Corporation, a wholesale supplier, to distribute its nationally advertised distilled spirits. Neither Royal nor Reitman have a written contract with Brown-Forman. The relationship of each petitioner with Brown-Forman was protected by *N.J.S.A.* 33:1-93.6, which prohibits:

> discrimination in the sale of any nationally advertised brand of alcoholic beverage other than malt alcoholic beverage, by importers, blenders, distillers, rectifiers and wineries, to duly licensed wholesalers of alcoholic beverages who are authorized by such importers, blenders, distillers, rectifiers and wineries to sell such nationally advertised brand in New Jersey.

In the summer of 1993, Royal and Reitman began discussing the possibility of combining their respective businesses. Ultimately, as discussed in greater detail *infra*, those discussions led to the formation of R & R Marketing, L.L.C. (R & R), also a petitioner herein.[1] The major issue that apparently pervaded these discus477sions was the form or structure of the proposed venture. It seems evidently clear from the record that the corporate representatives and their respective counsel considered the advantages or disadvantages of a partnership, limited liability company, and holding company. Each party weighed tax considerations of the

1. Another company, R & W Warehouse and Transportation Co. (R & W), became a part of the limited liability company as of the date of its formation. R & W was engaged solely in providing transportation in the distribution of the products purchased from Brown-Forman and was not itself a licensed liquor wholesaler. R & W was an integral part of the limited liability company as of the date of petitioners' petition and as of the date of the administrative decision which prefaces this appeal. At oral argument, however, we were advised that R & W is no longer part of R & R Marketing.

potential prospective structures. Of greater significance to each company, though, was whether a new entity would retain the protection afforded Royal and Reitman under *N.J.S.A.* 33:1-93.6.

In exploring this central issue, Neil Wassner, a Reitman financial consultant, spoke with Charles Sapienza, then-Executive Director of the New Jersey Wine and Spirits Wholesalers Association. From Wassner's notes, it is apparent that Sapienza opined that if there were a "change in control" of a wholesaler, the statutory protection would continue, but if a new entity was established, the new entity would "probably lose" the statutory protection.

After fully exploring their options, both companies concluded that either a partnership or a limited liability company structure provided the "optimum" tax advantages, but that a holding company structure might provide the optimum benefit of preserving the existing franchises and the statutory protection under *N.J.S.A.* 33:1-93.6. Both companies also discussed the issue of whether Royal and Reitman could continue their ownership rights and "sub-job" to the partnership in the event that R & R could not become an authorized wholesaler.

In November 1993, prior to reaching a decision as to the structure of R & R, Reitman's attorney sought an advisory opinion from the Director of the Division of ABC regarding whether the creation of an "operating partnership" would deprive the petitioners of their statutory protection. In a subsequent communication to the Director, counsel also informed the Director of the possibility that petitioners would form a limited liability company. Director ⊥478 John Holl refused to issue an advisory opinion because he believed the same issue could arise as a contested case before the Division in the future.

During the investigatory stage preceding their formation as a limited liability company, petitioners discussed with and obtained the consent from some of their other liquor suppliers regarding the transfer of their wholesaler authorizations to R & R. Petitioners admit that they neither specifically asked for nor received the consent of Brown-Forman to continue to distribute its products.[2]

In July 1994, Royal and Reitman entered into an agreement which created R & R as a limited liability company pursuant to the Act. They executed an Operating Agreement which contained a non-competition clause:

> 2.7 *Other Business Interests of the Members.* No Member, nor any of their present or future Affiliates, directly or indirectly, by itself or in any other form or combination with any other person or entity, shall, during the term of the Company engage in the wholesale distribution or sale, in, to or from New Jersey, of alcoholic or non-alcoholic beverages or conduct a warehousing business in New Jersey for alcoholic or non-alcoholic beverages. Except as set forth in this Section 2.7, the Members and their Affiliates may engage in or possess interests in other business ventures of every kind and nature and neither the Company nor any other Member shall have any rights by virtue of this Agreement in any such other business ventures of a Member or the income or profits derived therefrom by that Member.

The Operating Agreement contained an exception to the Section 2.7 non-competition clause in the event that a supplier did not consent to Royal's and Reitman's transfer of their wholesaler authorizations to R & R:

> 4.6 *Distribution and Warehouse Contracts.* All Distribution and Warehouse Contracts between Royal, Reitman or R & W and manufacturers or distributors of alcoholic or non-alcoholic beverages shall, to the extent possible, be transferred and assigned to the Company as the contracting party in the place of Royal, Reitman or ⊥479R & W. To the extent any such Distribution or Warehouse Contract cannot be transferred or the other party thereto refuses to consent to such transfer, if such consent is necessary, such contract shall remain in the name of Royal, Reitman or R & W. In such event, Royal, Reitman or R & W shall purchase beverages from or

2. The record seems clear that Brown-Forman was made aware of petitioners' intention to form R & R, and that Brown-Forman never expressly disapproved of petitioners' plan, nonetheless, the record is clear that Brown-Forman never expressly sanctioned the formation of R & R.

perform warehousing services for the other party to such contract and sell the same directly to and perform such warehousing services on behalf of the Company at cost so that the Company would be in the same economic position with respect to such contract as it would have been in had such contract been transferred pursuant to this section 4.6. Each Member shall take such action as is necessary or reasonable in order to effect the intent of this Section 4.6.[3]

The term "Distribution Contract" is defined in the Operating Agreement as "all contracts, oral or written, to which Reitman, R & W, Royal or the Company is a party, or any other form of authorization pursuant to which any of them is authorized to distribute or sell alcoholic or non-alcoholic beverages."[4]

Soon after R & R's creation, it attempted to purchase alcoholic beverages from Brown–Forman. However, Brown–Forman refused to fill those orders. On July 20, 1994, petitioners filed a Verified Petition against Brown–Forman seeking protection under *N.J.S.A.* 33:1–93.6 and *N.J.A.C.* 13:2–18.1.

Petitioners simultaneously sought *ad interim* relief mandating Brown–Forman to supply them with certain alcoholic beverages during the pendency of the proceeding. On the same day, the Director granted interim relief to Reitman and Royal, but denied same to R & R. The ruling was confirmed in an order dated July 22, 1994.

⌊480Specifically, petitioners argued in their Verified Petition that: (1) *N.J.S.A.* 33:1–93.6 should be liberally construed to protect their interests; (2) their agreements creating R & R conveyed their privileges under the statute; (3) the formation of the limited liability company should be treated like a corporate merger and therefore Reitman's and Royal's authorizations were legally transferred to R & R through the limited liability company's formation.

In its answer, Brown–Forman claimed that R & R was not protected under the statute because it never authorized R & R to sell its brands, and further that Reitman and Royal lost their protections under the statute because they gave up their ability to act as independent wholesalers by forming the limited liability company in the manner that they did.

After full discovery, Brown–Forman successfully moved for summary judgment, and petitioners' verified petition was dismissed. In reaching this decision, the Director concluded that as a matter of law R & R was not an authorized wholesaler under *N.J.S.A.* 33:1–93.6, and thus was not entitled to statutory protection. The Director reasoned that petitioners' interpretation of the pertinent statute could lead to other authorized wholesalers entering into numerous joint ventures to distribute products with or through unauthorized wholesalers. Additionally, the Director concluded that petitioners' interpretation would undermine the goal of the statute to balance the protections afforded wholesalers with the competitive interests of suppliers, stating:

> [*N.J.S.A.* 33:1–93.6] is designed to balance interests. If the interpretation urged by Petitioners is correct, then authorized wholesalers would be able to auction off their "authorized status" to the highest bidders among non-authorized wholesalers.
>
> This interpretation of the statute would lead to chaos, effectively destroying a manufacturer's ability to create a stable distribution network. One of the purposes of the Alcoholic Beverage Law is to promote stability in the marketing of alcoholic beverages, which in turn fosters moderation

3. Petitioners' intent is clarified in an inter-company communication written by Reitman's counsel:

> The simplest alternative would be to follow the method of operation described in Section 4.6, described above. Royal and Reitman would each purchase products from the appropriate suppliers and then resell those products to R & R. R & R would then sell the products to its customers through its Reitman division, its Royal division, or any other divisions it may have.

4. Both Royal and Reitman executed Transfer, Assignment and Assumption Agreements through which they transferred to R & R all of their primary interests in their operating assets, particularly their respective authorizations to sell alcoholic and non-alcoholic beverages. (Assets excepted from these agreements are not pertinent to this appeal.)

> and responsibility in the use of alcoholic beverages.

He was also concerned that such trade instability would "create a real danger of 'price wars' and other destabilizing practices."

⌊481The Director also addressed petitioners' claim that the formation of a limited liability company should be treated like a corporate merger, by which all personal property, tangible and intangible, becomes vested in the new corporation, and all constituent companies cease to exist. *See N.J.S.A.* 14A:10–6(d), (e). He distinguished New Jersey's Corporations Law from the Limited Liability Company Act, which leaves the issue of whether the separate parties to the company may continue to exist largely to the Operating Agreement, and which provides that the newly-formed company is an entity separate from its members.

He further concluded that Royal and Reitman could not retain their individual authorizations to distribute respondent's products because, according to R & R's operating and other agreements, they remained as separate entities only to "front" for R & R:

> The system set up by Royal and Reitman requires them in the first instance to transfer their distribution contracts to R & R. If they are unable to do so, they must purchase [the] product themselves and sell it directly to R & R "at cost" so that R & R achieves the same economic position if [sic] would have been in had the contract been transferred. In short, they have agreed to front for R & R.
>
> Brown-Forman correctly characterizes this as a "sham arrangement." Once Reitman and Royal executed agreements obligating them to front for R & R, they forfeited their protection under the statute.

In addition, the Director dismissed petitioners' estoppel claim, finding that they did not show that they relied upon Brown-Forman's conduct to their detriment. He concluded that petitioners predicated their decision to form a limited liability company not on franchise concerns but rather on the extent of the tax benefits.

Petitioners appeal from the Director's decision. We reverse.

I

[1, 2] Generally, on appeal from an administrative decision, we will not upset the ultimate determination of an agency unless it was arbitrary, capricious or unreasonable, or violated legislative policies expressed or implied in the act governing the agency. *Campbell v. Dep't of Civil Serv.*, 39 *N.J.* 556, 562, 189 *A.*2d 712⌊482(1963). When an error in a factfinding of an administrative agency is alleged, the court gives "due regard" to the ability of the factfinder to judge credibility and, where an agency's expertise is a factor, to that expertise. *Close v. Kordulak Bros.*, 44 *N.J.* 589, 599, 210 *A.*2d 753 (1965).

[3] When asked to review an agency's interpretation of a statute or strictly legal decision, we respect the agency's expertise. *Mayflower Sec. Co., Inc. v. Bureau of Sec.*, 64 *N.J.* 85, 93, 312 *A.*2d 497 (1973). Ultimately, though, interpretation of statutes is a judicial, not an administrative, function, and the court is not bound by the agency's interpretation. *Ibid.*

II

The Director's interpretation of *N.J.S.A.* 33:1–93.6, a law he was charged with safeguarding, is obviously entitled to deference based upon his expertise. However, he concluded as a matter of law that petitioners were not entitled to protection under the statute. This court is not bound by the Director's conclusions of law. Moreover, although his ultimate findings affected petitioners' rights under *N.J.S.A.* 33:1–93.6, the Director's conclusions were also based on his interpretation of the Limited Liability Company Act, a statute of relatively recent origin which the Director is not charged in safeguarding. As a result, this court is not bound by the Director's finding that a limited liability company formed by two authorized wholesalers is not entitled to protection under *N.J.S.A.* 33:1–93.6 because the company itself is not an authorized wholesaler.

III

[4] The Limited Liability Company Act was enacted in 1994. Section 42:2B–8(b) of the Act provides that:

> A limited liability company shall possess and may exercise all the powers and privileges granted by this act or by any other law or by its operating agreement, together with any powers incidental thereto, so far as such powers and privileges ⌊483are necessary or convenient to the conduct, promotion or attainment of the business, purposes or activities of the limited liability company.

Under the Act, a "member" of a limited liability company acquires a "limited liability company interest," which is defined as "a member's share of the profits and losses of a limited liability company and a member's right to receive distributions of the limited liability company's assets." *N.J.S.A.* 42:2B–21; *see also N.J.S.A.* 42:2B–2 (defining "limited liability company interest").

The Act "is to be liberally construed to give the maximum effect to the principal of freedom of contract and to the enforceability of operating agreements." *N.J.S.A.* 42:2B–66; *see also* Peter D. Hutcheon, *The New Jersey Limited Liability Company Statute: Background and Concepts,* 18 *Seton Hall Legis. J.* 111, 129 (1993) ("[Section] 8(b) does invest private parties with quasi law-making power, by expressly endorsing the concept of private ordering as a source of common law."). Further, Section 42:2B–67 provides that "[i]n any case not provided for in this act, the rules of law and equity, including the law merchant, shall govern."

In enacting the Act, the Legislature obviously sought to encourage capital investment within the State by encouraging the formation of limited liability companies. Although parties forming a limited liability company under the LLC are given somewhat wide latitude in structuring their organizations through operating agreements, they may not circumvent the mandates of other statutes, such as *N.J.S.A.* 33:1–93.6. *See N.J.S.A.* 42:2B–67. This court must therefore consider New Jersey's interest in promoting the formation of limited liability companies together with the remedial purposes behind the *N.J.S.A.* 33:1–93.6.

New Jersey's anti-discrimination statute, *N.J.S.A.* 33:1–93.6, and its corresponding administrative regulation, *N.J.A.C.* 13:2–18, have been construed as designed for "the protection of the public through the promotion of temperance and elimination of the racketeer and bootlegger." *Canada Dry Ginger Ale, Inc. v. F & A Distrib. Co.,* 28 N.J. 444, 455, 147 *A.*2d 15 (1958). "[T]he statute seeks to achieve as far as necessary the independence of wholesa⌊484lers from distillers[,] ... and ... to prevent the distiller from arbitrarily closing the source of supply to a wholesaler." *Ibid.* The statute and the Director's authority to enforce it shall be liberally construed. *Ibid.*

The effect of the law is to prevent alcohol suppliers from arbitrarily terminating their relationships with wholesalers. Further, according to the Attorney General, the law is to secure equitable competition among wholesalers. Originally, it applied to all wholesalers. In 1966, the Act limited its scope to "duly licensed wholesalers of alcoholic beverages who are *authorized* " by the manufacturers or suppliers. *N.J.S.A.* 33:1–93.6 (emphasis added). While the statute offers expansive protection to "authorized" wholesalers, *see American B.D. Co. v. The House of Seagrams, Inc.,* 107 *N.J.Super.* 264, 267, 258 *A.*2d 129 (App.Div.1969), it does not define the exact method or criteria upon which a licensed wholesaler becomes an "authorized" wholesaler.

The crux of the Director's decision seems predicated on the fact that although both Royal and Reitman are separately authorized wholesalers, their newly-formed limited liability corporation is technically not an authorized wholesaler. Yet, as petitioners argue, had Royal and Reitman effectuated a corporate merger the new corporate entity would have preserved their authorized wholesaler status. *N.J.S.A.* 14A:10–6.[5]

Because both *N.J.S.A.* 33:1–93.6 and the Limited Liability Company Act are to be liberally construed, affording petitioners protection under *N.J.S.A.* 33:1–93.6 would not

5. Under *N.J.S.A.* 14A:10–6(b), upon the completion of a corporate merger, "[t]he separate existence of all parties to the plan of merger or consolidation ... shall cease." The surviving corporation thus succeeds to "all the rights, privileges, powers, immunities, purposes and franchises, both public and private" of the merging corporations. *N.J.S.A.* 14A:10–6(c).

defeat the purpose of that statute but would advance New Jersey's goal in promoting the formation of limited liability companies as expressed in the Limited Liability Company Act. The essential relationship between Brown-Forman and R & R has not changed by combining ⌊485the individual corporate entities under the umbrella of a limited liability company.

In *Joseph H. Reinfeld, Inc. v. Schieffelin & Co.*, 94 *N.J.* 400, 466 *A.*2d 563 (1983), the Court held that where only the supplier's state of incorporation changes, it cannot avoid the anti-discrimination statute. *Id.* at 409, 466 *A.*2d 563. In *Reinfeld,* the supplier terminated all of its wholesalers and went out of business; the "new" supplier authorized only one wholesaler to distribute its products. *Id.* at 408, 466 *A.*2d 563. However, the "old" and "new" supplier "had the same directors, officers and salespeople. Only the state of incorporation changed." *Id.* at 409, 466 *A.*2d 563. The Court held that were it to allow the supplier "to avoid the anti-discrimination statute through such corporate legerdemain, [it] would plainly frustrate the statute's purpose." *Ibid.See also Royal Liquor v. Brown-Forman,* 4 *N.J.A.R.* 248 (1982) (holding that a supplier that undergoes a corporate reorganization may not terminate the authorizations of wholesalers previously authorized to distribute its brands).

R & R was formed by two authorized wholesalers who transferred their authorizations via their operating, transfer and assignment agreements to R & R. Petitioners maintain that both Royal and Reitman are in complete control of their respective sales forces. Further, petitioners state that the same officers that were in control of Brown-Forman's account with each petitioner prior to the joint venture would be in control of the joint venture. As a result, the relationships between Royal and Brown-Forman and Reitman and Brown-Forman arguably did not change. Actually, the business conducted between them may have been simply made more efficient by the formation of R & R. Interests of equity thus may dictate that R & R be afforded protection under *N.J.S.A.* 33:1-93.6. *See N.J.S.A.* 42:2B-67.

In response to petitioners' arguments, Brown-Forman, citing *Reinfeld* and *Royal Liquor* argues: "Just as the protections granted wholesalers by the statute cannot be artificially constrained by a supplier's corporate transactions, so too wholesalers ⌊486may not employ corporate gimmickry in order to artificially expand the group of wholesalers authorized to sell a supplier's products." Although that argument has facial appeal, its persuasiveness pales when two authorized wholesalers combine under a newly-formed corporate structure.

More important, this is not a case where an authorized wholesaler and an unauthorized wholesaler seek protection under *N.J.S.A.* 33:1-93.6 for a newly-formed corporate entity. The Director's concerns seem more applicable to those instances where an authorized wholesaler seeks to combine its business with the business of an unauthorized wholesaler, thereby circumventing the limitations imposed by the anti-discrimination statute as amended in 1966. In such a case, a decision by a supplier to refuse to sell to the newly-formed entity may indeed be legitimate and not discriminatory. Moreover, approval of a wholesaler is the prerogative of the supplier who has the right to select its own distribution network.

However, as noted, where the new entity is composed of previously approved wholesalers, the supplier's control of its distribution system is not dissipated. It is quite apparent that the Director elevated form over substance in this particular case. As such, his decision was arbitrary and unreasonable. *See Campbell, supra,* 39 *N.J.* at 562, 189 *A.*2d 712. Although "[a] limited liability company formed under the act shall be a separate legal entity," *N.J.S.A.* 42:2B-11(b), nonetheless, we cannot overlook the fact that the new separate legal entity is composed of two entities which previously were authorized wholesalers and entitled to the benefits of the anti-discrimination provisions and policies embodied in *N.J.S.A.* 33:1-93.6.

We recognize that at its inception, R & R was comprised of Royal, Reitman, and R & W Warehouse and Transportation Co., a business clearly not engaged in wholesaling of alcoholic beverages, but engaged in transportation. The State in its amicus curiae brief, in fact, argues that "R & R is not solely made up of authorized wholesalers and thus

[is] not entitled to the statuary protection." We find that argument unpersuasive, as R & W's ⊥487participation in the limited liability company as a deliverer does not expand the class of authorized wholesalers protected by *N.J.S.A.* 33:1–93.6. Whether an authorized wholesaler utilizes its own employees or an outside company to deliver its products seems irrelevant absent evidence that the use of a delivery service in some manner interferes with the intended function of the distribution system.[6]

Because we have concluded that the Director erred in reaching his decision, it is not necessary to consider petitioners' other contentions that Royal and Reitman could continue to operate independently within the framework of R & R's Operating Agreement, section 4.6, or that Brown–Forman should be estopped from refusing to recognize R & R as an authorized wholesaler. Our decision renders each of those arguments moot.

The decision of the Director denying the protections of the anti-discrimination statute, *N.J.S.A.* 33:1–93, to petitioners is reversed.

NOTES

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NOTES

THE SINGLE MEMBER LLC:
ITS HIGHEST USE & ISSUES OF CONCERN

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THE SINGLE MEMBER LLC:
ITS HIGHEST USE & ISSUES OF CONCERN

TABLE OF CONTENTS

THE SINGLE-MEMBER LIMITED LIABILITY COMPANY

I. Check-the-Box Regulations and Kentucky H.B. 666 (1998 amendments).

II. Does a single-member LLC need an operating agreement?

III. Uses for single-member LLCs.

A. Liability firewalls.

B. Bankruptcy and bankruptcy remote financing/special purpose entity.

C. Avoidance of transfer taxes.

D. Like-kind exchanges (IRC § 1031).

E. Comparison with corporate subsidiaries (*i.e.*, qualified Sub S subsidiary).

F. Avoidance of ancillary probate.

IV. Review of Revenue Ruling 99-5 (disregarded entity to tax partnership).

V. Review of Revenue Ruling 99-6 (tax partnership to disregard entity).

VI. Insolvency and the problem of "Wrongful" Distributions.

VII. Applicability of at-risk rules (IRC § 465).

VIII. Applicability of passive loss rules (IRC § 469).

IX. Foreign Hybrids (proposed regulations).

X. Employment Tax.

THE KENTUCKY SINGLE-MEMBER LLC: A "USER-FRIENDLY" BUSINESS INNOVATION KENTUCKY ENTREPRENEURS SHOULD CONSIDER

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I. INTRODUCTION

When an entrepreneur contemplates starting a business, one of the first issues analyzed is what form of business entity is best suited for transacting his or her particular business. While there are a number of factors which go into making this selection, the decision most often comes down to two: (1) how can the business owner limit his or her personal liable? and (2) how can taxes be minimized? Over time a variety of different forms of doing business have evolved in an attempt to create the ideal business entity. "C" corporations, "S" corporations, general and limited partnerships and limited liability companies are the basic forms of doing business from which the business owner can select. Recently, a new form of doing business has been made available to Kentucky entrepreneurs – the single member limited liability company ("SMLLC"). Like the other business entity selections, the SMLLC has attributes which are extremely attractive to the first time business owner or even businesses which look to expand or protect their existing operations. The fact that the SMLLC provides its owner limited liability while being "transparent" from its owner for both federal and state income tax purposes should be enough to catch the entrepreneur's attention. Moreover, the steps necessary to accomplish these results are relatively simple and convenient and maintaining the entity and its limited liability is no more difficult and in some respects easier than the Kentucky corporation.

II. THE KENTUCKY SINGLE-MEMBER LIMITED LIABILITY COMPANY — WHAT IS IT?

In 1994, Kentucky enacted the Kentucky Limited Liability Company Act (the "Act"). As the 42nd state to pass such legislation, Kentucky entrepreneurs, for the first time, had the opportunity to utilize a business entity which offered its owners a complete limited liability shield comparable to that of a corporation, as well as favorable partnership tax treatment. To ensure partnership tax treatment, the Act required a limited liability company to have at least two owners. Consequently, the sole proprietor could not take advantage of the LLC. However, on December 17, 1996 the Internal Revenue Service issued regulations that permit taxpayers to treat unincorporated entities as partnerships for federal income tax purposes without complying with the prior four-prong entity classification rules under IRC §7701. In addition, these regulations recognize that a business entity with a single owner that is not a corporation will be "disregarded" as an entity separate from its owner. (See Treas. Reg. §301.7701-2(c)(2)). The development of the SMLLC is changing the approach of tax planners to a number of common business transactions. In response to these federal regulatory developments, Kentucky amended the Act in 1996 to permit SMLLCs. (See H.B. 666, Chap. 341). At the present time only seven states either specifically do not allow or have not yet addressed the classification of the domestic SMLLC. A simple change such as this creates wide ranging opportunities for Kentucky businesses.

A Kentucky SMLLC is an entity which: (i) is formed pursuant to and is governed by the Act (as opposed to the corporate or partnership statutes), (ii) has, by definition, only one owner, (iii) offers the sole owner limited liability (i.e. the ability to limit one's personal liability for debts and obligations of the LLC to the amount of equity or capital committed to the business) and (iv) which, for federal and state tax purposes, is disregarded as a separate taxable entity from its owner. What this all means is that an entrepreneur, on the one hand, or an existing business entity seeking to limit its exposure in a new business venture, on the other, may now utilize the more informal and flexible SMLLC and in doing so, limit personal liability and have all the activities of the SMLLC treated as if they were conducted by a sole proprietor or a branch or division of the owner.

A written operating agreement, which is similar to a corporation's bylaws or a partnership agreement, is suggested in order to give the entity validity for state law purposes. While some commentators argue that it is not possible to have an "agreement" with only one party, this argument overlooks the fact that for state law purposes, there are two parties, the sole owner and the LLC. Moreover, it is important to establish to outside third parties that it is the LLC and not the owner that owns the assets, compensates its employees, contracts with outsiders and, in general, transacts all business. The formalities of forming and operating a SMLLC should correspond to those carried out by a multi-owner LLC in order to ensure the benefits of limited liability.

III. FEDERAL AND STATE TAX TREATMENT

In order to take advantage of this new business entity, the entrepreneur is required to file Articles of Organization with the Kentucky Secretary of State's office. The SMLLC is available to existing businesses as well as proprietors, which include both professionals and non-professionals. One "person" must own 100% of the SMLLC. A "person", however, includes individuals, trusts, estates, partnerships or other entities taxable as an association, company or corporation. The determination of whether an entity has a single owner is based on the underlying facts and circumstances. (See PLR 199911033, December 18, 1998, which provides guidance on the single member requirements.) The Internal Revenue Service requires SMLLCs to file Form SS-4 "Application for Taxpayer Identification Number" with the appropriate IRS Service Center although the LLC will not be given a separate number, but rather will operate under the owners' taxpayer identification number.

The tax treatment afforded the SMLLC is unique. For federal and Kentucky tax purposes, the Kentucky SMLLC is disregarded as an entity transparent from its owner unless the owner elects to have the LLC taxed as a corporation. A SMLLC may elect a classification other than its default classification or change its classification by filing Form 8832, Entity Classification Election. In simple terms, this means that it is completely ignored as a separate tax paying entity and consequently all business activities conducted by the SMLLC will be reported on the owner's tax return. No separate taxable year and no separate tax attributes, and, as a result, no separate tax return is required to be filed with the IRS or Kentucky tax authorities. The owner of a SMLLC is treated as directly owning the entity's assets and therefore not having a separate basis in the membership interest in the SMLLC. A loan from the owner to the SMLLC is ignored. All activities are treated in the same manner as a sole proprietorship with respect to an individual owner and either a branch or division of the business entity owner. A disposition of all the interest in the SMLLC by the member is treated as a disposition of the underlying assets by the member. Nothing this simple is available to a S corporation, partnership or even a multi-owner LLC. And the beauty of this is that it requires no affirmative action on the part of the owner. No election needs to be filed nor statements issued to obtain or preserve this tax treatment.

There are situations where the classification of the SMLLC can change as a result of its change in status. For example, a SMLLC could add a member and become a partnership for tax purposes. (See Rev. Rul. 99-5, 1999-5 I.R.B. 8). A disregarded entity may also enter into a business combination (e.g., merger) with an LLC which elected "corporation" status and becomes a corporation. Finally, an LLC with multiple members could reduce its membership to a sole owner and thus become a disregarded entity. (See Rev. Rul. 99-6, 1999-6 I.R.B. 6). If any of these situations are contemplated, the parties involved are best advised to consider the attendant tax consequences and document the transaction accordingly.

IV. PLANNING OPPORTUNITIES

With the creation of the SMLLC, a number of significant planning opportunities arise:

A. Limited Liability Protection for the Sole Proprietor.

Anyone contemplating starting a business or an existing business considering a new business endeavor should consider seriously the SMLLC. There is no reason now why an individual should expose his or her personal assets unnecessarily to claims of creditors. The sole proprietor should be a thing of the past. With the SMLLC, the sole proprietor may now engage in business with the added insurance of limited liability protection. With a SMLLC, unlike any other business entity, the owner will not be required to go to the expense of filing a separate tax return or paying tax for the entity itself.

B. Alternative to the Corporate Subsidiary.

Small and medium sized corporations, which in the past, have grouped various businesses into separate subsidiary corporations in an effort to limit exposure and insulate themselves from liabilities now can use separate SMLLCs. A corporate owner will no longer need to maintain the often complicated formalities associates with operating one or more subsidiaries nor struggle with the complex consolidated return regulations for tax purposes to achieve its objectives.

C. Acquiring and Selling Real Estate; Like-Kind Exchanges.

Limited liability companies provide the ideal means of acquiring, managing and selling real estate. The setting up of separate SMLLCs, to hold real estate will limit the owner's exposure. The use of a SMLLC in Internal Revenue Code Section 1031 like-kind exchange transactions create additional flexibility in structuring to allow the owner the benefit of limited liability, as well as financing opportunities. Specifically in the context of Section 1031 exchanges, the ability to transfer the acquired property directly to a SMLLC will remove the individual from the chain of title and all the potential claims to which all property owners are vulnerable.

D. Avoidance of Transfer Taxes Associated With the Sale of Business Assets.

Kentucky, in general, imposes a 6% sales tax on the sale of business assets. In order to avoid the sales tax on the sale of assets, the seller might consider forming a SMLLC immediately prior to the sale, transfer the asset(s) to be purchased into the LLC and then sell the member interest to the purchaser. No sales tax is incurred since the sale involves intangible business assets (i.e. the member interest). The purchaser gets a step up in basis in the acquired assets and can continue to operate the LLC since it is disregarded for income tax purposes. This technique is also available with the sale of real estate. It is extremely valuable in the transfer of real estate since by owning the interest in the LLC rather than the real estate, the purchaser never enters the "chain of title" for environmental purposes.

V. CONCLUSION

The Kentucky SMLLC will undoubtedly work its way into business transactions going forward. Entrepreneurs, corporations, lenders and governmental authorities will all find themselves assessing the benefits and drawbacks associated with conducting business in or with a SMLLC. There do remain certain problems with the SMLLC, such as transacting business in jurisdictions which currently do not recognize SMLLCs or dealing with self-employment tax issues or merely educating oneself on the SMLLC, all of which will be resolved in the near future. These problems, however, should not preclude an entrepreneur from embracing the SMLLC.

ADDENDUM

- IRS FORM 8832 (ENTITY CLASSIFICATION ELECTION)
- IRS REVENUE RULING 99-5
- IRS REVENUE RULING 99-6
- IRS NOTICE 99-6
- PRIVATE LETTER RULING 9807013
- PRIVATE LETTER RULING 199911033
- PRIVATE LETTER RULING 199914006

Form **8832** (December 1996) Department of the Treasury Internal Revenue Service

Entity Classification Election

OMB No. 1545-1516

Please Type or Print	Name of entity	Employer identification number (EIN)
	Number, street, and room or suite no. If a P.O. box, see instructions.	
	City or town, state, and ZIP code. If a foreign address, enter city, province or state, postal code and country.	

1 Type of election (see instructions):

a ☐ Initial classification by a newly-formed entity (or change in current classification of an existing entity to take effect on January 1, 1997)

b ☐ Change in current classification (to take effect later than January 1, 1997)

2 Form of entity (see instructions):

a ☐ A domestic eligible entity electing to be classified as an association taxable as a corporation.

b ☐ A domestic eligible entity electing to be classified as a partnership.

c ☐ A domestic eligible entity with a single owner electing to be disregarded as a separate entity.

d ☐ A foreign eligible entity electing to be classified as an association taxable as a corporation.

e ☐ A foreign eligible entity electing to be classified as a partnership.

f ☐ A foreign eligible entity with a single owner electing to be disregarded as a separate entity.

3 Election is to be effective beginning (month, day, year) (see instructions) . . . . ▶ ___/___/___

4 Name and title of person whom the IRS may call for more information	**5** That person's telephone number

Consent Statement and Signature(s) (see instructions)

Under penalties of perjury, I (we) declare that I (we) consent to the election of the above-named entity to be classified as indicated above, and that I (we) have examined this consent statement, and to the best of my (our) knowledge and belief, it is true, correct, and complete. If I am an officer, manager, or member signing for all members of the entity, I further declare that I am authorized to execute this consent statement on their behalf.

Signature(s)	Date	Title

For Paperwork Reduction Act Notice, see page 2. Cat. No. 22598R Form **8832** (12-96)

General Instructions

Section references are to the Internal Revenue Code unless otherwise noted.

Paperwork Reduction Act Notice

We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

Recordkeeping . . .1 hr., 20 min.
Learning about the law or the form . . .1 hr., 41 min.
Preparing and sending the form to the IRS . . . .17 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Tax Forms Committee, Western Area Distribution Center, Rancho Cordova, CA 95743-0001. **DO NOT** send the form to this address. Instead, see **Where To File** on page 3.

Purpose of Form

For Federal tax purposes, certain business entities automatically are classified as corporations. See items **1** and **3** through **8** under the definition of corporation on this page. Other business entities may choose how they are classified for Federal tax purposes. Except for a business entity automatically classified as a corporation, a business entity with at least two members can choose to be classified as either an association taxable as a corporation or a partnership, and a business entity with a single member can choose to be classified as either an association taxable as a corporation or disregarded as an entity separate from its owner.

Generally, an eligible entity that does not file this form will be classified under the default rules described below. An eligible entity that chooses not to be classified under the default rules or that wishes to change its current classification must file Form 8832 to elect a classification. The IRS will use the information entered on this form to establish the entity's filing and reporting requirements for Federal tax purposes.

Default Rules

Existing entity default rule.— Certain domestic and foreign entities that are already in existence before January 1, 1997, and have an established Federal tax classification, generally do not need to make an election to continue that classification. However, for an eligible entity with a single owner that claimed to be a partnership under the law in effect before January 1, 1997, that entity will now be disregarded as an entity separate from its owner. If an existing entity decides to change its classification, it may do so subject to the rules in Regulations section 301.7701-3(c)(1)(iv). A foreign eligible entity is treated as being in existence prior to the effective date of this section only if the entity's classification is relevant at any time during the 60 months prior to January 1, 1997.

Domestic default rule.—Unless an election is made on Form 8832, a domestic eligible entity is:

1. A partnership if it has two or more members.

2. Disregarded as an entity separate from its owner if it has a single owner.

Foreign default rule.—Unless an election is made on Form 8832, a foreign eligible entity is:

1. A partnership if it has two or more members and at least one member does not have limited liability.

2. An association if all members have limited liability.

3. Disregarded as an entity separate from its owner if it has a single owner that does not have limited liability.

Definitions

Business entity.—A business entity is any entity recognized for Federal tax purposes that is not properly classified as a trust under Regulations section 301.7701-4 or otherwise subject to special treatment under the Code. See Regulations section 301.7701-2(a).

Corporation.—For Federal tax purposes, a corporation is any of the following:

1. A business entity organized under a Federal or state statute, or under a statute of a federally recognized Indian tribe, if the statute describes or refers to the entity as incorporated or as a corporation, body corporate, or body politic.

2. An association (as determined under Regulations section 301.7701-3).

3. A business entity organized under a state statute, if the statute describes or refers to the entity as a joint-stock company or joint-stock association.

4. An insurance company.

5. A state-chartered business entity conducting banking activities, if any of its deposits are insured under the Federal Deposit Insurance Act, as amended, 12 U.S.C. 1811 et seq., or a similar Federal statute.

6. A business entity wholly owned by a state or any political subdivision thereof.

7. A business entity that is taxable as a corporation under a provision of the Code other than section 7701(a)(3).

8. A foreign business entity listed in Regulations section 301.7701-2(b)(8). However, a foreign business entity listed in those regulations generally will not be treated as a corporation if all of the following apply:

a. The entity was in existence on May 8, 1996.

b. The entity's classification was relevant (as defined below) on May 8, 1996.

c. No person (including the entity) for whom the entity's classification was relevant on May 8, 1996, treats the entity as a corporation for purposes of filing that person's Federal income tax returns, information returns, and withholding documents for the tax year including May 8, 1996.

d. Any change in the entity's claimed classification within the 60 months prior to May 8, 1996, was a result of a change in the organizational documents of the entity, and the entity and all members of the entity recognized the Federal tax consequences of any change in the entity's classification within the 60 months prior to May 8, 1996.

e. The entity had a reasonable basis (within the meaning of section 6662) for treating the entity as other than a corporation on May 8, 1996.

f. Neither the entity nor any member was notified in writing on or before May 8, 1996, that the classification of the entity was under examination (in which case the entity's classification will be determined in the examination).

Binding contract rule.—If a foreign business entity described in Regulations section 301.7701-2(b)(8)(i) is formed after May 8, 1996, under a written binding contract (including an accepted bid to develop a project) in effect on May 8, 1996, and all times thereafter, in which the parties agreed to engage (directly or indirectly) in an active and substantial business operation in the jurisdiction in which the entity is formed, **8** on page 2 is applied by substituting the date of the entity's formation for May 8, 1996.

Eligible entity.—An eligible entity is a business entity that is not included in items **1** or **3** through **8** under the definition of corporation on page 2.

Limited liability.—A member of a foreign eligible entity has limited liability if the member has no personal liability for any debts of or claims against the entity by reason of being a member. This determination is based solely on the statute or law under which the entity is organized (and, if relevant, the entity's organizational documents). A member has personal liability if the creditors of the entity may seek satisfaction of all or any part of the debts or claims against the entity from the member as such. A member has personal liability even if the member makes an agreement under which another person (whether or not a member of the entity) assumes that liability or agrees to indemnify that member for that liability.

Partnership.—A partnership is a business entity that has **at least** two members and is not a corporation as defined on page 2.

Relevant.—A foreign eligible entity's classification is relevant when its classification affects the liability of any person for Federal tax or information purposes. The date the classification of a foreign eligible entity is relevant is the date an event occurs that creates an obligation to file a Federal tax return, information return, or statement for which the classification of the entity must be determined.

Effect of Election

The resulting tax consequences of a change in classification remain the same no matter how a change in entity classification is achieved. For example, if an organization classified as an association elects to be classified as a partnership, the organization and its owners must recognize gain, if any, under the rules applicable to liquidations of corporations.

Who Must File

File this form for an **eligible entity** that is one of the following:

- A domestic entity electing to be classified as an association taxable as a corporation.
- A domestic entity electing to change its current classification (even if it is currently classified under the default rule).
- A foreign entity that has more than one owner, all owners have limited liability, and it elects to be classified as a partnership.
- A foreign entity that has at least one owner without limited liability, and it elects to be classified as an association taxable as a corporation.
- A foreign entity with a single owner having limited liability, and it elects to have the entity disregarded as an entity separate from its owner.
- A foreign entity electing to change its current classification (even if it is currently classified under the default rule).

Do not file this form for an eligible entity that is:

- Tax-exempt under section 501(a), or
- A real estate investment trust (REIT), as defined in section 856.

When To File

See the instructions for line 3.

Where To File

File Form 8832 with the Internal Revenue Service Center, Philadelphia, PA 19255. Also attach a copy of Form 8832 to the entity's Federal income tax or information return for the tax year of the election. If the entity is not required to file a return for that year, a copy of its Form 8832 must be attached to the Federal income tax or information returns of all direct or indirect owners of the entity for the tax year of the owner that includes the date on which the election took effect. Although failure to attach a copy will not invalidate an otherwise valid election, each member of the entity is required to file returns that are consistent with the entity's election. In addition, penalties may be assessed against persons who are required to, but who do not, attach Form 8832 to their returns. Other penalties may apply for filing Federal income tax or information returns inconsistent with the entity's election.

Specific Instructions

Employer Identification Number (EIN)

Show the correct EIN on Form 8832. If the entity does not have an EIN, it generally must apply for one on **Form SS-4,** Application for Employer Identification Number. If the filing of Form 8832 is the only reason the entity is applying for an EIN, check the "Other" box on line 9 of Form SS-4 and write "Form 8832" to the right of that box. If the entity has not received an EIN by the time Form 8832 is due, write "Applied for" in the space for the EIN. **Do not** apply for a new EIN for an existing entity that is changing its classification. If you are electing to disregard an entity as separate from its owner, enter the owner's EIN.

Address

Include the suite, room, or other unit number after the street address. If the Post Office does not deliver mail to the street address and the entity has a P.O. box, show the box number instead of the street address.

Line 1

Check box 1a if the entity is choosing a classification for the first time **and** the entity does not want to be classified under the applicable default classification. **Do not** file this form if the entity wants to be classified under the default rules.

Check box 1b if the entity is changing its current classification to take effect later than January 1, 1997, whether or not the entity's current classification is the default classification. However, once an eligible entity makes an election to change its classification (other than an election made by an existing entity to change its classification as of January 1, 1997), the entity cannot change its classification by election again during the 60 months after the effective date of the election. However, the IRS may permit (by private letter ruling) the entity to change its classification by election within the 60-month period if more than 50% of the ownership interests in the entity as of the effective date of the election are owned by persons that did not own any interests in the entity on the effective date of the entity's prior election.

Line 2

Check the appropriate box if you are changing a current classification (no matter how achieved), or are electing out of a default classification. **Do not** file this form if you fall within a default classification that is the desired classification for the new entity.

Line 3

Generally, the election will take effect on the date you enter on line 3 of this form or on the date filed if no date is entered on line 3. However, an election specifying an entity's classification for Federal tax purposes can take effect no more than 75 days prior to the date the election is filed, nor can it take effect later than 12 months after the date on which the election is filed. If line 3 shows a date more than 75 days prior to the date on which the election is filed, the election will take effect 75 days before the date it is filed. If line 3 shows an effective date more than 12 months from the filing date, the election will take effect 12 months after the date the election was filed.

Regardless of the date filed, an election will in no event take effect before January 1, 1997.

Consent Statement and Signatures

Form 8832 must be signed by:

1. Each member of the electing entity who is an owner at the time the election is filed; or

2. Any officer, manager, or member of the electing entity who is authorized (under local law or the organizational documents) to make the election and who represents to having such authorization under penalties of perjury.

If an election is to be effective for any period prior to the time it is filed, each person who was an owner between the date the election is to be effective and the date the election is filed, and who is not an owner at the time the election is filed, must also sign.

If you need a continuation sheet or use a separate consent statement, attach it to Form 8832. The separate consent statement must contain the same information as shown on Form 8832.

Rev. Rul. 99-5
1999-6 I.R.B. 8, 1999 WL 533687 (I.R.S.)

Internal Revenue Service (I.R.S.)

Revenue Ruling

DISREGARDED ENTITY TO PARTNERSHIP

Released: January 14, 1999

Published: February 8, 1999

26 CFR 1.721-1: Nonrecognition of gain or loss on contribution.

Disregarded entity to partnership. This ruling describes the federal income tax consequences when a single member limited liability company that is disregarded as an entity separate from its owner under section 301.7701-3 of the Procedure and Administration Regulations becomes an entity with more than one owner that is classified as a partnership for federal tax purposes.

ISSUE

What are the federal income tax consequences when a single member domestic limited liability company (LLC) that is disregarded for federal tax purposes as an entity separate from its owner under § 301.7701-3 of the Procedure and Administration Regulations becomes an entity with more than one owner that is classified as a partnership for federal tax purposes?

FACTS

In each of the following two situations, an LLC is formed and operates in a state which permits an LLC to have a single owner. Each LLC has a single owner, A, and is disregarded as an entity separate from its owner for federal tax purposes under § 301.7701-3. In both situations, the LLC would not be treated as an investment company (within the meaning of § 351) if it were incorporated. All of the assets held by each LLC are capital assets or property described in § 1231. For the sake of simplicity, it is assumed that neither LLC is liable for any indebtedness, nor are the assets of the LLCs subject to any indebtedness.

Situation 1. B, who is not related to A, purchases 50% of A's ownership interest in the LLC for $5,000. A does not contribute any portion of the $5,000 to the LLC. A and B continue to operate the business of the LLC as co-owners of the LLC.

Situation 2. B, who is not related to A, contributes $10,000 to the LLC in exchange for a 50% ownership interest in the LLC. The LLC uses all of the contributed cash in its business. A and B continue to operate the business of the LLC as co-owners of the LLC.

After the sale, in both situations, no entity classification election is made under § 301.7701-3(c) to treat the LLC as an association for federal tax purposes.

LAW AND ANALYSIS

Section 721(a) generally provides that no gain or less shall be recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership.

Section 722 provides that the basis of an interest in a partnership acquired by a contribution of property, including money, to the partnership shall be the amount of the money and the adjusted basis of the property to the contributing partner at the time of the contribution increased by the amount (if any) of gain recognized under § 721(b) to the contributing partner at such time.

Section 723 provides that the basis of property contributed to a partnership by a partner shall be the adjusted basis of the property to the contributing partner at the time of the contribution increased by the amount (if any) of gain recognized under § 721(b) to the contributing partner at such time.

Section 1001(a) provides that the gain or loss from the sale or other disposition of property shall be the difference between the amount realized therefrom and the adjusted basis provided in § 1011.

Section 1223(1) provides that, in determining the holding period of a taxpayer who receives property in an exchange, there shall be included the period for which the taxpayer held the property exchanged if the property has the same basis in whole or in part in the taxpayer's hands as the property exchanged, and the property exchanged at the time of the exchange was a capital asset or property described in § 1231.

Section 1223(2) provides that, regardless of how a property is acquired, in determining the holding period of a taxpayer who holds the property, there shall be included the period for which such property was held by any other person if the property has the same basis in whole or in part in the taxpayer's hands as it would have in the hands of such other person.

HOLDING(S)

Situation 1. In this situation, the LLC, which, for federal tax purposes, in disregarded as an entity separate from its owner, is converted to a partnership when the new member, B, purchases an interest in the disregarded entity from the owner, A. B's purchase of 50% of A's ownership interest in the LLC is treated as the purchase of a 50% interest in each of the LLC's assets, which are treated as held directly by A for federal tax purposes. Immediately thereafter, A and B are treated as contributing their respective interests in those assets to a partnership in exchange for ownership interests in the partnership.

Under § 1001, A recognizes gain or loss from the deemed sale of the 50% interest in each asset of the LLC to B.

Under § 721(a), no gain or loss is recognized by A or B as a result of the conversion of the disregarded entity to a partnership.

Under § 722, B's basis in the partnership interest is equal to $5,000, the amount paid by B to A for the assets which B is deemed to contribute to the newly-created partnership. A's basis in the partnership interest is equal to A' s basis in A's 50% share of the assets of the LLC.

Under § 723, the basis of the property treated as contributed to the partnership by A and B is the adjusted basis of that property in A's and B's hands immediately after the deemed sale.

Under § 1223(1), A's holding period for the partnership interest received includes A's holding period in the capital assets and property described in § 1231 held by the LLC when it converted from an entity that was disregarded as an entity separate from A to a partnership. B's holding period for the partnership interest begins on the day following the date of B's purchase of the LLC interest from A. See Rev. Rul. 66-7, 1966-1 C.B. 188, which provides that the holding period of a purchased asset is computed by excluding the date on which the asset is acquired. Under § 1223(2), the partnership's holding period for the assets deemed transferred to it includes A's and B's holding periods for such assets.

Situation 2. In this situation, the LLC is converted from an entity that is disregarded as an entity separate from its owner to a partnership when a new member. B, contributes cash to the LLC, B's contribution is treated as a contribution to a partnership in exchange for an ownership interest in the partnership. A is treated as contributing all of the assets of the LLC to the partnership in exchange for a partnership interest.

Under § 721(a), no gain or loss is recognized by A or B as a result of the conversion of the disregarded entity to a partnership.

Under § 722, B's basis in the partnership interest is equal to $10,000, the amount of cash contributed to the partnership. A's basis in the partnership interest is equal to A's basis in the assets of the LLC which A was treated as contributing to the newly-created partnership.

Under § 723, the basis of the property contributed to the partnership by A is the adjusted basis of that property in A's hands. The basis of the property contributed to the partnership by B is $10,000, the amount of cash contributed to the partnership.

Under § 1223(1), A's holding period for the partnership interest received includes A's holding period in the capital and § 1231 assets deemed contributed when the disregarded entity converted to a partnership. B's holding period for the partnership interest begins on the day following the date of B's contribution of money to the LLC. Under § 1223(2), the partnership's holding period for the assets transferred to it includes A's holding period.

Rev. Rul. 99-6
1999-6 I.R.B. 6, 1999 WL 11852 (I.R.S.)

Internal Revenue Service (I.R.S.)

Revenue Ruling

PARTNERSHIP TO DISREGARDED ENTITY

Released: January 14, 1999

Published: February 8, 1999

26 CFR 1.708-1: Continuation of partnership.

Partnership to disregarded entity. This ruling describes the federal income tax consequences if one person purchases all of the ownership interests in a domestic limited liability company (LLC) that is classified as a partnership under section 301.7701-3 of the Procedure and Administration Regulations, causing the LLC's status as a partnership to terminate under section 708(b)(1)(A) of the Code.

ISSUE

What are the federal income tax consequences if one person purchases all of the ownership interests in a domestic limited liability company (LLC) that is classified as a partnership under § 301.7701-3 of the Procedure and Administration Regulations, causing the LLC's status as a partnership to terminate under § 708(b)(1)(A) of the Internal Revenue Code?

FACTS

In each of the following situations, an LLC is formed and operates in a state which permits an LLC to have a single owner. Each LLC is classified as a partnership under § 301.7701-3. Neither of the LLCs holds any unrealized receivables or substantially appreciated inventory for purposes of § 751(b). For the sake of simplicity, it is assumed that neither LLC is liable for any indebtedness, nor are the assets of the LLCs subject to any indebtedness.

Situation 1. A and B are equal partners in AB, an LLC. A sells A's entire interest in AB to B for $10,000. After the sale, the business is continued by the LLC, which is owned solely by B.

Situation 2. C and D are equal partners in CD, an LLC. C and D sell their entire interests in CD to E, an unrelated person, in exchange for $10,000 each. After the sale, the business is continued by the LLC, which is owned solely by E.

After the sale, in both situations, no entity classification election is made under § 301.7701-3(c) to treat the LLC as an association for federal tax purposes.

LAW

§ 708(b)(1)(A) and § 1.708-1(b)(1) of the Income Tax Regulations provide that a partnership shall terminate when the operations of the partnership are discontinued and no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership.

Section 731(a)(1) provides that, in the case of a distribution by a partnership to a partner, gain is not recognized to the partner except to the extent that any money distributed exceeds the adjusted basis of the partner's interest in the partnership immediately before the distribution.

Section 731(a)(2) provides that, in the case of a distribution by a partnership in liquidation of a partner's interest in a partnership where no property other than money, unrealized receivables (as defined in § 751(c)), and inventory (as defined in § 751(d)(2)) is distributed to the partner, loss is recognized to the extent of the excess of the adjusted basis of the partner's interest in the partnership over the sum of (A) any money distributed, and (B) the basis to the distributee, as determined under § 732, of any unrealized receivables and inventory.

Section 732(b) provides that the basis of property (other than money) distributed by a partnership to a partner in liquidation of the partner's interest shall be an amount equal to the adjusted basis of the partner's interest in the partnership, reduced by any money distributed in the same transaction.

Section 735(b) provides that, in determining the period for which a partner has held property received in a distribution from a partnership (other than for purposes of § 735(a)(2)), there shall be included the holding period of the partnership, as determined under § 1223, with respect to the property.

Section 741 provides that gain or loss resulting from the sale or exchange of an interest in a partnership shall be recognized by the transferor partner, and that the gain or loss shall be considered as gain or loss from a capital asset, except as provided in § 751 (relating to unrealized receivables and inventory items).

Section 1.741-1(b) provides that § 741 applies to the transferor partner in a two-person partnership when one partner sells a partnership interest to the other partner, and to all the members of a partnership when they sell their interests to one or more persons outside the partnership.

Section 301.7701-2(c)(1) provides that, for federal tax purposes, the term "partnership" means a business entity (as the term is defined in § 301.7701- 2(a)) that is not a corporation and that has at least two members.

In Edwin E. McCauslen v. Commissioner, 45 T.C. 588 (1966), one partner in an equal, two-person partnership died, and his partnership interest was purchased from his estate by the remaining partner. The purchase caused a termination of the partnership under § 708(b)(1)(A). The

Tax Court held that the surviving partner did not purchase the deceased partner's interest in the partnership, but that the surviving partner purchased the partnership assets attributable to the interest. As a result, the surviving partner was not permitted to succeed to the partnership's holding period with respect to these assets.

Rev. Rul. 67-65, 1967-1 C.B. 168, also considered the purchase of a deceased partner's interest by the other partner in a two-person partnership. The Service ruled that, for the purpose of determining the purchaser's holding period in the assets attributable to the deceased partner's interest, the purchaser should treat the transaction as a purchase of the assets attributable to the interest. Accordingly, the purchaser was not permitted to succeed to the partnership's holding period with respect to these assets. *See also* Rev. Rul. 55-68, 1955-1 C.B. 372.

ANALYSIS AND HOLDINGS

Situation 1. The AB partnership terminates under § 708(b)(1)(A) when B purchases A's entire interest in AB. Accordingly, A must treat the transaction as the sale of a partnership interest. Reg. § 1.741-1(b). A must report gain or loss, if any, resulting from the sale of A's partnership interest in accordance with § 741.

Under the analysis of McCauslen and Rev. Rul. 67-65, for purposes of determining the tax treatment of B, the AB partnership is deemed to make a liquidating distribution of all of its assets to A and B, and following this distribution, B is treated as acquiring the assets deemed to have been distributed to A in liquidation of A's partnership interest.

B's basis in the assets attributable to A's one-half interest in the partnership is $10,000, the purchase price for A's partnership interest. Section 1012. Section 735(b) does not apply with respect to the assets B is deemed to have purchased from A.

Therefore, B's holding period for these assets begins on the day immediately following the date of the sale. See Rev. Rul. 66- 7, 1966-1 C.B. 188, which provides that the holding period of an asset is computed by excluding the date on which the asset is acquired.

Upon the termination of AB, B is considered to receive a distribution of those assets attributable to B's former interest in AB, B must recognize gain or loss, if any, on the deemed distribution of the assets to the extent required by § 731(a). B's basis in the assets received in the deemed liquidation of B's partnership interest is determined under § 732(b). Under § 735(b), B's holding period for the assets attributable to B's one-half interest in AB includes the partnership's holding period for such assets (except for purposes of § 735(a)(2)).

Situation 2. The CD partnership terminates under § 708(b)(1)(A) when E purchases the entire interests of C and D in CD. C and D must report gain or loss, if any, resulting from the sale of their partnership interests in accordance with § 741.

For purposes of classifying the acquisition by E, the CD partnership is deemed to make a liquidating distribution of its assets to C and D. Immediately following this distribution, E is deemed to acquire, by purchase, all of the former partnership's assets.

Compare Rev. Rul. 84-111, 1984-2 C.B. 88 (Situation 3), which determines the tax consequences to a corporate transferee of all interests in a partnership in a manner consistent with *McCauslen*, and holds that the transferee's basis in the assets received equals the basis of the partnership interests, allocated among the assets in accordance with § 732(c).

E's basis in the assets is $20,000 under § 1012. E's holding period for the assets begins on the day immediately following the date of sale.

Payment of Employment Taxes with Respect to Disregarded Entities

Notice 99-6

PURPOSE

This notice solicits comments from taxpayers and practitioners regarding issues related to employment tax reporting and payment by qualified subchapter S subsidiaries and other entities that are disregarded as entities separate from their owners for federal tax purposes. This notice also discusses two methods of employment tax compliance that will be accepted by the Service until such time as formal reporting procedures are provided in other guidance.

Since the recent enactment of legislation and promulgation of regulations providing that certain wholly owned entities will be disregarded as entities separate from their owners, the Service has received many questions from taxpayers concerning the treatment of disregarded entities for federal employment tax purposes. To help employers comply with the employment tax requirements, the Department of the Treasury and the Internal Revenue Service intend to issue guidance illustrating the proper method for reporting employment taxes with respect to these entities.

BACKGROUND

Under § 1361 of the Internal Revenue Code (as amended by § 1308 of the Small Business Job Protection Act of 1996, Pub. L. No. 104–188, 110 Stat. 1755 and § 1601 of the Taxpayer Relief Act of 1997, Public Law 105–34, 111 Stat. 788), an S corporation may own a qualified subchapter S subsidiary. Section 1361(b)-(3)(B) defines the term "qualified subchapter S subsidiary" (QSub) as a domestic corporation that is not an ineligible corporation (as defined in § 1361(b)(2)), if (1) an S corporation holds 100 percent of the stock of the corporation, and (2) that S corporation elects to treat the subsidiary as a QSub. Except as otherwise provided in regulations, a corporation for which a QSub election is made is not treated as a separate corporation for federal tax purposes, and all assets, liabilities, and items of income, deduction, and credit of the QSub are treated as assets, liabilities, and items of income, deduction, and credit of the parent S corporation. Similar rules apply to qualified REIT subsidiaries under § 856(i).

Regulations issued under § 7701 of the Code provide for another type of disregarded entity. Section 301.7701–2(c)(2) of the Procedure and Administration Regulations provides that a business entity that has a single owner and that is not a corporation under § 301.7701–2(b) is disregarded as an entity separate from its owner for all federal tax purposes.

In general, employment tax responsibilities rest with an employer. For federal employment tax purposes, the common law rules for determining the identity of the employer ordinarily apply. Under these rules, the person for whom services are performed as an employee is generally considered the employer for purposes of the employment tax provisions. An employer generally is required to withhold and pay over applicable taxes from employees' wages, pay employer taxes, make timely tax deposits, file employment tax returns, and issue wage statements to employees (collectively, "employment tax obligations").

REQUEST FOR COMMENTS

Section 1361(b)(3) and § 301.7701–2(c)(2) cause the owner of a disregarded entity to be treated as the employer of the disregarded entity's employees for federal employment tax purposes. Thus, the owner generally is responsible for complying with all the employment tax obligations related to those employees.

Since enactment of the QSub statute and promulgation of the disregarded entity provision of the regulations, however, many taxpayers have mistakenly interpreted § 1361(b)(3) and § 301.7701–2(c)(2) as applying only for federal income tax purposes. In addition, the Service has received numerous comments and questions from other taxpayers that have properly interpreted the statute concerning the difficulties that arise from application of these provisions. Some of these taxpayers have expressed a strong preference for the continued recognition for employment tax purposes of the separate state law entities. Other taxpayers have expressed a preference for a literal application of the provisions, resulting in the treatment of the owner of the disregarded entity as the employer.

Prior to issuing formal guidance, the Service is requesting comments concerning employment tax and certain reporting issues relating to disregarded entities that should be addressed in future guidance. This notice solicits comments from taxpayers and practitioners regarding the following issues:

1) Any increase or decrease in the administrative burden on taxpayers created by a system of filing employment tax returns under the owner's name and taxpayer identification number where employees are actually employed by a state law entity that is disregarded as an entity separate from its owner for federal tax purposes;

2) Whether different rules should apply to newly formed disregarded entities with no previous employment tax history as opposed to entities in existence prior to the time when they became disregarded;

3) Different results (both in amount of tax, type of tax, and time and method of deposits) that arise from filing as one employer as compared to filing as separate employers;

4) Appropriate methods for notifying the service center about changes in employment tax obligations when an entity's status as a disregarded entity changes;

5) Possible issues arising in situations

where the owner or the disregarded entity is formed or domiciled in a country other than the United States;

6) Additional issues relating to employment taxes and disregarded entities including, but not limited to, confusion for employees, employers, and state and federal agencies resulting from a single entity reporting structure for employment tax purposes; and

7) Whether any guidance issued should also apply to qualified REIT subsidiaries (as defined in § 856(i)).

Comments are also requested concerning issues related to disregarded entities but outside the employment tax area. Those issues include but are not limited to the following:

1) Information reporting on IRS Form 1099s issued by, or with respect to, disregarded entities and their owners; and

2) Issues related to qualified or nonqualified deferred compensation plans, fringe benefit and welfare plans, and other compensation arrangements.

Written comments should be sent to the following address:

Internal Revenue Service
CC:DOM:CORP (NT 99-6;
CC:DOM:P&SI:1)
P.O. Box 7604, Ben Franklin Station
Washington, DC 20044

In the alternative, comments may be hand delivered between the hours of 8:00 a.m. and 5:00 p.m. to the courier's desk at 1111 Constitution Avenue, NW, Washington, DC, or submitted electronically via the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

Because the Service and Treasury would like to receive comments early in the developmental stages of potential guidance, comments should be forwarded to one of the addresses above prior to April 20, 1999. However, to the extent possible, consideration will be given to comments received after that date.

TEMPORARY EMPLOYMENT TAX PROCEDURES

Until additional guidance is issued, the Service generally will accept reporting and payment of employment taxes with respect to the employees of a QSub or an entity disregarded as an entity separate from its owner under § 301.7701–2(c)(2) if made in one of two ways:

1) Calculation, reporting, and payment of all employment tax obligations with respect to employees of a disregarded entity by its owner (as though the employees of the disregarded entity are employed directly by the owner) and under the owner's name and taxpayer identification number; or

2) Separate calculation, reporting, and payment of all employment tax obligations by each state law entity with respect to its employees under its own name and taxpayer identification number.

If the second method is chosen, the owner retains ultimate responsibility for the employment tax obligations incurred with respect to employees of the disregarded entity. This method merely permits the employment tax obligations of the owner incurred with respect to the disregarded entity to be fulfilled through the separate calculation, reporting, and payment of employment taxes by the disregarded entity. Accordingly, the Service will not proceed against the owner for employment tax obligations relating to employees of a disregarded entity if those obligations are fulfilled by the disregarded entity using its own name and taxpayer identification number, even if there are differences in the timing or amount of payments or deposits as calculated under the second method. If the first method is selected, a final employment tax return should be filed with respect to a disregarded entity that formerly calculated, reported, and paid its employment tax obligations on a separate basis.

An owner of multiple disregarded entities may choose the first method with respect to some disregarded entities and the second method with respect to its other disregarded entities. The fact that an owner of a disregarded entity chooses to calculate, report, and pay its employment tax obligations under the second method with respect to a given disregarded entity for one taxable year will not preclude the owner from switching to the first method in a subsequent taxable year. However, if the owner uses the first method of calculating, reporting, and paying employment tax obligations with respect to a given disregarded entity for a return period that begins on or after April 20, 1999, the taxpayer must continue to use the first method unless and until otherwise permitted by the Commissioner.

DRAFTING INFORMATION

The principal authors of this notice are Deanna Walton of the Office of Assistant Chief Counsel (Passthroughs and Special Industries) and John Richards of the Office of Associate Chief Counsel (Employee Benefits and Exempt Organizations). For further information regarding this notice contact Ms. Walton at (202) 622-3050 or Mr. Richards at (202) 622-6040 (not toll-free calls).

PLR 9807013
1998 WL 57886 (I.R.S.)

Internal Revenue Service (I.R.S.)

Private Letter Ruling

Issue: February 13, 1998
November 13, 1997

Section 1031 -- Exchange of Property Held for Productive Use or Investment
1031.00-00 Exchange of Property Held for Productive Use or Investment

Dear ***

This letter responds to your request for a private letter ruling, dated May 16, 1997, submitted on behalf of Taxpayer. Taxpayer, a State A limited partnership, requests a ruling that the receipt of several parcels of real property (each parcel is a "Replacement Property", collectively, the parcels are the "Replacement Properties") by an entity owned by Taxpayer will be treated as the receipt of real property directly by the Taxpayer for purposes of qualifying the receipt of such Replacement Property for nonrecognition of gain under § 1031 of the Code.

FACTS

Taxpayer, a State A limited partnership, uses the accrual method for maintaining its accounting books and for preparing its federal income tax returns. The Taxpayer's taxable year ends on December 31. The Taxpayer's partners are LLC, a State A limited liability company, and GP, a general partnership organized in State B.

Taxpayer's business operations consist of the ownership and leasing of a single parcel of improved land. The improvements to the land consist of a commercial office building and related structures. The land and improvements are leased to a single lessee under a long-term lease. Collectively, the land and building are referred to as the "Relinquished Property".

The Relinquished Property serves as security for the Taxpayer's indebtedness. Under the terms of the indebtedness, Taxpayer is required to hold only the Relinquished Property.

Taxpayer has determined that it is in its partners' best interests to dispose of the Relinquished Property. Taxpayer has identified a party interested in acquiring the Relinquished Property. Each Replacement Property will be subject to indebtedness ("Replacement Indebtedness") secured by that Replacement Property. Taxpayer wishes to acquire each Replacement Property subject to its Replacement Indebtedness. The terms of each Replacement Indebtedness require that, for such indebtedness to be taken subject to as part of an exchange, the Replacement Property securing such Replacement Indebtedness must be acquired by a single asset entity.

Taxpayer proposes to achieve its business objectives by engaging in the following actions:

(1) Taxpayer will transfer title to the Relinquished Property directly to a qualified intermediary (within the meaning of §1.1031(k)-1(g)(4) of the Income Tax Regulations).

(2) Taxpayer will form a separate entity (a "Replacement Entity") to take title to each Replacement Property to be received in the exchange. Accordingly, Taxpayer will form one such entity for each of the Replacement Properties.

(3) Each Replacement Entity will receive title to its designated Replacement Property directly from the qualified intermediary as part of the overall exchange.

(4) Each Replacement Entity will be a "business entity" that is a "domestic eligible entity" within the meaning of §301.7701-2 and 3 of the regulations.

(5) Taxpayer will be the sole owner of the ownership interests in each Replacement Entity.

(6) Each Replacement Entity will either: (i) file a timely and proper election to be disregarded as an entity separate from its owner pursuant to § 301.7701-3 of the regulations, or (ii) will not file any election pursuant to § 301.7701-3(c) regarding its classification and will instead rely on the default classification rule for single owner entities pursuant to § 301.7701-3(b)(1)(ii).

(7) Each Replacement Entity will hold its Replacement Property either for productive use in a trade or business or for investment, in each case, within the meaning of § 1031 of the Code.

(8) Neither Taxpayer nor any Replacement Entity will be a bank as defined in § 581 of the Code.

(9) Taxpayer has represented that the exchange of the Relinquished Property for the Replacement Properties will comply with the requirements of §1.1031(k)-1 of the regulations relating to the qualification of such exchange for nonrecognition of gain or loss under § 1031(a) of the Code.

LAW AND ANALYSIS

Section 1031(a)(2) of the Code provides that no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment. Section 1031(a)(2) excludes from eligibility for nonrecognition treatment any exchange of interests in a partnership, stock, or certificates of trust or beneficial interest.

Section 301.7701-2(c)(2) of the regulations provides that, in general, a business entity that has a single owner and is not a corporation (as defined in § 301.7701-2(b)) is disregarded as an entity separate from its owner for federal tax purposes unless the entity elects to treat itself as an association for federal tax purposes. Because each Replacement Entity will be disregarded as an entity separate from its owner for federal tax purposes, the assets of each Replacement Entity will be treated as assets of the Taxpayer.

CONCLUSION

Taxpayer's receipt of the Replacement Properties by the Replacement Entities will be treated as the receipt of real property directly by the Taxpayer for purposes of qualifying the receipt of such Replacement Property for nonrecognition of gain under §1031 of the Code.

Except as specifically ruled above, no opinion is expressed as to the federal tax treatment of the above transactions under other provisions of the Code and regulations that may be applicable. No opinion is expressed as to the tax treatment of any conditions existing at the time of or effects resulting from the transaction that are not specifically covered by the above ruling. A copy of this letter ruling should be attached to the appropriate federal income tax returns for the taxable years in which the transactions described herein are consummated.

This letter ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

Assistant Chief Counsel
(Income Tax & Accounting)
By
David L. Crawford
Branch Chief, Branch 5

PLR 199911033, 1999 WL 148569 (I.R.S.)

Internal Revenue Service (I.R.S.)

Chief Counsel Advisory

Issue: March 19, 1999
December 18, 1998

Section 7701--Definitions
7701.00-00 Definitions

This responds to a letter dated November 10, 1998, and prior correspondence submitted on behalf of Trust and requesting rulings under §§1031 and 7701 of the Internal Revenue Code.

FACTS

You have represented the facts as follows. A is the grantor of Trust. Under § 671, all of the income, deductions, and credits against tax of the trust are treated as those of A for purposes of computing A's taxable income. On Date1, the trustees of Trust assigned all of their rights in a contract to sell a parcel of real estate (the Relinquished Property) to Intermediary pursuant to an exchange agreement dated Date1. Intermediary is a "qualified intermediary" as defined in § 1.1031-1(g)(4) of the Income Tax Regulations. As required by those regulations, notice of the assignment was given to the buyer on Date2.

As contemplated by the exchange agreement, Intermediary will acquire like- kind property (the Replacement Property), and transfer it to Trust. The intent of the parties is that the transfer of the Relinquished Property and the receipt of the Replacement Property will constitute a nontaxable deferred exchange under § 1031(a)(3). Consistent with the requirements of that section, Trust identified the Replacement Property that it will acquire by Date3.

The Replacement Property will be financed by Lender. Lender insists that legal title to the Replacement Property be held by a bankruptcy remote entity. To satisfy this requirement, Trust will form a State limited liability company (LLC) pursuant to a limited liability company agreement (the Agreement) between the Trustees and Member2, a corporation wholly owned by Trust. To protect the Lender's interest, one of the members of the Board of Directors of Member2 will be a representative of Lender. The Replacement Property will be transferred directly to LLC.

Except as otherwise provided in section 7.1 of the Agreement, all decisions of the LLC will be made solely by Trust. Under section 7.1, for so long as the loan from Lender is, outstanding without the approval of Member2 (whose Board of Directors vote must be unanimous) the LLC may not: (1) file or consent to the filing of a bankruptcy or insolvency petition or otherwise institute insolvency proceedings; (2) dissolve, liquidate, merge, consolidate, or sell substantially all of its assets; (3) engage in any business activity other than those specified in its Certificate of Formation;

(4) borrow money or incur indebtedness other than the normal trade accounts payable and any other indebtedness expressly permitted by the documents evidencing and securing the loan from Lender; (5) take or permit any action that would violate any provision of any of the documents evidencing or securing the loan from Lender; (6) amend the Certificate of Formation concerning any of the aforesaid items; or (7) amend any provision of the Agreement concerning any of the aforesaid items. With respect to items 2 and 7, the LLC must have the prior written consent of the Lender.

With the exception of the rights contained in section 7.1, Member2 has no other rights relating to the management of the LLC. Section 5 of the Agreement provides that all profits, losses, and credits of the LLC will be allocated to Trust. In addition, all distributions of net cash flow and capital proceeds will be made entirely to Trust. Furthermore, upon the dissolution of LLC, Trust will wind up the affairs of LLC in any manner permitted or required by law, provided that the payment of any outstanding obligations owed to Lender will have priority over all other expenses or liabilities.

RULINGS REQUESTED

Based on these facts and representations, you have requested that we rule as follows:

(1) The LLC will be treated as having a single owner for purposes of §§ 301.7701-2(c)(2) and 301.7701-3 and, in the absence of any election to the contrary, will be disregarded as an entity separate from its owner; and

(2) The acquisition of Replacement Property by the LLC will be treated as a direct acquisition by Trust for purposes of § 1031(a)(3).

LAW AND ANALYSIS

Section 301.7701-2(a) of the Procedure and Administration Regulations provides that business entities are entities recognized for federal tax purposes but not properly classified as trusts under § 301.7701-4 or otherwise subject to special treatment under the Code. A business entity with two or more members is classified for federal tax purposes as either a partnership or a corporation. Under § 301.7701-3(b)(1)(i), a domestic eligible entity (as defined in § 301.7701-3(a)) will be treated as a partnership unless it elects to be treated as a corporation. A business entity with only one owner is classified as a corporation or is disregarded as an entity separate from its owner. Under § 301.7701-3(b)(1)(ii), a domestic eligible entity with a single owner is disregarded as an entity separate from its owner unless it elects to be treated as a corporation under § 301.7701-3(c).

Since LLC is a domestic eligible entity and you have represented that it will not file an election to be treated as a corporation, its federal tax classification depends upon the number of members of LLC. The cases of Commissioner v. Tower, 327 U.S. 280 (1946) and Commissioner v. Culbertson, 337 U.S. 733 (1949), provide general principles regarding the determination of whether individuals have joined together as partners in a partnership. The primary inquiry is whether the parties had the intent to join together to operate a business and share in its profits and losses. The inquiry is essentially factual and all relevant facts and circumstances must be examined. Furthermore, it is federal, not state, law that controls for income tax purposes, regardless of how the parties are treated under state law.

In Herbert M. Luna, 42 T.C. 1067, 1077 (1964), the court stated that the following factors should be considered in determining whether the parties intended to be a partnership: (1) the agreement of the parties and their conduct in executing its terms; (2) whether business was conducted in the joint names of the parties; (3) whether the parties filed Federal partnership returns or otherwise represented to the Service or to persons with whom they dealt that they were joint venturers; (4) whether separate books of account were maintained for the venture; (5) the contributions, if any, which each party has made to the venture; (6) whether each party was a principal and co-proprietor, sharing a mutual proprietary interest in the net profits and having an obligation to share losses, or whether one party was the agent or employee of the other, receiving for his services contingent compensation in the form of a percentage of income; (7) the parties' control over income and capital and the right of each to make withdrawals; and (8) whether the parties exercised mutual control over and assumed mutual responsibility for the enterprise.

In this case, the members of LLC have not come together to form a partnership for federal tax purposes because, as evidenced by the LLC agreement, Trust and Member2 did not enter into the Agreement to operate a business and share profits and losses. Member2 is a member of LLC for the sole limited purpose of preventing Trust from placing LLC into bankruptcy on its own volition. Member2 has no interest in LLC's profits or losses and neither manages the enterprise nor has any management rights other than those limited rights described above. Thus, for federal tax purposes LLC will not be treated as a partnership between Trust and Member2 but rather as being owned solely by Trust. Because Trust is the sole owner of LLC and LLC will not elect to be treated as a corporation for federal tax purposes, LLC will be disregarded as an entity separate from Trust. Accordingly, the transfer of Replacement Property to LLC will be treated as a transfer of the Replacement Property to Trust for purposes of § 1031(a)(3).

CONCLUSION

Based on the facts submitted and the representations made, we rule as follows:

(1) Provided that LLC does not file an election to be treated as a corporation for federal tax purposes under § 301.7701-3(c), LLC will be disregarded as an entity separate from Trust; and

(2) The acquisition of Replacement Property by LLC will be treated as a direct acquisition by Trust for purposes of § 131(a)(3).

Except as specifically ruled on above, no opinion is expressed or implied concerning the federal tax consequences of the facts described above under any other provisions of the Code. In particular, no opinion is expressed concerning whether the transaction described above otherwise meets the requirements for nonrecognition of gain treatment under § 1031.

This ruling is directed only to the taxpayer requesting it. Section 6110(j)(3) provides that it may not be used or cited as precedent.

Sincerely yours,

Dianna K. Miosi
Chief, Branch 1
Office of the Assistant Chief Counsel (Passthroughs and Special Industries)

CCA 199914006
PLR 199914006, 1999 WL 196695 (I.R.S.)

Internal Revenue Service (I.R.S.)

Chief Counsel Advisory

Issue: April 9, 1999
December 23, 1998

Section 707--Transactions Between Partner and Partnership
707.00-00 Transactions Between Partner and Partnership
707.03-00 Guaranteed Payments

Section 721--Nonrecognition of Gain or Loss in Contributions
721.00-00 Nonrecognition of Gain or Loss in Contributions

Section 761--Terms Defined
761.00-00 Terms Defined

This responds to your authorized representative's letter, dated December 11, 1998, and prior correspondence, requesting rulings under §§ 707 and 721 of the Internal Revenue Code and § 301.7701-3 of the Procedure and Administration Regulations concerning the proposed contribution of real estate property (the ""Property") to a partnership.

FACTS AND REPRESENTATIONS

PRS is a STATE1 general partnership that began business on D1. LLC was formed under STATE2 law on D2. PRS contributed the Property to LLC in exchange for a 100 percent interest in LLC on D3.

PRS also owns 100 percent of the voting stock of MEMBER2. MEMBER2 is a STATE2 corporation organized on D2. On D3, MEMBER2 became a member of LLC pursuant to an agreement with PRS. The agreement states that PRS requested that, pursuant to STATE2 statute, MEMBER2 become a member of LLC without holding a membership interest.

Under the LLC agreement, MEMBER2 is not entitled to receive any distributions, income, gain, profit, loss, deduction, credit, or other sum from LLC. Except as noted below, MEMBER2 has no management, approval, voting, consent, or veto rights in connection with LLC. MEMBER2 may not transfer, sell, assign, hypothecate, or otherwise encumber its interest in LLC, nor may it withdraw from LLC. MEMBER2's rights are limited to approving any act by LLC: (1) to engage in any business or activity beyond its stated purpose; (2) to file a voluntary or involuntary petition for bankruptcy; (3) to voluntarily dissolve, liquidate, consolidate, or merge with any other entity; (4) to sell substantially all of LLC's assets; or (5) to amend LLC's certificate of formation, its stated purpose, or its governing agreement regarding dissolution and liquidation. MEMBER2 is also required to continue LLC's business in the event of PRS's bankruptcy. PRS paid MEMBER2 a to join LLC under these conditions.

Pursuant to CITE1, a person may be admitted to a limited liability company as a member of the limited liability company and may receive a limited liability company interest in the limited liability company without making a contribution or being obligated to make a contribution to the limited liability company. Unless otherwise provided in the limited liability company agreement, a person may be admitted to a limited liability company as a member of the limited liability company without acquiring a limited liability company interest in the limited liability company.

LLC currently owns and operates the Property, which has a fair market value of approximately b. LLC plans to contribute the Property to an unrelated partnership ("Partnership") in exchange for an interest in Partnership. In addition, LLC may receive a cash disbursement to reimburse LLC for the capital expenses it and PRS incurred in developing the Property during the two years prior to the date of contribution. LLC represents that this cash reimbursement will not exceed the amount of capital expenditures incurred by PRS and LLC within 2 years of the date of the contribution of the Property to Partnership, the capital expenditures were incurred with respect to the Property, and the amount of the reimbursement will not exceed 20 percent of the Property's fair market value at the time of contribution.

LAW AND ANALYSIS

Section 707(a)(1) provides that if a partner engages in a transaction with a partnership other than in his capacity as a member of such partnership, the transaction shall, except as otherwise provided in this section, be considered as occurring between the partnership and one who is not a partner.

Section 707(a)(2)(B) provides that if (i) there is a direct or indirect transfer of money or other property by a partner to a partnership, (ii) there is a related direct or indirect transfer of money or other property by the partnership to such partner (or another partner), and (iii) the transfers when viewed together are properly characterized as a sale or exchange of property, than such transfers shall be treated either as a transaction described in s 707(a)(1) or as a transaction between two or more partners acting other than in their capacity as members of the partnership.

Section 1.707-3(a)(1) of the Income Tax Regulations provides that, except as otherwise provided, if a transfer of property by a partner to a partnership and one or more transfers of money or other consideration by the partnership to that partner are described in § 1.707-3(b)(1), the transfers are treated as a sale of property, in whole or in part, to the partnership.

Section 1.707-3(b)(1) provides that a transfer of property (excluding money or an obligation to contribute money) by a partner to a partnership and a transfer of money or other consideration (including the assumption of or the taking subject to a liability) by the partnership to the partner constitute a sale of property, in whole or in part, by the partner to the partnership only if based on all the facts and circumstances (i) the transfer of money or other consideration would not have been made but for the transfer of property; and (ii) in cases in which the transfers are not made simultaneously, the subsequent transfer is not dependent on the entrepreneurial risks of partnership operations.

Section 1.707-3(c)(1) provides that, if within a two-year period a partner transfers property to a partnership and the partnership transfers money or other consideration to the partner (without regard to the order of the transfers), the transfers are presumed to be a sale of the property to the partnership unless the facts and circumstances clearly establish that the transfers do not constitute a sale.

Section 1.707-4(d) states that a transfer of money or other consideration by the partnership to a partner is not treated as part of a sale of property by the partner to the partnership under § 1.707-3(a) to the extent that the transfer to the partner is made to reimburse the partner for, and does not exceed the amount of, capital expenditures that (1) are incurred during the two year period preceding the transfer by the partner to the partnership; and (2) are incurred by the partner with respect to property contributed to the partnership by the partner, but only to the extent that the reimbursed capital expenditures do not exceed 20 percent of the fair market value of the property at the time of contribution.

Section 721(a) provides that no gain or loss shall be recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership.

Section 761(a) defines partnership as including a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not a corporation or a trust or estate. A partner is a member of a partnership. Section 761(b).

Section 301.7701-2(a) provides that business entities are entities recognized for federal tax purposes that are not properly classified as trusts under § 301.7701-4 or otherwise subject to special treatment under the Code. A business entity with two or more members is classified for federal tax purposes as either a partnership or a corporation. A business entity with only one owner is classified as a corporation or is disregarded; if the entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner.

Section 301.7701-3(b)(1)(ii) states that, unless it elects otherwise, a domestic eligible entity with a single owner is disregarded as an entity separate from its owner. Section 301.7701-3(a) defines an eligible entity as a business entity that is not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8).

The cases of Commissioner v. Tower, 327 U.S. 280 (1946) and Commissioner v. Culbertson, 337 U.S. 733 (1949), provide general principles regarding the determination of whether individuals have joined together as partners in a partnership. The primary inquiry is whether the parties intended to join together to operate a business and share in its profits and losses. The inquiry is essentially factual and all relevant facts and circumstances must be examined. Furthermore, it is federal, not state, law that controls for income tax purposes, regardless of how the parties are treated under state law.

Factors to consider in determining whether the parties intended to be a partnership include: 1) the agreement of the parties and their conduct in executing its terms; 2) whether business was conducted in the joint names of the parties; 3) whether the parties filed federal partnership returns or otherwise represented to the Service or to persons with whom they dealt that they were joint venturers; 4) whether separate books of account were maintained for the venture; 5) the contributions, if any, which each party has made to the venture; 6) whether each party was a principal and co-proprietor, sharing a mutual proprietary interest in the net profits and having an obligation to share losses, or whether one party was the agent or employee of the other, receiving for his services contingent compensation in the form of a percentage of income; 7) the parties' control over income and capital and the right of each to make withdrawals; and 8) whether the parties exercised mutual control over and assumed mutual responsibility for the enterprise. Luna v. Commissioner, 42 T.C. 1067, 1077 (1964).

Here, LLC is not a partnership for federal tax purposes because, as evidenced by the LLC agreement, PRS and MEMBER2 did not enter into the agreement to operate a business and share profits and losses. MEMBER2 has no interest in LLC's profits or losses and neither manages the enterprise nor has any management rights other than those limited rights described above. Thus, for federal tax purposes PRS and MEMBER2 will not be treated as partners in LLC. Instead, PRS will be treated as LLC's sole owner. Because PRS is the sole owner of LLC and PRS will not elect to treat it as a separate entity for federal tax purposes, LLC will be disregarded as an entity separate from PRS. Accordingly, LLC's ownership interest in the Property will be treated as owned directly by PRS, LLC's capital expenditures to the Property will be treated as PRS's capital expenditures, and reimbursement payments made to LLC will be treated as being paid to PRS. Furthermore, PRS will be treated as transferring the Property to Partnership. Finally, the cash reimbursements paid by Partnership to PRS for capital expenditures that PRS incurred with respect to the Property during the two year period preceding the transfer of Property to the Partnership, in an amount not exceeding 20 percent of the fair market value of the Property at the time of contribution, will not cause the contribution of the Property to Partnership to be treated as a sale under § 707.

CONCLUSIONS

Based solely on the facts submitted and the representations made, we conclude that under § 301.7701-3 LLC will be disregarded as an entity separate from PRS. In addition, under § 721 PRS will not recognize gain or loss on its contribution of the Property to Partnership due to the reimbursement of capital expenditures to PRS as a result of the contribution.

Except as specifically ruled on above, no opinion is expressed or implied regarding the consequences of this transaction under any other provision of the Code. Specifically, no ruling was requested and none was provided concerning the nature of PRS's claimed capital expenditures.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Daniel J. Coburn
Assistant to the Branch Chief, Branch 1
Office of the Assistant Chief Counsel (Passthroughs & Special Industries)

THE LLC AS AN ESTATE AND WEALTH TRANSFER PLANNING TOOL

Melony J. Lane
Ogden Newell & Welch
Louisville, Kentucky

SECTION C

ESTATE PLANNING WITH LIMITED LIABILITY COMPANIES

TABLE OF CONTENTS

ESTATE PLANNING WITH
<u>LIMITED LIABILITY COMPANIES</u>

Melony J. Lane
Ogden Newell & Welch

I. <u>General Estate Planning Benefits</u>. Limited Liability Companies (LLCs) provide many benefits in estate planning, including:

A. <u>Centralized Management</u>. LLCs can serve as a vehicle for the common management and control of family assets. The assets owned by an LLC are managed together even if the membership interests are owned by a number of family members and/or trusts for the benefit of family members. Real estate is a good example of an asset that is more easily managed in an LLC:

<u>Example #1</u>: Jim and Mary are married and have three adult children: Jim, Jr. (age 36), David (age 32), and Sue (age 28). Jim and Mary own rental real estate and they would like their children to receive some of the benefits of the rental income. However, Jim and Mary are concerned about the administrative difficulties commonly associated with having multiple owners of real estate. In addition, David lives several hundred miles away and is not able to participate in day-to-day decisions regarding the property. A simple solution for Jim and Mary is to form an LLC, transfer the real estate to the LLC, and then give non-voting membership interests to the children. This will allow the children to share in the rental income in the same proportion as the membership interests they own, while allowing Jim and Mary to retain control over the management of the property.

B. <u>Creditor Protection</u>. A second common purpose of LLCs is creditor protection. LLCs help protect the LLC assets from creditors, spouses, and even the so-called "black sheep" of the family. LLCs offer this protection by limiting the ability of the owners of the non-voting membership interests to dispose of their ownership interests or to "spend" the LLC assets. LLCs also restrict the rights of creditors and spouses. Bottom line is that creditors and new found ex-spouses typically do not want non-voting LLC membership interests because of the many restrictions placed on such ownership.

C. Ease of Gifting. Thirdly, LLCs can facilitate the making of gifts from senior family members to junior family members. Such gifts are typically made using non-voting membership interests, which effectively enables the ownership of the LLC capital to be separated from the control.

Example #2: Consider Jim and Mary in Example #1 above. Jim and Mary would like to use their rental real estate to make their $10,000 annual exclusion gifts. Making gifts of the real estate directly would require deeds to be prepared and recorded each year. These deeds become public record when recorded and must state the value of the property being transferred. Jim and Mary are not fond of the hassle involved with preparing deeds every year, nor do they like the idea of their neighbors knowing what they are giving to their children. The LLC previously suggested to Jim and Mary will relieve their concerns because the gifts will only require transfers on the books of the LLC.

D. Valuation Discounts. Perhaps the most talked about benefit of LLCs in an estate planning context is the valuation discounts that result from the fact that the non-voting membership interests have no control over the management of the LLC. Discounts typically range from 20% to 50%. The effect of the discounts is that more LLC interests may be given away outside of the estate tax system.

Example: In addition to the three children, Jim and Mary have three grandchildren. Thus, Jim and Mary may give away $120,000 each year estate and gift tax free in annual exclusion gifts. Their real estate is valued at $3,000,000. It would take Jim and Mary nearly 25 years to give away directly the property in question in annual exclusion gifts, and that is assuming no increase in market value. However, if the gifts each year consist of non-voting LLC membership interests discounted at 40%, Jim and Mary may give away $200,000 of underlying value each year ($200,000 x 60% = $120,000).

II. Special Concerns Regarding Gifts of Non-Voting Membership Interests.

A. Annual Exclusion. IRC § 2503(b) provides that the first $10,000 given by a donor to an individual each year is not a taxable gift. Thus, a donor may give up to $10,000 per year to as many donees as the donor chooses without making a taxable gift. However, only gifts of present interests qualify for the annual exclusion. A present interest is defined as "an unrestricted right to the immediate use, possession, or enjoyment of property or the income from property." (Reg. § 25.2503-3.)

LLC Operating Agreements generally vest exclusive management control in the voting membership interests. The management control typically includes the discretion to determine the amount and timing of distributions among the membership interests, such that the owner of non-voting interests has no control over the distribution decisions. The question then becomes: "Does a donee of an LLC non-voting membership interest have 'an unrestricted right to the immediate use, possession, or enjoyment of property or the income from the property'?"

TAM 9131006 and PLR 9415007 found gifts of limited partnership interests to constitute present interest gifts. In both rulings, the Service reasoned that the general partner had a fiduciary duty to the partnership and to the limited partners in exercising the discretion regarding distributions; and thus, the retained management powers were not the equivalent of a trustee's discretionary authority to distribute or withhold trust income or property.

Conversely, in TAM 9751003, the Service ruled that gifts of limited partnership interests were not present interest gifts where the general partner had the discretion to distribute income or to retain income "for any reason whatsoever." Here, the Service reasoned that the general partner's discretion to retain income "for any reason whatsoever" was "extraordinary and outside of the scope of a business purpose restriction." The Service added that such discretion relieved the general partner of the fiduciary duty ordinarily imposed upon a general partner. For a more detailed discussion of the impact of TAM 9751003 on estate planning with LLCs, see "A Warning Shot, Yes: But From a Cannon or a Pea-Shooter?" by Turney P. Berry and Thomas E. Rutledge, attached as Appendix A.

Note that while the rulings in TAMs 9131006 and 9751003 and PLR 9415007 discuss the issue of present interest gifts in the context of gifts of limited partnership units, the analysis would be the same for LLCs.

B. Estate Tax Exclusion. Under certain circumstances, property interests transferred by a decedent during the decedent's lifetime will be included in the decedent's estate for federal estate tax purposes. Two of these circumstances are of particular concern to estate planners utilizing LLCs:

(1) IRC §2036(a)(2) provides for the inclusion of property transferred by the decedent where the decedent retained "the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom."

(2) IRC §2038(a)(1) provides for the inclusion of property transferred by the decedent where the decedent retained the right to alter, amend, revoke, or terminate the enjoyment of the transferred property.

These Code provisions present the question of whether gifts of non-voting LLC membership interests will be included in the decedent's estate where the decedent has retained the voting LLC interests.

The Service ruled in PLRs 9131006, 9310039, 9332006, and 9415007 that gifts of limited partnership units while retaining general partnership units will not cause the limited partnership units to be included in the decedent's estate. The Service based these rulings upon the fact that the general partner has a fiduciary duty to the partnership and the limited partners that would circumvent the individual interests that sections 2036 and 2038 are intended to tax. Again, the analysis for LLCs would be very similar to that of limited partnerships.

An open issue is whether voting stock which is subject to §2036(b) can be given away through an LLC or whether the retention of the vote is caught by §2036(b). Section 2036(b) provides in part as follows:

(b) Voting Rights. --

(1) In General. -- For purposes of subsection (a)(1), the retention of the right to vote (directly or indirectly) shares of stock of a controlled corporation shall be considered to be a retention of the enjoyment of transferred property.

(2) Controlled Corporation. -- For purposes of paragraph (1), a corporation shall be treated as a controlled corporation if, at any time after the transfer of the property and during the 3-year period ending on the date of the decedent's death, the decedent owned (with the application of section 318), or had the right (either alone or in conjunction with any person) to vote stock possessing at least 20 percent of the total combined voting power of all classes of stock.

Thus, the Service may try to argue that the voting stock owned by the LLC, which the decedent previously transferred to the LLC, is included in the decedent's gross estate where the decedent retained the voting LLC interests and disposed of the non-voting interests.

PLANNING TIP:	**Be careful when drafting LLC Operating Agreements not to relieve those holding voting membership interests of their fiduciary duties.**

III. Valuation. As with limited partnerships, one of the greatest estate planning benefits of LLCs is the valuation discounts that result from the restrictions and limitations placed upon the non-voting membership interests. These discounts typically range from 20% to 50% of the net asset value.

A. Lack of Marketability Discounts. Non-voting LLC interests generally do not have any control in the management of the LLC. In addition, the non-voting members are generally restricted in the transfer of their LLC interests. Restrictions such as these substantially reduce the marketability of the non-voting membership interests, and thus the amount that a willing buyer would pay for such interests.

B. Minority Discounts. Transfers of LLC interests may produce another discount where the transfer is of a minority interest. Again, this is because a willing buyer will not pay 100% of the underlying asset value for a minority interest. When considering minority interest discounts, it is important to remember that it is the interest being transferred that is important and not to whom the interest is being transferred. This is because the fair market value is based upon what the *hypothetical* buyer is willing to pay and what the *hypothetical* seller is willing to accept. Thus, the fact that the transfer of a minority interest will result in the transferee holding a majority interest should be irrelevant for purposes of computing the minority discount.

C. Voting Premium. Estate planners recognize that there is a premium attached to the voting rights of LLC voting interests. Often, we estimate the premium at 50% of par value of the voting interest. However, such an estimation may be an undervaluation.

The proper premium to apply to voting interests of a closely-held corporation was recently addressed in Simplot v. Commissioner, 112 T.C. No. 13 (1999). Mr. Simplot died in 1993 owning 18 of the 76.445 shares of Class A voting stock and 3,942.48 of the 141,288.584 shares of Class B non-voting stock of a closely-held corporation. After determining the value of the company as a whole, the court calculated the per share value of the Class A and Class B shares. The court then applied a premium to the Class A shares of 3% of the value of the company as a whole. The court followed with a 35% lack of marketability discount to the Class A shares and 40% discount to the Class B shares. The resulting value of a Class A share was $215,539.01 and $3,417.05 for a Class B share. Although the court's rationale for applying the voting premium in the manner in which it did is not entirely clear, the ratio of the Class A stock to the Class B stock appeared to be an important factor.

It is important to note that the voting shares owned by Mr. Simplot at the time of his death did not constitute voting control. Thus, the decision may be criticized by arguing that a hypothetical buyer would not have paid such an extreme premium for a voting privilege that did not carry with it control. Nevertheless, the court did recognize that the voting interest in question had "swing vote" potential, which may have been a factor. One can only imagine the premium that would have been applied had Mr. Simplot's voting stock represented a controlling interest.

Although Simplot involved the valuation of closely-held corporate stock, it does present a concern for estate planning attorneys utilizing LLCs. If the rationale in Simplot were applied to gifts of voting membership interests, substantial tax consequences could result. Consider, for example, an LLC with underlying asset values of $10 million. If a premium of 3% of the total value were attributed to the voting interests, which constituted a 1% interest, the value of such 1% interest would increase from $100,000 par value to $400,000.

D. Statute of Limitations on Gift Valuations. IRC §6501 provides a 3 year statute of limitations for the valuation of gifts properly disclosed on a gift tax return. Thus, if the gifts are properly disclosed on a gift tax return, the IRS only has 3 years to act before being forever barred from challenging the value of the gifts. However, the question becomes: "what is 'properly disclosed'?"

The proposed Treasury Regulations provide:

> a transfer will be adequately disclosed on the return only if it is reported in a manner adequate to apprise the Internal Revenue Service of the nature of the gift and the basis for the value so reported. Transfers reported on the gift tax return as transfers of property by gift will be considered adequately disclosed . . . only if the return provides a complete and accurate description of the transaction.

The proposed Regulations include the following list of information that must be included on the gift tax return in order for the "complete and accurate description" criteria to be met:

(i) A description of the transferred property and any consideration received by the transferor;

(ii) The identity of, and relationship between, the transferor and the transferee;

(iii) A detailed description of the method used to determine the fair market value of property transferred, including any relevant financial data and a description of any discounts, such as discounts for blockage, minority or fractional interests, and lack of marketability, claimed in valuing the property. In the case of the transfer of an interest in an entity (e.g., a corporation or partnership) that is not actively traded, a description of any discount claimed in valuing the entity or any assets owned by such entity, including a statement regarding the fair market value of 100 percent of the entity (determined without regard to any discounts in valuing the entity or any assets owned by the entity), the pro rata portion of the entity subject to the transfer, and the fair market value of the transferred interest as reported on the return. If the entity that is the subject of the transfer owns an interest in another non-actively traded entity (either directly or through ownership of an entity), the information required in this paragraph (f)(2)(iii) must be provided for each entity and the assets owned by each entity;

(iv) If the property is transferred in trust, the trust's tax identification number and a brief description of the terms of the trust;

(v) Any restrictions on the transferred property that were considered in determining the fair market value of the property; and

(vi) A statement of the relevant facts affecting the gift tax treatment of the transfer that reasonably may be expected to apprise the Internal Revenue Service of the nature of any potential controversy concerning the gift tax treatment of the transfer, or in lieu of this statement, a concise description of the legal issue presented by the facts. In addition, a statement describing any position taken that is contrary to any temporary or final Treasury regulations or revenue rulings.

In other words, the IRS wants to be told that gifts are valued in a manner with which the IRS may not agree, and wants a statement as to how those valuations were determined. Thus, care must be taken when preparing gift tax returns to ensure that the gift tax return starts the statute of limitations to run.

Of course, taxable gifts must be reported on a gift tax return. But what about nontaxable annual exclusion gifts? Some commentators advocate filing a gift tax return to report nontaxable gifts where the valuation of the gift may be in question, such as gifts of LLC units that reflect valuation discounts. If such gifts are properly reported, the 3 year statute of limitations will apply. If the gifts are not reported, the valuation may be questioned by the IRS at any time. Nevertheless, the decision regarding whether to draw the gifts to the attention of the IRS can be a difficult decision that requires careful cost-benefit analysis.

PLANNING TIP:	**High quality appraisals are indispensable for estate and gift tax valuations involving LLC membership interests. Valuations are only as reliable as the appraisals upon which they are based.**

IV. IRS Attacks on Valuation Discounts. There are four common arguments the IRS asserts to challenge the discounts associated with LLC membership interests:

(1) Partnership or LLC is disregarded for purposes of valuing a transfer of property that flowed through the entity to the natural objects of the transferor's bounty;

(2) §2703(a)(2) argument that the property transferred is the underlying assets of the LLC or partnership rather than the LLC membership interests or partnership units;

(3) Entity restrictions that are greater than state law restrictions must be disregarded as "applicable restrictions" pursuant to §2704(b); and

(4) Transferor made a gift on formation of the entity equal to the reduction in value of the transferor's resulting interest in the entity.

TAM 9842003 discussed each of these arguments as they applied to a family partnership that was formed four months prior to the decedent's death and to which the decedent had transferred substantial assets within six weeks prior to her death. In TAM 9842003, the decedent and two of the decedent's children formed a family partnership four months prior to the decedent's death. To form the partnership, the decedent contributed $9,900 in exchange for a 99% limited partnership interest and Child A and Child B each contributed $50 in exchange for 1/2% general partnership interests. Thereafter, and within six weeks of the decedent's death, the decedent transferred to the partnership securities valued at over $1,700,000, $145,000 of money market funds, two parcels of real estate (including the decedent's personal residence), and approximately $90,000 of cash. During this same period, the same two children each contributed to the partnership an additional $10,000 of cash. The decedent's federal estate tax return reported the decedent's 99% limited partnership interest valued at 60% of the fair market cash value of the assets that the decedent had transferred to the partnership within the six weeks prior to the date of the decedent's death. The Service's arguments for disregarding the 40% discount are summarized below:

A. <u>Disregard of Flow-Through Entity</u>. The Service cited <u>In re Estate of Murphy v. Commissioner</u>, T.C. Memo. 1990-472, in support of its theory that "the entire transaction, including the transfer of assets to the partnership by the Trust, must be viewed as a single testamentary transaction occurring at the Decedent's death" and thus the partnership must be disregarded for purposes of valuing the property transferred to the decedent's heirs.

In Murphy, a marital trust owned a 51.41% controlling interest in a closely held corporation and the trust assets were subject to the decedent's general power of appointment. Shortly before the decedent's death, the decedent appointed 1.76% of the stock to her children such that the marital trust owned a minority interest of 49.65% at the time of her death. The decedent's estate claimed a minority interest when valuing the 49.65% interest in the decedent's taxable estate. The court concluded that the sole purpose of the transfer to the children prior to the decedent's death was to obtain a minority discount on the shares remaining to be taxed in the estate and that as such the step transaction had to be disregarded for valuation purposes.

The Service found the instant case to be similar to Murphy, stating:

> [T]he sole or primary purpose for the transaction was the reduction of federal transfer taxes. The only discernible purpose for the transfers to the partnership was to depress the value of the Decedent's assets as these assets passed through Decedent's gross estate, into the control of her children, via the partnership. The arrangement merely operated to convey the assets to the same individuals who would have received the assets in any event under the testamentary instruments. "Nothing of substance" was intended to change as a result of the transactions and, indeed, the transactions did nothing to affect Decedent's or her children's interests in the underlying assets "except to reduce federal transfer taxes." The control exercised by Decedent and her children over the assets did not change at all as a result of the transactions.

B. Property Transferred is Underlying Assets. Next, the Service stated that §2703(a)(2) applied to the transaction. §2703(a)(2) provides that the value of property for estate and gift tax purposes is to be determined without regard "to any restriction on the right to sell or use the property." The issue is: What is "property"? Here, the

Service opined that the property transferred was the underlying partnership assets (rather than the partnership interests themselves) and thus, pursuant to §2703(a)(2), the restrictions found in the partnership agreement regarding the right to sell or use the property must be disregarded for valuation purposes. The difficulty with the Service's position is that §2033 includes in a decedent's gross estate the value of all "property" to the extent of the decedent's interest in the property. Section 2033 generally refers to the state law property interests of a decedent, which are the partnership units, not the underlying assets.

Even if §2703(a) applies, it will not cause the partnership to be ignored if §2703(b) applies. The §2703(b) exception provides that §2703(a) does not apply to any option, agreement, right, or restriction which meets *each* of the following requirements:

(1) It is a bona fide business arrangement.

(2) It is not a device to transfer such property to members of the decedent's family for less than full and adequate consideration in money or money's worth.

(3) Its terms are comparable to similar arrangements entered into by persons in an arms' length transaction.

The Service noted that intra-family transactions are subject to special scrutiny for transfer tax purposes and that such transfers are presumed not to be at arm's length. (Citing Kincaid v. United States, 682 F.2d 1220 (5th Cir. 1982).) The Service found it inconceivable that the decedent would accept in an arm's length transaction a partnership interest worth only a fraction of the property transferred to the partnership. Further, the Service found it inconceivable that the decedent would give up control over such a substantial portion of her liquid assets to anyone other than family members.

Thus, the Service ruled that any restrictions placed upon the partnership assets via the partnership agreement were to be disregarded for valuation purposes.

C. Disregard of "Applicable Restrictions". The Service next argued that any partnership restrictions which were greater than the restrictions placed upon the partnership interests under state law must be disregarded pursuant to §2704(b) for purposes of valuing the transferred partnership interest.

§2704(b)(1) provides in part:

> in the case of a transfer of an interest in a partnership to a member of the transferor's family, if the transferor and members of the transferor's family hold, immediately before the transfer, control of the entity, then any "applicable restriction" shall be disregarded in determining the value of the transferred interest.

§2704(b)(2) defines "applicable restriction" to include any restriction:

> (A) which effectively limits the ability of the partnership to liquidate, and
>
> (B) with respect to which the transferor or any member of the transferor's family, either alone or collectively, has the right after such transfer to remove, in whole or in part, the restriction.

Thus, the Service stated that any restrictions that limited the ability to liquidate the entity (in whole or in part) that exceeded the limitations provided under state law were disregarded for valuation purposes. In so stating, the Service denied the estate's argument that §2704(b) only applied to limitations regarding liquidation of the partnership itself and not to liquidation of a partner's interest in the partnership.

D. Gift on Formation. Finally, the Service stated an alternate argument that the value of the discount applied to the decedent's limited interest did not disappear but rather was transferred to Child A and Child B upon creation of the partnership when the children received the general interests. Here, the Service argued that while the decedent's limited interest may have been entitled to a discount for lack of control, that the children's controlling general interests were worth more than the proportionate value of the discounted partnership. Thus, the Service found that the decedent made a gift by virtue of contributing the bulk of the partnership assets and taking back a limited partnership interest at a value that was diminished by 40%.

The Service further explained this argument as follows:

> [T]he entire transaction (i.e., the creation of the partnership, the subsequent death of the Decedent, and the passage of the partnership interests to the family members) must be viewed as an integrated donative plan. The Decedent intentionally transferred assets in exchange for a partnership interest worth significantly less than the assets transferred, enabling the other partners, in conjunction with other family members, to ultimately realize the full value of the underlying assets on the death of the Decedent, when the Decedent's retained partnership interest passed to her beneficiaries. Thus, there was no "disappearance" of value when Decedent transferred assets to the partnership. Rather, the difference in value between the Decedent's assets and the Decedent's partnership interest was transferred by the Decedent to the other partners and to the testamentary beneficiaries of Decedent's partnership interest, to be ultimately realized in the future.

This issue can largely be avoided if the parent retains control of the partnership in the beginning, thus retaining the right to liquidate. If the partnership is formed on day one and control is transferred on day two, the Service may try to collapse the transactions as in Murphy above.

For additional discussion regarding IRS attacks on valuation discounts, see S. Stacy Eastland, *One Practitioner's Random Thoughts on Current Valuation Issues Involving Entities (Limited Partnerships, Limited Liability Companies, Limited Liability Partnerships, and Corporations)*, ALI-ABA Course of Study: Estate Planning for the Family Business Owner, July 29-31, 1999, Volume 1, Page 149.

V. Valuation Adjustment Clauses. The IRS will not typically recognize gift tax savings clauses where the gift itself is subject to change upon an attack by the IRS on the valuation of the gift. (See Procter v. Commissioner, 142 F.2d 824 (4th Cir. 1944).) However, Procter involved gifts that stated that if the valuation of the gift was increased upon audit, the donor would receive back any amount of the gift in excess of a stated amount. The court in Procter held that such arrangements were against public policy because they would eliminate the Service's incentive to seek out undervaluations, yet neither the donor nor the donees ever actually used the clause to adjust the gifts. (See also TAM 9309001.)

Nevertheless, there may be an opportunity to utilize a valuation adjustment clause where a charity is the intended recipient of any excess gift upon an increase in valuation of the gift. Such a clause would state that any amount of the gift above a stated amount would be transferred to designated charities or charitable fund at a community foundation. Thus, although the IRS will not have a great incentive to challenge undervaluations, a third party (the charity) would have an interest such that the clause may actually be used to make adjustments.

PLANNING TIP:	**When using a charitable valuation adjustment clause, it is important to provide the charity with a copy of the gift document and the valuation report. It may also be helpful to arrange the transfer such that some amount goes to the charity immediately upon the transfer rather than waiting for an audit.**

For additional discussion regarding charitable allocation clauses, see "A Meditation on Charitable Allocation Clauses: Can Something That Limits Value Have Unlimited Value?" by Turney P. Berry, attached as Appendix B.

CASE STUDY

THE FAMILY

Jim	60
Mary	59
Jim, Jr. - married with 2 children	36
David - married with 1 child	32
Sue - married with 0 children	28

This is Jim and Mary's first (and it appears last) marriage. The children are all born of this marriage and each of them is married for the first time.

No one is currently dependent on Jim and Mary for support.

Jim and Mary's estate planning objectives are to:

A. Provide for each other while either is alive;
B. Eventually pass assets to the descendants after the deaths of both Jim and Mary; and
C. Save taxes wherever consistent with A and B.

THE ASSETS

Jim - Single Name		
Marketable Securities		$1,700,000
Rental Property		3,000,000
Jim & Mary - Joint with Right of Survivorship		
Residence	$450,000 x .5	225,000
Total for purposes of federal estate taxes		$4,925,000
Mary - Single Name		
Marketable Securities		$ 525,000
Mary & Jim - Joint with Right of Survivorship		
Same as in Jim's figures		225,000
Total for purposes of federal estate taxes		$ 750,000
TOTAL		$5,675,000

Plan #1 - Simple Wills

Jim and Mary each have very simple wills that leave all to the survivor and to the descendants, per stirpes, upon the death of the second spouse.

Ignoring (1) funeral and administrative expenses; and (2) assuming no change in asset values, we have the following federal estate tax consequences at the death of each spouse:

At the death of:	Jim	Mary
Gross Estate	$4,925,000	$5,675,000
- Marital Deduction	4,925,000	-0-
Taxable Estate	$ -0-	$5,675,000
Tentative Federal Estate Tax	$ -0-	$2,762,000
- Unified Credit *	-0-	211,000**
Gross Federal Estate Tax	$ -0-	$2,551,000***

The results are no different if Mary predeceases Jim.

* In 1999, the first $650,000 of estate assets (known as the "applicable exemption amount") can pass free from estate taxes by reason of the "applicable credit amount," which is commonly known as the "unified credit." The unified credit is equal to the tax generated on the applicable exemption amount. In 1999, the unified credit is $211,300. The applicable exemption amount is increasing gradually from the current $650,000 to $1,000,000 in the year 2006.

** Rounded to the nearest thousandth.

*** As of July 1, 1998, Kentucky no longer imposes an inheritance tax on assets passing to the decedent's parents, children, grandchildren, and siblings. However, Kentucky does continue to collect the credit for state inheritance taxes where one is given on the decedent's federal estate tax return. This figure includes the Kentucky Estate Tax which is an amount equal to the credit for state death taxes.

Plan #2 - Basic Estate Plan

In the Basic Estate Plan, Jim and Mary sign Wills and trusts that will allow them to take advantage of their applicable exemption amounts. This is accomplished by directing the applicable exemption amount to a trust for the benefit of the surviving spouse of which the descendants may also be beneficiaries. The remaining estate assets pass either outright to the surviving spouse or to a trust for the sole benefit of the surviving spouse. As with Plan 1, all assets will pass to the descendants at the death of the survivor.

The Federal Estate Tax results of Plan 2 are:

At death of:	Jim	Mary
Gross Estate	$4,925,000	$5,025,000
- Marital Deduction	4,275,000	-0-
Taxable Estate	$ 650,000	$5,025,000
Tentative Fed. Est. Tax	$ 211,000	$2,405,000
- Unified Credit	211,000	211,000
Fed. Est. Tax Payable	$ -0-	$2,194,000

Plan 2 results in tax savings of $357,000 compared to the taxes in the Simple Wills Plan.

Plan #3 - Basic Plan + LLC

Jim forms a Limited Liability Company (LLC) and contributes the rental real estate (total fair market value of $3,000,000) to the LLC. The LLC is structured to have 99% non-voting membership interests and a 1% voting interest.

Owner	Voting Interests	Non-Voting Interests	Total Interests
Jim	100	9900	10,000

Each membership interest will be entitled to an equal share of profits and assets upon liquidation, but only the voting interests will vote. Thus, the non-voting membership interests have no voice in the management of the LLC.

Jim would then give $650,000 (the amount of his 1999 unified credit) of non-voting units either outright to his children or to a Crummey Trust for the benefit of Mary and their descendants. A Crummey trust is a type of trust gifts to which will qualify for the gift tax annual exclusion. Assuming a 40% discount for lack of marketability and minority interest, this would remove $1,083,000 of underlying value from Jim's estate. In addition, the LLC units that Jim owns at his death would receive a discount for lack of marketability of approximately 20% for estate tax purposes. The estate tax consequences are as follows:

	At death of:	Jim	Mary
1.	Personal Estate	$3,459,000[1]	$ 750,000
2.	+ Assets from Jim's line 4	N/A	3,459,000
3.	Gross Estate	$3,459,000	$4,209,000
4.	- Marital Deduction	3,459,000	-0-
5.	Taxable Estate	$ -0-	$4,209,000
6.	+ Adjusted Taxable Gifts	650,000	-0-
7.	Taxable Transfers	$ 650,000	$4,209,000
8.	Tentative Federal Estate Tax	$ 211,000	$1,956,000
9.	- Credit	211,000	211,000
10.	Federal Estate Tax Payable	$ -0-	$1,745,000

Taxes have been reduced from $2,551,000 in the Simple Wills Plan to $1,745,000, for a tax savings of $806,000.

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1 $4,925,000 - $1,083,000 - $383,000 (20% discount on the remaining $1,917,000 of LLC units).

Alternative Plan #3 - Basic Plan + LLC + GRAT

In this Plan #3, Jim would create a Grantor Retained Annuity Trust (GRAT) for the non-voting FLP units.

A GRAT is a method to give away assets at less than fair market value for gift tax purposes and still enjoy the benefit of such assets (through an annuity) for a term of years. Here is how it works. Instead of giving the non-voting units to Jim's Crummey Trust, Jim transfers the units to an irrevocable trust of which he may be the Trustee. The gift tax value of the already discounted units is further reduced because of two rights retained by Jim, namely: (1) the right to receive an annuity for a fixed number of years; and (2) the right to direct the disposition of the assets if Jim dies during that time.

Note that the longer the term of the GRAT, the smaller the annuity Jim receives from the trust and the greater his gift; also, the likelihood that Jim will die before the termination of his retained interest is greater - if so the fair market value of the assets, in this case the non-voting LLC units, will be included in Jim's estate. Therefore, Jim's age at the time of the transfer has an effect on the value of his gift. A second item which has an effect on the value of the gift is the IRS interest factor which varies each month. In October, 1999, the IRS rate is 7.2%.

The chart below shows the approximate percentage of the units' value that will constitute Jim's gift.

Term in Years	Annuity Percentage	Gift Percentage
2	55.463%	1.224%
5	24.520%	3.316%
7	18.685%	4.466%
10	14.370%	6.525%
12	12.725%	7.935%
15	11.119%	10.101%

An annuity of 14.370% payable to Jim for 10 years will result in a gift by Jim of 6.525% of the assets contributed.

A 14.370% GRAT for 10 years reduces an already discounted gift of Jim's 9900 non-voting units of $1,782,000 ($2,970,000 x 60%) to $116,276 and removes $2,970,000 in underlying assets from Jim's estate.

The estate tax consequences if Jim outlives the 10-year term of his retained interest are[2]:

At death of:		Jim	Mary
1.	Personal Estate	$1,955,000[3]	$ 750,000
2.	+ Assets from Jim's line 4	N/A	1,421,000
3.	Gross Estate	$1,955,000	$2,171,000
4.	- Marital Deduction	1,421,000	-0-
5.	Taxable Estate	$ 534,000	$2,171,000
6.	+ Adjusted Taxable Gifts	116,000	-0-
7.	Taxable Transfers	$ 650,000	$2,171,000
8.	Tentative Federal Estate Tax	$ 211,000	$ 865,000
9.	- Credit	211,000	211,000
10.	Federal Estate Tax Payable	$ -0-	$ 654,000

Taxes have been reduced from $2,551,000 in the Simple Wills Plan to $654,000, for a tax savings of $1,897,000.

Note, however, that the unified credit used in this analysis is the 1999 amount of $211,000 (which is actually $211,300), which is calculated on the 1999 applicable exemption amount of $650,000. At the end of the 10 year GRAT, which would place Jim and Mary in the year 2009, the applicable exemption amount would be $1,000,000, increasing the unified credit to $346,000 ($345,800 without rounding). Jim and Mary would owe the following federal estate taxes at the death of the survivor in year 2009 as long as they each owned $1,000,000 of assets in their individual names:

At death of:	Jim	Mary
Gross Estate[4]	$1,821,000	$1,821,000
- Marital Deduction	821,000	-0-
Taxable Estate	$1,000,000	$1,821,000
Tentative Fed. Est. Tax	$ 346,000	$ 700,000
- Unified Credit	346,000	346,000
Fed. Est. Tax Payable	$ -0-	$ 354,000

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2 This example does not consider the effect of asset appreciation or income. For instance, it does not value the annuity payments from the GRAT. If Jim does not create the GRAT, those payments will be included in his estate as well, thus their effect is neutral.

3 $4,925,000 - $2,970,000

4 (($4,925,000 - $2,970,000) + $116,000 + $750,000) = $2,821,000 total taxable estates of Jim and Mary divided such that Jim has a $1,821,000 personal estate and Mary has $1,000,000.

APPENDIX A

A WARNING SHOT, YES: BUT FROM A CANNON OR A PEA-SHOOTER?

TURNEY P. BERRY
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The National Office of the Internal Revenue Service appeared to fire yet another warning shot with respect to family limited partnerships, as well as to family limited liability companies, in Technical Advice Memorandum 9751003, which disallowed annual exclusions for transfers of limited partnership interests. This article argues that TAM 9751003 is probably wrong, can be easily overcome even if it is correct, and therefore should not affect annual exclusion transfers of interests in well-drafted limited partnerships and limited liability companies.

The Facts, or How We Got Here In the First Place

The facts of the TAM set forth a complicated series of transfers of assets between family members and entities controlled by family members.

A widow, age 71, gave a building (Building #2) worth $110,000 to each of 11 family members on December 30, 1991. On January 1, 1992 those family members reallocated the ownership interests among themselves so that each of four "family units" owned 25% of the building. On September 24, 1992 the widow created an S corporation of which she was sole shareholder and capitalized it with $9800. The next day she created seven trusts, one for each of her minor grandnieces and grandnephews, each with $10. On December 22, 1992 the widow formed the limited partnership and on December 31, 1992 transferred a 94.77% interest in a rental building (Building #1) to the partnership for a 90.6% limited partnership interest and transferred the remaining interest in Building #1 to the S corporation. The S corporation in turn transferred its interest in the building to the limited partnership in exchange for a 5% general partnership interest.

Simultaneously, the four family units transferred their interests in Building #2 to the limited partnership in exchange for 1.1% limited partnership units, per family unit, or 4.4% in total.

After the transfers above, the limited partnership had the following partners: the S corporation, a 5% general partner; the widow, a 90.6% limited partner, and the grandnieces and nephews, collectively, 4.4% limited partners. Next the widow gave limited partnership units totaling 29% to 35 family members and trusts. On March 10, 1993 another 42% of the widows units were given away to the same 35 individuals and trusts. In November 1993 the widow and corporation made capital contributions to the partnership which increased the widow's limited partnership interest to 27.6%. On January 1, 1994 the widow gave her 27.6% interest to the 35 individuals and trusts. Each time a gift was made, certain family members made other gifts within a family unit. In addition, the IRS noted that on March 10, 1993 the partners consented to the intra-family transfers of December 31, 1992 and on January 1, 1994 the partners consented to the intra-family transfers of March 10, 1993. The applicable provisions of the partnership agreement will be discussed below. The widow claimed an annual exclusion for the gifts to family members and trusts for the 1993 and 1994 gifts.

<u>The Annual Exclusion Generally</u>.

Code § 2503(b) (all references to the "Code" will be to the Internal Revenue Code of 1986 as amended to date) provides for an exclusion from the definition of taxable gifts under a certain amount, "other than gifts of future interests in property". Treas. Reg. § 25.2503-3(a) defines a future interest as not only reversions and remainders but also "other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at future date or time." (See a discussion of another portion of that Regulation below.)

The Supreme Court discussed the meaning of future interest in *Fondren v. Commissioner*, 324 U.S. 18 at 20-21 (1945) stating: "The question is of time, not when title vests but when enjoyment begins. Whatever puts the barrier of a substantial period between the will of the beneficiary or donee now to enjoy what has been given him and that enjoyment makes the gift one of a future interest within the meaning of the regulation." *Fondren* involved gifts to various trusts.

Annual Exclusions in the Partnership Context.

Limited partnerships by definition have general partners and at least one, and potentially more than one, class of limited partner. The rights of the partners are established by applicable state law or, more commonly, by the partnership agreement. Generally, the rights of the limited partner, at a minimum, are restricted with respect to such things as the ability to compel distributions, the ability to sell or gift the limited partnership interest, and the ability to otherwise manage the partnership assets. Similar limits apply to non-manager members in manager-managed LLCs, as well as to non-voting members in LLCs with voting and non-voting interests.

The IRS takes the position that if the authority of the general partner is overly broad, then the rights of the limited partner would be future in nature. A gift of such limited partnership interests would not qualify for the gift tax annual exclusion under Code § 2503(b). The issue for the IRS is the extent of the general partner's authority. In particular the IRS is concerned with the limited partner's right to receive distributions and to transfer the limited partnership interest.

The Agreement in TAM 9751003.

The Service set forth the following provisions of the limited partnership agreement as being relevant to its ruling:

(1) CONCERNING DISTRIBUTIONS OF INCOME

Section 5.1: the General Partner may distribute funds of the partnership to the partners at such times and in such amounts as the General Partner, in its sole discretion, determines to be appropriate. Without limiting the generality of the foregoing, the General Partner shall have complete discretion to retain funds within the partnership for future partnership expenditures OR FOR ANY OTHER REASON WHATSOEVER. [*Emphasis supplied.*]

(2) CONCERNING WITHDRAWAL/RETURN OF CAPITAL CONTRIBUTIONS

Section 3.2: [No right to withdraw or receive capital unless otherwise specified in the agreement.]

Section 7.4: No Limited Partner shall be entitled to . . . the return of its Capital Contributions except to the extent, if any, that distributions made pursuant to the express terms of this Agreement may be considered as such by law or upon dissolution and liquidation of the Partnership, and then only to the extent expressly provided for in the Agreement and as permitted by law.

Section 7.4: No Limited Partner shall be entitled to . . . withdraw from the Partnership except upon the assignment by it of all of its Partnership Interest IN ACCORDANCE WITH SECTION 10.2. [*Emphasis supplied.*]

(3) CONCERNING TRANSFERS OF THE INTERESTS

Section 10.2: Except as provided in this Article to the contrary, no Limited Partner's interest in the Partnership shall be assigned, mortgaged, pledged, subjected to a security interest or otherwise encumbered, in whole or in part, and any attempt by any Limited Partner to assign or otherwise encumber its interest shall be void ab initio. Notwithstanding the preceding sentence, [Donor] may, at any time and from time to time . . . transfer and assign her interest in the partnership by written instrument . . .

(4) CONCERNING SUBSTITUTION OF LIMITED PARTNERS

Section 10.3. No person may become a Substituted Limited Partner except an assignee who complies with this Section 10.3. No assignee of a Partnership Interest of a Limited Partner or any portion thereof shall have the right to become a Substituted Limited Partner unless all of the following conditions are satisfied:

(a) the assignor executes a written instrument of assignment together with such other instruments as the General Partner may deem necessary to effect the admission of the assignee as a Substituted Partner;

(b) such instrument has been delivered to, received and approved in writing by the General Partner; and (c) the Super Majority Vote of the Partners (which must also include the vote of the General Partner) to such substitution has been obtained, the granting or denial of which shall be within the sole discretion of each Partner.

A Super Majority Vote of the partners means (i) so long as Donor or her estate is a limited partner, a vote of Donor, or her estate, together with the vote of the partners holding at least 50 percent of the partnership interests held by partners other than Donor or her estate, or (ii) if neither Donor nor her estate is a limited partner, a vote of the partners holding at least 67 percent of the partnerships interests.

Application of Section 2503(b) To TAM 9751003.

The IRS first looked at the limited partners' rights to receive income. The TAM cited *Commissioner v. Disston*, 325 U.S. 442 (1945) (gifts in trust to minors where corpus was to be withheld until age 45 and although income could be distributed for education, comfort and support of a minor, the Court found that in fact no income was likely to be distributed); *Maryland National Bank v. United States*, 609 F. 2d 1078 (4th Cir. 1980) (gift of present right to receive income from property which historically produced no income); and *Calder v. Commissioner*, 85 T.C. 713 (1985) (no annual exclusion for gifts of artwork to a trust even though the trustee could convert it into income producing property because there was no indication the trustees intended to do so), summarizing their holdings as: "a right to receive income is a present interest only if, at the time of the gift, there is a requirement for a steady and ascertainable flow of income to the donee."

The limited partnership in question gave the general partner "complete discretion" whether or not to distribute or retain income, for "any reason whatsoever." The IRS concluded that the rights of the general partner were outside the scope of a business purpose; thus, the partnership overcame the fiduciary duty which is generally imposed on a general partner which "clothes the general partner with the authority to withhold income for reasons unrelated to the conduct of the partnership." This effort to alleviate the general partner of a fiduciary obligation to withhold distributions for reasons having nothing to do with partnership and its business easily contrast with the usual rule of fidelity to the limited partners. *See, e.g., USACafes, L.P. Litigation*, 600 A.2d 43 (Del. Ch. 1991); CALLISON, PARTNERSHIP LAW AND PRACTICE § 21.07 (1997).

The IRS denied the annual exclusion for the principal portion of the gift on similar grounds stating that an economic right requiring joint action with others is a contingent interest regarded as a future interest, citing *Ryerson v. United States*, 312 U.S. 405 (1941) (trust corpus subject to joint power in beneficiaries rather than sole power), *Blasdel v. Commissioner*, 478 F. 2d 226 (5th Cir. 1973) (distribution of income and corpus subject to majority approval of beneficiaries and majority approval of a local bank), and *Chanin v. United States*, 393 F. 2d 972 (Ct. Cl 1968) (gifts of stock into a closely-held corporation). Absent a super-majority (including the general partner's vote) as provided in Section 10.3 of the partnership agreement, the limited partnership interests could not be transferred nor the capital of the limited partner withdrawn until 2022. Thus, the IRS concluded that only title to the limited partnership interests vested in the donees and they lacked the necessary "tangible and immediate economic benefit required under section 2503(b)" to be a present interest.

Previous IRS Rulings.

In TAM 9131006, a Washington limited partnership was at issue and the IRS discussed, under Washington law, "that general partners have a fiduciary duty to limited partners and that limited partners should be able to expect the highest standard of conduct from general partners." (Citations omitted). The IRS noted specifically that: "The decedent, as general partner, possessed no powers that are not otherwise contained in the standard limited partnership agreement, regardless of whether the partners are related or not."

With respect to transfer restrictions, a limited partnership interest was subject only to a right of first refusal. The Service determined, therefore, that gifts of the limited partnership interests were present interests:

> In the instant case, the gifts of the partnership interests constituted outright gifts of ownership interests in a business entity. Each donee received the immediate use, possession and enjoyment of the subject matter of the gifts, gifts because there were no restrictions on the withdrawal of capital accounts in the partnership agreement. Put another way, the decedent could not legally resist another partner's demand for the repayment of his capital account. Thus, as in *Crummey*, each donee had the unrestricted, immediate right to withdraw and enjoy his gift "as so much cash put to his credit." *Id.* Accordingly, the decedent made gifts of a present interest which qualified for the annual exclusion from gift tax.

In Private Letter Ruling 9415007, the Service ruled similarly. The general partner was described as having "exclusive management control of the Partnership, including full discretion to determine the amount and timing of distributions to the partners ..." so long as any distributions were made in accordance with each partner's interest in the partnership. The Service cited the fiduciary duty of the general partner. Likewise in Technical Advice Memorandum 8611004, Oklahoma law was cited as to the fiduciary duties of the general partner with the result that the annual exclusion was allowed.

Somewhat similar is Revenue Ruling 76-360, 1976-2 C. B. 298, in which the IRS determined that a gift of non-income producing stock was not a present interest where the stock was subject to an agreement that the donees could transfer the stock only to a few family members for two years after the gift was made.

Is TAM 9751003 Correct?

There are at least two arguments that the determination made in TAM 9751003 is incorrect. The first is that the partnership agreement in question did not in fact overcome the fiduciary duty of the general partner. The success of such an argument is difficult to assess because the applicable state law is unknown. Apparently the Service believes that adding the language "or for any other reason whatsoever" to a general grant of discretion transforms the discretion from being subject to fiduciary duty into discretion which is not so bound. Is fiduciary duty really so easily overcome? Some courts have required specificity in any efforts to contractually alter the fiduciary duty standards. *See, e.g.*, *Newburger Loeb & Co. v. Gross*, 563 F.2d 1057 (2nd Cir. 1977). Agreements permitting self-dealing transactions and the deriving of personal benefits from partnership property have been strictly construed. *Froemming v. Gate City Fed Sav. & Loan Ass'n*, 822 F.2d 733 (8th Cir. 1986). Other courts have said that fiduciary obligations are not subject to modification by agreement. *See, e.g.*, *Wartski v. Bedford*, 962 F.2d 11 (1st Cir. 1991); *Konover Dev Corp v. Zeller*, 635 A.2d 798 (Conn. 1994); *Labovitz v. Dolan*, 545 N.E.2d 304 (Ill. 1990); *Knopke v. Knopke*, 837 S.W.2d 907 (Mo App 1992).

A second argument comes from a close reading of the cases cited by the TAM. Those cases deal with situations in which something which could be the gift of a present interest was not because of the entity or medium through which it was given. For example, property into a trust or a corporation where the rights to the property were limited by the trust or corporation. In TAM 9751003, however, the IRS determines that gifts of these particular limited partnership interests could not, under any circumstances (absent a rewriting of the partnership agreement) give rise to an annual exclusion. Is the Service really ruling that what was given were the buildings owned by the partnership, with a partnership wrapper that deprived the donee of any "present interest"? That is another version, in effect, of the argument the Service has made with respect to the valuation of limited partnership interests under a variety of theories -- step-transaction, substance over form, section 2703, (*see, e.g.*, TAMs 9719006, 9723009, 9725002, 9750002). Section 2703 is inapplicable to the present interest test -- that is, cannot be used to justify ignoring the terms of the limited partnership -- and the TAM did not make the other arguments.

Of interest is what the Treasury Regulations themselves say about interests in property that have properties of a future interest, by definition. Treas. Reg. § 25.2503-3(a) provides that:

> The term [future interest] has no reference to such contractual rights as exist in a bond, note (though bearing no interest until maturity), or in a policy of life insurance, the obligations of which are to be discharged by payments in the future. But a future interest or interests in such contractual obligations may be created by the limitations contained in a trust or other instrument of transfer effecting a gift.

The Regulation would seem clear that it must be the instrument of transfer effecting a gift that creates the future interest, not the instrument creating the property which is given.

Effect of the IRS Position in TAM 9751003.

Limited partnerships are formed for a variety of tax and non-tax reasons. Generally those reasons require that the authority of the general partners be expanded and the rights of the limited partners be curtailed. For example, the ability of the creditors of a limited partner to obtain value from the limited partner's interest in the partnership is adversely affected if the limited partner cannot compel the partnership to distribute cash (or other readily marketable property). Likewise, it is often undesirable for spouses or non-family members to have the ability to become a partner and thus transfer restrictions are typically placed on the limited partnership interests. For gift tax valuation purposes the more the rights of the limited partners are restricted the lower the fair market value of the interests (subject to the application, if any, of Code §§ 2703 and 2704(b)).

Each advisor and client must determine the wisdom of ignoring the IRS ruling position. If compliance is determined to be advisable, it would seem clear that the general partner must remain a fiduciary with respect to the limited partner. That would appear to be possible while continuing to give the general partner the discretion needed to accomplish the other purposes of the partnership. Stated differently, if the general partner may distribute income or allow transfers in its sole discretion, but remains subject to the fiduciary duty set forth by applicable state law, the facts would be substantially different from those of TAM 9751003. May a fiduciary have sole discretion? Arguably yes -- the general partner may not act arbitrarily or with malice, but yet is not subject to any preset standard.

APPENDIX B

<u>Charitable Allocation Clauses: Can Something That Limits Value Have Unlimited Value?</u>

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A charitable allocation clause is an attempt to minimize the negative effects that can result from the audit adjustment by the Internal Revenue Service of the value of noncharitable gifts or bequests. A donor or decedent would transfer assets to a trust containing a charitable allocation clause; the clause would direct the trustee to allocate contributed assets having a certain value to a fund for the benefit of taxable beneficiaries, and to allocate all excess assets to charity.

To illustrate, parents could contribute $2,100,000 in marketable securities to a partnership that has 100 general partnership units and 9900 limited partnership units. Parents could give the 9900 limited units to a trust at an appraised value of $1,260,000 (a 40% discount). The trust could provide that the first $1,250,000 of contributed assets be allocated to a fund for the benefit of parents' children, grandchildren and other descendants (a family fund), with the remaining contributed assets being allocated to the parent's donor advised fund at the local community foundation (or to other designated charitable organizations). The Trustee would review the appraisal of the limited units and would provide a copy to the local community foundation. Assuming the appraisal were in good order, the community foundation would agree that it should receive $10,000 worth of units from the transfer but no more.

1. **<u>Benefits</u>**.

An effective charitable allocation clause in a trust might have two benefits. The IRS may be reluctant to audit transfers made to a trust containing such a clause because no gift or estate tax could be collected. In addition, even if the IRS did audit a transfer, and increased the value of the transferred assets, the result would not be payment of gift or estate tax but rather the reallocation of assets from the noncharitable fund to the designated charity. If that charity were a donor advised fund at a community foundation, the funds would remain available for the family's charitable purposes.

2. Drafting the Clause.

A charitable allocation clause could be drafted as a formula, similar to a traditional formula marital deduction funding clause: the amount passing to the family fund would be the maximum amount that could pass free of estate or gift tax by reason of the applicable credit amount (with any appropriate adjustments). However, a simpler clause might specify a sum that would pass to the family fund with the remaining assets passing to the charitable fund. This approach would work equally well for lifetime and testamentary transfers.

Charitable allocation clauses in testamentary situations may be in common use already. For instance, a bequest of an amount equal to $1,000,000 to each of a testator's living children with the residue passing to the testator's foundation is, in effect, a charitable allocation clause. The testator's personal representative will allocate assets to fill the children's $1,000,000 bequests based on the personal representative's valuation of the estate's assets but such an allocation will not alter the amount of estate tax paid by the estate. If the personal representative undervalues the estate's assets the effect is that the children will receive "too much" and the foundation "too little". However, the IRS has little incentive to challenge valuations in the estate because no tax will be generated.

A sample clause suitable for an inter vivos or testamentary transfer might read as follows:

> Trustee will allocate to the trust administered under Article __ for the benefit of my spouse and my descendants a fraction of the assets added to the trust, the numerator of which is $______ and the

> denominator of which is the fair market value of the assets added to the trust on the date of addition. The remaining assets will be allocated to the charitable organizations identified in Article __ as provided therein. Trustee may estimate the value of the assets to be allocated hereunder and make a preliminary allocation if Trustee notifies all beneficiaries that the allocation may be later adjusted. Trustee will exercise reasonable discretion in allocating the assets and may, but need not, take into consideration appraisals of such assets (whether or not obtained by Trustee) and any determination made by a federal or state taxing authority as to the value of such assets.

The purpose of a fractional allocation is to avoid an IRS question about appreciation and depreciation between the time the assets are added and the time they are allocated. If there is no such concern then the amount to be allocated to the family fund may be described as "an amount equal to" the desired dollar amount.

3. **<u>Role of the Charitable Organization</u>.**

The charitable organization should receive a copy of the appraisal from the trustee and should be asked to consent to the proposed allocation. In general, assuring that the charitable organization receives something under the likely appraised values would seem to be desirable. Not only would the charitable organization receive assets for its time and trouble and the trust appears to work because assets actually went to charity.

May the donor's private foundation be the beneficiary? In principle the answer is yes. However, the purpose of the clause is to reduce IRS challenges. If the donor's private foundation is the potential recipient then not only may the IRS claim that no independent party valued the gift, but also that the private foundation improperly surrendered its legal right to collect from the trust thereby making a gift to a disqualified person, (Treas. Reg. §53.4946-1(a)(vii)). Such a gift would be an act of self-dealing. Treas. Reg. §53.4941(f).

A charitable organization should not be lackadaisical about its duty as the donee under a charitable allocation clause. A charitable organization that did not collect all that it were due could be subject to sanction both by the Internal Revenue Service, for facilitating private inurement, and by the attorney general or other state authority regulating charities.

4. **Contrast with Marital Allocation Clause.**

A marital deduction clause is an alternative to the charitable allocation clause in order to avoid assets leaving the family unit. Such a clause allows the IRS to claim that the surviving spouse made a gift if the marital share is funded with assets having "too little" value. In Rev. Rul. 84-105, 1984-2 C.B. 197, the IRS determined that the surviving spouse made a gift by acquiescing to the underfunding of a pecuniary marital bequest. If the trust were a QTIP trust a QTIP election will need to be made on the donor's next gift tax return, which must be timely filed, in order to avoid a tax. The filing may be avoided by using a general power of appointment marital trust.

5. **Use after 1997 Change in the Gift Tax Statute of Limitations.**

Charitable allocation clauses were less attractive before the change in the gift tax statute of limitations. For instance, in TAM 8611004 the National Office redetermined the number of units of a partnership that had been given away by the decedent during lifetime in order to determine the number that should be included in the decedent's estate. The gift had been described as such interest in the partnership as had a stated dollar value. The TAM determined that even though the decedent and other partners thought the decedent had assigned a particular percentage of the partnership in fact less had been assigned; the decedent had not made a gift because the decedent retained the right to repossess the excess partnership units that had been assigned in error.

More generally, if the IRS may examine all gifts at the time of the estate tax audit, the auditing agent would retain significant leverage by advocating the reallocation of assets to a charitable organization rather than allowing them to stay in the family fund. The family would be somewhat happier having assets go to charity rather than to the government but at the same time the donor had not known of the readjustment and had not planned for it.

If gifts to the trust are properly disclosed the gift tax statute of limitations will expire three years after the return is filed. Suppose a gift tax examination results in the increase of gift values and assets are allocated to charity; the donor knows of that result (unless the donor has died before the audit is complete which is unlikely in most instances) and can plan accordingly. In the example which began this discussion, suppose the partnership were valued without a discount. The allocation clause would create an $800,000 charitable fund at a community foundation which could be used to benefit the donors' charitable causes. If the donors intended to bequeath assets to charity those bequests could be eliminated and charitable fund assets used instead.

6. <u>Income Tax Deduction</u>.

If assets are allocated to a charitable organization by the Trustee does the donor receive an income tax deduction? An income tax deduction should be allowed to a donor with respect to whose gift Trustee allocates a part to a charitable organization within the same calendar year. The Trustee's actions were mandated by the trust agreement and thus the contribution should be treated as being made by the donor.

What if the Trustee allocates assets to a charitable organization pursuant to a charitable allocation clause but does so after the year in which the donor makes the contribution to the trust? Section 170 provides that a deduction is allowed for contributions paid within the taxable year. Even if the Trustee's subsequent allocation of assets is retroactive, for purposes of the trust, section 170 would seem to prohibit any deduction from being taken as of the date of the initial contribution. May the donor take an income tax deduction in the year in which the Trustee's subsequent allocation is made? The answer ought to be yes. The donor's income tax position in that instance is helped if the trust is a grantor trust for income tax purposes.

7. **Does the Clause Work?**

The IRS has consistently opposed certain arrangements designed to limit its ability to collect tax by increasing the value of assets transferred during life or at death. For instance, a donor may not give assets to a donee with the proviso that assets having a value in excess of $X will be returned to the donor. On the other hand, marital deduction - exemption equivalent clauses have been used for decades, as have testamentary formula clauses of various types (e.g. a formula that zeros out charitable lead trust gifts). Which analysis is more appropriate for charitable allocation clauses?

The bedrock case is Commissioner v. Procter, 142 F.2d 824 (4th Cir. 1944), cert. denied 323 U.S. 756 (1944). The applicable provision that was struck down in that case read as follows:

> Eleventh: The settlor is advised by counsel and satisfied that the present transfer is not subject to Federal gift tax. However, in the event it should be determined by final judgment or order of a competent federal court of last resort that any part of the transfer in trust hereunder is subject to gift tax it is agreed by all the parties hereto that in that event the excess property hereby transferred which is decreed by such court to be subject to gift tax shall automatically be deemed not to be included in the conveyance in trust hereunder and shall remain the sole property of Frederic W. Procter free from the trust hereby created.

Stated simply, in Procter a gift was made with an agreement that if more than a certain amount were determined to have been given the excess would be returned to the donor. The court invalidated the clause on three public policy grounds: (1) public officials would be discouraged from attempting to collect the tax since the only effect would be to defeat the gift; (2) the adjustment provision would tend to obstruct the administration of justice by requiring the court to address a moot case; and (3) the provisions should not be permitted to defeat a judgment rendered by the court.

In King v. United States, 545 F.2d 700 (10^{th} Cir. 1976) aff'g 424 F. Supp. 117 (D. Colo. 1975), the clause examined provided that in an intra-family sales transaction if the value of closely-held stock were determined to be higher by the Internal Revenue Service the higher price would be paid. The District Court and Tenth Circuit concluded that the purpose of the clause was not to limit the ability of the IRS to examine the transaction but rather was part of a sale conducted on arms-length terms. The seller did not make a gift because there was no donative intent under Treasury Regulation Section 25.2512-8. Because the opinion rests on the arms-length nature of the transaction it is of limited guidance in other situations.

In Ward v. Commissioner, 87 T.C. 78 (1986), parents gave a certain number of shares to their sons subject to an adjustment clause that provided that if the value of the shares for gift tax purposes was increased the sons would return some shares to the parents but if the value were decreased the parents would give more shares to the sons. The Tax Court invalidated the adjustment clause.

More recently the Tax Court has considered a savings clause in a private annuity situation in Estate of McClendon v. C.I.R., T.C. Memo. 1993-459. There the private annuity agreement included an adjustment provision which increased the annuity if the value of the property transferred by the annuitant were increased upon gift tax audit. The court held:

> Based upon our review of Procter and Ward, the adjustment clause at issue in the instant case does not merit consideration for purposes of determining petitioner's gift tax liability, and we so hold. In our view, it makes little sense to expend precious judicial resources to resolve the question of whether a gift resulted from the private annuity transaction only to render that issue moot. Equally important, our determination that the private annuity agreement resulted in a taxable gift is not directly binding on Bart or the McLendon Family Trust who are not parties to this case. See Ward v. Commissioner, supra at 114. Consequently, there being no assurance that the terms of the adjustment clause will be respected, it shall have no impact on this case.

A different kind of adjustment clause was at issue in Harwood v. Commissioner, 82 T.C. 239 (1984). There the trust provided that notes would be issued to the grantors if the value of gifts exceeded $400,000. However, the determination of whether to issue the notes was left to the trustee:

> In the event that the value of the partnership interest listed in Schedule "A" shall be finally determined to exceed $400,000 for purposes of computing the California or United States Gift Tax, and in the opinion of the Attorney for the trustee *a lower value is not reasonably defendable*, the trustee shall immediately execute a promissory note to the trustors in the usual form at 6 percent interest in a principal amount equal to the difference between the value of such gift and $400,000. The note shall carry interest and be effective as of the day of the gift. [Italics added.]

The court found that the discretion of the trustee did make a difference:

> We do not believe that the savings clause here under consideration falls within the ambit of Procter ... Procter is apposite only if we read the words "finally determined" to refer to a final judgment by a court of competent jurisdiction. Such an interpretation, however, would render a nullity the succeeding phrase "and in the opinion of the Attorney for the trustee a lower value is not reasonably defendable," since it would be absurd for the trustee to defend a lower value after a final judgment had been rendered. We believe the more reasonable interpretation of the clause at issue is to read "finally determined" to mean either eventually determined by appraisers or "determined by the IRS."

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> On this reading of the savings clause, the trustee has no power to issue notes to the grantors upon a determination by a court that the value of property transferred to the trustee exceeded $400,000.

The IRS has contested a formula clause in Evelyn East v. Commissioner, Tax Court Docket No. 12019-98. The clause there allocated units having a certain value to grandchildren's trusts with excess units being allocated to trusts for children only. The IRS appears to be taking a position based on Procter. Taxpayer's counsel has indicated the case will likely be settled.

This analysis suggests that the kind of charitable allocation clause under consideration here is distinguishable in two ways from those struck down using a Procter analysis. One distinguishing factor would be that the grantors would not receive back any excess gifts, rather any excess would be distributed to charity. A second distinguishing factor is that the clause is similar to that in Harwood in that it gives discretion to the Trustee regarding the amount of the allocation rather than making it automatic.

Is the effectiveness of the clause enhanced if the IRS is allowed to collect some tax? For example, suppose the clause were drafted such that amounts above $1,100,000 were transferred to a charitable fund, and then assets appraised at $1,000,000 were transferred to the trust. The IRS could adjust the value on audit upwards by $100,000 and collect gift tax on that additional gift. However, the amount of the gift tax that might be owed would be capped at a level acceptable to the client (in the illustration, the tax on $100,000).

8. Effect of Special Attacks on Limited Partnerships.

What is the effect of attacks on family limited partnerships on the clause. For instance, if the law turned out to be that no discounts were allowed for gifts of limited partnership interests holding marketable securities to family members, but discounts remained in place for gifts to others – charities, for instance – what is the effect on the trust discussed at the beginning of this section? Presumably the IRS would take the position that the units had an undiscounted value for purposes of allocation to the fund for the descendants. Does that automatically mean that more is allocated to charity? The answer could be no if the valuation of the units under normal state law valuation principles is unchanged. Stated differently, if values increase because appraisals are wrong or state law rights are misunderstood the clause may work, but if values increase simply because the IRS disregards the partnership (under a Murphy theory for instance) or because section 2703 or section 2704 alter the valuation in a limited context – family transfers – the clause may not work.

May the clause be drafted so that it "ties in" to value as finally determined for federal gift tax purposes including Chapter 14 and Murphy type arguments? Arguably yes but that would seem to increase the ability of the IRS to argue that in fact the clause was nothing more than a mechanism to avoid gift tax.

May the clause be drafted in reverse? To illustrate, assume $2,100,000 of marketable securities in a limited partnership with 9900 limited units, representing 99% of the partnership units, given to a trust. The trust provides that the first $10,000 worth of units will be allocated to charity and the next $1,250,000 to a fund for descendants, and amounts beyond that to charity again. Is it possible for the IRS to claim that units have one value on the front and back ends and a different value in the middle?

ISSUES ASSOCIATED WITH USING LLCs IN STRUCTURING STRATEGIC ALLIANCES

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ISSUES IN STRUCTURING A LIMITED LIABILITY COMPANY JOINT VENTURE: Marathon Ashland Petroleum LLC—A Case Study

TABLE OF CONTENTS

ISSUES IN STRUCTURING
A LIMITED LIABILITY COMPANY JOINT VENTURE

Marathon Ashland Petroleum LLC -- A Case Study

I. **Introduction to Marathon Ashland Petroleum LLC Joint Venture (various Ashland web-site articles; Item 2 to 1/16/98 8-K and recitals to Limited Liability Company Agreement).**

II. **The Formation Process: Master Formation Agreement; Asset Transfer and Contribution Agreement; Operating Agreement; Put/Call, Registration Rights and Standstill Agreement.**

III. **Structure Of Joint Venture Relationship:**

A. Use of Delaware LLC

B. Initial Capital Contributions (Section 4.01)

C. Additional Capital Contributions (Section 4.02)

D. Distributions (Section 5.02)

E. Tax Allocations (Section 6.01)

F. Management (Article VIII)

(i) Board of Managers (Section 8.02 and 8.08)

(ii) Super Majority Decisions by Board of Managers (8.08)

(iii) Annual Capital Budget (Section 8.09)

(iv) Business Plan (Section 8.10)

(v) Affiliate Transactions (Section 8.11)

(vi) Officers (Article IX)

G. Restrictions on Transfer (Article X)

(i) General Restriction on Transfer (Section 10.01)

(ii) Transfers by Operation of Law (Section 10.02)

(iii) Transfers Subject to Right of First Refusal (Section 10.03)

(iv) No Withdrawal (Section 10.05)

IV. Put/Call, Registration Rights, Standstill Agreement

A. Special Termination Right (Section 2.01)

B. Marathon Call Right (Article III)

C. Ashland Put Right (Article IV)

D. Determination of Appraised Value of LLC (Article VI)

E. Registration Rights (Article X)

F. Standstill Agreement (Article XII)

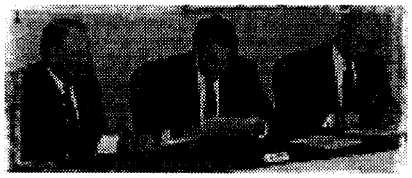
G. Member Noncompetition Agreement (Section 14.01)

H. Nonsolicitation of LLC Employees (Section 14.02(a))

I. Confidentiality Agreement (Section 14.02(b))

J. Company Noncompetition Agreement (Section 14.03)

K. Dispute Resolution (Section 16.01)



Definitive agreements signed for Marathon, Ashland joint venture

Victor G. Beghini (left), Thomas J. Usher (center), and Paul W. Chellgren sign the formation agreement creating Marathon Ashland Petroleum LLC.

Findlay, OH, Dec. 12 — Thomas J. Usher, chairman of USX Corporation, Victor G. Beghini, president of Marathon Oil, and Paul W. Chellgren, Ashland chairman and chief executive officer, signed definitive agreements today that will formally create Marathon Ashland Petroleum LLC. Marathon has a 62 percent interest and Ashland a 38 percent interest in the new company which is expected to commence operations January 1, 1998.

Plans to pursue the joint venture were first announced last May 15 when a letter of intent to seek a combination of the major elements of the two firms' downstream operations was signed. As announced on December 8, the Federal Trade Commission has advised both companies that it has completed the antitrust review of their refining and marketing joint venture announced earlier this year, and will permit the transaction to proceed.

Potential efficiencies to be derived from the joint venture have been broadly estimated to be in excess of $200 million annually on a pre-tax basis. While a modest part of these efficiencies will begin to be achieved in mid- to late 1998, full realization of efficiencies should occur over the next few years as the joint venture's integration plans are implemented. Certain transition costs, principally severance and relocation, will be incurred by both parents in connection with the formation of the new company; however, these one-time costs are not expected to be significant, nor are any major asset dispositions anticipated in connection with the combination at this time.

"Today's signing represents the culmination of months of comprehensive planning and discussion and reflects the efforts of hundreds of dedicated Marathon, USX and Ashland employees. More importantly, this signing represents the creation of a new company, one well-suited to the demands of a changing market," Usher stated. "The prospect of combining complementary assets and integrating marketing and operations strengths through Marathon Ashland Petroleum LLC is extremely exciting. I expect the joint venture to be a formidable competitor."

"We're very pleased that the definitive agreements have been signed," said Chellgren. "Marathon, USX and Ashland employees are to be commended for the hard work, dedication and aggressive pace that they've maintained toward building one of the strongest and most competitive downstream companies in the industry. It's our goal to close the transaction as near to year-end as possible and integrate the operations of the two companies as soon as possible."

J.L. "Corky" Frank, Marathon's executive vice president for refining, marketing and transportation, will be president of the joint venture, and D. Duane Gilliam, Ashland Petroleum president, will be executive vice president. Other officers of the joint venture from both companies have also been announced. Headquarters for Marathon Ashland Petroleum will be located in Findlay, Ohio.

"This signing combines the downstream resources of the two outstanding parent companies in an exciting growth-oriented venture," Frank said. "I see the potential for significantly enhancing the value provided to customers and other stakeholders through the joint venture's economies of scale, feedstock purchasing, market access, and refining/transportation flexibility. But the most important resource of all is our employees," he emphasized. "Innovation and performance derives from people. Because of the caliber of our people, I have no doubt that our performance will grow to be best of class."

Marathon and Ashland have agreed that exploration, production and chemical businesses are not to be part of the joint venture. Ashland's refinery-produced petrochemicals will be included in the joint venture. Other exclusions include Ashland's Valvoline division, along with certain Marathon equity investments in pipelines.

Plans are to continue employing the existing brands that each of the parent companies have utilized successfully. In the future, the joint venture will develop a brand strategy that will maximize the market impact of the brand offering. Marathon operates under the Marathon brand and through its Emro Marketing Company brands: Speedway, Bonded, Cheker, Starvin' Marvin, United, Gastown, Wake Up and Kwik Sak. Ashland brands include: Ashland, SuperAmerica and Rich Oil.

Marathon Ashland Petroleum LLC will have six percent of total U.S. refining capacity with seven plants located at Garyville, LA, (255,000 b/d); Catlettsburg, KY, (220,000 b/d); Robinson, IL, (180,000 b/d); St. Paul Park, MN, (70,000 b/d); Texas City, TX, (70,000 b/d); Detroit, MI, (70,000 b/d); and Canton, OH, (70,000 b/d). The new company will have 84 light products and asphalt terminals in the Midwest and Southeast regions of the United States, 5,400 retail marketing outlets in 20 states, and significant pipeline holdings. On a pro forma basis, the joint venture's combined total assets would have been roughly $7 billion at the end of 1996 and reported sales revenues for 1996 would have been approximately $20 billion, which includes approximately $7 billion of excise taxes and matching buy/sell transactions.

Marathon Oil Company is a part of the USX-Marathon Group (NYSE:MRO), a unit of USX Corporation. Ashland Inc. (NYSE:ASH) is a large energy and chemical company engaged in petroleum refining and marketing; coal and highway construction.

For more information on Marathon, see the website at www.marathon.com or www.usx.com.

For more information on Ashland, see the website at www.ashland.com.

This press release includes forward-looking statements, particularly concerning the amount of savings from potential efficiencies. These statements contain the words "expected," potential," or "estimated," indicating that future outcomes are not known with certainty and subject to risk factors. Some factors that could potentially cause actual outcomes to differ materially from information set forth in the forward-looking statements include; unanticipated costs to implement shared technology, difficulties in integrating corporate structures, delays in leveraging volume procurement advantages or delays in personnel rationalization. In addition, in accordance with the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, USX has included in its Form 10-Q for the period ended March 31, 1997, meaningful cautionary statements identifying important factors, but not necessarily all factors, that could cause actual results to differ materially from those set forth in the forward-looking statements.

Marathon Ashland Petroleum LLC to locate Speedway SuperAmerica LLC headquarters in Ohio

Findlay, Ohio—Marathon Ashland Petroleum LLC (MAPLLC) today announced plans to locate the corporate headquarters for Speedway SuperAmerica LLC (SSALLC) in Enon, Ohio, the site of EMRO Marketing's current headquarters.

The final decision is contingent upon, and subject to, formal approval of various available support programs negotiated and agreed upon by SSALLC management, the State of Ohio and local township officials. These formal approvals are expected to be granted by late July.

SSALLC is the wholly-owned subsidiary of MAPLLC that conducts its marketing operations primarily under the Speedway and SuperAmerica names.

To accommodate relocations, SSALLC will lease space in a building to be built adjacent to the existing facility. Construction on the new building is slated to commence as soon as final approvals for the move are granted and a lease with the new building owners is signed.

"It is a pleasure to call Enon home for the newly created Speedway SuperAmerica LLC operation," said Riad Yammine, president, EMRO marketing. "We're proud of our past association with this community, we're eager to continue to draw from its skilled labor pool and we're looking forward to welcoming our business partners to the area."

"The combination of SuperAmerica and Speedway management in one location will create a powerhouse team in the retail gasoline industry," said John Pettus, SuperAmerica president.

Provided approvals by state and township officials are secured on schedule, SSALLC anticipates the move to Enon will take place over a period of time beginning in August and ending in early 1999.

Based in Findlay, Ohio, Marathon Ashland Petroleum LLC (MAP) is the nation's sixth largest refiner with 935,000 barrels-per-day capacity in its seven-refinery system. MAP's retail marketing system comprises approximately 5,400 locations in 20 states, more than half of which are brand locations. Speedway SuperAmerica LLC, MAP's wholly-owned retail subsidiary, is the nation's second-largest company-owned and operated gasoline and convenience store chain. MAP serves the Midwest and Southeast as a wholesale marketer with 88 light product and asphalt terminals and access, through lease or ownership interest, to more than 10,500 miles of pipeline. MAP, operational since Jan. 1, 1998, is a combination of downstream assets of Marathon Oil Company and Ashland Inc.

Marathon Ashland Petroleum LLC Announce Key Appointments

Marathon Ashland Petroleum LLC President J. L. "Corky" Frank announced today a series of organizational changes effective September 1, 1998.

John P. Surma has been appointed president—Speedway SuperAmerica LLC in Enon, Ohio. Surma was senior vice president—finance & administration for Marathon Oil Company in Houston. Surma came to Marathon in 1997 from the Pittsburgh office of PricewaterhouseCoopers LLP, where he was an audit partner. He is a native of Pittsburgh and holds a bachelor's degree in accounting from Pennsylvania State University and is a certified public accountant.

Riad N. Yammine has been appointed executive vice president—strategic planning and business development for Marathon Ashland Petroleum. In this newly established position, Yammine will report to J. L. Frank and will be located in Findlay, Ohio.

Yammine has been president—Speedway since 1988. Prior to that time, he held several key management positions with Marathon Oil Company. He began his employment with Marathon in 1961 and holds a bachelor's degree in petroleum engineering from Pennsylvania State University.

John F. Pettus has elected to retire around the end of the year after completing 33 years of service. Until his retirement, Pettus is appointed to the position of executive vice president—Speedway SuperAmerica LLC responsible for special projects and integration efforts related to the consolidation of the Speedway and SuperAmerica organizations. Pettus will report to J. P. Surma and will continue to be located in Lexington, Kentucky.

Pettus was president—SuperAmerica since 1988. Previously, he held several key management positions with Ashland Inc. He began his employment with Ashland Inc. in 1965 and holds a bachelor's degree in business administration from Western Kentucky University.

Based in Findlay, Ohio, Marathon Ashland Petroleum LLC (MAP) is the nation's sixth largest refiner with 935,000 barrels-per-day capacity in its seven-refinery system. MAP's retail marketing system comprises approximately 5,400 locations in 20 states, more than half of which are brand locations. Speedway SuperAmerica LLC, MAP's wholly owned retail subsidiary, is the nation's second-largest company-owned and operated gasoline and convenience store chain. MAP serves the Midwest and Southeast as a wholesale marketer with 88 light product and asphalt terminals and access, through lease or ownership interest, to more than 10,500 miles of pipeline. MAP, operational since Jan. 1, 1998, is a combination of downstream assets of Marathon Oil Company and Ashland Inc.

MAP Fact Sheet

Headquarters:
Marathon Ashland Petroleum LLC
539 South Main Street
Findlay, OH 45840-3295

(419) 422-2121 Phone
(419) 425-7040 FAX

Marathon Ashland Petroleum LLC (MAP) Stats:

- MAP national rankings point to our strengths.
- Refining: Our capacity of 935,000 bpd., represents 6% of the U.S. total capacity. Garyville, LA –232,000 bpd capacity Catlettsburg, KY –222,000 bpd capacity Robinson, IL –192,000 bpd capacity St. Paul Park, MN –70,000 bpd capacity Detroit, MI– 74,000 bpd capacity Canton, OH– 73,000 bpd capacity Texas City, TX– 72,000 bpd capacity
- Pipeline: Owns, leases or has an ownership interest in approximately 10,500 miles of pipeline. This total reflects interests in 667 miles of Capline, the large pipeline that transports crude oil from St. James, LA, to Patoka, IL, and in 107 miles of pipeline in the Louisiana Offshore Oil Port (LOOP) and LOCAP systems.
- Terminals: 88 light product and asphalt terminals.
- Marketing: Approximately 5,400 outlets in 20 states, including Alabama, Florida, Georgia, Illinois, Indiana, Kentucky, Louisiana, Michigan, Minnesota, Mississippi, North Carolina, North Dakota, Ohio, Pennsylvania, South Carolina, South Dakota, Tennessee, Virginia, West Virginia, and Wisconsin.
- Informational graphic showing our operations at a glance.

New Company

Marathon Ashland Petroleum LLC (MAP) is indeed a new company, formed January 1, 1998, from the downstream operations of its long established parent companies, Marathon Oil Company—of the USX-Marathon Group, a 62 percent interest owner—and Ashland Inc., a 38 percent interest owner.

"MAP's strength is that we have a good asset base, a strong logistical system and significant market share," states company President J. L. "Corky" Frank. "But I would hasten to say that assets do not tell the whole story ... our people are uniquely capable. They are the source of our innovation, our vision, and our commitment. They will make that commitment real."

"We're not focusing on what Marathon did or what Ashland has done, but identifying what is best for this company to do," states Duane Gilliam, Executive Vice President, "and to wring out efficiencies through best business practices and see that all synergies are harvested."

A High Performance Combination

Marathon Ashland Petroleum LLC is a combination of two of the nation's premier energy companies. We're a new company with a long history - roots which reach to the early years of the oil industry. Our vision stresses: success through efficiency, efficiency through innovation, innovation through people.

Marathon Ashland commands $6.5 billion in assets. Our operations stretch across 20 states with refining, transportation and marketing systems positioned to respond to market changes and challenges; enhance supply options and product choice for our customers; create value for our stakeholders; and operate responsibly in the communities we serve. Our rankings point to our strengths. Building on our strengths, finding new efficiencies and new interrelationships is the logic and the theme of this exciting new company.

Our Speedway SuperAmerica component is a unique combination of two convenience store merchants - both judged the industry's best. Every day millions of people shop Speedway SuperAmerica - people who value service, a wide variety of merchandise, and an emphasis on convenience.

The materials on pages 1-3 are found at http://www.mapllc.com

ASHLAND INC
Form 8-K Filing Date: 1/16/98

Item 2. Acquisition or Disposition of Assets

Effective January 1, 1998, Ashland Inc. (the "Registrant") and Marathon Oil Company ("Marathon") completed a transaction to form Marathon Ashland Petroleum LLC, a Delaware limited liability company (the "Company"). On January 2, 1998, the Registrant and Marathon jointly announced the closing of the transaction. Definitive agreements creating the venture were signed December 12, 1997. Plans to pursue the combination were announced May 15, 1997, when the parties executed a Letter of Intent. The foregoing summary of the attached January 2, 1998 press release is qualified in its entirety by the complete text of such document, a copy of which is attached hereto as Exhibit 99.1.

Pursuant to a **Master Formation Agreement** between the Registrant and Marathon; an **Asset Transfer and Contribution Agreement** by and among the Registrant, Marathon and the Company; a Parent Agreement by and among USX Corporation, the parent of Marathon ("USX"), Marathon and the Registrant; and certain other conveyancing documents, the Registrant and Marathon contributed the major elements of their respective petroleum supply, refining, marketing and transportation businesses to the Company in exchange for, in the case of the Registrant, a 38% ownership interest in the Company and, in the case of Marathon, a 62% ownership interest in the Company. The Registrant's and Marathon's other businesses, including their respective exploration, production and chemical businesses (other than the Registrant's refinery-produced chemicals) were not contributed to the Company. Other exclusions include the Registrant's Valvoline division and APAC construction subsidiary, along with equity investments in certain pipelines for both companies.

In connection with the formation of the Company, the Registrant and Marathon entered into a Limited Liability Company Agreement dated as of January 1, 1998 (the "LLC Agreement"). The LLC Agreement provides that the Company will be managed by a Board of Managers consisting of the President of the Company (with no voting power), three representatives designated by Marathon, and two representatives designated by the Registrant. The LLC Agreement provides for an initial term of the Company expiring on December 31, 2022 (25 years from its formation). The term will automatically be extended for successive ten year periods unless at least two years prior to the end of a term, either the Registrant or Marathon gives notice to the other party that it wants to terminate the term of the Company.

The foregoing description of the LLC Agreement is qualified in its entirety by reference to the provisions of such agreement, which is attached hereto as Exhibit No. 10.1

In connection with the formation of the Company, Marathon, the Registrant, the Company and USX Corporation also entered into a Put/Call, Registration Rights and Standstill Agreement (the "Put/Call Agreement"). The Put/Call Agreement provides that at any time after December 31, 2004, Marathon will have the right to purchase from Registrant for cash, and the Registrant will have the right to sell to Marathon for cash and/or, at Marathon's option (subject to certain limitations), Marathon or USX debt or equity securities, all the Registrant's ownership interests in the Company, on the terms provided in the Put/Call Agreement. The Put/Call Agreement contains registration rights with respect to any debt or equity securities of Marathon or USX that the Registrant receives. The Put/Call Agreement also sets forth various standstill agreements between certain of the parties and limitations on each party's ability to engage in activities that are competitive with certain businesses of one or more of the other parties.

The foregoing description of the Put/Call Agreement is qualified in its entirety by reference to the provisions of such agreement, which is attached hereto as Exhibit No. 10.2.

LIMITED LIABILITY COMPANY AGREEMENT
of
MARATHON ASHLAND PETROLEUM LLC

Dated as of January 1, 1998

TABLE OF CONTENTS

LIMITED LIABILITY COMPANY AGREEMENT dated as of January 1, 1998, of **MARATHON ASHLAND PETROLEUM LLC** (the "Company"), by and between **Marathon Oil Company**, an Ohio corporation ("Marathon"), and **Ashland Inc.**, a Kentucky corporation ("Ashland"), as Members.

Preliminary Statement

WHEREAS, on June 11, 1997, Marathon and Emro Marketing Company ("Emro Marketing") formed the Company (formerly known as "Emro Supply, LLC") by filing a Certificate of Formation of the Company with the Secretary of State of the State of Delaware and executed the Limited Liability Company Agreement of the Company pursuant to which Marathon received a 60% interest in the Company and Emro Marketing received a 40% interest in the Company;

WHEREAS, on July 18, 1997, Emro Marketing assigned its interest in the Company to Marathon and Fuelgas Company, Inc., a wholly owned subsidiary of Marathon ("Fuelgas"), with Marathon receiving an additional 39% interest in the Company and Fuelgas receiving a 1% interest in the Company, which interest will be transferred to Marathon immediately following the Closing (for purposes of this Agreement and the other Transaction Documents, all references to Marathon's interest in the Company shall be deemed to include the 1% interest owned by Fuelgas);

WHEREAS, on July 18, 1997, Marathon and Fuelgas executed the First Amended and Restated Limited Liability Company Agreement of the Company and filed an Amended and Restated Certificate of Formation of the Company with the Secretary of State of the State of Delaware;

WHEREAS, on October 29, 1997, Marathon and Fuelgas filed a Second Amended and Restated Certificate of Formation of the Company with the Secretary of State of the State of Delaware to change the name of the Company to Marathon Ashland Petroleum LLC;

WHEREAS, on December 8, 1997, Marathon and Fuelgas executed the Second Amended and Restated Limited Liability Company Agreement of the Company which became effective on December 10, 1997;

WHEREAS the parties hereto desire that the Company (a) be a premier petroleum supply, refining, marketing and transportation business, (b) create a highly efficient, cost-effective and competitive petroleum supply, refining, marketing and transportation system, (c) deliver to the Members the highest possible economic value added, (d) be customer-focused and market-driven in its business strategy, (e) be a respected and responsible member of the communities in which the Company will operate, with a high regard for environmental responsibility and employee safety, and (f) seek to maximize Distributable Cash to the Members consistent with the foregoing, including capital spending levels which over time are expected to be generally equivalent to the level of non-cash charges; and

WHEREAS the Members desire to enter into this Agreement to set forth the rights and responsibilities of each of them with respect to the governance, financing and operation of the Company.

NOW, THEREFORE, the parties hereto hereby agree as follows:

ARTICLE I
Certain Definitions; Applicable GAAP Certain Definitions; Applicable GAAP

SECTION 1.01. Definitions.

Defined terms used in this Agreement shall have the meanings ascribed to them by definition in this Agreement or in Appendix A. In addition, when used herein the following terms have the following meanings:

"Accounting Determination" has the meaning set forth in Section 1.02.

"Acquisition Expenditures" means, in connection with any acquisition by the Company and its subsidiaries, without duplication (i) the purchase price paid or to be paid for the net assets or capital stock or other equity interests in connection with such acquisition, (ii) any Indebtedness assumed by the Company and its subsidiaries in connection with any such acquisition, (iii) any contingent liabilities assumed or incurred by the Company and its subsidiaries in connection with any such acquisition to the extent that such contingent liabilities are required to be reflected on the balance sheet of the Company and its subsidiaries in accordance with Financial Accounting Standard Number 5 (or any successor or superseding provision of Applicable GAAP), and (iv) all other costs and expenses incurred or to be incurred by the Company or any of its subsidiaries in connection with any such acquisition to the extent that such costs and expenses would be capitalized if such acquisition were consummated.

"Adjustable Amount" has the meaning set forth in Section 8.13.

"Additional Monetary Amount" has the meaning set forth in Section 14.03(c).

"Additional Required Cash Amount" has the meaning set forth in Section 14.01(a).

"Adjusted DD&A" means:

(i) for the twelve-month periods ended December 31, 1995 and 1996, $348 million and $346 million, respectively;

(ii) for the twelve-month period ended December 31, 1997, the total combined depreciation, depletion and amortization expense of the Marathon Business and the Ashland Business during such twelve-month period, including, without duplication, (a) any gains (deductions from depreciation, depletion and amortization) or losses (additions to depreciation, depletion and amortization) on asset retirements during such period and (b) pro forma depreciation, depletion and amortization expense related to the Financed Properties during such period (calculated in the same manner such pro forma depreciation, depletion and amortization expense was calculated in Schedule A, which considers the placed-in-service dates of the Financed Properties);

(iii) for the twelve-month period ended September 30, 1998, the sum of:

(a) the total combined depreciation, depletion and amortization expense of the Marathon Business and the Ashland Business during the period commencing on October 1, 1997, and ended on the date immediately preceding the Closing Date, including, without duplication, (1) any gains (deductions from depreciation, depletion and amortization) or losses (additions to depreciation, depletion and amortization) on asset retirements during such period and (2) pro forma depreciation, depletion and amortization expense related to the Financed Properties during such period (calculated in the same manner such pro forma depreciation, depletion and amortization expense was calculated in Schedule A, which considers the placed-in-service dates of the Financed Properties); and

(b) the total depreciation, depletion and amortization expense of the Company and its subsidiaries for the period commencing on the Closing Date and ended on September 30, 1998, including (1) any gains (deductions from depreciation, depletion and amortization) or losses (additions to depreciation, depletion and amortization) on asset retirements during such period, (2) depreciation, depletion and amortization expense related to the Garyville Propylene Upgrade Project during such period and (3) depreciation, depletion and amortization expense related to all Company-funded Capital Expenditures, but excluding (4) depreciation, depletion and amortization expense related to Member-Funded Capital Expenditures and (5) the increase or decrease in such depreciation, depletion and amortization expense related to the Ashland Transferred Assets (including pro forma depreciation, depletion and amortization expense related to the Financed Properties) resulting from the application of purchase accounting treatment to the transactions contemplated by the Transaction Documents (such purchase accounting treatment causing an increase or decrease in the estimated useful lives and the net book value of the Ashland Transferred Assets); and

(iv) for the twelve-month period ended September 30, 1999, and each twelve-month period ended September 30 thereafter, the total depreciation, depletion and amortization expense of the Company and its subsidiaries for such twelve-month period, including, without duplication, (a) any gains (deductions from depreciation, depletion and amortization) or losses (additions to depreciation, depletion and amortization) on asset retirements during such period, (b) depreciation, depletion and amortization expense related to the Garyville Propylene Upgrade Project during such period and (c) depreciation, depletion and amortization expense related to Company-funded Capital Expenditures but excluding (d) depreciation, depletion and amortization expense related to Member-Funded Capital Expenditures and (e) the increase or decrease in such depreciation, depletion and amortization expense related to the Ashland Transferred Assets (including pro forma depreciation, depletion and amortization expense related to the Financed Properties) resulting from the application of purchase accounting treatment to the transactions contemplated by the Transaction Documents (such purchase accounting treatment causing an increase or decrease in the estimated useful lives and the net book value of the Ashland Transferred Assets);

all as determined on a consolidated basis with respect to (x) in the case of any period ending prior to the Closing Date, Marathon and its subsidiaries or Ashland and its subsidiaries, as applicable, or (y) in the case of any period ending on or after the Closing Date, the Company and its subsidiaries, in each case in accordance with Applicable GAAP.

"Adjusted EBITDA" means:

(i) for the twelve-month periods ended December 31, 1995 and 1996, $657 million and $600 million, respectively;

(ii) for the twelve-month period ended December 31, 1997, the sum of:

(a) Historical EBITDA for such twelve-month period, plus

(b) $80 million, minus

(c) 38% of an amount equal to (1) the sum of the amounts calculated pursuant to clauses (a) and (b) above for such twelve-month period less (2) the Adjusted DD&A for such twelve-month period.

(iii) for the twelve-month period ended September 30, 1998, the sum of:

(a) for the period commencing on October 1, 1997, and ended on the date immediately preceding the Closing Date, the sum of:

(1) Historical EBITDA for such period, plus

(2) $20 million, minus

(3) 38% of an amount equal to (A) the sum of the amounts calculated pursuant to clauses (1) and (2) above with respect to such period less (B) the Adjusted DD&A for such period; and

(b) for the period commencing on the Closing Date and ended on September 30, 1998, the sum of:

(1) EBITDA of the Company and its subsidiaries for such period, plus

(2) $12.4 million, minus

(3) the Tax Distribution Amounts paid or to be paid in respect of each of the three Fiscal Quarters (or portion thereof) included in such period; and

(iv) for the twelve-month period ended September 30, 1999 and each twelve-month period ended September 30 thereafter, the sum of:

(a) EBITDA of the Company and its subsidiaries for such twelve-month period, minus

(b) the Tax Distribution Amounts paid or to be paid in respect of each of the four Fiscal Quarters included in such twelve-month period;

all as determined on a consolidated basis with respect to (x) in the case of any period ending prior to the Closing Date, Marathon and its subsidiaries or Ashland and its subsidiaries, as applicable, or (y) in the case of any period ending on or after the Closing Date, the Company and its subsidiaries, in each case in accordance with then Current GAAP (other than Ordinary Course Lease Expenses which shall be calculated in accordance with Applicable GAAP).

"Advanced Amount" has the meaning set forth in Section 14.01(b).

"Affiliate Transaction" means any agreement or transaction between the Company or any of its subsidiaries and any Member or any Affiliate of any Member that:

(a) for purposes of Section 7.03(a)(i), will result or is reasonably anticipated will result in expenditures, contingent or actual liabilities or benefits to the Company and its subsidiaries in excess of $2 million;

(b) for purposes of Section 7.03(b), is either (i) outside the ordinary course of the Company and its subsidiaries' business and results or will result in contingent or actual liabilities or benefits to the Company and its subsidiaries in excess of $100,000 in the applicable Fiscal Year or (ii) within the ordinary course of the Company and its subsidiaries' business and results or will result in expenditures, contingent or actual liabilities or benefits to the Company and its subsidiaries (A) in excess of $2 million individually in the applicable Fiscal Year or (B) when taken together with all other agreements or transactions entered into the same Fiscal Year as such agreement or transaction which are either related to such agreement or transaction or are substantially the same type of agreement or transaction as such agreement or transaction, in excess of $2 million in the aggregate in the applicable Fiscal Year; and

(c) for purposes of Section 8.08(k)(i), is either (i) outside the ordinary course of the Company and its subsidiaries' business and will result or is reasonably anticipated will result in expenditures, contingent or actual liabilities or benefits to the Company and its subsidiaries in excess of $2 million or (ii) within the ordinary course of the Company and its subsidiaries' business and will result or is reasonably anticipated will result in expenditures, contingent or actual liabilities or benefits to the Company and its subsidiaries in excess of $25 million.

For purposes of this definition of Affiliate Transaction, any guarantee by a Member or any Affiliate of any Member of any obligations of the Company or any of its subsidiaries that is provided by such Member or such Affiliate without cost to the Company and its subsidiaries shall not be deemed to be an Affiliate Transaction. Notwithstanding the foregoing, the term "Affiliate Transaction" shall not include any distributions of cash or other property to the Members pursuant to Article V.

"Affiliate Transaction Dispute Notice" has the meaning set forth in Section 8.11(b).

"Aggregate Tax Rate" has the meaning set forth in Section 5.01(a)(i).

"Agreed Additional Capital Contributions" has the meaning set forth in Section 4.02(c).

"Agreement" means this Limited Liability Company Agreement of the Company, as the same may be amended, restated, supplemented or otherwise modified from time to time.

"Annual Capital Budget" has the meaning set forth in Section 8.09(a).

"Applicable GAAP" has the meaning set forth in Section 1.02.

"Approved Marathon Crude Oil Purchase Program" has the meaning set forth in Section 8.12.

"Arbitratable Dispute" has the meaning set forth in Section 13.04(a).

"Arbitration Payment Due Date" has the meaning set forth in Section 14.03(a).

"Arbitration Proceeding" has the meaning set forth in Section 14.01(a).

"Arbitration Tribunal" has the meaning set forth in Appendix B.

"Arm's-Length Transaction" has the meaning set forth in Section 8.11(a).

"Ashland Designated Sublease Agreements" shall mean the Ashland Sublease Agreements attached as Exhibits L-1, L-2, L-3 and L-4 to the Asset Transfer and Contribution Agreement.

"Ashland-Funded Capital Expenditures" has the meaning set forth in Section 4.02(a).

"Audited Financial Statements" has the meaning set forth in Section 7.02(c).

"Average Annual DD&A" means:

(a) for Fiscal Year 1998, the average of the Adjusted DD&A for the three twelve-month periods ended December 31, 1995, 1996 and 1997;

(b) for Fiscal Year 1999, the average of the Adjusted DD&A (i) for the two twelve-month periods ended December 31, 1996 and 1997 and (ii) for the one twelve-month period ended September 30, 1998;

(c) for Fiscal Year 2000, the average of the Adjusted DD&A (i) for the twelve-month period ended December 31, 1997 and (ii) for the two twelve-month periods ending on September 30, 1998 and 1999; and

(d) for Fiscal Year 2001 and each Fiscal Year thereafter, the average of the Adjusted DD&A for the three twelve-month periods ending on September 30 in each of the three Fiscal Years immediately preceding such Fiscal Year.

"Average Adjusted EBITDA" means:

(a) for Fiscal Year 1998, the average of the Adjusted EBITDA for the three twelve-month periods ended

December 31, 1995, 1996 and 1997;

(b) for Fiscal Year 1999, the average of the Adjusted EBITDA (i) for the two twelve-month periods ended December 31, 1996 and 1997 and (ii) for the one twelve-month period ended September 30, 1998;

(c) for Fiscal Year 2000, the average of the Adjusted EBITDA (i) for the twelve-month period ended December 31, 1997 and (ii) for the two twelve-month periods ending on September 30, 1998 and 1999; and

(d) for Fiscal Year 2001 and each Fiscal Year thereafter, the average of the Adjusted EBITDA for the three twelve-month periods ending on September 30 in each of the three Fiscal Years immediately preceding such Fiscal Year.

"Average Annual Level" means for any twelve-month period ending on September 30 of any calendar year, the average of the level of the Price Index ascertained by adding the twelve monthly levels of the Price Index during such twelve-month period and dividing the total by twelve.

"Bareboat Charters" has the meaning set forth in Section 9.3(k) of the Asset Transfer and Contribution Agreement.

"Base Level" means 161.2.

"Base Rate" has the meaning set forth in Section 1.01 of the PutCall, Registration Rights and Standstill Agreement.

"Board of Managers" has the meaning set forth in Section 8.02(a).

"Bulk Motor Oil Business" has the meaning set forth in Section 14.03(h) of the PutCall, Registration Rights and Standstill Agreement.

"Business Plan" has the meaning set forth in Section 8.10.

"Capital Account" has the meaning set forth in Section 6.01.

"Capital Expenditures" means, for any period, the aggregate of all expenditures incurred by the Company and its subsidiaries during such period that, in accordance with Applicable GAAP, are or should be included in "additions to property, plant or equipment" or similar items reflected in the consolidated statement of cash flows of the Company and its subsidiaries; provided, however, that Capital Expenditures shall not include (a) exchanges of such items for other items, (b) expenditures of proceeds of insurance settlements by the Company or any of its subsidiaries in respect of lost, destroyed or damaged assets, equipment or other property to the extent such expenditures are made to replace or repair such lost, destroyed or damaged assets, equipment or other property within 18 months of such loss, destruction or damage, (c) funds expended by a Member or an Affiliate of a Member to purchase any Subleased Property that is contributed to the Company or a subsidiary of the Company pursuant to Section 4.01(c)(i)(A) or (d) Member-Funded Capital Expenditures; all as determined on a consolidated basis with respect to the Company and its subsidiaries in accordance with Applicable GAAP.

"Capital Lease" means any lease of (or other arrangement conveying the right to use) real or personal property, or a combination thereof, which obligations are required to be classified and accounted for as capital leases on a consolidated balance sheet of the Company and its subsidiaries in accordance with Applicable GAAP.

"Closing Date Affiliate Transactions" has the meaning set forth in Section 8.08(k)(i)(A).

"Company Independent Auditors" has the meaning set forth in Section 7.01.

"Company Investment Guidelines" has the meaning set forth in Section 8.15.

"Company Leverage Policy" has the meaning set forth in Section 8.14.

"Competitive Business" has the meaning set forth in Section 14.01(a) of the PutCall, Registration Rights and Standstill Agreement.

"Competitive Third Party" has the meaning set forth in Section 14.01(d) of the PutCall, Registration Rights and Standstill Agreement.

"Contracting Member" has the meaning set forth in Section 8.11(b).

"Covered Person" means any Member, any Affiliate of a Member or any officers, directors, shareholders, partners, employees, representatives or agents of a Member or their respective Affiliates, or any Representative, or any employee, officer or agent of the Company or its Affiliates.

"Critical Decision" means each Primary Critical Decision and each Other Critical Decision.

"Critical Decision Termination Date" means (a) in the case of any Other Critical Decision, the first anniversary of the Closing Date or (b) in the case of any Primary Critical Decision, the first anniversary of the Closing Date or, if the Critical Decision Termination Date shall be extended with respect to such Primary Critical Decision as provided in Section 8.19(c), the fifteen-month anniversary of the Closing Date.

"Crude Oil Purchases" means any purchase of crude oil by the Company or any of its subsidiaries from Marathon or any Affiliate of Marathon.

"Current GAAP" means, at any time, GAAP as in effect at such time.

"Delinquent Member" has the meaning set forth in Section 14.01(a).

"Designated Sublease Agreements" means the Ashland Designated Sublease Agreements and the Marathon Designated Sublease Agreements.

"Designated Sublease Amount" means any obligation of a Member to the Company or a subsidiary of the Company under Section 4.01(c) with respect to a Subleased Property or a Designated Sublease Agreement.

"Dispute" has the meaning set forth in Section 13.01.

"Dispute Notice" has the meaning set forth in Section 13.02.

"Disputed Capital Contribution Amount" has the meaning set forth in Section 13.04(a).

"Disputed Indemnification Amount" has the meaning set forth in Section 14.01(a).

"Disputed Monetary Amount" has the meaning set forth in Section 14.01(a).

"Distributable Cash" means, for each Fiscal Quarter, without duplication:

(a) the Short-Term Investments of the Company and its subsidiaries on the last day of such Fiscal Quarter, minus

(b) the Ordinary Course Debt of the Company and its subsidiaries on the last day of such Fiscal Quarter, minus

(c) the Tax Distribution Amount to be paid in respect of such Fiscal Quarter, minus

(d) funds held on the last day of such Fiscal Quarter for financing Special Projects or Permitted Catlettsburg Capital Projects, minus

(e) if the notional repayment of principal for Special Project Indebtedness or Permitted Catlettsburg Capital Project Indebtedness during such Fiscal Quarter calculated using a notional repayment schedule established and approved by the Board of Managers in accordance with the Company Leverage Policy was more than the amount of actual principal repayments for such Special Project Indebtedness or Permitted Catlettsburg Project Indebtedness during such Fiscal Quarter, the amount of such excess, plus

(f) if the amount of the actual principal repayments for Special Project Indebtedness or Permitted Catlettsburg Capital Project Indebtedness during such Fiscal Quarter was more than the notional repayment of principal for such Special Project Indebtedness or Permitted Catlettsburg Capital Project Indebtedness during such Fiscal Quarter (calculated in the manner described in clause (e) above), the amount of such excess, plus or minus

(g) any adjustments or reserves (including any adjustments for minimum cash balance requirements, including cash reserves for accrued or withheld Taxes not yet due) in the amounts and for the time periods established and approved by the Board of Managers pursuant to a vote in accordance with Section 8.07(b).

"Distribution Date" has the meaning set forth in Section 5.01(a).

"Distributions Calculation Statement" has the meaning set forth in Section 5.01(c).

"EBITDA" means for any period:

(a) net income, plus

(b) to the extent deducted in computing such net income, the sum of (i) estimated or actual Federal, state, local and foreign income tax expense, (ii) interest expense, (iii) depreciation, depletion and amortization expense, (iv) non-cash charges resulting from the cumulative effect of changes in accounting principles, and (v) non-cash lower of cost or market inventory or fixed asset writedowns; minus

(c) to the extent added in computing such net income, (i) any interest income (excluding interest income on accounts receivable related to marketing programs), (ii) non-cash gains resulting from the cumulative effect of changes in accounting principles and (iii) non-cash lower of cost or market inventory or fixed asset gains;

all as determined on a consolidated basis (x) in the case of any period ended prior to the Closing Date, Marathon and its subsidiaries or Ashland and its subsidiaries, as applicable, or (y) in the case of any period ending on or after the Closing Date, with respect to the Company and its subsidiaries, in each case in accordance with then Current GAAP. For purposes of this definition, depreciation, depletion and amortization expense will include any gains (deductions from depreciation, depletion and amortization) or losses (additions to depreciation, depletion and amortization) on asset retirements and excess purchase price amortization adjustments. For the avoidance of doubt, EBITDA shall not include any revenues or expenses constituting Member-Funded Capital Expenditures or Member-Indemnified Expenditures.

"Executive Officers" has the meaning set forth in Section 9.01(a).

"Final Monetary Amount" has the meaning set forth in Section 14.03(a).

"Financed Properties" means each of the properties listed in Schedule 1.01.

"Fiscal Quarter" means the three-month period ended March 31, June 30, September 30 and December 31 of each Fiscal Year.

"Fiscal Year" has the meaning set forth in Section 6.05.

"Fuelgas Interest" means the 1% interest in the Company which is owned by Fuelgas.

"GAAP" means United States generally accepted accounting principles applied on a consistent basis.

"Garyville Propylene Upgrade Project" means the propylene splitter with a capacity of approximately 800 million pounds per year that is being constructed at the Garyville refinery for the production of propylene.

"Historical EBITDA" means for any period ending prior to the Closing Date the sum of:

(a) EBITDA of the Marathon Business for such period as adjusted for each of the "EBIT Adjustment" items set forth in lines 10-55 of Schedule B-1 and each of the "Depreciation Adjustment" items set forth in lines 133 through 150 of Schedule B-1, in each case calculated for such period in the same manner that such adjustments were calculated in Schedule B-1, plus

(b) EBITDA of the Ashland Business for such period as adjusted for each of the "EBIT Adjustment" items set forth in lines 11-56 of Schedule B-2 and each of the "Depreciation Adjustment" items set forth in lines 111-120 of Schedule B-2, in each case calculated for such period in the same manner that such adjustments were calculated in Schedule B-2;

all determined on a consolidated basis with respect to Marathon and its subsidiaries or Ashland and its subsidiaries, as applicable, in accordance with then Current GAAP.

"Initial GAAP" has the meaning set forth in Section 1.02.

"Initial Term" has the meaning set forth in Section 2.03.

"Maralube Express Business" has the meaning set forth in Section 14.03(d)(i) of the PutCall, Registration Rights and Standstill Agreement.

"Marathon Crude Oil Purchase Program" has the meaning set forth in Section 8.12.

"Marathon Designated Sublease Agreements" shall mean the Marathon Sublease Agreements attached as Exhibits E-1, E-2 and E-3 to the Asset Transfer and Contribution Agreement.

"Marathon-Funded Capital Expenditures" has the meaning set forth in Section 4.02(a).

"Material Adverse Effect" has the meaning set forth in the Asset Transfer and Contribution Agreement.

"Member-Funded Capital Expenditures" has the meaning set forth in Section 4.02(a).

"Member-Indemnified Expenditures" has the meaning set forth in Section 4.02(b).

"Monetary Dispute" has the meaning set forth in Section 14.01(a).

"Non-Contracting Member" has the meaning set forth in Section 8.11(b).

"Non-Delinquent Member" has the meaning set forth in Section 14.01.

"Non-Terminating Member" has the meaning set forth in the PutCall, Registration Rights and Standstill Agreement.

"Normal Annual Capital Budget Amount" means, for each Fiscal Year, an amount equal to the sum of:

(i) an amount equal to 130% of the Average Annual DD&A for such Fiscal Year, plus

(ii) if, with respect to any Fiscal Year, (a) the Average Adjusted EBITDA for such Fiscal Year less the amount calculated pursuant to clause (i) above for such Fiscal Year exceeds (b) $240 million (such excess, the "Excess EBITDA" for such Fiscal Year), the sum of (1) the lesser of: (x) 10% of the Average Annual DD&A for such Fiscal Year and (y) the Excess EBITDA for such Fiscal Year and (2) 50% of the amount by which the Excess EBITDA for such Fiscal Year exceeds an amount equal to 10% of the Average Annual DD&A for such Fiscal Year.

An example of the calculation of Adjusted DD&A, Adjusted EBITDA, Average Annual DD&A, Average Adjusted EBITDA and the Normal Annual Capital Budget Amount is shown in Schedule A. In the event of any inconsistency between such Schedule A and the language of this definition of Normal Annual Capital Budget Amount, neither shall control over the other.

"Offer Notice" has the meaning set forth in Section 10.04(a).

"Ordinary Course Debt" means, without duplication, the aggregate outstanding principal amount of all loans and advances under any committed or uncommitted credit facilities (including any commercial paper borrowings or borrowings under the Revolving Credit Agreement, but excluding trade payables), provided that Ordinary Course Debt shall not include any Permitted Intercompany Debt, any Special Project Indebtedness or any Permitted Catlettsburg Capital Project Indebtedness.

"Ordinary Course Lease Expense" means, with respect to any Fiscal Year, the rental or lease expense for such Fiscal Year of assets rented or financed by operating leases (as determined in accordance with Applicable GAAP).

"Original Lease" means the lease or charter underlying a Marathon Designated Sublease Agreement or an Ashland Designated Sublease Agreement in which Marathon or Ashland, as applicable, is the lessee or charterer.

"Other Critical Decision" means each of the Level III decisions set forth in paragraphs 2(c)(iii), (v), (vii), (viii) and (ix) of the Retail Integration Protocol.

"Packaged Motor Oil Business" has the meaning set forth in Section 14.03(h) of the PutCall, Registration Rights and Standstill Agreement.

"Percentage Interest" has the meaning set forth in Section 3.01.

"Permitted Catlettsburg Capital Project Indebtedness" has the meaning set forth in the Company Leverage Policy.

"Permitted Catlettsburg Capital Projects" has the meaning set forth in the Company Leverage Policy.

"Permitted Intercompany Debt" has the meaning set forth in the Company Leverage Policy.

"Price Index" means the Consumer Price Index for All Urban Consumers of the United States Department of Labor Bureau of Labor Statistics for all Urban Areas (on the 1982-84 equals 100 standard).

"Primary Critical Decision" means each of the Level III decisions set forth in paragraphs 2(c)(i), (ii), (iv) and (vi) of the Retail Integration Protocol.

"Prime Rate" means the rate of interest per annum publicly announced from time to time by Citibank, NA, as its prime rate in effect at its principal office in New York; each change in the Prime Rate shall be effective on the date such change is publicly announced as being effective.

"Private Label Packaged Motor Oil Business" has the meaning set forth in Section 14.03(h) of the PutCall Registration Rights and Standstill Agreement.

"Profit and Loss", as appropriate, means, for any period, the taxable income or tax loss of the Company and its subsidiaries under Code Section 703(a) and Treasury Regulation Section 1.703-1 for the Fiscal Year, adjusted as follows:

(a) All items of income, gain, loss or deduction required to be separately stated pursuant to Code Section 703(a)(1) shall be included;

(b) Tax exempt income as described in Code Section 705(a)(1)(B) realized by the Company during such Fiscal Year shall be taken into account as if it were taxable income;

(c) Expenditures of the Company described in Code Section 705(a)(2)(B) for such Fiscal Year, including items treated under Treasury Regulation Section 1.704-1(b)(2)(iv)(i) as items described in Code Section 705(a)(2)(B), shall be taken into account as if they were deductible items;

(d) With respect to any property (other than money) which has been contributed to the capital of the Company, "Profit" and "Loss" shall be computed in accordance with the provisions of Treasury Regulation Section 1.704-1(b)(2)(iv)(g) by computing depreciation, amortization, income, gain, loss or deduction based upon the fair market value of such property at the date of contribution;

(e) With respect to any property of the Company which has been revalued as required or permitted by Treasury Regulations under Code Section 704(b), "Profit" or "Loss" shall be determined based upon the fair market value of such property as determined in such revaluation; and

(f) With respect to any property of the Company which (i) is distributed in kind to a Member, or (ii) has been revalued under Section 6.03 upon the occurrence of any event specified in Treasury Regulation Section 1.704-1(b)(2)(iv)(f), the difference between the adjusted basis for federal income tax purposes and the fair market value shall be treated as gain or loss upon the disposition of such property.

"Qualified Candidate" has the meaning set forth in Section 9.02(c).

"Quick Lube Business" has the meaning set forth in Section 14.03(h) of the PutCall, Registration Rights and Standstill Agreement.

"Refundable Amount" has the meaning set forth in Section 14.03(d).

"Representatives" has the meaning set forth in Section 8.01

"Response" has the meaning set forth in Section 13.02.

"Retail Integration Protocol" means the Speedway SuperAmerica LLC Retail Integration Protocol attached hereto as Exhibit A.

"Revolving Credit Agreement" has the meaning set forth in Section 2.2(a) of the Master Formation Agreement.

"Section 8.11(b) Affiliate Transaction" has the meaning set forth in Section 8.11(b).

"Security Interest" has the meaning set forth in Section 14.05(a).

"Selling Member" has the meaning set forth in Section 10.04(a).

"Senior Manager" has the meaning set forth in Section 13.02.

"Shared Service" means an administrative service that is provided to the Company or its subsidiaries by Marathon, Ashland or any of their respective Affiliates pursuant to the Shared Services Agreement or provided to Marathon, Ashland or any of their respective Affiliates by the Company or its subsidiaries pursuant to the Shared Services Agreement.

"Shared Services Agreement" means the Shared Services Agreement by and among Marathon, Ashland and the Company, including the Schedules thereto, attached as Exhibit U to the Asset Transfer and Contribution Agreement.

"Short-Term Investments" means, without duplication, collected or available bank cash balances, the fair market value of any investment made by the Company or any of its subsidiaries pursuant to the Company's Investment Guidelines and the fair market value of any investment made by the Company or any of its subsidiaries that should have been made pursuant to the Company's Investment Guidelines, but excluding Incidental Cash and any cash balances that represent uncollected funds.

"Significant Shared Service" means (a) any Shared Service related to the Treasury and Cash Management function and (b) any Shared Service (or group of related Shared Services) that results or is reasonably anticipated to result in the payment by or to the Company or any of its subsidiaries of more than $2 million in any contract year in the period during which such Shared Service will be provided. For purposes of determining whether the $2 million threshold of this definition has been satisfied, payments for all Shared Services in each of the following general administrative areas shall be aggregated within each area specified below and considered related Shared Services: Human Resources; Health, Environment and Safety; Law; Public Affairs; Governmental Affairs; Finance and Accounting (including Internal Audit); Administrative Services; Information Technology Services; Procurement; Business Development; Aviation; Engineering and Technology; Economics; and Security.

"Sole Arbitrator" has the meaning set forth in Appendix B.

"Special Project" has the meaning set forth in the Company Leverage Policy.

"Special Project Indebtedness" has the meaning set forth in the Company Leverage Policy.

"Special Termination Right" has the meaning set forth in Section 2.01(a) of the PutCall, Registration Rights and Standstill Agreement.

"Subleased Property" has the meaning set forth in Section 4.01(c).

"Super Majority Decision" has the meaning set forth in Section 8.08.

"Surplus Cash" has the meaning assigned to such term in the Company Leverage Policy.

"Tax Distribution Amount" has the meaning set forth in Section 5.01(a).

"Tax Liability" means, with respect to a Fiscal Year, a Member's liability for Federal, state, local and foreign taxes attributable to taxable income allocated to such Member pursuant to Section 6.03 and Section 10.03, taking into account any Tax deduction or loss specifically allocated to a Member pursuant to this Agreement or any other Transaction Document.

"Term of the Company" has the meaning set forth in Section 2.03.

"Terminating Member" has the meaning set forth in Section 2.01(a) of the PutCall, Registration Rights and Standstill Agreement.

"Unaudited Financial Statements" has the meaning set forth in Section 7.02(a).

"Valvoline Business" has the meaning set forth in Section 14.03(h) of the PutCall, Registration Rights and Standstill Agreement.

SECTION 1.02. Applicable GAAP

In connection with the calculation pursuant to this Agreement of Adjusted DD&A, Capital Expenditures or Ordinary Course Lease Expenses, the determination of whether a lease is a Capital Lease or the determination of whether the Company has entered into an operating lease for purposes of Section 8.16 (each such calculation or determination, an "Accounting Determination"), the Company shall apply then Current GAAP; provided, however, that if at any time after the date of this Agreement, a change shall occur in GAAP which would result in any Accounting Determination being different under Current GAAP than such Accounting Determination would have been under GAAP as in effect on the date of this Agreement ("Initial GAAP"), then (a) the Members shall negotiate in good faith to make such amendments to the relevant provisions of this Agreement as shall be required to preserve the economic and other results intended by the Members as of the date of this Agreement with respect to such Accounting Determination and (b) unless and until such time as the Members shall in good faith mutually agree to such amendments, Initial GAAP shall be applied to make such Accounting Determination or, if the Members shall have previously amended the relevant provisions of this Agreement pursuant to this Section 1.02 in response to a prior change in GAAP, then GAAP as in effect at the time the most recent such previous amendment was made shall be used to make such Accounting Determination (the GAAP that is actually applied by the Company in making any such Accounting Determination pursuant to this Agreement being the "Applicable GAAP").

ARTICLE II
General Provisions

SECTION 2.01. Formation; Effectiveness.

The Company has been formed as a limited liability company pursuant to the provisions of the Delaware Act by the filing of the Certificate of Formation with the Secretary of State of the State of Delaware. Pursuant to Section 18-201(d) of the Delaware Act, the provisions of this Agreement shall be effective as of the Closing Date. Each Member hereby adopts, confirms and ratifies the Certificate of Formation and all acts taken in connection therewith. Ashland shall be admitted as a member of the Company upon its execution and delivery of this Agreement. Except as provided in this Agreement, the rights, duties, liabilities and powers of the Members shall be as provided in the Delaware Act.

SECTION 2.02. Name.

The name of the Company shall be Marathon Ashland Petroleum LLC. The Board of Managers may adopt such trade or fictitious names as it may determine.

SECTION 2.03. Term.

Subject to the provisions of Article XIV providing for early termination in certain circumstances and the provisions of Article IX of the PutCall, Registration Rights and Standstill Agreement, the initial term of the Company (the "Initial Term") began on the date the Certificate of Formation was filed with the Secretary of State of the State of Delaware, and shall continue until the close of business on December 31, 2022 and, thereafter, the term of the Company shall be automatically extended for successive 10-year periods unless at least two years prior to the end of the Initial Term or any succeeding 10-year period, as applicable, a Member notifies the Board of Managers and the other Member in writing that it wants to terminate the term of the Company at the end of the Initial Term or such 10-year period, in which event, the term of the Company shall not thereafter be extended for a successive ten-year term. The President of the Company shall notify each Member in writing at least six months prior to each such two-year notification date that the Term of the Company will be automatically extended unless a Member provides a notice to the contrary pursuant to this Section 2.03. The failure of the President of the Company to give such notice, or any defect in any notice so given, shall not affect the Members' rights to terminate the Term of the Company pursuant to this Section 2.03, and shall not result in a termination of the Term of the Company unless a Member provides a notice to the contrary pursuant to this Section 2.03. The Initial Term, together with any such extensions, is hereinafter referred to as the "Term of the Company". The existence of the Company as a separate legal entity shall continue until the cancelation of the Certificate of Formation in the manner provided in the Delaware Act.

SECTION 2.04. Registered Agent and Office.

The name of the registered agent of the Company for service of process on the Company in the State of Delaware is The Corporation Trust Company, and the address of the registered agent and the address of the office of the Company in the State of Delaware is co The Corporation Trust Company, 1209 Orange Street, Wilmington, Delaware 19801. The Board of Managers may change such office and such agent from time to time in its sole discretion.

SECTION 2.05. Purpose.

(a) The purpose of the Company is to engage in any lawful act or activity for which a limited liability company may be formed under the Delaware Act (either directly or indirectly through one or more subsidiaries). It is the Members' understanding and intent that (i) the Company will be an independent, self-funding entity, (ii) no additional capital contributions are expected to be required by the Members and (iii) the administrative requirements of the Company will generally be provided by the Company's own employees. In furtherance of this understanding and intent, and without limiting the generality of the foregoing, unless the Members shall mutually agree otherwise, the following administrative functions and services shall be provided substantially by the Company and its subsidiaries' employees (or by its unaffiliated third party contractors) under the supervision and control of the Company's officers: Human Resources; Health, Environment and Safety; Law; Finance and Accounting; Internal Audit; Treasury and Cash Management; and Information Technology. For the avoidance of doubt, the Members acknowledge and agree that the provision at any time of the specific Shared Services identified and described in Schedule 10.2(e) to the Marathon Asset Transfer and Contribution Agreement Disclosure Letter and Schedule 10.2(e) to the Ashland Asset Transfer and Contribution Agreement Disclosure Letter to the Company and its subsidiaries by the Members shall not be deemed to violate the requirements of the immediately preceding sentence.

(b) The Company, and the President on behalf of the Company, may enter into and perform the Transaction Documents and the Commercial Documents to which the Company is a party without any further act, vote or approval of the Board of Managers or the Members notwithstanding any other provision of this Agreement, the Delaware Act or other Applicable Law. The President of the Company is hereby authorized to enter into such Transaction Documents and such Commercial Documents on behalf of the Company, but such authorization shall not be deemed a restriction on the power of the Board of Managers to enter into other agreements on behalf of the Company.

SECTION 2.06. Powers.

In furtherance of its purposes, but subject to all the provisions of this Agreement, the Company shall have the power and is hereby authorized to:

(a) acquire by purchase, lease, contribution of property or otherwise, own, operate, hold, sell, convey, transfer or dispose of any real or personal property which may be necessary, convenient or incidental to the accomplishment of the purpose of the Company;

(b) act as a trustee, executor, nominee, bailee, director, officer, agent or in some other fiduciary capacity for any person or entity and to exercise all the powers, duties, rights and responsibilities associated therewith;

(c) take any and all actions necessary, convenient or appropriate as trustee, executor, nominee, bailee, director, officer, agent or other fiduciary, including the granting or approval of waivers, consents or amendments of rights or powers relating thereto and the execution of appropriate documents to evidence such waivers, consents or amendments;

(d) borrow money and issue evidences of indebtedness in furtherance of any or all of the purposes of the Company, and secure the same by mortgage, pledge or other lien on the assets of the Company;

(e) invest any funds of the Company pending distribution or payment of the same pursuant to the provisions of this Agreement;

(f) prepay in whole or in part, refinance, recast, increase, modify or extend any Indebtedness of the Company and, in connection therewith, execute any extensions, renewals or modifications of any mortgage or security agreement securing such Indebtedness;

(g) enter into, perform and carry out contracts of any kind, including, without limitation, contracts with any person or entity affiliated with any of the Members, necessary to, in connection with, convenient to, or incidental to the accomplishment of the purposes of the Company;

(h) employ or otherwise engage employees, managers, contractors, advisors, attorneys and consultants and pay reasonable compensation for such services;

(i) enter into partnerships, limited liability companies, trusts, associations, corporations or other ventures with other persons or entities in furtherance of the purposes of the Company; and

(j) do such other things and engage in such other activities related to the foregoing as may be necessary, convenient or incidental to the conduct of the business of the Company, and have and exercise all of the powers and rights conferred upon limited liability companies formed pursuant to the Delaware Act.

ARTICLE III
Members

SECTION 3.01. Members; Percentage Interests.

The names and addresses of the Members and their respective percentage interests in the Company ("Percentage Interests") are as follows:

Members	Percentage Interests
Marathon Oil Company 5555 San Felipe P.O. Box 3128 Houston, TX 77056-2723	62%
Ashland Inc. P.O. Box 391 Ashland, KY 41114	38%

Marathon's Percentage Interest shall be deemed to include the Fuelgas Interest. Promptly after the Closing, Marathon will cause Fuelgas to merge with and into Marathon.

SECTION 3.02. Adjustments in Percentage Interests.

Marathon's and Ashland's Percentage Interests, and the Percentage Interests of each other Member, if any, shall be adjusted (a) at the time of any Transfer of such Member's Membership Interests pursuant to Section 10.02 and (b) at the time of the admission of each new Member pursuant to such terms and conditions as the Board of Managers from time to time shall determine pursuant to a vote in accordance with Section 8.07(b), in each case to take into account such Transfer or admission of a new Member.

ARTICLE IV
Capital Contributions;
Assumption of Assumed Liabilities

SECTION 4.01. Contributions.

(a) On or before the Closing Date, Marathon shall contribute, convey, transfer, assign and deliver to the Company or shall have contributed, conveyed, transferred, assigned and delivered to the Company, the **Marathon Transferred Assets**, and Ashland shall contribute, convey, transfer, assign and deliver to the Company or shall have contributed, conveyed, transferred, assigned and delivered to the Company, the **Ashland Transferred Assets**, in each case pursuant to terms and conditions of the **Asset Transfer and Contribution Agreement**. In addition, any additional assets that Marathon or Ashland are required to contribute, convey, transfer, assign and deliver to the Company at a later date pursuant to the terms and conditions of the Asset Transfer and Contribution Agreement shall be so contributed at such later date.

(b) The Company shall assume, as of the Closing Date, the Assumed Liabilities pursuant to the terms of the Asset Transfer and Contribution Agreement.

(c) Payments or Damages under Designated Sublease Agreements as Contributions. (i) Each Member has agreed, pursuant to the Designated Sublease Agreements to which it is a party, to sublease to the Company or one of its subsidiaries the assets or property listed on Schedule 4.01(c) ("Subleased Property") for a nominal consideration in lieu of transferring such property to the Company or such subsidiary, free of any Liens, other than Permitted Encumbrances, as a capital contribution.

(A) If at any time after the date of this Agreement a Member in its capacity as a sublessor shall become the owner of any Subleased Property, such Member shall promptly contribute, convey, transfer, assign and deliver to the Company (or, if the Company so directs, to one of its subsidiaries) at no cost to the Company or such subsidiary, and the Company hereby agrees to accept, or to cause such subsidiary to accept, such Subleased Property and the related Designated Sublease Agreement shall be terminated with respect to such Subleased Property, all as more specifically set forth in such Designated Sublease Agreement. In addition, if at any time after the date of this Agreement a Member assigns to the Company (or a subsidiary of the Company) a purchase option with respect to a Subleased Property pursuant to a Designated Sublease Agreement and the Company or such subsidiary exercises such purchase option and pays all or a portion of the purchase price therefor, such Member shall promptly reimburse the Company or such subsidiary such amount so paid and, if not so reimbursed, such amount shall be subject to set-off pursuant to Section 14.04. Any such payment by the Company shall be treated as a distribution to the appropriate Member for capital account purposes, and any such amount paid to the Company or such subsidiary by a Member in connection with such reimbursement obligation, or to the extent of a set-off applied pursuant to Section 14.04 as a result of such failure to so reimburse, shall be treated as a capital contribution to the Company.

(B) Any amount paid by the Company or any of its subsidiaries under a Designated Sublease Agreement to cure or prevent a payment default by the sublessor Member under the underlying Original Lease shall be reimbursed to the Company or such subsidiary by such Member, and if not so reimbursed, shall be subject to set-off pursuant to Section 14.04. Any such payment by the Company shall be treated as a distribution to the appropriate Member for capital account purposes, and any such amount paid to the Company or such subsidiary by a Member in connection with a default of its payment obligations under its respective Designated

Sublease Agreements, or to the extent of a set-off applied pursuant to Section 14.04 as a result of such default, shall be treated as a capital contribution to the Company.

(C) None of the capital contributions pursuant to (A) and (B) above shall result in any adjustment to the Members' respective Percentage Interests in the Company.

(ii) If (A) a Member commences a voluntary case under any applicable bankruptcy, insolvency, liquidation, receivership, reorganization or other similar law now in effect, or an order for relief is entered against such Member in an involuntary case under any such law and (B) a trustee of such Member rejects a Designated Sublease Agreement of such Member, then (1) the Member shall be obligated to reimburse the Company for the Loss to the Company as a result of such rejected Designated Sublease Agreement, which Loss, if not so reimbursed, shall be subject to set-off pursuant to Section 14.04 prior to the interest of such Member in any distributions hereunder and (2) the amount of such Loss shall be deemed to be the loss of use of such Subleased Property for the economic life thereof rather than any other period.

SECTION 4.02. Additional Contributions.

(a) Member-Funded Capital Expenditures. For each Capital Expenditure project identified on Schedule 4.02(a)-1, Marathon shall contribute to the Company the amount of funds necessary to comply with its obligations under Section 7.1(j) of the Asset Transfer and Contribution Agreement with respect to such Capital Expenditure project as, when and if the Company actually incurs Capital Expenditures related to such Capital Expenditure project (such Capital Expenditures, as, when and if they are funded by Marathon, are referred to herein as the "Marathon-Funded Capital Expenditures"). For each Capital Expenditure project identified on Schedule 4.02(a)-2, Ashland shall contribute to the Company the amount of funds necessary to comply with its obligations under Section 7.2(k) of the Asset Transfer and Contribution Agreement with respect to such Capital Expenditure project as, when and if the Company actually incurs Capital Expenditures related to such Capital Expenditure project (such Capital Expenditures, as, when and if they are funded by Ashland, are referred to herein as the "Ashland-Funded Capital Expenditures", and together with the Marathon-Funded Capital Expenditures, the "Member-Funded Capital Expenditures"). Each Member-Funded Capital Expenditure shall be treated as a capital contribution to the Company, but shall not result in any adjustment to the Members' respective Percentage Interests in the Company. To the extent permitted by applicable Tax law, any Tax deduction by the Company of a Member-Funded Capital Expenditure shall be specially allocated so that each Member will have the Tax benefit of its Member-Funded Capital Expenditures.

(b) Indemnification Payments as Contributions. Any indemnity amount paid by Marathon or Ashland to the Company under Article IX of the Asset Transfer and Contribution Agreement (each a "Member-Indemnified Expenditure") shall be treated as a capital contribution to the Company, but shall not result in any adjustment to the Members' respective Percentage Interests in the Company. A determination of whether the associated Loss will be deducted or capitalized by the Company for Tax purposes shall be made by the Company at the direction of the Indemnifying Party. Any Tax deduction or loss claimed by the Company with respect to the indemnified amount shall be specially allocated to the Indemnifying Party.

(c) Other Additional Capital Contributions. The Members shall make other additional capital contributions ("Agreed Additional Capital Contributions") pro rata based on their respective Percentage Interests if and to the extent such capital contributions are approved by the Board of Managers pursuant to a vote in accordance with Section 8.07(b).

(d) No Third-Party Beneficiaries. The provisions of this Agreement, including without limitation, this Section 4.02, are intended solely to benefit the Members and, to the fullest extent permitted by Applicable Law, shall not be construed as conferring any benefit upon any creditor of the Company other than the Members, and no such creditor of the Company other than the Members shall be a third-party beneficiary of this Agreement, and no Member or member of the Board of Managers shall have any duty or obligation to any creditor of the Company to issue any call for capital pursuant to this Agreement.

SECTION 4.03. Negative Balances; Withdrawal of Capital; Interest.

Neither of the Members shall have any obligation to the Company or to the other Member to restore any negative balance in its Capital Account. Neither Member may withdraw capital or receive any distributions from the Company except as specifically provided herein. No interest shall be paid by the Company on any capital contributions.

ARTICLE V
Distributions

SECTION 5.01. Distributions.

(a) Within 45 days after the end of each Fiscal Quarter, the Company shall distribute to the Members (the date of such distribution being a "Distribution Date") an amount in cash (the "Tax Distribution Amount") determined as follows:

(i) The maximum Tax Liability of each Member with respect to its allocable portion (as provided in Section 6.03) of the Company's estimated taxable income for such Fiscal Quarter shall be determined, based upon the highest aggregate marginal statutory Federal, state and local income tax rate (determined taking into account the deductibility, to the extent allowed, of income-based taxes paid to governmental entities) to which any Member may be subject for the related Fiscal Year (and excluding any deferred taxes) (the "Aggregate Tax Rate").

(ii) If the Tax Liability determined in clause (i) is positive with respect to either Member, there shall be a cash distribution to each of the Members, in accordance with their Percentage Interests, of an aggregate amount such that neither Member shall receive less than its Tax Liability.

(iii) In the event that the Tax Liability with respect to a Fiscal Quarter, determined pursuant to clause (i) above, is negative with respect to each Member, such negative Tax Liability shall not give rise to a payment obligation on the part of either Member, but shall be carried forward and shall offset the positive Tax Liability of the Members in succeeding Fiscal Quarters.

(iv) Following a determination by the Company of the Company's actual net taxable income with respect to a Fiscal Year, the maximum Tax Liability of each Member with respect to its allocable portion (as provided in Section 6.03) of the Company's net taxable income for such Fiscal Year shall be determined, based upon the Aggregate Tax Rate. If the maximum Tax Liability of any Member for the Fiscal Year is in excess of the cash distributions previously made to the Member for such Fiscal Year under clause (ii) above and subsection (b) below, the Company shall make a cash distribution to all the Members, in accordance with their Percentage Interests, of an aggregate amount such that the excess is eliminated for all the Members. Such distribution shall be made within 45 days of the date the Company's actual net taxable income is determined.

(v) In the event that the Company Independent Auditors determine pursuant to Section 7.02(d) that the Company's actual net taxable income with respect to a Fiscal Year is greater than the amount determined by the Company pursuant to clause (iv) above, the Company shall make a determination of the amount of cash, if any, required to be distributed to the Members, in accordance with their Percentage Interests, such that, after taking into account cash distributions previously made to a Member under clause (ii) above and subsection (b) below, no Member shall receive less than its Tax Liability for such Fiscal Year based on such higher net taxable income amount. The Company shall, within 15 days after the determination is made, distribute such additional amount of cash to the Members, in accordance with their Percentage Interests.

(vi) In the event that the Company Independent Auditors determine pursuant to Section 7.02(d) that the Company's actual net taxable income with respect to a Fiscal Year is less than the amount determined by the Company pursuant to clause (iv) above, a determination shall be made of the excess Tax Distribution Amount that was distributed to the Members in respect of such Fiscal Year based on the Company's determination of its actual net taxable income and the Company shall deduct from the next Tax Distribution Amount payable to the Members pursuant to this Section 5.01, the amount of such excess distribution.

(b) In addition to the distributions pursuant to Section 5.01(a), on each Distribution Date, the Company shall distribute to the Members all Distributable Cash for the Fiscal Quarter to which such Distribution Date relates. Subject to Section 5.02(b), each such distribution shall be allocated between the Members pro rata based upon their respective Percentage Interests.

(c) The Company shall prepare and distribute to each Member within 45 days after the end of each Fiscal Quarter a statement (a "Distributions Calculation Statement") setting forth the calculations (in reasonable detail) used by the Company for purposes of distributions pursuant to this Section 5.01 of (i) the Tax Distribution Amount for each Member for such Fiscal Quarter, (ii) the amount of Distributable Cash for such Fiscal Quarter and (iii) the allocation of such Distributable Cash between the Members.

SECTION 5.02. Certain General Limitations.

(a) Notwithstanding any provision to the contrary contained in this Agreement, the Company, and the Board of Managers on behalf of the Company, shall not be required to make a distribution to either Member with respect to such Member's Membership Interests if such distribution would violate Section 18-607 of the Delaware Act or other applicable law.

(b) Notwithstanding any other provision of this Article V, all amounts distributed to the Members in connection with a dissolution of the Company or the sale or other disposition of all or substantially all the assets of the Company that results in a dissolution of the Company shall be distributed to the Members in accordance with their respective Capital Account balances, as adjusted pursuant to Article VI for all Company operations up to and including the date of such distribution.

SECTION 5.03. Distributions in Kind.

The Company shall not distribute to the Members any assets in kind unless approved by the Board of Managers pursuant to a vote in accordance with Section 8.07(b). If cash and property in kind are to be distributed simultaneously, the Company shall distribute such cash and property in kind in the same proportion to each Member, unless otherwise approved by the Board of Managers pursuant to a vote in accordance with Section 8.07(b). For purposes of determining amounts distributable to Members under Section 5.01, for purposes of determining Profit and Loss under Section 1.01, for purposes of making adjustments to Capital Accounts under Article VI and for purposes of allocations under Article VI, any property to be distributed in kind shall have the value assigned to such property by the Board of Managers pursuant to a vote in accordance with Section 8.07(b) and such value shall be deemed to be part of and included in Distributable Cash for purposes of determining distributions to the Members under this Agreement.

SECTION 5.04. Distributions in the Event of an Exercise of the Marathon Call Right, Ashland Put Right or the Special Termination Rights.

In the event of an exercise by Marathon of its Marathon Call Right or its Special Termination Right or the exercise by Ashland of its Ashland Put Right or its Special Termination Right pursuant to the PutCall, Registration Rights and Standstill Agreement, certain distributions to Ashland or Marathon, as applicable, will be suspended in accordance with the provisions of Section 5.01 thereof.

ARTICLE VI
Allocations and Other Tax Matters

SECTION 6.01. Maintenance of Capital Accounts.

An account (a "Capital Account") shall be established and maintained in the Company's books for each Member in accordance with Treasury Regulation Section 1.704-1(b)(2)(iv) and to which the following provisions apply to the extent not inconsistent with such Regulation:

(a) There shall be credited to each Member's Capital Account (i) the amount of money contributed by such Member to the Company (including liabilities of the Company assumed by such Member as provided in Treasury Regulation Section 1.704-1(b)(2)(iv)(c)), (ii) the fair market value of any property contributed by the Member to the Company (net of liabilities secured by such contributed property that the Company is considered to assume or take subject to under Code Section 752), and (iii) such Member's share of the Company's Profit;

(b) There shall be debited from each Member's Capital Account (i) the amount of money distributed to such Member by the Company (including liabilities of such Member assumed by the Company as provided in Treasury Regulation Section 1.704-1(b)(2)(iv)(c)) other than amounts which are in repayment of debt obligations of the Company to such Member, (ii) the fair market value of property distributed to such Member (net of liabilities secured by such property that such Member is considered to assume or take subject to under Code Section 752), and (iii) such Member's share of the Company's Loss;

(c) To each Member's Capital Account there shall be credited, in the case of an increase, or debited, in the case of a decrease, such Member's share of any adjustment to the adjusted basis of Company assets pursuant to Code Section 734(b) or Code Section 743(b) to the extent provided by Treasury Regulation Section 1.704-(b)(2)(iv)(m); and

(d) Upon the transfer of all or any part of the Membership Interests of a Member, the Capital Account of the transferee Member shall include the portion of the Capital Account of the transferor Member attributable to such transferred Membership Interest (or portion thereof).

SECTION 6.02. Allocation of Profit and Loss.

(a) Except as provided in Section 6.02(b), Profit or Loss for any Fiscal Year shall be allocated between the Members in proportion to their respective Percentage Interests.

(b) To the extent any Tax deduction or loss is specifically allocated to a Member pursuant to this Agreement (other than pursuant to Section 6.03) or any other Transaction Document, including any deduction or loss indemnified by a Member, any Member-Funded Capital Expenditure, any Member-Indemnified Expenditure and any special allocations pursuant to Sections 6.12, 6.13 and 6.14, the associated Profit and Loss shall be allocated to the same Member.

SECTION 6.03. Tax Allocations.

For income tax purposes only, each item of income, gain, loss, deduction and credit of the Company shall be allocated between the Members in accordance with their respective shares of Profit and Loss, subject to the rules of Section 704(c)(1)(A) of the Code and the Treasury Regulations promulgated thereunder. The allocation of income, gain, loss and deduction with respect to property contributed by a Member to the Company shall be pursuant to the method set forth in Treasury Regulation Section 1.704-3(c) (traditional method with curative allocations), with book depreciation (as that term is used in Treasury Regulation Section 1.704-1(b)(2)(iv)(g)(3)) for assets fully depreciated for federal income tax purposes based on the applicable recovery period (as determined in Code Section 168(c)) for new assets of the same type. Any other elections or other decisions relating to allocations under this Section 6.03, including the determination of the fair market value of contributed property and the decision to adjust the Capital Accounts to reflect the fair market value of the Company's assets upon the occurrence of any event specified in Treasury Regulation Section 1.704-1(b)(2)(iv)(f), shall be made jointly by the Members in any manner that reasonably reflects the purpose and intention of this Agreement. Items described in this Section 6.03 shall neither be credited nor charged to the Members' Capital Accounts.

SECTION 6.04. Entity Classification.

The Members intend that the Company be treated as a partnership for Federal income tax purposes. Accordingly, neither the Tax Matters Partner nor either Member shall file any election or return on its own behalf or on behalf of the Company that is inconsistent with that intent.

SECTION 6.05. Fiscal Year.

The fiscal year (the "Fiscal Year") of the Company for tax and accounting purposes shall be the 12-month (or shorter) period ending on the last day of December of each year.

SECTION 6.06. Tax Returns.

(a) The Company shall cause to be prepared and timely filed all Federal, state, local and foreign income tax returns and reports required to be filed by the Company and its subsidiaries. The Company shall provide copies of all the Company's Federal, state, local and foreign tax returns (and any schedules or other required filings related to such returns) that reflect items of income, gain, deduction, loss or credit that flow to separate Member returns, to the Members for their review and comment prior to filing, except as otherwise agreed by the Members. The Members agree in good faith to resolve any difference in the tax treatment of any item affecting such returns and schedules. However, if the Members are unable to resolve the dispute, the position of the Tax Matters Partner shall be followed if nationally recognized tax counsel acceptable to both Members provides an opinion that substantial authority exists for such position. Substantial authority shall be given the meaning ascribed to it in Code Section 6662. If the Members are unable to resolve the dispute prior to the due date for filing the return, including approved extensions, the position of the Tax Matters Partner shall be followed, and amended returns shall be filed if necessary at such time the dispute is resolved. The costs of the dispute shall be borne by the Company. The Members agree to file their separate Federal income tax returns in a manner consistent with the Company's return, the provisions of this Agreement and in accordance with applicable Federal income tax law.

(b) The Company shall elect the most rapid method of depreciation and amortization allowed under Applicable Law, unless the Members agree otherwise. The failure of either Member to agree that the Company should elect a less rapid method of depreciation or amortization is not subject to any dispute resolution provisions.

(c) The Members shall provide each other with copies of all correspondence or summaries of other communications with the Internal Revenue Service or any state, local or foreign taxing authority (other than routine correspondence and communications) regarding the tax treatment of the Company's operations. No Member shall enter into settlement negotiations with the Internal Revenue Service or any state, local or foreign taxing authority with respect to any issue concerning the Company's income, gains, losses, deductions or credits if the tax adjustment attributable to such issue (assuming the then current Aggregate Tax Rate) would be $2 million or greater, without first giving reasonable advance notice of such intended action to the other Member.

SECTION 6.07. Tax Matters Partner.

(a) Initially, Marathon shall be the "Tax Matters Partner" of the Company within the meaning of Section 6231(a)(7) of the Code, and shall act in any similar capacity under state, local or foreign law, but only with respect to returns for which items of income, gain, loss, deduction or credit flow to the separate returns of the Members. In the event of a transfer of any Member's interest in the Company, the Tax Matters Partner shall be the Member with the largest Percentage Interest following such transfer.

(b) The Tax Matters Partner shall incur no liability (except as a result of the gross negligence or willful misconduct of the Tax Matters Partner) to the other Member including, but not limited to, liability for any additional taxes, interest or penalties owed by the other Member due to adjustments of Company items of income, gain, loss, deduction or credit at the Company level.

SECTION 6.08. Duties of Tax Matters Partner.

(a) Except as provided in Section 6.08(b), the Tax Matters Partner shall cooperate with the other Member and shall promptly provide the other Member with copies of notices or other materials from, and inform the other Member of discussions engaged in with, the Internal Revenue Service or any state, local or foreign taxing authority and shall provide the other Member with notice of all scheduled administrative proceedings, including meetings with agents of the Internal Revenue Service or any state, local or foreign taxing authority, technical advice conferences, appellate hearings, and similar conferences and hearings, as soon as possible after receiving notice of the scheduling of such proceedings, but in any case prior to the date of such scheduled proceedings.

(b) The duties of the Tax Matters Partner under Section 6.08(a) shall not apply with respect to notices, materials, discussions, proceedings, meetings, conferences, or hearings involving any issue concerning the Company's income, gains, losses, deductions or credits if the tax adjustment attributable to such issue (assuming the then current Aggregate Tax Rate) would be less than $2 million except as otherwise required under Applicable Law.

(c) The Tax Matters Partner shall not extend the period of limitations or assessments without the consent of the other Member, which consent shall not be unreasonably withheld.

(d) The Tax Matters Partner shall not file a petition or complaint in any court, or file any claim, amended return or request for an administrative adjustment with respect to partnership items, after any return has been filed, with respect to any issue concerning the Company's income, gains, losses, deductions or credits if the tax adjustment attributable to such issue (assuming the then current Aggregate Tax Rate) would be $2 million or greater, unless agreed by the other Member. If the other Member does not agree, the position of the Tax Matters Partner shall be followed if nationally recognized tax counsel acceptable to both Members issues an opinion that a reasonable basis exists for such position. Reasonable basis shall be given the meaning ascribed to it for purposes of applying Code Section 6662. The costs of the dispute shall be borne by the Company.

(e) The Tax Matters Partner shall not enter into any settlement agreement with the Internal Revenue Service or any state, local or foreign taxing authority, either before or after any audit of the applicable return is completed, with respect to any issue concerning the Company's income, gains, losses, deductions or credits, unless any of the following apply:

(i) both Members agree to the settlement;

(ii) the tax effect of the issue if resolved adversely would be, and the tax effect of settling the issue is, proportionately the same for both Members (assuming each otherwise has substantial taxable income);

(iii) the Tax Matters Partner determines that the settlement of the issue is fair to both Members and the amount of the tax adjustment attributable to such issue (assuming the then current Aggregate Tax Rate) would be less than $2 million; or

(iv) nationally recognized tax counsel acceptable to both Members determines that the settlement is fair to both Members and is one it would recommend to the Company if both Members were owned by the same person and each had substantial taxable income.

In all events, the costs incurred by the Tax Matters Partner in performing its duties hereunder shall be borne by the Company in accordance with the Shared Services Agreement.

(f) The Tax Matters Partner may request extensions to file any tax return or statement without the written consent of, but shall so inform, the other Member.

SECTION 6.09. Survival of Provisions.

The provisions of this Agreement regarding the Company's tax returns and Tax Matters Partner shall survive the termination of the Company and the transfer of any Member's interest in the Company and shall remain in effect for the period of time necessary to resolve any and all matters regarding the federal, state, local and foreign taxation of the Company and items of Company income, gain, loss, deduction and credit.

SECTION 6.10. Section 754 Election.

In the event that a Member purchases the Membership Interests of a Selling Member pursuant to Section 10.04, the purchasing Member shall have the right to direct the Tax Matters Partner to make an election under Section 754 of the Code. The purchasing Member shall pay all costs incurred by the Company in connection with such election, including any costs borne by the Company to maintain records required as a result of such election. The purchasing Member, at its option and expense, may maintain on behalf of the Company any records required as a result of such election.

SECTION 6.11. Qualified Income Offset, Minimum Gain Chargeback.

Notwithstanding anything to the contrary in this Agreement, there is hereby incorporated a qualified income offset provision which complies with Treasury Regulation Section 1.704-1(b)(2)(ii)(d) and minimum gain chargeback and partner minimum gain chargeback provisions which comply with the requirements of Treasury Regulation Section 1.704-2 and such provisions shall apply to the allocation of Profits and Losses.

SECTION 6.12. Tax Treatment of Designated Sublease Agreements.

(a) For purposes of Article VI, Ashland or Marathon, as the case may be, shall be treated as transferring to the Company all of its interest in Subleased Property pursuant to an Ashland Designated Sublease Agreement or a Marathon Designated Sublease Agreement, as if the leasehold interest in such Subleased Property was an Ashland Transferred Asset or a Marathon Transferred Asset.

(b) Payments under the Original Lease made by Ashland or Marathon, as the case may be, after the effective date of the Ashland Designated Sublease Agreement or Marathon Designated Sublease Agreement, as the case may be, shall be treated as made by the Company or its subsidiaries, and then immediately reimbursed by Ashland or Marathon, as the case may be.

(c) All items of loss, deduction and credit attributable to payments under the Original Lease made by Ashland or Marathon, as the case may be, including payments by the Company or any of its subsidiaries that are charged to Ashland or Marathon by set-off or other means, shall be allocated entirely to the Member incurring such payments.

(d) Depreciation and amortization deductions, if any, as well as any deductions or offsets to taxable income or gain, attributable to property described in the Ashland Designated Sublease Agreements or the Marathon Designated Sublease Agreements, as the case may be, shall be allocated entirely to Ashland or Marathon, as the case may be, except to the extent such deductions or offsets are attributable to amounts paid by the Company or any of its subsidiaries and not reimbursed by Ashland or Marathon, as the case may be, either directly or indirectly.

SECTION 6.13. Tax Treatment of Reimbursed Liability Payments.

Any tax deduction or loss attributable to payments by the Company or any of its subsidiaries of Assumed Liabilities, as described in Schedules 2.3(d) and 3.3(d) to the Asset Transfer and Contribution Agreement, that are reimbursed by a Member either directly or indirectly, shall be allocated entirely to such Member.

SECTION 6.14. Tax Treatment of Disproportionate Payments.

Except as otherwise provided in this Agreement or in any other Transaction Document, any Tax deduction or loss reflected on a Tax return, report or other Tax filing by the Company, attributable to (i) payments made or costs incurred by a Member, (ii) payments made or costs incurred by the Company and reimbursed or to be reimbursed by a Member and (iii) payments made or costs incurred by the Company and not shared among the Members based on their Percentage Interests, shall be allocated among the Members to take into account the amounts paid, incurred, reimbursed or shared by each.

ARTICLE VII
Books and Records

SECTION 7.01. Books and Records; Examination.

The Board of Managers shall keep or cause to be kept such books of account and records with respect to the Company's business as they may deem appropriate. Each Member and its duly authorized representatives shall have the right at any time to examine, or to appoint independent certified public accountants (the fees of which shall be paid by such Member) to examine, the books, records and accounts of the Company and its subsidiaries, their operations and all other matters that such Member may wish to examine, including, without limitation, all documentation relating to actual or proposed transactions with either Member or any Affiliate of either Member. The Company, and the Board of Managers, shall not have the right to keep confidential from the Members any information that the Board of Managers would otherwise be permitted to keep confidential from the Members pursuant to Section 18-305(c) of the Delaware Act. The Company's books of account shall be kept using the method of accounting determined by the Board of Managers. The Company Independent Auditors (the "Company Independent Auditors") shall be an independent public accounting firm selected by the Board of Managers pursuant to a vote in accordance with Section 8.07(b) or Section 8.07(c), as applicable, and shall initially be Price Waterhouse LLP.

SECTION 7.02. Financial Statements and Reports.

(a) Unaudited Monthly Financial Statements. (i) The Company shall prepare and send to each Member (at the same time) promptly, but in no event later than noon on the 15th Business Day after the last day of each month, the following unaudited financial statements with respect to the Company and its subsidiaries: a balance sheet, a statement of operations, a statement of cash flows and a statement of changes in capital (collectively, "Unaudited Financial Statements") as at the end of and for such month.

(ii) The Company shall prepare and send to each Member promptly, but in no event later than noon on the 20th Business Day after the last day of each month, an unaudited financial summary booklet containing a breakdown of such operating and financial information by major department or division of the Company and its subsidiaries as at the end of and for such month as either Member shall reasonably request; provided that each Member shall be provided with the same information at the same time as the other Member.

(b) Unaudited Quarterly Financial Statements. The Company shall prepare and send to each Member (at the same time) promptly, but in no event later than the 30th day after the last day of each Fiscal Quarter, (i) Unaudited Financial Statements as at the end of and for such Fiscal Quarter; (ii) a management's discussion and analysis of financial condition and results of operations section prepared in accordance with Rule 303 of Regulation S-K of the Securities Act with respect to such Fiscal Quarter; and (iii) an unaudited statement of changes in the Members' capital accounts as at the end of and for such Fiscal Quarter.

(c) Audited Annual Financial Statements. Within 75 days after the end of each Fiscal Year, the Board of Managers shall cause (i) an examination to be made, at the expense of the Company, by the Company Independent Auditors, covering (A) the assets, liabilities and capital of the Company and its subsidiaries, and the Company's and its subsidiaries' operations during such Fiscal Year, (B) an examination of the Distributions Calculation Statement for such Fiscal Year, and (C) all other matters customarily included in such examinations and (ii) to be delivered to each Member (at the same time) a copy of the report of such examination, stating that such examination has been performed in accordance with generally accepted auditing standards, together with (1) the following financial statements with respect to the Company and its subsidiaries certified by such accountants as having been prepared in accordance with GAAP: a balance sheet, a statement of operations, a statement of cash flows and a statement of changes in capital as at the end of and for such Fiscal Year (collectively, the "Audited Financial Statements") and (2) a management's discussion and analysis of financial condition and results of operations section prepared in accordance with Rule 303 of Regulation S-K of the Securities Act with respect to such Fiscal Year. The Company shall prepare the Audited Financial Statements in such manner and form as is necessary to enable Ashland to file such Audited Financial Statements with the Commission in accordance with Item 3-09 of Regulation S-X under the Exchange Act.

(d) Schedule of Members' Capital Accounts. (i) Preliminary Annual Capital Account Schedule. The Company shall prepare and send to each Member (at the same time) promptly, but in no event later than the 75th day after the last day of each Fiscal Year, a schedule showing the respective Capital Accounts of the Members based on the Company's estimated taxable income for such Fiscal Year.

(ii) Examination. Within 15 days after the date the Company determines its net taxable income with respect to any Fiscal Year, but in no event later than 7 months after the end of such Fiscal Year, the Board of Managers shall cause (i) an examination to be made, at the expense of the Company, by the Company Independent Auditors, covering (A) the determination of the Company's taxable income with respect to such Fiscal Year and (B) the respective Capital Accounts of the Members based on the Company's taxable income for such Fiscal Year and (ii) to be delivered to each Member (at the same time) a copy of the report of such examination, stating that such examination has been performed in accordance with generally accepting auditing standards.

(iii) Final Annual Capital Account Schedule. The Company shall prepare and send to each Member (at the same time) promptly, but in no event later than the 15th day after the date the Company files its federal income tax return with respect to each Fiscal Year, a schedule showing the respective Capital Accounts of the Members based on the Company's actual taxable income for such Fiscal Year.

(e) Other Financial Information. The Company shall prepare and send to each Member (at the same time) promptly such other financial information as a Member shall from time to time reasonably request.

SECTION 7.03. Notice of Affiliate Transactions; Annual List.

(a) (i) The Company shall notify each Member of any Affiliate Transaction (other than an Affiliate Transaction that is a Significant Shared Service) that the Company or any of its subsidiaries is considering entering into or renewing or extending the term thereof (whether pursuant to contractual provisions thereof or otherwise), which notice shall be given, to the extent reasonably possible, sufficiently in advance of the time that the Company intends to enter into, renew or extend the term of such Affiliate Transaction so as to provide the Members with a reasonable opportunity to examine the documentation related to such Affiliate Transaction.

(ii) The Company shall notify each Member of any Affiliate Transaction that is a Significant Shared Service that the Company or any of its subsidiaries is considering entering into or renewing or extending the term thereof (whether pursuant to contractual provisions thereof or otherwise), which notice shall be given, to the extent reasonably possible, sufficiently in advance of the time that the Company intends to enter into, renew or extend the term of such Affiliate Transaction so as to provide the Members with a reasonable opportunity to examine the documentation related to such Affiliate Transaction.

(b) Within 60 days after the end of each Fiscal Year, the Company shall prepare and distribute to each Member a list setting forth a description of each Affiliate Transaction entered into by the Company or any of its subsidiaries during such Fiscal Year and identifying all of the parties to such Affiliate Transactions; provided that if two or more Affiliate Transactions either (i) constitute a series of related transactions or agreements or (ii) are substantially the same type of transaction or agreement, the Company need not separately describe each such Affiliate Transaction but instead can describe such related or similar Affiliated Transactions as a group.

ARTICLE VIII
Management of the Company

SECTION 8.01. Managing Members.

The business and affairs of the Company shall be managed by the Members acting through their respective representatives on the Board of Managers ("Representatives"). The President and the Representatives shall be deemed "managers" of the Company within the meaning of the Delaware Act. Except for such matters as may be delegated to a Member from time to time by the Board of Managers pursuant to a vote in accordance with Section 8.07(b), and subject to the provisions of Sections 6.07 and 6.08, no Member shall act unilaterally on behalf of the Company or any of its subsidiaries without the approval of the other Member and no Member shall have the power unilaterally to bind the Company or any of its subsidiaries.

SECTION 8.02. Board of Managers.

(a) The Members shall exercise their management authority through a board of managers (the "Board of Managers") consisting of (i) the President of the Company, who shall not be deemed a Representative hereunder and who shall not be entitled to vote on any matter coming before the Board of Managers, and (ii) five Representatives, each of whom shall be entitled to vote, three of whom shall be designated by Marathon and two of whom shall be designated by Ashland. In the event of a Transfer by a Member of its Membership Interests pursuant to Article X, effective at the time of such Transfer, (i) such Member's Representatives shall automatically be removed from the Board of Managers and (ii) the transferee of such Membership Interests shall be permitted to designate the number of Representatives to the Board of Managers as is equal to the number previously designated by the transferor of such Membership Interests. Such transferee shall promptly notify the other Member as to the names of the persons who such transferee has designated as its Representatives on the Board of Managers.

(b) Each Representative may be removed and replaced, with or without cause, at any time by the Member designating him or her, but, except as provided in Section 8.02(a), may not be removed or replaced by any other means. A Member who removes one or more of its Representatives from the Board of Managers shall promptly notify the other Member as to the names of its replacement Representatives.

SECTION 8.03. Responsibility of the Board of Managers.

The Board of Managers shall be responsible for overseeing the operations of the Company and shall, in particular, have sole jurisdiction to approve each of the following matters:

(i) hiring senior executives of the Company, evaluating their performance and planning for their succession;

(ii) reviewing and approving Company strategies, Business Plans and Annual Capital Budgets;

(iii) reviewing and approving significant external business opportunities for the Company, including acquisitions, mergers and divestitures;

(iv) reviewing and approving policies of the Company that maintain high standards in areas of environmental responsibility, employee safety and health, community, government, employee and customer relations;

(v) reviewing external and internal audits and management responses thereto; and

(vi) establishing compensation and benefits policies for employees of the Company.

SECTION 8.04. Meetings.

(a) Except as set forth in Section 8.04(h), all actions of the Board of Managers shall be taken at meetings of the Board of Managers in accordance with this Section 8.04.

(b) As soon as practicable after the appointment of the Representatives, the Board of Managers shall meet for the purpose of organization and the transaction of other business.

(c) Regular meetings of the Board of Managers shall be held at such times as the Board of Managers shall from time to time determine, but no less frequently than once each Fiscal Quarter; provided that an annual meeting of the Board of Managers (which annual meeting shall count as one of the regular quarterly meetings) shall be held no later than June 30 of each Fiscal Year.

(d) Special meetings of the Board of Managers shall be held whenever called by any Member. Any and all business may be transacted at a special meeting that may be transacted at a regular meeting of the Board of Managers.

(e) The Board of Managers may hold its meetings at such place or places as the Board of Managers may from time to time by resolution determine or as shall be designated in the respective notices or waivers of notice thereof; however, the Board of Managers shall consider holding meetings from time to time at each of the Member's corporate headquarters and at the operational sites of the Company.

(f) Notices of regular meetings of the Board of Managers or of any adjourned meeting shall be given at least two weeks prior to such meeting, unless otherwise agreed by each Member. Notices of special meetings of the Board of Managers shall be mailed by the Secretary or an Assistant Secretary to each member of the Board of Managers addressed to him or her at his or her residence or usual place of business, so as to be received at least two Business Days before the day on which such meeting is to be held, or shall be sent to him or her by telegraph, cable, facsimile or other form of recorded communication or be delivered personally, by overnight courier or by telephone so as to be received not later than two Business Days before the day on which such meeting is to be held. Such notice shall include the purpose, time and place of such meeting and shall set forth in reasonable detail the matters to be considered at such meeting. However, notice of any such meeting need not be given to any member of the Board of Managers if such notice is waived by him or her in writing or by telegraph, cable, facsimile or other form of recorded communication, whether before or after such meeting shall be held, or if he or she shall be present at such meeting.

(g) Action by Communication Equipment. The members of the Board of Managers may participate in a meeting of the Board of Managers by means of video or telephonic conferencing or similar communications equipment by means of which all persons participating in the meeting can hear each other, and such participation shall constitute presence in person at such meeting.

(h) Unanimous Action by Written Consent. Any action required or permitted to be taken at any meeting of the Board of Managers may be taken without a meeting if all the Representatives consent thereto in writing and such writing is filed with the minutes of the proceedings of the Board of Managers.

(i) Organization. Meetings of the Board of Managers shall be presided over by a chair, who will be a member of the Board of Managers selected by a majority of the Board of Managers. The Secretary of the Company or, in the case of his or her absence, any person whom the person presiding over the meeting shall appoint, shall act as secretary of such meeting and keep the minutes thereof.

SECTION 8.05. Compensation.

Unless the Members otherwise agree, no person shall be entitled to any compensation from the Company in connection with his or her services as a Representative.

SECTION 8.06. Quorum.

(a) Quorum for Super Majority Decisions. Subject to Section 14.01(e) of the PutCall, Registration Rights and Standstill Agreement and Sections 14.01 and 14.05 and Section 5 of Schedule 8.14, at all meetings of the Board of Managers, the quorum required for the transaction of any business that constitutes a Super Majority Decision shall be the presence, either in person or by proxy, of (i) at least one Representative of each Member and (ii) a majority of all the Representatives on the Board of Managers (which may include the Representatives referred to in the preceding clause (i)).

(b) Quorum for Other Decisions. Subject to Sections 14.01 and 14.05 and Section 5 of Schedule 8.14, at all meetings of the Board of Managers, the quorum required for the transaction of any business that does not constitute a Super Majority Decision shall be (i) in the case of all matters that were described in the notice in reasonable detail for such meeting delivered to the members of the Board of Managers pursuant to Section 8.04(f), the presence, either in person or by proxy, of a majority of all the Representatives on the Board of Managers and (ii) in the case of all matters that were not described in the notice in reasonable detail for such meeting delivered to the members of the Board of Managers pursuant to Section 8.04(f), the presence, either in person or by proxy, of (A) at least one Representative of each Member and (B) a majority of all the Representatives on the Board of Managers (which may include the Representatives referred to in the preceding clause (A)).

(c) Rescheduled Meetings. The Company shall use its reasonable best efforts to schedule the time and place of each meeting of the Board of Managers so as to ensure that a quorum will be present at each such meeting and that at least one Representative of each Member will be present at each such meeting. In the absence of a quorum at any such meeting or any adjournment or adjournments thereof, a majority in voting interest of those present in person or by proxy and entitled to vote thereat may reschedule such meeting from time to time until the Representatives requisite for a quorum, as aforesaid, be present in person or by proxy. At any such rescheduled meeting at which a quorum is present, any business may be transacted that might have been transacted at the meeting as originally called.

SECTION 8.07. Voting.

(a) General. Each Representative shall be entitled to cast one vote on all matters coming before the Board of Managers. In exercising their voting rights under this Agreement, the Representatives may act by proxy.

(b) Super Majority Decisions. Subject to Section 14.01(e) of the PutCall, Registration Rights and Standstill Agreement and Sections 14.01 and 14.05 and Section 5 of Schedule 8.14, all Super Majority Decisions to be decided by the Board of Managers shall be approved by the unanimous affirmative vote of the votes cast by the Representatives who are present, either in person or by proxy, at a duly called meeting of the Board of Managers at which a quorum is present. The parties acknowledge and agree that all references in this Agreement, any other Transaction Document and any appendices, exhibits or schedules hereto or thereto to any determination, decision, approval or other form of authorization by the Board of Managers pursuant to a vote in accordance with Section 8.07(b) shall be deemed to mean that such determination, decision, approval or other form of authorization shall constitute a Super Majority Decision which requires the approval of the Board of Managers in accordance with this Section 8.07(b).

(c) Other Decisions. Subject to Sections 14.01 and 14.05 and Section 5 of Schedule 8.14, all matters other than Super Majority Decisions to be decided by the Board of Managers shall be approved by the affirmative vote of a majority of the votes cast by the Representatives who are present, either in person or by proxy, at a duly called meeting of the Board of Managers at which a quorum is present, unless the vote of a greater number of Representatives is required by Applicable Law or this Agreement.

SECTION 8.08. Matters Constituting Super Majority Decisions.

Subject to the provisions of Section 8.07(b), each of the following matters, and only the following matters, shall constitute a "Super Majority Decision" which requires the approval of the Board of Managers pursuant to Section 8.07(b):

(a) (i) the purchase or investment by the Company or any of its subsidiaries of or in any assets or securities, or any group of assets or securities, that have an aggregate purchase price or cost of more than $20 million, if the purpose or effect of such purchase or investment is to enable the Company to enter into a line of business other than (A) the Company's Business as such Business is conducted on the Closing Date or (B) any other line of business that is approved after the Closing Date by the Board of Managers as a Super Majority Decision under this Section 8.08(a)(i) pursuant to a vote in accordance with Section 8.07(b), provided that any such purchase or investment by the Company or any of its subsidiaries shall not require a Super Majority Decision under this Section 8.08(a) if and to the extent such purchase or investment is being made to enable the Company to enter into the Bulk Motor Oil Business, the Packaged Motor Oil Business, the Private Label Packaged Motor Oil Business andor the Quick Lube Business and, at the time of such purchase or investment, (1) the Company and its subsidiaries are permitted to engage in such business under Section 14.03(b) of the PutCall, Registration Rights and Standstill Agreement and (2) Ashland and its Affiliates shall own (beneficially or otherwise) 20% or more of the Valvoline Business (it being understood and agreed that this proviso shall not limit or constitute an exception to any other provision of Section 8.08); and

(ii) the determination of whether any new line of business approved by the Board of Managers as a Super Majority Decision under Section 8.08(a)(i) should constitute a "Competitive Business" for purposes of Section 14.01 of the PutCall, Registration Rights and Standstill Agreement;

(b) any reorganization, merger, consolidation or similar transaction between the Company or any of its subsidiaries and any person (other than a direct or indirect Wholly Owned Subsidiary of the Company) or any sale or lease of all or substantially all of the Company's or any of its subsidiaries' assets to any person (other than a direct or indirect Wholly Owned Subsidiary of the Company);

(c) the admission of a new Member (other than as a result of a Transfer of an existing Member's Membership Interests pursuant to Article X) or the issuance of any additional Membership Interests or other equity interests to any person, including any existing Member;

(d) except as expressly provided in Sections 4.01(c), 4.02(a) and 4.02(b), the acceptance or requirement of any additional capital contributions to the Company by either Member;

(e) the initial hiring of the following officers of the Company: the President; the Executive Vice President; the officers principally in charge of (i) refining, (ii) wholesale and branded marketing, (iii) retail marketing (two initially), (iv) supply and transportation and (v) environmental health and safety and human resources; the Senior Vice President-Finance and Commercial Services of the Company; and the general counsel of the Company;

(f) (i) the approval of Acquisition Expenditures, Capital Expenditures and other expenditures included in the Annual Capital Budget for any Fiscal Year (other than (A) Ordinary Course Lease Expenses, (B) up to $100 million in the aggregate for all periods in Capital Expenditures of the Company and its subsidiaries directly associated with the Garyville Propylene Upgrade Project, (C) Member-Funded Capital Expenditures, (D) Member-Indemnified Expenditures and (E) Capital Expenditures of the Company and its subsidiaries directly associated with Permitted Catlettsburg Capital Projects that are funded with Permitted Catlettsburg Capital Project Indebtedness) that exceed the Normal Annual Capital Budget Amount for such Fiscal Year; and

(ii) the incurrence of rentals or operating leases which result in aggregate Ordinary Course Lease Expenses (other than Ordinary Course Lease Expenses incurred under the Bareboat Charters) for any Fiscal Year that exceed $80 million; provided, however, in the event the Company or one of its subsidiaries shall make any acquisition or divestiture, the Members shall negotiate in good faith to adjust the dollar amount set forth in this Section 8.08(f)(ii) to take into account the effect of such acquisition or divestiture;

(g) (i) except for any acquisition or capital project related to the Bulk Motor Oil Business, the Packaged Motor Oil Business, the Private Label Motor Oil Business andor the Quick Lube Business, any acquisition, divestiture or individual capital project (other than (i) Ordinary Course Lease Expenses, (ii) up to $100 million in the aggregate for all periods in Capital Expenditures of the Company and its subsidiaries directly associated with the Garyville Propylene Upgrade Project, (iii) Member-Funded Capital Expenditures, (iv) Member-Funded Indemnified Expenditures and (v) Capital Expenditures of the Company and its subsidiaries directly associated with Permitted Catlettsburg Capital Projects that are funded with Permitted Catlettsburg Capital Project Indebtedness) where the liability or consideration involved is more than $50 million in the aggregate (including contingent liabilities only to the extent required to be reflected on the balance sheet of the Company in accordance with Financial Accounting Standard Number 5 (or any successor or superseding provision of Current GAAP));

(ii) any acquisitions or individual capital projects related to the Bulk Motor Oil Business, the Packaged Motor Oil Business, the Private Label Motor Oil Business andor the Quick Lube Business during any Fiscal Year where the liability or consideration involved is more than $50 million in the aggregate in such Fiscal Year (including contingent liabilities only to the extent required to be reflected on the balance sheet of the Company in accordance with Financial Accounting Standard Number 5 (or any successor or superseding provision of Current GAAP)); provided that nothing in this Section 8.08(g)(ii) shall be deemed or interpreted to permit the Company or any of its subsidiaries to engage in any of such businesses except as and to the extent expressly permitted under Section 14.03 of the PutCall, Registration Rights and Standstill Agreement;

(iii) for the avoidance of doubt, acquisitions or individual capital projects related to the Maralube Express Business shall be subject to clause (i) of this Section 8.08(g) and not clause (ii) of this Section 8.08(g);

(h) the initiation or settlement of any action, suit, claim or proceeding involving (i) an amount in excess of $50 million (with respect to initiation) or $25 million (with respect to settlement), (ii) material non-monetary relief (including, without limitation, entering into any consent decree that has or could reasonably be expected to (A) impose any material obligation on Ashland or any of its Affiliates or the Company or any of its subsidiaries or (B) have a material adverse effect on the business, operations, assets, liabilities, results of operations, cash flows, condition (financial or otherwise) or prospects of Ashland or any of its Affiliates or the Company or any of its subsidiaries) or (iii) the initiation or settlement of any criminal action, suit, claim or proceeding (other than a misdemeanor) if such criminal action, suit or proceeding has or could reasonably be expected to (A) impose any material obligation on Ashland or any of its Affiliates or (B) have a material adverse effect on the business, operations, assets, liabilities, results of operations, cash flows, condition (financial or otherwise) or prospects of Ashland or any of its Affiliates;

(i) any change in the Company Independent Auditors unless the new firm is one of the "Big Six" accounting firms (or any successor thereto) or a firm of comparable stature in Ashland's opinion;

(j) any modification, alteration, amendment or termination of this Agreement or any other Transaction Document to which the Company or any of its subsidiaries is a party;

(k) (i) in the case of any Affiliate Transaction that is not a Crude Oil Purchase, a Significant Shared Service or a Designated Sublease Agreement, (A) any Affiliate Transaction (other than the Affiliate Transactions listed on Schedule 8.08(k)(i)(A) (the "Closing Date Affiliate Transactions")), (B) any material amendment to or change in the terms or provisions of any Affiliate Transaction that was either a Closing Date Affiliate Transaction or previously approved by the Board of Managers pursuant to Section 8.08(k)(i)(A) (it being understood that a renewal or extension of the term of an Affiliate Transaction pursuant to contractual provisions that were previously approved by the Board of Managers pursuant to this Section 8.08(k)(i) or that were included in a Closing Date Affiliate Transaction on the Closing Date shall be deemed for purposes of this Agreement not to constitute a new Affiliate Transaction or a material amendment to or change in an Affiliate Transaction) or (C) any amendment or change in the terms or provisions of any agreement or transaction between the Company or any of its subsidiaries and any Member or any Affiliate of any Member which causes such agreement or transaction to become an Affiliate Transaction;

(ii) in the case of Crude Oil Purchases, the approval of such Crude Oil Purchases in accordance with Section 8.12(a);

(iii) in the case of any Significant Shared Service, (A) any agreement or transaction constituting a Significant Shared Service (other than the specific Significant Shared Services identified and described in Schedule 10.2(e) to the Asset Transfer and Contribution Agreement), (B) any material amendment to or change in the terms and provisions of any Significant Shared Service identified and described in Schedule 10.2(e) to the Asset Transfer and Contribution Agreement or thereafter approved by the Board of Managers in accordance with this Section 8.08(k)(iii), (C) subject to the provisions of Section 8.11(b) and except as expressly provided in Section 8.12(b), any cancelation or failure by the Company or any of its subsidiaries to renew any Significant Shared Service provided by Ashland or any Affiliate of Ashland to the Company or any of its subsidiaries or provided by the Company or any of its subsidiaries to Ashland or any Affiliate of Ashland and (D) the periodic review and approval of Significant Shared Services in accordance with Section 8.12(b); and

(iv) any material amendment to or change in the terms or provisions of, cancelation, termination or failure to renew, any Designated Sublease Agreement or any election by the Company to refuse or reject the contribution of any Subleased Property to the Company or any of its subsidiaries;

(l) the commencement of a voluntary case under any applicable bankruptcy, insolvency or other similar law now or hereafter in effect, or the consent to the entry of an order for relief in an involuntary case under any such law, or the consent to the appointment of or the taking possession by a receiver, liquidator, assignee, custodian, trustee or sequestrator (or similar official) of the Company or any of its subsidiaries or for any substantial part of the Company's or any of its subsidiaries' property, or the making of any general assignment for the benefit of creditors;

(m) (i) the modification, alteration or amendment of the amount, timing, frequency or method of calculation of distributions to the Members from that provided in Article V or (ii) an adjustment to the amount of Distributable Cash pursuant to clause (g) of the definition of "Distributable Cash" in Section 1.01;

(n) (i) the modification, alteration or amendment of the Company Leverage Policy, or (ii) the approval of any matter which the Company Leverage Policy provides is to be approved by the Board of Managers as a Super Majority Decision;

(o) (i) the approval of any distribution by the Company to the Members of any assets in kind, (ii) the approval of any distribution by the Company to the Members of cash and property in kind on a non-pro rata basis, and (iii) the determination of the value assigned to such assets in kind;

(p) each Critical Decision or material amendment thereto made on or prior to the Critical Decision Termination Date for such Critical Decision; and

(q) the delegation to a Member of the power to unilaterally bind the Company or any of its subsidiaries with respect to any matter.

SECTION 8.09. Annual Capital Budget.

(a) In Fiscal Year 1999 and in each Fiscal Year thereafter, the Executive Officers of the Company shall timely prepare or cause to be prepared a draft capital budget (the "Annual Capital Budget") for such Fiscal Year, which shall set forth in reasonable line item detail the proposed Acquisition Expenditures, Capital Expenditures and the Ordinary Course Lease Expenditures of the Company and its subsidiaries for such Fiscal Year, including all

Ordinary Course Lease Expenditures and all Capital Expenditures of the Company and its subsidiaries directly associated with the Garyville Propylene Upgrade Project. In addition, to the extent that information can reasonably be obtained on the nature of assets rented or financed by operating leases, such information shall be presented along with the Annual Capital Budget. Copies of the Annual Capital Budget shall be provided to each Member (at the same time) and to the Board of Managers. No later than November 15 of each Fiscal Year, the Executive Officers shall present to the Board of Managers the Annual Capital Budget for their review, consideration and approval, with such additions, deletions and changes thereto as the Board of Managers shall deem necessary.

(b) If the Board of Managers shall fail to approve an Annual Capital Budget for any Fiscal Year, the total expenditures provided for in the Annual Capital Budget for such Fiscal Year shall be in an amount equal to the Normal Annual Capital Budget Amount for such Fiscal Year.

(c) No later than July 15 of each Fiscal Year, the Board of Managers shall review the Annual Capital Budget for such Fiscal Year and shall make such additions, deletions and changes thereto as the Board of Managers shall deem necessary.

SECTION 8.10. Business Plan.

In Fiscal Year 1999 and in each Fiscal Year thereafter, the Executive Officers of the Company shall timely prepare or cause to be prepared a draft business plan (the "Business Plan") for the next three Fiscal Years. Copies of the Business Plan shall be provided to each Member (at the same time) and to the Board of Managers. No later than November 15 of each Fiscal Year, the Executive Officers shall present to the Board of Managers the Business Plan for their review, consideration and approval, with such additions, deletions and changes thereto as the Board of Managers shall deem necessary.

SECTION 8.11. Requirements as to Affiliate Transactions.

(a) The Company and its subsidiaries shall only be permitted to enter into or renew or extend the term thereof (whether pursuant to contractual provisions thereof or otherwise) an agreement or a transaction with a Member or an Affiliate of a Member (which, solely for purposes of this Section 8.11, shall be deemed to include any entity more than 10% of the voting stock or other ownership interests of, or economic interest in, which is owned by a Member (other than the Company or any of its subsidiaries)) on the same terms or on terms no less favorable to the Company or such subsidiary than could be obtained from a third party on an arm's-length basis (an "Arm's-Length Transaction").

(b) (i) If (A) the Company or any subsidiary of the Company enters into, renews or extends the term of (pursuant to contractual provisions thereof that were previously approved by the Board of Managers or otherwise) or materially amends or changes the terms or provisions of, any agreement or transaction between the Company or any of its subsidiaries and any Member or any Affiliate of any Member (a "Section 8.11(b) Affiliate Transaction") or proposes to do any of the foregoing and (ii) not later than 90 days after receiving written notice thereof from the Company pursuant to Section 7.03 or otherwise (which notice describes the material terms and conditions of such transaction in reasonable detail), the Member that is not (or whose Affiliate is not) a party to such Section 8.11(b) Affiliate Transaction (the "Non-Contracting Member") notifies the Company and the Member that is (or whose Affiliate is) a party to such Section 8.11(b) Affiliate Transaction (the "Contracting Member") in writing that the Non-Contracting Member believes in good faith that either such Affiliate Transaction is not an Arm's-Length Transaction or that the quality of the service being provided or to be provided by the Contracting Member is inferior to that which the Company and its subsidiaries could otherwise obtain on comparable terms and conditions, then the Company shall promptly (and, in any event within 30 days) provide the Non-Contracting Member with a reasonably detailed explanation of the basis for the Company's determination that such new, renewed or extended Affiliate Transaction is an Arm's-Length Transaction or the quality of the service being provided or to be provided to the Company and its subsidiaries is not inferior.

(ii) If following receipt of such evidence, the Non-Contracting Member is not reasonably satisfied that such Affiliate Transaction is an Arm's-Length Transaction or the quality of the service being provided or to be provided to the Company and its subsidiaries is not inferior, then, at the written request of the Non-Contracting Member (such written request being an "Affiliate Transaction Dispute Notice"), the Company shall (A) modify the terms of such Affiliate Transaction so that it becomes an Arm's-Length Transaction, (B) if the Company had given the Members written notice pursuant to Section 7.03(a) prior to entering into, renewing or extending such Affiliate Transaction, not enter into, renew or extend such Affiliate Transaction or (C) if the Company had given the Members written notice pursuant to Section 7.03(a) prior to entering into, renewing or extending such Affiliate Transaction, enter into, renew or extend such Affiliate Transaction in which event the determination of whether such Affiliate Transaction is an Arm's Length Transaction andor whether the quality of the service being provided is inferior shall be in accordance with the Dispute Resolution Procedures set forth in Article XIII or (D) if the Company shall not have given the Members written notice pursuant to Section 7.03(a) prior to entering into, renewing or extending such Affiliate Transaction, commence the dispute resolution procedures set forth in Article XIII.

(iii) For purposes of Article XIII, a Non-Contracting Member's delivery of an Affiliate Transaction Dispute Notice to the Company shall constitute delivery of a Dispute Notice thereunder, and the Company shall be required to deliver a Response to the Non-Contracting Member within 30 days thereafter. If it is finally determined pursuant to such Dispute Resolution Procedures that such Affiliate Transaction is an Arm's-Length Transaction and, if disputed, that the quality of service being so provided is not inferior, then the Company shall be permitted to enter into, renew or extend such Affiliate Transaction. If it is finally determined pursuant to such Dispute Resolution Procedures that such Affiliate Transaction is not an Arm's-Length Transaction or that the quality of service being so provided is inferior, then the Company shall either modify the terms of such

Affiliate Transaction so that it becomes an Arm's-Length Transaction and, if disputed, with an adequate level of quality of service or not enter into, renew or extend such Affiliate Transaction. In the event that such Affiliate Transaction has already been entered into, renewed or extended, then (A) the Company and the Contracting Member shall make such modifications to the terms of such Affiliate Transaction as are necessary so that such Affiliate Transaction becomes an Arm's-Length Transaction and, if disputed, with an adequate level of quality of service and (B) the Contracting Member shall pay the Company an amount equal to the difference between (I) the costs incurred by the Company under such Affiliate Transaction since the time of such entering into, renewal or extension and (II) the costs that the Company would have incurred under such Affiliate Transaction during such time period had such Affiliate Transaction been an Arm's-Length Transaction and, if disputed, with an adequate level of quality of service at the time of such initial agreement, renewal or extension.

SECTION 8.12. Review of Certain Affiliate Transactions Related to Crude Oil Purchases and Shared Services.

(a) (i) Not less than 30 days prior to the regular meeting of the Board of Managers during the fourth Fiscal Quarter of each Fiscal Year (or, if no regular meeting of the Board of Managers is scheduled during such Fiscal Quarter, at a special meeting of the Board of Managers during such Fiscal Quarter), the Company shall submit to the Board of Managers a reasonably detailed description of any proposed transactions or agreements related to crude oil purchases by the Company and its subsidiaries from Marathon or any Affiliate of Marathon that are intended to remain in effect or to be put into effect during such next Fiscal Year (collectively, the "Marathon Crude Oil Purchase Program"). Following such submission, the Company shall provide the Board of Managers promptly with such information with respect to such Marathon Crude Oil Purchase Program and the Company's other proposed crude oil purchases and policies for such next Fiscal Year as any Representative shall reasonably request. At each such regular or special meeting during the fourth Fiscal Quarter of each Fiscal Year, the Board of Managers shall review such Marathon Crude Oil Purchase Program. During such next Fiscal Year, the Company and its subsidiaries shall be permitted to purchase crude oil from Marathon or any Affiliate of Marathon only on the terms and conditions of the proposed transactions and agreements submitted to and approved by the Board of Managers at such regular or special meeting pursuant to a vote in accordance with Section 8.07(b) (the "Approved Marathon Crude Oil Purchase Program"). Any purchase (or group of related purchases) of crude oil by the Company or any of its subsidiaries from Marathon or any Affiliate of Marathon during such Fiscal Year that is an Affiliate Transaction for purposes of Section 8.08(k) and is not made under or in accordance with the Approved Marathon Crude Oil Purchase Program and any material amendment to or change in the Approved Marathon Crude Oil Purchase Program during such Fiscal Year shall be made only with the prior approval of the Board of Managers pursuant to a vote in accordance with Section 8.07(b).

(ii) The Company shall prepare and send to each Member (at the same time) promptly, but in no event later than the 30th day after the last day of each Fiscal Quarter, (A) a summary of all Crude Oil Purchases during such Fiscal Quarter, (B) a description of any amendments to, changes in or deviations from the Approved Marathon Crude Oil Purchase Program in effect during such Fiscal Quarter, (C) a description of any then known proposed amendments to, changes in or deviations from the Approved Marathon Crude Oil Purchase Program in effect during the remaining balance of the Fiscal Year and (D) such other information with respect to purchases of crude oil by the Company and its subsidiaries as either Member shall reasonably request.

(b)(i) All administrative services that Marathon, Ashland and each of their respective Affiliates provide to the Company or any of its subsidiaries, and that the Company and its subsidiaries provide to Marathon, Ashland or any of their respective Affiliates, shall be pursuant to the Shared Services Agreement. To the extent that there is a conflict between the Shared Services Agreement, Schedule 10.2(e) to the Marathon Asset Transfer and Contribution Agreement Disclosure Letter or Schedule 10.2(e) to the Ashland Asset Transfer and Contribution Agreement Disclosure Letter, on the one hand, and this Agreement, on the other hand, this Agreement shall control.

(ii) Not less than 90 days prior to each of the annual meetings of the Board of Managers held in 2000, 2003 and every three years thereafter, the Company shall submit to the Board of Managers the provisions of the Shared Services Agreement that relate to each Significant Shared Service then in effect or that is proposed to be put into effect. Following such submission, the Company shall provide the Board of Managers promptly with such information with respect to such Significant Shared Services and with respect to any other Shared Services then being provided or proposed to be provided as any Representative shall reasonably request. At each such annual meeting, unless all the Representatives otherwise agree, the Board of Managers shall review each such Significant Shared Service and shall determine pursuant to a vote in accordance with Section 8.07(b) whether such Significant Shared Service should be continued (or, in the case of any proposed Significant Shared Service, put into effect). Unless the Board of Managers approves pursuant to a vote in accordance with Section 8.07(b) the continuation or effectiveness of a Significant Shared Service, the Shared Service Agreement to the extent it relates to such Significant Shared Service shall be terminated effective 90 days after such annual meeting or at such later date as the Board of Managers shall specify pursuant to a vote in accordance with Section 8.07(b) and the Company shall be deemed at the time of such annual meeting to have given notice to the Member providing or receiving (or whose Affiliate is providing or receiving) such Significant Shared Service that the Company is terminating the Shared Service Agreement with respect to such Significant Shared Service.

SECTION 8.13. Adjustable Amounts.

Within 30 days following the date on which the United States Department of Labor Bureau of Labor Statistics for all Urban Areas publishes the Price Index for the month of September of each Fiscal Year commencing September, 1998, the Company shall determine whether the Average Annual Level for the immediately preceding twelve-month period exceeds the Base

Level. If the Company determines that the Average Annual Level for such twelve-month period exceeds the Base Level, then the Company shall increase or decrease each of the dollar amounts set forth in this Agreement (other than the $348 million and $346 million amounts set forth in the definition of Adjusted DD&A, the $657 million, $600 million, $80 million, $20 million and $12.4 million amounts set forth in the definition of Adjusted EBITDA, the $240 million amount set forth in the definition of "Normal Annual Capital Budget Amount" in Section 1.01, the $100 million amount set forth in Section 8.08(f)(i) and any dollar amount set forth in any Appendix, Exhibit or Schedule to this Agreement, including Schedule 8.14) (each dollar amount that is adjusted pursuant to this Section 8.13 being an "Adjustable Amount"), including, without limitation, the following amounts, to an amount calculated by multiplying the relevant Adjustable Amount by a fraction whose numerator is the Average Annual Level for such twelve-month period and whose denominator is the Base Level: (i) the $100,000, $2 million and $25 million amounts set forth in the definition of "Affiliate Transaction" and the $2 million amount set forth in the definition of "Significant Shared Service" in each case in Section 1.01; (ii) the $2 million amount set forth in Section 6.06(c); (iii) the $2 million amounts set forth in Sections 6.08(b), (d) and (e); (iv) the $20 million amount set forth in Section 8.08(a)(i); (v) the $80 million amount set forth on Section 8.08(f)(ii) (or such other dollar amount as shall be agreed pursuant to the proviso to Section 8.08(f)(ii)); (vi) the $50 million amount set forth in Section 8.08(g); (vii) the $50 million and $25 million amounts set forth in Section 8.08(h)(i); and (viii) each $7.5 million amount set forth in Section 14.01(a); provided that in no event shall any Adjustable Amount be decreased below the initial amount thereof set forth herein. Within five Business Days after making such determinations, the Company shall distribute to each Member a notice setting forth: (A) the amount by which the Average Annual Level for such Fiscal Year exceeded the Base Level and (B) the calculations of any adjustments made to the Adjustable Amounts pursuant to this Section 8.13. Any adjustment made to the Adjustable Amounts pursuant to this Section 8.13 shall be effective as of January 1st of the next Fiscal Year.

SECTION 8.14. Company Leverage Policy.

The leverage policy for the Company shall be the leverage policy set forth on Schedule 8.14, with such modifications, alterations or amendments thereto as the Board of Managers shall from time to time approve pursuant to a vote in accordance with Section 8.07(b) (such leverage policy, as so modified, altered or amended, is referred to herein as the "Company Leverage Policy").

SECTION 8.15. Company's Investment Guidelines.

The Company's Senior Vice President-Finance and Commercial Services, Vice President-Finance and Controller and Treasurer (or Treasury Manager) shall constitute an Investment Policy Committee of the Company and shall establish investment guidelines for the Company and its subsidiaries (such investment guidelines, as they may be modified, altered or amended by such Investment Policy Committee from time to time, are referred to herein as the "Company Investment Guidelines"). The initial Company Investment Guidelines is set forth on Schedule 8.15. The Company and its subsidiaries shall only make investments that are permitted under the Company Investment Guidelines at the time of such investments. In addition, the Company and its subsidiaries shall invest all Surplus Cash (after meeting daily cash requirements) in accordance with the Company Investment Guidelines.

SECTION 8.16. Requirements as to Operating Leases.

The Company and its subsidiaries shall not enter into any operating lease (as determined in accordance with Applicable GAAP) if the purpose or intent of entering into such operating lease is to circumvent the Company Leverage Policy or the super majority voting requirement for Capital Expenditures of the Company set forth in Section 8.08(f). The lease by the Company and its subsidiaries of vehicles, railcars and computers in accordance with the historical practices of the Ashland Business and the Marathon Business shall not be deemed to violate this Section 8.16, provided, for the avoidance of doubt, that all Ordinary Course Lease Expenses related to any such leases shall be considered Ordinary Course Lease Expenses for the purposes of Section 8.08(f)(ii).

SECTION 8.17. Limitations on Actions Relating to the Calculation of Distributable Cash.

Notwithstanding anything to the contrary contained in this Agreement, the Company shall not, and shall cause its subsidiaries not to (a) modify, alter or amend the Company Investment Guidelines, (b) accelerate the payment of the Company's and its subsidiaries' accounts payable, (c) delay the collection of the Company's and its subsidiaries' accounts receivable or (d) take any other action, if the purpose or intent of such action is to reduce the amount of Distributable Cash in a manner that is inconsistent with the intent of the Members to maximize the amount of Distributable Cash distributions to the Members.

SECTION 8.18. Reliance by Third Parties.

Persons dealing with the Company are entitled to rely conclusively upon the power and authority of the Board of Managers herein set forth. Except as provided in this Agreement, neither the President, nor a Representative, nor any Member shall have any authority to bind the Company or any of its subsidiaries.

SECTION 8.19. Integration of Retail Operations.

(a) Until the Critical Decision is made regarding the location of the Company's retail operations' headquarters, the Company's retail operations' business shall have headquarters in both Enon, Ohio and Lexington, Kentucky.

(b)(i) The Company shall make a formal recommendation to the Board of Managers with respect to each Critical Decision not later than the ten-month anniversary of the Closing Date. Following receipt of a formal recommendation with respect to any Critical Decision, Marathon and Ashland shall negotiate in good faith to reach an agreement with respect to such Critical Decision not later than the first anniversary of the Closing Date.

(ii) Each formal recommendation with respect to any Critical Decision shall be accompanied by a report on the business and economic analyses used by the Company to arrive at such recommendation, including but not limited to, a reasonably detailed description of the risks and benefits of the recommended decision and the anticipated impact of the recommended decision on the Speedway and SuperAmerica brand images and business models.

(iii) Following receipt of any formal recommendation with respect to any Critical Decision, each Member may request, and the Company shall promptly provide to both Members, such additional information and analyses (including studies by outside consultants) as such Member may reasonably request; provided, however, any additional information request shall not extend the Critical Decision Termination Date.

(c) If any Primary Critical Decision shall not have been agreed by the Board of Managers pursuant to a vote in accordance with Section 8.07(b) prior to the first anniversary of the Closing Date, the Critical Decision Termination Date with respect to such Primary Critical Decision shall be automatically, and without any further action required by either Member, the Company or the Board of Managers, extended until the fifteen-month anniversary of the Closing Date. During the period of such extension, the Company shall provide promptly to each Member such additional information or analyses (including studies by outside consultants) as either Member shall reasonably request. Not later than 30 days prior to the fifteen-month anniversary of the Closing Date, the Company shall, if requested by either Member, again make a formal recommendation to the Board of Managers with respect to such Primary Critical Decision. Such formal recommendation shall include a report on the supporting business and economic analyses described in Section 8.19(b)(ii). Any request for additional information shall not extend the Critical Decision Termination Date.

(d) Until such time as the implementation of any Critical Decision shall have been completed in all material respects, the President of the Company shall report to the Board of Managers at each regular meeting of the Board of Managers on the implementation of such Critical Decision and on any material modifications or changes to such Critical Decision.

(e) To the extent there is any conflict between the terms and provisions of this Agreement and the terms and provisions of the Retail Integration Protocol, the terms and provisions of this Agreement shall control.

ARTICLE IX
Officers

SECTION 9.01. (a) Election, Appointment and Term of Office.

The executive officers of the Company (the "Executive Officers") shall consist solely of: a President; an Executive Vice President; an officer principally in charge of refining; an officer principally in charge of wholesale and branded marketing; the officer or officers (two initially) principally in charge of retail marketing; an officer principally in charge of supply and transportation; an officer who shall be the Senior Vice President-Finance and Commercial Services of the Company; and an officer who shall be the general counsel of the Company. Schedule C sets forth a list of (i) the persons who Marathon and Ashland have chosen to serve initially as the Executive Officers of the Company, (ii) the executive office for which each such person is to serve and (iii) whether each such person was designated by Marathon or Ashland. Marathon and Ashland agree that the composition of the initial Executive Officers is intended to reflect their respective Percentage Interests in the Company. Accordingly, if any person identified on Schedule C is for any reason unable or unwilling to serve as an Executive Officer at the Closing Date, the Member who designated such person shall have the right to designate a substitute person, subject to the right of the other Member to consent to such substitute nominee (which consent shall not be unreasonably withheld). Marathon and Ashland shall cause their respective Representatives to promptly approve the appointment of each person listed on Schedule C to the related executive office position listed on Schedule C.

(b) Except as otherwise determined by the Board of Managers, each Executive Officer shall hold office until his or her death or until his or her earlier resignation or removal in the manner hereinafter provided. Except as otherwise expressly provided herein, the Executive Officers shall have such powers and duties in the management of the Company as generally pertain to their respective offices as if the Company were a corporation governed by the General Corporation Law of the State of Delaware.

(c) The Board of Managers may elect or appoint such other officers to assist and report to the Executive Officers as it deems necessary. Subject to the preceding sentence, each such officer shall have such authority and shall perform such duties as may be provided herein or as the Board of Managers may prescribe. The Board of Managers may delegate to any Executive Officer the power to choose such other officers and to prescribe their respective duties and powers.

(d) Except as otherwise determined by the Board of Managers, if additional officers are elected or appointed during the year pursuant to Section 9.01(c), each such officer shall hold office until his or her death or until his or her earlier resignation or removal in the manner hereinafter provided.

SECTION 9.02. Resignation, Removal and Vacancies.

(a) Any officer may resign at any time by giving written notice to the President or the Secretary of the Company, and such resignation shall take effect at the time specified therein or, if the time when it shall become effective shall not be specified therein, when accepted by action of the Board of Managers. Except as aforesaid, the acceptance of such resignation shall not be necessary to make it effective.

(b) All officers and agents elected or appointed by the Board of Managers shall be subject to removal at any time by the Board of Managers with or without cause.

(c) Vacancies in all Executive Officer positions may only be filled by the majority vote of the Representatives on the Board of Managers. In each instance where a vacant Executive Officer position is to be filled, Marathon, after consultation with the Company, shall first send Ashland a notice which discloses the name and details of the candidate for the vacant Executive Officer position that the Representatives of Marathon will nominate and vote in favor of for such position. Ashland shall thereafter have the right, by notice to the Company and Marathon within ten days after receipt of such notice from Marathon, to veto such candidate. Each candidate that Marathon proposes for a vacant Executive Officer position shall be a bona fide candidate who is willing and able to serve and who Marathon in good faith believes is qualified to fill such vacant Executive Officer position (a "Qualified Candidate"). In the event Ashland exercises its veto with respect to a Qualified Candidate, the vacancy will be filled by the majority vote of the Representatives on the Board of Managers.

SECTION 9.03. Duties and Functions of Executive Officers.

(a) President. The President of the Company, who shall be a non-voting member of the Board of Managers, shall be in charge of the day-to-day operations of the Company and shall preside at all meetings of the Board of Managers and shall perform such other duties and exercise such powers, as may from time to time be prescribed by the Board of Managers.

(b) Executive Vice President. The Executive Vice President of the Company initially shall report to the President and be the officer principally in charge of all supply, refining, marketing and transportation operations of the Company other than the Company's retail operations.

(c) Other Executive Officers. The Executive Officers of the Company other than the President and the Executive Vice President shall perform such duties and exercise such powers, as may from time to time be prescribed by the President or the Board of Managers.

ARTICLE X
Transfers of Membership Interests

SECTION 10.01. Restrictions on Transfers.

(a) General. Except as expressly provided by this Article X, neither Member shall Transfer all or any part of its Membership Interests to any person without first obtaining the written approval of the other Member, which approval may be granted or withheld in its sole discretion. Notwithstanding anything to the contrary contained in this Agreement, no Transfer by a Member of its Membership Interests to any person shall be made except to a permitted assignee under Article XV of the PutCall, Registration Rights and Standstill Agreement.

(b) Transfer by Operation of Law. In the event a Member shall be party to a merger, consolidation or similar business combination transaction with a third party or sell all or substantially all its assets to a third party, such Member may Transfer all (but not part) of its Membership Interests to such third party; provided, however, that such Member shall not be permitted to Transfer its Membership Interests to such third party as aforesaid if the purpose or intent of such merger, consolidation, similar business combination transaction or sale is to circumvent or avoid the application of Sections 10.01(c) and 10.04 to the Transfer of such Member's Membership Interests to such third party.

(c) Transfer by Sale to Third Party. At any time after December 31, 2002, a Member may sell all (but not part) of its Membership Interests (and, in the case of Ashland, the Ashland LOOPLOCAP Interest) to any person (other than a Transfer by operation of law pursuant to Section 10.01(b), a Transfer to a Wholly Owned Subsidiary pursuant to Section 10.01(d) or a Transfer by Ashland to Marathon pursuant to Section 10.01(e)) if (i) it shall first have offered the other Member the opportunity to purchase such Membership Interests (and, in the case of Ashland, the Ashland LOOPLOCAP Interest) pursuant to the right of first refusal procedures set forth in Section 10.04, (ii) such sale is completed within the time periods specified in Section 10.04, (iii) the other Member shall have approved the purchaser of such Membership Interests (and, in the case of Ashland, the Ashland LOOPLOCAP Interest), which approval shall not be unreasonably withheld or delayed and (iv) it shall use its commercially reasonable best efforts to (A) terminate the outstanding Original Lease underlying each of its Designated Sublease Agreements on or prior to the date of such Transfer and (B) contribute the related Subleased Property to the Company or one of its subsidiaries at no cost to the Company or such subsidiary on or prior to the date of such Transfer; provided, however, that (i) such Member shall not be obligated to pay more than a reasonable amount as consideration therefor to, or make more than a reasonable financial accommodation in favor of, or commence litigation against, a third party lessor with respect to any such underlying Original Lease in order to obtain any consent required from such lessor and (ii) any additional cost associated with exercising an option under the Original Lease to purchase Subleased Property or to terminate the Original Lease shall be deemed not to constitute an obligation to pay more than a reasonable amount. In the event that such Member is unable to terminate an outstanding Original Lease in accordance with this Section 10.02(b), then (i) the Company shall be entitled to continue to sublease the Subleased Property pursuant to the related Designated Sublease Agreement until the term of the Original Lease expires, (ii) the Member shall continue to use its commercially reasonable best efforts to terminate the Original Lease and contribute the Subleased Property to the Company as provided above; provided, however that (A) such Member shall not be obligated to pay more than a reasonable amount as consideration therefor to, or make more than a reasonable financial accommodation in favor of, or commence litigation against, a third party lessor with respect to any such Original Lease in order to obtain any consent required from such lessor and (b) any additional cost associated with exercising an option under the Original Lease to purchase Subleased Property or to terminate the Original Lease shall be deemed not to constitute an obligation to pay more than a reasonable amount and (iii) if such Member subsequently acquires fee title to the Subleased Property, such Member shall contribute such Subleased Property to the Company or one of its subsidiaries at no cost to the Company or such subsidiary at such time. It is expressly understood and agreed that, in determining whether to reasonably withhold its approval of a proposed purchaser of Marathon's Membership Interests pursuant to this Section 10.01(c), Ashland shall be entitled to consider the creditworthiness of such proposed purchaser, including whether such proposed purchaser is likely to be able to perform all of Marathon's and USX's respective obligations under the PutCall, Registration

Rights and Standstill Agreement.

(d) Transfer to Wholly Owned Subsidiary. A Member may Transfer all (but not part) of its Membership Interests at any time to a Wholly Owned Subsidiary of such Member if (i) such Member shall have received an opinion from nationally recognized tax counsel acceptable to both Members that such Transfer will not result in a termination of the status of the Company as a partnership for Federal income tax purposes and (ii) the transferring Member enters into an agreement with the other Member providing that so long as such Wholly Owned Subsidiary holds such transferring Member's Membership Interests, such Wholly Owned Subsidiary shall remain a Wholly Owned Subsidiary of such transferring Member.

(e) Transfer Pursuant to PutCall, Registration Rights and Standstill Agreement. Ashland may Transfer all of its Membership Interests to Marathon in connection with the exercise by Marathon of its Marathon Call Right or its Special Termination Right or the exercise by Ashland of its Ashland Put Right. In addition, Marathon may Transfer all of its Membership Interests to Ashland in connection with the exercise by Ashland of its Special Termination Right.

(f) Consequences of Permitted Transfers. (i) In connection with any Transfer by a Member to a third party transferee pursuant to Section 10.01(b), (A) such third party transferee shall at the time of such Transfer become subject to all of such transferring Member's obligations hereunder and shall succeed to all of such transferring Member's rights hereunder and (B) such transferring Member shall be relieved of all of its obligations hereunder other than with respect to any default hereunder by such transferring Member or any of its Affiliates hereunder that occurred prior to the time of such Transfer.

(ii) In connection with any Transfer by a Member to a third party transferee or to the other Member pursuant to Section 10.01(c), (A) such third party transferee or such other Member shall at the time of such Transfer become subject to all of such transferring Member's obligations hereunder and shall succeed to all of such transferring Member's rights hereunder and (B) such transferring Member shall at the time of such Transfer be relieved of all of its obligations hereunder other than with respect to any default hereunder by such transferring Member or any of its Affiliates that occurred prior to the time of such Transfer.

(iii) In connection with any Transfer by a Member to a Wholly Owned Subsidiary of such Member pursuant to Section 10.01(d), (A) such Wholly Owned Subsidiary shall at the time of such Transfer become subject to all of such Member's obligations hereunder and shall succeed to all of such Member's rights hereunder and (B) such Member shall not be relieved of its obligations hereunder without the prior written consent of the other Member, which consent shall not be unreasonably withheld or delayed.

(iv) In connection with any Transfer by Ashland to Marathon pursuant to Section 10.01(e), (A) Marathon shall at the time of such Transfer become subject to all of Ashland's obligations hereunder and shall succeed to all of Ashland's rights hereunder and (B) Ashland shall at the time of such Transfer be relieved of all of its obligations hereunder other than with respect to any default hereunder by Ashland or any of its Affiliates that occurred prior to the Exercise Date (as such term is defined in the PutCall, Registration Rights and Standstill Agreement).

(v) In connection with any Transfer by Marathon to Ashland pursuant to Section 10.01(e), (A) Ashland shall at the time of such Transfer become subject to all of Marathon's obligations hereunder and shall succeed to all of Marathon's rights hereunder and (B) Marathon shall at the time of such Transfer be relieved of all of its obligations hereunder other than with respect to any default hereunder by Marathon or any of its Affiliates that occurred prior to the Special Termination Exercise Date (as such term is defined in the PutCall, Registration Rights and Standstill Agreement).

(vi) In connection with any Transfer by Ashland to a third party transferee pursuant to Section 10.01(b), 10.01(c) or 10.01(d), such third party transferee shall at the time of such Transfer succeed to all of Ashland's veto rights under Section 9.02(c); provided, that if Ashland Transfers its Membership Interests to a third party transferee pursuant to Section 10.01(c), such third party transferee shall not thereafter be permitted to transfer its veto rights under Section 9.02(c) to another third party transferee pursuant to Section 10.01(c).

(vii) In connection with any Transfer by a Member to a third party transferee pursuant to this Article X, such transferring Member shall retain all of the rights granted to a Member under Article VII to examine the books and records of the Company and to receive financial statements and reports prepared by the Company until such time following such Transfer as such transferring Member ceases to have any liability under Article IX of the Asset Transfer and Contribution Agreement.

(g) Consequences of an Unpermitted Transfer. Any Transfer of a Member's Membership Interests made in violation of the applicable provisions of this Agreement shall be void and without legal effect.

SECTION 10.02. Conditions for Admission.

No transferee of all of the Membership Interests of any Member shall be admitted as a Member hereunder unless (a) such Membership Interests are Transferred to a person in compliance with the applicable provisions of this Agreement, (b) such transferee shall have executed and delivered to the Company such instruments as the Board of Managers deems necessary or desirable in its reasonable discretion to effectuate the admission of such transferee as a Member and to confirm the agreement of such transferee or recipient to be bound by all the terms and provisions of this Agreement with respect to the Membership Interests acquired by such transferee and (c) such transferee shall have executed and delivered an assignment and assumption agreement pursuant to Section 15.04 of the PutCall, Registration Rights and Standstill Agreement.

SECTION 10.03. Allocations and Distributions.

Subject to applicable Treasury Regulations, upon the Transfer of all the Membership Interests of a Member as herein provided, the Profit or Loss of the Company attributable to the Membership Interests so transferred for the Fiscal Year during which such Transfer occurs shall be allocated between the transferor and transferee as of the date set forth on the written assignment, and such allocation shall be based upon any permissible method agreed to by the Members that is provided for in Code Section 706 and the Treasury Regulations issued thereunder. Except as otherwise expressly provided in Section 5.01 of the PutCall, Registration Rights and Standstill Agreement, distributions shall be made to the holder of record of the Membership Interests on the date of distribution.

SECTION 10.04. Right of First Refusal.

(a) If a Member (the "Selling Member") shall desire to sell all (but not part) of its Membership Interests (which, for purposes of this Section 10.04, shall be deemed to include, in the case of Ashland, the Ashland LOOPLOCAP Interest) pursuant to Section 10.01(c), then the Selling Member shall give notice (the "Offer Notice") to the other Member, identifying the proposed purchaser from whom it has received a bona fide offer and setting forth the proposed sale price (which shall be payable only in cash or purchase money obligations secured solely by the Membership Interests being sold) and the other material terms and conditions upon which the Selling Member is proposing to sell such Membership Interests to such proposed purchaser. No such sale shall encompass or be conditioned upon the sale or purchase of any property other than such Membership Interests (other than, in the case of Ashland, the Ashland LOOPLOCAP Interest). The other Member shall have 30 days from receipt of the Offer Notice to elect, by notice to the Selling Member, to purchase the Membership Interests offered for sale on the terms and conditions set forth in the Offer Notice.

(b) If a Member makes such election, the notice of election shall state a closing date not later than 60 days after the date of the Offer Notice. If such Member breaches its obligation to purchase the Membership Interests of the Selling Member on the same terms and conditions as those contained in the Offer Notice after giving notice of its election to make such purchase (other than where such breach is due to circumstances beyond such Member's reasonable control), then, in addition to all other remedies available, the Selling Member may, at any time for a period of 270 days after such default, sell such Membership Interests to any person at any price and upon any other terms without further compliance with the procedures set forth in Section 10.04.

(c) If the other Member gives notice within the 30-day period following the Offer Notice from the Selling Member that it elects not to purchase the Membership Interests, the Selling Member may, within 120 days after the end of such 30-day period (or 270 days in the case where such parties have received a second request under HSR), sell such Membership Interests to the identified purchaser (subject to clause (iii) of Section 10.01(c)) on terms and conditions no less favorable to the Selling Member than the terms and conditions set forth in such Offer Notice. In the event the Selling Member shall desire to offer the Membership Interests for sale on terms and conditions less favorable to it than those previously set forth in an Offer Notice, the procedures set forth in this Section 10.04 must again be initiated and applied with respect to the terms and conditions as modified.

SECTION 10.05. Restriction on Resignation or Withdrawal.

Except in connection with a Transfer permitted pursuant to Section 10.01, neither Member shall resign or withdraw from the Company without the consent of the other Member. Any purported resignation or withdrawal from the Company in violation of this Section 10.05 shall be null and void and of no force or effect.

ARTICLE XI
Liability, Exculpation and Indemnification

SECTION 11.01. Liability.

Except as otherwise provided by the Delaware Act, the debts, obligations and liabilities of the Company, whether arising in contract, tort or otherwise, shall be solely the debts, obligations and liabilities of the Company, and no Covered Person shall be obligated personally for any such debt, obligation or liability of the Company solely by reason of being a Covered Person.

SECTION 11.02. Exculpation.

(a) No Covered Person shall be liable to the Company or any other Covered Person for any loss, damage or claim incurred by reason of any act or omission performed or omitted by such Covered Person in good faith on behalf of the Company and in a manner reasonably believed to be within the scope of authority conferred on such Covered Person by this Agreement, except that a Covered Person shall be liable for any such loss, damage or claim incurred by reason of such Covered Person's gross negligence, wilful misconduct or breach of Section 12.02.

(b) A Covered Person shall be fully protected in relying in good faith upon the records of the Company and upon such information, opinions, reports or statements presented to the Company by any person as to any matters the Covered Person reasonably believes are within such other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the Company, including information, opinions, reports or statements as to the value and amount of the assets, liabilities, profits, losses, or any other facts pertinent to the existence and amount of assets from which distributions to Members might properly be paid.

SECTION 11.03. Indemnification.

To the fullest extent permitted by Applicable Law, a Covered Person shall be entitled to indemnification from the Company for any loss, damage or claim incurred by such Covered Person by reason of any act or omission performed or omitted by such Covered Person in good faith on behalf of the Company and in a manner reasonably believed to be within the scope of authority conferred on such Covered Person by this Agreement, except that no Covered Person shall be entitled to be indemnified in respect of any loss, damage or claim incurred by such Covered Person by reason of gross negligence, wilful misconduct or breach of Section 12.02 with respect to such acts or omissions; provided, however, that any indemnity under this Section 11.03 shall be provided out of and to the extent of Company assets only, and no Covered Person shall have any personal liability on account thereof.

ARTICLE XII
Fiduciary Duties

SECTION 12.01. Duties and Liabilities of Covered Persons.

To the extent that, at law or in equity, a Covered Person has duties (including fiduciary duties) and liabilities relating thereto to the Company or to any other Covered Person, a Covered Person acting under this Agreement shall not be liable to the Company or to any other Covered Person for its good faith reliance on the provisions of this Agreement. The provisions of this Agreement, to the extent that they expand or restrict the duties and liabilities of a Covered Person otherwise existing at law or in equity, are agreed by the parties hereto to replace such other duties and liabilities of such Covered Person.

SECTION 12.02. Fiduciary Duties of Members of the Company and Members of the Board of Managers.

Each Member and each member of the Board of Managers shall have the fiduciary duties of loyalty and care (similar to the fiduciary duties of loyalty and care of directors of a business corporation governed by the General Corporation Law of the State of Delaware) to the Company and all of the Members. Notwithstanding any provision of this Agreement to the contrary, each Member and each member of the Board of Managers agrees to and shall exercise good faith, fairness and loyalty to the Company and to all of the Members, and shall make all decisions in a manner that such Member or such member of the Board of Managers reasonably believes to be in the best interest of the Company and all of the Members. Notwithstanding the foregoing, this Section 12.02 is not intended to limit a Member's ability to exercise or enforce any of its rights and remedies under this Agreement and the other Transaction Documents in good faith, including, without limitation, Article IX of the Asset Transfer and Contribution Agreement.

ARTICLE XIII
Dispute Resolution Procedures

SECTION 13.01. General.

All controversies, claims or disputes between the Members or between the Company and either Member that arise out of or relate to this Agreement or the construction, interpretation, performance, breach, termination, enforceability or validity of this Agreement, or the commercial, economic or other relationship of the parties hereto, whether such claim is based on rights, privileges or interests recognized by or based upon statute, contract, tort, common law or otherwise and whether such claim existed prior to or arises on or after the date of this Agreement (a "Dispute") shall be resolved in accordance with the provisions of this Article XIII (except as otherwise expressly provided in Sections 6.06 and 6.08). Notwithstanding anything to the contrary contained in this Article XIII, nothing in this Article XIII shall limit the ability of the directors and officers of either Member from communicating directly with the directors and officers of the other Member.

SECTION 13.02. Dispute Notice and Response.

Either Member may give the other Member written notice (a "Dispute Notice") of any Dispute which has not been resolved in the normal course of business. Within fifteen Business Days after delivery of the Dispute Notice, the receiving Member shall submit to the other Member a written response (the "Response"). The Dispute Notice and the Response shall each include (i) a statement setting forth the position of the Member giving such notice, a summary of the arguments supporting such position and, if applicable, the relief sought and (ii) the name and title of a senior manager of such Member who has authority to settle the Dispute and will be responsible for the negotiations related to the settlement of the Dispute (the "Senior Manager").

SECTION 13.03. Negotiation Between Senior Managers.

(a) Within 10 days after delivery of the Response provided for in Section 13.02, the Senior Managers of both Members shall meet or communicate by telephone at a mutually acceptable time and place, and thereafter as often as they reasonably deem necessary, and shall negotiate in good faith to attempt to resolve the Dispute that is the subject of such Dispute Notice. If such Dispute has not been resolved within 45 days after delivery of the Dispute Notice, then the Members shall attempt to settle the Dispute pursuant to Section 13.04.

(b) All negotiations between the Senior Managers pursuant to this Section 13.03 shall be treated as compromise and settlement negotiations. Nothing said or disclosed, nor any document produced, in the course of such negotiations which is not otherwise independently discoverable shall be offered or received as evidence or used for impeachment or for any other purpose in any current or future arbitration or litigation.

SECTION 13.04. Negotiation Between Chief Executive Officer and President.

(a) If the Dispute has not been resolved by negotiation between the Senior Managers pursuant to Section 13.03, then within 10 Business Days after the expiration of the 45 day period provided in Section 13.03, the Chief Executive Officer of Ashland and the President of Marathon shall meet or communicate by telephone at a mutually acceptable time and place, and thereafter as often as they reasonably deem necessary, and shall negotiate in good faith to attempt to resolve the Dispute that is the subject of such Dispute Notice. If such Dispute has not been resolved within 20 Business Days after the expiration of the 45 day period provided in Section 13.03, then (i) if the Dispute relates solely to (A) a claim by a Member or the Board of Managers that the other Member has failed to pay the Company a Designated Sublease Amount or an amount in respect of a Member-Funded Capital Expenditure, a Member-Funded Indemnity Expenditure or an Agreed Additional Capital Contribution required to be made by it pursuant to Section 4.02 (a "Disputed Capital Contribution Amount"), (B) the determination of any of the following amounts with respect to any period: distributions pursuant to Article V; the Aggregate Tax Rate; Adjusted DD&A; Adjusted EBITDA; EBITDA; Distributable Cash; the Average Annual Level and adjustments to Adjustable

Amounts; the Normal Annual Capital Budget Amount; Ordinary Course Lease Expenses; Profit and Loss; the Tax Distribution Amount; the Tax Liability of any Member; and the determination of fair market value of property distributed in kind under Section 15.03, (C) the resolution of any dispute arising under Section 8.11(b) with respect to Affiliate Transactions or (D) the resolution of any dispute arising under Section 8.12 with respect to certain Affiliate Transactions related to Crude Oil Purchases and Shared Services (any Dispute relating to any of the matters set forth in clause (A), (B), (C) or (D) above being referred to herein as an "Arbitratable Dispute"), such Dispute shall be settled pursuant to the arbitration procedures set forth in Appendix B and (ii) if the Dispute does not relate primarily to an Arbitratable Dispute, each party hereto shall be permitted to take such actions at law or in equity as it is otherwise permitted to take or as may be available under Applicable Law.

(b) All negotiations between the Chief Executive Officer of Ashland and the President of Marathon pursuant to this Section 13.04 shall be treated as compromise and settlement negotiations. Nothing said or disclosed, nor any document produced, in the course of such negotiations which is not otherwise independently discoverable shall be offered or received as evidence or used for impeachment or for any other purpose in any current or future arbitration or litigation.

SECTION 13.05. Right to Equitable Relief Preserved.

Notwithstanding anything in this Agreement or Appendix B to the contrary, either Member or the Company may at any time seek from any court of the United States located in the State of Delaware or from any Delaware state court, any interim, provisional or injunctive relief that may be necessary to protect the rights or property of such party or maintain the status quo before, during or after the pendency of the negotiation process or the arbitration proceeding or any other proceeding contemplated by Section 13.03 or 13.04.

ARTICLE XIV
Rights and Remedies with Respect to Monetary Disputes

SECTION 14.01. Ability of Company to Borrow to Fund Disputed Monetary Amounts.

(a) If the Company or a Member on behalf of the Company (a "Non-Delinquent Member") claims that the other Member (a "Delinquent Member") owes the Company a monetary amount in respect of either (i) a Disputed Capital Contribution Amount or (ii) an indemnification obligation under Article IX of the Asset Transfer and Contribution Agreement that the Company or the Non-Delinquent Member claims the Delinquent Member owes the Company and is either (A) past due or (B) in dispute (a "Disputed Indemnification Amount") (each such claim described in clauses (i) and (ii) above being a "Monetary Dispute", and each such claimed amount being a "Disputed Monetary Amount"), and if (1) the Disputed Monetary Amount itself, or when added together all other Disputed Monetary Amounts, exceeds $7.5 million; (2) the Board of Managers (by vote of a majority of the Representatives of the Non-Delinquent Member at a special or regular meeting of the Board of Managers (which majority shall constitute a quorum for purposes of the transaction of such business)) has determined that an out-of-pocket disbursement of such Disputed Monetary Amount or any portion thereof by the Company or one of its subsidiaries within the next twelve months is reasonably necessary for the operation and conduct of the Company's Business and, accordingly, that such amount should be paid within the next twelve months; (3) the aggregate amount of all Disputed Monetary Amounts (or portions thereof) that the Board of Managers shall have determined pursuant to clause (2) above should be paid within the next twelve months (such aggregate amount being the "Additional Required Cash Amount") exceeds $7.5 million; (4) postponement by the Company or such subsidiary of such disbursement until such time as the Monetary Dispute is reasonably likely to be finally resolved pursuant to an arbitration proceeding in accordance with Appendix B to this Agreement or Appendix B to the Asset Transfer and Contribution Agreement, as applicable (an "Arbitration Proceeding"), would have, or would reasonably be expected to have, a Material Adverse Effect on the Company's Business; and (5) the Delinquent Member has not paid the Company the Disputed Monetary Amount pursuant to Section 14.02 or otherwise, then the Board of Managers (by vote of a majority of the Representatives of the Non-Delinquent Member at a special or regular meeting of the Board of Managers (which majority shall constitute a quorum for purposes of the transaction of such business)) shall be permitted to cause the Company to incur an amount of Indebtedness equal to such Additional Required Cash Amount, which Indebtedness may be borrowed from a third party or the Non-Delinquent Member.

(b) If the Non-Delinquent Member lends the Company the Additional Required Cash Amount pursuant to Section 14.01(a), then (i) the amount actually lent by the Non-Delinquent Member (the "Advanced Amount") and all accrued interest thereon shall be due and payable on the Arbitration Payment Due Date (provided that the Company shall be permitted to prepay the Advanced Amount in whole or in part at any time prior to such date); and (ii) the Advanced Amount shall bear interest at the Base Rate from the date on which such advance is made until the date that the Advanced Amount, together with all interest accrued thereon, is repaid to the Non-Delinquent Member.

SECTION 14.02. Interim Payment of Disputed Monetary Amount.

In order to reduce the amount of liquidated damages that a Delinquent Member would be required to pay to the Company pursuant to Section 14.03 in the event that such Delinquent Member loses in an Arbitration Proceeding with respect to a Monetary Dispute, the Delinquent Member shall be permitted to pay the Company the related Disputed Monetary Amount prior to the commencement of such Arbitration Proceeding. The Arbitration Tribunal or Sole Arbitrator, as applicable, shall not take into consideration in determining the liability of the Delinquent Member, a decision by such Delinquent Member to pay the Disputed Monetary Amount prior to the commencement of the Arbitration Proceeding.

SECTION 14.03. Liquidated Damages.

(a) No Interim Payment of Disputed Monetary Amount—Delinquent Member is Found Liable for Final

Monetary Amount. If (i) it is finally determined in an Arbitration Proceeding that a Delinquent Member owes the Company a monetary amount in respect of (A) a Disputed Capital Contribution Amount or (B) a Disputed Indemnification Amount (each such finally determined amount being a "Final Monetary Amount") and (ii) the Delinquent Member had not paid the Company the Disputed Monetary Amount prior to the commencement of such Arbitration Proceeding pursuant to Section 14.02, then the Delinquent Member shall promptly, and in any event on or before the tenth Business Day following the date on which the Arbitration Tribunal or Sole Arbitrator makes its final determination (such tenth Business Day being the "Arbitration Payment Due Date"), pay to the Company (A) the Final Monetary Amount, together with interest, accrued from the commencement of the Arbitration Proceeding to the date that the Delinquent Member pays the Final Monetary Amount to the Company, on the Final Monetary Amount, at a rate per annum equal to (1) during the period from the commencement of the Arbitration Proceeding to the Arbitration Payment Due Date, the Prime Rate and (2) at any time thereafter, 150% of the Prime Rate, in each case, with daily accrual of interest, plus (B) an amount equal to 25% of the Final Monetary Amount.

(b) Interim Payment of Disputed Monetary Amount—Delinquent Member is Found Liable for the Same Amount. If (i) it is finally determined in an Arbitration Proceeding that a Delinquent Member owes the Company a Final Monetary Amount, (ii) the Final Monetary Amount is equal to the Disputed Monetary Amount and (iii) the Delinquent Member had paid the Company the Disputed Monetary Amount prior to the commencement of such Arbitration Proceeding pursuant to Section 14.02, then if the Final Monetary Amount is equal to the Disputed Monetary Amount, the Delinquent Member shall not owe the Company any other amount in respect of the Monetary Dispute.

(c) Interim Payment of Disputed Monetary Amount—Delinquent Member is Found Liable for a Greater Amount. If (i) it is finally determined in an Arbitration Proceeding that a Delinquent Member owes the Company a Final Monetary Amount, (ii) the Final Monetary Amount is greater than the Disputed Monetary Amount and (iii) the Delinquent Member had paid the Company the Disputed Monetary Amount prior to the commencement of such Arbitration Proceeding pursuant to Section 14.02, then the Delinquent Member shall promptly, and in any event on or before the Arbitration Payment Due Date, pay to the Company an amount (an "Additional Monetary Amount") equal to (A) the Final Monetary Amount less (B) the Disputed Monetary Amount, together with interest, accrued from the commencement of the Arbitration Proceeding to the date that the Delinquent Member pays the Additional Monetary Amount to the Company, on the Additional Monetary Amount, at a rate per annum equal to (1) during for the period from the commencement of the Arbitration Proceeding to the Arbitration Payment Due Date, the Prime Rate and (2) at any time thereafter, 150% of the Prime Rate, in each case, with daily accrual of interest.

(d) Interim Payment of Disputed Monetary Amount—Delinquent Member is Found Liable for a Lesser Amount. If (i) it is finally determined in an Arbitration Proceeding that a Delinquent Member owes the Company a Final Monetary Amount, (ii) the Final Monetary Amount is less than the Disputed Monetary Amount and (iii) the Delinquent Member had paid the Company the Disputed Monetary Amount prior to the commencement of such Arbitration Proceeding, then the Company shall promptly, and in any event on or before the Arbitration Payment Due Date, repay to the Delinquent Member an amount (a "Refundable Amount") equal to (A) the Disputed Monetary Amount less (B) the Final Monetary Amount, together with interest, accrued from the commencement of the Arbitration Proceeding to the date that the Company repays the Refundable Amount to the Delinquent Member, on the Refundable Amount, at a rate per annum equal to (1) during the period from the commencement of the Arbitration Proceeding to the Arbitration Payment Due Date, the Prime Rate and (2) at any time thereafter, 150% of the Prime Rate, in each case, with daily accrual of interest.

(e) Interim Payment of Disputed Monetary Amount—Delinquent Member is Found Not Liable for Disputed Monetary Amount. If (i) it is finally determined in an Arbitration Proceeding that a Delinquent Member does not owe the Company the related Disputed Monetary Amount and (ii) the Delinquent Member had paid the Company the Disputed Monetary Amount prior to the commencement of such Arbitration Proceeding, then the Company shall promptly, and in any event on or before the Arbitration Payment Due Date, repay to the Delinquent Member an amount equal to the Disputed Monetary Amount, together with interest, accrued from the commencement of the Arbitration Proceeding to the date that the Company repays the Disputed Monetary Amount to the Delinquent Member, on the Disputed Monetary Amount, at a rate per annum equal to (A) during the period from the commencement of the Arbitration Proceeding to the Arbitration Payment Due Date, the Prime Rate and (B) at any time thereafter, 150% of the Prime Rate, in each case, with daily accrual of interest.

SECTION 14.04. Right of Set-Off.

Notwithstanding any provision to the contrary contained in this Agreement, if at the time of a Distribution Date a Delinquent Member has failed to pay the Company an amount that it was required pursuant to Section 14.03 to pay to the Company on or before such Distribution Date, then on such Distribution Date, the Company shall be permitted to set off from the distribution that it would otherwise be required to make to such Delinquent Member pursuant to Section 5.01 on such Distribution Date, an amount equal to such unpaid amount. If the amount of the distribution that such Delinquent Member was otherwise entitled to receive pursuant to Section 5.01 on such Distribution Date is less than the aggregate amount that such Delinquent Member owes to the Company pursuant to Section 14.03, then the Company shall be permitted to set off from subsequent distributions that it would otherwise make to such Delinquent Member pursuant to Section 5.01 the remaining unpaid amount until such time as such remaining unpaid amount shall have been paid in full. A Delinquent Member's interest in distributions to be made to such Delinquent Member pursuant to Section 5.01 shall be reduced by any amount set off by the Company against such distributions pursuant to this Section 14.04(a).

SECTION 14.05. Security Interest.

(a) Each Member hereby agrees that if (i) it has failed to pay the Company an amount that it was required to pay to the Company pursuant to Section 14.03 on or prior to the related Arbitration Payment Due Date, and (ii) the Board of Managers (by vote of a majority of the Representatives of the other Member at a special or regular meeting of the Board of Managers (which majority shall constitute a quorum for purposes of the transaction of such business) so requests, such Member shall (A) on the Business Day next following such Arbitration Payment Due Date, grant to the Company, as security for the performance of its obligation to pay the Company such amount owed (but for no other amount), a first priority security interest in its Membership Interests and the proceeds thereof (a "Security Interest"), all under the Uniform Commercial Code of the State of Delaware and (ii) promptly thereafter, execute and deliver to the Company all financing statements and other instruments that the Board of Managers (by vote of a majority of the Representatives of the other Member at a special or regular meeting of the Board of Managers (which majority shall constitute a quorum for purposes of the transaction of such business)) may request to effectuate and carry out the preceding provisions of this Section 14.05(a). The Company shall be entitled to all the rights and remedies of a secured party under the Uniform Commercial Code of the State of Delaware with respect to any Security Interest granted by such Member. At the option of the Company, this Agreement or a carbon, photographic, or other copy hereof may serve as a financing statement with respect to any such Security Interest. For purposes of perfecting a Security Interest, a Member's Membership Interests shall be deemed to be a "security" governed by Chapter 8 of the Delaware Uniform Commercial Code and as such term is therein defined in Section 8-102(c) thereunder.

(b) If the Company incurs Indebtedness pursuant to Section 14.01 by borrowing from a Non-Delinquent Member, the Company shall be permitted to assign all its rights with respect to a Security Interest granted to it pursuant to Section 14.05(a) to such Non-Delinquent Member as security for such Indebtedness; provided that such Non-Delinquent Member shall not be permitted to assign such Security Interest to a third party.

ARTICLE XV
Dissolution and Termination

SECTION 15.01. Dissolution.

The Company shall be dissolved and its business and affairs wound up upon the earliest to occur of any one of the following events:

(a) the expiration of the Term of the Company;

(b) the sale or other disposition of all or substantially all the property of the Company;

(c) the written consent of both Members;

(d) the unanimous agreement of all Representatives on the Board of Managers;

(e) the bankruptcy, involuntary liquidation or dissolution of either Member; or

(f) the entry of a decree of judicial dissolution pursuant to Section 18-802 of the Delaware Act.

The bankruptcy, involuntary liquidation of dissolution of a Member shall cause a Member to cease to be a member of the Company. Notwithstanding the foregoing, the Company shall not be dissolved and its business and affairs shall not be wound up upon the occurrence of any event specified in (i) clause (e) above if within 90 days after the date on which such event occurs, the remaining Member elects in writing to continue the business of the Company or (ii) clause (a) above if a Non-Terminating Member purchases the Membership Interests of the Terminating Member pursuant to its Special Termination Right. Except as provided in this paragraph and Section 15.01(e), and to the fullest extent permitted by the Delaware Act, the occurrence of an event that causes a Member to cease to be a member of the Company shall not cause the Company to be dissolved or its business or affairs to be wound up, and upon the occurrence of such an event, the business of the Company shall continue without dissolution.

SECTION 15.02. Winding Up of Company.

Upon dissolution, the Company's business shall be liquidated in an orderly manner. The Board of Managers shall act as the liquidating trustee (unless the Board of Managers elects to appoint a liquidating trustee) to wind up the affairs of the Company pursuant to this Agreement. In performing its duties, the liquidating trustee is authorized to sell, distribute, exchange or otherwise dispose of the assets of the Company in accordance with the Delaware Act and in any reasonable manner that the liquidating trustee shall determine to be in the best interest of the Members or their successors-in-interest.

SECTION 15.03. Distribution of Property.

In the event the Board of Managers determines that it is necessary in connection with the liquidation of the Company to make a distribution of property in kind, such property shall be transferred and conveyed to the Members so as to vest in each of them as a tenant in common an undivided interest in the whole of such property equal to their interests in the property based upon the amount of cash that would be distributed to each of the Members in accordance with Article V if such property were sold for an amount of cash equal to the fair market value of such property, as determined and approved by the Board of Managers pursuant to a vote in accordance with Section 8.07(b).

SECTION 15.04. Time Limitation.

Any liquidating distribution pursuant to this Article XV shall be made no later than the later of (a) the end of the taxable year during which such liquidation occurs and (b) 90 days after the date of such liquidation.

SECTION 15.05. Termination of Company.

The Company shall terminate when all assets of the Company, after payment of or due provision for all debts, liabilities and obligations of the Company, shall have been distributed to the Members in the manner provided for in this Agreement, and the Certificate of Formation shall have been canceled in the manner provided by the Delaware Act.

ARTICLE XVI
Miscellaneous

SECTION 16.01. Notices.

Any notice, consent or approval to be given under this Agreement shall be in writing and shall be deemed to have been given if delivered: (i) personally by a reputable courier service that requires a signature upon delivery; (ii) by mailing the same via registered or certified first-class mail, postage prepaid, return receipt requested; or (iii) by telecopying the same with receipt confirmation (followed by a first-class mailing of the same) to the intended recipient. Any such writing will be deemed to have been given: (a) as of the date of personal delivery via courier as described above; (b) as of the third calendar day after depositing the same into the custody of the postal service as evidenced by the date-stamped receipt issued upon deposit of the same into the mails as described above; and (c) as of the date and time electronically transmitted in the case of telecopy delivery as described above, in each case addressed to the intended party at the address set forth below:

To the Board of Managers:
Marathon Ashland Petroleum LLC
539 South Main Street
Findlay, Ohio 45840
Attn: General Counsel
Phone: (419) 422-2121
Fax: (419) 421-4115

To Marathon:
Marathon Oil Company
5555 San Felipe
P.O. Box 3128
Houston, TX 77056-2723
Attn: General Counsel
Phone: (713) 296-4137
Fax: (713) 296-4171

To Ashland:
Ashland Inc.
1000 Ashland Drive
Russell, KY 41169
Attn: General Counsel
Phone: (606) 329-3333
Fax: (606) 329-3823

Any party may designate different addresses or telecopy numbers by notice to the other parties.

SECTION 16.02. Merger and Entire Agreement.

This Agreement (including the Exhibits, Schedules and Appendices attached hereto), together with the other Transaction Documents (including the exhibits, schedules and appendices thereto) and certain other agreements executed contemporaneously with the Master Formation Agreement constitutes the entire Agreement of the parties hereto and supersedes any prior understandings, agreements, or representations by or among the parties hereto, written or oral, to the extent they relate in any way to the subject matter hereof.

SECTION 16.03. Assignment.

A party hereto shall not assign all or any of its rights, obligations or benefits under this Agreement to any third party otherwise than (i) in connection with a Transfer of its Membership Interests pursuant to Article X, (ii) with the prior written consent of the other party hereto, which consent may be withheld in such party's sole discretion, (iii) the granting by a Member of a Security Interest to the Company pursuant to Section 14.05 or (iv) pursuant to Article V of the PutCall, Registration Rights and Standstill Agreement, and any attempted assignment not in compliance with this Section 16.03 shall be void ab initio.

SECTION 16.04. Parties in Interest.

This Agreement shall inure to the benefit of, and be binding upon, the parties hereto and their respective successors, legal representatives and permitted assigns.

SECTION 16.05. Counterparts.

This Agreement may be executed in counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

SECTION 16.06. Amendment; Waiver.

This Agreement may not be amended except in a written instrument signed by each of the parties hereto and expressly stating it is an amendment to this Agreement. Any failure or delay on the part of any party hereto in exercising any power or right hereunder shall not operate as a waiver thereof, nor shall any single or partial exercise of any such right or power preclude any other or further exercise thereof or the exercise of any other right or power hereunder or otherwise available at law or in equity.

SECTION 16.07. Severability.

If any term, provision, covenant, or restriction of this Agreement or the application thereof to any person or circumstance, at any time or to any extent, is held by a court of competent jurisdiction or other Governmental Authority to be invalid, void or unenforceable, the remainder of the terms, provisions, covenants and restrictions of this Agreement (or the application of such provision in other jurisdictions or to persons or circumstances other than those to which it was held invalid or unenforceable) shall in no way be affected, impaired or invalidated, and to the extent permitted by Applicable Law, any such term, provision, covenant or restriction shall be restricted in applicability or reformed to the minimum extent required for such to be enforceable. This provision shall be interpreted and enforced to give effect to the original written intent of the parties hereto prior to the determination of such invalidity or unenforceability.

SECTION 16.08. GOVERNING LAW.

THIS AGREEMENT SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF DELAWARE, WITHOUT GIVING EFFECT TO THE PRINCIPLES OF CONFLICTS OF LAW THEREOF. THIS AGREEMENT SHALL BE CONSTRUED IN ACCORDANCE WITH SECTION 18-1101 OF THE DELAWARE ACT. ANY RIGHT TO TRIAL BY JURY WITH RESPECT TO ANY CLAIM OR PROCEEDING RELATED TO OR ARISING OUT OF THIS AGREEMENT, OR ANY TRANSACTION OR CONDUCT IN CONNECTION HEREWITH, IS WAIVED.

SECTION 16.09. Enforcement.

The parties hereto agree that irreparable damage would occur in the event that any of the provisions of this Agreement were not performed in accordance with their specific terms or were otherwise breached. It is accordingly agreed that the parties hereto shall be entitled to an injunction or injunctions to prevent breaches of this Agreement and to enforce specifically the terms and provisions of this Agreement in the Delaware Chancery Court; provided that if the Delaware Chancery Court does not have jurisdiction with respect to such matter, the parties hereto shall be entitled to enforce specifically the terms and provisions of this Agreement in any court of the United States located in the State of Delaware or in Delaware state court, this being in addition to any other remedy to which they are entitled at law or in equity. In addition, each of the parties hereto (i) consents to submit itself to the personal jurisdiction of the Delaware Chancery Court in the event that any dispute arises out of this Agreement or any of the transactions contemplated by this Agreement; provided that if the Delaware Chancery Court does not have jurisdiction with respect to any such dispute, such party consents to submit itself to the personal jurisdiction of any Federal court located in the State of Delaware or any Delaware state court, (ii) agrees to appoint and maintain an agent in the State of Delaware for service of legal process, (iii) agrees that it will not attempt to deny or defeat such personal jurisdiction by motion or other request for leave from any such court, (iv) agrees that it will not plead or claim in any such court that any action relating to this Agreement or any of the transactions contemplated by this Agreement in any such court has been brought in an inconvenient forum and (v) agrees that it will not initiate any action relating to this Agreement or any of the transactions contemplated by this Agreement in any court other than (1) the Delaware Chancery Court, or (2) if the Delaware Chancery Court does not have jurisdiction with respect to such action, a Federal court sitting in the State of Delaware or a Delaware state court.

SECTION 16.10. Creditors.

None of the provisions of this Agreement shall be for the benefit of or enforceable by any creditor of the Company or of any Member.

SECTION 16.11. No Bill for Accounting.

In no event shall either Member have any right to file a bill for an accounting or any similar proceeding.

SECTION 16.12. Waiver of Partition.

Each Member hereby waives any right to partition of the Company property.

SECTION 16.13. Table of Contents, Headings and Titles.

The table of contents and section headings of this Agreement and titles given to Exhibits and Schedules to this Agreement are for reference purposes only and are to be given no effect in the construction or interpretation of this Agreement.

SECTION 16.14. Use of Certain Terms; Rules of Construction.

As used in this Agreement, the words "herein", "hereof" and "hereunder" and other words of similar import refer to this Agreement as a whole and not to any particular paragraph, subparagraph, section, subsection or other subdivision. Whenever the context may require, any pronoun used in this Agreement shall include the corresponding masculine, feminine or neuter forms, and the singular form of nouns, pronouns and verbs shall include the plural and vice versa. Each party hereto agrees that any rule of construction to the effect that any ambiguities are to be resolved against the drafting party shall not be employed in the interpretation or construction of this Agreement or any Transaction Document.

SECTION 16.15. Holidays.

Notwithstanding any deadline for payment, performance, notice or election under this Agreement, if such deadline falls on a date that is not a Business Day, then the deadline for such payment, performance, notice or election will be extended to the next succeeding Business Day.

SECTION 16.16. Third Parties.

Nothing herein expressed or implied is intended or shall be construed to confer upon or give any person and their respective successors, legal representatives and permitted assigns any rights, remedies or basis for reliance upon, under or by reason of this Agreement.

SECTION 16.17. Liability for Affiliates.

Except where and to the extent that a contrary intention otherwise appears, where a Member undertakes to cause its Affiliates to take or abstain from taking any action, such undertaking shall mean (i) in the case of any Affiliate that is controlled by such Member, that such Member shall cause such Affiliate to take or abstain from taking such action and (ii) in the case of an Affiliate that controls or is under common control with such Member, that such Member shall use its commercially reasonable best efforts to cause such Affiliates to take or abstain from taking such action; provided, however, that such Member shall not be required to violate, or cause any director of such Affiliate to violate, any fiduciary duty to minority shareholders of such Affiliate.

IN WITNESS WHEREOF, this Agreement has been duly executed by the Members as of the day and year first above written.

MARATHON OIL COMPANY
by s Victor G. Beghini

Name: Victor G. Beghini
Title: President

ASHLAND INC.
by s Paul W. Chellgren

Name: Paul W. Chellgren
Title: Chairman of the Board
and Chief Executive Officer

[85244.6]

Each of the undersigned persons hereby accepts his rights and authority as a Representative and agrees to perform and discharge his duties and obligations as a member of the Board of Managers, in each case until such person's successor as a Representative is designated or until such person's resignation or removal as a Representative in accordance with this Agreement.

s Thomas J. Usher

Name: Thomas J. Usher

s Paul W. Chellgren

Name: Paul W. Chellgren

s Victor G. Beghini

Name: Victor G. Beghini

s J.A. Fred Brothers

Name: J. A. Fred Brothers

s John P. Surma

Name: John P. Surma

D-46

EXHIBIT D

PUT/CALL, REGISTRATION RIGHTS
and
STANDSTILL AGREEMENT

Dated as of January 1, 1998

among Marathon Oil Company, USX Corporation, Ashland Inc., and Marathon Ashland Petroleum LLC

TABLE OF CONTENTS

ARTICLE XI
Covenants

ARTICLE XII
Standstill Agreement

ARTICLE XIII
Indemnification

ARTICLE XIV
Company Competitive Businesses;Detrimental Activities;
Limitations on the Company Entering into Valvoline's Business

ARTICLE XV
Survival; Assignment

ARTICLE XVI
Dispute Resolution Procedures

ARTICLE XVII
Miscellaneous

PUTCALL, REGISTRATION RIGHTS AND STANDSTILL AGREEMENT dated as of January 1, 1998 by and among MARATHON OIL COMPANY, an Ohio corporation ("Marathon"), USX CORPORATION, a Delaware corporation ("USX"), ASHLAND INC., a Kentucky corporation ("Ashland"), and MARATHON ASHLAND PETROLEUM LLC, a Delaware limited liability company (the "Company").

Preliminary Statement

WHEREAS Marathon and Ashland have previously entered into a Master Formation Agreement dated as of December 12, 1997, relating to the formation of the Company, which will own and operate certain of Marathon's and Ashland's respective petroleum supply, refining, marketing, and transportation businesses;

WHEREAS Marathon and Ashland have previously entered into an Asset Transfer and Contribution Agreement dated as of December 12, 1997, pursuant to which, among other things, Marathon and Ashland will transfer their respective Businesses (as defined below) to the Company;

WHEREAS Marathon, USX and Ashland have previously entered into a Parent Agreement dated as of December 12, 1997;

WHEREAS Marathon and Ashland have entered into an LLC Agreement dated as of the date hereof in order to establish the rights and responsibilities of each of them with respect to the governance, financing and operation of the Company;

WHEREAS Marathon and Ashland have agreed that under certain circumstances, Ashland will sell to Marathon and Marathon will purchase from Ashland all of Ashland's Membership Interests and the Ashland LOOPLOCAP Interest (each as defined below), upon the terms and subject to the conditions set forth herein;

WHEREAS Marathon and Ashland have agreed that if Marathon or Ashland elects to terminate the Term of the Company pursuant to Section 2.03 of the LLC Agreement, then the non-terminating Member shall have the right to purchase from the terminating Member all of the terminating Member's Membership Interests, upon the terms and subject to the conditions set forth herein;

WHEREAS Marathon and USX have agreed that Marathon and USX will grant Ashland certain registration rights with respect to any Securities (as defined below) that Marathon or USX issues to Ashland pursuant to this Agreement in connection with the purchase by Marathon of Ashland's Membership Interests and the Ashland LOOPLOCAP Interest, upon the terms and subject to the conditions set forth herein;

WHEREAS Marathon and USX have agreed to certain restrictions with respect to actions relating to Ashland Voting Securities (as defined below), upon the terms and subject to the conditions set forth herein;

WHEREAS Ashland has agreed to certain restrictions with respect to actions relating to USX Voting Securities (as defined below), upon the terms and subject to the conditions set forth herein; and

WHEREAS Marathon, USX and Ashland have agreed to certain restrictions with respect to certain of their business activities, upon the terms and subject to the conditions set forth herein.

NOW, THEREFORE, the parties hereto hereby agree as follows:

ARTICLE I
Certain Definitions; Adjustable Amounts; Representations and Warranties

SECTION 1.01. Definitions.

Defined terms used in this Agreement shall have the meanings ascribed to them by definition in this Agreement or in Appendix A. In addition, when used herein the following terms have the following meanings:

"Actively Traded Marathon Equity Securities" means Marathon Equity Securities for which there is an active trading market on the National Market System of the NASDAQ or on a National Securities Exchange during the period commencing 30 days prior to the Closing Date or applicable Installment Payment Date and ending on the Closing Date or such Installment Payment Date.

"Adjustable Amount" has the meaning set forth in Section 1.02.

"Adjustable Amounts Notice" has the meaning set forth in Section 1.02.

"Adjustment Year" has the meaning set forth in Section 1.02.

"Agreement" means this PutCall, Registration Rights, and Standstill Agreement, as the same may be amended, restated, supplemented or otherwise modified from time to time.

"Appraised Value Determination Date" has the meaning set forth in Section 6.01(c).

"Appraised Value of the Company" has the meaning set forth in Section 6.01(c).

"Ashland Designated Sublease Agreements" means the Ashland Sublease Agreements attached as Exhibits L-1, L-2, L-3 and L-4 to the Asset Transfer and Contribution Agreement.

"Ashland Exercise Period Distributions" has the meaning set forth in Section 5.01(a)(i).

"Ashland LOOPLOCAP Interest" means (i) the 4.0% interest in LOOP LLC owned by Ashland on the date hereof pursuant to the limited liability company agreement of LOOP LLC dated as of October 18, 1996, among Ashland, Marathon Pipe Line Company, Murphy Oil Corporation, Shell Oil Company and Texaco Inc. and (ii) the 86.20 shares of common stock of LOCAP, Inc. owned by Ashland, which shares on the date hereof represent an 8.6% interest in LOCAP, Inc.; provided that in the event there is a reclassification of the LOOP, LLC membership interests or the common stock of LOCAP, Inc. into one or more different types or classes of securities, the "Ashland LOOPLOCAP Interest" shall instead include such different types or classes of securities.

"Ashland LOOPLOCAP Irrevocable Proxy" has the meaning set forth in Section 9.02(e).

"Ashland LOOPLOCAP Revocable Proxy" has the meaning set forth in Section 5.02(c).

"Ashland Material Adverse Effect" means, for purposes of Section 1.03, either (i) a material adverse effect on the ability of Ashland to perform its obligations under this Agreement or (ii) an effect on the business, operations, assets, liabilities, results of operations, cash flows, condition (financial or otherwise) or prospects of Ashland's Business which results in a Loss of two million dollars ($2,000,000) or more, or, if such Loss is not susceptible to being measured in monetary terms, is otherwise materially adverse to Ashland's Business; provided that any such effect relating to or resulting from any change in the price of petroleum or petroleum byproducts, general economic conditions or local, regional, national or international industry conditions (including changes in financial or market conditions) shall be deemed not to constitute an Ashland Material Adverse Effect.

"Ashland Membership Interests" means the initial Membership Interests of Ashland on the date hereof, together with any additional Membership Interests that Ashland may hereafter acquire.

"Ashland Put Exercise Date" has the meaning set forth in Section 4.03.

"Ashland Put Exercise Notice" has the meaning set forth in Section 4.03.

"Ashland Put Price" has the meaning set forth in Section 4.01.

"Ashland Put Price Election Date" has the meaning set forth in Section 4.04(b).

"Ashland Put Price Election Notice" has the meaning set forth in Section 4.04(a).

"Ashland Put Right" has the meaning set forth in Section 4.01.

"Ashland Representatives Revocable Proxies" has the meaning set forth in Section 5.02(a).

"Ashland Special Termination Right" means the Special Termination Right granted to Ashland pursuant to Section 2.01.

"Ashland Voting Securities" means the securities of Ashland (i) having the power under ordinary circumstances to elect at least a majority of the board of directors of Ashland (whether or not any senior class of stock has voting power by reason of any contingency) or (ii) convertible into or exchangeable for securities of Ashland having the power under ordinary circumstances to elect at least a majority of the board of directors of Ashland (whether or not any senior class of stock has voting power by reason of any contingency).

"Average Annual Level" means for any twelve-month period ending on December 31 of any calendar year, the average of the level of the Price Index ascertained by adding the twelve monthly levels of the Price Index during such twelve-month period and dividing the total by twelve.

"Base Level" has the meaning set forth in the LLC Agreement.

"Base Rate" means a rate of interest closely approximating that of comparable term senior debt securities or debt obligations priced to trade at par issued by USX or issued by Marathon and fully guaranteed by USX, or issued by a firm of comparable credit standing.

"Blackout Period" has the meaning set forth in Section 10.01(b).

"Bulge Bracket Investment Banking Firm" means an investment banking firm that is listed as one of the top 10 investment banking firms for all domestic equity issues in terms of the aggregate dollar amount of such issues (with full credit given to the lead manager) as reported in the latest issue of Investment Dealers' Digest or a publication (or otherwise) of similar national repute which provides rankings of investment banking firms by size of domestic issues.

"Bulk Motor Oil Business" has the meaning set forth in Section 14.03(h).

"Cash" means United States dollars or immediately available funds in United States dollars.

"Closing" has the meaning set forth in Section 9.01(a).

"Closing Date" has the meaning set forth in Section 9.01(a).

"Commission" means the Securities and Exchange Commission or any successor agency having jurisdiction under the Securities Act.

"Company Competitive Business" has the meaning set forth in Section 14.01(a).

"Company Competitive Business Assets" has the meaning set forth in Section 14.01(d).

"Company Competitive Third Party" has the meaning set forth in Section 14.01(d).

"Company Material Adverse Effect" means, for purposes of Section 1.03, an effect on the business, operations, assets, liabilities, results of operations, cash flows, condition (financial or otherwise) or prospects of the Company's Business which results in a Loss of two million dollars ($2,000,000) or more, or, if such Loss is not susceptible to being measured in monetary terms, is otherwise materially adverse to the Company's Business; provided that any such effect relating to or resulting from any change in the price of petroleum or petroleum byproducts, general economic conditions or local, regional, national or international industry conditions (including changes in financial or market conditions) shall be deemed not to constitute a Company Material Adverse Effect.

"Competitive Business Purchase Price" has the meaning set forth in Section 14.04.

"Confidential Information" has the meaning set forth in Section 14.02(b).

"Confidentiality Agreement" has the meaning set forth in Section 14.02(b).

"Delayed Closing Date" has the meaning set forth in Section 9.03(b).

"Delayed Closing Date Interest Period" has the meaning set forth in Section 9.03(b).

"Delayed Installment Payment Date" has the meaning set forth in Section 9.06.

"Delayed Installment Payment Date Interest Period" has the meaning set forth in Section 9.06.

"Demand Registration" has the meaning set forth in Section 10.01(a).

"Designated Sublease Agreements" means the Ashland Designated Sublease Agreements and the Marathon Designated Sublease Agreements.

"Disclosing Party" has the meaning set forth in Section 14.02(b).

"Dispute" has the meaning set forth in Section 16.01.

"Dispute Notice" has the meaning set forth in Section 16.02.

"Distributable Cash" has the meaning set forth in the LLC Agreement.

"Escrow Account" has the meaning set forth in Section 5.01(a)(ii)(B).

"Exchange Act" means the Securities Exchange Act of 1934, as amended.

"Exercise Date" means the Special Termination Exercise Date, the Marathon Call Exercise Date or the Ashland Put Exercise Date, as applicable.

"Exercise Period Distributions" means Ashland Exercise Period Distributions or Marathon Exercise Period Distributions, as applicable.

"Fair Market Value" has the meaning set forth in Section 7.01.

"14.01(d) Presentation Meeting" has the meaning set forth in Section 14.01(d).

"14.01(d) Scheduled Closing Date" has the meaning set forth in Section 14.01(d).

"14.03(d) Offer Notice" has the meaning set forth in Section 14.03(d).

"14.03(d) Purchase Election Notice" has the meaning set forth on Section 14.03(d).

"14.03(d) Scheduled Closing Date" has the meaning set forth in Section 14.03(d).

"14.03(f) Offer Notice" has the meaning set forth in Section 14.03(f)(i).

"14.03(f) Purchase Election Notice" has the meaning set forth in Section 14.03(f)(i).

"14.04 Appraisal Process Commencement Date" has the meaning set forth in Section 14.04.

"14.04 Appraisal Report" has the meaning set forth in Section 14.04.

"14.04 Initial Opinion Values" has the meaning set forth in Section 14.04.

"14.04 Subsequent Appraisal Process Commencement Date" has the meaning set forth in Section 14.04.

"14.04 Third Opinion Value" has the meaning set forth in Section 14.04.

"Fully Distributed Sale" has the meaning set forth in Section 8.04.

"Holding Period" has the meaning set forth in Section 8.03.

"Installment Payment" has the meaning set forth in Section 4.02(b).

"Installment Payment Date" means a Scheduled Installment Payment Date or a Delayed Installment Payment Date, as applicable.

"Investment Grade Rating" means a rating of BBB- or higher by S&P or Baa3 or higher by Moody's or the equivalent of such rating by S&P and Moody's.

"Issuer" has the meaning set forth in Section 10.01(a).

"Issuer Material Adverse Effect" means either (i) a material adverse effect on the ability of the Issuer to perform its obligations under this Agreement or (ii) a material adverse effect on the business, operations, assets, liabilities, results of operations, cash flows, condition (financial or otherwise) or prospects of the Issuer and its subsidiaries, taken as a whole; provided, however, that any such effect relating to or resulting from any change in the price of petroleum or petroleum byproducts, general economic conditions or local, regional, national or international industry conditions (including changes in financial or market conditions) or any change in applicable tax laws or regulations shall be deemed not to constitute an Issuer Material Adverse Effect.

"LIBOR Rate" means, for any one-month period or portion thereof, the per annum rate (rounded to the nearest 110,000 of 1%) for U.S. dollar deposits for such one-month period which appears on Bloomberg Page DG522a Equity GPGX as of 11:00 a.m. London time on the second London business day preceding the first day of such one-month period. "Bloomberg Page DG522a Equity GPGX" means the display page designated "DG522a Equity GPGX" on the Bloomberg, L.P. quotation service (or replacement page or successor service for displaying comparable rates).

"Losses" has the meaning set forth in Section 10.04.

"Long Term Debt" means Indebtedness with a maturity of one year or longer.

"Maralube Express Business" has the meaning set forth in Section 14.03(d)(i).

"Marathon Call Exercise Date" has the meaning set forth in Section 3.03.

"Marathon Call Exercise Notice" has the meaning set forth in Section 3.03.

"Marathon Call Price" has the meaning set forth in Section 3.01.

"Marathon Call Right" has the meaning set forth in Section 3.01.

"Marathon Debt Securities" has the meaning set forth in Section 8.01.

"Marathon Designated Sublease Agreements" means the Marathon Sublease Agreements attached as Exhibits E-1, E-2 and E-3 to the Asset Transfer and Contribution Agreement.

"Marathon Equity Securities" means any of (i) the class of common stock of USX designated as USX-Marathon Group Common Stock, par value $1.00 per share, (ii) the class of common equity securities of Marathon or, if USX has transferred all of the assets and liabilities of the Marathon Group to a Marathon Group Subsidiary (as such term is defined in the Certificate of Incorporation of USX) pursuant to Section 2(a) of Division I of Article Fourth of the Certificate of Incorporation of USX and the Board of Directors of USX has declared that all of the outstanding shares of USX-Marathon Group Common Stock be exchanged for shares of common stock of the Marathon Group Subsidiary, the Marathon Group Subsidiary; provided, that so long as Marathon shall be a subsidiary of USX, such common equity securities shall constitute Marathon Equity Securities only if such class accounts for USX's primary ownership interest in Marathon, or (iii) the common equity securities of USX (but only if a single class of common equity securities of USX exists), in each case (1) registered pursuant to Section 12 of the Exchange Act and (2) issued to Ashland pursuant to Section 4.02(c); provided that in the event there is a reclassification of any of the foregoing classes of common stock into one or more different types or classes of securities, "Marathon Equity Securities" shall instead include such different types or classes of securities.

"Marathon Exercise Period Distributions" has the meanings set forth in Section 5.01(b)(i).

"Marathon Material Adverse Effect" means, for purposes of Section 1.03, either (i) a material adverse effect on the ability of Marathon to perform its obligations under this Agreement or (ii) an effect on the business, operations, assets, liabilities, results of operations, cash flows, condition (financial or otherwise) or prospects of Marathon's Business which results in a Loss of two million dollars ($2,000,000) or more, or, if such Loss is not susceptible to being measured in monetary terms, is otherwise materially adverse to Marathon's Business; provided that any such effect relating to or resulting from any change in the price of petroleum or petroleum byproducts, general economic conditions or local, regional, national or international industry conditions (including changes in financial or market conditions) shall be deemed not to constitute a Marathon Material Adverse Effect.

"Marathon Membership Interests" means the initial Membership Interests of Marathon on the date hereof, together with any additional Membership Interests that Marathon may hereafter acquire.

"Marathon Representatives Revocable Proxies" has the meaning set forth in Section 5.02(b).

"Marathon Special Termination Right" means the Special Termination Right granted to Marathon pursuant to Section 2.01.

"Market Value of the Company" has the meaning set forth in Section 6.01(c).

"Maximum Offering Size" has the meaning set forth in Section 10.01(e).

"Mid-Level Employee" has the meaning set forth in Section 14.02(a)(ii).

"Minimum Lube Oil Purchase Amount" has the meaning set forth in Section 14.03(h).

"Moody's" means Moody's Investors Service Inc. and any successor thereto.

"National Securities Exchange" means a securities exchange registered as a national securities exchange under Section 6 of the Exchange Act.

"9.04(b) Post-Scheduled Closing Date Distribution Amount" has the meaning set forth in Section 9.04(b).

"9.08(b) Post-Scheduled Closing Date Distribution Amount" has the meaning set forth in Section 9.08(b).

"Non-Terminating Member" has the meaning set forth in Section 2.01(a).

"Offering Memorandum" means any offering memorandum prepared in connection with a sale of Securities effected in accordance with Section 4(2) or Rule 144A under the Securities Act, including all amendments and supplements to such offering memorandum, all exhibits thereto and all materials incorporated by reference in such offering memorandum.

"Other Holders" has the meaning set forth in Section 10.01(e).

"Packaged Motor Oil Business" has the meaning set forth in Section 14.03(h).

"Percentage Interest" has the meaning set forth in the LLC Agreement.

"Permitted Investments" means any of the following: (i) any investment in direct obligations of the United States of America or any agency thereof or obligations Guaranteed by the United States of America or any agency thereof; (ii) investments in time deposit accounts, certificates of deposit and money market deposits maturing within 180 days of the date of acquisition thereof issued by a bank or trust company which is organized under the laws of the United States of America, any state thereof or any foreign country recognized by the United States of America having capital, surplus and undivided profits aggregating in excess of $250,000,000 (or the foreign currency equivalent thereof) and whose Long Term debt is rated "A" (or higher) by Moody's or S&P; (iii) repurchase agreements having terms of not more than 30 days that are (A) collateralized by underlying securities of the types described in clause (i) above having a fair market value at the time the Company enters into such repurchase agreements of at least 102% of the principal amount of such repurchase agreements and (B) entered into with a bank meeting the qualifications described in clause (ii) above; (iv) investments in commercial paper, maturing not more than 90 days after the date of acquisition, issued by a corporation (other than an Affiliate of any of the parties hereto) organized and in existence under the laws of the United States of America, any state thereof or any foreign country recognized by the United States of America with a rating at the time as of which any investment therein is made of both "P-1" (or higher) according to Moody's and "A-1" (or higher) according to S&P; and (v) investments in securities with maturities of six months or less from the date of acquisition issued or fully guaranteed by any state, commonwealth or territory of the United States of America, or by any political subdivision or taxing authority thereof, and rated at least "A" by S&P or "A" by Moody's.

"Price Index" has the meaning set forth in the LLC Agreement.

"Private Label Packaged Motor Oil Business" has the meaning set forth in Section 14.03(h).

"Qualifying Public Offering" has the meaning set forth in Section 8.04.

"Quick Lube Business" has the meaning set forth in Section 14.03(h).

"Registration Statement" means any registration statement under the Securities Act which permits the public offering of Securities, including the prospectus included therein, all amendments and supplements to such registration statement or prospectus, including post-effective amendments, all exhibits thereto and all materials incorporated by reference in such registration statement.

"Representatives" has the meaning set forth in Section 14.02(b).

"Response" has the meaning set forth in Section 16.02.

"Required Disclosure" has the meaning set forth in Section 7.03(a).

"Required Disclosure Date" has the meaning set forth in Section 7.03(a).

"Scheduled Closing Date" has the meaning set forth in Section 9.01(a).

"Scheduled Installment Payment Date" has the meaning set forth in Section 4.02(b).

"Securities" means Marathon Debt Securities andor Marathon Equity Securities.

"Securities Act" means the Securities Act of 1933.

"Securities Document" has the meaning set forth in Section 8.02.

"Senior Employee" has the meaning set forth in Section 14.02(a)(ii).

"S&P" means Standard & Poor's Corporation and any successor thereto.

"7.03(b) Appraisal Process Commencement Date" has the meaning set forth in Section 7.03(b).

"7.03(b) Appraisal Report" has the meaning set forth in Section 7.03(b).

"7.03(b) Discount Amount" has the meaning set forth in Section 7.03(b).

"7.03(b) Initial Opinion Values" has the meaning set forth in Section 7.03(b).

"7.03(b) Subsequent Appraisal Process Commencement Date" has the meaning set forth in Section 7.03(b).

"7.03(b) Third Opinion Value" has the meaning set forth in Section 7.03(b).

"7.04 Appraisal Process Commencement Date" has the meaning set forth in Section 7.04(b).

"7.04 Appraisal Report" has the meaning set forth in Section 7.04(b).

"7.04 Discount Amount" has the meaning set forth in Section 7.04(b).

"7.04 Initial Opinion Values" has the meaning set forth in Section 7.04(b).

"7.04 Subsequent Appraisal Process Commencement Date" has the meaning set forth in Section 7.04(b).

"7.04 Third Opinion Value" has the meaning set forth in Section 7.04(b).

"6.01 Appraisal Process Commencement Date" has the meaning set forth in Section 6.01(b).

"6.01 Appraisal Report" has the meaning set forth in Section 6.01(b).

"6.01 Initial Opinion Values" has the meaning set forth in Section 6.01(b).

"6.01 Subsequent Appraisal Process Commencement Date" has the meaning set forth in Section 6.01(b).

"6.01 Third Opinion Value" has the meaning set forth in Section 6.01(b).

"Special Termination Exercise Date" has the meaning set forth in Section 2.03.

"Special Termination Exercise Notice" has the meaning set forth in Section 2.03.

"Special Termination Price" has the meaning set forth in Section 2.01(a).

"Special Termination Right" has the meaning set forth in Section 2.01(a).

"Tax Liability" has the meaning set forth in the LLC Agreement.

"Tax Liability Distributions" means the cash distributions to which a Member is entitled pursuant to Section 5.01(a) of the LLC Agreement.

"Terminating Member" has the meaning set forth in Section 2.01(a).

"Terminating Member's Membership Interests" means, if Ashland is the Terminating Member, the Ashland Membership Interests and, if Marathon is the Terminating Member, the Marathon Membership Interests.

"Terminating Member's Percentage Interest" means, if Ashland is the Terminating Member, the Ashland Percentage Interest and, if Marathon is the Terminating Member, the Marathon Percentage Interest.

"Termination Notice" has the meaning set forth in Section 2.01(a).

"Trading Day" means any day on which the New York Stock Exchange is open for business.

"Underwritten Public Offering" means an underwritten public offering of Securities pursuant to an effective Registration Statement under the Securities Act.

"USX Material Adverse Effect" means, for purposes of Section 1.03, a material adverse effect on the ability of USX to perform its obligations under this Agreement.

"USX Voting Securities" means the securities of USX (i) having the power under ordinary circumstances to elect at least a majority of the board of directors of USX (whether or not any senior class of stock has voting power by reason of any contingency) or (ii) convertible into or exchangeable for securities of USX having the power under ordinary circumstances to elect at least a majority of the board of directors of USX (whether or not any senior class of stock has voting power by reason of any contingency); provided, that each class of common equity securities of USX, and any securities of USX convertible into or exchangeable for any such class, shall constitute USX Voting Securities regardless of whether such class has the power under ordinary circumstances to elect at least a majority of the board of directors of USX.

"Valvoline" has the meaning set forth in Section 14.03(h).

"Valvoline Business" has the meaning set forth in Section 14.03(h).

"Valvoline Competitive Business Assets" has the meaning set forth in Section 14.03(d).

"Valvoline Competitive Third Party" has the meaning set forth in Section 14.03(d).

"Weighted Average Price" has the meaning set forth in Section 7.03(a).

SECTION 1.02. Adjustable Amounts.

Within 30 days following the date on which the United States Department of Labor Bureau of Labor Statistics for all Urban Areas publishes the Price Index for (a) the month of December, 2002 and (b) thereafter, the month of December in each five year anniversary of the year 2002 (the year 2002 and each such five year anniversary being an "Adjustment Year"), the Company shall determine whether the Average Annual Level for the applicable Adjustment Year exceeds the Base Level. If the Company determines that the Average Annual Level for such Adjustment Year exceeds the Base Level, then the Company shall increase or decrease each of the following amounts (each, an "Adjustable Amount") to an amount calculated by multiplying the relevant Adjustable Amount by a fraction whose numerator is the Average Annual Level for such Adjustment Year and whose denominator is the Base Level: (i) the two million dollars ($2,000,000) amount set forth in the definition of "Ashland Material Adverse Effect"; (ii) the two million dollars ($2,000,000) amount set forth in the definition of "Company Material Adverse Effect"; (iii) the two million dollars ($2,000,000) amount set forth in the definition of "Marathon Material Adverse Effect"; (iv) the $250 million amount set forth in clause (ii) of the definition of "Permitted Investments" in Section 1.01; and (v) the $100 million and $25 million amounts set forth in Section 10.01(a); provided that in no event shall any Adjustable Amount be decreased below the initial amount thereof set forth herein. Within five Business Days after making such determinations, the Company shall distribute to each Member a notice (an "Adjustable Amounts Notice") setting forth: (A) the amount by which the Average Annual Level for such Adjustment Year exceeded the Base Level and (B) the calculations of any adjustments made to the Adjustable Amounts pursuant to this Section 1.02. Any adjustment made to the Adjustable Amounts pursuant to this Section 1.02 shall be effective as of the date on which the Company delivers to the Members the related Adjustable Amounts Notice.

SECTION 1.03. Representations and Warranties.

Each of Marathon and USX represents and warrants to Ashland, and Ashland represents and warrants to each of Marathon and USX, in each case as of the date hereof and will be required to represent and warrant as of any Closing Date, as follows:

(a) Due Organization, Good Standing and Power. It is a corporation duly organized, validly existing and in good standing under the laws of the jurisdiction of its incorporation with the power and authority to own, lease and operate its assets and to conduct the business now being or to be conducted by it. It is duly authorized, qualified or licensed to do business as a foreign corporation or other organization in good standing in each of the jurisdictions in which its right, title or interest in or to any of the assets held by it or the business conducted by it requires such authorization, qualification or licensing, except where the failure to be so authorized, qualified, licensed or in good standing would not have and would not reasonably be expected to have, individually or in the aggregate, a Marathon Material Adverse Effect, a USX Material Adverse Effect or an Ashland Material Adverse Effect, as the case may be. It has all requisite power and authority to enter into this Agreement and to perform its obligations hereunder.

(b) Authorization and Validity of Agreements. The execution and delivery by it of this Agreement and the consummation by it of the transactions contemplated hereby have been duly authorized and approved by all necessary corporate or other action on its part. This Agreement has been duly executed and delivered by it. This Agreement is its legal, valid and binding obligation, enforceable against it in accordance with its terms.

(c) Lack of Conflicts. Except as set forth on Schedule 1.03(c) to the Marathon, USX or Ashland PutCall, Registration Rights and Standstill Disclosure Letter, as applicable, neither the execution and delivery by it of this Agreement nor the consummation by it of the transactions contemplated hereby does or will (i) conflict with, or result in the breach of any provision of, its charter or by-laws or similar governing or organizational documents or any of its subsidiaries, (ii) violate any Applicable Law or any permit, order, award, injunction, decree or judgment of any Governmental Authority applicable to or binding upon it or any of its subsidiaries or to which any of their respective properties or assets is subject, (iii) violate, conflict with or result in the breach or termination of, or otherwise give any other person the right to terminate, or constitute a default, an event of default or an event which with notice, lapse of time or both, would constitute a default or an event of default under the terms of, any mortgage, indenture, deed of trust or lease or other agreement or instrument to which it or any of its subsidiaries is a party or by which any of their respective properties or assets is subject, except, in the case of clauses (ii) or (iii), for such violations, conflicts, breaches, terminations and defaults which would not have and would not reasonably be expected to have, individually, a Company Material Adverse Effect.

(d) No Consents. Except as set forth on Schedule 1.03(d) to the Marathon, USX or Ashland PutCall, Registration Rights and Standstill Disclosure Letter, as applicable, no Governmental Approval or other consent is required by it for the execution and delivery by it of this Agreement or for the consummation of the transactions contemplated hereby except (a) for such Governmental Approvals or other consents as have been obtained or are contemplated hereby to be obtained after Closing or (b) where the failure to obtain such Governmental Approvals or other consents would not have and would not reasonably be expected to have, individually, a Company Material Adverse Effect.

ARTICLE II
Special Termination Right

SECTION 2.01. Special Termination Right.

(a) If Ashland or Marathon (the "Terminating Member") notifies the Board of Managers of the Company and the other Member (the "Non-Terminating Member") in writing pursuant to Section 2.03 of the LLC Agreement that it wants to terminate the term of the Company at the end of the Initial Term or any succeeding 10-year period (any such notice being a "Termination Notice"), then, subject to Section 2.01(b), the Non-Terminating Member shall have the right, exercisable at any time during the 180-day period following its receipt from the Terminating Member of a Termination Notice, to purchase from the Terminating Member on the Scheduled Closing Date (the "Special Termination Right"), and the Terminating Member shall thereupon be required to sell to the Non-Terminating Member on the Scheduled Closing Date, all of its Membership Interests and, in the circumstance where Ashland is the Terminating Member, the Ashland LOOPLOCAP Interest, for an aggregate amount equal to the purchase price (the "Special Termination Price") set forth in Section 2.02(a), plus interest on the Special Termination Price at a rate per annum equal to the Base Rate, with daily accrual of interest, for the period commencing on the Special Termination Exercise Date and ending on the Scheduled Closing Date. The Special Termination Right shall automatically terminate at the close of business on the 180th day following the Non-Terminating Member's receipt of a Termination Notice, unless previously exercised by the Non-Terminating Member in accordance with the provisions of Section 2.03.

(b) Notwithstanding anything to the contrary contained in Section 2.01(a), if Marathon and Ashland each deliver a Terminating Notice to the Board of Managers of the Company and the other Member, then neither Marathon nor Ashland shall have a Special Termination Right.

SECTION 2.02. Special Termination Price.

(a) Amount. The Special Termination Price shall be an amount equal to the product of (i) 100% of the Appraised Value of the Company multiplied by (ii) the Terminating Member's Percentage Interest.

(b) Timing of Payment. The Non-Terminating Member shall pay the entire Special Termination Price, together with accrued interest calculated as set forth in Section 2.01, on the Scheduled Closing Date.

(c) Form of Consideration. The Non-Terminating Member shall pay the Special Termination Price, and all accrued interest, in Cash.

SECTION 2.03. Method of Exercise.

The Non-Terminating Member shall exercise its Special Termination Right by delivering to the Terminating Member a notice of such exercise (the "Special Termination Exercise Notice"). The date of the Terminating Member's receipt of the Special Termination Exercise Notice shall be deemed to be the date of the Non-Terminating Member's exercise of its Special Termination Right (the "Special Termination Exercise Date") and, except as expressly provided in Sections 9.08(a) and 9.09, the Non-Terminating Member's exercise of its Special Termination Right shall thereafter be irrevocable.

ARTICLE III
Marathon Call Right

SECTION 3.01. Marathon Call Right.

Subject to Section 3.04, at any time on and after December 31, 2004, Marathon shall have the right to purchase from Ashland on the Scheduled Closing Date (the "Marathon Call Right"), and Ashland shall thereupon be required to sell to Marathon on the Scheduled Closing Date, all of Ashland's Membership Interests and the Ashland LOOPLOCAP Interest, for an aggregate amount equal to the purchase price (the "Marathon Call Price") set forth in Section 3.02(a), plus interest on the Marathon Call Price at a rate per annum equal to the Base Rate, with daily accrual of interest, for the period commencing on the Marathon Call Exercise Date and ending on the Scheduled Closing Date.

SECTION 3.02. Marathon Call Price.

(a) Amount. The Marathon Call Price shall be an amount equal to the product of (i) 115% of the Appraised Value of the Company multiplied by (ii) Ashland's Percentage Interest.

(b) Timing of Payment. Marathon shall pay the entire Marathon Call Price, together with accrued interest calculated as set forth in Section 3.01, on the Scheduled Closing Date.

(c) Form of Consideration. Marathon shall pay the Marathon Call Price, and all accrued interest, in Cash.

SECTION 3.03. Method of Exercise.

Marathon shall exercise its Marathon Call Right by delivering to Ashland a notice of such exercise (the "Marathon Call Exercise Notice"). The date of Ashland's receipt of the Marathon Call Exercise Notice shall be deemed to be the date of Marathon's exercise of its Marathon Call Right (the "Marathon Call Exercise Date") and, except as expressly provided in Sections 9.03(a), 9.04(a) and 9.05, Marathon's exercise of its Marathon Call Right shall thereafter be irrevocable.

SECTION 3.04. Limitation on Marathon's Ability To Exercise Its Marathon Call Right.

If prior to the Marathon Call Exercise Date, Ashland elects to Transfer its Membership Interests to a third party pursuant to Section 10.01(c) of the LLC Agreement, and in connection therewith delivers to Marathon the requisite Offer Notice pursuant to Section 10.04 of the LLC Agreement, Marathon shall not be permitted to exercise its Marathon Call Right for a period commencing on the date of Marathon's receipt of such Offer Notice and ending on the earliest of (i) 120 days (or 270 days if a second request has been made under HSR) following such receipt, (ii) the closing of such Transfer, and (iii) the date such proposed Transfer by Ashland shall have been finally abandoned. After such period, Marathon shall be entitled to exercise its Marathon Call Right.

ARTICLE IV
Ashland Put Right

SECTION 4.01. Ashland Put Right.

Subject to Section 4.05, at any time after December 31, 2004, Ashland shall have the right to sell to Marathon on the Scheduled Closing Date (the "Ashland Put Right"), and Marathon shall thereupon be required to purchase from Ashland on the Scheduled Closing Date, all of Ashland's Membership Interests and the Ashland LOOPLOCAP Interest, for an aggregate amount equal to the purchase price (the "Ashland Put Price") set forth in Section 4.02, plus interest on the Ashland Put Price (or, in the event that Marathon elects to pay the Ashland Put Price in installments, any unpaid portion of the Ashland Put Price) at a rate per annum equal to the Base Rate, with daily accrual of interest, for the period commencing on the Ashland Put Exercise Date and ending on the Scheduled Closing Date (or, in the event that Marathon elects to pay the Ashland Put Price in installments, on the applicable Scheduled Installment Payment Date).

SECTION 4.02. Ashland Put Price.

(a) Amount. The Ashland Put Price shall be an amount equal to the sum of (i) for that portion of the Ashland Put Price to be paid to Ashland in Cash or in Marathon Debt Securities, an amount equal to the product of (x) 85% of the Appraised Value of the Company multiplied by (y) Ashland's Percentage Interest multiplied by (z) the percentage of the Ashland Put Price to be paid to Ashland in Cash andor in Marathon Debt Securities, plus (ii) for that portion of the Ashland Put Price to be paid to Ashland in Marathon Equity Securities, an amount equal to the product of (x) 90% of the Appraised Value of the Company multiplied by (y) Ashland's Percentage Interest multiplied by (z) the percentage of the Ashland Put Price to be paid to Ashland in Marathon Equity Securities.

(b) Timing of Payment. Subject to Section 4.02(d), Marathon shall have the right to elect, by specifying in the Ashland Put Price Election Notice, to (i) pay the entire Ashland Put Price on the Scheduled Closing Date or (ii) pay the Ashland Put Price in three equal installments (each an "Installment Payment"), in either case, together with accrued interest calculated as set forth in Section 4.01. If Marathon elects to pay the Ashland Put Price in installments, Marathon shall pay Ashland (x) the first Installment Payment on the Scheduled Closing Date; (y) the second Installment Payment on the first anniversary of the Scheduled Closing Date; and (z) the third Installment Payment on the second anniversary of the Scheduled Closing Date (each such date being a "Scheduled Installment Payment Date"), in each case, together with accrued interest calculated as set forth in Section 4.01.

(c) Form of Consideration. Subject to Section 4.02(d), Marathon shall have the right to elect, by specifying in an Ashland Put Price Election Notice, to pay the Ashland Put Price (i) entirely in Cash or (ii) in a combination of Cash and Securities; provided that at least 50% of the Ashland Put Price (and at least 50% of each Installment Payment if Marathon elects to pay in installments) shall consist of Cash; provided further, that the sum of (x) the Fair Market Value of any Securities issued to Ashland on the Closing Date (or on any Installment Payment Date) plus (y) the amount of Cash paid to Ashland on the Closing Date (or on such Installment Payment Date) in respect of the Ashland Put Price, in each case exclusive of any interest paid thereon, shall equal the Ashland Put Price (or the applicable Installment Payment); and provided further, that in no event shall Marathon or USX issue to Ashland an amount of Marathon Equity Securities that would cause Ashland to own, directly or indirectly, at the Closing or on any Scheduled Installment Payment Date in the aggregate 10% or more of the number of shares of such class of Marathon Equity Securities that are outstanding on the Closing Date and are publicly held (it being understood and agreed that for purposes of this Section 4.02(c), any shares of such class of Marathon Equity Securities that are either held by Marathon or any of its Affiliates or subject to restrictions on transfer shall not be considered publicly held). Marathon shall pay all accrued interest in Cash.

(d) Consequences of Failure to Make Certain Elections. Notwithstanding anything to the contrary in this Agreement:

(i) if Marathon fails to deliver to Ashland an Ashland Put Price Election Notice within the requisite time period set forth in Section 4.04(a) or if Marathon delivers to Ashland an Ashland Put Price Election Notice that states that the entire Ashland Put Price will be paid at Closing but does not state whether any portion of the Ashland Put Price will be paid in Securities, Marathon shall thereafter be required to pay Ashland the entire Ashland Put Price in Cash on the Closing Date;

(ii) if Marathon delivers to Ashland an Ashland Put Price Election Notice pursuant to Section 4.04(a) that does not indicate whether it is electing to pay the Ashland Put Price in installments, Marathon shall thereafter be required to pay Ashland the entire Ashland Put Price on the Closing Date;

(iii) if Marathon delivers to Ashland an Ashland Put Price Election Notice pursuant to Section 4.04(a) that does not indicate the form of consideration regarding the Ashland Put Price (or, if such Ashland Put Price Election Notice states that Marathon has elected to pay the Ashland Put Price in installments, the first Installment Payment), Marathon shall thereafter be required to pay Ashland the entire Ashland Put Price (or first Installment Payment) in Cash on the Closing Date;

(iv) if Marathon has elected in its Ashland Put Price Election Notice delivered pursuant to Section 4.04(b) to pay the Ashland Put Price in installments and thereafter if Marathon fails to deliver to Ashland an Ashland Put Price Election Notice within the requisite time period set forth in Section 4.04(b) for any Scheduled Installment Payment Date, Marathon shall thereafter be required to pay Ashland the entire Installment Payment in Cash on the applicable Installment Payment Date;

(v) if Marathon elects in any Ashland Put Price Election Notice to issue (or to have USX issue) to Ashland Actively Traded Marathon Equity Securities on the Closing Date (or applicable Installment Payment Date) and at any time prior to the Closing Date (or such Installment Payment Date), such Securities cease for whatever reason to be Actively Traded Marathon Equity Securities, Marathon shall thereafter be required to pay Ashland the entire Ashland Put Price (or the applicable Installment Payment) in Cash on the Closing Date (or applicable Installment Payment Date); and

(vi) if Marathon elects in any Ashland Put Price Election Notice to issue (or to have USX issue) to Ashland Actively Traded Marathon Equity Securities on the Closing Date (or applicable Installment Payment Date) and Marathon fails to give the related Required Disclosure on the applicable Required Disclosure Date, Marathon shall thereafter be required to pay to Ashland the entire Ashland Put Price (or the applicable Installment Payment) in Cash on the Closing Date (or on such Installment Payment Date).

SECTION 4.03. Method of Exercise.

Ashland may exercise its Ashland Put Right by delivering to Marathon a notice of such exercise (the "Ashland Put Exercise Notice"). The date of Marathon's receipt of the Ashland Put Exercise Notice shall be deemed to be the date of Ashland's exercise of its Ashland Put Right (the "Ashland Put Exercise Date") and, except as expressly provided in Sections 9.03(a), 9.04(a) and 9.05, Ashland's exercise of its Ashland Put Right shall thereafter be irrevocable.

SECTION 4.04. Ashland Put Price Election Notice.

(a) Notice re: Closing. Within five Business Days after the Appraised Value Determination Date, Marathon shall notify Ashland (a "Ashland Put Price Election Notice") as to (i) whether it elects to pay the Ashland Put Price (A) entirely at Closing or (B) in three equal installments and (ii) whether Marathon elects to pay part of the Ashland Put Price or first Installment Payment, as applicable, at Closing in Securities, and, if so, (A) the name of the issuer of such Securities, (B) the type of such Securities, (C) the portion of the Ashland Put Price or first Installment Payment, as applicable, which will be comprised of such Securities, (D) whether it elects to impose a Holding Period with respect to any of such Securities and (E) the length of any such Holding Period.

(b) Notices re: Second and Third Scheduled Installment Payment Dates. Within 45 days prior to each of the second and third Scheduled Installment Payment Dates, if applicable, Marathon shall deliver to Ashland an Ashland Put Price Election Notice as to whether Marathon elects to pay part of the applicable Installment Payment in Securities, and, if so, (i) the name of the issuer of such Securities, (ii) the type of Securities, (iii) the portion of the applicable Installment Payment which will be comprised of such Securities, (iv) whether it elects to impose a Holding Period with respect to any of such Securities and (v) the length of any such Holding Period. The date of Ashland's receipt of any Ashland Put Price Election Notice is referred to herein as the "Ashland Put Price Election Date" with respect to such Ashland Put Price Election Notice.

(c) Additional Information With Respect to Securities. If Marathon elects to pay any part of the Ashland Put Price in Securities, then in addition to the information provided to Ashland in the Ashland Put Price Election Notice pursuant to Section 4.04(a) or 4.04(b), Marathon shall provide Ashland and its advisors with any other information concerning such Securities that Ashland or its advisors may reasonably request.

(d) Irrevocability of Elections. Marathon's elections as set forth in an Ashland Put Price Election Notice shall be irrevocable upon Ashland's receipt of such Ashland Put Price Election Notice; provided that at any time prior to the date that is ten Business Days prior to the Closing Date (or applicable Installment Payment Date) Marathon shall have the right to change a previous election to pay part of the Ashland Put Price (or applicable Installment Payment) in Securities to an election to pay a greater portion of or the entire Ashland Put Price (or applicable Installment Payment) in Cash, or to change a previous election to pay the Ashland Put Price in installments to an election to pay the entire or remaining Ashland Put Price on the Closing Date (or applicable Installment Payment Date).

SECTION 4.05. Limitation on Ashland's Ability To Exercise its Ashland Put Right.

If prior to the Ashland Put Exercise Date, Marathon elects to Transfer all of its Membership Interests to a third party pursuant to Section 10.01(c) of the LLC Agreement, and in connection therewith delivers to Ashland the requisite Offer Notice pursuant to Section 10.04 of the LLC Agreement, Ashland shall not be permitted to exercise its Ashland Put Right for a period commencing on the date of Ashland's receipt of such Offer Notice and ending on the earlier of (i) 120 days (270 days if a second request has been made under HSR) following such receipt, (ii) the closing of such Transfer, and (iii) the date such proposed Transfer by Marathon shall have been finally abandoned. After such period, Ashland shall be entitled to exercise its Ashland Put Right.

ARTICLE V
Termination of Certain Distributions; Revocable Proxies

SECTION 5.01. Termination of Certain Distributions.

(a) Distributions to Ashland. (i) Subject to Sections 9.04(a), 9.05, 9.08(a) and 9.09, in the event that Marathon exercises its Marathon Call Right or its Special Termination Right, or in the event that Ashland exercises its Ashland Put Right, then on the relevant Exercise Date, Ashland shall cause each of its Representatives to authorize Marathon's Representatives to cause the Company to withhold from Ashland all distributions of Distributable Cash and all Tax Liability Distributions that Ashland would otherwise be entitled to receive pursuant to Article V of the LLC Agreement during the period from the relevant Exercise Date to the Closing Date, other than (i) all distributions of Distributable Cash and Tax Liability Distributions that are attributable to any Fiscal Quarter that ends on or prior to the close of business on the relevant Exercise Date, (ii) a pro rata portion of all distributions of Distributable Cash and Tax Liability Distributions that are attributable to the portion of a Fiscal Quarter that begins prior to the relevant Exercise Date and that ends after such Exercise Date and (iii) all Tax Liability Distributions that are attributable to the period from the relevant Exercise Date to the Closing Date to the extent that Ashland has any Tax Liability during such period ("Ashland Exercise Period Distributions").

(ii) Any Ashland Exercise Period Distributions withheld from Ashland pursuant to Section 5.01(a)(i) shall be distributed by the Company as follows:

(A) if at the time such distribution is so withheld, either (1) USX's Long Term Debt has an Investment Grade Rating and USX has agreed in writing to guarantee (which guarantee shall be a guarantee of payment) Marathon's obligations to pay to Ashland in the circumstances set forth in Sections 9.04(a) and 9.05 (pursuant to a guarantee agreement in form and substance reasonably satisfactory to Ashland and its counsel) or (2) Marathon's Long Term Debt has an Investment Grade Rating, then the Company shall pay such Ashland Exercise Period Distributions directly to Marathon; and

(B) if at the time such distribution is so withheld, (1) Marathon's Long Term Debt does not have an Investment Grade Rating and (2) either (x) USX's Long Term Debt does not have an Investment Grade Rating or (y) USX's Long Term Debt has an Investment Grade Rating but USX has not agreed in writing to guarantee Marathon's payment obligations described in clause (2) of subparagraph (A) above, then Marathon's Representatives shall cause the Company to, and the Company shall, deposit all Ashland Exercise Period Distributions into an escrow account to be established by the Company (the "Escrow Account") and to release such deposits from the Escrow Account only in accordance with this Agreement. All amounts in the Escrow Account shall be invested only in Permitted Investments.

(b) Distributions to Marathon. (i) Subject to Sections 9.08(a) and 9.09, in the event that Ashland exercises its Special Termination Right in accordance with the terms hereof, then on the Special Termination Exercise Date, Marathon shall cause each of its Representatives to authorize Ashland's Representatives to cause the Company to withhold from Marathon all distributions of Distributable Cash and all Tax Liability Distributions that Marathon would otherwise be entitled to receive pursuant to Article V of the LLC Agreement during the period from the Special Termination Exercise Date to the Closing Date, other than (A) all distributions of Distributable Cash and Tax Liability Distributions that are attributable to any Fiscal Quarter that ends on or prior to the close of business on the Special Termination Exercise Date, (B) a pro rata portion of all distributions of Distributable Cash and Tax Liability Distributions that are attributable to the portion of a Fiscal Quarter that begins prior to the Special Termination Exercise Date and that ends after the Special Termination Exercise Date and (C) all Tax Liability Distributions that are attributable to the period from the Special Termination Exercise Date to the Closing Date to the extent that Marathon has any Tax Liability during such period ("Marathon Exercise Period Distributions").

(ii) Any Marathon Exercise Period Distributions withheld from Ashland pursuant to Section 5.01(a) shall be distributed by the Company as follows:

(A) if at the time such distribution is so withheld, Ashland's Long Term Debt has an Investment Grade Rating, then the Company shall pay such Marathon Exercise Period Distributions directly to Ashland; and

(B) if at the time such distribution is so withheld, Ashland's Long Term Debt does not have an Investment Grade Rating, then Ashland's Representatives shall cause the Company to, and the Company shall, deposit all Marathon Exercise Period Distributions into an Escrow Account and to release such deposits from the Escrow Account only in accordance with this Agreement. All amounts in the Escrow Account shall be invested only in Permitted Investments.

SECTION 5.02. Revocable Proxies.

(a) Ashland Representatives Revocable Proxies. Subject to Sections 9.04(a), 9.05, 9.08(a) and 9.09, in the event that Marathon exercises its Marathon Call Right or its Special Termination Right, or in the event that Ashland exercises its Ashland Put Right, then on the relevant Exercise Date, Ashland shall cause each of its Representatives to grant to Marathon's Representatives a proxy (the "Ashland Representatives Revocable Proxies") which shall authorize Marathon's Representatives to cast each Ashland Representative's vote at a Board of Managers' meeting (but not by written consent in lieu of a meeting in accordance with Section 8.04(h) of the LLC Agreement unless Marathon shall have given Ashland prior written notice of the specific action to be taken by such written consent) in favor of or against any of the Super Majority Decisions described in Sections 8.08 of the LLC Agreement, as Marathon's Representatives shall, in their sole discretion, determine, other than any vote with respect to a Super

Majority Decision described in Sections 8.08(c) (admission of a new Member; issuance of additional Membership Interests), 8.08(d) (additional capital contributions), 8.08(i) (change in Company's independent auditors), 8.08(j) (amendments to LLC Agreement or other Transaction Documents to which Company or its subsidiaries is a party), 8.08(l) (bankruptcy), 8.08(m) (modification of provisions re: distributions of Distributable Cash) or 8.08(q) (delegation to a Member of power to unilaterally bind the Company), with respect to which Ashland's Representatives shall retain all of their rights and authority to vote; provided that Marathon shall not, and shall cause each of its Representatives not to, take any action through the exercise of the Ashland Representatives Revocable Proxies to cause the Company's status as a partnership for Federal income tax purposes to terminate prior to the Closing Date.

(b) Marathon Representative Revocable Proxy. Subject to Sections 9.08(a) and 9.09, in the event that Ashland exercises its Special Termination Right, then on the Special Exercise Date, Marathon shall cause each of its Representatives to grant to Ashland's Representatives a proxy (the "Marathon Representatives Revocable Proxies") which shall authorize Ashland's Representatives to cast each Marathon Representative's vote at a Board of Managers' meeting (but not by written consent in lieu of a meeting in accordance with Section 8.04(h) of the LLC Agreement unless Ashland shall have given Marathon prior written notice of the specific action to be taken by such written consent) in favor of or against any of the Super Majority Decisions described in Sections 8.08 of the LLC Agreement, as Ashland's Representatives shall, in their sole discretion, determine, other than any vote with respect to a Super Majority Decision described in Section 8.08(c), 8.08(d), 8.08(i), 8.08(j), 8.08(l), 8.08(m) or 8.08(q) (except as expressly provided in Section 5.01), with respect to which Marathon's Representatives shall retain all of their rights and authority to vote; provided that Ashland shall not, and shall cause each of its Representatives not to, take any action through the exercise of the Marathon Representatives Revocable Proxies to cause the Company's status as a partnership for Federal income tax purposes to terminate prior to the Closing Date.

(c) Ashland LOOPLOCAP Revocable Proxy. Subject to Sections 9.04(a), 9.05, 9.08(a) and 9.09, in the event that Marathon exercises its Marathon Call Right or its Special Termination Right, or in the event that Ashland exercises its Ashland Put Right, then on the relevant Exercise Date, Ashland shall grant to Marathon, or such other person as Marathon shall designate, a proxy (the "Ashland LOOPLOCAP Revocable Proxy") which shall authorize Marathon and its Representatives (or such other person) to exercise on Ashland's behalf, all of Ashland's voting rights with respect to the Ashland LOOPLOCAP Interest.

ARTICLE VI
Determination of the Appraised Value of the Company

SECTION 6.01. Determination of Appraised Value of the Company.

(a) Negotiation Period. If Marathon exercises its Special Termination Right or its Marathon Call Right or if Ashland exercises its Special Termination Right or its Ashland Put Right, then for a period of 60 days following the relevant Exercise Date, Marathon and Ashland shall negotiate in good faith to seek to reach agreement as to the Market Value of the Company. If Marathon and Ashland reach such an agreement, then the Market Value of the Company shall be deemed to be the amount so agreed upon by Marathon and Ashland.

(b) Appraisal Process. In the event Marathon and Ashland are unable to reach an agreement as to the Market Value of the Company within the 60-day period referred to in Section 6.01(a), then within five Business Days after the expiration of such 60-day period (such fifth Business Day being referred to herein as the "6.01 Appraisal Process Commencement Date"), Marathon and Ashland each shall select a nationally recognized investment banking firm to (i) prepare a report which (A) sets forth such investment banking firm's determination of the Market Value of the Company (which shall be a single amount as opposed to a range) and (B) includes work papers which indicate the basis for and calculation of the Market Value of the Company (a "6.01 Appraisal Report") and (ii) deliver to Marathon or Ashland, as the case may be, an oral and written opinion addressed to such party as to the Market Value of the Company. The fees and expenses of each investment banking firm shall be paid by the party selecting such investment banking firm. Each of Marathon and Ashland shall instruct its respective investment banking firm to (i) not consult with the other investment banking firm with respect to its view as to the Market Value of the Company prior to the time that both investment banking firms have delivered their respective opinions to Marathon or Ashland, as applicable, (ii) determine the Market Value of the Company in accordance with Section 6.01(c), (iii) deliver their respective 6.01 Appraisal Reports, together with their oral and written opinions as to the Market Value of the Company (the "6.01 Initial Opinion Values"), within 60 days after the 6.01 Appraisal Process Commencement Date, and (iv) deliver a copy of its written opinion and its 6.01 Appraisal Report to the Company, the other party and the other party's investment banking firm at the time it delivers its oral and written opinion to Marathon or Ashland, as applicable.

If the 6.01 Initial Opinion Values differ and the lesser 6.01 Initial Opinion Value equals or exceeds 90% of the greater 6.01 Initial Opinion Value, the Market Value of the Company shall be deemed to be an amount equal to (i) the sum of the 6.01 Initial Opinion Values divided by (ii) two.

If the 6.01 Initial Opinion Values differ and the lesser 6.01 Initial Opinion Value is less than 90% of the greater 6.01 Initial Opinion Value, then:

(i) within two Business Days after both investment banking firms have delivered their respective opinions to Marathon or Ashland, as applicable, each investment banking firm shall, at a single meeting at which Marathon, Ashland, the Company and the other investment banking firm are present, make a presentation with respect to its 6.01 Initial Opinion Value. At such presentation, Marathon, Ashland, the Company and the other investment banking firm shall be entitled to ask questions as to the basis for and the calculation of such investment banking firm's 6.01 Initial Opinion Value; and

(ii) Marathon and Ashland shall, within five Business Days after the date Marathon and Ashland receive the 6.01 Initial Opinion Values (such fifth Business Day being referred to herein as the "6.01 Subsequent Appraisal Process Commencement Date"), jointly select a third nationally recognized investment banking firm to (A) prepare a 6.01 Appraisal Report and (B) deliver an oral and written opinion addressed to Marathon and Ashland as to the Market Value of the Company. The fees and expenses of such third investment banking firm shall be paid 50% by Marathon and 50% by Ashland. Such third investment banking firm shall not be provided with the 6.01 Initial Opinion Values and shall not consult with the initial investment banking firms with respect thereto. During such five-Business Day period, Marathon and Ashland shall negotiate in good faith to independently reach an agreement as to the Market Value of the Company. If Marathon and Ashland reach such an agreement, then the Market Value of the Company shall be deemed to be the amount so agreed upon by Marathon and Ashland. If Marathon and Ashland are unable to reach such an agreement, then Marathon and Ashland shall instruct such third investment banking firm to (A) determine the Market Value of the Company in accordance with Section 6.01(c) and (B) deliver its 6.01 Appraisal Report, together with its oral and written opinion (the "6.01 Third Opinion Value"), within 60 days after the 6.01 Subsequent Appraisal Process Commencement Date. The Market Value of the Company in such circumstance shall be deemed to be an amount equal to (A) the sum of (x) the 6.01 Third Opinion Value plus (y) whichever of the two 6.01 Initial Opinion Values is closer to the 6.01 Third Opinion Value (or, if the 6.01 Third Opinion Value is exactly halfway between the two 6.01 Initial Opinion Values, the 6.01 Third Opinion Value), divided by (B) two.

(c) Definition of Market Value of the Company. For purposes of this Agreement, the Market Value of the Company (the "Market Value of the Company") means the fair market value of the combined common equity of the Company as of the relevant Exercise Date, (including, in the circumstance where Marathon has exercised its Marathon Call Right or its Special Termination Right or Ashland has exercised its Ashland Put Right, the Ashland LOOPLOCAP Interest) assuming the consummation of a transaction designed to achieve the highest value of such combined common equity. In determining the Market Value of the Company, (i) consideration should be given as to (A) all possible transaction participants (other than Marathon or Ashland or their respective Affiliates) and categories of possible transactions; (B) a range of analytical methodologies, potentially including, but not limited to, the following: comparable trading analysis, comparable transaction analysis, discounted cash flow analysis, leveraged buyout analysis and break-up analysis; and (C) the value to the Company of all indemnification obligations of Marathon, USX and Ashland in favor of the Company pursuant to any Transaction Document (including, without limitation, Article IX of the Asset Transfer and Contribution Agreement), to the extent such indemnification obligations remain in effect after the Closing and (ii) no separate incremental value will be attributed to the Ashland LOOPLOCAP Interest. In determining the Market Value of the Company, no consideration should be given to the values that are initially assigned to assets of the Company for purchase accounting or tax accounting purposes. The Market Value of the Company as determined pursuant to this Section 6.01 is referred to herein as the "Appraised Value of the Company", and the date on which the Market Value of the Company is so determined is referred to herein as the "Appraised Value Determination Date".

ARTICLE VII
Determination of the Fair Market Value of Securities

SECTION 7.01. General.

The fair market value of any Securities to be issued to Ashland on the Closing Date and on any subsequent Installment Payment Date, shall be determined pursuant to the following procedures (the fair market value of such Securities as so determined being the "Fair Market Value" of such Securities).

SECTION 7.02. Determination of Fair Market Value of Marathon Debt Securities.

The Fair Market Value of any Marathon Debt Securities shall be deemed to be an amount equal to the aggregate stated principal amount of such Marathon Debt Securities.

SECTION 7.03. Determination of Fair Market Value of Actively Traded Marathon Equity Securities.

(a) Fair Market Value Where There is No Holding Period. The Fair Market Value of any Actively Traded Marathon Equity Securities to be issued to Ashland on the Closing Date or applicable Installment Payment Date for which Marathon has not elected a Holding Period shall be deemed to be an amount equal to the product of (i) the aggregate number of such Actively Traded Marathon Equity Securities to be issued to Ashland multiplied by (ii) the Weighted Average Price (as defined below) of such Actively Traded Marathon Equity Securities on the National Market System of the NASDAQ or the relevant National Securities Exchange, as reported by The Wall Street Journal or, if not reported thereby, as reported by any other authoritative source, for the ten full Trading Days immediately preceding the Business Day immediately preceding the Closing Date or applicable Installment Payment Date; provided that at least five Trading Days prior to the commencement of such ten full Trading Day period (the "Required Disclosure Date"), Marathon shall have made appropriate public disclosure (including by issuing a press release and filing a copy of such press release with the Commission) of (A) the existence of the Transaction, (B) the Ashland Put Price and (C) the information required to be included in the Ashland Put Price Election Notice (each such public disclosure being a "Required Disclosure"). Marathon shall provide Ashland with a copy of each Required Disclosure prior to Marathon making such disclosure public. Any such Required Disclosure shall be in form and substance reasonably satisfactory to Ashland and its counsel. For purposes of this Section 7.03(a), the "Weighted Average Price" means the quotient of (1) the product of (x) the number of shares in each trade in such Actively Traded Marathon Equity Securities that occurred during such ten full Trading Day period multiplied by (y) the price at which each such trade occurred, divided by (2) the total number of shares traded in such Actively Traded Marathon Equity Securities that occurred during such ten full Trading Day period. In the event of (i) any split, combination or reclassification of the class of Actively Traded Marathon Equity Securities to be issued to Ashland on the Closing Date or applicable Installment Payment Date, (ii) any issuance or the authorization of any issuance of any other securities in exchange or in substitution for the shares of such class of Actively Traded Marathon Equity Securities or (iii) any issuance or declaration of cash or stock dividends or other distributions with respect to such class of Actively Traded Marathon Equity Securities, in each case at any time during the ten full Trading Day period referred to above, Marathon and Ashland shall make such adjustment to the Fair Market Value of such Actively Traded Equity Securities determined pursuant to this Section 7.03(a) as Marathon and Ashland shall mutually agree so as to preserve the economic benefits to Ashland expected on the date of this Agreement as a result of the issuance to it of such Actively Traded Marathon Equity Securities as part of the Ashland Put Price.

(b) Fair Market Value Where There is a Holding Period. In the event that Marathon elects pursuant to Section 4.04(a) or 4.04(b) to impose a Holding Period on any Actively Traded Marathon Equity Securities, the Fair Market Value of such Actively Traded Marathon Equity Securities shall be deemed to be an amount equal to (i) the Fair Market Value of such Actively Traded Marathon Equity Securities as determined pursuant to Section 7.03(a), minus (ii) a discount factor that takes into account such limitation on Ashland's ability to freely trade such Actively Traded Marathon Equity Securities (a "7.03(b) Discount Amount"). The 7.03(b) Discount Amount with respect to the Fair Market Value of such Actively Traded Marathon Equity Securities shall be determined pursuant to the following procedures:

(i) Negotiation Period. For a period of 15 days following the applicable Ashland Put Price Election Date, Marathon and Ashland will negotiate in good faith to seek to reach an agreement as to the 7.03(b) Discount Amount. If Marathon and Ashland reach such an agreement, then the 7.03(b) Discount Amount shall be deemed to be the amount so agreed upon by Marathon and Ashland.

(ii) Appraisal Process. In the event Marathon and Ashland are unable to reach an agreement as to the 7.03(b) Discount Amount within the 15-day period referred to in clause (i) above, then within five Business Days after the expiration of such 15-day period (such fifth Business Day being referred to herein as the "7.03(b) Appraisal Process Commencement Date"), Marathon and Ashland each shall select a nationally recognized investment banking firm to (A) prepare a report which (1) sets forth such investment banking firm's determination of the 7.03(b) Discount Amount (which shall be a single amount as opposed to a range) and (2) includes work papers which indicate the basis for and the calculation of the 7.03(b) Discount Amount (a "7.03(b) Appraisal Report") and (B) deliver to Marathon or Ashland, as the case may be, an oral and written opinion addressed to such party as to the 7.03(b) Discount Amount. The fees and expenses of each investment banking firm shall be paid by the party selecting such investment banking firm. Each of Marathon and Ashland shall instruct its respective investment banking firm to (i) not consult with the other investment banking firm with respect to its view as to the 7.03(b) Discount Amount prior to the time that both investment banking firms have delivered their respective opinions to Marathon and Ashland, as applicable, (ii) deliver their respective 7.03(b) Appraisal Reports, together with their oral and written opinions as to the 7.03(b) Discount Amount (the "7.03(b) Initial Opinion Values"), within 15 days after the 7.03(b) Appraisal Process Commencement Date, and (iii) deliver a copy of its written opinion and its 7.03(b) Appraisal Report to the Company, the other party and the other party's investment banking firm at the time it delivers its oral and written opinion to Marathon or Ashland, as applicable.

If the 7.03(b) Initial Opinion Values differ and the lesser 7.03(b) Initial Opinion Value equals or exceeds 90% of the greater 7.03(b) Initial Opinion Value, the 7.03(b) Discount Amount shall be deemed to be an amount equal to (1) the sum of the 7.03(b) Initial Opinion Values divided by (2) two.

If the 7.03(b) Initial Opinion Values differ and the lesser 7.03(b) Initial Opinion Value is less than 90% of the greater 7.03(b) Initial Opinion Value, then:

(i) within two Business Days after both investment banking firms have delivered their respective opinions to Marathon or Ashland, as applicable, each investment banking firm shall, at a single meeting at which Marathon, Ashland, the Company and the other investment banking firm are present, make a presentation with respect to its 7.03(b) Initial Opinion Value. At such presentation, Marathon, Ashland, the Company and the other investment banking firm shall be entitled to ask questions as to the basis for and the calculation of such investment banking firm's 7.03(b) Initial Opinion Value; and

(ii) Marathon and Ashland shall, within five Business Days after the date Marathon and Ashland receive the 7.03(b) Initial Opinion Values (such fifth Business Day being referred to herein as the "7.03(b) Subsequent Appraisal Process Commencement Date"), jointly select a third nationally recognized investment banking firm to (i) prepare a 7.03(b) Appraisal Report and (ii) deliver an oral and written opinion addressed to Marathon and Ashland as to the 7.03(b) Discount Amount. The fees and expenses of such third investment banking firm shall be paid 50% by Marathon and 50% by Ashland. Such third investment banking firm shall not be provided with the 7.03(b) Initial Opinion Values and shall not consult with the initial investment banking firms with respect thereto. During such five-Business Day period, Marathon and Ashland shall negotiate in good faith to independently reach an agreement as to the 7.03(b) Discount Amount. If Marathon and Ashland reach such an agreement, then the 7.03(b) Discount Amount shall be deemed to be the amount so agreed upon by Marathon and Ashland. If Marathon and Ashland are unable to reach such an agreement, then Marathon and Ashland shall instruct such third investment banking firm to deliver its 7.03(b) Appraisal Report, together with its oral and written opinion as to the 7.03(b) Discount Amount (the "7.03(b) Third Opinion Value"), within 15 days after the 7.03(b) Subsequent Appraisal Process Commencement Date. The 7.03(b) Discount Amount in such circumstance shall be deemed to be an amount equal to (1) the sum of (x) the 7.03(b) Third Opinion Value plus (y) whichever of the two 7.03(b) Initial Opinion Values is closer to the 7.03(b) Third Opinion Value (or, if the 7.03(b) Third Opinion Value is exactly halfway between the two 7.03(b) Initial Opinion Values, the 7.03(b) Third Opinion Value), divided by (2) two.

SECTION 7.04. Determination of Fair Market Value of Non-Actively Traded Marathon Equity Securities.

(a) Negotiation Period. If Marathon proposes to issue (or to have issued) to Ashland Marathon Equity Securities that are not Actively Traded Marathon Equity Securities, then for a period of 15 days following the applicable Ashland Put Price Election Date, Marathon and Ashland will negotiate in good faith to seek to reach an agreement as to the Fair Market Value of such Marathon Equity Securities, taking into account, if there is a Holding Period, a discount factor that takes into account such limitation on Ashland's ability to freely trade such Marathon Equity Securities (a "7.04 Discount Amount"). If Marathon and Ashland reach such an agreement, then the Fair Market Value of such Marathon Equity Securities shall be deemed to be the amount so agreed upon by Marathon and Ashland.

(b) Appraisal Process. In the event Marathon and Ashland are unable to reach an agreement as to such Fair Market Value of Marathon Equity Securities and such 7.04 Discount Amount, if any, within the 15-day period referred to in clause (a) above, then within five Business Days after the expiration of such 15-day period (such fifth Business Day being referred to herein as the "7.04 Appraisal Process Commencement Date"), Marathon and Ashland each shall select a nationally recognized investment banking firm to (i) prepare a report which (1) sets forth such investment banking firm's determination of the Fair Market Value of such Marathon Equity Securities (which shall be a single amount as opposed to a range), taking into account, if there is a Holding Period, a 7.04 Discount Amount, which is determined by such investment banking firm, and (2) includes work papers which separately indicate the basis for and the calculation of the Fair Market Value of such Marathon Equity Securities and, if there is a Holding Period, the basis for and the calculation of the 7.04 Discount Amount (a "7.04 Appraisal Report") and (ii) deliver to Marathon or Ashland, as the case may be, an oral and written opinion addressed to such party as to the Fair Market Value of such Marathon Equity Securities (which opinion shall take into account a 7.04 Discount Amount if there is a Holding Period with respect to such Marathon Equity Securities). The fees and expenses of each investment banking firm shall be paid by the party selecting such investment banking firm. Each of Marathon and Ashland shall instruct its respective investment banking firm to (i) not consult with the other investment banking firm with respect to its view as to the Fair Market Value of such Marathon Equity Securities and the 7.04 Discount Amount prior to the time that both investment banking firms have delivered their respective opinions to Marathon and Ashland, as applicable, (ii) deliver their respective 7.04 Appraisal Reports, together with their oral and written opinions as to the Fair Market Value of such Marathon Equity Securities (the "7.04 Initial Opinion Values"), within 15 days after the 7.04 Appraisal Process Commencement Date, and (iii) deliver a copy of its written opinion and its 7.04 Appraisal Report to the Company, the other party and the other party's investment banking firm at the time it delivers its oral and written opinion to Marathon or Ashland, as applicable.

If the 7.04 Initial Opinion Values differ and the lesser 7.04 Initial Opinion Value equals or exceeds 90% of the greater 7.04 Initial Opinion Value, the Fair Market Value of such Marathon Equity Securities shall be deemed to be an amount equal to (1) the sum of the 7.04 Initial Opinion Values divided by (2) two.

If the 7.04 Initial Opinion Values differ and the lesser 7.04 Initial Opinion Value is less than 90% of the greater 7.04 Initial Opinion Value, then:

(i) within two Business Days after both investment banking firms have delivered their respective opinions to Marathon or Ashland, as applicable, each investment banking firm shall, at a single meeting at which Marathon, Ashland, the Company and the other investment banking firm are present, make a presentation with respect to its 7.04 Initial Opinion Value. At such presentation, Marathon, Ashland, the Company and the other investment banking firm shall be entitled to ask questions as to the basis for and the calculation of such investment banking firm's 7.04 Initial Opinion Value; and

(ii) Marathon and Ashland shall, within five Business Days after the date Marathon and Ashland receive the 7.04 Initial Opinion Values (such fifth Business Day being referred to herein as the "7.04 Subsequent Appraisal Process Commencement Date"), jointly select a third nationally recognized investment banking firm to (i) prepare a 7.04 Appraisal Report and (ii) deliver an oral and written opinion addressed to Marathon and Ashland as to the Fair Market Value of such Marathon Equity Securities (which opinion shall take into account a 7.04 Discount Amount if there is a Holding Period with respect to such Marathon Equity Securities). The fees and expenses of such third investment banking firm shall be paid 50% by Marathon and 50% by Ashland. Such third investment banking firm shall not be provided with the 7.04 Initial Opinion Values and shall not consult with the initial investment banking firms with respect thereto. During such five-Business Day period, Marathon and Ashland shall negotiate in good faith to independently reach an agreement as to the Fair Market Value of such Marathon Equity Securities. If Marathon and Ashland reach such an agreement, then the Fair Market Value of such Marathon Equity Securities shall be deemed to be the amount so agreed upon by Marathon and Ashland. If Marathon and Ashland are unable to reach such an agreement, then Marathon and Ashland shall instruct such third investment banking firm to deliver its 7.04 Appraisal Report, together with its oral and written opinion as to the Fair Market Value of such Marathon Equity Securities (the "7.04 Third Opinion Value"), within 15 days after the 7.04 Subsequent Appraisal Process Commencement Date. The Fair Market Value of such Marathon Equity Securities in such circumstance shall be deemed to be an amount equal to (i) the sum of (x) the 7.04 Third Opinion Value plus (y) whichever of the two 7.04 Initial Opinion Values is closer to the 7.04 Third Opinion Value (or, if the 7.04 Third Opinion Value is exactly halfway between the two 7.04 Initial Opinion Values, the 7.04 Third Opinion Value), divided by (ii) two.

ARTICLE VIII
Certain Matters Relating to Securities

SECTION 8.01. Certain Requirements with Respect to Marathon Debt Securities.

All debt securities issued to Ashland pursuant to Section 4.02(c) shall (i) be unsecured senior public fixed income debt securities of (a) USX or (b) Marathon and fully guaranteed as to performance by USX; (ii) have maturities of 5 to 7 years; (iii) have yields which are comparable to those of 5 to 7 year public debt instruments issued by companies whose Long Term Debt at the time of the issuance of such debt securities to Ashland is rated by S&P and Moody's at least equal to the respective ratings by S&P and Moody's of USX's Long Term Debt; (iv) be priced to trade at par initially; and (v) have covenants substantially the same as those included in other outstanding senior publicly traded debt instruments of USX, including a negative pledge providing for pari passu security rights and usual and customary successorship provisions concerning changes in USX's ownership (all such debt securities are referred to herein as "Marathon Debt Securities").

SECTION 8.02. Procedures with Respect to the Issuance of Securities.

All Securities to be issued hereunder shall be accompanied on the Closing Date or applicable Installment Payment Date by (i) a certificate from an authorized officer of the Issuer and (ii) an opinion from such Issuer's counsel, in each case as to such matters as Ashland may reasonably request, including, but not limited to the matters substantially as follows (which shall be made as of the Closing Date or applicable Installment Payment Date):

(i) the Issuer is a corporation duly organized, validly existing and in good standing under the laws of the jurisdiction of its incorporation with the power and authority to own, lease and operate its assets and to conduct the business now being or to be conducted by it. The Issuer is duly authorized, qualified or licensed to do business as a foreign corporation or other organization in good standing in each of the jurisdictions in which its right, title or interest in or to any of the assets held by it or the business conducted by it requires such authorization, qualification or licensing, except where the failure to be so authorized, qualified, licensed or in good standing would not, individually or in the aggregate, result in an Issuer Material Adverse Effect;

(ii) the Issuer's authorized capitalization is as set forth in its Exchange Act filings (or, in the circumstance where Ashland has made a Demand Registration, as set forth in the Registration Statement or Offering Memorandum, as applicable, with respect to such Securities). All of the outstanding equity securities of the Issuer are duly and validly authorized and issued, are fully paid and nonassessable and were not issued in violation of or subject to any preemptive rights or other contractual rights to purchase securities;

(iii) if such Securities are Marathon Equity Securities, such Securities are duly authorized, validly issued and outstanding, are fully paid and nonassessable, and were not issued in violation of or subject to any preemptive rights or other contractual rights to purchase securities;

(iv) if such Securities are Marathon Debt Securities, such Securities have been duly authorized and validly issued by the Issuer and constitute legal, valid and binding obligations of the Issuer enforceable against the Issuer in accordance with their terms, except as such enforcement is subject to the effect of any applicable bankruptcy, insolvency, reorganization or other law relating to or affecting creditors' rights generally and general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law); '

(v) such Securities conform in all material respects to the description thereof contained in the Issuer's Exchange Act filings (or, in the circumstance where Ashland has made a Demand Registration, to the description thereof contained in the Registration Statement or Offering Memorandum, as applicable, with respect to such Securities) and the certificates evidencing such Securities will be, upon issuance, in due and proper form;

(vi) if such Securities are Marathon Equity Securities, such Securities have been authorized conditionally for listing on each national securities exchange on which the other securities of the Issuer of the same class are listed at the time of the Closing Date or Installment Payment Date, subject to issuance and certain other conditions that are not material;

(vii) if such Securities are Marathon Debt Securities, the execution and delivery by the Issuer of each agreement pursuant to which such Securities have been issued or which relate to such Securities (each, a "Securities Document") and the consummation by it of the transactions contemplated thereby have been duly authorized and approved by all necessary corporate or other action on the part of the Issuer. Each Securities Document has been duly executed and delivered by the Issuer and constitutes its legal, valid and binding obligation, enforceable against it in accordance with its terms, except as such enforcement is subject to the effect of any applicable bankruptcy, insolvency, reorganization or other law relating to or affecting creditors' rights generally and general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law);

(viii) neither the execution and delivery by the Issuer of the Securities Documents (in the case of Marathon Debt Securities), nor the issuance of the Securities pursuant to this Agreement andor such Securities Documents will (a) conflict with, or results in the breach of any provision of, the charter or by-laws or similar governing or organizational documents of the Issuer or any of its subsidiaries, (b) violate any Applicable Law or any permit, order, award, injunction, decree or judgment of any Governmental Authority applicable to or binding upon the Issuer or any of its subsidiaries or to which any of their respective properties is subject or (c) violate, conflict with or result in the breach or termination of, or otherwise give any other person the right to terminate, or constitute a default, event of default or an event which with notice, lapse of time or both, would constitute a default or event of default under the terms of, any mortgage, indenture, deed of trust or lease or other agreement or instrument to which the Issuer or any of its subsidiaries is a party or by which any of their respective properties or assets is subject, except, in the case of clauses (b) and (c) for such violations, conflicts, breaches, terminations and defaults which would not, individually or in the aggregate, result in an Issuer Material Adverse Effect; and

(ix) except as set forth on a schedule to such certificate or opinion, no Governmental Approval or other consent is required by the Issuer for the execution and delivery by it of the Securities Documents (in the case of Marathon Debt Securities) or the issuance of the Securities pursuant to this Agreement andor such Securities Documents, except (a) for such Governmental Approvals or other consents as have been obtained or (b) where the failure to obtain such Governmental Approvals or other consents would not, individually or in the aggregate, result in an Issuer Material Adverse Effect.

If any Securities are issued by Marathon and guaranteed by USX, each of Marathon and USX shall provide Ashland with a certificate and an opinion of counsel in accordance with this Section 8.02.

SECTION 8.03. Holding Period.

If Marathon elects (by so notifying Ashland in the Ashland Put Price Election Notice) to impose a Holding Period with respect to sales by Ashland of Marathon Equity Securities issued to Ashland on the Closing Date or on an Installment Payment Date, as applicable, then Ashland shall not be permitted to sell such Marathon Equity Securities during such Holding Period. The term "Holding Period", with respect to any Marathon Equity Securities, means the period commencing on the Closing Date or applicable Installment Payment Date and ending on such later date as Marathon shall state in the Ashland Put Price Election Notice; provided that the length of a Holding Period with respect to any Marathon Equity Securities shall in no event exceed 30 days.

SECTION 8.04. Manner of Sale of Marathon Equity Securities.

Ashland agrees to sell all Marathon Equity Securities (i) pursuant to a bona fide Underwritten Public Offering managed by one or more Bulge Bracket Investment Banking Firms selected by Ashland, or by one or more other investment banking firms selected by Ashland and to which Marathon or USX shall not have reasonably objected, in a manner reasonably designed to effect a broad distribution of such Marathon Equity Securities (a "Qualifying Public Offering"), (ii) to any person, provided that after giving effect to such sale such person beneficially owns, together with such person's Affiliates, no more than 5% of the Marathon Equity Securities of the relevant issuer then outstanding on a fully diluted basis (a "Fully Distributed Sale") or (iii) to a broker or underwriter selected by Ashland who agrees to effect any subsequent transfer by it of such Marathon Equity Securities in a Qualifying Public Offering or a Fully Distributed Sale.

ARTICLE IX
Closing; Conditions to Closing; Consequences of Delay

SECTION 9.01. Closing.

(a) Closing Date. The closing (the "Closing") of (i) the purchase and sale of Ashland's Membership Interests and the Ashland LOOPLOCAP Interest pursuant to Marathon's exercise of its Special Termination Right or Marathon Call Right or Ashland's exercise of its Ashland Put Right or (ii) the purchase and sale of Marathon's Membership Interests pursuant to Ashland's exercise of its Special Termination Right, shall be held at the offices of Marathon, at 10:00 a.m. on the later of (x) the 60th day after the Appraised Value Determination Date (or at such other place or at such other time or such other date as Marathon and Ashland shall mutually agree) (the "Scheduled Closing Date") and (y) the fifth Business Day following the satisfaction or waiver of all conditions to the obligations of Marathon and Ashland set forth in Section 9.02. The date on which the Closing actually occurs is referred to herein as the "Closing Date".

(b) Purchase Procedures in the Event of the Exercise by Marathon of its Special Termination Right or its Marathon Call Right. In the event that Marathon exercises its Special Termination Right or Marathon Call Right, at the Closing:

(i) Marathon shall deliver to Ashland, in Cash or by wire transfer to a bank account designated in writing by Ashland, immediately available funds in an amount equal to the sum of (x) the Special Termination Price or Marathon Call Price, as applicable, plus (y) the amount of interest payable pursuant to Section 3.01, plus (z) the amount of interest, if any, payable pursuant to Section 9.04(b), 9.05, 9.08(b) or 9.09;

(ii) Ashland shall Transfer to Marathon (or, if Marathon so elects by written notice to Ashland, a Wholly Owned Subsidiary of Marathon or USX) in accordance with Article X of the LLC Agreement, all of Ashland's Membership Interests;

(iii) Ashland shall Transfer to Marathon or, if Marathon so elects by written notice to Ashland, to the Company or such other person as Marathon shall direct, the Ashland LOOPLOCAP Interest; and

(iv) the Company shall release to Marathon any amounts held in the Escrow Account, including any income earned thereon.

(c) Purchase Procedures in the Event of the Exercise by Ashland of its Ashland Put Right. In the event that Ashland exercises its Ashland Put Right, at the Closing:

(i) Marathon shall deliver to Ashland, in Cash or by wire transfer to a bank account designated in writing by Ashland, immediately available funds in an amount equal to the sum of (x) the Cash portion of the Ashland Put Price or first Installment Payment, as applicable, plus (y) the amount of interest payable pursuant to Section 4.01, plus (z) the amount of interest, if any, payable pursuant to Section 9.04(b), 9.05, 9.08(b) or 9.09;

(ii) Marathon andor USX, as applicable, shall issue the Securities to be issued on the Closing Date, if any, which Securities shall be accompanied by the certificate(s) and opinion(s) referred to in Section 8.02;

(iii) Ashland shall Transfer to Marathon or, if Marathon so elects by written notice to Ashland, a Wholly Owned Subsidiary of Marathon or USX in accordance with Article X of the LLC Agreement, all of Ashland's Membership Interests;

(iv) Ashland shall Transfer to Marathon or, if Marathon so elects by written notice to Ashland, to the Company or such other person as Marathon shall direct, the Ashland LOOPLOCAP Interest; and

(v) the Company shall release to Marathon any amounts held in the Escrow Account, including any income earned thereon.

In addition, on each of two remaining Scheduled Installment Payment Dates, if any, (i) Marathon shall deliver to Ashland, in Cash or by wire transfer to a bank account (which bank account has been designated in writing by Ashland at least two Business Days prior to the applicable Installment Payment Date), immediately available funds in an amount equal to the sum of (x) the Cash portion of the second and third Installment Payments, respectively, plus (y) the amount of interest payable pursuant to Section 4.01, plus (z) the amount of interest, if any, payable pursuant to Section 9.04(b) or 9.05; and (ii) Marathon andor USX, as applicable, shall issue the Securities to be issued on such Installment Payment Dates, if any, which Securities shall be accompanied by the certificate(s) and opinion(s) referred to in Section 8.02.

(d) Purchase Procedures in the Event of the Exercise by Ashland of its Special Termination Right. In the event that Ashland exercises its Special Termination Right at the Closing:

(i) Ashland shall deliver to Marathon, in Cash or by wire transfer to a bank account designated in writing by Marathon, immediately available funds in an amount equal to the sum of (x) the Special Termination Price plus (y) the amount of interest payable pursuant to Section 2.01, plus (z) the amount of interest, if any, payable pursuant to Section 9.08(b) or 9.09;

(ii) Marathon shall Transfer to Ashland (or, if Ashland so elects by written notice to Marathon, a Wholly Owned Subsidiary of Ashland) in accordance with Article X of the LLC Agreement, all of Marathon's Membership Interests; and

(iii) the Company shall release to Ashland any amounts held in the Escrow Account, including any income earned thereon.

SECTION 9.02. Conditions to Closing.

(a) Marathon's Obligation in the Event of an Exercise by Marathon of its Special Termination Right or its Marathon Call Right or an Exercise by Ashland of its Ashland Put Right. Marathon's obligation to purchase and pay for Ashland's Membership Interests and the Ashland LOOPLOCAP Interest pursuant to this Agreement in the event of an exercise by Marathon of its Special Termination Right or its Marathon Call Right or in the event of an exercise by Ashland of its Ashland Put Right is subject in each case to the satisfaction (or waiver by Marathon) as of the Closing of the following conditions:

(i) As of the Closing Date, there shall be no (i) injunction or restraining order of any nature issued by any Governmental Authority which directs, or which has the effect of directing, that the Closing shall not be consummated as herein provided or (ii) investigation, action or other proceeding that shall have been brought by any Governmental Authority and be pending on the Closing Date, or that shall have been threatened by any Governmental Authority, in any such case against Marathon or Ashland in connection with the consummation of the transactions contemplated by this Agreement which is reasonably likely to result in an injunction or restraining order which directs, or which has the effect of directing, that the Closing shall not be consummated as herein provided;

(ii) the waiting period under the HSR Act, if applicable to the purchase and sale of Ashland's Membership Interests pursuant to this Agreement shall have expired or been terminated; and

(iii) Ashland shall have Transferred to Marathon (or, if Marathon shall have so elected by written notice to Ashland, a Wholly Owned Subsidiary of Marathon or USX) all of its Membership Interests on the Closing Date free and clear of all Liens.

It is understood and agreed that a breach by Ashland of any of its representations or warranties in this Agreement shall not constitute a condition to Marathon's obligation to purchase and pay for Ashland's Membership Interests and the Ashland LOOPLOCAP Interest pursuant to this Agreement in the circumstances set forth above; provided that Marathon shall not be deemed to have waived any right to make a Claim against Ashland with respect to any Loss that Marathon suffers as a result of any such breach.

(b) Ashland's Obligation in the Event of an Exercise by Marathon of its Special Termination Right or its Marathon Call Right or an Exercise by Ashland of its Ashland Put Right. Ashland's obligation to sell its Membership Interests and the Ashland LOOPLOCAP Interest to Marathon pursuant to this Agreement in the event of an exercise by Marathon of its Special Termination Right or its Marathon Call Right or in the event of an exercise by Ashland of its Ashland Put Right is subject in each case to the satisfaction (or waiver by Ashland) as of the Closing of the following conditions:

(i) As of the Closing Date, there shall be no (i) injunction or restraining order of any nature issued by any Governmental Authority which directs, or which has the effect of directing, that the Closing shall not be consummated as herein provided or (ii) investigation, action or other proceeding that shall have been brought by any Governmental Authority and be pending on the Closing Date, or threatened by any Governmental Authority, in any such case against Marathon or Ashland in connection with the consummation of the transactions contemplated by this Agreement which is reasonably likely to result in an injunction or restraining order which directs, or which has the effect of directing, that the Closing shall not be consummated as herein provided;

(ii) the waiting period under HSR Act, if applicable to the purchase and sale of Ashland's Membership Interests pursuant to this Agreement shall have expired or been terminated;

(iii) Marathon shall have delivered to Ashland, in Cash or by wire transfer to a bank account designated in writing by Ashland, immediately available funds in an amount equal to (x) the Special Termination Price or Marathon Call Price, as applicable, or the Cash portion of the Ashland Put Price or applicable Installment Payment, plus (y) the amount of interest payable pursuant to Section 3.01 or 4.01, as applicable, plus (z) the amount of interest, if any, payable pursuant to Section 9.04(b) or 9.05; and

(iv) Marathon or USX, as applicable, shall have issued the Securities to be issued on the Closing Date, if any, accompanied by the certificate(s) and opinion(s) referred to in Section 8.02.

It is understood and agreed that a breach by Marathon or USX of any of its respective representations or warranties in this Agreement shall not constitute a condition to Ashland's obligation to sell its Membership Interests and the Ashland LOOPLOCAP Interest to Marathon pursuant to this Agreement in the circumstances set forth above; provided that Ashland shall not be deemed to have waived any right to make a Claim against Marathon or USX with respect to any Loss that Ashland suffers as a result of any such breach.

(c) Ashland's Obligation in the Event of an Exercise by Ashland of its Special Termination Right. Ashland's obligation to purchase and pay for Marathon's Membership Interests pursuant to this Agreement in the event of an exercise by Ashland of its Special Termination Right is subject to the satisfaction (or waiver by Ashland) as of the Closing of the following conditions:

(i) As of the Closing Date, there shall be no (i) injunction or restraining order of any nature issued by any Governmental Authority which directs, or which has the effect of directing, that the Closing shall not be consummated as herein provided or (ii) investigation, action or other proceeding that shall have been brought by any Governmental Authority and be pending on the Closing Date, or that shall have been threatened by any Governmental Authority, in any such case against Marathon or Ashland in connection with the consummation of the transactions contemplated by this Agreement which is reasonably likely to result in an injunction or restraining order which directs, or which has the effect of directing, that the Closing shall not be consummated as herein provided;

(ii) the waiting period under the HSR Act, if applicable to the purchase and sale of Marathon's Membership Interests pursuant to this Agreement shall have expired or been terminated; and

(iii) Marathon shall have Transferred to Ashland (or, if Ashland shall have so elected by written notice to Marathon, a Wholly Owned Subsidiary of Ashland) all of its Membership Interests on the Closing Date free and clear of all Liens.

It is understood and agreed that a breach by Marathon or USX of any of its respective representations or warranties in this Agreement shall not constitute a condition to Ashland's obligation to purchase and pay for Marathon's Membership Interests pursuant to this Agreement in the circumstances set forth above; provided that Ashland shall not be deemed to have waived any right to make a Claim against Marathon or USX with respect to any Loss that Ashland suffers as a result of any such breach.

(d) Marathon's Obligation in the Event of an Exercise by Ashland of its Special Termination Right. Marathon's obligation to sell its Membership Interests to Ashland pursuant to this Agreement in the event of an exercise by Ashland of its Special Termination Right is subject to the satisfaction (or waiver by Marathon) as of the Closing of the following conditions:

(i) As of the Closing Date, there shall be no (i) injunction or restraining order of any nature issued by any Governmental Authority which directs, or which has the effect of directing, that the Closing shall not be consummated as herein provided or (ii) investigation, action or other proceeding that shall have been brought by any Governmental Authority and be pending on the Closing Date, or threatened by any Governmental Authority, in any such case against Marathon or Ashland in connection with the consummation of the transactions contemplated by this Agreement which is reasonably likely to result in an injunction or restraining order which directs, or which has the effect of directing, that the Closing shall not be consummated as herein provided;

(ii) the waiting period under HSR Act, if applicable to the purchase and sale of Marathon's Membership Interests pursuant to this Agreement shall have expired or been terminated; and

(iii) Ashland shall have delivered to Marathon, in Cash or by wire transfer to a bank account designated in writing by Marathon, immediately available funds in an amount equal to (x) the Special Termination Price plus (y) the amount of interest payable pursuant to Section 2.01 plus (z) the amount of interest, if any, payable pursuant to Section 9.08(b) or 9.09.

It is understood and agreed that a breach by Ashland of any of its representations or warranties in this Agreement shall not constitute a condition to Marathon's obligation to sell its Membership Interests to Ashland pursuant to this Agreement in the circumstances set forth above; provided that Marathon shall not be deemed to have waived any right to make a Claim against Ashland with respect to any Loss that Marathon suffers as a result of any such breach.

(e) Consequences of Inability To Transfer the Ashland LOOPLOCAP Interest on the Closing Date. It shall not be a condition to the Closing of the Marathon Call Right, the Ashland Put Right or the Marathon Special Termination Right, as applicable, that Ashland shall have Transferred the Ashland LOOPLOCAP Interest to Marathon, the Company or such other person as Marathon shall direct. In the event that any consents or approvals required for such Transfer are not obtained prior to the Closing of the Marathon Call Right, the Ashland Put Right or the Marathon Special Termination Right, as applicable, and as a consequence Ashland is not able to Transfer the Ashland LOOPLOCAP Interest to Marathon, the Company or such other person as Marathon shall direct, as applicable, on the Closing Date, the parties hereto shall use their commercially reasonable best efforts to achieve any lawful and reasonable (including with respect to the costs and expenses to be borne by Ashland) arrangement proposed by Marathon under which Marathon or the Company, as applicable, shall obtain the economic claims, rights and benefits under the Ashland LOOPLOCAP Interest. Such reasonable arrangement may include (i) Ashland subcontracting, sublicensing or subleasing to Marathon, the Company or such other person as Marathon shall direct, as applicable, any and all of Ashland's rights, and delegating all of Ashland's obligations, under the Ashland LOOPLOCAP Interest, and (ii) Ashland granting to Marathon, the Company or such other person as Marathon shall direct, as applicable, a proxy (the "Ashland LOOPLOCAP Irrevocable Proxy") which shall authorize such party to exercise on Ashland's behalf, all of Ashland's voting rights with respect to the Ashland LOOPLOCAP Interest. The costs and expenses incurred in connection with any such arrangements shall be borne 62% by Marathon and 38% by Ashland.

SECTION 9.03. Consequences of a Delayed Closing of the Marathon Call Right or the Ashland Put Right Where Ashland Is at Fault.

(a) Right to Revoke Ashland Put Exercise Notice or Marathon Call Exercise Notice. If the Closing of the Marathon Call Right or the Ashland Put Right shall not have occurred on or prior to the date that is 180 days after the Scheduled Closing Date, and (i) the delay is due to (x) a failure by Ashland to timely perform in any material respect any of its covenants and agreements contained herein or (y) the fact that any of Ashland's representations and warranties contained herein have ceased to be true and correct in any material respect, and (ii) neither Marathon nor USX shall have (x) failed to timely perform in any material respect any of its covenants and agreements contained herein or (y) breached any of its representations and warranties contained herein in any material respect, then Marathon shall thereafter have the right, exercisable at any time prior to the Closing by written notice to Ashland, to revoke Ashland's Ashland Put Exercise Notice or its Marathon Call Exercise Notice, as applicable.

(b) Adjustment to Ashland Put Price or Marathon Call Price. If the Closing of the Marathon Call Right or the Ashland Put Right does not occur on the Scheduled Closing Date, and (i) the delay is due to (x) a failure by Ashland to timely perform in any material respect any of its covenants and agreements contained herein or (y) the fact that any of Ashland's representations and warranties contained herein have ceased to be true and correct in any material respect, and (ii) neither Marathon nor USX shall have (x) failed to timely perform in any material respect any of its covenants and agreements contained herein or (y) breached any of its representations and warranties contained herein in any material respect, then on such later date on which the Closing actually takes place (such later date being the "Delayed Closing Date") Marathon shall deduct from the Marathon Call Price or the Ashland Put Price (or the first Installment Payment, as applicable) payable to Ashland on the Delayed Closing Date, an amount equal to the amount of interest accrued during the period commencing at 12:01 a.m. on the day immediately following the Scheduled Closing Date and ending on and including the Delayed Closing Date (the "Delayed Closing Date Interest Period") on the Marathon Call Price, or the Ashland Put Price (or the first Installment Payment thereof, as applicable), at a rate perannum equal to the 30-day LIBOR Rate multiplied by 1.5, with daily accrual of interest.

(c) Other Consequences. In the event that Marathon revokes Ashland's Ashland Put Exercise Notice or its Marathon Call Exercise Notice pursuant to Section 9.03(a), each of Marathon and Ashland shall thereafter have the right to exercise their respective Marathon Call Right and Ashland Put Right in accordance with the terms of this Agreement. Any such revocation shall not operate as a release of Ashland from any liability it may have to Marathon for any breach of its obligations under this Agreement and such revocation shall not in any way preclude Marathon from exercising any right or power hereunder or otherwise available to it at law or in equity as a result of any such breach.

SECTION 9.04. Consequences of a Delayed Closing of the Marathon Call Right or the Ashland Put Right Where Marathon or USX Is at Fault.

(a) Revocation of Proxies; Payment of Distributions to Ashland; Right To Revoke Ashland Put Exercise Notice or Marathon Call Exercise Notice. If the Closing of the Marathon Call Right or the Ashland Put Right does not occur on the Scheduled Closing Date, and (i) the delay is due to (x) a failure by Marathon or USX to timely perform in any material respect any of its respective covenants and agreements contained herein or (y) the fact that any of Marathon's or USX's respective representations and warranties contained herein (or in any certificate required to be delivered to Ashland pursuant to Section 9.02(b)(iv)) have ceased to be true and correct in any material respect, and (ii) Ashland shall not have (x) failed to timely perform in any material respect any of its covenants and agreements contained herein or (y) breached any of its representations and warranties contained herein in any material respect, then (i) effective as of 12:01 a.m. on the day immediately following the Scheduled Closing Date, all Ashland Representatives Revocable Proxies and the Ashland LOOPLOCAP Revocable Proxy shall automatically be revoked; (ii) Marathon shall, and shall cause each of its Representatives to, promptly take all such actions as are necessary to provide that the Company shall thereupon resume making distributions of Distributable Cash and Tax Liability Distributions directly to Ashland pursuant to Article V of the LLC Agreement; (iii) Marathon shall immediately pay to Ashland an amount equal to all Exercise Period Distributions received by Marathon from the

Company in accordance with the provisions of Section 5.01(a)(ii), together with interest on each such Exercise Period Distribution at a rate per annum equal to the Base Rate, with daily accrual of interest, from (but excluding) the date such amount was otherwise payable to Ashland (or, if earlier, the date such amount was paid to Marathon) to (and including) the date such amount is paid to Ashland in accordance with the provisions of this clause (iii); (iv) the Company shall immediately release to Ashland all amounts then held in the Escrow Account, including any income earned thereon; and (v) if the Closing shall not have occurred on or prior to the date that is 180 days after the Scheduled Closing Date, Ashland thereafter shall have the right, exercisable at any time prior to the Closing by written notice to Marathon, to revoke its Ashland Put Exercise Notice or Marathon's Marathon Call Exercise Notice, as applicable.

(b) Adjustments to Ashland Put Price or Marathon Call Price. In addition, if the Closing of the Marathon Call Right or the Ashland Put Right does not occur on the Scheduled Closing Date, and (i) the delay is due to (x) a failure by Marathon or USX to timely perform in any material respect any of its respective covenants and agreements contained herein or (y) the fact that any of Marathon's or USX's respective representations and warranties contained herein have ceased to be true and correct in any material respect, and (ii) Ashland shall not have (x) failed to timely perform in any material respect any of its covenants and agreements contained herein or (y) breached any of its representations and warranties contained herein in any material respect, then Marathon shall be entitled to deduct from the Marathon Call Price or from the Ashland Put Price (or the first Installment Payment, as applicable) payable to Ashland on the Delayed Closing Date, an amount (the "9.04(b) Post-Scheduled Closing Date Distribution Amount") equal to the amount of any Ashland Exercise Period Distributions that Ashland shall have received from the Company in Cash during the Delayed Closing Date Interest Period and, on the Delayed Closing Date, Marathon shall pay to Ashland in addition to the Marathon Call Price or the Ashland Put Price (or the first Installment Payment, as applicable) and related accrued interest payable pursuant to Section 3.01 or 4.01, as applicable, an amount in Cash equal to the amount of interest accrued during the Delayed Closing Interest Period on an amount equal to (1) the Marathon Call Price or the Ashland Put Price (or the first Installment Payment thereof, as applicable) minus (2) the 9.04(b) Post-Scheduled Closing Date Distribution Amount, at a rate per annum equal to the 30-day LIBOR Rate multiplied by 1.5, with daily accrual of interest.

(c) Other Consequences. In the event that Ashland revokes its Ashland Put Exercise Notice or Marathon's Marathon Call Exercise Notice pursuant to clause (v) of Section 9.03(a), each of Ashland and Marathon shall thereafter have the right to exercise their respective Ashland Put Right and Marathon Call Right in accordance with the terms of this Agreement. Any such revocation shall not operate as a release of Marathon or USX from any liability it may have to Ashland for any breach of its obligations under this Agreement and such revocation shall not in any way preclude Ashland from exercising any right or power hereunder or otherwise available to it at law or in equity as a result of any such breach.

SECTION 9.05. Consequences of a Delayed Closing of the Marathon Call Right or the Ashland Put Right Where No Party Is at Fault.

If the Closing of the Marathon Call Right or the Ashland Put Right does not occur on the Scheduled Closing Date, and the delay is not due to a failure by any party hereto to timely perform in any material respect any of its respective covenants and agreements contained herein or to the fact that any party's representations and warranties contained herein have ceased to be true and correct in any material respect, then Marathon shall pay to Ashland on the Delayed Closing Date, in addition to the Marathon Call Price or the Ashland Put Price (or the first Installment Payment, as applicable) and related accrued interest payable pursuant to Section 3.01 or 4.01, as applicable, an amount in Cash equal to the amount of interest accrued during the Delayed Closing Interest Period on the Marathon Call Price or the Ashland Put Price (or the first Installment Payment, as applicable), at a rate per annum equal to the Base Rate, with daily accrual of interest. If the Delayed Closing Date does not occur on or prior to the date that is 180 days after the Scheduled Closing Date and the delay is not due to an action or failure to act by any of Marathon, USX or Ashland, then (i) effective as of 12:01 a.m. on the day immediately following the last day of such 180-day period, all Ashland Representatives Revocable Proxies and the Ashland LOOPLOCAP Revocable Proxy shall automatically be revoked; (ii) Marathon shall, and shall cause each of its Representatives to, promptly take all such actions as are necessary to provide that the Company shall resume making distributions of Distributable Cash and Tax Liability Distributions directly to Ashland pursuant to Article V of the LLC Agreement; (iii) Marathon shall immediately pay to Ashland an amount equal to all Exercise Period Distributions received by Marathon from the Company in accordance with the provisions of Section 5.01(a)(ii), together with interest on each such Exercise Period Distribution at a rate per annum equal to the Base Rate, with daily accrual of interest, from (but excluding) the date such amount was otherwise payable to Ashland (or, if earlier, the date such amount was paid to Marathon) to (and including) the date such amount is paid to Ashland in accordance with the provisions of this clause (iii); (iv) the Company shall immediately release to Ashland all amounts then held in the Escrow Account, including any income earned thereon; and (v) the parties shall be restored to their rights as though the Ashland Put Right or the Marathon Call Right had never been exercised, without liability to any party and without any effect on the ability of Ashland to exercise its Ashland Put Right or Marathon to exercise its Marathon Call Right in accordance with the terms of this Agreement in the future.

SECTION 9.06. Consequences of Delayed Second or Third Scheduled Installment Payment.

If Marathon shall fail to make an Installment Payment on the second or third Scheduled Installment Payment Date, if applicable, then on such later date on which the applicable Installment Payment is actually made (such later date being a "Delayed Installment Payment Date"), Marathon shall pay to Ashland, in addition to the applicable Installment Payment and related accrued interest payable pursuant to Section 3.01 or 4.01, as applicable, an amount in Cash equal to the amount of interest accrued during the period commencing on the day immediately following the Scheduled Installment Payment Date and ending on and including the date of the payment of the relevant Installment Payment (the "Delayed Installment Payment Date Interest Period") on the applicable Installment Payment, at a rate per annum equal to the 30 day LIBOR Rate multiplied by 1.5, with daily accrual of interest.

SECTION 9.07. Consequences of a Delayed Closing of the Special Termination Right Where Terminating Member Is at Fault.

(a) Continuation of Term of the Company; Right to Specific Performance. If the Closing of the Special Termination Right shall not have occurred on or prior to the Scheduled Closing Date, and (i) the delay is due to (x) a failure by the Terminating Member (or, if Marathon is the Terminating Member, Marathon or USX) to timely perform in any material respect any of its covenants and agreements contained herein or (y) the fact that any of the Terminating Member's (or, if Marathon is the Terminating Member, Marathon's or USX's) representations and warranties contained herein have ceased to be true and correct in any material respect, and (ii) the Non-Terminating Member (or, if Marathon is the Non-Terminating Member, Marathon or USX) shall not have (x) failed to timely perform in any material respect any of its covenants and agreements contained herein or (y) breached any of its representations and warranties contained herein in any material respect, then the Non-Terminating Member shall have the right to elect, by written notice to the Company and the Terminating Member, to either (i) terminate the Term of the Company at the end of the Initial Term or the then-current 10-year extension thereof, as applicable (in which case the Term of the Company shall automatically terminate upon the expiration of the Initial Term or the then-current 10-year extension thereof), or (ii) extend the Term of the Company for two additional years following the expiration of the Initial Term or the then-current 10-year extension thereof, as applicable (in which case the Term of the Company shall automatically be extended for such additional two-year period).

(b) Adjustment to Special Termination Price. If the Closing of the Special Termination Right does not occur on the Scheduled Closing Date, and (i) the delay is due to (x) a failure by the Terminating Member (or, if Marathon is the Terminating Member, Marathon or USX) to timely perform in any material respect any of its covenants and agreements contained herein or (y) the fact that any of the Terminating Member's (or, if Marathon is the Terminating Member, Marathon's or USX's) representations and warranties contained herein have ceased to be true and correct in any material respect, and (ii) the Non-Terminating Member (or, if Marathon is the Terminating Member, Marathon or USX) shall not have (x) failed to timely perform in any material respect any of its covenants and agreements contained herein or (y) breached any of its representations and warranties contained herein in any material respect, then on the Delayed Closing Date the Non-Terminating Member shall deduct from the Special Termination Price payable to the Terminating Member on the Delayed Closing Date, an amount equal to the amount of interest accrued during the Delayed Closing Date Interest Period on the Special Termination Price, at a rate per annum equal to the 30-day LIBOR Rate multiplied by 1.5, with daily accrual of interest.

SECTION 9.08. Consequences of a Delayed Closing of the Special Termination Right Where Non-Terminating Member Is at Fault.

(a) Revocation of Proxies; Payment of Distributions to Terminating Member; Right to Revoke Special Termination Exercise Notice. If the Closing of the Special Termination Right does not occur on the Scheduled Closing Date, and (i) the delay is due to a failure by the Non-Terminating Member (or, if Marathon is the Non-Terminating Member, Marathon or USX) to timely perform in any material respect any of its covenants and agreements contained herein or (y) the fact that any of the Non-Terminating Member's (or, if Marathon is the Non-Terminating Member, Marathon's or USX's) representations and warranties contained herein have ceased to be true and correct in any material respect, and (ii) the Terminating Member (or, if Marathon is the Terminating Member, Marathon or USX) shall not have (x) failed to timely perform in any material respect any of its covenants and agreements contained herein or (y) breached any of its representations and warranties contained herein in any material respect, then (i) effective as of 12:01 a.m. on the day immediately following the Scheduled Closing Date, all Marathon Representative Revocable Proxies (in the circumstance where Marathon is the Terminating Member) or all Ashland Representative Revocable Proxies and the Ashland LOOPLOCAP Revocable Proxy (in the circumstance where Ashland is the Terminating Member) shall automatically be revoked; (ii) the Non-Terminating Member shall, and shall cause each of its Representatives to, promptly take all such actions as are necessary to provide that the Company shall thereupon resume making distributions of Distributable Cash and Tax Liability Distributions directly to the Terminating Member pursuant to Article V of the LLC Agreement; (iii) the Non-Terminating Member shall immediately pay to the Terminating Member an amount equal to all Exercise Period Distributions received by the Non-Terminating Member from the Company in accordance with the provisions of Section 5.01(a)(ii) or Section 5.01(b)(ii), as applicable, together with interest on each such Exercise Period Distribution at a rate per annum equal to the Base Rate, with daily accrual of interest, from (but excluding) the date such amount was otherwise payable to the Terminating Member (or, if earlier, the date such amount was paid to the Non-Terminating Member) to (and including) the date such amount is paid to the Terminating Member in accordance with the provisions of this clause (iii); (iv) the Company shall immediately release to the Terminating Member all amounts then held in the Escrow Account, including any income earned thereon; and (v) if the Closing shall not have occurred on or prior to the date that is 120 days before the expiration of the Initial Term or the then-current 10-year extension thereof, each of the Terminating Member and the Non-Terminating Member thereafter shall have the right, exercisable at any time prior to the Closing by written notice to the other party, to revoke the Non-Terminating Member's Special Termination Exercise Notice, in which event the Term of the Company shall automatically terminate upon the expiration of the Initial Term or the then-current 10-year extension thereof.

(b) Adjustments to Special Termination Price. In addition, if the Closing of the Special Termination Right does not occur on the Scheduled Closing Date, and (i) the delay is due to (x) a failure by the Non-Terminating Member (or, if Marathon is the Non-Terminating Member, Marathon or USX) to timely perform in any material respect any of its covenants and agreements contained herein or (y) the fact that any of the Non-Terminating Member's (or, if Marathon is the Non-Terminating Member, Marathon's or USX's) representations and warranties contained herein have ceased to be true and correct in any material respect, and (ii) the Terminating Member (or, if Marathon is the Terminating Member, Marathon or USX) shall not have (x) failed to timely perform in any material respect any of its covenants and agreements contained herein or (y) breached any of its representations and warranties contained herein in any material respect, then the Non-Terminating Member shall be entitled to deduct from the Special Termination Price payable to the Terminating Member on the Delayed Closing Date, an amount (the "9.08(b) Post-Scheduled Closing Date Distribution Amount") equal to the amount of any Exercise Period Distributions that the Terminating Member shall have received from the Company in Cash during the Delayed Closing Date Interest Period and, on the Delayed Closing Date, the Non-Terminating Member shall pay to the Terminating Member in addition to the Special Termination Price and related accrued interest payable pursuant to Section 2.01, an amount in Cash equal to the amount of interest accrued during the Delayed Closing Interest Period on an amount equal to (1) the Special Termination Price minus (2) the 9.08(b) Post-Scheduled Closing Date Distribution Amount, at a rate per annum equal to the 30-day LIBOR Rate multiplied by 1.5, with daily accrual of interest.

(c) Other Consequences. In the event that the Terminating Member revokes the Non-Terminating Member's Special Termination Exercise Notice, then the Non-Terminating Member shall not thereafter have the right to exercise its Special Termination Right. Any such revocation shall not operate as a release of the Non-Terminating Member from any liability it may have to the Terminating Member for any breach of its obligations under this Agreement and such revocation shall not in any way preclude the Terminating Member from exercising any right or power hereunder or otherwise available to it at law or in equity as a result of any such breach.

SECTION 9.09. Consequences of Delayed Closing of Special Termination Right Where No Party Is at Fault.

If the Closing of the Special Termination Right does not occur on the Scheduled Closing Date, and the delay is not due to a failure by any party hereto to timely perform in any material respect any of its respective covenants and agreements contained herein or to the fact that any party's representations and warranties contained herein have ceased to be true and correct in any material respect, then the Non-Terminating Member shall pay to the Terminating Member on the Delayed Closing Date, in addition to the Special Termination Price and related accrued interest payable pursuant to Section 2.01, an amount in Cash equal to the amount of interest accrued during the Delayed Closing Interest Period on the Special Termination Price, at a rate per annum equal to the Base Rate, with daily accrual of interest. If the Delayed Closing Date does not occur on or prior to the date that is 120 days before the expiration of the Initial Term or the then-current 10-year extension thereof and the delay is not due to an action or failure to act by the Terminating Member or the Non-Terminating Member, then (i) effective as of 12:01 a.m. on the day immediately following such 120th day before the expiration of the Initial Term or the then-current 10-year extension thereof, all Marathon Representative Revocable Proxies (in the circumstance where Marathon is the Terminating Member) or all Ashland Representative Revocable Proxies and the Ashland LOOPLOCAP Revocable Proxy (in the circumstance where Ashland is the Terminating Member) shall be revoked; (ii) the Non-Terminating Member shall, and shall cause each of its Representatives to, promptly take all such actions as are necessary to provide that the Company shall resume making distributions of Distributable Cash and Tax Liability Distributions directly to the Terminating Member pursuant to Article V of the LLC Agreement; (iii) the Non-Terminating Member shall immediately pay to the Terminating Member an amount equal to all Exercise Period Distributions received by the Non-Terminating Member from the Company in accordance with the provisions of Section 5.01(a)(ii) or Section 5.01(b)(ii), as applicable, together with interest on each such Exercise Period Distribution at a rate per annum equal to the Base Rate, with daily accrual of interest, from (but excluding) the date such amount was otherwise payable to the Terminating Member (or, if earlier, the date such amount was paid to the Non-Terminating Member) to (and including) the date such amount is paid to the Terminating Member in accordance with the provisions of this clause (iii); (iv) the Company shall immediately release to the Terminating Member all amounts then held in the Escrow Account, including any income earned thereon; and (v) the Term of the Company shall automatically terminate upon the expiration of the Initial Term or the then-current 10-year extension thereof.

ARTICLE X
Registration Rights

SECTION 10.01. Registration upon Request.

(a) Ashland shall have the right to make a written demand upon the issuer or, in the case of any Marathon Debt Securities issued by Marathon and guaranteed by USX, issuers of any class of Securities delivered or to be delivered to Ashland as payment of any portion of the Ashland Put Price (both parties hereinafter referred to collectively as the "Issuer"), on not more than six separate occasions (subject to the provisions of this Section 10.01), to either, at Ashland's option, (i) register under the Securities Act all or a portion of such Securities for purposes of a public offering by Ashland of such Securities or (ii) prepare an Offering Memorandum that covers all or a portion of such Securities for purposes of a private placement by Ashland of such Securities (either of such requests being referred to herein as a "Demand Registration") that were not registered under the Securities Act at the time of issuance thereof to Ashland on the Closing Date or Installment Payment Date, as the case may be, and the Issuer shall use its best efforts to file a Registration Statement and cause such Securities to be registered under the Securities Act (in the case of a Demand Registration for a public offering) or to prepare a final Offering Memorandum (in the case of a Demand Registration for a private placement) (i) in the case of any Securities to be delivered to Ashland on the Closing Date or any Installment Payment Date, not later than the Scheduled Closing Date or applicable Scheduled Installment Payment Date or (ii) in the case of any Securities that have been delivered to Ashland on the Closing Date or any Installment Payment Date, in each case not later than 60 days after such written demand by Ashland; provided that each Demand Registration shall cover Securities having an aggregate fair market value (based on the then-current market value of such Securities or, if such market value cannot be determined, based on the expected offering price of such Securities) equal to (i) in the case of a public offering, $100 million or more, unless Ashland shall hold less than $100 million of Securities, in which event, the remaining Securities held by Ashland and (ii) in the case of a private placement, $25 million or more, unless Ashland shall hold less than $25 million of Securities, in which event, the remaining Securities held by Ashland.

(b) Notwithstanding the provisions of Section 10.01(a), the Issuer (i) shall not be obligated to prepare or file more than one Registration Statement pursuant to this Section 10.01 during any six month period (measured from the effective date (or, in the case of a private placement, the closing date) of the most recently requested Demand Registration to the date of the demand by Ashland for a subsequent Demand Registration) and (ii) shall be entitled to postpone the filing of any Registration Statement otherwise required to be prepared and filed by it pursuant to Section 10.01(a), and to prevent Ashland from initially distributing any Offering Memorandum required to be prepared by the Issuer pursuant to Section 10.01(a), in each case (x) if the Issuer is actively pursuing an Underwritten Public Offering, for a period of up to 90 days following the closing of any Underwritten Public Offering; provided that the Issuer is advised by its managing underwriter or underwriters in writing (with a copy to Ashland), that the price at which securities would be offered in such offering would, in its or in their opinion, be materially adversely affected by the registration or the initial dissemination of the Offering Memorandum so requested, or (y) for a period of up to 90 days if the Issuer determines in its reasonable judgment and in good faith that the registration and distribution of such Securities (or the private placement thereof, in the case of a sale by Ashland of such securities pursuant to Section 4(2) or Rule 144A of the Securities Act) would materially adversely impair or interfere with in any material respect any contemplated material financing, acquisition, disposition, corporate reorganization or other similar transaction involving the Issuer or any of its subsidiaries or Affiliates ((x) or (y) being hereinafter referred to as a "Blackout Period"), provided, however, that the aggregate number of days included in all Blackout Periods during any consecutive 12 months shall not exceed 180 days, and; provided further, however, that a period of at least 30 days shall elapse between the termination of any Blackout Period and the commencement of the immediately succeeding Blackout Period. In the event of such postponement, Ashland shall have the right to withdraw such request for registration or request for preparation of an Offering Memorandum by giving written notice to the Issuer within 20 days after receipt of notice of postponement and, in the event of such withdrawal, such request shall not be counted for purposes of determining the number of Demand Registrations to which Ashland is entitled pursuant to Section 10.01(a).

(c) A registration requested pursuant to this Section 10.01 shall not be deemed to have been effected unless the Registration Statement relating thereto (i) has become effective under the Securities Act and (ii) has remained effective for a period of at least 90 days (or such shorter period in which all Securities included in such registration have actually been sold thereunder); provided, however, that if after any Registration Statement requested pursuant to this Section 10.01 becomes effective such Registration Statement is interfered with by any stop order, injunction or other order or requirement of the Commission or other Governmental Authority solely due to the actions or omissions to act of the Issuer prior to being effective for 90 days and less than 75% of the Securities have been sold thereunder, such Registration Statement shall be at the sole expense of the Issuer and shall not constitute a Demand Registration. In addition, a request for the preparation of an Offering Memorandum pursuant to this Section 10.01 shall not be deemed to have been effected unless the information contained in such Offering Memorandum has remained "reasonably current" (as such term is defined in Rule 144A under the Securities Act) for a period of at least 90 days (or such shorter period in which all Securities covered by such Offering Memorandum have actually been sold thereunder); provided, however, that if such Offering Memorandum is interfered with by any stop order, injunction or other order or requirement of the Commission or other Governmental Authority solely due to the actions or omissions to act of the Issuer prior to such Offering Memorandum being made available to Ashland for 90 days and less than 75% of the Securities have been sold pursuant thereto, such Offering Memorandum shall be at the sole expense of the Issuer and shall not constitute a Demand Registration.

(d) On or after the date hereof, the Issuer shall not grant to any other holder of its securities, whether currently outstanding or issued in the future, any incidental or "piggy-back" registration rights with respect to any Registration Statement filed or Offering Memorandum prepared pursuant to a Demand Registration under this Section 10.01 and, without the prior consent of Ashland, will not permit any holder of its securities to participate in any offering or private placement made pursuant to a Demand Registration under this Section 10.01.

(e) If a Demand Registration involves an Underwritten Public Offering and the managing underwriter or underwriters shall advise the Issuer and Ashland in writing that, in its view, the number of securities requested to be included in such registration (including, without limitation, Securities requested to be included by Ashland, securities which the Issuer proposes to be included, and securities proposed to be included by other holders of securities entitled to include securities in such registration pursuant to incidental or "piggy-back" registration rights other than those pursuant to this Article X (the "Other Holders")) exceeds the largest number of shares of securities which can be sold without having an adverse effect on such offering, including the price at which such securities can be sold (the "Maximum Offering Size"), the Issuer shall include in such registration, in the priority listed below, up to the Maximum Offering Size:

(i) first, all Securities requested to be registered by Ashland;

(ii) second, all securities requested to be included in such registration by any Other Holder (allocated, if necessary, for the offering not to exceed the Maximum Offering Size, pro rata among such Other Holders on the basis of the relative number of securities requested to be included in such registration); and

(iii) third, any securities proposed to be registered by the Issuer or by any Other Holders pursuant to incidental or "piggy-back" registration rights.

(f) Ashland may, at any time, prior to the effective date of the Registration Statement or the initial distribution of the Offering Memorandum relating to such request, revoke such request by providing a written notice to the Issuer, in which case such request, as so revoked, shall not constitute a Demand Registration.

SECTION 10.02. Covenants of the Issuer.

(a) Registration Statement Covenants. In the event that any Securities are to be registered pursuant to Section 10.01, the Issuer covenants and agrees that it shall (i) use its best efforts to effect the registration, (ii) cooperate in the sale of the Securities and (iii) as expeditiously as possible:

(1) prepare and file with the Commission a Registration Statement with respect to such Securities on Form S-3, if permitted, or otherwise on any form for which the Issuer then qualifies or which counsel for the Issuer shall deem appropriate, and which form shall be available for the sale of the Securities in accordance with the intended methods of distribution thereof, and use its best efforts to cause such Registration Statement to become and remain effective;

(2) prepare and file with the Commission amendments and supplements to such Registration Statement and prospectus used in connection therewith as may be necessary to maintain the effectiveness of such registration and to comply with the provisions of the Securities Act with respect to the disposition of all securities covered by such Registration Statement until the earlier of (i) such time as all of such securities have been disposed of in accordance with the intended methods of disposition by Ashland set forth in such Registration Statement and (ii) the expiration of 90 days after the date such Registration Statement becomes effective; provided that before filing a Registration Statement or prospectus, or any amendments or supplements thereto, the Issuer shall furnish to Ashland and its counsel, copies of all documents proposed to be filed;

(3) furnish to Ashland such number of copies of such Registration Statement and of each amendment and supplement thereto (in each case including all exhibits), such number of copies of the prospectus and prospectus supplement, as applicable, in conformity with the requirements of the Securities Act, and such other documents as Ashland may reasonably request in order to facilitate the disposition of the Securities by Ashland;

(4) use its best efforts to register or qualify such Securities covered by such Registration Statement under such other securities or blue sky laws of such jurisdictions as Ashland shall reasonably request, and do any and all other acts and things which may be reasonably necessary or advisable to enable Ashland to consummate the disposition in such jurisdictions of the Securities owned by Ashland, except that the Issuer shall not for any such purpose be required to (i) qualify generally to do business as a foreign corporation in any jurisdiction where, but for the requirements of this Section 10.04(a)(4), it would not be obligated to be so qualified, (ii) subject itself to taxation in any such jurisdiction or (iii) consent to general service of process in any such jurisdiction);

(5) use its best efforts to cause such Securities covered by such Registration Statement to be registered with or approved by such other governmental agencies or authorities as may be necessary to enable Ashland to consummate the disposition of such Securities;

(6) notify Ashland at any time when a prospectus relating to a Registration Statement is required to be delivered under the Securities Act within the appropriate period mentioned in Section 10.02(a)(2), of the happening of any event as a result of which such Registration Statement contains an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading in light of the circumstances then existing, and at the request of Ashland, prepare and furnish to Ashland a reasonable number of copies of an amended or supplemental prospectus as may be necessary so that, as thereafter delivered to the purchasers of such Securities, such prospectus shall not contain an untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein not misleading in light of the circumstances then existing;

(7) otherwise use its best efforts to comply with all applicable rules and regulations of the Commission, and make available to Ashland, as soon as reasonably practicable (but not more than eighteen months) after the effective date of the Registration Statement, an earnings statement which shall satisfy the provisions of Section 11(a) of the Securities Act and the rules and regulations promulgated thereunder;

(8) use its best efforts to cause all such Securities that are Marathon Equity Securities to be listed on any securities exchange on which the securities of the Issuer are then listed, if such Securities are not already so listed and if such listing is then permitted under the rules of such exchange, and to provide a transfer agent and registrar for such Securities covered by such Registration Statement no later than the effective date of such Registration Statement;

(9) use its best efforts to obtain a "cold comfort" letter or letters from the Issuer's independent public accountants in customary form; and

(10) cooperate with Ashland and the managing underwriter or underwriters, if any, to facilitate the timely preparation and delivery of certificates (not bearing any restrictive legends) representing the Securities to be sold under such Registration Statement, and enable such Securities to be in such denominations and registered in such names as the managing underwriter or underwriters, if any, or Ashland may request.

(b) Offering Memorandum Covenants. In the event that any Securities are to be sold by Ashland by means of an Offering Memorandum prepared by the Issuer pursuant to Sections 10.01, the Issuer covenants and agrees that it shall (i) cooperate in the sale of the Securities and (ii) as expeditiously as possible:

(1) prepare the Offering Memorandum;

(2) prepare amendments and supplements to such Offering Memorandum as may be necessary to keep the information in such Offering Memorandum "reasonably current" (as such term is defined in Rule 144A under the Securities Act) and to comply with the provisions of the Securities Act with respect to the disposition

of all securities covered by such Offering Memorandum until the earlier of (i) such time as all of such securities have been disposed of in accordance with the intended methods of disposition by Ashland set forth in such Offering Memorandum and (ii) the expiration of 90 days after the date such Offering Memorandum (in definitive form) is circulated to the initial purchasers; provided that before making any amendments or supplements thereto, the Issuer shall furnish to Ashland and its counsel, copies of all proposed amendments or supplements;

(3) furnish to Ashland such number of copies of such Offering Memorandum and of each amendment and supplement thereto (in each case including all exhibits), and such other documents as Ashland may reasonably request in order to facilitate the disposition of the Securities by Ashland;

(4) use its best efforts to register or qualify such Securities covered by such Offering Memorandum under such other securities or blue sky laws of such jurisdictions as Ashland shall reasonably request, and do any and all other acts and things which may be reasonably necessary or advisable to enable Ashland to consummate the disposition in such jurisdictions of the Securities owned by Ashland, except that the Issuer shall not for any such purpose be required to (i) qualify generally to do business as a foreign corporation in any jurisdiction where, but for the requirements of this Section 10.02(b)(4), it would not be obligated to be so qualified, (ii) subject itself to taxation in any such jurisdiction or (iii) consent to general service of process in any such jurisdiction);

(5) use its best efforts to cause such Securities covered by such Offering Memorandum to be registered with or approved by such other governmental agencies or authorities as may be necessary to enable Ashland to consummate the disposition of such Securities;

(6) notify Ashland at any time prior to the completion of the sale of the Securities by Ashland that are covered by the Offering Memorandum, of the happening of any event as a result of which such Offering Memorandum contains an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading in light of the circumstances then existing, and at the request of Ashland, prepare and furnish to Ashland a reasonable number of copies of an amended or supplemental Offering Memorandum as may be necessary so that, as thereafter delivered to the purchasers of such Securities, such Offering Memorandum shall not contain an untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein not misleading in light of the circumstances then existing;

(7) otherwise use its best efforts to comply with all applicable rules and regulations of the Commission;

(8) use its best efforts to cause all such Securities that are Marathon Equity Securities to be listed on any securities exchange on which the securities of the Issuer are then listed, if such Securities are not already so listed and if such listing is then permitted under the rules of such exchange, and to provide a transfer agent and registrar for such Securities covered by such Offering Memorandum no later than the effective date of such Offering Memorandum;

(9) use its best efforts to obtain a "cold comfort" letter or letters from the Issuer's independent public accountants in customary form; and

(10) cooperate with Ashland and the initial purchasers, if any, to facilitate the timely preparation and delivery of certificates representing the Securities to be sold under such Offering Memorandum, and enable such Securities to be in such denominations and registered in such names as the initial purchasers, if any, or Ashland may request.

The Issuer may require Ashland to furnish the Issuer with such information regarding Ashland and pertinent to the disclosure requirements relating to the registration andor the distribution of such Securities pursuant to this Article X as the Issuer may from time to time reasonably request in writing.

Ashland agrees that, upon receipt of any notice from the Issuer of the happening of any event of the kind described in Section 10.02(a)(6) or 10.02(b)(6), or of the imposition by the Issuer of a Blackout Period of the type described in clause (y) of 10.01(b)(ii), Ashland shall forthwith discontinue such disposition of such Securities pursuant to the Registration Statement or Offering Memorandum covering such Securities until Ashland's receipt of the copies of the supplemented or amended prospectus or Offering Memorandum contemplated by Section 10.02(a)(6) and 10.02(b)(6), respectively, or the expiration of such Blackout Period, as applicable, and, if so directed by the Issuer, Ashland shall deliver to the Issuer (at the Issuer's expense) all copies, other than permanent file copies then in Ashland's possession, of the prospectus or Offering Memorandum covering such Securities current at the time of receipt of such notice. In the event the Issuer shall give any such notice, the period mentioned in Section 10.02(a)(2) or 10.02(b)(2), as applicable, shall be extended by the number of days during the period from the date of the giving of such notice pursuant to Section 10.02(a)(6) or 10.02(b)(6), as applicable, and through the date when Ashland shall have received the copies of the supplemented or amended prospectus or Offering Memorandum contemplated by Section 10.02(a)(6) or 10.02(b)(6), respectively, or the expiration of such Blackout Period, as applicable.

SECTION 10.03. Fees and Expenses.

In connection with any registration pursuant to this Article X or the preparation of any Offering Memorandum pursuant to this Article X, (i) Ashland shall pay all agent fees and commissions and underwriting discounts and commissions related to the Securities being sold by Ashland and the fees and disbursements of its counsel and accountants and (ii) the Issuer shall pay all fees and disbursements of its counsel and accountants and the expenses, including fees incurred in the preparation of a cold comfort letter requested by Ashland pursuant to Section 10.02(a)(9) or 10.02(b)(9), as applicable. All others fees and expenses in connection with any Registration Statement or Offering Memorandum (including, without limitation, all registration and filing fees, all printing costs, all fees and expenses of complying with securities or blue sky laws) shall be borne by Ashland; provided that Ashland shall not pay any expenses relating to work that would otherwise be incurred by the Issuer including, but not limited to, the preparation and filing of periodic reports with the Commission.

SECTION 10.04. Indemnification and Contribution.

In the case of any offering registered pursuant to this Article X or any private placement pursuant to an Offering Memorandum prepared by the Issuer pursuant to this Article X, the Issuer agrees to indemnify and hold Ashland, each underwriter or initial purchaser, if any, of the Securities under such registration or covered by such Offering Memorandum and each person who controls any of the foregoing within the meaning of Section 15 of the Securities Act, and any director, officer, employee, stockholder, partner, agent or representative, of the foregoing, harmless against any and all losses, claims, damages or liabilities (including reasonable legal fees and other reasonable expenses incurred in the investigation and defense thereof) (collectively "Losses") to which they or any of them may become subject under the Securities Act or otherwise, insofar as any such Losses shall arise out of or shall be based upon (i) any untrue statement or alleged untrue statement of a material fact contained in the Registration Statement (as amended if the Issuer shall have filed with the Commission any amendment thereof) or Offering Memorandum (as amended if the Issuer shall have prepared and delivered to Ashland for private distribution any amendment to such Offering Memorandum), or the omission or alleged omission to state therein a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading or (ii) any untrue statement or alleged untrue statement of a material fact contained in the prospectus relating to the sale of such Securities (as amended or supplemented if the Issuer shall have filed with the Commission any amendment thereof or supplement thereto), or the omission or alleged omission to state therein a material fact necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading; provided that the indemnification contained in this Section 10.04 shall not apply to such Losses which shall arise out of or shall be based upon any such untrue statement or alleged untrue statement, or any such omission or alleged omission, which shall have been made in reliance upon and in conformity with information furnished in writing to the Issuer by Ashland or such underwriter or initial purchaser, as the case may be, specifically for use in connection with the preparation of the Registration Statement, the prospectus contained in the Registration Statement or the Offering Memorandum, as applicable, or any such amendment thereof or supplement therein.

Notwithstanding the foregoing provisions of this Section 10.04, the Issuer shall not be liable to Ashland, any person who participates as an underwriter in the offering or sale of such Securities, any person who participates as an initial purchaser in the private placement of such Securities or any other person, if any, who controls Ashland or any underwriter or initial purchaser (within the meaning of the Securities Act), under the indemnity agreement in this Section 10.04 for any such Losses that arise out of Ashland's or such other person's failure to send or give a copy of the final prospectus or final Offering Memorandum to the person asserting an untrue statement or alleged untrue statement or omission or alleged omission at or prior to the written confirmation of the sale of the Securities to such person if such statement or omission was corrected in such final prospectus or final Offering Memorandum and the Issuer has previously furnished copies thereof in accordance with this Agreement.

In the case of each offering registered pursuant to this Article X and each private placement pursuant to this Article X, Ashland shall agree, and each underwriter or initial purchaser, if any, participating therein shall agree, substantially in the same manner and to the same extent as set forth in the preceding paragraph, severally to indemnify and hold harmless the Issuer and each person who controls the Issuer within the meaning of Section 15 of the Securities Act, and any director, officer, employee, stockholder, partner, agent or representative of the Issuer, with respect to any statement in or omission from such Registration Statement (as amended or as supplemented, if amended or supplemented as aforesaid) or Offering Memorandum (as amended or as supplemented, if amended or supplemented as aforesaid), as applicable, if such statement or omission shall have been made in reliance upon and in conformity with information furnished in writing to the Issuer by Ashland or such underwriter or initial purchaser, as the case may be, specifically for use in connection with the Registration Statement, the prospectus contained in such Registration Statement or the Offering Memorandum, as applicable, or any such amendment thereof or supplement thereto.

Each party indemnified under this Section 10.04 shall, promptly after receipt of notice of the commencement of any claim against any such indemnified party in respect of which indemnity may be sought hereunder, notify the indemnifying party in writing of the commencement thereof. The failure of any indemnified party to so notify an indemnifying party of any action shall not relieve the indemnifying party from any liability in respect of such action which it may have to such indemnified party on account of the indemnity contained in this Section 10.04, unless (and only to the extent) the indemnifying party was prejudiced by such failure, and in no event shall such failure relieve the indemnifying party from any other liability which it may have to such indemnified party. In case any action in respect of which indemnification may be sought hereunder shall be brought against any indemnified party and it shall notify an indemnifying party of the commencement thereof, the indemnifying party shall be entitled to participate therein and, to the extent that it may desire, jointly with any other indemnifying party similarly notified, to assume the defense thereof through counsel reasonably satisfactory to the indemnified party, and after notice from the indemnifying party to such indemnified party of its election so to assume the defense thereof, the indemnifying party shall not be liable to such indemnified party under this Section 10.04 for any legal or other expenses subsequently incurred by such indemnified party in connection with the defense thereof, other than reasonable costs of investigation (unless (i) such indemnified party reasonably objects to such assumption on the grounds that there may be defenses available to it which are different from or in addition to those available to such indemnifying party, (ii) the indemnifying party and such indemnified party shall have mutually agreed to the retention of such counsel or (iii) in the reasonable opinion of such indemnified party representation of such indemnified party by the counsel retained by the indemnifying party would be inappropriate due to actual or potential differing interests between such indemnified party and any other party represented by such counsel in such proceeding, in which case the indemnified party shall be reimbursed by the indemnifying party for the reasonable expenses incurred in connection with retaining one firm of separate legal counsel; provided that (i) in circumstances where Ashland or an underwriter or initial purchaser is the indemnifying party, the indemnifying party shall not be liable for more than one firm of legal counsel for all indemnified parties and (ii) in circumstances where the Issuer is the indemnifying party, the indemnifying party shall not be liable for more than (A) one firm of legal counsel for Ashland, each person who controls Ashland within the meaning of Section 15 of the Securities Act, and any director, officer, employee, stockholder, partner, agent or representative of Ashland, and (B) one firm of legal counsel for the underwriters or initial purchasers, if any, indemnified under this Section 10.04, each person who controls such underwriters or initial purchasers within the meaning of Section 15 of the Securities Act, and any director, officer, employee, stockholder, partner, agent or representative of such underwriters or initial purchasers). No indemnifying party shall, without the prior written consent of the indemnified party, effect any settlement of any claim or pending or threatened proceeding in respect of which the indemnified party is or could have been a party and indemnity could have been sought hereunder by such indemnified party, unless such settlement includes an unconditional release of such indemnified party from all liability arising out of such claim or proceeding. If an indemnifying party shall have expressly acknowledged its indemnification obligations with respect to a claim or pending or threatened proceeding, then the indemnified party with respect to such claim or pending or threatened proceeding shall not, without the prior written consent of the indemnifying party, effect any settlement of such claim or pending or threatened proceeding.

If the indemnification provided for in this Section 10.04 is unavailable to an indemnified party or is insufficient to hold such indemnified party harmless from any Losses in respect of which this Section 10.04 would otherwise apply by its terms (other than by reason of exceptions provide herein), then each applicable indemnifying party, in lieu of indemnifying such indemnified party, shall have a joint and several obligation to contribute to the amount paid or payable by such indemnified party as a result of such Losses, in such proportion as is appropriate to reflect the relative benefits received by and fault of the indemnifying party, on the one hand, and such indemnified party, on the other hand, in connection with the offering or private placement to which such contribution relates as well as any other relevant equitable considerations. The relative benefit shall be determined by reference to, among other things, the amount of proceeds received by each party from the offering or private placement to which such contribution relates. The relative fault shall be determined by reference to, among other things, each party's relative knowledge and access to information concerning the matter with respect to which the claim was asserted, and the opportunity to correct and prevent any statement or omission. The amount paid or payable by a party as a result of any Losses shall be deemed to include any legal or other fees or expenses incurred by such party in connection with any investigation or proceeding, to the extent such party would have been indemnified for such expenses if the indemnification provided for in this Section 10.04 was available to such party.

The parties hereto agree that it would not be just and equitable if contribution pursuant to this Section 10.04 were determined by pro rata allocation or by any other method of allocation that does not take account of the equitable considerations referred to in the immediately preceding paragraph. No person guilty of fraudulent misrepresentation (within the meaning of Section 11(f) of the Securities Act) shall be entitled to contribution from any person who was not guilty of such fraudulent misrepresentation.

SECTION 10.05. Underwriting Agreement; Purchase Agreement.

In connection with any underwritten offering or private placement of Securities pursuant to a Demand Registration under Section 10.01, the Issuer and Ashland shall enter into an underwriting agreement with the underwriters for such offering or a purchase agreement with the initial purchasers for such private placement, such underwriting agreement or purchase agreement to contain such representations and warranties by the Issuer and Ashland and such other terms and provisions as are customarily contained in underwriting agreements with respect to secondary distributions or purchase agreements with respect to private placements, including, without limitation, indemnities and contribution to the effect and to the extent provided in Section 10.04 (and customary provisions with respect to indemnities and contribution by such underwriters or initial purchasers).

SECTION 10.06. Undertaking To File Reports.

For as long as Ashland holds Securities, the Issuer shall use its best efforts to file, on a timely basis, all annual, quarterly and other reports required to be filed by it under Sections 13 and 15(d) of the Exchange Act and the rules and regulations of the Commission thereunder, as amended from time to time, or any successor statute or provisions.

ARTICLE XI
Covenants

SECTION 11.01. Cooperation; Commercially Reasonable Best Efforts.

Each of the parties hereto shall cooperate with each other in good faith, and shall cause their respective officers, employees, agents, auditors and representatives to cooperate with each other in good faith, to cause the Closing to occur. In addition, each of the parties hereto shall use its commercially reasonable best efforts to cause the Closing to occur.

SECTION 11.02. Antitrust Notification; FTC or DOJ Investigation.

(a) Each of Marathon, USX and Ashland shall as promptly as practicable, but in no event later than 30 days following the relevant Exercise Date, file with the FTC and the DOJ the notification and report form, if any, required for the transactions contemplated hereby and any supplemental information requested in connection therewith pursuant to the HSR Act. Any such notification and report form and supplemental information shall be in substantial compliance with the requirements of the HSR Act. Each of Marathon, USX and Ashland shall furnish to the other such necessary information and reasonable assistance as the other may request in connection with its preparation of any filing or submission which is necessary under the HSR Act. Each of Marathon, USX and Ashland shall keep each other apprised of the status of any communications with, and any inquiries or requests for additional information from, the FTC and the DOJ and shall comply promptly with any such inquiry or request.

(b) In the event that Marathon, USX and Ashland are not required to file with the FTC and the DOJ any notification and report form pursuant to the HSR Act, but the FTC or the DOJ nevertheless commences an investigation with respect to the transactions contemplated hereby, each of Marathon, USX and Ashland shall comply promptly with any inquiry or request made by the DOJ or the FTC in connection with such investigation.

(c) In the event that Marathon, USX and Ashland file notification and report forms with the FTC and the DOJ pursuant to Section 11.02(a) or the FTC or the DOJ commences an investigation with respect to the transactions contemplated hereby, then, in addition to the obligations of Marathon, USX and Ashland set forth in Section 11.02(a) and 11.02(b), as applicable, Marathon, USX and Ashland agree as follows:

(i) In the case of Marathon's exercise of its Marathon Call Right, each of Marathon and USX shall take all such actions as are necessary to obtain any clearance required under the HSR Act or from the FTC or DOJ in connection with any such investigation, as applicable, for the purchase and sale of Ashland's Membership Interests and the Ashland LOOPLOCAP Interest pursuant to this Agreement, including divesting or holding separate any assets or commencing or defending litigation; provided, however, that neither Marathon nor USX shall be required to take any action proposed by the FTC or the DOJ that would or would reasonably be expected to have a material adverse effect on the business, operations, assets, liabilities, results of operations, cash flows, condition (financial or otherwise) or prospects of the Company and its subsidiaries, taken as a whole.

(ii) In the case of (A) Ashland's exercise of its Ashland Put Right or (B) Marathon's exercise of its Special Termination Right, each of Marathon and USX shall take all such actions as are necessary to obtain any clearance required under the HSR Act or from the FTC or DOJ in connection with any such investigation, as applicable, for the purchase and sale of Ashland's Membership Interests and the Ashland LOOPLOCAP Interest pursuant to this Agreement, including divesting or holding separate any assets or commencing or defending litigation; provided, however, that neither Marathon nor USX shall be required to take any action proposed by the FTC or the DOJ that would or would reasonably be expected to have a material adverse effect on the business, operations, assets, liabilities, results of operations, cash flows, condition (financial or otherwise) or prospects of (A) the Company and its subsidiaries, taken as a whole, (B) Marathon and its subsidiaries, taken as a whole, or (C) USX and its subsidiaries, taken as a whole.

(iii) In the case of Ashland's exercise of its Special Termination Right, Ashland shall take all such actions as are necessary to obtain any clearance required under the HSR Act or from the FTC or DOJ in connection with any such investigation, as applicable, for the purchase and sale of Marathon's Membership Interests pursuant to this Agreement, including divesting or holding separate any assets or commencing or defending litigation; provided, however, that Ashland shall not be required to take any action proposed by the FTC or the DOJ that would or would reasonably be expected to have a material adverse effect on the business, operations, assets, liabilities, results of operations, cash flows, condition (financial or otherwise) or prospects of (A) the Company and its subsidiaries, taken as a whole or (B) Ashland and its subsidiaries, taken as a whole.

SECTION 11.03. Governmental Filings re: Ashland LOOPLOCAP Interest.

(a) Each of the parties hereto shall as promptly as practical, but in no event later than five Business Days following the relevant Exercise Date, file all documentation with all relevant Governmental Entities that is required to be filed with such Governmental Entities in connection with the purchase and sale of the Ashland LOOPLOCAP Interest on the Scheduled Closing Date. Each of the parties hereto shall keep the other apprised of the status of any communications with, and any inquiries or requests for additional information from, such Governmental Entities and shall comply promptly with any such inquiry or request.

(b) In addition to the obligations of the parties hereto set forth in Section 11.03(a), Marathon and USX agree as follows:

(i) In the case of Marathon's exercise of its Marathon Call Right, each of Marathon and USX shall take all such actions as are necessary to obtain any requisite approvals from such Governmental Entities as are required in connection with the purchase and sale of the Ashland LOOPLOCAP Interest pursuant to this Agreement, including commencing or defending litigation; provided, however, that neither Marathon nor USX shall be required to take any such action that would or would reasonably be expected to have a material adverse effect on the business, operations, assets, liabilities, results of operations, cash flows, condition (financial or otherwise) or prospects of the Company and its subsidiaries, taken as a whole.

(ii) In the case of Marathon's exercise of its Special Termination Right or Ashland's exercise of its Ashland Put Right, each of Marathon and USX shall take all such actions as are necessary to obtain any requisite approvals from such Governmental Entities as are required in connection with the purchase and sale of the Ashland LOOPLOCAP Interest pursuant to this Agreement, including commencing or defending litigation; provided, however, that neither Marathon nor USX shall be required to take any such action that would or would reasonably be expected to have a material adverse effect on the business, operations, assets, liabilities, results of operations, cash flows, condition (financial or otherwise) or prospects of (A) the Company and its subsidiaries, taken as a whole, (B) Marathon and its subsidiaries, taken as a whole, or (C) USX and its subsidiaries, taken as a whole.

SECTION 11.04. Designated Sublease Agreements.

(a) Ashland Designated Sublease Agreements. In the event of (i) Marathon's exercise of its Marathon Call Right, (ii) Ashland's exercise of its Ashland Put Right or (iii) Marathon's exercise of its Special Termination Right, Ashland shall use its commercially reasonable best efforts to (A) terminate the outstanding Original Lease underlying each Ashland Designated Sublease Agreement on or prior to Closing and (B) contribute the related Subleased Property to the Company or one of its subsidiaries at no cost to the Company or such subsidiary on or prior to Closing; provided, however, that (i) Ashland shall not be obligated to pay more than a reasonable amount as consideration therefor to, or make more than a reasonable financial accommodation in favor of, or commence litigation against, a third party lessor with respect to any such underlying Original Lease in order to obtain any consent required from such lessor and (ii) any additional cost associated with exercising an option under the Original Lease to purchase Subleased Property shall be deemed not to constitute an obligation to pay more than a reasonable amount. In the event that Ashland is unable to terminate an outstanding Original Lease in accordance with this Section 11.04(a), then (i) the Company shall be entitled to continue to sublease the Subleased Property pursuant to the related Ashland Designated Sublease Agreement until the term of the Original Lease expires, (ii) Ashland shall continue to use its commercially reasonable best efforts to terminate the Original Lease and contribute the Subleased Property to the Company as provided above; provided, however, that (A) Ashland shall not be obligated to pay more than a reasonable amount as consideration therefor to, or make more than a reasonable financial accommodation in favor of, or commence litigation against, a third party lessor with respect to any such underlying Original Lease in order to obtain any consent required from such lessor and (B) any additional cost associated with exercising an option under the Original Lease to purchase Subleased Property shall be deemed not to constitute an obligation to pay more than a reasonable amount and (iii) if Ashland subsequently acquires fee title to the Subleased Property, Ashland shall contribute such Subleased Property to the Company or one of its subsidiaries at no cost to the Company or such subsidiary at such time.

(b) Marathon Designated Sublease Agreements. In the event of Ashland's exercise of its Special Termination Right, Marathon shall use its commercially reasonable best efforts to (A) terminate the outstanding Original Lease underlying each Marathon Designated Sublease Agreement on or prior to Closing and (B) contribute the related Subleased Property to the Company or one of its subsidiaries at no cost to the Company or such subsidiary on or prior to Closing; provided, however, that (i) Marathon shall not be obligated to pay more than a reasonable amount as consideration therefor to, or make more than a reasonable financial accommodation in favor of, or commence litigation against, a third party lessor with respect to any such underlying Original Lease in order to obtain any consent required from such lessor and (ii) any additional cost associated with exercising an option under the Original Lease to purchase Subleased Property shall be deemed not to constitute an obligation to pay more than a reasonable amount. In the event that Marathon is unable to terminate an outstanding Original Lease in accordance with this Section 11.04(b), then (i) the Company shall be entitled to continue to sublease the Subleased Property pursuant to the related Marathon Designated Sublease Agreement until the term of the Original Lease expires, (ii) Marathon shall continue to use its commercially reasonable best efforts to terminate the Original Lease and contribute the Subleased Property to the Company as provided above; provided, however, that (A) Marathon shall not be obligated to pay more than a reasonable amount as consideration therefor to, or make more than a reasonable financial accommodation in favor of, or commence litigation against, a third party lessor with respect to any such underlying Original Lease in order to obtain any consent required from such lessor and (B) any additional cost associated with exercising an option under the Original Lease to purchase Subleased Property shall be deemed not to constitute an obligation to pay more than a reasonable amount and (iii) if Marathon subsequently acquires fee title to the Subleased Property, Marathon shall contribute such Subleased Property to the Company or one of its subsidiaries at no cost to the Company or such subsidiary at such time.

ARTICLE XII
Standstill Agreement

SECTION 12.01. Restrictions of Certain Actions by Marathon and USX.

Each of Marathon and USX covenants and agrees that, from the date hereof through the six-month anniversary of the earlier to occur of (a) the date that Ashland and its Affiliates do not own any Membership Interests, and (b) the date that Marathon and its Affiliates do not own any Membership Interests, it shall not, and it shall cause each of its Affiliates (including, for the avoidance of doubt, Employee Benefit Plans of USX, Marathon and their respective Affiliates) not to, singly or as part of a partnership, limited partnership, syndicate or other group (as those terms are defined in Section 13(d)(3) of the Exchange Act), directly or indirectly:

(i) acquire, offer to acquire, or agree to acquire, by purchase, gift or otherwise, more than 1% of any class of any Ashland Voting Securities, except (A) pursuant to a stock split, stock dividend, rights offering, recapitalization, reclassification or similar transaction, (B) in connection with the transfer of Ashland Voting Securities to a Marathon or USX Employee Benefit Plan as contemplated by Section 3.1(v) of the Asset Transfer and Contribution Agreement or (C) the ownership by any Employee Benefit Plan of USX, Marathon or any of their respective Affiliates of any interest in any diversified index, mutual or pension fund managed by an independent investment advisor, which fund in turn holds, directly or indirectly, Ashland Voting Securities; provided that not more than 5% of such fund's assets are comprised of Ashland Voting Securities;

(ii) make, or in any way participate in any "solicitation" of "proxies" to vote (as such terms are defined in Rule 14a-1 under the Exchange Act), solicit any consent or communicate with or seek to advise or influence any person or entity with respect to the voting of any Ashland Voting Securities or become a "participant" in any "election contest" (as such terms are defined or used in Rule 14a-11 under the Exchange Act) with respect to Ashland;

(iii) form, join, encourage or in any way participate in the formation of, any "person" within the meaning of Section 13(d)(3) of the Exchange Act with respect to any Ashland Voting Securities;

(iv) deposit any Ashland Voting Securities into a voting trust or subject any such Ashland Voting Securities to any arrangement or agreement with respect to the voting thereof;

(v) initiate, propose or otherwise solicit shareholders for the approval of one or more shareholder proposals with respect to Ashland as described in Rule 14a-8 under the Exchange Act, or induce or attempt to induce any other person to initiate any shareholder proposal;

(vi) seek election to or seek to place a representative on the Board of Directors of Ashland or seek the removal of any member of the Board of Directors of Ashland;

(vii) except with the approval of management of Ashland, call or seek to have called any meeting of the shareholders of Ashland;

(viii) otherwise act to seek to control, disrupt or influence the management, business, operations, policies or affairs of Ashland;

(ix) (A) solicit, seek to effect, negotiate with or provide any information to any other person with respect to, (B) make any statement or proposal, whether written or oral, to the Board of Directors of Ashland or any director or officer of Ashland with respect to, or (C) otherwise make any public announcement or proposal whatsoever with respect to, any form of business combination transaction involving Ashland (other than the Transaction), including, without limitation, a merger, exchange offer, or liquidation of Ashland's assets, or any restructuring, recapitalization or similar transaction with respect to Ashland;

(x) seek to have Ashland waive, amend or modify any of the provisions contained in this Section 12.01;

(xi) disclose or announce any intention, plan or arrangement inconsistent with the foregoing; or

(xii) advise, assist, instigate or encourage any third party to do any of the foregoing.

If either Marathon or USX or any of their respective Affiliates owns or acquires any Ashland Voting Securities in violation of this Section 12.01, such Ashland Voting Securities shall immediately be disposed of to persons who (i) are not Marathon or USX or Affiliates thereof and (ii) do not own, individually or as part of a "group" (within the meaning of Section 13(d)(3) of the Exchange Act), more than 5% of the then outstanding Ashland Voting Securities; provided that Ashland may also pursue any other available remedy to which it may be entitled as a result of such violation.

SECTION 12.02. Restrictions of Certain Actions by Ashland.

Ashland covenants and agrees that, from the date hereof through the later to occur of (a) the six-month anniversary of the earlier to occur of (i) the date that Marathon and its Affiliates do not own any Membership Interests and (ii) the date that Ashland and its Affiliates do not own any Membership Interests and (b) in the event that Ashland or its Affiliates acquires USX Voting Securities pursuant to the Closing of the Ashland Put Right, the date on which Ashland and its Affiliates do not own more than 5% of the then outstanding USX Voting Securities, it shall not, and it shall cause each of its Affiliates (including, for the avoidance of doubt, Employee Benefit Plans of Ashland and its Affiliates) not to, singly or as part of a partnership, limited partnership, syndicate or other group (as those terms are defined in Section 13(d)(3) of the Exchange Act), directly or indirectly:

(i) acquire, offer to acquire, or agree to acquire, by purchase, gift or otherwise, more than 1% of any class of USX Voting Securities, except (A) pursuant to a stock split, stock dividend, rights offering, recapitalization, reclassification or similar transaction and except for any issuance of USX Voting Securities to Ashland as payment of any portion of the Ashland Put Price in accordance with the provisions of this Agreement or (B) the ownership by any Employee Benefit Plan of Ashland or any of its Affiliates of any interest in any diversified index, mutual or pension fund managed by an independent investment advisor, which fund in turn holds, directly or indirectly, USX Voting Securities; provided that not more than 5% of such fund's assets are comprised of USX Voting Securities;

(ii) make, or in any way participate in any "solicitation" of "proxies" to vote (as such terms are defined in Rule 14a-1 under the Exchange Act), solicit any consent or communicate with or seek to advise or influence any person or entity with respect to the voting of any USX Voting Securities or become a "participant" in any "election contest" (as such terms are defined or used in Rule 14a-11 under the Exchange Act) with respect to USX;

(iii) form, join, encourage or in any way participate in the formation of, any "person" within the meaning of Section 13(d)(3) of the Exchange Act with respect to any USX Voting Securities;

(iv) deposit any USX Voting Securities into a voting trust or subject any such USX Voting Securities to any arrangement or agreement with respect to the voting thereof;

(v) initiate, propose or otherwise solicit shareholders for the approval of one or more shareholder proposals with respect to USX as described in Rule 14a-8 under the Exchange Act, or induce or attempt to induce any other person to initiate any shareholder proposal;

(vi) seek election to or seek to place a representative on the Board of Directors of USX or seek the removal of any member of the Board of Directors of USX or seek the removal of any member of the Board of Directors of USX;

(vii) except with the approval of management of USX, call or seek to have called any meeting of the shareholders of USX;

(viii) otherwise act to seek to control, disrupt or influence the management, business, operations, policies or affairs of USX;

(ix) (A) solicit, seek to effect, negotiate with or provide any information to any other person with respect to, (B) make any statement or proposal, whether written or oral, to the Board of Directors of USX or any director or officer of USX with respect to, or (C) otherwise make any public announcement or proposal whatsoever with respect to, any form of business combination transaction involving USX (other than the Transaction), including, without limitation, a merger, exchange offer, or liquidation of USX's assets, or any restructuring, recapitalization or similar transaction with respect to USX;

(x) seek to have USX waive, amend or modify any of the provisions contained in this Section 12.02;

(xi) disclose or announce any intention, plan or arrangement inconsistent with the foregoing; or

(xii) advise, assist, instigate or encourage any third party to do any of the foregoing.

If Ashland or any of its Affiliates owns or acquires any USX Voting Securities in violation of this Section 12.02, such USX Voting Securities shall immediately be disposed of to persons who (i) are not Ashland or Affiliates thereof and (ii) do not own, individually or as part of a "group" (within the meaning of Section 13(d)(3) of the Exchange Act), more than 5% of the then outstanding USX Voting Securities; provided that USX may also pursue any other available remedy to which it may be entitled as a result of such violation.

ARTICLE XIII
Indemnification

SECTION 13.01. Indemnification re: Ashland Representatives' Revocable Proxies and the Ashland LOOPLOCAP Revocable Proxy.

In the event that Ashland's Representatives grant Marathon's Representatives the Ashland Representatives Revocable Proxies pursuant to Section 5.02(a) and Ashland grants to Marathon or a person designated by Marathon, as applicable, the Ashland LOOPLOCAP Revocable Proxy pursuant to Section 5.02(c), each of Marathon, USX and the Company agree to indemnify and hold Ashland, its Representatives, their respective Affiliates and any director, officer, employee, stockholder, partner, agent or representative of Ashland or its Affiliates harmless against any and all Losses to which they or any of them may become subject, insofar as any such Losses shall arise out of, are based upon or relate to any obligations or liabilities of whatever kind and nature, primary or secondary, direct or indirect, absolute or contingent, known or unknown, whether or not accrued, which arise on or after the relevant Exercise Date and which are attributable to (i) in the event that the Closing occurs, (A) the Company and its subsidiaries or LOOP, LLC or LOCAP, Inc., (B) Ashland's ownership interest in the Company or the Ashland LOOPLOCAP Interest, (C) actions taken by Marathon's Representatives pursuant to the Ashland Representatives Revocable Proxies or (D) actions taken by Marathon or the Company, as applicable, pursuant to the Ashland LOOPLOCAP Revocable Proxy, and (ii) in the event that Ashland or Marathon revokes Ashland's Ashland Put Exercise Notice or Marathon's Marathon Call Exercise Notice pursuant to Section 9.03(a), 9.04(a), 9.05, 9.08(a) or 9.09, or Ashland revokes Marathon's Special Termination Exercise Notice pursuant to Section 9.08(a) or 9.09 (A) actions taken by Marathon's Representatives pursuant to the Ashland Representatives Revocable Proxies or (B) actions taken by Marathon or the Company, as applicable, pursuant to the Ashland LOOPLOCAP Revocable Proxy.

SECTION 13.02. Indemnification re: Marathon Representatives Revocable Proxies.

In the event that Marathon's Representatives grant Ashland's Representatives the Marathon Representatives Revocable Proxies pursuant to Section 5.02(b), each of Ashland and the Company agree to indemnify and hold Marathon, its Representatives, their respective Affiliates and any director, officer, employee, stockholder, partner, agent or representative of Marathon or its Affiliates harmless against any and all Losses to which they or any of them may become subject, insofar as any such Losses shall arise out of, are based upon or relate to any obligations or liabilities of whatever kind and nature, primary or secondary, direct or indirect, absolute or contingent, known or unknown, whether or not accrued, which arise on or after the Special Termination Exercise Date and which are attributable to (i) in the event that the Closing occurs, (A) the Company and its subsidiaries or (B) actions taken by Ashland's Representatives pursuant to the Marathon Representatives Revocable Proxies and (ii) in the event that Marathon revokes Ashland's Special Termination Exercise Notice pursuant to Section 9.08(a) or 9.09, actions taken by Ashland's Representatives pursuant to the Marathon Representatives Revocable Proxies.

SECTION 13.03. Indemnification re: Transfer of Economic Interests in the Ashland LOOPLOCAP Interest to Marathon, the Company or a Person Designated by Marathon.

To the extent that Ashland is unable to Transfer the Ashland LOOPLOCAP Interest to Marathon, the Company or a person designated by Marathon, as applicable, at Closing, and as a result thereof, Ashland enters into any arrangement under which Marathon, the Company or such other person shall obtain the economic claims, rights and benefits under the Ashland LOOPLOCAP interest, including a grant to Marathon, the Company or such other person, as applicable, of the Ashland LOOPLOCAP Irrevocable Proxy, each of Marathon, USX and the Company agree to indemnify and hold Ashland, its Representatives, their respective Affiliates and any director, officer, employee, stockholder, partner, agent or representative of Ashland or its Affiliates harmless against any and all Losses to which they or any of them may become subject, insofar as any such Losses shall arise out of, be based upon or relate to any obligations or liabilities of whatever kind and nature, primary or secondary, direct or indirect, absolute or contingent, known or unknown, whether or not accrued, which arise on or after the relevant Exercise Date and which are attributable to (i) LOOP, LLC, (ii) LOCAP, Inc., (iii) Ashland's ownership interest in LOOP, LLC and LOCAP, Inc., (iv) any such arrangements between Ashland and Marathon, the Company or such other person or (v) actions taken by Marathon, the Company or such other person, as applicable, pursuant to the Ashland LOOPLOCAP Irrevocable Proxies.

SECTION 13.04. Procedures Relating to Indemnification Under This Article XIII.

The procedures for Indemnification under this Article XIII shall be the procedures for indemnification set forth in Section 9.7 of the Asset Transfer and Contribution Agreement.

ARTICLE XIV
Company Competitive Businesses;Detrimental Activities; Limitations on the Company Entering into Valvoline's Business

SECTION 14.01. Competitive Businesses.

(a) Subject to Sections 14.01(b), 14.01(d) and 14.03(c), and except to the extent otherwise provided in Schedule 14.01(a), each of Marathon, USX and Ashland hereby agrees that during the Term of the Company, it shall not, and it shall cause its Affiliates not to, engage in any business within North America which is substantially in competition with (i) the Company's Business conducted on the date hereof or (ii) any new line of business of the Company that the Board of Managers has approved in accordance with Section 8.07(b) of the LLC Agreement (but only if and to the extent that the Board of Managers specifically determined pursuant to Section 8.07(b) of the LLC Agreement that such new line of business should also constitute a Company Competitive Business) (each such business in clauses (i) and (ii), a "Company Competitive Business"); provided, however, that nothing in this Section 14.01 shall be deemed or interpreted to prohibit Ashland or any of its Affiliates from engaging in the Valvoline Business.

(b) Notwithstanding any limitation contained in Section 14.01(a), Marathon, USX and Ashland and their respective Affiliates shall be permitted to engage in a Company Competitive Business if: (i) Marathon or Ashland, as applicable, shall have first presented the Company, at a meeting of the Board of Managers at which at least one of the Representatives of the other Member was present, with the opportunity to pursue or engage in such Company Competitive Business and (ii) one or more of the Representatives of the other Member on the Board of Managers shall have voted against the Company pursuing such Company Competitive Business.

(c) If Marathon, USX or Ashland or any of their respective Affiliates is permitted pursuant to Section 14.01(b) to engage in a Company Competitive Business and, in connection therewith, wishes to use any of the properties, facilities or other assets of the Company or any of its subsidiaries, Marathon or Ashland and their respective Representatives will negotiate in good faith with the Company to reach a reasonable agreement as to the nature and scope of any agreement between the Company or any such subsidiary and such Member with respect to the use of such property, facility or other assets. Any transaction relating to such property, facility or assets shall be deemed for purposes of the LLC Agreement to constitute an Affiliate Transaction that was entered into outside the ordinary course of the Company's business.

(d) Notwithstanding any limitation contained in Section 14.01(a), Marathon, USX and Ashland and their respective Affiliates shall be permitted to purchase: (i) less than an aggregate of 10% of any class of stock of a person engaged, directly or indirectly, in one or more Competitive Businesses (a "Company Competitive Third Party"); provided that such stock is listed on a national securities exchange or is quoted on the National Market System of NASDAQ; (ii) less than 10% in value of any instrument of Indebtedness of a Company Competitive Third Party; (iii) a Company Competitive Third Party (whether by merger or purchase of all or substantially all of such Company Competitive Third Party's assets) which engages, directly or indirectly, in one or more Company Competitive Businesses which accounted for less than 20% of such Company Competitive Third Party's consolidated revenues for the most recently completed fiscal quarter; and (iv) a Company Competitive Third Party (whether by merger or purchase of all or substantially all of such Company Competitive Third Party's assets or otherwise) which engages, directly or indirectly, in one or more Company Competitive Businesses which accounted for greater than 20% of such Company Competitive Third Party's consolidated revenues for the most recently completed fiscal quarter; provided that a purchase by Marathon, USX or Ashland or any of their respective Affiliates of a Company Competitive Third Party pursuant to this clause (iv) shall only be permitted if within 30 Business Days after the earlier to occur of (A) the execution of definitive agreements with respect to such purchase or (B) the closing of such purchase, Marathon, USX, Ashland or such Affiliate, as applicable, shall present the Company with the opportunity to purchase the portion of such Company Competitive Third Party's business that is in substantial competition with the Company in North America (the "Company Competitive Business Assets") at a purchase price determined in accordance with Section 14.04, at a special or regular meeting of the Board of Managers (such meeting, a "14.01(d) Presentation Meeting").

(e) If the Board of Managers determines at the 14.01(d) Presentation Meeting (by a vote of a majority of the Representatives of the Member not purchasing such Company Competitive Third Party's business at a special or regular meeting of the Board of Managers (which majority shall constitute a quorum for purposes of the transaction of business)) to purchase the Company Competitive Business Assets, the closing date with respect to such purchase shall not be later than 60 days after the date of the determination of the Purchase Price pursuant to Section 14.04 or, if later, 30 days after the Company has received any antitrust clearance or other Governmental Approval required in connection with such purchase (the "14.01(d) Scheduled Closing Date"). If the Company breaches its obligation to purchase the Company Competitive Business Assets on the 14.01(d) Scheduled Closing Date after the Board of Managers shall have determined to make such purchase as provided in the immediately preceding sentence (other than where such breach is due to circumstances beyond the Company's reasonable control), then Marathon, USX, Ashland or such Affiliate, as applicable, shall be permitted to retain such Company Competitive Business Assets and the Company shall cease to have the right to purchase such Company Competitive Business Assets. If the Company breaches its obligation to purchase the Company Competitive Business Assets on the 14.01(d) Scheduled Closing Date after the Board of Managers shall have determined to make such purchase as provided in the first sentence of this Section 14.01(e)and such breach is due to circumstances beyond the Company's reasonable control, then, if the closing of the purchase by the Company of the Company Competitive Business Assets does not occur within 270 days after the Scheduled Closing Date, Marathon, USX, Ashland or such Affiliate, as applicable, shall be permitted to retain such Company Competitive Business Assets and the Company shall cease to have the right to purchase such Company Competitive Business Assets. If the Board of Managers determines at the 14.01(d) Presentation Meeting not to purchase such Company Competitive Business Assets, then Marathon, USX, Ashland or such Affiliate, as applicable, shall be permitted to retain such Company Competitive Business Assets and the Company shall cease to have the right to purchase such Company Competitive Business Assets.

(f) It is the intention of each of the parties hereto that if any of the restrictions or covenants contained in this Section 14.01 is held by a court of competent jurisdiction to cover a geographic area or to be for a length of time that is not permitted by Applicable Law, or is in any way construed by a court of competent jurisdiction to be too broad or to any extent invalid, such provision shall not be construed to be null, void and of no effect, but to the extent such provision would be valid or enforceable under Applicable Law, a court of competent jurisdiction shall construe and interpret or reform this Section 14.01 to provide for a covenant having the maximum enforceable geographic area, time period and other provisions (not greater than those contained in this Section 14.01) as shall be valid and enforceable under such Applicable Law. Each of the parties hereto acknowledges that any breach of the terms, conditions or covenants set forth in this Section 14.01 shall be competitively unfair and may cause irreparable damage to the Company because of the special, unique, unusual, extraordinary and intellectual character of the Company's business, and the Company's recovery of damages at law will not be an adequate remedy. Accordingly, each of the parties hereto agrees that for any breach of the terms, covenants or agreements of this Section 14.01, a restraining order or an injunction or both may be issued against such person, in addition to any other rights or remedies the Company or the other parties hereto may have.

SECTION 14.02. Detrimental Activities.

(a) Solicitation, Recruiting or Hiring of Employees. Each of Marathon, USX and Ashland hereby agrees that during the Term of the Company, without the consent of each of the Members, it shall not, and it shall cause its Affiliates not to, solicit, recruit or hire any employee of the Company or any of its subsidiaries (other than solicitations that are directed at the public in general in publications available to the public in general) if:

(i) such employee is an Executive Officer or the officer principally in charge of environmental health and safety and human resources, unless, subject to clauses (iii) and (iv) below, such solicitation, recruitment or hiring is consented to in advance by Ashland (in the case of a solicitation, recruitment or hiring by Marathon, USX or any of their respective Affiliates) or by Marathon (in the case of a solicitation, recruitment or hiring by Ashland or any of its Affiliates), which consent shall not be unreasonably withheld;

(ii) such employee reports directly to (A) an Executive Officer or the officer principally in charge of environmental health and safety and human resources(a "Senior Employee") or (B) a Senior Employee (a "Mid-Level Employee"), unless, subject to clauses (iii) and (iv) below, at the time of such solicitation, recruitment or hiring, the total number of Senior Employees and Mid-Level Employees that have been hired by Marathon, USX, Ashland and their respective Affiliates during the then preceding twenty-four months is less than 10% of the total number of Senior Employees and Mid-Level Employees employed by the Company at the time Marathon, USX, Ashland or an Affiliate thereof wishes to solicit, recruit or hire such Senior Employee or Mid-Level Employee (based on the average number of Senior Employees and Mid-Level Employees employed by the Company during such twenty-four-month period);

(iii) the hiring of such employee, when considered together with all other employees hired by Marathon, USX, Ashland and their respective Affiliates during the then preceding twenty-four months, would have or would reasonably be expected to have, a significant detrimental impact on the department of the Company in which such employee is then working; or

(iv) such employee is being solicited, recruited or hired for a position in a Competitive Business of such person or such person's Affiliates.

Notwithstanding the foregoing, the employees of the Company shall not be required to accept any job offer by Marathon, USX, Ashland or any of their respective Affiliates and a refusal to accept such a job offer shall not negatively affect an employee's career opportunities at the Company.

(b) Disclosure of Confidential Information. Each of Marathon, USX and Ashland (each, a "Disclosing Party") hereby agrees that during the Term of the Company, it shall not, and it shall cause its Affiliates not to, disclose or furnish to anyone any confidential information relating to the Company and its subsidiaries ("Confidential Information") except pursuant to a confidentiality agreement in form and substance reasonably satisfactory to the other parties hereto which expressly provides that the other parties hereto shall be a beneficiary thereof (a "Confidentiality Agreement"). The foregoing restriction on disclosure of Confidential Information shall not apply to (i) information which is or becomes part of the public domain through no fault or breach of the Disclosing Party; (ii) information which at the time of disclosure is already in the possession of the Disclosing Party in written form and was not received directly or indirectly from the Company or any of its subsidiaries under a requirement of confidentiality; (iii) information received by the Disclosing Party from a third party; provided that the Disclosing Party, after reasonable inquiry, has no reason to believe that the third party obtained the information directly or indirectly from the Company or any of its subsidiaries under a requirement of confidentiality; (iv) information required to be disclosed under subpoena or other mandatory legal process; provided, that the Disclosing Party shall give the Company timely notice of the service of the subpoena or other process so that the Company may seek a protective order or other legal remedy to prevent such disclosure; (v) information which has been subsequently and independently acquired or developed by the Disclosing Party without violating any of its obligations under this Section 14.02(b) or under any Confidentiality Agreement; and (vi) information which is required or advisable to be disclosed under the Securities Act or the Exchange Act. Notwithstanding the foregoing, a Disclosing Party shall be permitted to disclose Confidential Information to its directors, officers, employees, auditors, agents, advisors and representatives (such persons being collectively referred as its "Representatives") if the Disclosing Party informs its Representatives of the confidential nature of the Confidential Information and obtains their agreement to be bound by this Section 14.02(b) and not to disclose such Confidential Information to any other person. Each Disclosing Party shall be responsible for any breach of this Section 14.02 by its Representatives.

SECTION 14.03. Limitations on the Company Entering into the Valvoline Business.

(a) Subject to Sections 14.03(b) and 14.03(d), the Company hereby agrees that it shall not, and it shall cause its Affiliates (other than Marathon, Ashland and their respective subsidiaries (other than the Company and its subsidiaries)) not to, engage in any business worldwide which is substantially in competition with the Valvoline Business. Notwithstanding the foregoing, the provisions of this Section 14.03(a) shall terminate on the first date on which Ashland and its Affiliates shall own (beneficially or otherwise) less than 20% of the Valvoline Business.

(b)(i) Notwithstanding any limitation contained in Section 14.03(a), if in any two consecutive calendar years, (A) Valvoline shall not have purchased from the Company and its subsidiaries a quantity of lube oil at least equal to the Minimum Lube Oil Purchase Amount and (B)(1) such failure to purchase was due to the fact that the Company and Valvoline could not in good faith agree to mutually acceptable terms and conditions for the sale by the Company and its subsidiaries to Valvoline of at least such quantity of lube oil and (2) such failure was not due, in whole or in part, to the failure of the Company and its subsidiaries to produce and offer for sale to Valvoline the Minimum Lube Oil Purchase Amount during either such calendar year, the failure of the Company and its subsidiaries to produce and offer for sale to Valvoline lube oil satisfying contractual specifications or any other failure of the Company or its subsidiaries to satisfy in any material respect any of its then existing material contractual obligations to Valvoline, then the Company and its subsidiaries shall be permitted to engage in a business which is substantially in competition with Valvoline's Bulk Motor Oil Business andor Valvoline's Packaged Motor Oil Business (but, except as expressly permitted in Section 14.03(a), no other business that constitutes part of the Valvoline Business); provided that, notwithstanding the foregoing, the Company and its subsidiaries shall not be permitted to enter into or engage in any such business if the Company and its subsidiaries shall have substantially ceased production at the Catlettsburg, Kentucky refinery of lube oil for sale to third parties (other than due to a force majeure or an inability to find a willing buyer for its lube oil) for any period of 90 consecutive days or more prior to the time the Company and its subsidiaries shall first enter or propose to enter into such business.

(ii) Notwithstanding any limitation contained in Section 14.03(a), if in each of the four calendar years following the consecutive two-year period provided for in Section 14.03(b)(i), (A) Valvoline shall not have purchased from the Company and its subsidiaries a quantity of lube oil at least equal to the Minimum Lube Oil Purchase Amount and (B)(1) such failure to purchase was due to the fact that the Company and Valvoline could not in good faith agree to mutually acceptable terms and conditions for the sale by the Company and its subsidiaries to Valvoline of at least such quantity of lube oil and (2) such failure was not due, in whole or in part, to the failure of the Company and its subsidiaries to produce and offer for sale to Valvoline the Minimum Lube Oil Purchase Amount during any such calendar year, the failure of the Company and its subsidiaries to produce and offer for sale to Valvoline lube oil satisfying contractual specifications or any other failure of the Company or its subsidiaries to satisfy in any material respect any of its existing material contractual obligations to Valvoline, then at any time after the conclusion of such consecutive four-year period, the Company and its subsidiaries shall be permitted to engage in a business which is substantially in competition with Valvoline's Private Label Packaged Motor Oil Business andor Valvoline's Quick Lube Business; provided that, notwithstanding the foregoing, the Company and its subsidiaries shall not be permitted to enter into or engage in any such business if the Company and its subsidiaries shall have substantially ceased production at the Catlettsburg, Kentucky refinery of lube oil for sale to third parties (other than due to a force majeure or an inability to find a willing buyer for its lube oil) for any period of 90 consecutive days or more prior to the time the Company and its subsidiaries shall first enter or propose to enter into such business.

(iii) The provisions set forth in this Section 14.03(b) permitting the Company and its subsidiaries to engage in a new business in competition with the Valvoline Business if certain conditions are satisfied shall be an exception only to the super majority vote requirement in Section 8.08(a) of the LLC Agreement, and shall not be an exception to any other supermajority vote requirements of Section 8.08 of the LLC Agreement.

(c) Notwithstanding any limitation contained in Section 14.01(a), if at any time the Company or any of its subsidiaries enters into, other than as expressly permitted in Section 14.03(d), either the Bulk Motor Oil Business, the Packaged Motor Oil Business, the Private Label Packaged Motor Oil Business or the Quick Lube Business, Ashland and its subsidiaries thereafter shall be permitted to enter into a business which is substantially in competition with the Company's lube oil production business.

(d) Notwithstanding any limitation contained in Section 14.03(a), subject to Section 8.08 of the LLC Agreement, the Company and its subsidiaries shall be permitted to (i) engage, directly or through its own dealers, jobbers or jobber dealers, in the business currently conducted under the brand name "Maralube Express" (the "Maralube Express Business"); (ii) engage, directly or through its own dealers, jobbers or jobber dealers, in the truck stop oil change business; (iii) engage, directly or through its own dealers, jobbers, or jobber dealers, in the oil, lubricants, antifreeze and other, in each case automotive fluid change business and auto and light truck maintenance service, in each case incidental to operating their service stations or other retail units; (iv) engage, directly or through its own dealers, jobbers, or jobber dealers, in the sale of lubricants to farm, government, school and other similar commercial accounts; (v) engage, directly or through its own dealers, jobbers, or jobber dealers, in the sale of car care products and chemicals, antifreeze and rust preventatives in service stations or similar retail units that are owned or operated by them, in each case incidental to operating their service stations or other retail units; (vi) engage, directly or through its own dealers, jobbers, or jobber dealers, in the collection of used lubricants at service stations or similar retail units that are owned or operated by them, in each case incidental to operating their service stations or other retail units; (vii) enter into contractual agreements with Valvoline or other third party packagers with respect to the packaging by Valvoline or such other third party packagers of lube oil products for sale (A) in service stations or similar retail units that are owned or operated by the Company and its subsidiaries or its dealers, jobbers or jobber dealers or to farm, government, school or other similar commercial accounts pursuant to clause (iv) above and (B) solely under the brandnames or trademarks of such service stations; and (viii) purchase a Person (whether by merger or purchase of all or substantially all the assets or otherwise) which engages, directly or indirectly, in a business that is substantially in competition with the Valvoline Business (a "Valvoline Competitive Third Party") provided that less than 33% of such Valvoline Competitive Third Party's consolidated revenues for the most recently completed fiscal quarter are derived from businesses which are substantially in competition *with*

Valvoline's Business; provided further that a purchase by the Company or one of its subsidiaries of a Valvoline Competitive Third Party shall be permitted only if within 30 Business Days after the earlier to occur of (A) the execution of definitive agreements with respect to such purchase or (B) the closing of such purchase, the Company shall give notice (a "14.03(d) Offer Notice") to Ashland, identifying the portion of such Valvoline Competitive Third Party's business that is substantially in competition with the Valvoline Business (the "Valvoline Competitive Business Assets") and offering to sell to Ashland such Valvoline Competitive Business Assets at a purchase price determined in accordance with Section 14.04.

(e) Ashland shall have 90 days from receipt of the 14.03(d) Offer Notice to elect, by notice to the Company (a "14.3(d) Purchase Election Notice"), to purchase such Valvoline Competitive Business Assets. If Ashland makes such election, the notice of election shall state a closing date not later than 60 days after the date of the Section 14.03(d) Purchase Election Notice or, if later, 30 days after Ashland has received any antitrust clearance or other Governmental Approval required in connection with such purchase (a "14.03(d) Scheduled Closing Date"). If Ashland breaches its obligation to purchase the Valvoline Competitive Business Assets on the 14.03(d) Scheduled Closing Date after giving notice of its election to make such purchase (other than where such breach is due to circumstances beyond Ashland's reasonable control), then the Company shall be permitted to retain such Valvoline Competitive Business Assets. If Ashland breaches its obligation to purchase the Valvoline Competitive Business Assets on the 14.03(d) Scheduled Closing Date after giving notice of its election to make such purchase and such breach is due to circumstances beyond Ashland's reasonable control, then, if the closing of the purchase by Ashland of the Valvoline Competitive Business Assets does not occur within 270 days after the Scheduled Closing Date, the Company shall be permitted to retain such Valvoline Competitive Business Assets. If Ashland elects not to purchase such Valvoline Competitive Business Assets, then the Company shall be permitted to retain such Valvoline Competitive Business Assets.

(f) (i) If the Company and its subsidiaries are permitted under Section 14.03(d) to retain any Valvoline Competitive Business Assets and, at any time thereafter, the Company or any such subsidiary shall determine to sell such Valvoline Competitive Business Assets (or any portion thereof), then the Company shall give notice (a "14.03(f) Valvoline Offer Notice") to Ashland, identifying the proposed purchaser from whom it has received a bona fide offer and setting forth the proposed sale price (which shall be payable only in cash or purchase money obligations secured solely by such Valvoline Competitive Business Assets (or portion thereof) being sold) and the other material terms and conditions upon which the Company is proposing to sell such Valvoline Competitive Business Assets to such identified purchaser (or portion thereof). No such sale shall encompass or be conditioned upon the sale or purchase of any property other than such Valvoline Competitive Business Assets (or portion thereof). Ashland shall have 90 days from receipt of the Valvoline Offer Notice to elect, by notice to the Company (a "14.03(f) Valvoline Purchase Election Notice"), to purchase such Valvoline Competitive Business Assets (or portion thereof) on the terms and conditions set forth in the 14.03(f) Valvoline Offer Notice.

(ii) If Ashland makes such election, the notice of election shall state a closing date not later than 60 days after the date of the 14.03(f) Valvoline Purchase Election Notice. If Ashland breaches its obligation to purchase such Valvoline Competitive Business Assets (or portion thereof) on the same terms and conditions as those contained in the 14.03(f) Valvoline Offer Notice after giving notice of its election to make such purchase (other than where such breach is due to circumstances beyond Ashland's reasonable control), then the Company may, at any time for a period of 270 days after such default, sell such Valvoline Competitive Business Assets (or portion thereof) to any person at any price and upon any other terms without further compliance with the procedures set forth in this Section 14.03(f).

(iii) If Ashland gives notice within the 90-day period following the 14.03(f) Valvoline Offer Notice from the Company that it elects not to purchase such Valvoline Competitive Business Assets (or portion thereof), the Company may, within 120 days after the end of such 90-day period (or 270 days in the case where such parties have received a second request under HSR), sell such Valvoline Competitive Business Assets to the identified purchaser on terms and conditions no less favorable to the Company than the terms and conditions set forth in such 14.03(f) Valvoline Offer Notice. In the event the Company shall desire to offer such Valvoline Competitive Business Assets (or portion thereof) for sale to such identified purchaser or to any other person on terms and conditions less favorable to it than those previously set forth in a 14.03(f) Valvoline Offer Notice, the procedures set forth in this Section 14.03(f) must again be initiated and applied with respect to the terms and conditions as modified.

(g) It is the intention of each of the parties hereto that if any of the restrictions or covenants contained in this Section 14.03 is held by a court of competent jurisdiction to cover a geographic area or to be for a length of time that is not permitted by Applicable Law, or is in any way construed by a court of competent jurisdiction to be too broad or to any extent invalid, such provision shall not be construed to be null, void and of no effect, but to the extent such provision would be valid or enforceable under Applicable Law, a court of competent jurisdiction shall construe and interpret or reform this Section 14.03 to provide for a covenant having the maximum enforceable geographic area, time period and other provisions (not greater than those contained in this Section 14.03) as shall be valid and enforceable under such Applicable Law. Each of the parties hereto acknowledges that any breach of the terms, conditions or covenants set forth in this Section 14.03 shall be competitively unfair and may cause irreparable damage because of the special, unique, unusual, extraordinary and intellectual character of the applicable business, and recovery of damages at law will not be an adequate remedy. Accordingly, each of the parties hereto agrees that for any breach of the terms, covenants or agreements of this Section 14.03, a restraining order or an injunction or both may be issued against such person, in addition to any other rights or remedies the aggrieved party may have.

(h) For purposes of this Agreement, the following terms shall have the following meanings:

(i) "Bulk Motor Oil Business" means sales of blended (finished) motor oil in tanker truck, barge and tanker railcar quantities.

(ii) "Minimum Lube Oil Purchase Amount" means a quantity of lube oil at least equal to 70% of the quantity of lube oil that Valvoline purchased from the Catlettsburg, Kentucky refinery in the 1997 calendar year.

(iii) "Packaged Motor Oil Business" means the ownership, use andor operation (including toll processing through a third party's plant) of packaging facilities for the sale of packaged motor oil under third party brandnames or trademarks.

(iv) "Private Label Packaged Motor Oil Business" means the sale of packaged motor oil under third party andor the Company's brand names or trademarks.

(v) "Quick Lube Business" means the provision of services for changing oil, lubricants, antifreeze and other automotive fluids for passenger car and light commercial trucks and the provision of maintenance checks and related services.

(vi) "Valvoline" means the Valvoline division of Ashland.

(vii) "Valvoline Business" means the business currently engaged in by Valvoline, including (A) the production and marketing of automotive and industrial oils, automotive car care products and chemicals, antifreeze, rust preventives, (B) automotive services and (C) environmental recycling services (including collection of used oil, filters and related items). For the avoidance of doubt, the Valvoline Business includes the Bulk Motor Oil Business, the Packaged Motor Oil Business, the Private Label Packaged Motor Oil Business and the Quick Lube Business.

SECTION 14.04. Purchase Price of Competitive Business Assets.

In the event that (x) the Company elects to purchase any Company Competitive Business Assets pursuant to the proviso to Section 14.01(d)(iv) or (y) Ashland elects to purchase any Valvoline Competitive Business Assets pursuant to the second proviso to Section 14.03(d)(viii), the purchase price of such Company Competitive Business Assets or Valvoline Competitive Business Assets (the "Competitive Business Purchase Price") shall be determined pursuant to the following procedures:

(a) Negotiation Period. For a period of 15 days following the date the Board of Managers approves such purchase, Marathon and Ashland will negotiate in good faith to seek to reach an agreement as to the Competitive Business Purchase Price. If Marathon and Ashland reach such an agreement, then the Competitive Business Purchase Price shall be deemed to be the amount so agreed upon by Marathon and Ashland.

(b) Appraisal Process. (i) In the event Marathon and Ashland are unable to reach an agreement as to the Competitive Business Purchase Price within the 15 day period referred to in clause (a) above, then within five Business Days after the expiration of such 15-day period (such fifth Business Day being referred to herein as the "14.04 Appraisal Process Commencement Date"), Marathon and Ashland each shall select a nationally recognized investment banking firm to (A) prepare a report which (1) sets forth such investment banking firm's determination of the Competitive Business Purchase Price (which shall be a single amount as opposed to a range) and (2) includes work papers which indicate the basis for the calculations of the Competitive Business Purchase Price (a "14.04 Appraisal Report") and (B) deliver to Marathon or Ashland, as the case may be, an oral and written opinion addressed to such party as to the Competitive Business Purchase Price.

(ii) The fees and expenses of each investment banking firm shall be paid by the party selecting such investment banking firm.

(iii) Each of Marathon and Ashland shall instruct its respective investment banking firm to (A) not consult with the other investment banking firm with respect to its view as to the Competitive Business Purchase Price prior to the time that both investment banking firms have delivered their respective opinions to Marathon and Ashland, as applicable, (B) deliver their respective 14.04 Appraisal Reports, together with their oral and written opinions as to the Competitive Business Purchase Price (the "14.04 Initial Opinion Values"), within 15 days after the 14.04 Appraisal Process Commencement Date, and (C) deliver a copy of its written opinion and its 14.04 Appraisal Report to the Company, the other party and the other party's investment banking firm at the time it delivers its oral and written opinion to Marathon or Ashland, as applicable.

(iv) If the 14.04 Initial Opinion Values differ and the lesser 14.04 Initial Opinion Value equals or exceeds 90% of the greater 14.04 Initial Opinion Value, the Competitive Business Purchase Price shall be deemed to be an amount equal to (A) the sum of the 14.04 Initial Opinion Values divided by (B) two.

(v) If the 14.04 Initial Opinion Values differ and the lesser 14.04 Initial Opinion Value is less than 90% of the greater 14.04 Initial Opinion Value then:

(A) within two Business Days after both investment banking firms have delivered their respective opinions to Marathon or Ashland, as applicable, each investment banking firm shall, at a single meeting at which Marathon, Ashland, the Company and the other investment banking firm are present, make a presentation with respect to its 14.04 Initial Opinion Value. At such presentation, Marathon, Ashland, the Company and the other investment banking firm shall be entitled to ask questions as to the basis for and the calculation of such investment banking firm's 14.04 Initial Opinion Value; and

(B) Marathon and Ashland shall, within five Business Days after the date Marathon and

Ashland receive the 14.04 Initial Opinion Values (such fifth Business Day being referred to herein as the "14.04 Subsequent Appraisal Process Commencement Date"), jointly select a third nationally recognized investment banking firm to (1) prepare a 14.04 Appraisal Report and (2) deliver an oral and written opinion addressed to Marathon and Ashland as to the Competitive Business Purchase Price. The fees and expenses of such third investment banking firm shall be paid 50% by Marathon and 50% by Ashland. Such third investment banking firm shall not be provided with the 14.04 Initial Opinion Values and shall not consult with the initial investment banking firms with respect thereto. During such five-Business Day period, Marathon and Ashland shall negotiate in good faith to independently reach an agreement as to the Competitive Business Purchase Price. If Marathon and Ashland reach such an agreement, then the Competitive Business Purchase Price shall be deemed to be the amount so agreed upon by Marathon and Ashland. If Marathon and Ashland are unable to reach such an agreement, then Marathon and Ashland shall instruct such third investment banking firm to deliver its 14.04 Appraisal Report, together with its oral and written opinion as to the Competitive Business Purchase Price (the "14.04 Third Opinion Value"), within 15 days after the 14.04 Subsequent Appraisal Process Commencement Date. The Competitive Business Purchase Price in such circumstances shall be deemed to be an amount equal to (I) the sum of (x) the 14.04 Third Opinion Value plus (y) whichever of the two 14.04 Initial Opinion Values is closer to the 14.04 Third Opinion Value (or, if the 14.04 Third Opinion Value is exactly halfway between the two 14.04 Initial Opinion Values, the 14.04 Third Opinion Value), divided by (II) two.

ARTICLE XV
Survival; Assignment

SECTION 15.01. Survival and Assignment re: Marathon and USX.

(a) General. Except as expressly permitted by this Section 15.01, neither Marathon nor USX shall assign all or any part of its rights and obligations hereunder to any person without first obtaining the written approval of each of the other parties hereto, which approval may be granted or withheld in such parties' sole discretion.

(b) Merger or Sale of Substantially All of Marathon's or USX's Assets. In the event that Marathon or USX shall be a party to a merger, consolidation or other similar business combination transaction with a third party or sell all or substantially all its assets to a third party, Marathon's or USX's, as the case may be, rights and obligations hereunder shall be assignable to such third party in connection with such transaction; provided, however, that Marathon or USX shall not be permitted to assign its rights and obligations hereunder to such third party as aforesaid if the purpose or intent of such merger, consolidation, similar business combination transaction or sale is to circumvent or avoid the application of Sections 10.01(c) and 10.04 of the LLC Agreement to the related Transfer of Marathon's Membership Interests to such third party.

(c) Transfer of Marathon's Membership Interests Pursuant to Section 10.01(c) of the LLC Agreement. In the event that Marathon Transfers all of its Membership Interests to a third party pursuant to Section 10.01(c) of the LLC Agreement, then:

(i) such third party shall at the time of such Transfer become subject to all of Marathon's and USX's respective obligations hereunder and shall succeed to all of Marathon's and USX's respective rights hereunder;

(ii) such third party and its ultimate parent, if any, shall each become subject to the same standstill obligations that apply to Marathon and USX under Section 12.01, which standstill provisions shall remain in effect with respect to such third party and its ultimate parent, if any, through the six-month anniversary of the earlier to occur of (a) the date that Ashland and its Affiliates do not own any Membership Interests and (b) the date that such third party and its Affiliates do not own any Membership Interests;

(iii) such third party and its ultimate parent, if any, shall each become subject to the same non-compete covenants that apply to Marathon and USX under Article XIV; and

(iv) Marathon and USX shall each be relieved of all of its obligations hereunder other than (1) any default hereunder by Marathon or USX or any of their respective Affiliates that occurred prior to the time of such Transfer; (2) Marathon's and USX's respective obligations under Section 12.01 (which are in addition to, and not in lieu of such third party's obligations under Section 12.01); (3) Marathon's and USX's respective obligations under Article X with respect to any Securities that Marathon andor USX issued to Ashland pursuant to Section 4.02(c) prior to such Transfer or that Marathon andor USX intends to issue to Ashland pursuant to Section 4.02(c) after such Transfer; and (4) Marathon's and USX's respective obligations under Article XIV (which shall survive for six months from the date of such Transfer and which are in addition to, and not in lieu of such third party's obligations under Article XIV).

(d) Assignment of Marathon's Marathon Call Right and Special Termination Right. In the event of an assignment by Marathon of its rights and obligations under this Agreement to a third party pursuant to this Section 15.01, Marathon's rights and obligations related to its Marathon Call Right and its Special Termination Right shall also be assigned to such third party; provided, that such third party shall not be permitted to exercise the Marathon Call Right until the third anniversary of the date of such assignment.

SECTION 15.02. Survival and Assignment re: Ashland.

(a) General. Except as expressly permitted by this Section 15.02, Ashland shall not assign all or any part of its rights and obligations hereunder to any person without first obtaining the prior written approval of each of the other parties hereto, which approval may be granted in such parties' sole discretion.

(b) Merger or Sale of Substantially all of Ashland's Assets. In the event that Ashland shall be a party to a merger, consolidation or other similar business combination transaction with a third party or sell all or substantially all of its assets to a third party, Ashland's rights and obligations hereunder shall be assignable to such third party in connection with such transaction; provided, however, that Ashland shall not be permitted to assign its rights and obligations hereunder to such third party as aforesaid if the purpose or intent of such merger, consolidation, similar business combination transaction or sale is to circumvent or avoid the application of Sections 10.01(c) and 10.04 of the LLC Agreement to the related Transfer of Ashland's Membership Interests to such third party.

(c) Transfer of Membership Interests Pursuant to Section 10.01(c) of the LLC Agreement. In the event that Ashland Transfers all of its Membership Interests to a third party pursuant to Section 10.01(c) of the LLC Agreement, then:

(i) such third party shall at the time of such Transfer become subject to all of Ashland's obligations hereunder and shall succeed to all of Ashland's rights hereunder;

(ii) such third party and its ultimate parent, if any, shall each become subject to the same standstill obligations that apply to Ashland under Section 12.02, which standstill provisions shall remain in effect with respect to such third party and its ultimate parent, if any, through the later to occur of (i) the six-month anniversary of the earlier to occur of (A) the date that Marathon and its Affiliates do not own any Membership Interests and (B) the date that such third party and its Affiliates do not own any Membership Interests and (ii) in the event that such third party or its Affiliates acquires USX Voting Securities pursuant to the Closing of the Ashland Put Right, the date on which such third party and its Affiliates do not own more than 5% of the then outstanding USX Voting Securities;

(iii) such third party and its ultimate parent, if any, shall each become subject to the same non-compete covenants that apply to Ashland under Article XIV;

(iv) Ashland shall be relieved of all of its obligations hereunder other than (1) any default hereunder by Ashland or any of its Affiliates that occurred prior to the time of such Transfer; (2) Ashland's obligations under Section 12.02 (which are in addition to, and not in lieu of such third party's obligations under Section 12.02); and (3) Ashland's obligations under Article XIV (which shall survive for six months from the date of such Transfer and which are in addition to, and not in lieu of such third party's obligations under Article XIV); and

(v) Ashland shall retain all of its rights under Article X with respect to any Securities that are issued to Ashland pursuant to Section 4.02(c) prior to or after the date of such Transfer (which rights shall be in addition to and not in lieu of the rights that the third party of Ashland's Membership Interests is entitled to under Article X).

(d) Assignment of Ashland's Ashland Put Right and Special Termination Right. In the event of an assignment by Ashland of its rights and obligations under this Agreement to a third party pursuant to this Section 15.02, Ashland's rights and obligations related to its Ashland Put Right and its Special Termination Right shall also be assigned to such third party; provided that such third party shall not be permitted to exercise the Ashland Put Right until the third anniversary of the date of such assignment.

SECTION 15.03. Survival and Assignment re: the Company.

The Company shall not be permitted to assign its rights and obligations hereunder without the prior written consent of each of the other parties hereto, which consent shall not be unreasonably withheld.

SECTION 15.04. Assignment and Assumption Agreements.

Any assignment of Marathon's, USX's, Ashland's or the Company's respective rights and obligations hereunder pursuant to this Article XV shall be pursuant to an assignment and assumption agreement by and among the third party, such third party's ultimate parent, if any, and each of the parties hereto, in such form as the parties hereto shall reasonably approve.

SECTION 15.05. Consequences of Unpermitted Assignments.

Any attempted assignment in violation of this Article XV shall be void and without legal effect.

ARTICLE XVI
Dispute Resolution Procedures

SECTION 16.01. General.

All controversies, claims or disputes that arise out of or relate to the Agreement or the construction, interpretation, performance, breach, termination, enforceability or validity of the Agreement, or the commercial economic or other relationship of the parties thereto, whether such claim is based on rights, privileges or interests recognized by or based upon statute, contract, tort, common law or otherwise and whether such claim existed prior to or arises on or after the date of the Agreement (a "Dispute") shall be resolved in accordance with the provisions of this Article XVI. Notwithstanding anything to the contrary contained in this Article XVI, nothing in this Article XVI shall limit the ability of the directors and officers of a party hereto from communicating directly with the directors and officers of any other party hereto.

SECTION 16.02. Dispute Notice and Response.

A party hereto may give another party hereto written notice (a "Dispute Notice") of any Dispute which has not been resolved in the normal course of business. Within fifteen Business Days after delivery of the Dispute Notice, the receiving party shall submit to the other party a written response (the "Response"). The Dispute Notice and the Response shall each include a statement setting forth the position of the party giving such notice, a summary of the arguments supporting such position and, if applicable, the relief sought.

SECTION 16.03. Negotiation Between Chief Executive Officers.

(a) If a Dispute Notice is delivered prior to the Closing, within 10 Business Days after delivery of the Response provided for in Section 16.02, the Chief Executive Officer (in the case of Ashland and USX) andor the President (in the case of Marathon and the Company) of each party to such Dispute shall meet or communicate by telephone at a mutually acceptable time and place, and thereafter as often as they reasonably deem necessary, and shall negotiate in good faith to attempt to resolve the Dispute that is the subject of such Dispute Notice. If such Dispute has not been resolved within 20 Business Days after the delivery of the Response as provided for in Section 16.02, then each party shall be permitted to take such actions at law or in equity as it is otherwise permitted to take or as may be available under Applicable Law.

(b) All negotiations between the Chief Executive Officer(s) andor the President(s) pursuant to this Section 16.03 shall be treated as compromise and settlement negotiations. Nothing said or disclosed, nor any document produced, in the course of such negotiations which is not otherwise independently discoverable shall be offered or received as evidence or used for impeachment or for any other purpose in any current or future arbitration or litigation.

SECTION 16.04. Right to Equitable Relief Preserved.

Notwithstanding anything in this Agreement to the contrary, any party hereto may at any time seek from any court of the United States located in the State of Delaware or from any Delaware state court, any interim, provisional or injunctive relief that may be necessary to protect the rights or property of such party or maintain the status quo before, during or after the pendency of the negotiation process or any other proceeding contemplated by Section 16.03.

ARTICLE XVII
Miscellaneous

SECTION 17.01. Notices.

Any notice, consent or approval to be given under this Agreement shall be in writing and shall be deemed to have been given if delivered: (i) personally by a reputable courier service that requires a signature upon delivery; (ii) by mailing the same via registered or certified first-class mail, postage prepaid, return receipt requested; or (iii) by telecopying the same with receipt confirmation (followed by a first-class mailing of the same) to the intended recipient. Any such writing will be deemed to have been given: (a) as of the date of personal delivery via courier as described above; (b) as of the third calendar day after depositing the same into the custody of the postal service as evidenced by the date-stamped receipt issued upon deposit of the same into the mails as described above; and (c) as of the date and time electronically transmitted in the case of telecopy delivery as described above, in each case addressed to the intended party at the address set forth below:

To Marathon:
Marathon Oil Company
5555 San Felipe
P.O. Box 3128
Houston, TX 77056
Attn: General Counsel
Phone: (713) 296-4137
Fax: (713) 296-4171

To USX:
USX Corporation
600 Grant Street
Pittsburgh, PA, 15219-4776
Attn: General Counsel
Phone: (412) 433-1121
Fax: (412) 433-2015

To Ashland:
Ashland Inc.
1000 Ashland Drive
Russell, KY 41169
Attn: General Counsel
Phone: (606) 329-3333
Fax: (606) 329-3823

To the Company:
Marathon Ashland Petroleum LLC
539 South Main Street
Findlay, Ohio 45840
Attn: General Counsel
Phone: (419) 421-4115
Fax: (419) 422-2121

Any party may designate different addresses or telecopy numbers by notice to the other parties.

SECTION 17.02. Merger and Entire Agreement.

This Agreement (including the Schedules and Appendices attached hereto), together with the other Transaction Documents (including the exhibits, schedules and appendices thereto) and certain other agreements executed contemporaneously with the Master Formation Agreement constitutes the entire Agreement of the parties hereto and supersedes any prior understandings, agreements, or representations by or among the parties hereto, written or oral, to the extent they relate in any way to the subject matter hereof.

SECTION 17.03. Parties in Interest.

This Agreement shall inure to the benefit of, and be binding upon, the parties hereto and their respective successors, legal representatives and permitted assigns.

SECTION 17.04. Counterparts.

This Agreement may be executed in counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

SECTION 17.05. Amendment; Waiver.

This Agreement may not be amended except in a written instrument signed by each of the parties hereto and expressly stating it is an amendment to this Agreement. Any failure or delay on the part of any party hereto in exercising any power or right hereunder shall not operate as a waiver thereof, nor shall any single or partial exercise of any such right or power preclude any other or further exercise thereof or the exercise of any other right or power hereunder or otherwise available at law or in equity.

SECTION 17.06. Severability.

If any term, provision, covenant, or restriction of this Agreement or the application thereof to any Person or circumstance, at any time or to any extent, is held by a court of competent jurisdiction or other Governmental Authority to be invalid, void or unenforceable, the remainder of the terms, provisions, covenants and restrictions of this Agreement (or the application of such provision in other jurisdictions or to Persons or circumstances other than those to which it was held invalid or unenforceable) shall in no way be affected, impaired or invalidated, and to the extent permitted by Applicable Law, any such term, provision, covenant or restriction shall be restricted in applicability or reformed to the minimum extent required for such to be enforceable. This provision shall be interpreted and enforced to give effect to the original written intent of the parties hereto prior to the determination of such invalidity or unenforceability.

SECTION 17.07. GOVERNING LAW.

THIS AGREEMENT SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF DELAWARE, WITHOUT GIVING EFFECT TO THE PRINCIPLES OF CONFLICTS OF LAW THEREOF. ANY RIGHT TO TRIAL BY JURY WITH RESPECT TO ANY CLAIM OR PROCEEDING RELATED TO OR ARISING OUT OF THIS AGREEMENT, OR ANY TRANSACTION OR CONDUCT IN CONNECTION HEREWITH, IS WAIVED.

SECTION 17.08. Enforcement.

The parties hereto agree that irreparable damage would occur in the event that any of the provisions of this Agreement were not performed in accordance with their specific terms or were otherwise breached. It is accordingly agreed that the parties hereto shall be entitled to an injunction or injunctions to prevent breaches of this Agreement and to enforce specifically the terms and provisions of this Agreement in the Delaware Chancery Court; provided that if the Delaware Chancery Court does not have jurisdiction with respect to such matter, the parties hereto shall be entitled to enforce specifically the terms and provisions of this Agreement in any court of the United States located in the State of Delaware or in Delaware state court, this being in addition to any other remedy to which they are entitled at law or in equity. In addition, each of the parties hereto (i) consents to submit itself to the personal jurisdiction of the Delaware Chancery Court in the event that any dispute arises out of this Agreement or any of the transactions contemplated by this Agreement; provided that if the Delaware Chancery Court does not have jurisdiction with respect to any such dispute, such party consents to submit itself to the personal jurisdiction of any Federal court located in the State of Delaware or any Delaware state court, (ii) agrees to appoint and maintain an agent in the State of Delaware for service of legal process, (iii) agrees that it will not attempt to deny or defeat such personal jurisdiction by motion or other request for leave from any such court, (iv) agrees that it will not plead or claim in any such court that any action relating to this Agreement or any of the transactions contemplated by this Agreement in any such court has been brought in an inconvenient forum and (v) agrees that it will not initiate any action relating to this Agreement or any of the transactions contemplated by this Agreement in any court other than (1) the Delaware Chancery Court, or (2) if the Delaware Chancery Court does not have jurisdiction with respect to such action, a Federal court sitting in the State of Delaware or a Delaware state court.

SECTION 17.09. Table of Contents, Headings and Titles.

The table of contents and section headings of this Agreement and titles given to Schedules and Appendices to this Agreement are for reference purposes only and are to be given no effect in the construction or interpretation of this Agreement.

SECTION 17.10. Use of Certain Terms; Rules of Construction.

As used in this Agreement, the words "herein", "hereof" and "hereunder" and other words of similar import refer to this Agreement as a whole and not to any particular paragraph, subparagraph, section, subsection or other subdivision. Whenever the context may require, any pronoun used in this Agreement shall include the corresponding masculine, feminine or neuter forms, and the singular form of nouns, pronouns and verbs shall include the plural and vice versa. Each party hereto agrees that any rule of construction to the effect that any ambiguities are to be resolved against the drafting party shall not be employed in the interpretation or construction of this Agreement or any Transaction Document.

SECTION 17.11. Holidays.

Notwithstanding any deadline for payment, performance, notice or election under this Agreement, if such deadline falls on a date that is not a Business Day, then the deadline for such payment, performance, notice or election will be extended to the next succeeding Business Day.

SECTION 17.12. Third Parties.

Nothing herein expressed or implied is intended or shall be construed to confer upon or give any person and their respective successors, legal representatives and permitted assigns any rights, remedies or basis for reliance upon, under or by reason of this Agreement.

SECTION 17.13. Liability for Affiliates.

Except where and to the extent that a contrary intention otherwise appears, where any party hereto undertakes to cause its Affiliates to take or abstain from taking any action, such undertaking shall mean (i) in the case of an Affiliate that is controlled by such party, that such party shall cause such Affiliate to take or abstain from taking such action and (ii) in the case of an Affiliate that controls or is under common control with such party, that such party shall use its commercially reasonable best efforts to cause such Affiliates to take or abstain from taking such action; provided, however, that such party shall not be required to violate, or cause any director of an Affiliate to violate, any fiduciary duty to minority shareholders of such Affiliate.

SECTION 17.14. Schedules.

No representation or warranty hereunder shall be deemed to be inaccurate if the actual situation is disclosed pursuant to another representation or warranty herein or in a schedule to a PutCall, Registration Rights and Standstill Agreement Disclosure Letter or in any other Transaction Document or any exhibit, schedule or appendix thereto, whether or not an explicit cross-reference appears. Neither the specification of any dollar amount in any representation, warranty or covenant contained in this Agreement nor the inclusion of any specific item in a schedule to a PutCall, Registration Rights and Standstill Agreement Disclosure Letter is intended to imply that such amount, or higher or lower amounts, or the item so included or other items, are or are not material, and neither party shall use the fact of the setting forth of any such amount or the inclusion of any such item in any dispute or controversy involving the parties as to whether any obligation, item or matter not described herein or included in a schedule to a PutCall, Registration Rights and Standstill Agreement Disclosure Letter is or is not material for purposes of this Agreement.

IN WITNESS WHEREOF, this Agreement has been duly executed by the parties as of the day and year first above written.

MARATHON OIL COMPANY
by s Victor G. Beghini

Name: Victor G. Beghini
Title: President

USX CORPORATION
by s Thomas J. Usher

Name: Thomas J. Usher
Title: Chairman of the Board and Chief Executive Officer

ASHLAND INC.
by s Paul W. Chellgren

Name: Paul W. Chellgren
Title: Chairman of the Board and Chief Executive Officer

MARATHON ASHLAND PETROLEUM LLC
by s J. L. Frank

Name: J. L. Frank
Title: President

THE USE OF LLCs IN VENTURE CAPITAL TRANSACTIONS

William G. Strench
Brown, Todd & Heyburn PLLC
Louisville, Kentucky

SECTION E

THE USE OF LLCs IN VENTURE CAPITAL TRANSACTIONS

TABLE OF CONTENTS

THE USE OF LLCs IN VENTURE CAPITAL TRANSACTIONS

BY: WILLIAM G. STRENCH

BROWN, TODD & HEYBURN PLLC

I. REASONS FOR USING LLCs FOR VENTURE CAPITAL TRANSACTIONS

A. Description of Venture Capital Transactions

In this outline, the term "venture capital transaction" is used not only to describe traditional venture capital investments but also more broadly to include any transaction in which a business entity has two classes of ownership - active management which may make a minimal or no capital contribution to the business entity and passive (at least in the day-to-day sense) investors who will supply most of all if not all of the entity's equity capital. The structure of such transactions generally provides for the investors to receive a preferential return on their investment upon liquidation or dissolution, a fixed dividend (which usually accrues and is not currently payable), the right to convert their preferred equity position into a common equity position, board representation and the right to participate in some management decisions through consent requirements or veto rights with respect to certain business transactions. The investment terms would also generally include some form of "exit strategy" such as the ability to force the entity to repurchase the investors' shares after a certain period of time.

Until recently, the only suitable entity for venture capital transactions was the corporate form of entity. The corporation would issue preferred stock to the investors with the stock typically having a fixed dividend rate, liquidation preference, optional redemption rights, a conversion feature allowing it to be converted into common stock of the company and voting rights on an "as converted" basis. As described below, the corporate form in most instances is an inferior vehicle for structuring venture capital type transactions for a variety of reasons. However, despite the disadvantages of the corporate structure and the fact that limited liability companies have now become the "vehicle of choice" with respect to most new entity formations, most venture capital transactions continue to be structured as corporate transactions. This is likely explained by the complexity of using this form of business structure as well as the much greater familiarity of all participants with the corporate structure. Nonetheless, it may be expected that in the future an increasing percentage of such transactions will be conducted through limited liability companies.

B. Advantages of LLCs

Limited liability companies have a number of advantages over C corporations, the traditional form of entity used for venture capital investments.

1. Pass-Through Taxation

Limited liability companies are not subject to any entity level tax. Like partnerships and S corporations, only the owners (members) of LLCs are subject to taxation on the entity's income. In contrast, C corporations are subject to double taxation. The corporation is taxed on its earnings and profits and its shareholders are subject to tax upon receipt of dividends. A related tax advantage of LLCs is that they may pass through their losses to their owners. These losses may offset other taxable income earned by the members. Shareholders in a C corporation are not entitled to deduct losses at the corporate level.

2. *Special Tax Allocations*

Within certain parameters, a limited liability company has the ability to make special allocations of its income, deductions, gains and losses to its members. Accordingly, it may be possible to allocate all the losses to the investors who may be better able to derive the full benefit from them.

3. *Distribution of Appreciated Property*

Generally, there are no adverse tax consequences to an LLC or its members when the LLC distributes appreciated property to its members. Thus, if an LLC wishes to separate out a portion of its business or properties and transfer it to its members or to a separate entity owned by them, this can likely be accomplished on a tax-free basis. Conversely, under most circumstances, it is not possible to distribute appreciated property out of a C corporation without double taxation. Rather, the corporation recognizes gain on the appreciation and the shareholders will recognize dividend income up to the extent of the corporation's current or accumulated earnings and profits.

4. *State Tax Issue*

Under the tax laws of most states, including Kentucky, it is also preferable to operate in the LLC form as opposed to the corporate form. As is true at the federal level, C corporations are subject to double taxation under Kentucky law. LLCs are subject to only a single level of tax under Kentucky law. In addition, all Kentucky corporations (both S corporations and C corporations) are subject to the Kentucky license tax which is due annually. The amount of the tax is calculated on the basis of the amount of capital contributed to the corporation. No comparable tax exists for LLCs.

5. *Structural Flexibility.*

State corporate laws contain numerous mandatory provisions relating to the operation and management of corporations. Management of corporations is expressly delegated to the board of directors and not to shareholders. Although officers of a corporation can be granted broad managerial authority, certain duties of the board can never be delegated. State corporate law statutes contain specific procedures regarding the calling and holding of shareholder and board meetings and minimum vote requirements. Shareholders are provided with statutory rights relating to the inspection of corporate records including shareholder lists. Minimum vote requirements are necessary for the merger of the corporation, the sale of substantially all of its assets and dissolution. In contrast, there are almost no limits on the manner in which the management and operations of an LLC can be structured. As discussed below, this allows management and investor owners of LLCs to structure the economic, managerial and operational aspects in a manner that is consistent with their mutual objectives.

C. Disadvantages

An LLC may not be suitable for all venture capital transactions. The following is a summary of some of the disadvantages associated with LLCs.

1. Self-Employment Taxes

Unlike C and S corporations, management of LLCs may be subject to self-employment taxes on their distributive shares of income. Under certain circumstances, the tax may apply to income earned by management members on amounts they have contributed as equity to the company. Moreover, Congress and the IRS have not clarified to any significant degree the treatment of the self-employment tax in the LLC context. Therefore, it may not be possible to structure any LLC transaction to avoid this tax with any degree of certainty.

2. Tax-Free Mergers

Corporations may merge and, in some instances, engage in asset sales, in a manner that is tax-free to its shareholders under Section 368 of the Internal Revenue Code. There are no comparable provisions for a merger or asset sale involving a limited liability company. Thus, if the owners of an LLC anticipate that the company will be eventually sold to a public corporation in a transaction in which they will receive stock, it may be advantageous to form the entity as an S corporation or a C corporation. Although such a conversion from corporate to LLC form can be made later, the conversion may be ignored for tax purposes if it takes place shortly before the merger.

3. *Unavailability of Stock Options and Other Employee Benefits.*

S corporations and C corporations are permitted to grant their employees incentive stock options under Section 422 of the Code. An LLC is only permitted to issue nonqualified options. Unlike incentive stock options, a recipient of nonqualified options recognizes compensation income upon exercise of the option. Certain other fringe benefits are only available to employees of a corporation, such as medical expense reimbursement plans and deductions for premiums for group life insurance.

4. *Unrelated Business Taxable Income*

Certain types of investment vehicles such as IRAs will be taxed on the "unrelated business taxable income" they earn on investments in a pass-through entity. As such, these entities will be be subject to current tax on investments in LLCs whereas they would not be required to pay such taxes on C corporation investments.

D. Comparison to S Corporations

An S corporation has some of the same advantages over C corporations that LLCs possess such as the pass-through character of income earned by the entity. However, there are significant disadvantages to using S corporations in venture capital transactions. S corporations cannot be owned by partnerships, corporations or LLCs (unless they are wholly-owned subsidiaries) and must be owned by individuals or certain limited types of trusts. This precludes organized venture capital business entities from investing in S corporations. In addition, S corporations are only permitted to have a single class of stock and thus the preferred stock form of investment favored for venture capital investments is not permissible. For these reasons, S corporations are generally not a suitable investment vehicle for venture capital type transactions.

II. ADAPTING THE CORPORATE STRUCTURE TO LLCs

A. Capital Structure

The preferred stock structure favored for venture capital investments in C corporations can be readily adapted for investments in LLCs. With the flexibility afforded LLCs, the structure can be refined to more closely achieve the relative goals of the parties since, for the most part, there are no statutory constraints. Generally, the interests in the LLC can be designated as preferred units (or shares) and common units. The relative rights of holders of common units and preferred units are set forth in the operating agreement for the company. The following is a description of how the corporate preferred stock features can be adapted to the LLC form.

1. *Dividends*

As with preferred stock in a corporation, the preferred units can have a fixed dividend right that is either currently payable or that accrues until it is declared by the board of directors.

2. *Conversion Rights.*

It is possible to structure the preferred units to make them convertible into common units at a specified conversion rate. However, in the LLC format there is really no need to ever effect a conversion to common units. In a corporate structure, a preferred holder will want to retain all the advantages that preferred holders have over common holders. Therefore, a preferred holder will likely never convert except in connection with a public offering. A conversion is necessary in that instance since public shareholders generally prefer investing in companies with a single class of stock. As a practical matter, an LLC will need to convert to a corporate form in the event that it goes public. Therefore, there is no need to provide for conversion of the preferred units to common units.

3. *Liquidation Preference*

Generally, it is possible to provide for the same form of liquidation preference for preferred units in an LLC structure as can be achieved in the corporate setting. Care needs to be taken in drafting these provisions however since one of the safe harbor requirements for recognition of the tax allocation provisions in the LLC agreement is that any liquidating distributions must be made in accordance with positive account balances. To accomplish this, the ongoing allocations of taxable income and losses should be structured so that at liquidation, the preferred units will have capital account balances equal to their liquidation preference.

4. *Voting Rights.*

Voting rights can be established for preferred units in the same manner as are provided for in corporate venture capital transactions. Typically, preferred shares in a venture capital transaction are entitled to the number of votes that the holder would have if the shares were converted to common shares. Therefore, if one share of preferred stock is convertible into 100 shares of common stock in a corporation, the preferred would have 100 votes per preferred share. With the flexibility of the LLC structure, it is possible to modify general voting rights to achieve particular goals. For example, preferred shares can be given a greater number of votes with respect to certain types of actions requiring approval.

5. *Put Rights.*

As is true in a corporate setting, preferred units of an LLC can be made redeemable at the option of the holder after a specified number of years. This provides the investor with the ability to dispose of its investment if the company has not gone public or been sold within a specified number of years. The only constraint on these put rights under Kentucky law are certain solvency requirements similar to those under the corporate statute.

6. *Tax Treatment*

For C corporations and S corporations, the Code specifies exactly how the corporation and/or its owners are taxed with respect to the earnings of the corporation. This allocation of tax responsibility cannot be altered by contract. Conversely, in an LLC structure, the owners have significant flexibility in allocating taxable income and loss. In a venture transaction, income and losses would generally be allocated to provide the investors with all losses with income (after loss recoveries) allocated according to relative ownership percentages.

III. ADAPTING CORPORATE MANAGEMENT STRUCTURE TO THE LLC FORM

A. Board of Directors

A limited liability company may have a board of directors (sometimes described as the Board of Managers) that governs the affairs of the LLC just as a board would govern a corporation. Since the responsibilities, duties and obligations of board members, the manner of their election, appointment and removal are not addressed in the Kentucky LLC Act, these must be described in the operating agreement. Since there are no specific statutory provisions, the board of directors of an LLC can have attributes that are substantially dissimilar to those of a corporate board of directors. For example, board members can have different voting rights with some members having two votes and the others having one vote. In addition, if authorized in the operating agreement, the directors can act by written consent of less than all of the directors (the Kentucky Act requires that the board act by written consent only if there is unanimous consent).

B. Officers

As is the case for the board of directors, a LLC can also have officers with the same types of titles that officers of a corporation have. Again since there are no relevant statutory provisions, the responsibilities and duties of officers need to be specified in the operating agreement. In many instances, a shorthand method of describing such duties and responsibilities would be to state that the officers of the LLC shall have the same responsibilities and duties that officers of a Kentucky corporation with the same titles would have. Of course, the same flexibility exists with respect to officers as it does with directors. For example, the operating agreement can provide that officers may only be removed with the approval of the members or that approval of certain LLC actions require the consent of both the Board of Directors and the President of the company.

C. Manager or Member Managed Designation

One of the few mandatory requirements of the Kentucky LLC Act and other state limited liability company acts is the requirement that LLCs identify whether they will be member-managed or manager-managed. In the corporate type structure, it is generally preferable to provide that the LLC will be manager-managed. Any member of a member-managed LLC would have the statutory authority to bind the LLC, a generally undesirable result. If the LLC is to be manager-managed, the issue arises as to what individuals or groups of individuals should constitute managers. There are several alternatives in this regard. First each member of the board of directors could be designated a manager. The disadvantage of this approach is that each board member would have the authority to bind the LLC when the intent is to require the board to act in a collective fashion. Some operating agreements provide that the board of directors as a whole constitutes the manager of the LLC. While desirable in some respects, this structure does have certain practical limitations. For example, if action by the managers is required to authorize a particular agreement, a majority (or possibly all) of the directors would be required to execute the agreement. Generally, the best approach may be to identify the chief executive officer of the LLC as the manager. The terms of the operating agreement can provide that the CEO is subject to the control of the board of directors. Although there is some risk that the CEO could bind the LLC without board approval because of his or her status as a manager, this is similar to the risk that exists with a corporation where the CEO may have apparent authority to bind the corporation.

D. Fiduciary Duties

Under the corporation acts of all states, boards have certain fiduciary duties to the owners of the business which cannot be contracted away in the articles of incorporation or bylaws. No comparable provisions exist in the Kentucky LLC Act. Therefore, it may be possible to limit or eliminate altogether all fiduciary duties that board members and officers owe to the LLC's members. In addition, an operating agreement provision stating that one or more directors appointed by a particular group of members have no fiduciary duty to any other members is likely enforceable. This is a very useful provision in transactions in which the directors appointed by the investors have different interests than the management appointed directors. For example, if the investors believe it is an optimal time to sell the company for the purpose of satisfying their liquidity needs, the directors appointed by them could vote for such a sale even though the sale may not be optimal for owners of the company generally.

IV. OTHER MODIFICATIONS TO CORPORATE RULES

A. Access to Company Records.

The Kentucky Business Corporation Act (the "KBCA") and other state corporate laws contain very detailed provisions regarding a shareholder's ability to obtain access to corporate records, including shareholder lists. In the LLC context, it is arguably possible to completely eliminate such rights. If the rights are to be preserved in any form, the procedure should be addressed in the operating agreement.

B. Shareholder Meetings

Shareholders of Kentucky corporations have the ability to call shareholders meetings under certain circumstances. This right can be eliminated in the LLC context.

C. Indemnification and Limitation of Liability

The KBCA provides specific limitations on the ability to indemnify officers and directors and to eliminate their personal liability for actions taken in their corporate capacity. Although, for equitable reasons, it may be impossible to provide for mandatory indemnification in all instances and for the complete elimination of liability of officers and directors of an LLC, it is likely that rights of officers and directors in this regard can be significantly expanded beyond what it is available to corporate officers and directors.

D. Related Party Transactions

The KBCA has specific provisions dealing with related party transactions between the corporation and its officers, directors and shareholders. Because there are no such limitations under the Kentucky LLC Act, in theory, it might be possible to authorize all such transactions in the operating agreement. However, it is more likely a provision this broad would be held unenforceable as implicitly authorizing management to commit fraud with respect to the LLC's members. Accordingly, it is best to set up a specific procedure by which related party transactions can be approved and, in some cases, to authorize blanket approval of certain categories of transactions (e.g. sales of certain products using formula-derived pricing). If the approval procedure for such transactions is reasonable, it is likely to be held enforceable given the contractual nature of an operating agreement. Such procedures may include an independent third party appraisal or approval by disinterested directors.

V. MISCELLANEOUS ISSUES.

A. Conversion to C Corporation

There are a number of reasons a LLC may eventually may wish to convert to a C corporation. Very few public corporations exist in any form other than the C corporation form. As indicated above, if the business eventually wishes to merge with a corporation on a tax free transaction, it will need to be in corporate form to achieve this objective. There are three methods to convert a LLC into a corporation: (1) transfer all of the LLC's assets to a corporation followed by a distribution of the corporate stock to the members; (2) the transfer of the LLC interests by the members to the corporation in return for stock resulting in termination of the LLC and a distribution of its assets to the corporation; and (3) a liquidation by the members of the LLC followed by a transfer by the members of the distributed assets to the corporation in return for stock. The three methods of incorporation of a LLC may produce different tax consequences with regard to holding periods, share basis considerations, gain recognition and characterization and other tax issues, although generally most LLC's will be able to be converted into corporations without recognizing taxable income.

B. Pre-IPO Distributions

One unique advantage available to LLCs that is not available to C corporations is the ability to make a cash distribution to their owners prior to an initial public offering on a tax free basis. Generally, it may be possible for the LLC to distribute an amount equal to the LLC's aggregate capital contributions plus accumulated net earnings, less prior distributions, immediately prior to the IPO. This is often funded through a short term loan that will be paid from the IPO proceeds. Although such distributions prior to IPO are somewhat unusual, they may often be acceptable to the IPO underwriters because the pricing of such offerings is typically based on a multiple of earnings rather than on the company's net book value.

C. Securities Laws Holding Period

Under existing Securities and Exchange Commission interpretations of Rule 144, the rule that governs the ability of shareholders to sell shares acquired in a private transaction, conversion from a limited liability company to a corporation starts a new holding period. The effect of this interpretation is to impose a minimum one year limitation on the sale of shares following an IPO. An exception to this Rule exists if the conversion is mandatory at the election of the manager. Therefore, if there is any prospect of a LLC eventually going public, such a provision should be included in the operating agreement.

NON-PROFIT AND FOR-PROFIT HEALTH CARE ISSUES FOR THE LLC ENTITY

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SECTION F

TAX-EXEMPT ORGANIZATIONS AND LLCs

TABLE OF CONTENTS

TAX-EXEMPT ORGANIZATIONS AND LLC'S
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I. INTRODUCTION

In an effort to expand and diversify their exempt activities, exempt organizations[1] have discarded traditional approaches and actively pursued nontraditional, more sophisticated business opportunities, either on their own or by pooling their resources in partnership, with proprietary partners.[2] Because of the potential for abuse, the Internal Revenue Service ("IRS") has historically scrutinized an exempt organization's commercial endeavors, particularly in the areas of healthcare and low income housing, to determine whether the methods it uses to pursue and achieve its goals conflict with its legal obligations imposed by the Code.[3] Against this background, exempt organizations find themselves examining the attributes of limited liability companies ("LLC(s)") and whether LLCs will better protect an organization's exempt status when it is engaged in raising capital or developing new commercial relationships. By all indications, the IRS intends to closely police the non-traditional activities by tax-exempt organizations through the use of LLCs as joint venture vehicles and as the entity of choice for a newly created exempt organization.[4]

II. LLCs AS JOINT-VENTURE VEHICLES

In the past, the limited partnership was the vehicle of choice of tax-exempt organizations when forming ventures with for-profit enterprises or investors. Typically the tax-exempt organization served as a general partner while the individuals or taxable entities participated as limited partners. Now, with the presence of LLCs, tax-exempt organizations are looking to the LLC as a possible alternative to limited partnerships. The LLC, as an unincorporated association, from a business perspective offers the best of all worlds by providing its members with the limited liability of a corporation and the beneficial tax treatment and structural flexibility of a partnership.[5] Nonetheless, although the LLC possesses attributes common to both corporate and partnership law, its use by tax-exempt organizations is viewed with some apprehension by the business community, in general, and by the IRS in particular.[6]

Until recently, tax-exempt organizations have been apprehensive about utilizing LLCs and understandably so since the IRS had provided no real guidance prior to the issuance of Rev. Rul 98-15.[7] The only indication of the IRS's position, prior to Rev. Rul. 98-15, came in the form of Ltr Rul. 9517029 where it stated that a tax-exempt organization, when involved as a member of an LLC, must be able to demonstrate that it is in control of the operations and that the assets are not being "siphoned off" in a manner that would constitute use for non-exempt purposes.[8] The concepts applied by the IRS were very similar to those it had applied in the limited partnership setting. Moreover, the fundamental concepts of "control" and duty to further exempt purpose became the basis for Rev. Rul. 98-15.[9]

A. Prior History - The Limited Partnership Model.

Prior to the creation of LLCs, the IRS had gained considerable experience in analyzing exempt organizations' involvement in investment limited partnerships, particularly in the areas of healthcare and low-income housing.[10]

Traditionally, the IRS's focus has been on the exempt organization's role as the general partner.[11] While the limited partnership has served tax-exempt organizations well in procuring capital, it has forced the organizations to offer investors limited risk, a return on their capital investment, and substantial tax benefits at the expense of greater personal liability. As the general partner, the exempt organization's statutory and contractual obligations and duties to the limited partners, as viewed by the IRS, conflict with its duty to operate exclusively for charitable purposes, which can preclude exemption.[12] The same situations could arise with an LLC. A tax-exempt organization may participate as either a member in a member-managed LLC or as a manager in a manager-managed LLC. In both situations, the tax-exempt organization could find itself confronted with many of the same problems and tensions it would face as a general partner.

The IRS, having discarded its "per se" prohibition against a general partner,[13] employs a two-step approach in examining an organization's role as a general partner.[14] This approach examines the partnership relationship and the terms of the partnership agreement to determine whether: (i) the partnership is operated exclusively for exempt purposes, and (ii) the partnership structure, as represented in the partnership agreement, imposes certain duties and obligations on the tax-exempt organization that advance private interests at the expense of its charitable interests.

The IRS also has made clear that there is nothing per se objectionable with an exempt organization entering into a limited partnership where it either lacks the necessary funds or does not wish to expend all of its funds to acquire property.[15] This is a facts and circumstances analysis that places significance on the venture's charitable goals and the means by which it intends to achieve them.

B. Charitability.

The IRS began by examining the purpose or objective of the limited partnership. The issue of "charitability" is one that is fundamental to an exempt organization's involvement in any commercial venture regardless of the type of entity. The participation of the exempt organization must contribute importantly to its exempt purposes. This analysis involves an examination of the objectives of the parties rather than the type of vehicle used by the parties to achieve their objectives. In GCM 39862, 11/22/91, the IRS concluded that there is inherent tension between furthering charitable purposes and the obligations of a general partner to pursue the financial interests of the investors. While private interests can be advanced, they must be only "incidental" both qualitatively and quantitatively, i.e., the objectives pursued by the activity can only be accomplished by benefiting certain individuals, and the private benefit must not be substantial in comparison with the public benefit conferred by the activity.[16]

In GCM 39862,[17] for example, the IRS reexamined three letter rulings issued in the late 1980s involving joint ventures and concluded that tax-exempt hospitals did little to further their exempt purpose by serving as general partners in limited partnerships formed to share either gross or net revenue streams of income with participating medical staff physicians. Under each arrangement, the IRS found that the sale of the revenue stream of a medical department to a joint venture promoted the private interests of the physicians (as insiders) in both a direct and substantial manner and was advanced at the expense of the exempt organization. It concluded that the business venture did not provide a new healthcare provider or service or resource to the community, but simply enhanced and protected the hospital's market share by retaining and rewarding physicians for referrals and admissions while preempting physicians from creating a competitive provider. Conversely, in GCM 39005, 6/28/83, the IRS concluded that the partnership in which a tax-exempt organization served as a general partner was serving the organization's exempt purpose since the participation in the building and management of a government-financed housing project for limited-income handicapped and elderly persons served to further those charitable purposes set forth in its articles of incorporation and recognized by the IRS.[18]

C. Structure.

Once "Charitability" is found to exist, the IRS examined the structure of the limited partnership to determine if it inhibits the tax-exempt organization's exempt purpose. In its attempts to regulate a tax-exempt organization's involvement as a general partner, the IRS had required both adequate control of the venture to insure furtherance of exempt purpose and proper safeguards that serve to preserve and protect the organization's resources.[19]

To the extent that the investors were found to enjoy all the upside benefits and suffer none of the downside risks, the organization's exemption was in jeopardy. However, where the partnership had been structured to insulate the exempt organization from potential conflicts that would serve to advance the investors' private interests, the IRS would acquiesce.

An example of this approach can be seen in PLR 9736039 (June 9, 1997), where the IRS issued a favorable ruling that an organization's participation as a general partner in a low-income tax credit limited partnership did not jeopardize its IRC §501(c)(3) tax-exempt status. The ruling described a number of specific changes that the IRS required in the partnership agreement as a condition of issuing the ruling. The importance of this ruling lies, in part, in that its content provided much of the conceptual basis to the IRS in its issuance of Rev. Rul. 98-15.

D. The LLC and Rev. Rul 98-15.

1. In General.

With the corporate attributes of limited liability and participation in management along with the partnership characteristic of "freedom of contract," the LLC technically offers a tax-exempt organization greater control over the joint venture and greater protection for its assets than does a limited partnership.

First and foremost, the LLC offers all its members limited liability. Similar to the protection a corporation offers its shareholders, an LLC insulates both its members and managers from the debts, liabilities, and obligations it incurs.[20] In the past, the IRS has voiced strong objections where the tax-exempt organization, as the general partner, has unlimited personal exposure for the partnership's obligations.[21] By using an LLC, a tax-exempt organization can participate in a joint venture with for-profit investors and maintain control without having to expose its assets to the venture's liabilities. With an LLC there is no need to involve others in the management of the venture in an effort to spread the risk. Moreover, there is no statutory obligation which obligates a tax-exempt organization as the member or manager of the LLC to (i) contribute or loan additional capital to satisfy operating or capital deficits; (ii) personally return to an investor his capital contribution from its own assets; or (iii) provide indemnification to or create loss reserves for the investors.

From a statutory perspective, a tax-exempt organization can isolate itself entirely from losses related to the LLC's activities.[22] Equally important, the LLC will provide the exempt organization with limited liability without sacrificing an active role in the management of the venture. Unlike a limited partner, both members and managers can retain their limited liability status even though they participate actively in day-to-day management. By providing the tax-exempt organization with the ability to control the business venture through management without exposing its assets to substantial risk, the use of LLCs should remove a principal objection raised by the IRS in the limited partnership context.

E. **Fiduciary duties.**

The element of "control" required by the IRS imposes certain fiduciary duties on the tax-exempt organization to the LLC and its members that may interfere with the pursuit of the organization's exempt purposes. The duty of loyalty and the duty of care are often statutorily imposed on general partners in limited partnerships. The duty of loyalty imposes on the general partner the obligation to refrain from self-dealing, usurping business opportunities, and competing with the partnership, while the duty of care requires the general partner to refrain from engaging in grossly negligent, reckless conduct, intentional misconduct, or knowing violation of the law.[23]

State LLC statutes may or may not specify the fiduciary duties of members or managers. Consequently, depending on the particular state, management may have broad discretion in defining their fiduciary standards.[24] For example, the Kentucky Limited Liability Act does not define the fiduciary duties of the members or managers as it relates to the LLC. By using an LLC, tax-exempt organizations will have the flexibility to draft the standards of conduct for its fiduciaries in a manner that preserves its exempt status. While these duties may be varied by contract as well as by the particular management structure selected, the element of control required of the exempt organization by the IRS will most likely result, at a minimum, in the imposition by the courts of the customary duties of loyalty and care to the LLC's members.[25] These duties should not create an obstacle to the furtherance of a tax-exempt organization's exempt purposes subject to the following caveat.

It is the implicit duty of management to maximize an investor's return that has drawn the IRS's attention.[26] It has been suggested by the IRS that there is a duty on the part of the organization to maximize profits.[27] While a duty may exist to provide investors with a return on their capital, this duty must be balanced with the duty to achieve the objectives of the entity, itself. More important, the IRS has conceded that while this duty may create a conflict, with the tax-exempt organization's exempt purposes, that conflict can be overcome by a well-drafted agreement between the parties.[28]

1. Rev. Rul. 98-15.

In March 1998, the IRS issued Rev. Rul. 98-15,[29] the long-awaited pronouncement dealing with a joint venture in which a tax-exempt organization and a for-profit corporation formed a LLC. In this particular case, an exempt acute care hospital, in the hopes of attracting additional funding, contributed all its operating assets, including the hospital to the LLC, while the for-profit corporation contributed certain assets. In return, both entities received ownership interests in the LLC proportional and equal in value to their respective contributions. The Ruling examined two alternative situations and arrived at different conclusions.

a) Situation 1.

The LLC's articles of organization and operating agreement in this situation provided the following:

(1) The LLC was to be managed by a governing board consisting of three individuals chosen by the exempt organization and two chosen by the for-profit corporation. The exempt organization intended to appoint community leaders who had experience in hospital matters but were not on the hospital staff and did not otherwise engage in business with the hospital.

(2) The governing documents could be amended only with the approval of both members.

(3) A majority of three board members must approve certain major decisions, including those regarding the LLC's annual budgets, distributions of its earnings, selection of key executives, acquisition or disposition of health care facilities, contracts exceeding a certain dollar amount per year, changes to the types of services offered by the hospital, and renewal or termination of management agreements.

(4) The LLC must operate any hospital that it owns in a manner that furthers the tax-exempt members charitable purposes. It explicitly provided that it was the duty of the members of the governing board to operate the LLC in such a manner and that this duty overrides any duty they may have in operating the LLC for the financial benefit of its for-profit member.

(5) All returns of capital and earnings to the members must be proportional to their ownership interests. The exempt member intended to use any distributions that it received from the LLC to further its charitable purposes.

(6) The LLC enters into a management agreement with a management company unrelated to either member. The agreement is for five years, renewable for additional five-year periods by mutual consent. The LLC may terminate the agreement for cause. The management company will be paid a fee for its services based on the LLC's gross revenues. The other terms and conditions of the agreement must be reasonable and comparable to what other management companies receive for similar services at similarly situated hospitals.

The IRS concluded under this fact pattern that the tax-exempt corporation would be operated exclusively for a charitable purpose and that the LLC structure would provide only incidental benefit to the private interests of the for-profit corporation. Consequently, the tax-exempt corporation would retain its tax-exempt status.

b) Situation 2.

In this scenario, the IRS modified the set of facts, with the following results:

(1) The governing board consists of three individuals appointed by the tax-exempt organization and three appointed by the for-profit corporation.

(2) The major decisions requiring majority board approval include only the LLC's annual budgets, distributions over a required minimum level, unusually large contracts, and selection of key executives.

(3) The LLC's only purpose is to construct, develop, own, manage, operate, and take other action in connection with operating its health care facilities.

(4) There is no override of the board members' fiduciary duty to operate the LLC for the financial benefit of its owners.

(5) The management company is a wholly owned subsidiary of the for-profit corporation member.

(6) The management contract is renewable at the management company's discretion.

(7) The tax-exempt organization agrees to approve the selection of two individuals to serve as the LLC's CEO and CFO, both of whom have previously worked for the for-profit corporation in hospital management. They will receive compensation commensurate with that received by executives at similarly situated hospitals.

Under this set of facts, the IRS determined that the circumstances could not support a favorable determination that the tax-exempt corporation would be operated exclusively for a charitable purpose. It was found that the benefit to the for-profit corporation resulting from the LLC's activities would be more than incidental. The operational test was no met and the tax-exempt organization would lose its exempt status.

In analyzing the Rev. Rul 98-15, the IRS has focused on whether the tax-exempt organization can meet the operational test under Code §501(c)(3) by participating as a member of a joint venture LLC where it contributes all or substantially all of its assets to conduct activity to further its exempt purpose. In Situation 1, the IRS created a safe harbor for a structure which provides for the organizational, financial and management decisions to be determined by the tax-exempt entity. In Situation 2, the IRS invoked a new set of rules to ensure that the LLC satisfies the operational test of IRC §501(c)(3). From these two situations, the following guidelines can be drawn: first, the IRS applies the "aggregate approach" used in partnership taxation by attributing the activities of the LLC to the tax-exempt member when evaluating whether it is operating exclusively as an IRC §501(c)(3) organization; and second: there are a number of specific requirements that will be the focus of the IRS' attention when making the determination.

With the structural flexibility the LLC offers its members (and with some reliance on prior guidance advanced by the IRS In the limited partnership setting),[30] the governing documents (i.e., articles of organization and operating agreement) can be drafted to satisfy the requirements of Rev. Rul. 98-15.

1. ***A specific exempt business purpose should be established with a prohibition against altering it.*** Whether it is charitable, educational, or scientific, the furtherance of an exempt purpose must be the principal objective of the venture. The LLC must be operated in a manner to further its exempt purpose. The documents must include language which reveals that the for-profit motive of the for-profit partners is subordinate to the tax-exempts' exempt purpose. The governing documents should include a provision that prevents the altering of the business purpose if to do so would be inconsistent with the exempt organization's exempt status or with the tax exemption of the income generated from the business venture. Moreover, the tax exempt member must be able to initiate new LLC action to accomplish its needs.

2. ***For-profit should lack influence over the exempt organization.*** The non-profit members must be in control of the LLC's management without regard to its percentage ownership in the LLC. Strategic and day-to-day operational control must be vested in the tax-exempt. For-profit members should not have any strong or common interest in the exempt organization. Individuals of the for-profit should not be in the exempt organization control group, which would include officers, directors, employees, or representatives. It is clear that executives of the LLC should not be insiders of the for-profit. If such individuals are included for purposes of assuring compliance with the exempt purpose or minimizing disputes, they should not, in the aggregate, control the LLC's management. Where this occurs, it may prove helpful to create an independent committee to monitor the role of the exempt organization to insure that any conflicts with the charitable purpose are minimized.

3. ***Fiduciary Duty of the LLC Members/Managers.*** The duties of the members of the governing body of the LLC must operate the LLC to override any duty they may have in operating the LLC for the financial benefits of all its owners. The fiduciary duty requires the members to operate the LLC in a manner that furthers its charitable purpose and that this duty overrides the duty to operate the LLC for the financial benefits of its owners. All of those employed by the LLC should sign a conflict of interest disclosure statement and acknowledge their fiduciary duty to serve the LLC.

4. ***Capital contributions should determine each member's capital interest and any additional capital contributions should be pro rata.*** The exempt organization and the for-profit members should receive capital interests in the venture commensurate with their respective capital contributions. In the past, the IRS has focused on the exempt organization's nominal capital contributions as a way to minimize the conflict between its obligations to the venture and its exempt purpose.[31] Any additional capital required for the venture should be funded, in the form of equity or debt, by all members ratably, based on their capital interests.

5. ***Profits, losses, and cash should be allocated and distributed pro rata.*** Items of income, losses, deductions, and credits

should be allocated strictly by the members' percentage interests in capital. The use of special allocations should be limited to special circumstances.[32]

6. ***The rate of return on an investor's capital should be "reasonable" and most likely "capped" at a fixed rate.*** The LLC should provide for a reasonable return on an investor's capital, which should take into account tax benefits, cash flow from operations, and sales proceeds. It is suggested that the return be "capped" at a fixed amount or percentage to ensure that the pecuniary interests of the investors will not be achieved at the expense of the charitable purpose.[33] It appears that the priority return of an investor's capital is permissible.[34]

7. ***The exempt organization should have the first right to acquire the LLC's assets and property.*** To protect the charitable purpose, the exempt organization should be entitled to purchase the LLC's property before any sale to a third party.[35] The purchase price of the property should, most likely, be tied to the lesser of fair market value or a maximum return on the investor's capital.

8. ***Management contracts.*** An LLC may enter into a management contract with an independent third party. All contracts should be negotiated or bid at arm's length in order to establish that the arrangement is not for the benefit of the private interest of a third party.[36] The duration, including renewals, should be reasonable. The contract should consider performance standards that allow the tax-exempt to terminate the agreement early if necessary. Contracts or agreements that contain "incentive" provisions create a profit motive but do not bar exemption as long as the end result is reasonable and as long as appropriate checks and balances are present.[37]

Although the guidelines will most likely benefit the organization in its role as a member of an LLC, they may not go far enough in addressing critical situations commonly present in today's joint ventures. Conspicuously absent from this analysis are such issues as:

- Guarantees of investment returns or return on capital by exempt organizations.
- The consequences of the exempt organization's failure to fund a required additional capital contribution.
- The removal of the exempt organization from control, either as a general partner or a managing member.

What should be the result, for example, if the exempt organization as the managing member is simply not fulfilling its duties under the operating documents? This could occur where it fails to satisfy a future capital call or where it is unable to satisfy a performance guarantee in one from or another. Is it permissible to simply remove the exempt organization from management or buy out its interests? These remain open issues and undoubtedly will have to be dealt with by the LLC members in the operating documents.

The manner in which these issues are handled in the LLC's operating documents will more than likely have a profound effect on a tax-exempt organization's exempt status. A standard of "reasonableness" should be applied in these situations, keeping in mind that the promotion of private interests to an extent greater than otherwise would be justifiable on the basis of reasonable financial solvency would create a conflict of interest that is legally incompatible with the exempt organization's charitable purposes.

III. LLCs AS TAX-EXEMPT ORGANIZATIONS

Traditionally, only nonstock, non-profit corporations, charitable trusts and unincorporated associations are eligible for tax exemption.[38] Conspicuously absent from this list are partnerships and LLCs. Based in part on its fundamental profit motive and in part on its pass-through character (so that the assets and income are allocated and ultimately distributed by the partners rather than by the entity itself), the partnership has been precluded from qualifying as an exempt organization.[39]

The question now being asked is whether the LLC, otherwise recognized as a legitimate form of doing business under state law, will be accepted by the IRS as an organization exempt from tax under Code Section 501(c)(3). It is possible that an exempt organization and its members may find it advantageous to organize as an LLC. Alternatively, two or more tax-exempt organizations, might select the LLC over the traditional nonprofit corporation as their joint venture vehicle. The IRS has yet to issue a definitive statement that addresses the qualifications under Code Section 501(c)(3) of an organization formed as a limited liability company under any specific state statute. Moreover, history indicates that the IRS tends to react cautiously in examining different types of organizations outside the traditional structures. With respect to the LLC, therefore, the IRS most likely will move slowly, since unlike the other organization structures, the LLC lacks a historical background.[40]

A. State Law Questions.

Initially, whether an LLC can qualify for tax exemption will most likely depend on whether a nonprofit LLC will be recognized under a particular state's LLC statute. The IRS contends that fundamental to the tax-exemption is a requirement that a state have the oversight authority to ensure that use of assets will be dedicated to charitable purposes. Whether a nonprofit LLC can be formed may depend on implications drawn from the specific language of a particular state's statute. For example, both Delaware and Virginia apparently do not preclude nonprofit LLCs.[41] New York and Georgia, on the other hand, would seem to prohibit their use, based on a "for profit" requirement as a result of incorporating the reference to any "lawful business activity" in their respective statutes.[42] California neither expressly accepts nor rejects the formation of a nonprofit LLC,[43] but it appears unlikely that the state will recognize such an organization absent clear treatment in the California LLC Act itself or in the Internal Revenue Code.[44] Finally, Kentucky does not have a specific statute, unlike the corporate provisions of KRS Chapter 273, nor does the LLC Act itself, specifically authorize the organization of non-profit limited liability company. Since the LLC is a "creature of statute," requiring substantial compliance with state law, it is likely that the IRS will consider the tax-exempt issue only after it is convinced that state law permits the formation of nonprofit LLCs. Assuming that nonprofit LLCs can be formed under state law, what will, or what should be , the IRS's response when a request for exemption is submitted?

B. Qualifying an LLC for Exemption.

Initially it appears that an applicant for a tax-exempt LLC will have to convince the IRS that there is a valid business purpose to be served or benefits to be achieved or greater powers to be gained by using the LLC organization structure instead of the nonprofit corporation.[45] In a business context, LLCs are selected over the traditional forms because of the statutory restrictions or formalities associated with those forms. A similar argument can be made on behalf of the nonprofit LLC.

For example, the Revised Model Nonprofit Corporation Act specifically prohibits the organization from making any distributions of income or profit to its members.[46] Consequently, if nonprofit organizations incorporate in a state that has adopted the Model Act, with the intent to pursue a charitable objective, they would be precluded by statute from making any kind of distribution out of the nonprofit corporation to themselves. In many situations, this defeats the purpose of organizing in the first place. The formation of a nonprofit LLC could easily cure this problem. With the structural flexibility available in an LLC, the exempt organizations, by contract, can devise a procedure whereby distributions can be made without violating the law. Similarly, the LLC can be used where other statutory obligations imposed on nonprofit corporations, such as fiduciary duties, standards of conduct, indemnification, and corporate formalities, prove too restrictive.

Will the IRS be more inclined to rule favorably on an application submitted by a corporate-styled LLC rather than one organized with partnership attributes? Does the mere fact that a nonprofit LLC has been structured in a manner that would result in it being classified as a "corporation" under the check-the-box classification rules give the IRS a greater degree of comfort than a partnership-styled LLC? The IRS has indicated that this indeed may be the case. It has stated informally that a nonprofit LLC may have a better chance of receiving exempt status where it is classified as a corporation for federal tax purposes and inserts within its operating agreement the appropriate restrictive Code Section 501(c)(3) language with respect to distributions, control, and the dedication of assets on dissolution.[47] A partnership styled, on the other hand, presumably will not be acceptable for the simple reason that a partnership due to its pass-through nature, is not a taxable entity, and so cannot be tax-exempt.[48] As a result of its unique attributes and the fact that it is a relatively new and untested entity, the issue of whether an LLC can qualify as a tax-exempt organization in its own right remains at this time an open issue with the IRS.

In conclusion, a limited liability company that elects to be classified as an association for federal tax purposes will be required to demonstrate that its stated purposes are exclusively charitable, that its assets would upon dissolution be dedicated to exclusively charitable purposes, and that no part of its net earnings would inure to private shareholders or individuals. Provisions in either a limited liability company's operating documents or by operation of state law that permit assets to be used for non-exempt purposes or distributed to private persons will be considered to violate these requirements. The law of Kentucky is controlling in construing the terms of its articles, and where an organization contends that such terms have under Kentucky law a meaning different from their generally accepted meaning then clear and convincing reference to relevant court decisions, opinions of the Kentucky attorney-general, or other evidence of applicable Kentucky law is required.

A limited liability company that elects to be classified as a disregarded entity for federal tax purposes will also be required to satisfy the above-referenced requirements to qualify as a section 501(c)(3) organization.

IV. CONCLUSION

Tax-exempt organizations undoubtedly will continue to aggressively pursue their exempt purposes by engaging in commercial joint ventures with for-profit and other nonprofit partners. Accordingly, the emergence of the LLC should be of considerable interest to tax-exempt organizations. By offering the tax-exempt organization limited liability, the right to control the direction of the venture without interference from others, and the "freedom of contract" to structure the specific terms and conditions of the operating agreement, the LLC should go a long way in allocating risk and reward among all members that will serve to further the organization's charitable purposes. For these reasons alone, the LLC may, indeed, replace the traditional forms of doing business as an exempt organization's vehicle of choice when engaged in business transactions with for-profit investors. Moreover, in certain situations, the LLC, in and of itself, may prove to be a better vehicle for tax-exemption than the traditional nonprofit corporation or trust. At this time, there appear to be more questions than answers with respect to the LLC in general and its utility to tax-exempt organizations in particular. What is clear is that any involvement by tax-exempt organizations in LLCs should be done with care in order to insure that "concern for the bottom line is subrogated to the concern of the mission."[49]

V. ENDNOTES

1 For purposes of this, "exempt organization" refers only to those organizations qualifying under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the "Code").

2 See, for example, Mills, "Whole Hospital Joint Ventures Raise Questions About Exemption" and "Exempt Financing and Exempt Status Can Cloud Hospital Joint Ventures," 7 J. Tax'n of Exempt Orgs. 204 and 252 (March/April and May/June 1996).

3 An organization may satisfy the requirements of Code Section 501(c)(3) even though it operates a trade or business as a substantial part of its activities if the operation is in furtherance of its exempt purpose and if the organization is not organized or operated for the primary purpose of carrying on an unrelated business; Reg. 1.501(c)(3)-1(e). See also Code Section 513.

4 See "Tax-Exempts Should Participate in Limited Liability Companies With Care," 14 Tax Mgmt. Weekly Rep. 774 (5/29/95).

5 The LLC was referred to as the "greatest single discovery of modern times" at the ABA Tax Section's Exempt Organizations Committee meeting in Washington, D.C., on 5/19/95 (panel III, "Federal Tax Treatment of Investments in Limited Liability Companies by Exempt Organizations").

6 See note 4, *supra* (IRS warned exempt organizations that intend to participate as members in an LLC to be very careful that both their status in and returns from the LLC can be justified in terms of their exempt purpose).

7 *Id.*

8 *Id.*

9 Rev. Rul. 98-15, 1998-2.

10 See, e.g., GCMs 36293, 5/30/75, and 39005, 6/28/83 (low-income housing); GCM 39862, 11/22/91 (healthcare). In the healthcare area, the IRS has issued hospital audit guidelines that deal, in part, with joint ventures. See IRM 7(10) 69-38, section 333.4(3); Ann. 92-83, 1992-22 IRB 59.

11 See GCM 39444, 11/13/85, for a discussion of the IRS's focus on tax-exempt organizations' involvement as corporate general partners. The IRS has not concerned itself with a tax-exempt's interest as a *limited* partner in a limited partnership, even where the organization's exempt purpose is not advanced. Such arrangement may result in the assessment of tax on unrelated business taxable income under Section 512. Presumably, the same result would occur where an exempt organization participated as a member in a manager-managed LLC, where the organization has delegated exclusive authority and control of the business to the manager.

12 See GMC 39005, 6/28/93.

13 Plumstead Theatre Society, 675 F.2d 244 (CA-9, 1982).

14 See note 11, *supra.*

15 See GCM 39732, 5/19/88. The IRS also explained that it does not use a "but for" test in analyzing the exempt organization's participation in the limited partnership. There is no requirement that the taxpayer show that the purpose of the venture could not have been achieved but for participation in limited partnership.

16 To be qualitatively incidental, the benefit to the public cannot be achieved without necessarily benefiting private individuals. To the quantitatively incidental, the benefit must be insubstantial when viewed in relationship to the public benefit conferred by the activity. See also Housing Pioneers, Inc., 58 F.2d 401 (CA-9, 1995), where the court held that the entire plan was to lend the organization's exempt status in order to achieve a property tax reduction. The organization's participation, as a co-general partner, violated the operational test in that the operation of the partnership caused substantial federal and state tax benefits to flow to the nonexempt partners.

17 See also GCM 36293, 5/30/75, where the IRS concluded that the exempt organization failed to demonstrate a charitable purpose for its involvement in the limited partnership, since housing units were made available to both low-income and moderate-income tenants and the project was located in an affluent neighborhood.

18 In GCM 39005, 6/28/83, 100% of the housing units were held open to the elderly and handicapped with limited incomes. In addition, the organization conducted numerous programs to meet physical, social, and recreational needs of the tenants. The organization's engaging in these activities was viewed by the IRS as its being operated exclusively for charitable purposes. See, e.g., Rev. Rul. 79-18, 1979-1 CB 194.

19 See GMC 39005.

20 Ltr. Rul. 9517029. While there is no statutory obligation on the part of the exempt organization as a member-manager, business considerations may require the organization to become contractually liable for certain aspects of the LLCs operations. The contractual liabilities should be analyzed in the same manner as the statutory obligations of a general partner.

[21] See GCM 39546, 8/15/86, and Ltr. Rul. 8338127. See also Revised Uniform Limited Partnership Act RULPA), section 306, under which a general partner is jointly liable for all contractual obligations and jointly and severally liable for tort liabilities of a partnership.

[22] Contrast GCM 39546 8/15/86 (an exempt organization as general partner cannot fully insulate itself from all liabilities simply because of the state law requirements imposed on a general partner).

[23] Revised Uniform Partnership Act (1976) with 1985 Amendments (RUPA), section 403(a); a general partner's duties to the limited partnership are the same duties that bind partners in a general partnership. See RULPA section 404.

[24] For example, the California LLC statute aligns the fiduciary duties of a manager to what a partner owes a partnership and its partners; Calif. Corp. Code § 17153 (West 1995). Contrast that with Delaware, which allows members broad discretion in drafting their fiduciary standards of conduct; accordingly, members of an LLC can contract among themselves as to the standard of conduct owed to the LLC and its members. See Del. Code Ann. Tit. 6, §§ 18-107 and 108.

[25] See *Ribstein and Keatinge on Limited Liability Companies* (Clark Boradman Callaghan), § 9.01.

[26] See note 22, *supra;* GCM 39546, 8/15/86.

[27] See the edited transcript of the ABA Tax Section's Exempt Organizations Committee meeting in Chicago on 8/5/95 (panel on "Exempt Organizations Investing LLCs With For-Profit Investors").

[28] *Id.*

[29] See note 9, *supra.*

[30] See note 28, *supra.* See also Internal Revenue Service, *Exempt Organizations Continuing Professional Education Technical Instruction Program of 1986* (1/86), page 136, where IRS identifies certain factors, both favorable and unfavorable, to be considered when evaluating whether a partnership arrangement is consistent with a Code Section 501(c)(3) exemption.

[31] See GCM 39005; Ltr. Ruls. 8338127 and 8541108.

[32] GCMs 39732,39005, and 39444.

[33] See also Ltr. Rul. 8541108, GCM 39005 (where profits were limited by federal restrictions), and Ltr. Rul. 8338127.

[34] See also GCM 39732.

[35] See also GCMs 39005 and 39444; Ltr. Rul. 8338127.

[36] See also Ltr. Rul. 9438030; Housing Pioneers, Inc., *supra* note 15.

[37] GCMs 39005, 39862.

[38] See Rev. Proc. 82-2, 1982-1 CB 367.

[39] *IRS Exempt Organizations Handbook* (IRM 7751), section 315.1. See Emerson Institute, 356 F.2d 824 CA-D.C., 1966), *cert. den.*

[40] See note 4, *supra.* The IRS has recognized forms other than corporations and trusts as exempt from tax (e.g., a hospital organized and operated on a cooperative basis was held exempt under Section 501(e)(2))/

[41] See Del. Code Ann. tit. 6, §18-106(b); Va. Code Ann §13.1-1008.

[42] See N.Y.L.L.C. Law §201; Ga. Code Ann. §14-11-201(b)

[43] See Cal. Corp. Code §17002.

[44] See Short, *Overview of Beverly-Killea Limited Liability Company Act* (Publication #1L, Beverly Hills Bar Association, 1994), page.3.

[45] See note 10, *supra.*

[46] See Model Nonprofit Corporation Act, Section 13.01, Prohibited Distributions, Official Text with Official Comments, adopted by the ABA Business Law Section's Subcommittee on the Model Nonprofit Corporation Act, Suite 1987.

[47] See note 11, *supra.* See also PS-43-95, 5/9/96, and Slider, "Check-the-Box Proposed Regulations Make LLCs Even More Appealing." 3 JLLC51(Fall 1996).

[48] *Id.*

[49] GCM 39862.

COMPENSATION AND BENEFIT ISSUES FOR THE LLC

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SECTION G

COMPENSATION AND BENEFIT ISSUES FOR THE LLC

TABLE OF CONTENTS

COMPENSATION AND BENEFIT ISSUES
LIMITED LIABILITY COMPANIES

Whitney Wallingford

October 22, 1999

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1. ***Introduction.***

1.1 <u>*Selecting the Entity*</u>

(a) "C" Corporation
(b) "S" Corporation
(c) General Partnership
(d) Limited Liability Company
(e) Limited Partnership

1.2 <u>*Evaluating Investor and Investment Requirements*</u>

(a) Number of investors
(b) Capital required
(c) Labor requirements

1.3 <u>*Evaluating Income (Loss) Potential*</u>

2. ***Compensation and Taxation.***

2.1 <u>*Worker Classification*</u>.

(a) *Classification Categories*

(i) Employee
(ii) Independent Contractor
(iii) Partner
(iv) Limited Partner

(b) *Employee vs Independent Contractor*

(c) *Partner vs Limited Partner*

2.2 <u>Significance of classification</u>.

(a) *Tax Withholding for Employees*

(i) <u>Income Tax</u>. Employers are required to withhold tax from each wage payment according to the employee's Form W-4 and the correct withholding rate. IRC ¶ 3402.

(ii) <u>Social Security Taxes</u>. Employers are required to withhold social security taxes imposed on employees. IRC ¶ 3102(a).

(iii) <u>Liability for Tax</u>. Employers are liable for taxes required to be withheld and deducted from employees. IRC ¶ 3403.

(b) *Application of FICA.*

(i) Dual tax on employers and employees. IRC ¶3101 and 3111.

(ii) Taxes imposed on "wages." IRC ¶ 3101(a) and ¶3111(a).

(iii) Elements of taxation

(1) OASDI - 6.2%, up to "wage base". IRC ¶ 3101(a).

(2) HI - 1.45% IRC ¶ 3101(b).

(c) *Application of FUTA for Employees.*

(i) FUTA rate is 6.2%. IRC ¶ 3301.

(ii) subject to Federal wage base ($7,000). IRC ¶ 3306(b)(1).

(iii) Credit permitted for state unemployment taxes.

(d) *Trust Fund Taxes - Who is "responsible person*"

(i) Employer liable for taxes. IRC ¶ 3403.

(ii) Liability and 100% penalty extended to responsible persons failing to collect and pay the trust fund taxes. IRC ¶ 6672.

(iii) Will be applicable in worker classification cases.

(iv) Taxes may not be dischargable in bankruptcy. 11 USC ¶¶ 507 and 523.

(v) IRS previously attempted to analogize LLCs to general partnerships; thus, making all members responsible parties.

(vi) 1997 IRS Memorandum regarding the LLC collection procedure reverted to traditional corporate approach in determining responsible person.

(1) Requisite acts to be responsible

(2) Acted willfully

(3) Applicable defenses

(vii) Footnote of caution in Memorandum regarding transferee liability for distributions.

(e) *Employee Benefits Plan Coverage*

(i) Qualified and Non Qualified Plans.

(1) Coverage required under terms of plan or by law - The mis-classification of an individual as an independent contractor does not exclude claims for coverage. Caution must be exercised for both qualified and nonqualified plans. In *Vizcaino v. Microsoft Corp.*, 97 F.3d 1187, 20 EBC 1873 (9th Cir. 1996), on reh'g, 21 EBC 1273 (9th Cir. 1997) (en banc), cert. denied, No. 97-854 (1/26/98), the court concluded that individuals mis-classified as independent contractors were entitled to participate in Microsoft's 401(k) plan and employee stock purchase plan. It had previously been determined in an IRS audit that the individuals were common law employees. In *Vizcaino v. Microsoft Corp.*, No. 98-71388 (9th Cir. 5/12/99), the Ninth Circuit again held that all common law employees of Microsoft were entitled to participate in the plans.

(2) In *Abraham v. Exxon Corp.*, 85 F.3d 1126, 20 EBC 1353 (5th Cir. 1996). the Fifth Circuit reached a conclusion different from that in *Vizcaino v. Microsoft Corp.* under similar facts. Here the court did not require coverage for "leased employees"because the plan, by its terms, excluded leased employees.

(3) Review inclusion employees for IRC ¶410(b).

(ii) Other benefit plans

(f) *Significance for SECA*

(i) <u>SECA Application</u>

(1) Tax imposed on net earnings from self employment. IRC ¶1401(a).

(ii) <u>Tax rates</u>

(1) OASDI - 12.4% (subject to base) IRC ¶1401(a).

(2) HI - 2.9%. IRC ¶1401(b).

(iii) Exclusion under IRC ¶1401(a)(13) - excludes the distributive share of any income or loss of a limited partner (other than guaranteed payments).

(1) 1994 Proposed Regulations looked to state law

(A) whether the individual lacked the authority to make management decisions necessary to conduct the LLC's business, and

(B) whether the LLC could have been formed as a limited partnership rather than an LLC in the same jurisdiction, and the member could have qualified as a limited partner in the limited partnership under applicable law.

(2) 1997 Proposed Regulations - to be treated as a "limited partner", must not

(A) have personal liability;

(B) have authority to contract on behalf of the entity; or

(C) participate in the trade or business of the entity for more than 500 hours per taxable year.

(D) Proposed Regs permit bifurcation of interests for non-service partnerships.

2.3 *Unreasonable Compensation*

(a) IRC ¶ 162(a)(1) permits an employer to deduct "a reasonable allowance for salaries or other compensation for personal services actually rendered...." IRC ¶ 212 limits production of income expenses to "ordinary and necessary" expenses.

(i) The compensation must be reasonable in amount; and

(ii) Must be in fact for services rendered.

(b) For "self-employeds," IRC ¶ 162 conditions are satisfied for contribution limits as long as the contribution does not exceed the taxpayer's "earned income." IRC ¶ 404(a)(8)(b).

(c) Impact of reclassification for various entities

(d) Excessive Employee Remuneration - IRC ¶ 162(m).

(i) Public company annual "applicable employee remuneration" limit of $1,000,000.

(ii) Applies to CEO or individual within the 34 Act Reporting Group of Employees

(iii) Various exceptions.

3. ***Qualified Retirement Plans.***

3.1 *Characteristics of qualified plans*

(a) Current deduction
(b) No income inclusion
(c) Trust not subject to taxation

3.2 *Basic Plan Types*

(a) Defined Benefit
(b) Defined Contribution

3.3 *Contribution and Benefit Limits*

(a) Employees' based on compensation

(i) Defined Contribution Limitations

(1) Profit Sharing Plans - 15% of total compensation.

(2) Money Purchase Pension Plan - 25%.

(3) Combined Defined Contribution Limits - lesser of $30,000 or 25% of compensation.

(ii) Defined benefit limit is based upon maximum benefit - IRC ¶ 415(b).

(b) Self employed individuals contributions and benefits are based upon "earned income". IRC ¶ 401(c)(1).

(i) Under IRC ¶ 401(c)(1), an employee is defined to include a "self employed" individual.

(ii) A "self employed" individual is defined as an individual who has earned income for the taxable year.

(iii) For qualified plan purposes, earned income is defined as the net earnings from self employment determined only with respect to a trade or business in which personal services are a material incoming producing factor. Earned income is reduced by the amount of the sel employed individual's plan contribution. IRC ¶ 401(c).

(c) "S" Corporation shareholder-employees must have W-2 compensation in order to get plan contributions. While this has consistently been the interpretation of practitioners, the interpretation was confirmed in the case of *Durando v. U.S.*, 70 F.3d 548, 19 EBC 2191 (9th Cir. 1995), where the 9th Circuit held that S corporation shareholders may not treat pass-through income as net earnings from self-employment for qualified plan deduction purposes, even though the individuals may have performed services for the corporate plan sponsor. Section 401(c) extends qualified plan deductibility to the self-employed by expanding the definition of employee to include a sole proprietor or a partner in a partnership but does not, however, include shareholders of S corporations.

(d) Many Code provisions refer to "compensation" for purposes of determining compliance with coverage, participation, anti-discrimination and other provisions applicable to qualified plans.

(i) Generally, compensation is defined in Section 414(s) of the Code and consistent application and definition is required.

(ii) If an alternative definition of compensation is used for common law employees, an equivalent adjustment must be made form self employed individuals. Reg. ¶ 1-414(s)-1(g)(2). However, in determining if a definition of compensation is reasonable, the Sėrvice will exclude self employed individuals. Regs. ¶¶ 1.414(s)-1(d)(3)(iii)(A) and (B).

(iii) Compensation and benefit limits under IRC ¶ 415 require the use of earned income for self-employed individual. Reg. ¶ 1.415-2(d)(2)(ii).

(iv) *Plan Loans.*

(1) ERISA ¶ 406 and IRC ¶ 4975 both contain prohibited transaction rules precluding certain transactions between a plan and a "party-in-interest." While there is a prohibited transaction exemption for plan loans (ERISA ¶ 408 and IRC ¶ 4975(d)), the exemption is not applicable to loans made to an "owner-employee". IRC ¶ 4975(f)(6).

(2) An owner-employee is defined in IRC ¶ 401(c)(3) to include (1) a sole proprietor, and (2) a partner who owns more than 10 percent of either the capital interest or the profits interest in the partnership.

(3) A shareholder-employee is also treated as an owner-employee under the prohibited transaction rules. IRC ¶ 4975(f)(c).

(4) A shareholder-employee, for purposes of a prohibited transaction is an employee or officer of an S corporation who owns more than 5 percent of the outstanding stock of the "S" corporation on any day during the taxable year of such corporation. IRC ¶ 4975(f)(6)(C).

(5) Administrative exemptions may be obtained by filing for the exemption.

(v) *Life Insurance.* Contributions for self employed individuals allocated to the purchase of life, accident, health or other insurance are not deductible IRC ¶ 404(c).

4. ***Other Benefits***

4.1 <u>Medical Plans</u>.

(a) Premiums for employees not included in income. IRC ¶ 106(a).

(b) Benefits excluded from income. IRC ¶ 105(b).

(c) Rules not applicable to self employed individual. IRC ¶ 105(g).

(d) 2% Shareholder of S Corporation treated as self employed. IRC ¶ 1372(a). A "2-percent shareholder" is defined as "any person who owns (or is considered as owning within the meaning of section 318) on any day during the taxable year of the S corporation more than 2 percent of the outstanding stock of such corporation or stock possessing more than 2 percent of the total combined voting power of all stock of such corporation." IRC ¶ 1372(b).

(e) Deductions permitted under IRC ¶ 162(l):

1999 through 2001	60 percent
2002	70 percent
2003 and thereafter	100 percent

4.2 *Group Term Life Insurance*.

4.3 *Cafeteria Plans*.