2013

Tax Due Diligence, Warranties and Indemnification in Connection with Business Acquisitions of Private Companies: Selected Topics

Jerald David August

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WILLIAM & MARY LAW SCHOOL
59TH ANNUAL TAX CONFERENCE
SOPHISTICATED TAX PLANNING IN TURBULENT TIMES

NOVEMBER 7, 2013

Tax Due Diligence, Warranties and Indemnification In Connection With Business Acquisitions of Private Companies: Selected Topics

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I. THE DRAMATIS PERSONAE

A. The Seller.

The seller will obviously be concerned with negotiating and obtaining the highest price it believes the market will bear, which will obviously be reflected in what the actual buyer will agree to pay, taking into account various factors including the time value of money, the impact of debt, liquidity and current asset ratios, the security retained for deferred payments, etc. In other words, the seller will want the transaction to yield the highest net-after-tax return or yield to its owners, whether shareholders in a close corporation, whether a C or an S corporation, a single parent corporation, or with respect to the sale of the assets or ownership interests in an unincorporated or pass thru entity. In many instances, particularly in the purchase of a going concern reflected in a EBITDA or EBIT type purchase price formula and perhaps with contingent purchase price triggers or an earn-out, the seller will be motivated to deliver certain key management employees to the buyer as part of the deal. Indeed, in many if not most instances, the buyer will insist upon the delivery of such key management personnel and presumably will want to arrange to have its own employment agreements set in place at the closing. Frequently, this may require that the key management personnel be provided further economic incentives to remain on board.

In preparing for a sale, efforts should be made in advance to resolve potential problem areas, such as outstanding litigation, labor negotiations or disputes, or perhaps an extensive and potentially costly IRS and/or state tax audit or litigation. During the negotiation process, perhaps even prior to executing a letter of intent but after a right of inspection/confidentiality agreement has been entered into, each side will present a "normalized" or adjusted financial statement reflecting reasonable compensation, elimination of certain excess costs or benefits and eliminating nonrecurring or extraordinary expenses. The seller will be expected to produce audited financial statements, at least three to five years tax returns, and other environmental and regulatory information and assessments. Company owned real estate will be required to be appraised as well as being able to deliver a general warranty deed subject to pertinent disclosed exceptions. This is only a partial list of items that a seller must be cognizant of in getting ready to sell the company. Also relevant is the fiduciary obligations of the "insiders", directors and officers, and majority shareholder(s) in negotiating deal in order to secure the highest value or best price for the shareholders (owners). See, e.g., Revlon v. McAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

In broad brush, there are two methods for selling a privately owned company; to-wit: (i) a private process in which the company or its agents contact one or several carefully screened buyers without public disclosure that the company is for sale;
or (ii) an “auction” process in which multiple bidders are invited to review selected financial and business information and submit competing bids based not only on price but the form of consideration, the presence of contingent compensation and other contractual obligations. Talking with only one buyer may raise fiduciary duty concerns and, by definition, prevents the seller from having multiple potential buyers bid in a competitive process. In some instances, a seller may negotiate a “go shop” clause in the acquisition agreement that enables the seller to test the market for superior acquisition proposals for a limited time following the signing of the acquisition agreement. A “sale” could really involve a business combination such as a merger or joint venture in which the business synergies of the parties will be quite important to both sides.

B. The Buyer.

The buyer will want to make sure it is paying no more than what the target company, in terms of its projected post-closing operations, will provide in the form of an internal rate of return on its investment. Debt costs in a leveraged financing acquisition will play an important role. The buyer will insist that the seller satisfy certain financing and liquidity targets at closing, including that there will be no material change (or material adverse change) in the operations of the seller’s business prior to closing.

The buyer, as would be anticipated, will be motivated to pay a lower multiple of EBITDA or EBIT than the seller may desire and should be expected to provide its own “normalized” profit and loss projections that reflect a lower value for the target than the seller’s form of normalized earnings figures. The buyer may insist on a hold-back of the purchase price for tracking post-closing earnings of the target as well as establishing a reserve for contingent liabilities of the seller. The buyer will want to have a “free look” under a confidentiality agreement and perhaps with an exclusivity provision as well, to learn as much about the seller or the target company as it, its employees, agents, accountants and legal counsel can discover. A practical issue of vital concern to the seller of a business is the impact that such discovery by a “stranger” may have on the business operation of the seller, its employees and customers. In further elaboration, business owners are often concerned that the process for the sale of the business be conducted in secret to avoid disruption of employees, suppliers, and vendors, to discourage trade rumors and disparagement by competitors, and to preserve the confidentiality of financial statements, trade secrets, customer lists, and other sensitive information. An upfront confidentiality agreement is a must. The desire for maintaining confidentiality may be compromised in the “auction process”.

C. Seller’s and Buyer’s Accountants.

The accountants for the seller and buyer will each play a very critical role in the acquisition process. The seller’s accountant, in generally, is the first person with whom the seller or board of directors/officers of the seller will discuss the
economics and general terms of the sale. In some instances the seller will have its accountant be the contact party for filtering out the “real” potential buyers from those who should not be given full consideration. The accountants for both the buyer and the seller will need to assist the parties in analyzing and understanding how these purchase price formulas will operate and making sure such formulas really work when applied to the particular circumstances of the target Company. The accountants and other financial personnel will be the individuals who will “run the numbers” under various assumptions and make projections, particularly where there is a formula purchase price that is brought current through the date of purchase. There will also be important earnings statements, source and application of funds statements and balance sheets that will be given careful review by the buyer, buyer’s legal counsel and buyer’s accountant. The accountants will also have to work on the purchase price allocation in an asset sale or deemed asset sale under § 338(h)(10). The buyer’s accountant will be expected to analyze very carefully the tax accrual workpapers and uncertain tax position return schedules of the seller as well as its ASC 70 (FIN 48) computations and schedules. In connection with the buyer’s evaluation of the financial condition of the target Company, the seller’s accountant may need to assist the seller in preparing financial statements of the target Company in a format acceptable to the buyer. In addition, the buyer’s accountant will need to assist the buyer in its evaluation of the financial condition of the target Company to make sure the acquisition makes good economic sense. This may require analysis of tax returns and financial statements of the target Company, talking with the chief financial officer or other financial personnel of the target Company, and reviewing and inspecting the books and records of the target Company. Furthermore, if the seller will be receiving promissory notes or stock/equity of the buyer as part of the consideration for the acquisition transaction, the seller’s accountant may need to assist the seller in conducting a financial evaluation of the buyer to confirm the financial position of the buyer and assess potential risk of a default on future payments. The Acquisition Agreement will certainly contain detailed representations and warranties of the seller regarding the tax returns, financial statements, accounts receivable, employee benefits, and other financial matters of the target Company. The seller’s accountant, who usually has a good knowledge of the business of the target Company (i.e. tax returns, financial statements, litigation, claims by employees, employee benefit issues) needs to review these representations and warranties to make sure that these statements are accurate, and if not, propose appropriate adjustments to make such statements accurate. After the closing of the acquisition of the target Company, the accountants for the buyer and the seller may need to perform post-closing purchase price adjustments. Finally, the seller’s accountant will be expected (of course) to assist the seller in preparing final federal and state income tax, payroll and other returns for the target Company for the period ending on the date of closing, unless otherwise agreed upon by the parties, and will assist the seller and its owners, if seller is an entity in preparing final federal and state tax returns for the target Company and that of its owners or shareholders as the case may be. Seller’s legal counsel will want to consider what information of the seller is privileged in nature and should
not be disclosed, including perhaps, tax accrual workpapers and tax opinions received by the target from legal counsel or other tax advisors.

D. **Seller's Legal Counsel.**

The seller’s legal counsel helps the client evaluate the legal risks attendant to the decision to sell (or not sell) the company and with respect to any and all terms and conditions, representations and warranties, indemnifications, hold-backs, etc. The seller’s lawyer, in theory is not to make the business decision on economic matters although clients will invariably ask for a lawyer to make comments in this area. Lawyers, by definition, are not licensed to render economic advice to clients but frequently, as negotiators and advocates for a client, will, in effect attempt to obtain greater value (and less contractual risk) in effectuating the deal. Often the context in which this advice would be given is with respect to fiduciary duty impacts as also discussed in this Outline.

The seller’s counsel should have an understanding of the valuation model(s) that the parties are using in pricing out the deal and be able to be an effective negotiator and legal counsel to the its client the seller. Frequently, legal issues, including tax issues, must be addressed and advises rendered in the course of the sale process, starting from the initial negotiations and ending through the closing and into the post-acquisition adjustment period and perhaps claw-back or escrow periods. Seller’s counsel, as is true with buyer’s counsel, must advise his or her client of the legal risks involved in making business decisions, including the likelihood and consequences of adverse outcomes. Then the client will make the required decision consistent with sound business judgment principles.

E. **Buyer’s Legal Counsel.**

The buyer’s legal counsel has a rigorous task of performing due diligence on each and every potential material issue that could adversely affect the buyer if the deal is consummated. This includes gathering from the seller a list and details on all known and contingent liabilities and understanding what potential liabilities lurk in the “shadows”. This obviously will include identifying and aggregating both known and contingent tax liabilities. Buyer’s counsel will want to ensure that the seller’s representations and warranties are full and complete and are corroborated by the buyer’s legal counsel’s agents, accountants, and employees due diligence exercised during the pre-closing period. This may also involve a detailed physical audit of the seller’s place(s) of manufacture, distributing centers, and retail operations.

F. **Investment Banker or Business Broker.** Provided through the curtesy of Michael J. Mufson, Managing Director, Mufson Howe Hunter & Company LLC, 1717 Arch St., 39nd Floor, Philadelphia, PA 19103. The role of the investment banker in preparation of the sales process is due diligence, due diligence and more due diligence. Typically privately held companies have not been exposed to the
expectations of the sophisticated private equity investor and strategic buyer. In order to have an effective auction, the buyers will rely on the sellers disclosure about the business and the industry and will include forecasts of the expected growth rates and margins as well as historical financial information, most of the time adjusted for "add-backs". These add-backs are an attempt to show what the company would look like if it did not incur certain one time costs. It runs the gamut of adding back losses which were due to a closed operation or division to normalized salaries to adding back the compensation of wives, sons, daughters, mistresses, cars, boats, vacation homes, excess labor, bonuses, renegotiated contracts with lesser costs and so on. A seller's creativity is never lost in this exercise. A good investment banker is responsible for providing sufficient qualitative and quantitative information so the bidders will be able to place a bid in the auction process and the nature of all the data presented has a basis in fact. To have an effective auction, the information the buyer uses to base his/her bid is a function of the quality of the data received and reviewed. Since the buyer will eventually, if their bid is acceptable, will perform its due diligence and would expect to corroborate the data they based their proposal, if the data is materially deficient, the bid is dropped and the seller expectations are not met and it's a spiral downward progression from that point to a broken deal. The investment banker needs to be the conscience and to maintain the integrity of the information shared by the selling entity and set a reasonableness to forecasts and adjustments - tied back to the books and records of the Company with estimates and add backs based in reality, easily understood.

1. **Confidential Information Memorandum (CIM).** The investment banker is usually responsible for the preparation of the Confidential Information Memorandum (CIM) which becomes the basis to permit up to hundred or more of private equity funds and strategic buyers to bid in a process whereby without meeting the seller, a buyer could make an indication of interest and state a price for the business with basic terms and conditions of their bid. So what is a good scope of due diligence for an investment banker? It's not the most exciting part of the role but it's a study of the basics functions of a business and to become knowledgeable enough to intelligently articulate the company to both strategic and PE buyers. Below is a typical due diligence drill.

a. **Clients - concentration, growth in services, longevity of relationships, retention etc.**

b. **Competition - Barriers to entry, positioning of seller vis-à-vis the other companies in the industry, proprietary knowledge, processes etc.**
c. Management & Employees - Breadth, depth and quality, experience, leadership, creativity, recruiting/retention, skills of staff, etc.

d. Historical Operating Results - Annual growth rates, trends in product/service margins, financial condition, liabilities including contingent

e. Sales & Marketing - marketing/sales cycle, sales trends, pipeline, backlog, relationships with vendors, distributors and customers

f. Forecasts & Projections - Customary 3-5 year forecasts for sales and earnings, revenue mix, pricing model, key metrics/value drivers

g. Proforma Adjustments - Elimination of staff, compensation policies, non-recurring expenses, opportunities for synergies, other one time expenses to add back to EBITDA.

h. Tax Issues - from a big picture standpoint, the 10,000 foot view.

3. Valuation of the Selling Entity. Most view this function as the most basic of the investment banker's role but it is only as good as the data being used to support the pricing estimate. After the extensive due diligence exercise from above, a valuation range and the seller's expectations are reinforced or disappointed, possibly causing a delay or cancellation at this point in the process. Valuation is usually arrived at using 70% quantitative analysis, 20% art and experience and the balance good fortune. The basic approaches used are the following:

a. Comparable Public Company Analysis - Public market valuations for similar companies

b. Comparable M&A Transaction Analysis - transaction specific values paid for acquisitions in related industries paid by strategic buyers

c. Comparable Private Equity Valuations - values paid by private equity investors

d. Leverage Buy-Out Analysis - a value that could be potentially derived in a leveraged transaction

e. Discounted Cash Flow Analysis - present value of projected free cash flow, the inherent value of the sellers business
Asset and Liability Mix - There are of course a host of other assets or liabilities which will need to take into consideration to arrive at a valuation such as real estate owned, certain investments, intellectual property (which can be both a plus and a minus), contingent liabilities such as pension, environmental, employment etc. The classical valuation is usually based on the seller's proforma earnings before interest, taxes, depreciation and amortization or its EBITDA. This proforma EBITDA is arrived at by the collective wisdom of the selling entity and the investment banker based upon the expansive due diligence which enable the parties to have the confidence that such a number would withstand the buyers army of accountants, lawyers. consultants, lenders etc. during its due diligence period.

4. The Sale Process. Finally, at this point in the process, we can now attempt to sell the business. The time frame to complete the two exercises above is usually a 30 to 90 day effort, depending on the level of sophistication of the selling entity. The process to sell the business usually at this point is divided between strategic buyers and private equity groups. The client and the investment bank will discuss the potential buyers. The investment bank will prepare a confidentially agreement for PE shops and a mutual CA for strategic buyers.

a. Initiation of “Calling Program”. After the CA is created and approved by the seller, a calling program begins at the investment bank whereby anywhere from 65-200 potential buyers are contacted to determine their interest in the selling entity. Usually a CA is sent to the interested parties after a phone conversation and is followed up with a Confidential Information Memo. With the distribution of the CIM, a process letter is attached which establishes the terms and conditions of the sales process. The process letter states that by a particular date, the prospective bidder should submit an Indication of Interest (IOIs) to the investment bank stating price range, conditions to close, timing, financing wherewithal etc. Usually its 20 -30 days from the distribution of the CIM to the parties.

b. Submission of Indications of Interest. Upon the submission of IOIs, the bids are reviewed and usually 4-8 bidders are invited back to have management t meetings. Additionally, the invited parties gain access to a virtual data room chocked full of financial schedules and other corporate documents to permit the buyers to perform a "deep dive" due diligence effort on information typically not in the CIM. After the management meetings, the bidders are given another week or so of time to sharpen their pencils to provide their "best and final" offer. Once these final offers are
submitted, the seller will select from the bidders based upon price but also considers compatibility, terms, conditions to closing, management social issues and other relevant factors. At this point the bidder is usually granted exclusivity between a low of 45 to 90 days to complete the transaction, and the lawyers take the lead while a final deal structure is agreed to base upon certain tax efficiencies and it’s off to a closing.

II. THE ACQUISITION PROCESS

A. Preliminary Negotiation Matters and Disclosure of Information.

Once a potentially suitable buyer has been identified and wants to commence the negotiation process, the seller will be asked to provide a preliminary disclosure of information, such as financial statements and also tax returns of the seller for a period of years. The buyer will want to see “audited” financials prepared in accordance with GAAP but in many cases a privately owned company will only be able to provide “compilations” based on management representations. Prior to the delivery of any nonpublic information regarding the seller, the buyer will be requested to sign a confidentiality agreement, agreeing to keep such information confidential and to use it solely for the purpose of negotiating an acquisition. See Exhibit 1.

1. Preliminary Information Disclosure. Seller will, in general, be asked by the buyer or buyer’s counsel to submit, pursuant to the confidentiality agreement, the past 3 to 5 years (or more) financial statements, e.g., consolidated financial statements if seller is a member of or the common parent of a consolidated group of corporation, plus an overall narrative describing the seller’s business operations over the past ten years. Frequently, the investment banker or business broker working on behalf of the seller will prepare a confidential memorandum containing a prospectus-like outline of the seller’s business, assets, management team, and financial data. The disclosure materials agreed to be supplied should be stamped as “confidential” and reviewed by seller’s legal counsel before delivery and if the information provided needs to be qualified, it should be so stated in a letter signed by seller’s counsel when the information package is delivered. The disclosure materials should also contain a qualifier that they are not intended to be relied upon as the exclusive basis from which a decision to purchase is made by the buyer. The confidentiality agreement should be of a limited duration, perhaps as short as 2 to 3 months. If the deal does not go through the confidentiality agreement must mandate the return of all documents and copies of any documents made by the buyer so that the buyer will no longer have any documents provided by the seller the confidentiality agreement period terminates and there is no definitive agreement to purchase.
2. **Additional Advice Provided by Seller.** Seller, through its employees and agents, should make a document by document list of the information provided to buyer either at the inception of the confidential disclosure period or as may later be requested. Again, the seller would be well advised to consult with legal counsel prior to providing additional information.

3. **Restrictions on Use and Disclosure of Target Company’s Sensitive Information.**

4. **Standstill Agreement or Provision for Public Company Target; Prohibition on Third Party Contacts.** Usually given by the buyer in exchange for an exclusivity agreement ("no-shop") by the seller. This type of provision prohibits the prospective acquirer for a period of time from engaging in a tender offer or proxy fight or from otherwise engaging in a hostile takeover. Another factor is whether the standstill will (or possibly as a practical matter, "can") be used in the auction context. What is a reasonable period for the standstill? One year, two? The standstill agreement should, for the buyer’s protection, allow it to terminate in certain circumstances, i.e., a so-called, “fall away” provision. This protection should be quite important to the seller or target and its legal counsel. Other terms to the standstill should be considered. In a private company context, a provision in the confidentiality agreement (and possibly the LOI) is a prohibition on third party contact, including suppliers, customers, distributors, licensees, employees, etc. of the target company as defined.

B. **Letter of Intent (LOI).**

The Letter of Intent agreement should be entered into between the seller and buyer after preliminary negotiations are productive and parties wish to move forward. The LOI, however, should not be permitted, by the keen eye and advice of the seller’s counsel, to be the final Acquisition Agreement. Instead, it should simply set forth the key terms and conditions pertaining to the acquisition transaction. The Letter of Intent is usually nonbinding--meaning that either the buyer or the seller may terminate the acquisition at any time prior to signing the final Acquisition Agreement without any liability whatsoever. The confidentiality obligations of the buyer under the “confidentiality agreement” should be specifically recited as surviving the termination of the LOI.

1. **Detailed LOIs.** The contents of LOIs vary based on the preferences of the parties and the nature and size of the transaction. Some sellers want to limit the scope of the Letter of Intent to the basic economic terms of the transaction and address other significant non-economic items later in the Acquisition Agreement. On the other hand, some sellers may prefer to address most of the significant economic and non-economic items at the
Letter of Intent stage before proceeding any further with the acquisition transaction. From the seller's perspective, the advantage of a detailed Letter of Intent is that, early on in the acquisition process, the seller knows there is an agreement on the key elements of the transaction. The seller may at this stage of the transaction enjoy more contractual leverage than at any other time of the process and may want to obtain concessions from the buyer at the LOI stage. For example, post-acquisition employment agreements for key management of the seller or target Company, noncompetition covenants, escrows and “baskets,” on indemnifications and clawbacks may be best negotiated at this time. The drawback or problem with entering into a detailed LOI is that it is far more time consuming, costly, and more contentious than a “simple” LOI that merely covers primarily the economic terms of the transaction.

2. Essential Matters to be Contained in LOI. The LOI should address the following: (1) the structure of the deal (i.e. asset purchase, purchase of stock, § 338(h)(10) transaction, taxable or tax-free reorganization, etc.); (2) the purchase price (including any related formulas to determine the purchase price); including contingent payments or earn-out payments; (3) the type of consideration to be paid (i.e. cash, promissory notes, stock, or a combination of the foregoing); (4) the clawback provisions and funding of cash and/or stock escrow; (5) the basic and material terms of any employment or consulting agreements to be entered into by key management or shareholders of the seller with the buyer to be effective on closing; (6) the fundamental terms of any non-competition restrictions (what, where, and how long), and (7) the closing date.

3. Additional Matters for Insertion in the LOI. It is somewhat standard that the LOI permits the buyer to conduct a formal and comprehensive due diligence review of the business and affairs of the seller or target Company. Second, if the parties have not previously entered into a Confidentiality Agreement, the LOI will contain confidentiality provisions to ensure the secrecy of information exchanged between the buyer and the seller. Third, the LOI usually contains a “no-shop” provision which prohibits the seller from negotiating for the sale of the target Company with any other potential buyers while the LOI is in effect (and frequently for an extended period of time after the termination of the LOI). The buyer wants the seller to take the target Company “off the market” for a period of time (usually 60-90 days) while the buyer invests a significant amount of time and out of pocket costs in evaluating the transaction. Fourth, the LOI addresses how the costs and expenses related to the acquisition transaction are to be allocated, including costs and expenses related to brokers, attorneys, accountants and other professional advisors. Finally, many times the LOI requires the parties to refrain from disclosing the proposed acquisition transaction until a final definitive Acquisition Agreement is signed and delivered by the parties. The LOI will recite
which portions of the LOI are binding, such as the confidentiality provision and which part is not, such as a “good faith” effort standard to reach a definitive agreement (versus a “best efforts” clause or versus a “walk-away” provision). A sample letter of intent is included as Exhibit Two.

4. **Risks of LOI Agreement.** In several reported decisions, LOI have been held to constitute binding contractual obligations. See, e.g., Texaco, Inc. v. Pennzoil Co., 729 S.W.2d 768 (Tex. 1987) (finding Texaco liable to Pennzoil for interfering with Pennzoil's contract, set forth in a simple “memorandum of agreement,” to acquire Getty Oil and awarding Pennzoil $7.5 billion in damages, plus $3 billion in punitive damages). Counsel for both parties, particularly the seller, must advise the client to explicitly and unequivocally state that the parties do not intend to create a binding contract out of the LOI. Even as non-binding, the LOI serves as an agenda or list for the due diligence process to begin in earnest and a time-table or schedule for closing. The buyer, upon signing the LOI, may insist that the presence of the agreement (in principle) be the subject of a public announcement. This may concern the seller as it may draw a reaction, and not always favorable, from its employees, customers, vendors, creditors, banks, and competitors. The seller may still resist publication at the LOI stage.

C. **Deal Protection Measures.**

1. **Termination or Break-Up Fees.** Termination or break-up fees are payments required to be paid from one party to the other where a certain triggering event or events occur. Common triggering events include: (i) the failure of shareholders to approve the merger or acquisition of control or substantially all of the target Company's assets (often coupled with the consummation of a different transaction within a given time frame); (ii) failure to consummate the contemplated merger or acquisition of control or substantially all of the target Company's assets, for other reasons combined with a consummated transaction with another party within a given period of time after the Acquisition Agreement is signed; or (iii) a breach of a covenant, representation, or warranty in the Acquisition Agreement. See, e.g., In re J.P. Stevens & Co. Shareholders Litig., 542 A.2d 770, 782-83 (Del. Ch. 1988); H.F. Ahmanson & Co. v. Great W. Fin. Corp., C.A. No. 15650 (Del. Ch. June 3, 1997) (refusing to enjoin a 3% break-up fee in a $7 billion transaction, despite the fact that half the fee was payable solely upon the loss of a stockholder vote on the merger); Goodwin v. Live Entertainment, Inc., C.A. No. 15765, slip op. at 46 (Del. Ch. Jan. 22, 1999) (termination fee amounting to 3.125% of transaction value was “commonplace” and “within the range of reasonableness approved by this court in similar contexts”), aff'd, 741 A.2d 16 (Del. 1999). Where the termination fees start to exceed 3-4% of the transaction
value or if the termination fee is substantially greater than the costs incurred by the party asserting the claim for a termination fee, the courts may be more reluctant to enforce such a provision. See Brazen v. Bell Atlantic Corp., C.A. No. 14976, slip op. at 9-10 (Del. Ch. Mar. 19, 1997), aff'd on other grounds, 695 A.2d 43 (Del 1997).

2. Stock Options. Typically, stock options granted to the acquirer by the target Company to purchase a large number of shares or units of ownership of the target at a specific price if certain events occur is another form of deal protection. In so-called “merger of equals” transactions, such options are often reciprocal. Commentary on this subject states that “often, merger transactions provide for options to purchase 19.9% of the target company's stock, which is just below the threshold at which the stock exchange rules require stockholder approval (20%). Varallo and Raju, “A Process Based Model for Analyzing Deal Protection Measures”, 55 BUS.Law. 1609 (August 2000). The exercisability of a stock option is typically triggered upon the triggering of a termination fee.

There are however, certain negative aspects to the delivery of stock options to the acquiring company that may limit its use or make it unacceptable to the seller.

3. “No-Shop Provisions”. There are a variety of deal protection provisions that the parties may agree to that restricts a target company from shopping itself to other bidders once there is an LOI that has been signed. The buyer, in order to justify the substantial due diligence costs it will incur, will frequently insist on such a provision which can also take the form of a “non-solicitation” provision, an “anti-window shopping” provision or simply stated a “no-talk” provision. Of course, seller's legal counsel must be right on top of this situation and carefully explain to the owners of the target company, its owners, board members and key officers, and agents, of the nature of the limitation to ensure no violation occurs. A straightforward “no-shop” provision prohibits the target company (or its “insiders” such as shareholders) from shopping itself to other bidders, but may, if so provided in the LOI, permit it to exchange information with and talk to prospective bidders who first approach the target. Typical limitations on this basic no-shop provision could include requirements that before engaging in any discussions with or providing any information to a prospective bidder: (i) the target board must determine in good faith after receiving advice from outside counsel that the failure to provide such information or participate in such negotiations would result in a breach of fiduciary duty; (ii) the target board must determine that a competing transaction is a “superior proposal” (as defined by the agreement); and/or (iii) the target must give the acquirer at least some advance written notice (often 48 hours) of its intention to provide information and/or negotiate.
with the third party. See Varallo and Raju, “A Process Based Model For Analyzing Deal Protection Measures”, supra.

In Paramount Communications, Inc. v. QVC Network, Inc., 637 A.2d 34 (Del. 1994), the Delaware Supreme Court held, inter alia, that no-shop provisions are not per se invalid, but rather will be analyzed under the circumstances of a given case. In QVC, supra, the Delaware Supreme Court held that a no-shop provision, when combined with other defensive provisions, prevented the directors from carrying out their fiduciary duties in considering unsolicited bids or negotiating for the best value reasonably available to the stock-holders and therefore was invalid. Conversely, no-shop provisions will be upheld where they “do not foreclose other offers, but operate merely to afford some protection to prevent disruption of the Agreement by proposals from third parties that are neither bona fide nor likely to result in a higher transaction.” Thus, in using any protection measure, legal counsel must carefully review the case law in the applicable jurisdiction. See also Matador Capital Management Corp. v. BRC Holdings, Inc., 729 A.2d 280, 291 (Del Ch. 1998); In re Vitalink Communications Corp. Shareholders Litig., C.A. No. 12085 (Del Ch. Nov. 8 1991)(no-shop clause containing a fiduciary out provision valid since a market check was still possible). See discussion above on the use of a “standstill agreement” in exchange perhaps for the buyer’s insistence on obtaining an exclusivity clause. Typically the exclusivity provision should be of short duration.

4. **Lock-Up Provisions.** A lock-up provision is an arrangement pursuant to which a party acquires, or obtains an option to acquire, the right to vote a block of stock or right to agree to sell (or not sell) important assets of the target company. In a stock lock-up, the bidder is able to either purchase 1) authorized but unissued shares of the major or controlling stockholder, or 2) the shares of one or more large stockholders. The acquirer may also hold the option to exercise the shares at a higher price in the event of sale to a higher bidder, or to vote in favor of the acquirer’s bid. An asset lock-up occurs when the target firm grants an option for the acquisition of an asset. As with other deal protection strategies, lock-ups are not invalid per se, but may draw strict or close scrutiny from a court in review. Thus, for example, a lock-up arrangement that prohibits further bidding may be violative of state law. As a starting point, however, defensive or deal protection measures, lock-ups are not per se illegal. See Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1989)( asset lockup option granted to white knight by target corporation as part of merger agreement was invalid and unenforceable).

5. **Fiduciary Out Provisions.** Within the context of a negotiated LOI, in many cases the seller, at the urging of seller’s legal counsel, will want as a form of deal protection a fiduciary out provision with respect to a
transaction under negotiation. In general, a fiduciary-out provision allows the target company to take certain actions, including negotiating with a subsequent offeror and therefore terminate the acquisition agreement in place or to accept a superior offer where the directors’ fiduciary duty requires. Fiduciary-out clauses may be used in several contexts, including in a “no-shop” context. The fiduciary out allows the target’s board of directors to meet its obligations to its shareholders to sell the target at the “best price”, terms, etc. The need for the fiduciary-out relief provision would arise where the target board agrees to and recommends a merger with an acquiring corporation but subsequently the target receives a superior bid that the board is obligated to consider and perhaps even accept pursuant to its fiduciary duties.

Buyer’s counsel will, faced with a fiduciary out protection issue, want to place limits on restrictions on its exercise including a requirement that: (i) the board of directors of the target company first receive an opinion of outside counsel that not exercising the fiduciary out would constitute a breach of fiduciary duty; (ii) the target’s board of directors first make a determination that a competing bid is or is likely to lead to a “superior proposal”; (iii) the target corporation or company provide the acquisition company with written notice of any event that may give rise to the fiduciary out, and (iv) the target company provide the acquirer with a reasonable opportunity to make adjustments to the existing merger agreement to enable the target to proceed with the existing transaction.

6. Representations and Warranties of the Seller and Buyer. Should, of course be discussed as part of the LOI process so that there are no surprises later on when there may be a good faith obligation imposed on the seller or there is no “fiduciary out” provision. Note also the need for covenants of the seller pending closing; conditions precedent to the buyer’s obligation to close and conditions related to the seller’s obligation to close. The acquisition agreement must also set forth closing and termination provisions. Of critical concern is the indemnification provisions, including the tax indemnification provisions, as well as representations and warranties, which is discussed below.

D. Due Diligence Procedures or Process.

1. Buyer’s or Buyer’s Legal Counsel Request for Production of Documents. In general, the buyer, in accordance with the LOI (or Confidentiality Agreement) will provide seller’s counsel with a list of items as well as a questionnaire identifying specific information it wants to be produced concerning the target Company’s business. See Exhibits 3 and 4. The production frequently is voluminous and since this data will form the basis for various representations and warranties made by the seller, the buyer must keep careful records of the documents produced. Frequently reducing
the production to a CD-ROM disk containing all of the information produced (indexed to the due diligence questionnaire) is an efficient way to keep track of this mass of data. In some auction transactions, the seller may set up a password protected “data room” or “virtual data room” which is designed to provide a specific or prospective buyers with access to a set of disclosure materials prepared by the seller.

2. **Timing for Completion of Due Diligence Period.** The buyer will want to complete its due diligence prior to signing the Acquisition Agreement or may otherwise insist on a “contractual out” in the Acquisition Agreement based on a prescribed date for its completing due diligence. In some instances, however, the Acquisition Agreement and closing may be in close proximity, perhaps taking place on the same day. Where the parties contemplate a simultaneous signing and closing, this goal is usually accomplished or the “contractual out” provision presumably negotiated by the buyer will permit it to walk away just prior to the closing. The seller may want some form of non-materiality provision contained in the Acquisition Agreement so that the buyer can not “walk-away” if the due diligence problems or issues can not be “cured” or are not “material”, as defined.

3. **Newly Discovered Problems.** It is not unusual for a seller, during the due diligence period, to become concerned with a problem which the buyer brings to its attention that it did not expect would surface or be discovered prior to signing the LOI or Acquisition Agreement. The “problem” can take the form as an environmental or regulatory problem, or perhaps it’s a tax problem such as overstated inventory (taken by excessive cost of goods sold charges in prior years’ returns) or substantial (and problematic) tax accruals contained in TAWs. It could also be a state income or sales tax issue based on nexus problems which could be of some magnitude. This could arise, for example, where the buyer’s accountants learn that the seller has sales representatives in retail locations in shopping mall kiosks in various states for limited periods of time. Alternatively, it could be a potential exposure to income (or VAT) taxation in one or more foreign countries on the basis that the seller or an affiliate of the seller is doing business or otherwise maintains a permanent establishment in one or more foreign countries. In such instances sellers may be reluctant to make a full and complete disclosure to the buyer. At times, therefore, problems with contingent yet known obligations becomes a sensitive issue for seller and seller’s legal counsel. The choices in such situations are not always pleasant; (i) terminate the deal; or (ii) make full disclosure of the problem making the problem “public” so to speak; or (iii) simply make the required representations and warranties knowing that the indemnification problems may later come into play. In a “perfect world” these problems should be discussed with legal counsel before the negotiation process begins, even prior to the auction or invitation of offer process and certainly prior to
entering into a “please inspect us” confidentiality agreement. Where a disclosure is to be made of the sensitive item(s), in general, a full disclosure should or even must be made. In many cases, the problem(s) can be addressed and resolved by indemnification and a cash escrow.

4. Due Diligence Completion: The Buyer’s Perspective. From the buyer’s perspective, the due diligence process should be completed prior to the signing of the acquisition agreement, thus assuring that the seller’s representations in the agreement and the related disclosure schedules are complete and accurate. Where the parties contemplate a simultaneous signing and closing, this goal is usually accomplished. In practice, however, particularly with a deferred closing, the due diligence process frequently creeps to a conclusion well after the agreement is signed. This can give rise to awkward problems when significant omissions or “admissions against interest” are discovered in the disclosure schedules. Sellers are often reluctant to make full and complete disclosure, particularly to competitors, during negotiations. This is always a bad idea in view of the likely consequences of nondisclosure: either termination of the agreement (if negative information comes to light prior to the closing) or indemnification claims (when it comes to light after the closing). Clients must be educated at this stage to suppress their instincts to act as salespersons and instead to focus on adequately protecting themselves against potential liabilities by full, complete, and accurate disclosure.

E. Acquisition Agreement: Basic Structure.

While acquisition agreements will vary depending on the nature of the acquisition, the legal entities or individuals involved, and the consideration being exchanged, there are certain provisions that are contained in practically all acquisition agreements.

1. Basic Terms of the Transaction. Set forth as a separate article, this provision will include the parties to the transaction perhaps with a parenthetical acronym or term of art, the nature of the transaction to be effectuated, a description of the stock or assets to be transferred, the consideration to be paid, and the mechanics of the transaction. In the purchase price provision, which may be set forth in a separate article, such would include the formula for computing any contingent consideration or purchase price adjustment, the mechanics for the delivery of stock certificates, the establishment of escrows, and similar matters. Where the purchase price is to be payable in stock or securities of the buyer, the seller’s investment representations and any registration rights would also be included here. The Operative Terms provision and other parts of the Acquisition Agreement will make reference and attach as exhibits other agreements, corporate documents, escrow agreements, registration rights agreements, etc.
2. **Representations and Warranties of the Seller.** Typical seller warranties include: (i) proper organization formation; (ii) organization is certified to be in good standing; (iii) qualification to operate in other jurisdictions, as certified; (iv) capitalization of the seller and its subsidiaries or defective entities; (v) ownership of assets or shares of stock being sold; and (vi) transaction was authorized by proper corporate (or entity). The seller will list its assets, liabilities, contracts, permits, intangibles, etc., and will warrant its ownership subject to any financing arrangements including mortgages, UCC filings, etc. Additional seller warranties will include representations pertaining to its financial statements, such as “audited” (by independent outside auditors), “true and correct”, etc., and that there have been no “material adverse changes” in the business operations and assets of the seller since the most recent balance sheet date. Such representations will also include a list of specified events that have not occurred, such as dispositions of assets, accounting changes, losses, other forms of economic damage warranted not to have occurred since the balance sheet date, and a broad representation that there has been “no material adverse change” in the operations, assets, liabilities, or prospects of the business since that date. Many agreements contain specific representations concerning liabilities of the seller (fixed, absolute, accrued, contingent, or otherwise), taxes, assets (often including specific representations regarding accounts receivable, inventory, machinery and equipment, contracts, real estate, leases, and intellectual property), litigation, insurance, employee relations, and compliance with laws and regulations. Agreements frequently include representations relating to environmental compliance, employee and welfare benefit plans (including ERISA compliance), protection of intellectual property, absence of any self-dealing transactions, and other matters relevant to the transaction. (See discussion below on tax representations and warranties of the seller).

3. **Representations and Warranties of the Buyer.** In an “all” cash transaction, the buyer’s representations and warranties are generally limited to the corporate organization, good standing, and corporate authorization of the buyer. Where stock, securities or debt issued by the buyer as consideration, the capitalization of the buyer and the authorization, validity, and non-assessability of any shares to be issued are always included as representations and warranties which should survive the closing during the pay-out period. In such cases, the seller may insist upon additional representations regarding the buyer's business, with the result that the buyer's representations are largely a mirror image of the seller's. Where the issuer of stock or securities is a publicly held corporation, the seller typically requires representations regarding the buyer's compliance with the securities laws and often substitutes for more detailed representations, a representation that the issuer's current filings with the Securities and Exchange Commission are true, correct, and complete. (See discussion below on tax representations and warranties of the buyer).
4. **Covenants of the Seller and Buyer.** Generally the seller will covenant during the interim period between the signing of the Acquisition Agreement and the closing that it has conducted its business in the ordinary course, there have not been any material changes or developments in its operations or if there are will be disclosed, has used its best efforts to secure regulatory and other approvals for the consummation of the transaction, such as compliance with The Hart–Scott–Rodino Antitrust Improvements Act of 1976, P.L. 94-435 ("HSR Act"). The HSR Act is a set of amendments to the antitrust laws of the United States, principally the Clayton Antitrust Act. See 15 U.S.C. §18a, title II. The HSR Act provides that parties must not complete certain mergers, acquisitions or transfers of securities or assets, including grants of executive compensation, until they submitted detailed information with the U.S. Federal Trade Commission and Department of Justice and wait for those agencies to determine that the transaction will not adversely affect U.S. commerce under the antitrust laws. The filing requirement is triggered only if the value of the transaction and, in some cases, the size of the parties, exceed certain dollar thresholds, which are adjusted periodically under the Act. For the purpose of determining the "size of the parties", one assesses the size of the party's ultimate parent entity and all subsidiaries of that entity. The general rule is that a filing is required if three tests are met; (1) the transaction affects U.S. commerce; (2) either (a) one of the parties has annual sales or total assets of $136.4 million or more [as of 2012 this threshold amount increases periodically under the law], and the other party has sales or assets of $13.6 million or more [this amount adjusts periodically] (where an acquired person is not engaged in manufacturing, only its total assets, not its sales, are counted, unless its sales are over $136.4 million); or (b) the amount of stock the acquirer has is valued at $272.8 million or more [amount adjusts periodically] at any time; and (3) the value of the securities or assets of the other party held by the acquirer after the transaction is $68.2 million or more [adjusts periodically]. There is also a rule prohibiting "interlocking directorates", that is, it prohibits a person from serving on the board of directors of competing companies valued at over a certain size (this amount was $27.7 million in 2012); but does not apply if the two companies have annual sales in competition with each other of less than $2.7 million.

5. **Conditions Precedent to Closing.** Typical conditions to the buyer's obligation to close include a so-called "bring-down" certificate to the effect that all of the seller's representations and warranties are true and correct at the closing date and that the seller has complied with all of its covenants. More particularly, a bring-downing down is a provision requiring the representations and warranties that were made at signing to be made again on the closing date (or at another specified date). If a representation and warranty includes a materiality qualifier, it typically must be true at closing in all respects. For example, if a party makes a
representation and warranty at signing that there are no material environmental liabilities, it must also be true that there are no material environmental liabilities on the closing date. If a representation and warranty does not contain a materiality qualifier, the bring down itself is often qualified by a materiality or a material adverse change standard. For example, if a party makes a representation and warranty at signing that there are no environmental liabilities, the “bring down” may provide that the representation only needs to be true in all material respects or that a failure to be true would not result in a material adverse change. Representations and warranties that are only made as of a specified date are typically excluded from the “bring down”. A “bring down” condition is generally satisfied by the delivery of a certificate signed by an officer of a company (or for an LLC without officers, a manager or managing member) certifying that the representations and warranties are true and correct as of the date of the certificate, subject to any qualifications set out in the agreement. The “bring down” certificate is typically delivered at the closing of a transaction. In financing transactions, this certificate may be delivered at the time funding is required. Other conditions may include the receipt of stockholder approvals, tax rulings, legal opinions, updated financial statements (and perhaps the achievement of certain earning goals), and the delivery of related contracts such as escrow agreements, employment agreements, and noncompetition agreements. Similar conditions apply to the seller’s obligations, and include the payment of the consideration for the acquisition and related matters.

6. Closing and Termination Provisions. The Acquisition Agreement will invariably contain a termination provision whereby the agreement can be terminated based on the occurrence of certain events. Examples would be that the agreement may be cancelled by mutual consent of the parties at any time before closing or perhaps unwound post-closing under special unwind procedures. The agreement may provide that prior to closing if either party has breached any representation or covenant in any material respect and has not cured such breach within a prescribed period, then the non-breaching party may terminate. Another illustration of a termination provision is either party may terminate on the closing date if any of the conditions to that party’s obligation to close are not fulfilled (unless the failure results from that party’s own breach). Another termination provision is the so called “buyer’s out” provision which allows the buyer to have a right to terminate within a prescribed period after the signing of the Acquisition Agreement where it is not satisfied with the results during the due diligence investigation. In some instances the seller may have the right to terminate the agreement, as discussed above, by paying a “break-up” fee to the buyer if, for example it receives a better offer from a third party. Recently, it was reported in the business press that Verizon Communications will pay Vodagone a $10 billion (yes, billion) breakup fee as it was unable to complete a required debt financing. Fortunately for
Verizon, within a week or so it raised the required funds under the financing and avoided the break-up fee. The Verizon break up fee would have exceeded the biggest break up fee of $4.5 billion that Pfizer paid Wyeth in their $68.4 billion deal which eventually closed.

7. Indemnification Provisions. One of the most important §§ of the Acquisition Agreement is, of course, the indemnification provisions which allow, in general, the buyer, and in some cases the seller as well, to claim damages post-closing for losses incurred by the buyer directly or proximately resulting from a breach of a representation or covenant by the other party. The terms and conditions to the indemnification provision, including possible escrow or “hold-back” fund, can run the risk of being a “deal breaker” if the buyer is not satisfied with the contractual protection the seller is willing to provide. This would include whether the indemnification for liabilities is “absolute” or is based on a standard, such as “knowledge and belief”. Typical provisions include an agreement by the seller to indemnify the buyer for any losses resulting from any breach of its representations or covenants, upon receipt of a written demand by buyer. There is a time period set forth in the Agreement for notifying the seller of claims under the indemnification agreement but some events of breach may not have a time limit. The amount of the indemnification claim may be limited by a deductible, threshold, or ceiling or by the availability of insurance proceeds or offsetting tax benefits. Procedures for the defense of unresolved third party claims are usually provided. The indemnification rights may or may not be defined as the exclusive remedy under the agreement. The agreement may also provide for security for indemnification claims in the form of an escrow of cash or shares, or by set-off against any promissory note or future contingent payment payable by the buyer.

a. Who Should Provide the Indemnification. Either the seller (entity) alone or the seller and its shareholders, jointly and severally. The shareholders may want to have a cap placed on their individual liability for the seller’s breach of warranty.

b. Use of Escrow or Hold-Back.

c. Calculation of Damages. As mentioned in this paragraph, a damage clause contained in an indemnification provision may “tax-effect” the damage. For example, if the buyer had to pay $4M as an undisclosed claim against the seller (stock sale) post-closing, and the buyer was able to deduct the payment as an ordinary and necessary business expense under §162, then the agreement could provide that the damage amount is $4M less the applicable tax savings. If the buyer’s tax bracket (effective rate) is 40%, then the tax-effected calculation of the indemnification would be $2.4M.
But that would not be entirely correct since the recovery of the payment previously deducted by the buyer would be includible in income under § 111, the tax-benefit rule. That would then require a “gross-up” type computation permitting buyer to receive 40% of $2.4 or $960,000. So, the computation required under the indemnification might be that the buyer receives: (i) $4M (third party claim paid); less (ii) taxes saved on payment of $1.6M; plus (iii) the income tax paid on the recovery of the $2.4M or $960,000. This results in $3,360,000 required payment. It’s just one way of looking at the cost of the claim to the buyer (net-after-tax-effect).

d. Limits on Indemnification. “Caps”, “baskets” or “deductibles”, time limits, etc. A “cap” is a limit on the total amount of indemnification claims that may be asserted, usually stated as a percentage of the purchase price. A “basket” is a threshold amount, i.e., $10M, which aggregate indemnification claims must meet to be enforceable. For example, with a $10M basket, if the aggregate claims are less than such amount, then no claim may be indemnified. But if the claims in the aggregate are $1 above the $10M basket, then the entire amount would be indemnifiable. A “deductible” generally is associated with a “basket” provision. Thus, if the claims on the $10M basket were $12M, but there was a $1M deductible, then the indemnification claim would be for $13M.

e. Indemnification Payments Inter§ with EBITDA or EBIT Formula Purchase Prices. The computation of the indemnification amount may expand somewhat exponentially where the buyer successfully negotiates that claims (post-closing) reducing earnings result in damages on the amount that such adjustment would have reduced the purchase price. For example, suppose All-Star Sports (a fictitious company of course) sold 100% of its stock to a private equity firm “We Are Private” (WEP) for 10 times EBITDA (weighted average prior 3 years) of $13M for a purchase price of $130M. After the closing, the buyer contends that the financial statement of the seller produced during the due diligence period was overstated by $500,000 per year due to erroneous inventory accounting postings. This would have reduced EBITDA to $12.5M. Can the buyer claim that the “loss” is 10 times $500,000 or $5M? What if, however, post-closing EBITDA (annual) was $14M and not $12.5M (as corrected)? Has the buyer incurred a loss? Do the legal counsel for the parties take this issue on in the contractual language (and/or related document) or leave it open (to be resolved if and when the buyer wants to make a claim based this approach)? Note that there are usually no indemnification provisions in a stock sale where the target is a public company,
which is generally attributable to the impracticability of pursuing claims against a large number of individual stockholders. Still, there may be contractual protection against a "control group" of shareholders selling stock in the target corporation.

8. Miscellaneous Provisions. Includes provisions on amendments of the agreement or modifications, presence of a merger clause reflecting that any prior statements or discussions by the parties are deemed merged into the final document and therefore the agreement itself contains the entire set of terms and conditions agreed to by the parties. There will also be a provision for venue, specific performance, governing law, brokers fees and parties responsible for payment, notice provisions, and possibly dispute resolution provisions such as arbitration or mediation. Rights denying or granting specific performance may also be included.

III. GENERAL PLANNING CONSIDERATIONS IN ACQUISITIONS OF CORPORATIONS

After the determination of the purchase price and the timing for the buyer's delivery to seller of the stated consideration, the next most important consideration is the structure of the transaction. This includes consideration as to whether shareholders of the target corporation are to have an equity interest in the buyer, particularly if the buyer is a corporation, or will instead sell their entire stock interest for cash or debt that do not reflect a continuing propriety interest. Transactions that are structured to qualify as a tax free reorganization require a continuing meaningful equity interest by the target shareholders and a majority or all of the consideration paid must be in the form of stock, or in some cases, the stock of the acquiring corporation's parent corporation. Due diligence is heightened where the buyer is acquiring the stock of the target.

A. Deal Structure: An Overview. The Importance of Deal Structure

There are three basic ways in which one company may acquire another corporation: a purchase of stock, a purchase of assets, or a merger or other form of tax free reorganization. Each of these three basic forms has different tax, legal, and economic consequences to the parties. Indeed, differences among the three forms are so great that it is fair to say that agreeing upon the structure of a transaction is an essential prerequisite to agreeing on the price.

1. Sale of Stock. The buyer acquires a controlling interest, 80% or more, of target stock from its shareholders. A purchase of stock generally does not require a shareholder vote although a § 338(h)(10) acquisition of 100% of the stock of an S corporation target will require unanimous shareholder consent. After the deal is consummated the target will be a wholly owned or partially owned subsidiary of the acquiring corporation. The requirement of 80% or more stock ownership is necessary for the target to become a member of a consolidated group for consolidated income tax
reporting or in effectuating, at closing or at a later date a deemed or actual liquidation under § 332. If the target continues to conduct business operations, it remains liable on all of its presale debts and obligations to third parties, including unknown and contingent liabilities. The buyer or acquiring corporation, indirectly inherits the burden and economic risk associated with the liabilities of the target. A stock sale avoids the transfer of the target company’s leases, contracts, or other assets, which typically avoids the necessity of obtaining consents from landlords and other third parties although it should be noted that some leases or other contracts will state that consents are required or the lease/contract is void or voidable where there is a change of control of the target. Where the target company conducts its business operations on corporate owned real estate, an asset sale would generally trigger the imposition of real estate transfer taxes which can be quite costly. (The exception to this rule is where a lease or contract expressly provides that a change of control of the company will constitute a breach or require consent). For shareholders in a C corporation, a sale of stock will generally be preferred over an asset sale due to the avoidance of double taxation. Still, the buyer should be expected to insist on an asset purchase or § 338(h)(10) election, where relevant, in order to obtain a step-up in stock basis. A straight stock sale will cause the buyer to negotiate a substantial discount from the operational value of the target if the inside asset basis of the target is substantially lower than the enterprise value. A hidden tax cost to an asset sale under § 338(h)(10) where certain liabilities of the target are being assumed or taken subject to by the buyer (or acquisition subsidiary) of the buyer is that the debts assume are part of the computation of the “amount realized” or AGSP (under §338).

2. **Sale of Assets.** An asset sale is generally taxable to the seller (target corporation) unless otherwise is part of a Type C reorganization (voting stock for “substantially all” of the assets). In a straight asset sale, the buyer acquires all or substantially all of the target company's assets and assumes specific liabilities of the company. Liabilities assumed, as mentioned, are added to the amount realized by the seller from the transaction and are included in establishing the buyer’s cost basis in the assets for cost recovery purposes and in later computing gain or loss on sale or other taxable disposition of the assets purchased.

a. **§ 338(h)(10) Election.** A § 338(h)(10) election results in a deemed asset purchase (the “Oldco/Newco” fiction contained in the § 338 regulations). Generally for state law purposes a sale of substantially all of the assets of the seller will require shareholder approval, either a majority (in some states such as Delaware) or a “super-majority” in other states unless otherwise overridden by charter provision or shareholder agreement. Dissenting shareholders may be entitled to exercise appraisal rights. Leases,
contracts, mortgages in place, etc., will generally require third party approvals. As mentioned, seller owned real property sold to the buyer will generally result in real estate transfer taxes unless there is an applicable exemption. Where the target corporation is selling its assets or is deemed to sell its assets under a § 338(h)(10) election, is an S corporation, or alternatively, if the target is an unincorporated entity having multiple members such as a partnership or limited liability company taxable as a partnership, no gain or loss will usually be recognized at the corporate or entity level, and the stockholders or partners will instead incur a "single tax" (usually at capital gains rates); the buyer will obtain a stepped-up basis in the assets, as described above. The individual shareholders or partners will have ordinary income to the extent of recapture amounts are involved including §§1245 or 1250 recapture or recovery of previously expensed items (assumption of accrued but unpaid payables of an accrual basis seller). Where an S corporation is still within the recognition period under the built-in gains tax under §1374, then any recognized built-in gain or loss, and as subject to the taxable income limitation, must be taken into account and can result in a corporate level tax. Some states, such as Massachusetts, impose a corporate tax on "large" S corporations or a gross receipts and business income taxes such as Michigan. MCL§§208.1203, 208.1201.

b. **Straight or Deemed Asset Sale.** Where the target corporation selling its assets is a regular or C corporation, it will recognize gain or loss for federal (and state) income tax purposes on the sale of its assets; its stockholders will recognize a “double tax” (usually at capital gains rates) on the distribution of the net proceeds of sale from the corporation; and the tax basis of the assets of the company will be “stepped up” in the hands of the buyer to equal the purchase price (calculated as the amount of cash paid plus liabilities assumed). The stepped-up basis provides the buyer with larger depreciation deductions, including 15 year amortization of goodwill in accordance with §197. In some cases the shareholders of the seller will negotiate for a carve out of part of the consideration for “shareholder” goodwill under the rationale of the Martin Ice Cream case. In MartinIceCream Co. v. CIR, 110 TC 189 (1998), the buyer of the taxpayer's assets also made a payment to the taxpayer's principal shareholder, which the IRS attributed to the taxpayer as part of the selling price. The shareholder made no employment agreement or covenant not to compete with the buyer. The court rejected the attribution of this payment to the corporation, finding that it was for intangibles owned by the shareholder, akin to personal goodwill, and that “Those personal assets are entirely distinct from the intangible corporate asset of
corporate goodwill.”. The result of this characterization was that the payment was taxable only to the shareholder and although the shareholder was not a party to the case, it was presumably taxed to the shareholder as capital gain. See Solomon v. CIR, 95 TCM (CCH) 1389 (2008) (payment to shareholder/employees for “Customer List” was in fact payment for their covenant not to compete).

3. Merger or Consolidation. In a classic forward merger transaction, the company merges with and into the buyer and goes out of existence; the buyer, as the surviving corporation, succeeds to all of the assets and liabilities of the company as a matter of law; and the shares of the company are automatically converted into the merger consideration (which may be stock in the buyer, cash, or other consideration). A merger or consolidate will require board of director and shareholder approval of the target and dissenting shareholders may have appraisal rights under state law.

a. Forward Triangular Merger. In a forward triangular merger the acquiring corporation consummates the purchase through use of a subsidiary, i.e., a newly formed acquisition subsidiary. Where a portion of the consideration consists of stock or debt of the parent, the transaction may qualify for nonrecognition treatment. §§ 368(a)(1)(C) and (a)(2)(D). Shareholders of the target corporation may be offered the option of receiving shares of the purchasing corporation (parent) or cash. Continuity of interest guidelines need to be addressed, i.e., a percentage of consideration in purchasing corporation stock In a forward merger, the acquiring corporation generally inherits all liabilities of the target corporation by operation of law. In a forward merger, the leases, contracts, and permits of the company are assigned as a matter of law to the surviving corporation; no consent of landlords or others is required unless the lease or contract specifically so provides.

b. Reverse Triangular Merger. In a reverse triangular merger (sometimes referred to as a reverse subsidiary merger), P’s subsidiary (S) merges into target with target surviving the merger. To qualify under §368(a)(2)(B), target shareholders must exchange target stock amounting to control of the target (i.e., at least 80% of the combined voting power of all classes of stock entitled to vote, and 80% of the shares of each other class of the corporation's stock for voting stock of a corporation that is in control of S before the merger (i.e., P voting stock), and after the merger the target must hold substantially all of both its own properties and the properties of the merged subsidiary (other than P stock distributed in the transaction). A reverse triangular merger that fails to qualify as a
tax-free reverse triangular merger, because P acquires less than 80% of T's stock for P voting stock, may still be tax free under §351. Thus, where Transferee, a new holding company, acquired Company A and Company B, the acquisition of Company B was accomplished by Transferee forming a transitory Sub which merged into Company B. This merger did not qualify as a tax-free reverse subsidiary merger, because Company B stock was not exchanged for the requisite Transferee voting stock (see above). However, IRS disregarded this merger and treated it as a transfer by the Company B shareholders of their Company B stock as part of a §351 exchange in which Company A's and Company B's shareholders acquired control of Transferee. In a reverse merger, the target company retains all of its assets and liabilities and becomes a wholly-owned subsidiary of the buyer. In many instances the need for consents to assignments or deemed assignment of assets can be avoided as well as real estate transfer taxes. In general terms, the federal income tax consequences of a taxable forward merger are similar to those of a sale of assets, and the federal income tax consequences of a reverse subsidiary merger are similar to those of a sale of stock.

B. Seller's Tax Treatment

1. Taxable or Non-Taxable Acquisition. The basic choice for the target shareholders in contemplating the sale of the company is whether the transaction should be structured as a taxable sale of assets or stock or alternatively as a wholly or partially non-taxable reorganization under §368. In order to successfully engage in a non-taxable reorganization, additional requirements must be satisfied which heighten the due diligence undertaken by the corporate parties and their shareholders. In a non-taxable reorganization, the quality of consideration transferred to the target shareholders must satisfy the continuity of interest requirement. The target may also be required to transfer “substantially all of its assets”, which will require a look at all pre-closing distributions made by the target. A further important consideration is whether the target is an S corporation and for what period has such S status existed. Thus, asset or “inside” basis of the target corporation’s assets as well as stock or “outside” basis held by the various shareholders, must be identified and examined.

a. Preference for Stock Sale. In taxable transactions, target shareholders may frequently prefer to sell stock for several reasons: (1) avoids double taxation, although the buyer may discount the “inside” basis tax projected income tax liability as well as the inability to step-up basis in the target’s assets; (2) gain is frequently long term capital gain; (3) the target’s liabilities are effectively assumed by the buyer and without the incremental
amount realized for liability assumptions as if an asset sale or deemed asset sale under §338(h)(10) had occurred; (5) the shareholders of the target can terminate their legal relationship with the target; and (6) the sale can qualify for installment sale treatment under §453 which can also accommodate earn out type payments. As to “earn-outs” the regulations under §453 apply two tests or models applied in three contexts; (i) whether the contingent payments have a stated maximum amount; and (ii) if not, whether the contingent payments have a maximum term. See Treas. Reg. §15A.453-1(c). Sales with contingent payments are therefore classed as: (i) sales in which a maximum selling price is determinable; (ii) sales in which a maximum selling price is not determinable but the earn out payments are to be made within a stated period of time; and (iii) sales in which there is neither a maximum selling price nor a definite payment term. In certain instances, the seller (or group of sellers) may decide to elect out of installment sale treatment. Treas. Reg. §1.1001-1(g)(2)(ii)(“only in rare and extraordinary cases” will the fair market value of contingent payments be treated as not reasonably ascertainable). See, e.g., Patton Trust v. U.S., 87 AFTR2d 2001-1582 (Fed. Cl. Ct. 2001), aff’d 89 AFTR 2d 2002-1274 (Fed Cir. 2002)(rejected “open transaction” reporting when purchase consideration included contingent note payable from 40% of cash flow from business). Where the deferred payments obligation does not provide for adequate stated interest a portion of each deferred payment is deemed to be recharacterized as interest under §1275 or §483.

2. Recognition of Gain by Target Corporation in Taxable Sale. On a direct asset sale, or deemed asset sale under §338(g) or §338(h)(10), the target corporation will realize gain with respect to appreciated assets, including cost recovery allowance recapture, and loss with respect to depreciated assets assuming that the buyer is not a “related party” for purposes of §267. Where an S corporation is the seller, any built-in gain (or loss) recognized on the disposition will also be triggered. §1374. The built-in gains tax is then passed through as a deduction to the target shareholders in the year of sale. The availability of the installment sales provisions is also a relevant consideration where the buyer is making deferred payments. Assignment of income as well as “acceleration” of income issues affect the target corporation as well. See Lyon & Eustice, “Assignment of Income: Fruit and Tree as Irrigated by the P.G. Lake Case,” 17 Tax L. Rev. 293 (1962); Eustice, “Contract Rights, Capital Gain, and Assignment of Income—The Ferrer Case,” 20 Tax L. Rev. 51 (1964). For built-in gains tax implications of the assignment of income doctrine see Raby & Raby, “Accounting Adjustments vs. Other Types of Built-In Gains,” 70 Tax Notes 871 (Feb. 12, 1996); Looney, “Applying the Built-In Gains Tax to Built-In Income Items: The Service’s Ever-
Expanding Universe,” 8 J. S Corp. Tax’n 99 (1996). Where the target’s stock is being sold by a parent corporation, then the parent will report gain or loss on the sale of the stock, subject to the applicability of §338(h)(10).

C. **Buyer’s Tax Treatment**

1. **Basis/Tax History.**

   a. **Taxable Acquisition.** In a taxable acquisition, the buyer will acquire the assets or stock of the target corporation at a cost basis which may also include liabilities assumed that are secured by specific assets being purchased. Such basis will then be used for claiming cost recovery allowances, including amortization deductions for purchased intangibles in accordance with §197. The target corporation’s tax history will not be preserved. This could also occur where a stock acquisition is treated, under the step-transaction doctrine, as an asset acquisition.

   b. **Non-taxable Acquisition.** In a tax-free reorganization, the buyer, in general, will generally succeed to the inside basis in assets and tax attributes of the target subject to application limitations. See §§382, 383, 384; Treas. Reg. §1.1502-1(f) (defining “separate return limitation year”), Treas. Reg. §1.1502-21(c) (SRLY limitation), Treas. Reg. §1.1502-22(c) (capital loss SRLY). See Treas. Reg. §1.1374-5 (Lisbon Shops doctrine applicable for built-in gains purpose of NOLs of an acquired target and further subject to §§382, 269, etc.).

2. **Identity of Buyer.** The buyer frequently will establish an acquisition subsidiary in order to effectuate the acquisition, either taxable or non-taxable. A reverse triangular merger can avoid dissenters’ rights issues with the target as well as avoid potential sales and transfer tax issues. The buyer could also set up a transparent entity, such as a single member LLC, to acquire the target. Where the buyer is an S corporation, it may be critical to either acquire assets, or, if the target can provide legal assurances (and indemnification) that it is (and preferably always has been) an S corporation, then the buyer can purchase the stock of the target (with or without a §338(h)(10) election) and either continue to operate the target as a qualified Subchapter S subsidiary (QSUB), or immediately merge the target into a single member LLC of the buyer or directly into the buyer itself. For reorganization treatment, there must be “corporate parties” that are the ultimate transferee and transferor entities. Treas. Reg. §301.7701-2(b)(5). See August, “Mergers and Acquisitions Involving S Corporations”, Parts I, II and III, Bus. Ent. 2007. Alternatively, the buyer could be a partnership, general or limited, or a multi-member LLC. There
are also potential foreign structures for purchases by non-U.S. individuals or companies.

3. **Buyer Preference to Acquire Assets.** Generally, the buyer will prefer to simply acquire the target’s assets in order to avoid assuming the target’s stated, as well as unknown or contingent, liabilities, including tax obligations. Again, buyers typically prefer a direct asset sale to also achieve a cost basis in the target’s assets unless the target has inside basis in its assets in excess of their fair market values. Buyers also prefer, in many instances, to use their stock to acquire the target because of its internal cost. There may be other legal and business factors that may still require a purchase of the seller’s stock in particular situations.

**IV. PURCHASE OF TARGET’S ASSETS**

A. **Target Corporation**

1. **Direct Sale of Assets to Buyer.** Where a corporation sells or disposes of its assets in a taxable sale, gain or loss is recognized by the corporation. If a corporation sells a capital asset, or a §1231 asset, partly or wholly in exchange for debt instruments of the purchaser, such corporation may report the (nonrecapture) gain under the installment method, subject to various limitations and restrictions. For a C corporation seller, there is no effect on the shareholders, unless it distributes the proceeds, redeems shares of stock, or such corporation is liquidated. Earnings and profits are increased by virtue of any gain, including recapture amounts, less applicable taxes thereon. Where the corporation does not liquidate, then the seller may need to carefully consider the potential impacts of the accumulated earnings tax under §531, or, alternatively, the personal holding company tax under §541. There are also alternative minimum tax impacts as well. For the S corporation, gain from the sale of assets will result in the pass through of gain and loss to the shareholders in accordance with their proportionate stock interests. Alternative tax impacts are accounted for at the shareholder level. Where the corporation has converted to S status within the past ten years, §1374 may apply. See §1374(d)(7)(recognition period; for 2012 and 2013, the recognition period is 5 years and not 10 years). Thus, an asset sale by an S corporation, with a prior C history, could result in a forced double tax to the extent of its recognized built-in gains. The §1374 tax also applies to operating and liquidating distributions. Tax history is used in determining the taxable income or loss of the corporation in the year of sale. If the corporation liquidates, then the tax history is released.

2. **Deemed Asset Sale Treatment for Certain Qualified Stock Sales.**
a. **Regular § 338 Election.** In order for an acquiring corporation to be eligible to make a §338 election, it must satisfy the requirement of a "qualified stock purchase", i.e., any transaction or series of transactions in which stock (per §1504(a)(2), i.e., 80% or more voting and value) of 1 corporation is acquired by another corporation by purchase during the 12 month acquisition period. See §§338(d)(1), (d)(3). (e) and (f)(asset and stock consistency rules). If target makes a §338 election, then a stock sale by the target’s shareholders will be deemed to have sold all of its assets, subject to liabilities, to a deemed newly formed corporation in a fully taxable transaction, which is then immediately followed by the deemed liquidation of the target. Unless the target has substantial net operating losses or capital loss carryovers, a regular §338 liquidation is generally undesirable. See §336(e)(regulations permitting non-corporate purchaser to treat stock purchase as asset sale). Under §336(e) a domestic corporation (seller) selling or distributing stock of a domestic corporation it controls (target) in a "qualified disposition" can elect under §336(e) to have the transaction treated as if target disposed of its assets in a taxable transaction; and the seller will not recognize gain or loss on the disposition of its target stock. Similarly, S corporation shareholders can elect to treat a qualified disposition of S corporation stock as an asset sale. For a qualified disposition, the seller must dispose of 80% (or more) of the target’s stock by vote and value, per §1504(a)(2), within a 12 month period to one or more unrelated purchasers or distributees. The purchaser or distributee does not have to be a corporation, so a sale to one or more individuals can qualify for the election. A qualified disposition includes sales of stock as well as a §301 distribution and distributions of controlled corporation stock as part of a corporate division in which, absent the election, gain would be recognized by the distributing corporation per §§355(d)(2) or 355(e)(2).

b. **§ 338(h)(10) Election.** Sets forth a somewhat advantageous method of converting a qualified “purchase” of 80% or more of the target stock sale into an asset sale. This election may only be made for a target that is a domestic corporation that before the sale of its stock, is a member of an affiliated group of corporations (whether or not the group files consolidated returns) or is an S corporation. Where a §338(h)(10) election is made, the target corporation recognizes gain or loss as though it sold its assets on the acquisition date, but target shareholders generally recognize no gain or loss on selling target stock to the purchasing corporation. If the gain inherent in the target shareholders’ stock is similar in amount to the gain inherent in the target’s assets, § 338(h)(10) may provide a step-up in asset basis at a tax cost not significantly
greater than would be incurred with no election. Regulations further provide for deemed asset sale treatment for shareholders of an S corporation target provided all shareholders of the target consent.

3. Purchase of Partnership Interests, Both Direct and Indirect. Where the seller or target company owns one or more interests in an entity taxable as a partnership for federal (and state) income tax purposes, it will be important to consider whether the prior years K-1s are correct or if there are issues that must be taken into account. What items reported on the returns may be subject to IRS question or challenge. What about basis adjustments and allocation of debt under §752? The allocation of profit and loss provisions and distributions of cash under the operating agreement or the partnership agreement. This review would require inspection of all partnership or joint venture agreements, informational returns, book capital accounts and adjustments, schedule of contributions and distributions, particularly within the 7 year mixing bowl period. Also relevant is whether any TEFRA partnership audits are currently outstanding or tax litigation pending. The buyer would want to know as much as possible about the issues and the procedural context in which the current dispute is focused. See discussion below on relevant state income tax considerations.

4. Allocation of Consideration for Multiple Asset Sales. The consideration received from the sale of a going concern must be itemized into separate sales of each asset. This allocation is performed in accordance with the residual method of allocation under §1060. This allocation is critical not only in computing the amount of gain or loss and its character, but also in determining which part of the sale may qualify for installment sale reporting. See Bar-Deb Corp. v. U.S., 36 AFTR2d 75-5893 (1975, Ct. Cl. Tr. Div)(failed allocation of installment obligation by seller); Johnson v. Comm’r, 49 TC 324 (1968)(seller may not arbitrarily allocate payment received in year of sale); Monaghan v. Comm’r, 40 TC 680 (1963)(consideration for inventory separated from sale of remaining assets for ISO). See Rev. Rul. 68-13, 1968-1 CB 195, amplifying Rev. Rul. 57-434, 1957-2 CB 300.

B. Target Shareholders.

Where the proceeds of an asset sale are distributed to the shareholders then the shareholder-distributees must report income (or loss) under the distribution rules contained in Subchapter C or such portion of Subchapter S, i.e., §1368, which may apply. Thus, depending on the facts and circumstances, a distribution of sales proceeds will be treated as a dividend, a return of capital or capital gain. See also §§243-246, 1059. Where the distribution of sales proceeds is accomplished by redemption of part of the stock of the target corporation, the shareholder level tax
treatment may be a dividend equivalent or produce sale or exchange treatment in accordance with §§302 and 303. See also §304 (redemptions of stock through related corporation). The acquisition could also be structured as a “bootstrap” redemption or “Zenz deal”.

1. **Complete Liquidation of Target Corporation.** Where the target corporation completely liquidates as part of the acquisition, the general characterization rule at the shareholder level will be §331, or as to a controlling corporate distributee, will qualify for nonrecognition under §332. At the corporate level, for in-kind distributions in liquidation, see §§336, 337.

   a. **Direct Asset Purchase and Liquidation.** In some instances there will be liabilities of the target, either contingent, or known or unknown, which were not assumed by the buyer. There may also be other assets that are retained to pay additional claims. In such cases, a liquidating trust may be required. In such instance, it is essential that the trust be treated as such for tax purposes and not be viewed as an association taxable as a corporation. See Treas. Reg, §301.7701-4(d).

   (1) **Distributions in Liquidation.** Generally, the corporation will recognize gain or loss on the distribution of property in liquidation. §336. Compare §311 for distributions of property not in liquidation. Under §336(d)(1), the corporation is not permitted to recognize loss on the distribution of assets to a related person if the distribution is non-pro rata or the distribution consists of “disqualified property” (i.e., assets acquired in a §351 transaction or contribution to capital in the preceding 5 years). A second loss disallowance rule applies where a principal purpose of the transaction in which property was contributed to corporation in advance of liquidation was to recognize loss to offset corporate-level gain. §336(d)(2).

   (2) **Nexus with Installment Sales Rules.** See discussion below.

   b. **Forward Merger.** The target merges into the acquiring corporation or acquisition subsidiary and the former shareholders of the target receive the agreed consideration, such as cash and/or stock. This may be a preferable method for acquiring the assets of a target subsidiary to avoid technical legal issues generated through an assignment and bill of sale. For tax purposes, the forward (taxable) merger is treated as an asset sale and liquidation. Rev. Rul. 69-6, 1969-1 C.B. 104. In certain instances, a forward merger may qualify as a non-taxable Type A or Type C reorganization.
c. **Forward Triangular Merger.** Same as forward merger but through use of subsidiary, i.e., newly formed acquisition subsidiary. Where a portion of the consideration consists of stock or debt of the parent, the transaction may qualify for nonrecognition treatment. See §§368(a)(1)(C), 368(a)(2)(D). Shareholders of the target corporation may be offered the option of receiving shares of the purchasing corporation (or parent) or cash. Continuity of interest guidelines need to be addressed, i.e., % of consideration in purchasing corporation stock.

d. **§ 338(h)(10) Election.** Where a C corporation is the seller of target subsidiary stock and both corporation are members of an affiliated group, the buyer and seller may consent to an (h)(10) election. In such instance, the stock sale is treated as an asset sale followed by the (tax-free) complete liquidation of the target. The deemed sale occurs while the target is still a member of the affiliated (seller) group. In contrast, a regular §338 election results in the deemed sale taking place after the target stock is sold and is included in a one-day short year. §338(h)(9). The benefits of the (h)(10) election include the possible avoidance by the parent (seller) of liquidation gain per §332. Target gain, i.e., on the deemed asset sale, can be sheltered by any favorable tax attributes of the rest of the consolidated group. See PLR 9142013 (parent's contribution of stock of two wholly-owned subsidiaries to a newly formed subsidiary (Newco) followed by parent's prearranged sale of Newco stock to a third party (acquiror) constituted a broken §351 transaction and a qualified stock purchase of Newco shares such that parent and acquiror could join in making a §338(h)(10) election).

e. **Impact of State and Local Taxes.** Some (but not all) states will respect the §338(h)(10) election. States also vary on the computation of consolidated tax liability or may even deny consolidated reporting.

f. **§ 338(h)(10) Election.** Where S corporation shareholders are sellers of target S corporation stock, the corporation and all shareholders, as well as the purchasing corporation, may elect to treat the stock sale as an asset sale for federal income tax purposes. This results in shareholder level gain or loss on the deemed liquidation. Note that the character of the gain may change significantly where the target has ordinary income assets, recapture items and may be required to accelerate ordinary operating income in the year of the sale. There also is the gross up in the purchase price for liabilities assumed or taken subject to. Thus, in various instances, a straight up sale of stock for the equity value may
produce a more favorable result to the seller shareholder(s). Regulations endorse the use of the installment sale method for (h)(10) elections made by S corporation target shareholders. Treas. Reg. § 1.338(h)(10)-1(d)(8).

g. **Other Acquisition Techniques.** Use of holding company structures, e.g. “merger of equals”, “double dummies”, joint ventures, etc.

   (1) **Retained Interest Sales.** As an example of an acquisition structure, the buyer will want the key shareholders (or owners) of the seller or target company to retain an equity interest in the post-acquisition operations of the business, which for this purpose will most likely be a joint venture with an acquisition subsidiary or acquisition LLC/partnership. In some instances the buyer will want to finance the acquisition and incur debt at the acquisition entity. The structure of the deal will involve whether there is a 100% tax on the assets “purchased” of the seller or whether there will be a purchase of perhaps 79.9% (if §197(t)(9) recapture under the anti-churning rules is a concern which it may not be), in which case the 20.1% of the undivided ownership interest in the assets being contributed to the joint venture will be subject to §704(c). The buyer may want to structure the transaction as a purchase of a partnership interest in order to make a §754 election to avoid having a low inside basis.

2. **Use of Installment Sale Rules.**

   a. **C Corporations.** A shareholder that is a, “qualifying shareholder”, receiving an installment obligation in a complete liquidation (provided no “election out” is made) may treat the payments under the obligation instead of the obligation itself, as the consideration received in exchange for her stock. §453(h). In order to qualify, the installment obligation (ISO) must: (1) be acquired in respect to a sale or exchange of the target corporation’s assets within 12 months after the corporation adopted a plan of complete liquidation; and (2) the liquidation is completed within that 12-month period. §453(h)(1)(A). See Treas. Reg. §1.453-11(a)(1). Exception is made for installment sales of depreciable property to certain related parties, recapture items, certain sales of inventory, and ISOs attributable to certain tax avoidance transactions. See also Treas. Reg. §1.453-11(c)(2). The limitation on a shareholder’s use of §453 for reporting gain on complete liquidation for the portion attributable to inventory property is...
inapplicable (and therefore §453 reporting is permitted) if a bulk sale requirement is met. Treas. Reg. §1.453-11(c)(4)(i).

b. **S Corporations.** Under §453B(h), a distribution by an S corporation of an ISO with respect to which the shareholder is entitled to report his stock gain on the installment method is not treated as a disposition of the obligation by the S corporation. Thus, the shareholder is allowed to report gain over the same period of years that it could have been reported if the nonrecognition rules for 12-month liquidations had not been repealed. This rule does not apply, however, with respect to the built-in gains tax or for purposes of determining the corporation's tax liability. Thus, except for purposes of determining the tax on certain built-in gains or on passive investment income, an S corporation-distributee shareholder is also permitted to avoid recognition of gain or loss on the distribution of a qualifying ISO in complete liquidation. §453(h)(1).

3. **Compensation and Change of Control Issues Related to Acquisition of Target.**

a. **Reasonable Compensation and Excessive Compensation Restrictions.** See §§162(a), 162(m).

(1) **§ 162(a).** It should be noted that the taxpayer claiming a deduction, including compensation, has the burden of proving it was entitled to a larger amount of the compensation expense than allowed by the Service. See Botany Mills v. U.S. 279 U.S. 282 (1929). What constitutes “a reasonable allowance” for compensation for services actually rendered is a question of fact based on all relevant facts and circumstances. Heil Beauty Supplies v. Comm’r, 199 F.2d 193 (8th Cir. 1952). Compensation paid by a closely held corporation to one of its shareholders has been said, by courts in review of this issue, to be given intensive scrutiny to against the payments representing disguised dividends. See Kalamath Medical Services Bureau v. Comm’r, 29 T.C. 339, 347 (1957), aff’d, 261 F.2d 842 (9th Cir. 1958), cert. den. 359 U.S. 966 ((1959). But reasonableness of the amounts paid alone is not enough for the taxpayer to meet its burden of proof, it also must be intended to be paid as compensation. See Treas. Reg. §1.162-7(a). Nor-Cal Adjusters v. Comm’r, TC Memo. 1971-200 (1971)(bonuses paid only to officer shareholders in exact proportion to their share ownership and were based on available funds to absorb any excess taxable income

(2) § 162(m). § 162(m) of the Code limits the amount of compensation that may be deducted by a public company to $1 million per covered employee. In general, any accelerated vesting of stock-based awards or payments for cancellation of stock-based awards will be subject to the limitation contained in §162(m). Under §162(m)(4)(C) remuneration payable solely on account of the attainment of one or more performance goals is not included in the §162(m) computation of “applicable employee remuneration” but only if (i) the performance goals are determined by a compensation committee of the board of directors which board is comprised of solely 2 or more outside directors, (ii) the material terms for payment including performance goals that are disclosed to shareholders and approved by a majority vote before the payment of such performance based compensation, and before any payment of such remuneration, the compensation committee certifies that the performance goals and any other material terms have been satisfied. See Rev. Rul. 2012-19, 2012-28 IRB 16 (illustrating two scenarios in which one set of performance goals were not indicative of a dividend and one which was).

b. Compliance With § 409A. § 409A imposes a 20% excise tax (plus a potential additional 20% state excise tax for residents of certain states, e.g., California) on deferred compensation arrangements that fail the written plan requirements or otherwise fall out of compliance with §409A. Certain stock based awards such as §422 plans or restricted stock plans (“vested” rights), are exempt from §409A may become subject to §409A if modified after grant, including in connection with the assumption, substitution, or conversion by buyer of such awards upon the closing of a stock transaction or an asset transaction. In general, accelerating the exercise date of a stock-based award should not result in a violation of §409A subject to review of the regulations.

c. Compliance With § 422 for ISOs.

(1) General Rules Under § 422. An option is deemed to be an incentive stock option, or ISO, if it meets the requirements under §422 as well as §§421 and 424. The benefit of the ISO is, in general, to postpone income taxation of grants of stock options in the employer-corporation pursuant to a
written plan until the stock with respect the option had been exercised and held for more than one year, is sold. The exercise spread ("in the money amount") may be subject to alternative minimum tax (and receipt of a credit against the regular tax for a subsequent taxable sale.

(2) **Buyer’s Assumption of Target’s ISO Plan.** Where the buyer assumes the target’s ISO plan, it will be important to preserve ISO status both before and after the transaction. In this regard the target option plan cannot be amended to provide additional benefits or more favorable terms to its holder. However, acceleration of the exercise date may cause a portion of the option to lose ISO status, if such acceleration causes all options purporting to be ISOs to become first exercisable with respect to stock with a fair market value exceeding $100,000 during one calendar year. An ISO plan assumed by a buyer corporation and converted into buyer shares will forfeit its ISO status where: (i) the difference between the aggregate fair market value of shares subject to the target option and the aggregate exercise price of the target option, also referred to as the “spread”, increases immediately after the conversion, or (ii) the ratio of the exercise price to the market value of the stock after the conversion is more favorable to the optionee than the ratio of the exercise price to the market value of the stock immediately prior to the conversion.

(3) **Shareholder Approval Required.** Shareholder approval of the buyer corporation is required to assume the target’s ISO plan if buyer would like to make ISO grants under such plan post-acquisition.

(4) **Buyer Decides Not to Assume ISO Plan.** Where the buyer does not assume the ISO plan, the target corporation, the target may want to allow holders of the options to exercise their vested ISO’s before the closing. Target employees should be able to avoid incurring employment taxes on their share of the transaction value which withholding and taxes would occur if cash payments were received to extinguish their rights under the plan. In a taxable stock acquisition, the exercised shares would be sold to the acquiring corporation or entity.

"In the merger and acquisition world, i.e., change-in-control transactions, whether a particular change-in-control transaction is the product of a taxable or non-taxable acquisition, including a sale of substantially all assets of a corporation, requires both the target and acquiring companies as well as the target company’s officers, directors and most highly paid executives, to evaluate whether the acquisition will trigger application of the golden parachute provisions contained in Section 280G and Section 4999(a).

Application of Section 280G to Domestic Corporations

Section 280G(a) denies an income tax deduction (under chapter one) for compensation attributable to "excess parachute payments" as defined in Section 280G(b). Section 4999 imposes a 20% penalty tax, subject to withholding, on the recipient of an excess parachute payment. Thus, for individuals (officers, shareholders and highly compensated individuals, i.e., "disqualified individuals"), receiving excess parachute payments during 2013 when the maximum federal income tax rate on compensation is 39.6%, the add-on for the Section 4999 penalty drives up the tax rate applied against excess parachute payments to 59.6%. It should be noted that the Section 4999 penalty applies to the entire amount of the parachute payments in excess of the base period amount, not just the excess amount which is more than 3 times the base period amount. Section 2800(b)(1) defines "excess parachute payment" as the amount equal to the excess of any parachute payment over the portion of the base amount allocated to such payment.

In general, Section 280G must be considered where a payment is contingent on a change-in-control where the payment: (i) would not have been made had no change-in-control occurred; (ii) the payment is made as a result of an event closely associated with a change-in-control, and the event occurs within one year before or one year after the change-in-control, even if the payment is not directly contingent on the change-in-control; (iii) the payment is made under a new agreement entered into within one year before the change-in-control, or the payment is made under an existing agreement that is amended within one year before the change-in-control; (iv) the payment is made earlier than otherwise scheduled due to the change-in-control; (v) the vesting of a payment is accelerated on a change-in-control; or (vi) the payment is made under an agreement entered into after the change-in-control, and the agreement relates back to an agreement in existence prior to the change-in-control.
In setting up the calculus and required computations under Section 280G, target corporations need to evaluate the potential for excess parachute payment exposure not only based on compensation paid, including bonuses, but also amounts contained in severance packages based on an involuntary termination after a change-of-control, the vesting of previously unvested stock options and restricted stock, incentive compensation arrangement impacts, employee benefit impacts, deferred compensation arrangements as well as nonqualified retirement plans or supplemental executive retirement plans (SERPs).

Non-deductibility of Excess Parachute Payments

Section 280G(a) limits an employer-corporation (or eligible entity that elects to be taxed as a corporation under the check-the-box regulations) deductions for compensation payments that fall within the definition of "excess parachute payments". A "parachute payment" is a payment "in the nature of compensation" made to or for the benefit of a "disqualified individual" e.g., a shareholder, officer or "highly compensated employee" (as defined) which payment is contingent on a change-in-control in the ownership or effective control (again, as defined by the regulations), of a corporate employer or in the ownership of a substantial portion of its assets. An "excess parachute payment" is the amount by which the aggregate present value of all "parachute payments", i.e., one or more payments "in the nature of compensation" to or for the benefit of a "disqualified individual", that are contingent on a change-in-control in ownership or the effective control of a corporate employer or attributable to the sale or disposition of a substantial portion of its assets, exceeds three times the "base amount" that is allocated to the payment. Section 280G(b)(2)(A). A payment is presumed contingent on a change-in-control in ownership or control if made pursuant to an agreement made during the tax year preceding the tax year of the ownership change-in-control or applicable event. Section 280G(b)(2)(C). A compensation payment to a disqualified individual is also considered a parachute payment if it is made under an agreement that "violates any generally enforced securities laws or regulations."

The "base amount" is an individual's average annual compensation (which includes all forms of compensation received) during the "base period" which period is, in general, the five most recent taxable years ending before the date of the change-in-control of ownership or control or the portion of that period during which the individual performed personal services for the corporation.
Section 280G(d)(2). The base amount, in general, does not include payments made in the year of the change-in-control. Frequently, a disqualified individual's compensation amounts during the base periods will be significantly if not substantially less than those amounts received in the change-of-control year (or subsequent year(s)). For example, there could be performance bonus payments made to a disqualified individual due to the proposed acquisition. Moreover, disqualified individuals may hold several tranches of unexercised options or non-vested rights to deferred compensation that may be required to be deemed exercised (and redeemed) and vested and subject to payment by virtue of the change-of-control. See, e.g., Treas. Regs. Section 1.280G-1 (Q&A-24(b), (Q&A-24(c)(2)), the value of the contingent portion of the payment equals the difference between the amount of the payment to be made and the present value of the payment as of the new accelerated payment date (from the original payment date). Thus, where a disqualified individual has substantial amounts of deferred compensation or non-vested stock options required to be exercised on a change-of-control, there may be excess parachute payments present subject to applicable limitation such as the reasonable compensation exception. Special rules are set forth in the regulations for valuing stock options. Treas. Reg. Section 1.280G-1(Q&A 13) and vesting schedules for other forms of deferred compensation.

The statute provides for the opportunity to avoid or mitigate the "excess parachute payment" rules by statutory exception or where the taxpayer can establish, by clear and convincing evidence, that the total compensation received, including change-of-control payments, reflects reasonable compensation for services performed after the change-in-control in ownership or control or for services performed prior to the change-of-control. Section 280G(b)(4)(A), (b)(4)(B). A "small business exception", which is actually two exceptions, one for corporations that "are or could have been S corporations" and a vote of disinterested shareholders exception as are set forth in Section 280G(b)(5).

Generally, for purposes of computing the compensation amounts and base period calculations of disqualified persons, all members of an affiliated group of corporations are treated as one corporation, and all officers of all members of the group are considered officers of that one corporation. Any configuration of two or more corporations that does or may join together in filing consolidated returns is an affiliated group, but various types of corporations, most importantly foreign corporations, are generally treated as members of an affiliated group for this purpose, even
though they may not join in a consolidated return (unless the foreign corporation is organized in Mexico or Canada).

Section 280G(b)(4)(A) provides that an amount treated as a parachute payment will not include the portion of such payments which the taxpayer can establish, by clear and convincing evidence, is reasonable compensation for personal services rendered on or after the applicable date of change-in-control event. Section 280G(b)(4)(B) provides a reasonable compensation cut-down rule for the amount that the taxpayer can, by clear and convincing evidence, establishes that is reasonable compensation for personal services actually rendered before the applicable date of the change-in-control event. It is quite common for reasonable compensation studies to be summoned by the acquiring and/or target companies in attempting to avoid or mitigate the potential impact of the golden parachute payment rules and Section 4999 penalty. Still, the parachute payment must take into account the present value of any portion of the payment that the taxpayer can not prove constitutes reasonable compensation for future services.

As concerns payments made to a disqualified person to refrain from competition, in PLR 200110025 (3/12/2001) the Service held that payments made to an executive under a covenant not to compete after a change-of-control of the corporation did not constitute parachute payment to the extent that the taxpayer could establish by clear and convincing evidence that the amounts attributable to such a covenant were reasonable. See Treas. Reg. Section 1.280G-1, Q&A 11. In such event, the payments under the covenant not to compete will not qualify as parachute payments under Section 280G(b)(2)(A).

Private Shareholder Approval Exception to Section 280G

As mentioned, Section 280G(b)(5)(A)(ii) provides that shareholders of a privately held corporation may vote to remove excess parachute payments from being subject to Section 280G (and Section 4999). The shareholder approval requirements are contained in Section 280G(b)(5)(B). It requires that each subject payment be approved by a vote of the persons who owned, immediately before the change-in-control, more than 75% of the voting power of all outstanding shares in the corporation and there was adequate disclosure of all material facts concerning the subject payments to be made to a disqualified individual. Under the regulations, stock is not treated as "outstanding" if it is owned by a disqualified individual who will receive a payment that is characterized as a parachute payment unless all shareholders are
disqualified individuals. Treas. Reg. Section 1.280G-1, Q&A-7(b)(4). Therefore a non-resident alien employee-shareholder of a foreign privately held corporation is not entitled to vote on the exemption under Section 280G(b)(5)(A)(ii) with respect to payments to be made to other disqualified employees. The rule presumably reflects the view that any disqualified individual would have a bias in favor of approving of the parachute payments to be made pursuant to a change-of-control. Of course, the shareholder approval exception is not available to a publicly traded corporation.

Mr. August’s Blog post also discusses the application of Section 280G and Section 4999 to foreign corporations that are parties to a change of control transaction such as a merger or acquisition.


“In Sun Capital Partners III LP et al. v. New England Teamsters & Trucking Industry Pension Fund et al.; No. 12-2312 (1st Cir. 2013) (“Sun Capital Partners”) the First Circuit Court of Appeals, in a three judge panel opinion issued on July 24, 2013, reversed and vacated grants of summary judgment to two private equity funds in a case involving withdrawal liability for the pro rata share of unfunded vested benefits to a multiemployer pension fund of a bankrupt company, holding that one fund was not a passive investor and was in fact engaged in a trade or business (therefore incurring withdrawal liability) but that further factual development was required as to the other private equity fund. Chief Judge Sandra Lynch wrote the opinion.

The case, one of first impression, concerned the withdrawal liability for the pro rata share of unfunded vested benefits to a multiemployer pension fund of a bankrupt company, Scott Brass, Inc. (“SBI”) under ERISA, 29 U.S.C. Section 1001 et seq., as amended by the Multiemployer Pension Plan Amendment Act of 1980 (MPPAA), 29 U.S.C. Section 1381 et seq. The litigation addresses whether three groups: two private equity funds, which argued that they are mere passive investors that had indirectly controlled and revive SBI, a struggling portfolio company; and the New England Teamsters and Trucking Industry Pension Fund (“TPF”), to which the bankrupt company had withdrawal pension obligations and which seeks to impose those obligations on the equity funds. Were TPF to become insolvent, the vested benefits to the SBI workers are reduced to a PBGC guaranteed level. See
29 U.S.C. Section 1322a, 1426, 1431. As a party to the proceeding, the PBGC argued on brief, that the reduced guaranteed level is approximately $12,870 for employees with 30 years of service.

The MPPAA was enacted by Congress to protect the viability of defined pension benefit plans, to create a disincentive for employers to withdraw from multiemployer plans, and also to provide a means of recouping a fund’s unfunded liabilities. *Pension Benefit Guar. Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 720-22 (1984). MPPAA requires employers withdrawing from a multiemployer plan to pay their proportionate share of the pension fund’s vested but unfunded benefits. An employer withdraws when it permanently ceases its obligation to contribute or permanently ceases covered operations under the plan. 29 U.S.C. Section 1383(a).

The MPPAA provides: “For purposes of this subchapter, under regulations prescribed by the [PBGC], all employees of trades or businesses (whether or not incorporated) which are under common control shall be treated as employed by a single employer and all such trades and businesses as a single employer.” 29 U.S.C. Section 1301(b)(1).

To impose withdrawal liability on an organization other than the one obligated to the [pension] fund, two conditions must be satisfied: (i) the organization must be under ‘common control’ with the obligated organization; and (ii) the organization must be a trade or business.” See *McDougall v. Pioneer Ranch Ltd. P’ship*, 494 F.3d 571, 577 (7th Cir. 2007). The MPPAA’s broad definition of “employer” extends beyond the business entity withdrawing from the pension fund to impose liability on related entities. See *Cent. States, Se. & Sw. Areas Pension Fund v. Messina Prods., LLC*, 706 F.3d 874, 877 (7th Cir. 2013) (“When an employer participates in a multiemployer pension plan and then withdraws from the plan with unpaid liabilities, federal law can pierce corporate veils and impose liability on owners and related businesses.”).

While Congress in Section 1301(b)(1) authorizes the PBGC to prescribe regulations, those regulations “shall be consistent and coextensive with regulations prescribed for similar purposes by the Secretary of the Treasury under [26 U.S.C. Section 414(c)]” of the Internal Revenue Code. The PBGC adopted regulations pertaining to the meaning of “common control,” see 29 C.F.R. Section 4001.2, 4001.3(a), but has not adopted regulations defining or explaining the meaning of “trades or businesses.” The phrase “trades or businesses” as used in Section 1301(b)(1) also is not
defined in Treasury regulations and has not been given a definitive, uniform definition by the Supreme Court. See Comm'r of Internal Revenue v. Groetzinger, 480 U.S. 23, 27 (1987) ("substantial, regular and continuous" activity for purposes of Section 162(a)). The Supreme Court has warned that when it interprets the phrase "trade or business," it "do[es] not purport to construe the phrase where it appears in other places," except those Sections where it has previously interpreted the term. The Court has not provided an interpretation of the phrase as used in Section 1301(b)(1).

The First Circuit held that at least one of the private equity funds which operated SBI, through layers of fund-related entities, was not merely a "passive" investor, but sufficiently operated, managed, and was advantaged by its relationship with its portfolio company, the now bankrupt SBI (emphasis added). The Court also concluded that further factual development is necessary as to the other equity fund. We decide that the district court erred in ending the potential claims against the equity funds by entering summary judgment for them under the "trades or businesses" aspect of the two-part "control group" test under 29 U.S.C. Section 1301(b)(1). See Sun Capital Partners III, LP v. New Eng. Teamsters & Trucking Indus. Pension Fund, 903 F. Supp. 2d 107, 116-18, 124 (D. Mass. 2012).

As a result, the First Circuit remanded the case for further factual development and for further proceedings under the second part of the "control group" test, that of "common control," in 29 U.S.C. Section 1301(b)(1). The district court was, however, correct to enter summary judgment in favor of the private equity funds on the TPF's claim of liability on the ground that the funds had engaged in a transaction to evade or avoid withdrawal liability.

C. Consequences of Asset Purchase to Buyer

1. Aggregate Cost Basis.

a. Direct Asset Acquisition. Where the target's assets are purchased in a taxable transaction, the buyer's aggregate basis in the purchased assets will equal: (1) cash and value of property paid; and (2) liabilities assumed or taken subject to. § 1012. Interest, including OID, is not added to basis. Thus, the principal amount of any fixed payment obligations is included in basis even if the seller is reporting under § 453. For contingent payments, generally basis is not established until the amount of the contingency is determined and resolved.
b. **Regular § 338 Election.** In a deemed asset sale per §338, §338(b)(and the regulations thereunder) require that the new target’s aggregate basis in the target’s assets is equal to the sum of: (1) buyer’s cost or basis in the qualified stock purchase gross-up to reflect shares retained by minority shareholders; (2) the buyer’s basis in any non-recently purchased stock of the target; (3) the liabilities of the target, including liability for taxes resulting from the deemed sale; and (4) other adjustments required by the regulations.

c. **§ 338(h)(10) Election.** Where a deemed asset sale occurs pursuant to a §338(h)(10) election, the new target’s basis is based under the same rules as a regular §338 election except: (1) basis of assets to new target does not include any liability for tax arising out of the deemed asset sale (i.e., since the consolidated group of the seller will be bearing the tax liability); and (2) a basis step-up is made with respect to non-recently purchased stock. See Treas. Reg. §1.338(b)-1(e)(3)(ii). Query, as to (1), what if the buyer received payment from the target as to its tax liability on the deemed asset sale?

2. **Allocation of Basis Among Purchased Assets.** As mandated by §1060, the residual method of valuation is required to allocate the purchase price in actual asset sales as well as deemed asset sales under §338. See §1060(c)(definition of “applicable asset acquisition”); §338(b)(5). See *Peco Foods, Inc. & Subsidiaries v. Comm'r*, TC Memo 2012-18 (buyer of 2 processing plants wanted to subdivide acquired assets into subcomponents for depreciation purposes over agreed written allocations of the parties; Danielson rule applied to deny such reallocations). Compare *J.P. Emco Inc. v. U.S.*, 78 AFTR2d 96-6482 (Ct. Fed. Cl. 1996)(auto parts manufacturer’s allocation of amounts for depreciation purposes, to auto parts requirements contracts and to machines and equipment acquired in §338 stock purchase, using the residual method upheld on summary judgment so that refund claim upheld). Generally, buyers will want to have as much of the consideration allocated to ordinary income assets and tangible personal property. Sellers will tend to allocate to assets that produce long term capital gain, or, on the other hand, ordinary loss. As to purchased goodwill and similar items, §197 eliminates the issues of whether an intangible’s useful life can be estimated with reasonable accuracy and, if so, the length of that useful life; if an intangible is covered by §197(a) its cost is amortized over 180 months, regardless of the period during which the intangible is expected to be useful in the business. In order to trigger application of §1060, the acquisition must involve the purchase of any “active trade or business” (per §355 definition) or any other group of assets where “goodwill or going concern value could under any circumstances attach to such group”. Treas. Reg. §1.1060-1T(b)(2).
Under §1060, the allocation of the purchase price is to be made upon the following classes, in the following order:

a. First: cash and general deposit accounts (including savings and checking accounts) ("Class I");

b. Second: "actively traded personal property" under §1092(d)(1) (with some modifications), including publicly traded stock and U.S. government securities, as well as CDs and foreign currency ("Class II");

c. Third: accounts receivables, mortgages and credit card receivables from customers ("Class III");

d. Fourth: inventory, stock in trade and property held for sale to customers in the ordinary course of business ("Class IV");

e. Fifth: all assets other than Class I, II, III, IV, VI and VII assets, which would include property, plant and equipment ("Class V");

f. Sixth: §197 intangible assets, except goodwill and going concern value ("Class VI"), and

g. Seventh: goodwill and going concern value (whether or not the goodwill or going concern value qualifies as a Sec. 197 intangible) ("Class VII"). See Treas. Regs. §§1.1060-1(a)(1); 1.338-6(allocation of ADSP and AGUB among target assets) and 1.338-7(allocation of redetermined ADSP and AGUB among target assets). See also §1060(d) and Treas. Reg. §1.755-2T.

3. Purchase of §197 Intangibles. Under §197, amortization is permitted for acquisition or capitalized costs of certain intangible property, referred to as §197 intangibles, that a taxpayer acquires and holds in connection with the conduct of a trade or business or activity engaged in for profit.

a. Definition of §197 Intangible. Includes: (1) goodwill; (2) going concern value; (3) work-force in place; (4) information base; (5) customer based intangibles; (6) supplier based intangibles; (7) licenses, permits or other governmental issued rights; (8) covenants not to compete or similar agreements entered into in connection with any interest in a trade or business, i.e., liquor licenses, taxi medallions, airport rights, regulated transportation routes, and broadcasting licenses; and (9) any franchise, trademark or trade name (except intangibles described in §1253(d)(1)). Thus, for example, if the buyer pays a lump sum for the target's franchise, §197 would provide for 15 year amortization instead of a contingent payout method described in §1253. On the other
hand, buyers who are not adverse to the seller’s or other third party’s control over the subject intangibles, generally will prefer the currently deductibility of payments subject to §1253, which produce ordinary income to the recipient.

(1) **Use of Separate Company to Purchase Intangibles.** As part of the acquisition, consider use of a holding company with the acquisition subsidiary acquiring the business assets and the holding company purchasing the licenses and similar intangibles which it then leases to its subsidiary. This planning strategy may avoid state income tax on the royalty payments. See §§446(b), 482. See discussion of the licensing subsidiary issue in this Outline.

(2) **Consideration for Covenant Not to Compete.** Prior to 1993’s introduction of §197, consideration paid for a covenant not to compete was generally deductible in level amounts over the term of the covenant period. However, under §197, the period is 15 years even if the actual contract period is shorter.

(3) **Purchase of Personal Goodwill.** See discussion of Martin Ice Cream, infra.

b. **Anti-churning Rules.** Under special anti-churning rules in §197, goodwill, going concern value, or any other § 197 intangible acquired after the enactment date §197 (August 10, 1993, or July 25, 1991, where an election has been made) which would not have been amortizable prior to the enactment of §197, are generally not treated as § 197 intangibles if they were held or used by the taxpayer (or a related person) before the effective date and in certain other situations.

c. **Non-§ 197 Intangibles.** Certain property is excluded from the definition of §197, including interests in corporations or partnerships, futures and notional contracts, land, certain computer software, lease rights, rights under debt instruments, and sports franchises.

d. **Information Reporting Requirements.** Set §1060(e). Buyers and sellers are not required to agree on asset allocations, but once an agreement is made, both buyer and seller (but not IRS) are bound. Report allocation on IRS Form 8594. See also Form 8023 (§338 transactions).
e. **Non-Corporate Assets.** In trying to avoid double tax for an asset or deemed asset, sale of a corporation, note cases providing that non-corporate assets, include covenants not to compete from key shareholders, and, possibly, customer relationships or goodwill retained by shareholders are not corporate assets. See *Martin Ice Cream Company v. Comm'r*, 110 T.C. 189 (1998) (in the absence of an employment agreement or covenant not to compete, client relationships and goodwill personal to shareholder are not assets of target corporation); *Norwalk v. Commissioner*, T.C. Memo. 1998-279 (1998) (presence of shareholder level goodwill on liquidation of accounting firm not included in amount realized).

V. **PURCHASE OF TARGET STOCK IN A TAXABLE ACQUISITION (OUTSIDE OF § 338(H)(10))**

A. **Treatment of Target Shareholders**

1. **Taxable Acquisition of Stock.** Where shareholders of the target corporation sell their stock in a taxable acquisition which is not part of a §338 transaction, realized gain or loss is recognized in the year of sale, subject to application of §453 with respect to qualifying deferred payment obligations. §1001(a). The consideration for the taxable acquisition, which may take the form of a reverse (or forward) triangular merger, may include stock of the buyer corporation. The advantage of the reverse merger technique is to effectively force the shareholders of the target to sell their shares, although some states permit dissenter's rights in this context, but generally only as to the price at which the shares are sold. Where a shareholder owns more than one block of stock, gain or loss is determined with respect to each block. If a target shareholder owns more than one block of stock with differing bases, gain or loss is computed separately for each such block. Cf., *Wineberg v. Comm'r*, T.C. Memo 1961-336, aff'd, 326 F.2d 157 (9th Cir. 1963) (agreement as to allocation of purchase price between different blocks of stock that was entered into after the sale had no business purpose, and was disregarded). See also §§ 1202 (preferential rate for gain from sale of "qualified small business stock") §1045 (special rollover rule), (former) 341 (collapsible corporation provision) (repealed for taxable years beginning after 12/31/2002).

a. **Installment Sales of Stock.** Where ISO is received from buyer, capital gain on sale of stock reported pro rata as cash payments are received. Where number of payments is fixed but amount indefinite, basis is allocated equally to each payment unless the seller can establish a different method. See Treas. Reg. §15A.453-1(c)(3). As to unstated interest, see §483, or, where total payments exceed $250,000, see §1274. Among the requirements under §453 is at least one payment made after the close of the year in which
the sale occurred, debt obligations that are not payable on demand or are otherwise issued in readily tradable form in an established securities market, and the stock sold is not publicly traded. Where the amount of the shareholder’s ISOs exceed $5M, then an interest charge is imposed on the tax on the deferred gain. §453A. Additional special rules apply with respect to pledges and other taxable dispositions, related party sales, etc. of ISOs.

2. Non-Taxable Acquisition of Stock.

a. Treatment of target Shareholders. Where shareholders of the target corporation exchange their shares of stock in target for shares in the buyer, or the parent stock of the buyer, in a transaction described in §368(a), then the target shareholders will not recognize gain on the exchange. §354. “Nonqualified preferred stock” received in a reorganization in exchange for stock other than “nonqualified preferred stock” is not treated as stock or securities. §354(a)(2)(C)(i). Instead, it is other property (i.e., “boot”) on which gain (but not loss) is recognized when it is received in a reorganization exchange. § 356(e). Where cash or other property is received, the boot may either be taxed as dividend income or as capital gain, depending on the application of §§356(a)(1) or §356(a)(2). As to holders of securities of the target, no gain or loss is recognized upon the surrender of target securities in exchange for shares or securities in the acquiring corporation, so long as the principal amount of securities received does not exceed the principal amount of securities surrendered; if larger principal amount received, this is treated as "boot." §§354, 356. Warrants are treated as securities with a zero principal amount, with the effect that target shareholders do not recognize any gain upon receipt of warrants.

b. Comparison with Taxable Acquisition. The character of the consideration paid by the buyer corporation is the essential difference between a tax-free reorganization and a taxable acquisition of stock. Generally, in a tax-free transaction, the stock of the acquiring corporation or its parent, is the primary, if not the only, consideration paid for the target stock or assets. In contrast, a taxable stock acquisition can involve a variety of consideration, e.g., cash, buyer’s debt instruments, other property and stock. In a tax free reorganization, the acquiring corporation generally must acquire all, or “substantially all” of the acquired corporation’s assets, while in a taxable purchase, either of assets or stock, unwanted assets can be pruned out of the target. A non-taxable reorganization must also satisfy certain judicial requirements,
including the continuity of business enterprise, business purpose and continuity of shareholder interest requirements.

(1) **Continuity of Business Enterprise.** The buyer corporation must continue to operate a historic business of target or use target's historic business assets in a business. Under regulations also finalized in 1998, this requirement is generally fulfilled if target's assets are redeployed within the acquiring corporation's "qualified group" (defined as a group of corporations, 80% of the vote and value of at least one of which is owned by acquiring, and each member of which is similarly owned by at least one other member).

(2) **Continuity of Shareholder Interest.** Shareholders of the target corporation must receive a substantial equity interest in the acquiring corporation or its parent. For advance ruling purposes, the standard is that at least 50% of the target corporation must be acquired for the stock buyer corporation’s or its parent’s. After regulations issued in 1998, continuity of interest is not violated even where former target shareholders sell their stock immediately after the reorganization to the acquiring corporation or a related party. However, pre-closing extraordinary distributions by the target corporation are suspect. Post-reorganization asset drop-downs to a subsidiary, including a “grandchild” subsidiary are generally permitted.

c. **Forms of Tax-free Reorganizations.**

(1) **Type A Reorganization.** A statutory merger or consolidation (Type A);

(2) **Type B Reorganization.** The acquisition by one corporation, solely in exchange for all or part of its voting stock (or the voting stock of a parent corporation), of the stock of another corporation where the first corporation has “control” (as defined) of the second corporation immediately after the acquisition (Type B);

(3) **Type C Reorganization.** The acquisition by one corporation, in exchange for all or part of its voting stock (or the voting stock of a parent corporation), of substantially all the properties of another corporation (Type C). The consideration given by the acquiring corporation must be solely voting stock, except that liabilities of the acquired corporation may be assumed, property may be
taken subject to liabilities, and a limited amount of money or other consideration may be paid;

(4) **Type D Reorganization.** A transfer by a corporation of all or part of its assets to another corporation if, immediately after the transfer, the transferor, its shareholders (including its former shareholders), or both in combination, are in control of the transferee corporation, but only if the stock or securities of the transferee corporation are distributed under the plan in a transaction that qualifies under §§354, 355, or 356 (Type D); and

(5) **Triangular Mergers.** A transfer by a corporation of its assets by merger into a subsidiary of the acquiring corporation, where the target shareholders receive, in exchange for their target stock, sufficient stock of the parent of the acquisition subsidiary. This qualifies as a Type A reorganization. §368(a)(2)(D) (forward triangular merger). It may also result in a triangular Type C reorganization. The use of a disregarded or single member entity may be preferable to using an acquisition subsidiary to effectuate a forward triangular merger in order to accomplish a "straight" Type A merger instead of a §368(a)(2)(D) acquisition. This is to avoid the "substantially all" test and the "no subsidiary stock" prohibition. An alternative method of accomplishing the result is a reverse triangular merger. §368(a)(2)(E) (A reverse triangular merger may also qualify as a Type B reorganization). In either event, the parent corporation generally determines the adjusted basis in the surviving subsidiary's stock though a fiction—and if it had acquired all of target's assets directly from target in a tax-free carryover basis transaction, and then contributed those assets to the surviving subsidiary in a §351 contribution (the "over-the-top method" of adjusting basis). Treas. Regs. §§1.358-6(c)(1)(i), (c)(2)(i)(A).

d. **Effect on Target Corporation.** Generally, a target corporation recognizes neither gain nor loss if it exchanges its assets under the plan of reorganization for stock, securities or other property ("boot") of another corporation which is a party to the reorganization and distributes such property to its shareholders. §§361(a), 361(b)(1)(A). Other property received from the acquiring corporation which is not distributed to the shareholders results in gain recognition. §361(b)(1)(B). Loss is not recognized. §361(b)(2). See §361(b)(3) (transfers of property to creditors.
pursuant to reorganization). Gain is recognized on distributions of nonqualified property. §361(c).

e. **Effect on Buyer or Acquiring Corporation.** The acquiring corporation’s basis in the target’s assets in a tax-free reorganization is the same as the transferor-target’s basis, increased by the amount of any gain recognized to the target. §362(b). The transferor’s holding period in its assets also carries over. Generally, the acquiring corporation will inherit the tax attributes, including carryover items, and earnings and profits, of the target in an acquisitive reorganization (other than a Type B reorganization). The corporation does not incur any gain or loss on the exchange of its stock for the assets or stock of the target. §1032.

f. **Certain “Outbound” Reorganizations.** §367 and the regulations issued thereunder, restricts "outbound" tax-free reorganizations of a domestic target (i.e., the acquisition of a domestic target by a foreign acquiror). An otherwise qualifying reorganization will be tax-free to a transferring domestic shareholder generally only if:
   (a) domestic target complies with certain reporting requirements;
   (b) target shareholders who are U.S. persons will own, in the aggregate, no more than 50% in both voting power and value of the stock of foreign acquiror; (c) U.S. persons that are officers, directors or 5% domestic target shareholders will own, in the aggregate, no more than 50% in both voting power and value of the stock of foreign acquiror; (d) the transferring shareholder will not be a 5% or more shareholder of foreign acquiror after the transaction or, if the shareholder will be a 5% shareholder, the shareholder enters into a five-year "gain recognition agreement" (i.e., agrees to recognize the gain realized in the transaction if foreign acquiror disposes of domestic target within 5 years); (e) the foreign acquiror has been engaged in an active trade or business outside the United States for the preceding three years, and (f) the fair market value of foreign acquiror is at least equal to the fair market value of domestic target. See, e.g., §§897, 1297. PLR200132007, 8/13/2001 (foreign parent acquires domestic target via forward triangular merger).

g. **Problems With Qualifying Under Reorganization Rules.**

(1) **Type A Reorganizations.** In the statutory merger transaction, the target and buyer corporation have the most flexibility for qualifying a tax free exchange. There is no "solely for voting stock" requirement of Type B or certain Type C reorganizations; nonvoting stock is permissible
consideration and the continuity of interest rule allows the use of a substantial amount of cash or other property.

(2) **Type B Reorganizations.** In a Type B reorganization, the acquiring corporation must acquire control (i.e., 80% or more) of the stock of the target solely in exchange for its "voting stock". See Rev. Rul. 63-234 (voting preferred stock having "significant participation in management" permitted in Type B). No cash can be used. See Heverly v. Comm'r, 621 F.2d 1227 (3d Cir. 1980); Chapman v. Comm'r, 618 F.2d 856 (1st Cir. 1980). On the other hand, a target can redeem its shares prior to the reorganization and not violate the solely for voting stock limitation as long as the cash was not provided by the acquiring corporation. In a voting stock swap, acquiror can exchange, on a tax-free basis, its debt for target debt and its warrants or options for target warrants or options. Rev. Rul. 98-10, 1998 1 CB 643. Where a Type B is followed by a liquidation of the target, the transaction will be tested as a Type C reorganization. Rev. Rul. 67-274, 1967-1 C.B.

(3) **Type C Reorganizations.** In a Type C reorganization, the acquiring corporation must acquire substantially all of the properties of the target solely in exchange for its voting stock or the voting stock of its parent corporation. For ruling purposes, the Service regards the "substantially all" requirement as met where the acquisition includes 90% of the value of the net assets and 70% of the value of the gross assets the target immediately prior to the transaction. Rev. Proc. 77-37. A special rule, §368(a)(2)(B) provides that an acquiring corporation can transfer property other than voting stock for up to 20% of the assets required, but for this rule only, liabilities assumed must count as "boot". Therefore, for highly leveraged targets, only voting stock can be exchanged. In a Type C reorganization, the target generally must distribute all stock, securities or other consideration it receives and liquidate.

(4) **Forward Triangular Mergers.** Under §368(a)(2)(D), the target must transfer "substantially all" of its assets and no shares of the subsidiary corporation can be used. The fact that the merger could not have occurred under state or federal law directly into the controlling parent, e.g., foreign parent, is irrelevant. Under the "substantially all" test in this instance, it is not necessary that such assets be acquired solely for voting stock. Instead, any kind of consideration
will be satisfactory as long as the continuity of interest test is met. Treas. Reg. §1.368-2.

(5) Reverse Triangular Mergers. Under §368(a)(2)(E), the target must also effectively transfer “substantially all” of its assets and the shareholders of the target corporation must exchange 80% or more of target stock for voting stock of acquiring corporation or its parent company in exchange for voting stock of the acquiring company (parent). While a reverse triangular merger can resemble, or in fact constitute, a Type B reorganization, it has the benefit of forcing out minority shareholders of the target, facilitating the acquisition of problem contracts or assignment problems and permits some other consideration to be used since only 80% of the target stock must be acquired solely for voting stock. On the other hand, the “substantially all” restriction limits pre-transaction distributions by target and the rules generally are more restrictive than forward triangular mergers.

VI. ACQUISITION COSTS.

A. Types of Acquisition Costs.

1. Compensation Related Expenditures. This will include bonuses, severance payments, parachute payments, purchasing of options subject to change of control provisions.

2. Advisory Costs. Including investment banker fees and costs, including “success fees”, valuation or appraisal costs, the cost of receiving a fairness opinion(s), legal fees associated with structuring and negotiation of the transaction and conducting due diligence including review of legal documents, financial records, pending or projected litigation. Accounting fees incurred in responding to due diligence requests and reviewing the same. Review of financial statements, tax filings, both federal and state, etc. There are also preliminary costs incurred by both sides including investigatory expenses or other forms of preliminary expenses. The transaction costs can be quite substantial.

B. Tax Treatment of Acquisition Costs. Compare §162(a) (ordinary and necessary business expense) with §§263 (costs associated with the acquisition or improvement of an asset generally must be capitalized and added to cost basis of the acquired assets.

1. Final Regulations Issued in 2003 on §263. The rules require the capitalization of transactions costs which “facilitate” an acquisition,
creation, restructuring or reorganization of a business entity, or a transaction involving the acquisition of capital, but certain costs are exempt from this rule including employee compensation, certain de minimis transaction costs and overhead. See T.D. 9107, 69 Fed. Reg. 435 (1/5/2004). See Treas. Regs. §§1.263(a)-4(o), -5(m).

2. Relevant Provisions in the § 263 Regulations. Treas. Reg. §1.263(a)-4(c)(3)(i) provides that a purchaser must capitalize amounts paid to acquire an ownership interest in a corporation. Treas. Reg. §1.263(a)-5 provides rules for the treatment of costs associated with the acquisition of a trade or business. Generally, costs that facilitate the acquisition must be capitalized. Other costs would typically be deductible.

a. Facilitation Costs. Treas. Reg. §1.263(a)-5(b) provides, in part, that an amount is paid to facilitate a transaction if the amount is paid in the process of investigating or otherwise pursuing the transaction. Whether an amount is paid in the process of investigation or otherwise pursuing the transaction is determined based on all of the facts and circumstances.

b. Investigative Costs: The "On or After" Test. Treas. Reg. §1.263(a)-5(e) provides, in part, that except for certain facilitative costs listed in Treas. Reg. §1.263(a)-5(e)(2), an amount paid by the taxpayer in the process of investigating or otherwise pursuing a covered transaction facilitates the transaction only if it relates to activities performed on or after the earlier of the date a letter of intent or similar communication is executed or the date on which the material terms of the transaction are authorized or approved by the taxpayer’s board of directors.

c. Per Se Facilitative Costs. Treas. Reg. §1.263(a) 5(e)(2) provides a list of costs that are inherently facilitative, which are facilitative regardless of when performed. Such expenses include: amounts paid for activities performed in determining the value of the target, negotiating or structuring the transaction, preparing and reviewing transaction documents, preparing and reviewing regulatory filings required by the transaction, securing advice on the tax consequences of the transaction, securing an opinion as to the fairness of the transaction, obtaining shareholder approval of the transaction, and conveying property between the parties to the transaction.

d. Required Records; Allocation of Expenditures by the Parties. Treas. Reg. §1.263(a)-5(f) provides detailed rules concerning the supporting documentation necessary to establish the portion of any amount paid that is contingent on the successful closing of a
covered transaction that is allocable to activities that do not facilitate the transaction. In general, this documentation must consist of supporting records (for example, time records, itemized invoices, or other records) that identify the activities performed, the fee allocable to those activities, the date of performance, and the service provider. This documentation must be completed on or before the due date for the taxpayer's timely filed return (including extensions). Certain case decisions rendered prior to the promulgation of the intangibles regulations under §263 are authority for the proposition that the parties may allocate transactions costs among categories of expenditures pertinent to the transaction. McCrory v U.S., 651 F.2d 828 (2d Cir. 1981); A.E. Staley Manufacturing Co. v. Commissioner, 119 F.3d 482 (7th Cir. 1997); Wells Fargo & Co. v. Comm'r, 224 F.3d 874 (8th Cir. 2000). These cases applied the "Gilmore test" based on the "origin of the claim" standard to allocated the lump sum payment of fees among various categories of services provided. See U.S. v. Gilmore, 372 U.S. 39, 49 (1963). Treas. Reg. §1.263(a)-5(f) provides detailed rules concerning the necessary documentation, that § does not require time records. Other records may be used to establish an appropriate allocation. Courts have considered "the [taxpayer's] records, the files of the attorneys, the testimony of witnesses who know the facts, and opinion testimony," including materials such as board meeting minutes and presentations, "even if the apportionment derived . . . is 'less scientific'." See Putnam-Greene Financial Corp. v. U.S., 308 F. Supp. 2d 1374 (Mid. D.Ga. 2004)(citing to Estate of Morgan v. Comm'r, 332 F.2d 144 (5th Cir. 1964); Dye v. U.S., 121 F.3d 1399 (5th Cir. 1974)).

e. Ordinary and Necessary Expenses. § 162(a) allows a deduction for ordinary and necessary expenses paid or incurred by the taxpayer in carrying on a trade or business. Whether an expense is deductible under § 162 is ultimately a question of fact. See Comm'r v. Heininger, 320 U.S. 467 (1943). Determining whether an expense is ordinary and necessary requires an analysis of the facts and circumstances. Jones v. Comm'r, 242 F.2d 616, 620 (5th Cir. 1957).

f. Target or Seller’s Expenditures in General.

(1) Stock Sale.

(2) National Starch & Chemical Corp. v. Comm’r, 93 T.C. 67 (1989), aff’d, 918 F.2d 426 (3rd Cir. 1990), aff’d sub. nom. INDOPCO, Inc. v. Comm’r, 503 U.S. 709 (1992). Case involved a taxable stock purchase, although some
shareholders obtained tax free treatment under a §351 transaction, where the taxpayer claimed deductions for transactions costs on the basis that the target did not acquire any assets in the transaction and that the expenditures incurred by the directors of the target in exercise of their fiduciary obligations were incident to such fiduciary duty and not to the acquisition itself. The Service argued that the expenditures were incurred with the target’s corporate structure and that such expenditures are nondeductible capital expenditures, i.e., recapitalization followed by a reverse triangular merger. The Tax Court rejected both parties’ argument and adopted a rule that requires capitalization of any costs excepted to produce a benefit to the corporation for more than one year. The fiduciary obligation to act in the best interests of the target for the long term was proof that the expenditures should be capitalized. The Third Circuit affirmed but only that basis that only such costs that are attributable to a “separate and distinct asset” which is either acquired, created or enhanced as a result of such costs, should be capitalized. The Supreme Court affirmed but rejected the Third Circuit’s “separate and distinct asset” test. The Court found that both the operational benefits from the acquisition as well as administrative savings from not having to deal with public shareholders under the facts, resulted in a sufficient long-term benefit requiring capitalization. Compare Norwest Corp. v. Comm’r, 111 T.C. 105 (1992), f.r’d sub. nom., Wells Fargo & Co. v. Comm’r, 224 F.3d 874 (8th Cir. 2000)(reversed Tax Court and held executive compensation paid by target to investigate the effects of acquisition target for services rendered before management’s approval not required to be capitalized. The salaries would have been paid whether or not the acquisition took place). See also Metrocorp, Inc. v. Comm’r, 116 T.C. 211 (2001). On defense costs involved in a “hostile” takeover see U.S. v. Federated Department Stores, Inc., 170 B.R. 331 (S.D. Ohio 1994); Santa Fe Pacific Gold Co. v. Comm’r, 132 T.C. 12 (2009)(taxpayer permitted to deduct under §§162/165 fees paid to company for termination of merger agreement; no long term benefits derived). See Lipton v. Brennenman, “Expenses Related to Failed Merger Defense Held to Be Deductible Despite INDOPCO,” 82 U.Tax’n 26 (1995). See also TAMs 9043003 and 9042004.

3. Private Letter Ruling 200953014 (9/15/2009)(application of preceding parts of the regulations to §263 and pertinent case law). The ruling
involved a reverse subsidiary merger with Merger Sub merging with and into the target corporation. The statement of facts acknowledged that the target was involved in a "covered transaction" per Treas. Reg. §1.263(a)-5(e)(3) which in substance was a "going private" transaction. It was also stated in the facts of the ruling that all transactions costs were paid or reimbursed by the target at or prior to closing. The target’s shareholders received cash from the Merger Sub. As to payments made by the taxpayer to service providers (including to legal counsel and financial advisers, among others), the PLR held that the amounts were deductible by the target, even if the services were engaged by the other parties in the merger, if the target could demonstrate that the services were rendered either to or on its behalf, and that the fees were paid for or reimbursed by the taxpayer. The Ruling also addressed the deductibility of investigatory pre-decisional due diligence costs. Unless such amounts were "inherently facilitative," they were immediately deductible if they took place before the earlier of either the date on which “a letter of intent, exclusivity agreement, or similar written communication” was executed, or the “date on which the material terms of the transaction . . . are authorized or approved by the taxpayer's board of directors . . .” In the ruling, the due diligence costs were deductible to the taxpayer if they occurred prior to the execution of the exclusivity agreement with the sponsors. Finally, the IRS held that capitalized costs paid for financing the transaction were to be allocated to each underlying debt instrument and were deductible over the term of each instrument under Treas. Reg. §1.446.-5.

4. See Notice 2004-18, 2004-1 C.B. 605. Guidance on capitalized transactions costs in a tax-free transaction. The final regulations under §263(a) do not address the treatment of amounts required to be capitalized in certain other transactions to which the regulations apply (for example, amounts required to be capitalized in tax-free transactions, costs of a target in a taxable stock acquisition, and stock issuance costs). The preamble to the final regulations states that the Service and Treasury Department intend to issue separate guidance to address the treatment of these amounts and will consider at that time whether such amounts should be eligible for the 15-year safe harbor amortization period described in Treas. Reg. §1.167(a)-3(b). The Notice noted the uncertainty over whether costs that facilitate certain tax-free and taxable transactions and other restructurings are required to be capitalized under §263 and in accordance with Treas. Reg. §1.263(a)-5. See, e.g., Treas. Reg. §1.263(a)-5(g)(2)(acquirer's capitalized transaction costs that facilitate a taxable asset acquisition increase the basis of the acquired assets). The Service and Treasury Department are considering the treatment of capitalized costs that facilitate the following transactions: (i) tax-free asset acquisitions and dispositions; (ii) taxable asset acquisitions and dispositions (see §1.263(a)-5(g) for the treatment of certain transaction costs in taxable asset acquisitions); (iii) Type B reorganizations and other tax-free stock
acquisitions and dispositions; (iv) (additional examples, including §§355, 305 and 332 transactions identified in Notice).

VII. USE OF CONTINGENT CONSIDERATION

A. Earn Out Techniques.

Frequently in an acquisition, the buyer offers the seller contingent consideration whereby part of the purchase price is withheld and paid on a deferred basis assuming certain conditions are satisfied. Typical forms of contingent consideration include amounts paid on the attainment of certain post-acquisition earnings (or "earn-out") of the target, sales, cash flow or similar measure or favorable resolution of contingent liabilities. Typically, there is a maximum "cap" on the amount of any such additional consideration. This form of acquisition can assist where the parties can not agree on the price and/or the seller wants to have a continuing participation in the business for a designated period of time. This technique may strengthen the position of the target board of directors against possible shareholder claims of breach of fiduciary duty if, within a short time after the acquisition, the target or its assets is sold by the acquiror for a price substantially higher than that paid in the acquisition.

1. Use of Contingent Consideration in Taxable Acquisitions.

a. For the Seller. Contingent payments are treated as additional proceeds of sale, increasing gain or reducing the amount of loss. Seller can potentially use installment method to report gain. Treas. Reg. §15A.453-1(c)(3) generally provides for recovery of basis in equal amounts for each payment period irrespective of the amount of payment. Burnet v. Logan, ("open transaction" reporting is generally unavailable). Outside of the installment sale area, the seller will generally be required to include as an amount realized (i) the value of all non-contingent payments (determined according to the "issue price" of the resulting indebtedness) and (ii) the fair market value of the contingent payments. Treas. Reg. §1.1001-1(g). "Open transaction" reporting is permitted but only in "rare and extraordinary" cases.

b. For the Buyer. The purchaser is permitted to increase tax basis by the issue price of the contingent debt instrument and by the principal amount of the additional contingent payments. Treas. Reg. §§1.1012-1(g), 1.1275-4(c)(7)(Ex. 1). Where adequate interest is not provided on each contingent payment, OID needs to be calculated as of the time that the amount and timing of the payment is fixed. Treas. Reg. §1.1275-4(c). For OID purposes, the fixed portion of the purchase price is treated as a separate debt instrument. See Treas. Reg. §1.1274-2(g). The second portion, i.e.,
the contingent payment, is treated as a payment of principal in an amount equal to the present value of the payment, determined by discounting the payment at the test rate (per Treas. Reg. § 1.1275-4(c)(ii)(B)) from the date the payment is made to the issue date. The remainder of the payment is treated as a payment of interest. Reg § 1.1275-4(c)(4)(ii)(A). Special rules apply to contingent payments that become fixed more than six months before they are due. Treas. Reg § 1.1275-4(c)(4)(iii). Contingent-stock-issue payments can give rise to imputed-interest income under § 483, although former Regulations § 1.483-2(a)(2) (which was applicable to § 483 before its revision in 1984) stated that such interest income would not constitute boot that destroyed reorganization status (i.e., it was severable from the principal payments that must consist solely of voting stock). If, however, the parties provided for interest at the specified minimum rate or higher (payable either in stock or, more dangerously, in cash), § 483 could be avoided.

2. Use in Tax-Free Acquisitions.

a. Continuity of Interest Requirement. The “continuity of interest” requirement of Treas. Reg. § 1.368-1(b) is met where there is continuing interest through stock ownership in the acquiring corporation by the target shareholders equal in value, as of the effective date of the reorganization, to at least 50% of the value of all of the formerly outstanding stock of the target. This test is made on an aggregate shareholder basis. Sales, redemptions, and other dispositions of stock occurring prior or subsequent to the exchange which are part of the plan of reorganization will be considered in determining whether there is a 50% continuing interest through stock ownership as of the effective date of the reorganization. The Service has issued guidelines on favorable rulings on contingent stock deals: (1) presence of business purpose for the delayed issue of stock (such as indeterminacy of values); (2) the delayed stock is payable within five years; (3) there is a ceiling on the number of shares that can be issued; (4) at least 50 percent of the maximum number of shares of each class of stock is issued in the initial distribution; (5) either the agreement is not assignable or the rights to additional shares are not readily marketable; (6) the rights can give rise only to the receipt of additional stock; and (7) the rights are given in exchange for stock or assets of the acquired corporation (not as disguised compensation, royalties, and the like). See Rev. Proc. 77-37, 1977-2 CB 568, modified by Rev. Proc. 84-42, 1984-1 CB 521 as also modified by Rev. Proc. 89-30, 1989-1 CB 895. See also Jacobs, “Escrows and Their Tax Consequences,” 39 NYU Inst.

b. Boot. Case law provides that contingent rights to acquire additional stock do not constitute boot when issued in connection with a reorganization or a § 351 exchange, since the rights issued to the taxpayer could only result in the issuance of additional stock. See Rev. Ruls. 66-112, 1966-1 CB 68; 67-90, 1967-1 CB 79 (issue of additional stock contingent on value of acquiring corporation's stock allowed); 73-205, 1973-1 CB 188 (contingent-stock payout based on adjustment in conversion ratio of convertible preferred did not result in boot). Where the rights are negotiable, however, the Service treats the contingent rights as boot.

c. Imputed Interest Rules. Contingent stock payments may result in application of §483. If the parties provide for interest at the minimum required rate or higher (payable either in stock or, more problematically, in cash), §483 could be avoided. See also §1275(a)(1)("debt instrument" requirement). Treas. Reg. §1.483-4(b)(Ex.2)(nonapplicability of §1275 on contingent stock payments). See Rev. Rul. 70-300, 1970-1 CB 125. Amounts treated as interest under §§ 354(a)(2)(B) and 354(a)(3)(C) are neither a "dividend" nor "gain."

d. Issuance of Shares in Escrow. IRS ruling policy here again is that at least 50% of maximum number of shares must be issued unconditionally, all shares must be distributed within five years and sellers must have dividend and voting rights while shares in escrow. See Rev. Proc. 77-37, supra. Since stock is issued as of closing date (and exchanging shareholders are entitled to dividends) no interest is imputed on shares issued into escrow. Rev. Rul. 70-120

B. Tracking Stock.

The term "tracking" stock refers to stock of one corporation (generally, the acquiror or its parent) designed so that its value, in major part, depends on the performance of another corporation (generally, the target, or a corporation, the assets of which consist solely or primarily of those formerly owned by the target). A dividend feature is structured based on the target corporation's profitability or earnings. A tracking stock arrangement is similar to an earn out using contingent stock. For income tax purposes, where tracking stock is part of a tax-free reorganization, the question is whether any tracking stock (deemed issued by the acquiring corporation) is treated as "stock" or "boot". Another possibility is that the arrangement is a partnership between the target shareholders receiving tracked stock and the issuer. Tracking stock arrangements have also been used to mimic
the results of a spin-off under §355 or as part of a Type E recapitalization. See PLRs 9422057, 9526032, 9727017, 8817007. See Rizzi, Developments in Tracking Stock, J. Corp. Tax’n (2001).

VIII. STATE AND LOCAL TAX PLANNING ISSUES.

A. In General. State tax planning issues are generally quite important in terms of deal structure for both taxable and non-taxable acquisitions. Moreover, where the target company is engaged in business and investment operations in multiple states, the due diligence concerns of the buyer and buyer’s counsel are heightened. From a tax planning standpoint, consideration is frequently given to forming a holding company for engaging in the acquisition, using pass through or defective entities for ownership of tangible and intangible property, restructuring to narrow the jurisdictions in which there is business nexus, taking into account combined/consolidated filing options and examining pertinent modifications of allocating and apportion income. Of course, sales tax and real estate transfer tax issues are always important items for consideration. In addition, carryover of state income tax attributes must be identified and taken into account.

B. Combined or Consolidated Reporting. Most states follow the Internal Revenue Code in computing a corporation’s taxable income. There may be differences, however, with respect to the treatment of outstanding net operating losses and other carryovers. Some jurisdictions do not require federal consolidated groups of corporations to file a combined or consolidated state income tax return. This will result in a discontinuity between federal and state taxable income. For consolidated groups, state income regimes may not respect the deferred intercompany transaction provisions. Some states will require each member to file a separate return. As to combined return states, in general the combined group can be more broadly defined than an affiliated group under §1504. This means that intercompany transactions may be deferred for state income tax purposes but not for federal income tax purposes.

C. Section 338(h)(10) Elections. Some states do not respect a §338(h)(10) election or perhaps will respect a the sale of a consolidated subsidiary’s stock under §338(h)(10) but not of the stock of an S corporation. If not respected, double taxation can result under state income tax law, i.e., tax on the deemed sale of target’s assets and also taxing the target’s former shareholder or shareholders on gain from the sale of target stock. Nearly all states will respect the election that can be made under §338(g).

D. Characterization of Gain or Loss. Where a stock sale is involved, the characterization of the gain or loss as either business or nonbusiness income for state income tax purposes will be important. In general, business income is apportioned among the states in which business operations are conducted by a three factor formula, based on property, sales and payroll. Nonbusiness income is allocated to the particular state where the income is derived. In general,
nonbusiness capital gains and losses from sales of intangible personal property such as stocks or bonds are allocable to the taxpayer’s state of principle business operations. For jurisdictions that have adopted UDITPA (Uniform Division of Income for Tax Purposes Act) there are rules that are used to separate business income from nonbusiness income. Under the transaction test, the nature of the transaction which generates the income takes priority. Under the functional test, the disposition of the assets must be an integral part of the taxpayer’s regular business operations in order to be characterized as business income. Some states apply one test or the other in given contexts and some apply both. This can result in differences in the characterization of gains and losses among the states.

E. Transaction Taxes Associated With Acquisition. Real estate transfer taxes, sales and use taxes, recording fees and taxes.

F. Successor Liability Statutes. Can be applied to both stock purchases and asset purchases; and of course mergers. Knowledge of notification and other requirements, which can vary significantly by state, is necessary to minimize potential exposure. It is commonly or universally understood by lawyers and their business clients that where a buyer purchases a target company’s or seller’s assets in a direct or “straight” asset purchase, that tax liabilities of the seller are not assumed absent a specific contractual provision to the contrary.

1. **Imputed Liability on Buyer in Purchasing Assets.** Under various provisions of state law, however, liability for state taxes may be imposed on the purchaser if the seller fails to pay them. One potential source of liability is Article 6 of the Uniform Commercial Code (UCC) for states that have adopted Article 6 or another form or variant of the same principle.

2. **Successor Liability Statutes.** Many states have enacted successor liability laws which impose, for example, sales-tax on the buyer’s purchase of a business’ assets. Successor liability statutes ordinary impose on the buyer the obligation to withhold from the purchase price an amount sufficient to cover the seller’s liabilities for unpaid or accrued sales tax unless the seller provides the purchaser a certificate issued by the state revenue department stating that no tax is due. The parties may agree to forego the certificate procedure and make provision for the contingent liability via an indemnity and/or escrow. In some jurisdictions the certificate procedure is mandatory. See, e.g., N.Y.S. Tax Law §1141. A common issue under the states’ successor liability statutes is their application to assets acquired via foreclosure, repossession or similar enforcement action where a secured creditor acquires the asset(s) of a delinquent business owner. See, e.g., LKS Pizza, Inc. v. Commonwealth of Kentucky, 169 SW3d 46, 47 (Ky.App. 2005); In re McKeever, 819 P.2d 482 (Ariz. 1991)(lessor’s repossession of leased premises and operation of business was not a “purchase” for purposes of the statute); State v. Standard Oil Co., 313
G. SALT Compliance Issues of Target or Seller. The seller will be expected to identify and warrant while the buyer must exercise due diligence to confirm or determine the presence of outstanding state and local tax audits, litigation, potential claims for refund. Franchise and capital stock tax issues. This would include managed audit agreements, negotiated filing agreements, letter rulings and voluntary disclosures. Parties in the Acquisition Agreement should negotiate issues as to whether the buyer or the seller or target will be responsible for handling pending and pre-closing year audits and potential litigation on SALT matters. This would include sales tax, personal property tax, ad valorem taxes, license filings, regulatory filings, employment (state withholding and unemployment) taxes. This would be part of the representation and warranty process as well and the tax indemnification agreement. Where refund claims are generated for pre-closing periods, the seller should negotiate the right to receive such funds. Again, who will be responsible for the handling of the claims, litigation and who will bear the costs?

1. Licensing of Intangibles. In Geoffrey, Inc. v. South Carolina Tax Commission, 437 SE 2d 13 (S.C. 1993), cert. den. 510 U.S. 992 (1993) the taxpayer was a Delaware corporation formed to hold and manage trademarks of Toys “R” US. A wholly-owned second tier subsidiary, Geoffrey was incorporated in Delaware and had no employees or offices in South Carolina nor had any tangible property in South Carolina. Geoffrey licensed trademarks in its U.S. business (except for 5 states) to Toys “R” US for licensing fees. Toys “R” US paid South Carolina income tax on its revenues from store operations in South Carolina and deducted the royalty payments made to Geoffrey, Inc. South Carolina argued that it could tax the royalty income of Geoffrey as its use of its intangibles in the state was sufficient “nexus”. Geoffrey, Inc. argued such income tax assessment violated the Due Process and Commerce Clause. The South Carolina, responding to the due process argument, cited Quill Corp. v. North Dakota, 504 US 298 (1992), and found that the nexus requirement of the Due Process Clause can be met even in instances where the taxpayer has no physical presence in the taxing jurisdiction where the corporation has purposefully directed its activity at the jurisdiction’s economic location or “forum”. The South Carolina Supreme Court also found that the presence of Geoffrey’s Inc. intangible property in South
Carolina was an alternative ground for finding that the due process clause was satisfied.

See also Geoffrey, Inc. v. Commissioner of Revenue, 899 NE2d 87 (Sup. Jud. Crt. Mass. 2009) (per sibling holding in Capital One Bank, the commerce clause, art 1, § 8, of the United States Constitution, does not bar Massachusetts from imposing its corporate excise tax (Mass. G.L. c. 63, §39) on a foreign corporation, a wholly-owned subsidiary of Toy R Us, that does not have a physical presence in Massachusetts). See Capital One Bank v. Commissioner of Revenue, ante, (2008) (Capital One)(decided on same day as Geoffrey, supra, Mass. Supreme Court held that the constitutionality, under the commerce clause, of Massachusetts’s right to impose an income based excise on an out-of-State entity is not determined by the “physical presence” test articulated in Quill Corp. v. North Dakota, 504 U.S. 298, 317-318 (1992) (Quill), but by the “substantial nexus” test articulated in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977). Case involved licensing of trademarks, trade names and service marks to wholly owned subsidiary having an appraised value (7 years after transfer of $1.5 billion). Related issues involve the taxation of “cloud computing” and similar agreements for access to software, data and data processing; the location of computer servers, software and computer users. A&F Trademark, Inc. v. Tolson, 605 S.E.2d 187, cert. den. 126 S.Ct. 353 (U.S.2005)(North Carolina not barred under the commerce clause or due process clause to tax the royalty income of out of state intangible holding company on royalties earned from trademarks related to business conducted in North Carolina and that the income had been apportioned to North Carolina properly). See, Amdur, “State Income Tax Treatment of Intangible Holding Companies, 11 A.L.R. 6th 543(2006).

2. Income and Franchise Taxes of Target or Seller. Would require an indepth review of apportionment formulas, cumulative apportionment percentage, computation of apportionment factor numerators, denominators and supporting documentation, unitary business grouping, etc. Consideration of sourcing issues from sales of inventory, provision of services, income from intangibles, etc.


H. Purchase or Ownership of Partnership Interests or Interests in Unincorporated Entities. Where the seller or target company owns one or more interests in an entity taxable as a partnership for federal (and state) income tax purposes, it will be important to consider whether the prior years K-1s are correct as well as in evaluating whether there are other tax attributes or tax risks or liabilities that must be taken into account.
1. **Resident Partners/ Resident LLC Members.** Most states will tax a resident partner's distributive share of partnership income regardless of the state in which the income was earned. In cases involving partners who changed their state of residence, it was held that a former resident was subject to a state's income tax on his or her distributive share of deferred partnership income that accrued before his or her change of residence and that a former partner who withdrew from an out-of-state partnership was subject to a state's income tax on income received from the partnership after becoming a resident of the state. To eliminate double taxation, most states allow a resident partner an income tax credit for income taxes paid to another jurisdiction on the same income taxed by the state of resident but such may not always be the case. Moreover, a state may deny a partner a foreign tax credit for income taxes paid to a foreign country from the income of the partnership doing business in such foreign country.

2. **Non-Resident Partners/ Non-Resident LLC Members.** Many states will also impose its income tax on nonresident partners on their distributive shares of partnership income derived from sources in the state. There have been cases on the question and generally have resulted in favor of the taxing jurisdiction. These decisions have had to address several issues: (i) whether the partnership at issue was doing business in the taxing state; (ii) whether the income sought to be taxed was part of the partner's distributive share of partnership income; and (iii) the extent to which the partnership's income was derived from sources within the taxing state. There have been decisions where certain types of income received by a nonresident partner from a partnership doing business in a particular state were not taxable by that state. A nonresident partner also may realize income from the disposition of an interest in a partnership doing business in the taxing state. Yet there are decisions holding that a nonresident partner's gain on the sale of an interest in a limited partnership operating in the state was not taxable by the state.

3. **Guaranteed Payments.** Under §707(c), a guaranteed payment is a payment made to a partners determined without regard to the partnership's income, by a partnership to a partner for services or the use of capital. Guaranteed payments are considered as being made to a nonpartner, but only for the purposes of certain specified Code §§. For most other federal income tax purposes, guaranteed payments are regarded as a partner's distributive share of partnership ordinary income, but certain federal court decisions have treated guaranteed payments for services as compensation. For state income tax purposes, if a guaranteed payment to a nonresident partner of a partnership that is doing business in the taxing state is regarded as compensation for services performed outside the taxing state, not as a distributive share of partnership income, the source of the income generally will be the location where the services were performed. If a guaranteed payment to such a partner is regarded as compensation for the
use of capital, the source of the income generally would be the partner's domicile. In either situation, the payment would not be subject to the taxing state's income tax. To prevent this result, a number of states have enacted statutes that provide that, in determining the sources of a nonresident partner's income, no effect shall be given to a provision in the partnership agreement that characterizes payments to the partner as being for services or for the use of capital. Consequently, courts have held that various types of partnership payments alleged by nonresident partners to be guaranteed payments for services performed outside the state were part of the partner's distributive share of partnership income, and thus were subject to the state's income tax. Similarly interest paid by a partnership to a nonresident partner on the partner's capital contribution may be subject to state income tax.

4. Payments To Non-Resident Partners Not Subject to State Income Tax. There are decisions which have held that income received by a nonresident partner from a partnership doing business in the state was not taxable by the state: (i) foreign earned income allowance under §911; (ii) foreign housing allowances; (iii) a partner's distributive share of partnership's gain on the redemption of corporate stock; (iv) income from a partner's securities held by the partnership; (v) payment for a nonresident partner's services rendered before becoming a partner; and (vi) pensions paid to retired partners.

5. Extent Partnership Income Derived From Sources Within Taxing Jurisdiction. A nonresident partner's distributive share of "in-state" business income is taxable by the state only to that extent. Where partnership income is derived from sources both within and without the taxing state, a portion of the income is attributed to the state in which the income was deemed to be derived, perhaps under a formula set forth in applicable regulations. Courts have held that the in-state portion of the partnership in issue was properly determined by "direct accounting" (also called "separate accounting"), that is, by accounting records that segregate the partnership's in-state and out-of-state operations or by applying an apportionment formula to the total income.

6. Nonresident Partner's Disposition of Interest in Partnership. A nonresident partner also may realize income from the disposition of an interest in a partnership doing business in the state. Decisions go both ways. A corporation generally is subject to a state's income tax if it is a partner in a partnership doing business in the state.

7. Multi-jurisdictional Operations. In general, it may be stated that a state may impose its income tax only on the portion of a multistate corporation's income that is attributable to the state, i.e., under the Uniform Division of Income for Tax Purposes Act (UDITPA) or similar
statutory provision. Under UDITPA, "business income" includes "income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations." In general, business income is apportioned under a three factor formula; property, gross sales and payroll of the taxpayer in the taxing state during the tax year (the numerator) as compared with the total dollar amount of such element for the taxpayer everywhere during the tax year (the denominator). All other income is "nonbusiness income," which is "allocated" or assigned to the particular state deemed to be the situs of such income. UDITPA also is incorporated into the Multistate Tax Compact, the voluntary interstate compact created to promote uniformity in state taxation.

As to a multistate corporation which is a partner in a partnership, the courts have, in general, taken the view that the corporation's distributive share of the partnership's income and loss was "business income," apportionable as part of the corporation's income. In addition, in making the apportionment, the corporate partner's proportionate share of the partnership's property, payroll, and sales factors should be included in the corporation's apportionment factors overall. On the other hand, there is authority that, under a particular state's statutes, a corporate limited partner's distributive share of a partnership's loss from business conducted outside the taxing state was attributed to the partnership's out-of-state situs. In cases in which the issue was whether a corporate partner's gain on the sale of an interest in a partnership doing business in the taxing state was "business income," apportionable in part to the taxing state, or "nonbusiness income," allocable to the state of the corporation's commercial domicile, the courts held that the gains in issue were nonbusiness income.

The buyer and buyer's Tax Counsel and Accountant must make a careful review of the partnership tax returns and reporting positions made not only by the partnership in which the target is a member, but also how the target is further affected in making its proper allocations for apportionment for state income tax purposes.

IX. DUE DILIGENCE REQUESTS ON TAX MATTERS MADE BY BUYER'S COUNSEL IN CONNECTION WITH ACQUISITION.

A. Due Diligence Requests Related to Stock Acquisition or Merger Treated As a Tax-Free Reorganization. The following sets forth a list of items for consideration as part of a due diligence request in an acquisition primarily related to federal (but also state) income tax and related tax matters. There is quite a lot to consider and it is fair to say that the list is not all inclusive. In addition to the
formal list, buyer's counsel will want to have the buyer's accounting firm and well as tax counsel interview key accounting advisors and tax advisors for the target. Seller's tax counsel should explain to the client that if there is any item of sensitivity, the matter should be discussed with tax counsel before any disclosure takes place. Sensitivity to this, as with all potential liability questions, should be entertained by legal counsel for seller prior to entering into any LOI. If there is a sensitive matter and if it is asked to be produced, seller may have to insist on a "non-qualified, escape" provision as part of the LOI without cost to the seller. ( Portions of outline on VII and VIII taken from Bodoh, Dixon, Steinberg and Zarlenaga, "Traps for the Unwary in M&A Agreements", ALI-ABA Course of Study, April 2009 (Westlaw SP051 ALI-ABA 433).

1. General Production Requests.

   a. Business Overview Information.

      (1) SEC Filings (10K and 10Q)

      (2) Prior audited financials. Also internal financials.

      (3) Annual reports.

      (4) Other general information. Company brochures, website materials.

      (5) Credit reports on Target (buyer).

   b. Entity Structure Chart. Determine the extent to which there are any consolidated affiliates, brother-sister affiliates, single member entities, foreign entities, including foreign subsidiaries, hybrid or reverse hybrid entities, joint ventures, branches, foreign per se corporations. For example, a German GmbH (Gesellschaft mit beschränkter Haftung) is taxed as a corporation under German tax law but is not a per se foreign corporation under the CTB regulations and may either be a corporation or partnership or defective entity for U.S. tax purposes. See Treas. Reg. §§301.7701-2(a)(business entities); -2(b)(8)(foreign "per se" corporations; -2(b)(9)(business entities with multiple charters); -2(c)(other business entities).

      (1) Entities Eligible for Treaty Benefits. In general, an entity may derive benefits under a particular income tax treaty provided it is a "resident" of one of the contracting states. See, e.g., U.S. Model Income Tax Convention of 2006, Art. 1(1); OECD Model Tax Convention on Income and Capital, Article 1 (OECD 2005). A business entity is a "resident" of a country for this purpose if "under the laws
of that State, [it] is liable to tax...by reason of [its] domicile,...place of management, place of incorporation, or any other criterion of a similar nature,” but not if it “is liable to tax in that State in respect only of income from sources in that State or of profits attributable to a permanent establishment in that State”. U.S. Model Treaty, Article 4(1); OECD Model Treaty, Article 4(1). See also Rev. Rul. 2004-76, 2004-31 IRB 111 (corporation organized under laws of country X which has its place of effective management in country Y, and although it was resident of both countries under their domestic tax laws, X- & treaty tie breaker favored Y as the country of “residence; therefore, corporation was not entitled to benefits of U.S.-X income tax treaty.

(2) Production of Entity Classification elections (Forms 8832)
(3) Production of Subchapter S Elections (Form 2553). See discussion below on due diligence of S corporation status.
(4) Production of IC-DISC Election. §8991-996. A domestic corporation is eligible for the DISC deferral benefits where: (i) it timely files a DISC election; (ii) its qualified export assets represent 95% of its gross receipts; (iii) its QESs represent 95% of the adjusted basis of its assets on the last day of its taxable year; (iv) it only has one class of stock and the par value of such stock is at least $2,500; (v) it maintains its own bank account; (vi) maintains its own books and records; and (vii) has a taxable year which is the same of the shareholder owning the highest percentage of voting stock. See, August and Antaramian, “Choice of Entity for Engaging in Business Operations Outside the United States”, Bus.Ent. (Mar/Apr. 2008).
(5) Investment in Foreign Corporations or Entities. Determine whether entity is a controlled foreign corporation (§§951-959, 960, 962, 78); is an ownership interest in a passive foreign investment company or PFIC, and if so, whether the seller has made a QEF election under §1295. (Form 8621; information return by a shareholder of a PFIC or QEF) If one or more CFCs are involved, then production of all Forms 5471 will be necessary to review. The target may also have a subsidiary or may itself be a member in a foreign partnership (Form 8865, return of U.S. persons with respect to certain foreign partnerships).
(6) **FBAR Reports.** Production of FBAR filings or disclosure of non-filings that were required or were exempt, for the past 5 years, including corporate officers filing FBARs who have signature authority over any FBAR reports.

(7) **FATCA Filings.** While §6038D is directed towards "individuals" who holds any interest in a specified foreign financial account which accounts in the aggregate exceed $50,000 (or such higher dollar amount as the Secretary may prescribe), §6038D(f) provides that the regulations or other guidance may apply §6038D to any domestic entity formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets, in the same manner as if such entity were an individual. See Temp. Reg. §1.6038D-1T(a)(12)(specified domestic entity [reserved]).

(8) **Foreign Owned Domestic Corporation Filings/Record Keeping Requirement.** §6038A provides that if at any time during a taxable year a corporation, a/k/a “reporting corporation”, is a domestic corporation and is 25% foreign owned, such corporation must furnish information required in §6038A(b) and must maintain (in the location, manner and to the extent provided in the regulations) such records as may be appropriate to determine the correct treatment of transactions with related parties as the regulations prescribe or shall cause instead another person to so maintain such records. Required information includes the name, principal place of business, nature of business, and country or countries in which organized or resident, of each person which (A) is a related party to the reporting corporation, and (B) had any transaction with the reporting corporation during its taxable year. The other information that IRS may require may include, but is not limited to, information regarding the allocation and apportionment of deductible expenses (including the computation of deductible interest) to the U.S. branch of a foreign corporation. The penalty for failure to furnish the required information or maintain the records is $10,000 for each taxable year for which a failure occurs and is increased where failure continues after notification. §6038A(d). The purpose of these rules is to have all foreign corporations doing business in the U.S. subject to similar tax treatment as foreign corporations operating in the U.S. through U.S. subsidiaries and to ensure that foreign corporations' gross income and deductions attributable to their U.S. trade or business are properly determined.
(9) **Tax Withholding Production.** Certain payments made to non-U.S. persons will be subject to withholding and at specified rates. See §§1441, 1442, 1445, 1445, 897, 884. In the United States, there are multiple forms of withholding tax that range from withholding on U.S. earned income to withholding on the sale of real property owned by non-U.S. persons. Among the required withholdings are: (i) §1441 withholding on FDAP (see Rev. Proc. 2000-12) (and pertinent exemptions); (ii) §3406 U.S. backup withholding; (iii) §1445 FIRPTA withholding; (iv) §1446 partnership withholding (See Rev. Proc. 2003-64); and (v) §1471, et seq. FATCA withholding. See also §§1443 or 1461.

(a) List of payees, address, residence, nationality

(b) Type of withholding including forms filed with IRS

(c) Any and all W-8Ben forms received

(d) For payees that are entities, the classification of each entity and the beneficial owner of the payment under the rules of the foreign country involved. See Treas. Reg. §1.1441-6(b)(2).

(e) Designations of any U.S. payees and proof of same. All Forms W-9 (withholding not required if U.S payee provides a properly filled out Form W-9. Treas. Reg. §1.1441-1(d)(1). Proof of received of required documentation prior to payment; compliance with electronic confirmation procedures; and no notice from IRS that withholding certificate is incorrect or unreliable. Treas. Reg. §1.1441-1(e)(1)(ii)(B). See also Form W-8ECI (beneficial owner to identify ECI with U.S. trade or business).

(f) Effectively Connected Income Withholding Issues. ECI is not subject to withholding. However, ECI attributable to a U.S. trade or business that is not a permanent establishment under an income tax treaty is not exempt from withholding. Treas. Reg. §1.1441-4(a)(1). A Form W-8ECI (proposed) is required to be filed by the beneficial owner of the income and filed prior to payment to avoid withholding unless the withholding agent has actual knowledge or reason to know that the beneficial
owner is exempt from withholding. If the W-8ECI is not filed “prior” to the payment, 30% withholding is presumed to be the required result. Treas. Reg. §1.1441-4(a)(2).

(g) Filing of Forms 1041 and 1042-S for each year. A withholding agent must file an income tax return on Form 1042 (annual withholding return for U.S. source income of foreign persons) for income paid during the preceding year that the withholding agent is required to report on Form 1042-S (foreign person’s U.S. source income subject to withholding). Due date is 3/16 of each year following the year in which the income was paid. Withholding certificates or other statements or information provided to a withholding agent are not required to be attached to the return. A return must be filed even though no tax was required to be withheld during the preceding calendar year. The information required to be filed is substantial and each recipient must be identified on Form 1042-S as either: (i) a foreign beneficial owner, including a foreign estate or foreign accumulation trust; (ii) a qualified intermediary; (iii) a withholding foreign partnership; (iv) an authorized foreign agent; (v) a U.S. branch treated as a U.S. person; (vi) a nonwithholding foreign partnership or simple trust (but only to the extent income is ETB; (vii) a payee; and presumed to be a foreign person.

(h) Foreign Partner Withholding. Under §1446 a U.S. partnership or foreign partnership doing business in the U.S. is required to withhold on the partnership’s ECI allocable to its foreign partners for the tax year involved. §1446(a). The withholding is required to be taken at the highest applicable U.S. income tax rate on the “net” taxable income ECI regardless of whether any distributions are made attributable to such net income. See Treas. Reg. §1.1446-2. See Form 8804-C. T.D. 9394 (4/29/2008).

(i) FATCA Withholding and Information Filings (Chapter 4 of Subtitle A, §§1471 through 1474). Applies with and in addition to the current withholding rules including the partnership
withholding under §1446. Under Chapter 4, a withholding agent, including a partnership, is required to withhold 30% of any "withholdable payment" made to a foreign financial institution (FFI) or to a non-financial foreign entity (NFFE). Withholdable payments include U.S. source FDAP and gross proceeds from the sale of assets that could produce U.S. source interest or dividend income but do not include ECI. Withholding under FATCA can be avoided if the FFI enters into an agreement with the IRS to report information on U.S. accounts and to withhold on certain pass through payments. Withholding can also be avoided if NFFEs provide information on their substantial U.S. owners. But this is under the FATCA provisions. Final regulations were promulgated in January 2013. See T.D. 9610 (1/28/2013). The United States has also agreed to enter into certain "intergovernmental agreements" or IGAs of which there are two models so that the information from FFIs can be provided to their foreign tax administrators and then forwarded under the IGA to the U.S. There is a unilateral and bilateral form of information exchange.

(j)  FIRPTA Withholding §1445. Under §897, the sale of U.S. real property by a non-U.S. person or sale of stock of a U.S. real property holding corporation as defined, subjects the non-U.S. person to U.S. income tax on the gain as if the income was ETB. A withholding regime is applied on such gains or income under §1445(a) See Treas. Regs. §§ 1.1445-1 through 1.1445-8. See also Treas. Reg §1.1445-10T and Treas. Reg §1.1445-11T. When a U.S. real property interest (USRPI) is acquired from a foreign person, the transferee must withhold an amount equal to the lesser of: (i) 10% of the amount realized on the disposition, or (ii) the transferor's maximum tax liability, i.e., the maximum amount that the IRS determines the transferor could owe on its gain on the sale, plus the transferor's unsatisfied prior withholding tax liability as to that interest. The withholding under §1445 can not exceed the transferor's maximum tax liability as set forth (by request to the IRS) under §1445(c)(1)(B). See §1445(c). Taxes withheld must be reported and paid
over by the 20th day after the date of transfer. Production from the seller of any and all Forms 8288 and 8288-A is necessary. These forms are required to be filed to identify by number and name, address, etc. both the transferor and the transferee. Treas. Reg. §1.1445-1(c)(1) . See also §1461, §7202. No withholding is required if the amount realized is zero. Note that the person owning the USRPI can elect to treat its interest as a U.S. trade or business for all purposes of the Code. Exemptions are provided in §897(b) for: (i) the furnishing by the transferor of a nonforeign affidavit (§897(b)(2); (ii) affidavit provided by nonpublicly traded domestic corporation that its interests in corporation is not a USRPI (§897(b)(3)); (iii) transferee timely receives “qualifying statement” prior to or at closing. See §§897(b)(4), 897(b)(4)(B)(qualifying statement); (iv) the “residence” under $300,000 in value exemption (§897(b)(5)); and (vi) regularly traded stock on established securities market exception (§897(b)(6)).

Note: Not only should the buyer's due diligence team determine if the proper withholding was made by the seller but also whether any of its assets are subject to withholding or other informational return requirements, i.e., foreign subsidiary’s ownership in U.S. real property, etc.

Note: Inter§ with FATCA. Under Treas. Reg. §1.1474-6(c), an amount subject to withholding under §1445 is not subject to withholding under FATCA (Chapter 4). Also, a withholdable payment or a foreign pass thru payment subject to withholding under §1446 is not subject to FATCA withholding. See Treas. Reg. §1.1474-6(d).

c. **Capitalization and Equity Ownership.**

(1) **Foreign Ownership.** Will require detailed review of proper withholding, claims of tax treaty benefits, Form W-8BEN, examination of relevant treaties.

(2) **Where Target is an S Corporation.** Shareholder and entity level eligibility rules satisfied, see discussion below.
d. **Entity by Entity Estimates of Fair Market Value, Tax Basis in Assets, Earnings and Profits, Calculations of AMT (and AMT credits).** Presence of tax carryovers, tax elections made by target, etc. Other tax attributes.

e. **Prior Years' Income Tax and Informational Returns.**

1. United States filings, including income, employment and excise tax returns.

2. IRS and state outstanding audit reports, waivers of statute of limitations (Forms 870 and 870AD), pending appeals procedures, litigation proceedings, outstanding closing agreements and compromises.

3. Filings in all foreign countries

4. Filings in all states, including sales and use tax, income tax, franchise tax, etc.

5. Decision as to the number of years required to be produced. Minimally, for the required statute of limitations with respect to such return perhaps assuming that there could be a 6 year statute. Consider special situations such as the statute of limitations for a non-filed CFC schedule Form 5471.


7. Private letter ruling requests, denials, and issued PLRs.

f. **Accounting Methods and Accounting Periods.**

g. **Expensing versus Capitalization Issues.** See §§195, 263.

h. **Consolidated Return Issues**

1. Production of all consolidated income tax returns (federal and state).

2. Workpapers and schedules reconciling investment basis account adjustments as well as earnings and profits; production of any IBA study; earnings and profits study;

3. Production of any §382 study;
(4) Production of any tax basis or earnings and profits studies;

(5) Review of estimated tax payments for open years;

(6) Deferred intercompany transactions outstanding

(7) List of deferred intercompany transactions that would be accelerated as a result of the acquisition

(8) History of capital contributions, dividends, loan between common parent and target as well as other members of the group.

(9) Tax sharing agreements relevant to the consolidated group and any such agreement to which the common parent or the target was a party with respect to a predecessor group

(10) Reconciliation schedule for tax sharing payments, credits, outstanding liabilities, claims for refund, etc.

(11) Tax reserve assessment, including potential penalties and interest.

i. **Transfer Pricing Issues**

(1) Any and all intercompany or affiliate agreements, e.g., services, sales, loans, rental agreements, royalty agreements, licenses, intangibles agreements, cost-sharing agreements under Treas. Reg. §1.482-7.

(2) All transfer pricing valuations and expert reports; backup economic analysis and under the regulations to support arms-length dealings;

(3) Presence of APA Agreements

(4) International transfer pricing arrangements; application of pertinent tax treaties, limitation of benefits or treaty shopping issues.

(5) Any and all pending transfer pricing audits, appeals or potential litigation both within and without the states of operations, including international transfer pricing audits, appeals, etc.

i. **State and Local Tax Issues.**
j. Target Corporation's Accountants Workpapers. Documents prepared or obtained by the auditor in examining the client's financial records and in preparing tax returns and related filings. Workpapers are generally considered by the IRS to be "required records" under §6001. Work papers include schedules, analyses, transcriptions, memos, and confirmation results related to balance sheet and income statements and serve as the basis of the work performed and support the accountant's opinion. They may also include the nature, timing and extent of the auditing procedures performed and conclusions reached. Work papers may be in the form of data stored on paper, film, computer disk or CD, electronic media or other media.

k. Target Corporation's Tax Accrual Workpapers. In filing financial statements with the SEC, 15 U.S.C. § 781, public companies are required, by SEC regulations, to have their independent accountant firms verify that the financial statements have been issued in accordance with Generally Accepted Auditing Principles (GAAP), 17 C.F.R. § 210.1-02(d). As part of such financial statement production, the balance sheet must provide for contingent future tax liabilities beyond the tax liabilities reported on filed returns. To comply with the securities laws, therefore, a public company must prepare in-house or have prepared by outside auditors an analysis of their contingent tax liabilities. The analysis pinpoints the soft spots on the corporation's tax returns and indicates those areas in which the taxpayer has taken a position that may, on challenge, negotiation, or litigation, require the payment of more taxes. The analysis is known in the trade as the tax pool analysis, the noncurrent tax account, or tax accrual work papers. The Service has, in this area, maintained that it will seek TAWs and FIN 48 (ASC 70) workpapers and opinions under its policy of restraint. IRM, §4.10.20.3. See Jaworski, "Panel Debates Effect of FIN 48 on Transparency, Compliance" 116 Tax Notes 237 (7/23/07).

(1) FIN 48 (June 2006). In June 2006, the Financial Accounting Standards Board (FASB) approved the final version of FIN 48 (under FASB Statement 109 (1992)) for generally accepted accounting reporting principles with respect to uncertain tax positions. FIN 48 is effective for fiscal years beginning after 12/15/06 for public companies, and for fiscal years beginning on 1/1/07 (CHECK) for non-publicly traded or privately held calendar-year companies. FIN 48 applies not only to companies whose shares of stock are publicly traded and therefore are registered with the SEC in reporting "fair value" filings, but also to all
entities and enterprises that report financial results under GAAP. The scope of FIN 48 extends to all entities that use the GAAP method for financial accounting purposes, including tax-exempt organizations and pass-through entities.

(2) **ASC 740: GAAP Accounting for Taxes (Formerly FAS 109).** Set of financial accounting and reporting standards for the effects of income taxes that result from a company’s activities during the current and preceding years. Its primary objective is to recognize the amount of taxes payable or refundable for the current year and the deferred tax assets and liabilities relating to the future tax consequences of events that have been recognized in a company’s financial statements or tax returns.

(3) **Methodology.** In general, a two-step process: (i) step one: recognition: it is more likely than not that a tax liability has been incurred at the date of the financial statements; and, if so (ii) step two: measurement, i.e., the amount of the tax cost to the item can be reasonably estimated, etc. In setting forth this new and higher GAAP standard, FASB 109 required reporting companies to recognize on their financial statements the best estimate of their tax positions. In abandoning the prior calculus of whether a tax item would probably, or reasonably possibly, or remotely possibly survive IRS review, FIN 48 establishes a “recognition” or “nonrecognition” approach. For recognition of a tax position, the particular “unit of account” or item must have a more-likely-than-not chance of being sustained on the merits through audit, administrative, and judicial review. Where the position is “recognized,” the next or second step is to measure the expected benefit. Where the position or portion not to be recognized is then treated as a separate liability on the balance sheet. FIN 48 provides a detailed set of principles and applicable rules in determining how to treat uncertain tax items, referred to as “units of account,” and sets forth a two-step process to recognize and measure a tax position taken or expected to be taken on a tax return. FIN 48 is divided into various categories or segments, including guidance on the subjects of: (a) recognition; (b) derecognition; (c) classification; (d) interest and penalties; (e) accounting in interim periods; (f) disclosure; and (g) transition.
In general, differences in financial and tax accounting with respect to uncertain tax items will result in: (1) An increase in a liability for income taxes payable or a reduction of an anticipated income tax refund. (2) A reduction in a deferred tax asset or increase in a deferred tax liability. FIN 48 applies to “tax positions” contained in a previously filed tax return or a position that will result in a permanent reduction in taxes currently payable or a deferral of income taxes to be paid until a future year. The tax liability for uncertain tax positions under FIN 48. The production of tax accrual workpapers as well as FIN 48 workpapers involves waiver of the attorney-client privilege, work product doctrine and possibly the accountant-client privilege under §7525 as well as under state law. See August and Grimes, “Ability of IRS to Discover Tax Accrual and FIN 48 Workpapers”, Bus.Ent. (Nov./Dec. 2008). See also, Arthur Young & Co. v. U.S., 465 U.S. 805 (1984), aff’d and rev’d in part and remand’g 677 F.2d 211 (2nd Cir. 1982); Textron, Inc. v. Comm’r, 117 T.C. 67 (2001); Textron, Inc. 336 F3d 26 (1st Cir. 2003); Valero Energy Corp., 100 AFTR2d 2007-6473 (DC III., 2007).

This ultimately produces the tax reserve amount (deferred tax liabilities and deferred tax assets which are reflected on the target corporation’s balance sheet).

I. Uncertain Tax Positions. As now required on certain returns, i.e., the taxpayer has assets of at least $10M, the affected taxpayers are required to provide the IRS with a roadmap of areas to cover as part of an audit, and includes the taxpayer’s admission that the answers to the now disclosed positions are “uncertain”. See IRS Announc. 2010-30, 2010-19 IRB 668 (2010). In TD 9510 the Service issued the UTP requirements for certain corporations. The UTP instructions state that a complete and accurate disclosure on a particular tax year’s Schedule UTP will be treated as if the taxpayer filed a Form 8275, Disclosure Statement, or Form 8275-4, Regulation disclosure statement. See August, “The Uncertain State of Uncertain Tax Positions”, Bus. Ent. (May/Jun 2011).

m. Productions of all Listed or Reportable Transactions, or Transactions of Interest.

(1) Reportable Transactions. Treas. Reg. §1.6011-4. Reportable transactions include: (i) listed transactions; (ii) confidential transactions; (iii) loss transactions; (iv) transfers of interest entered into after November 1, 2006;
and (v) under proposed regulations certain patented transactions. Prop. Reg. §1.6011-4(a)(3).

(2) **Material Advisor Rules Can Affect Seller’s Counsel, Buyer’s Counsel.** See §6111. A “material advisor” with respect to a reportable transaction who receives compensation in excess of $50,000 for services rendered to individuals or pass thru entities, or $250,000 in all other cases, including corporations, must file Form 8918 with the IRS (such dollar amounts are reduced to $10,000 and $25,000 respectively for listed transactions. Treas. Reg. §301.6111-3. A material advisor is required to maintain a list for seven years for inspection for the IRS of those person for whom the advisor filed tax disclosure statements and additional information. See §6112. As to potential fines and penalties see §§6707A, 6709.

n. **Current Audits with Taxing Authorities.**

(1) Status of audit, issues, potential cost, including tax, interest and penalties. Access to taxpayer’s representative.

(2) **Litigation.** Access to taxpayer’s tax counsel.

(3) **Refund claims (and status).** Access to taxpayer’s representative.

(4) **Refund suits (and status).** Access to taxpayer’s tax counsel.

(5) **Potential criminal tax or related investigations, prosecutions.** Should target provide explanation? Waiver issues. Risks with confidentiality agreement?

o. **Information and Documentation Pertaining to Prior Acquisitions, Divestitures, Reorganizations, Whether Taxable or Not.**

p. **Calculation of Foreign Tax Credit Amounts, Including Carryovers, Excess Foreign Losses, and Excess Domestic Losses.**

(2) **Was the FTCs properly “claimed”?** See Forms 1116 (individual) and 1118 (corporation). This form must be attached to the taxpayer’s annual return.

(3) **Technical Taxpayer Test.** See Treas. Reg. §1.901-2(f)(1), §909.

(4) **Statute of Limitations Issues.** For FTCs, §6511(d)(3) extends the normal 3 year statute of limitations for refund claimed for FTCs to 10 years. Where the FTC election is changed, i.e., reduced and such change results in additional tax liability in earlier years, interest could be due as well. See General Dynamics Corp. v. U.S. 562 F.2d 1201 (Ct. Cl. 1977).

(5) **Limitations on Use of FTC.**
   
   (a) Overall limitation under §904(d).
   
   (b) Basket limitation rules under §904(d)(1).
   
   (c) Overall Foreign Loss Recapture. §904(f).
   
   (d) Overall Domestic Loss Rules. §904(g).
   
   (e) Carryover Rules. Forward 10, back 1.
   
   (f) Anti-Treaty Shopping Rules. §901(l)(1).
   
   (g) FTC Splitting Provision. §909.
   
   (h) § 901(m). Loss of FTC on foreign income not subject to U.S. taxation by reason of covered asset acquisitions. A “covered asset acquisition”, per §901(m)(2), means a qualified stock purchase per §338(d)(3) to which §338(a) applies, any transaction which is treated as an acquisition of assets and is treated as the acquisition of stock of a corporation (or is disregarded) for purposes of the foreign income taxes of the relevant foreign jurisdiction, any acquisition of an interest in a partnership which has an election in effect under §754, and as otherwise provided by regulations. See §901(m)(3)(“disqualified portion”).

q. **Tax Opinions**

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(1) Related to business transactions already consummated and having an impact on the acquisition or other years' tax returns.

(2) Related to transactions in which the law firm or tax advisor to the target charged a flat fee and participated in structuring the transaction. See Canal Corp. & Subs. v. Comm'r, 135 T.C. 199 (2010) (defense to substantial understatement penalty based on reliance on tax opinion rejected, even though “should” standard opinion received; reliance was not reasonable on various grounds including inherent conflict of interest and lack of sufficient independence where firm which issued the opinion help structure the arrange; tax opinion more of a “quid pro quo” arrangement than real tax opinion. What if you are buyer's counsel and see a Canal type situation(s) present? What if seller hires your law firm to represent it in the negotiations and sale of the target and also wants a tax opinion on the entire transaction? What if your private equity or business law partner has negotiated a fee for the entire transaction, including the tax opinion? See Donne, "Send Not to Know For Whom The Bell Tools", Bus. Ent. (Sep/Oct. 2011).

(3) Does buyer Step Into the Shoes of the seller for Prior Tax Opinions? Presumably yes. But consider whether reliance is reasonable: (i) the advice was based on all pertinent facts and circumstances and the law as it relates to those facts and circumstances, including the taxpayer's purposes for entering into the transaction. Also, the taxpayer must disclose to the advisor all facts the taxpayer knew, or reasonably should have known, that would be relevant to the tax issue before the advisor; (ii) the advice was not based on unreasonable factual or legal assumptions, including facts and assumptions that the taxpayer knew or reasonably should have known, were unlikely to be true; (iii) the advice must not be that a regulation is invalid unless the position is adequately disclosed; (iv) the bias or conflict of interest notion set forth in Canal (lack of independence). See Treas. Reg. §1.6664-4(c)(1).

(4) Related to compliance matters, including UTP filings.

(5) Related to potential tax litigation.

(6) Related to setting reserves for taxes in accordance with GAAP. Is there sufficient liquidity for the reserves?
(7) Related to interstate taxation both income, sales and use taxes; nexus, apportionment formulas, unitary, etc.

(8) Related to international taxation, including limitation of benefits under treaty, permanent establishment, carrying on business; proper amount of withholding, application of treaty reduction or exemption from withholding, branch taxes, etc. Required by SEC with respect to a related filing.

r. Employment Agreements, Stock Option Plans, Welfare Benefit Plans, Pension and Profit Sharing Plans, etc.

(1) Types of plans maintained by seller (and coordinated with buyer’s plans in an acquisition). Need production of board of director and compensation committee minutes approving of particular plans, awards, agreements, etc.

(a) Cash compensation plans

(i) § 409A compliance.

(ii) § 280G change of control implications and payouts. List of “disqualified individuals”, service start dates, and copies of Form W-2 for the past five (5) years with current or predecessor employer.

(iii) § 162(m) implications.

(iv) Reasonableness of compensation

(b) Severance plans.

(c) Stock based award plans; SARs, restricted stock, phantom stock plans, employee stock ownership plans (ESOPs).

(i) § 409A compliance.

(ii) § 280G change of control implications and payouts.

(iii) ESOP plans, documentation, annual valuations, production of “leveraged” financing arrangements, deductions claimed by employer-sponsor, etc.
(iv) Valuation appraisals pertinent to awards.

(d) Retirement plans, both qualified and non-qualified.

(i) Defined benefit plans.

(A) Actuarial reports for the past 3-5 years.

(ii) Defined contribution plans.

(iii) Profit-sharing plans.

(iv) § 401(k) plans.

(v) Other arrangements for deferred compensation.

Production of all plan documents, amendments, administrative service agreements, trust agreement or collective bargaining agreements for last 3-5 years. Documents related to potential withdrawal liability. IRS determination letters and/or opinions of counsel. IRS compliance statements or memos of “self-correction” under the EPRS.

Production of Forms 5500 filings for past 3-5 years and all schedules and financial statements as enclosed.

Production of “discrimination tests” for the last 3-5 years including ADP/ACP, §415 and top heavy tests, etc.

Fiduciary bond (ERISA §412), funding policy under ERISA §402(b) and fiduciary liability insurance policy.

Prior tax qualified plans that have been merged into the plan and copies of Forms 5310-A (and board resolutions).

(vi) Production of documents related to terminated profit sharing, § 401(k) and other qualified retirement plans.
Production of IRS determination letter on termination, final Form Series 5500 filing (and schedules and financial statements), PBGC filings and responses.

(e) Welfare plans. Medical, dental, unemployment, disability, accidental death, life insurance, fringe benefit, etc.

(f) International benefit plans. Plans maintained by the target outside of the United States may bring significant liabilities and complications.

(i) International social security issues.

(ii) Equalization agreements.

(g) Collective bargaining agreements, lists of all unions and work councils and work council contacts.

(i) Administrative (Internal Revenue Service or Department of Labor) correspondence, inquiries or examinations, audit reports, appeals, litigation matters, and whether audits are currently open.

(h) Worker Classification Information.

(i) List of employees. Including jurisdiction employed, base salary and bonus histories, “disqualified individuals” base salary, bonus histories and change of control awards for at least the past 5 years, accrued vacation, date of hiring. Whether dual employment status for U.S. and foreign based subsidiary for example.

(ii) List of consultants, independent contractors, leased employees, temporary employees working for at least 6 months, time period of work and work duties

(i) International Employees. Including by country all of the various types of plans set forth above and pertinent information, foreign administrative action and filings with respect to such plans
(i) Agreements related to non-employee workers.

(ii) Stock/Merger Transactions. Buyer will, by operation of law, acquire all obligations to its employees and liabilities, including funding obligations, e.g., defined benefit plan, under target corporation’s, compensation plans (see items 1-6 above). Such plans are subject to laws contained in ERISA, the Internal Revenue Code, the National Labor Relations Act and federal and state securities laws. As cited, there may be international plans maintained whereby the buyer is assuming such obligations and funding requirements in accordance with the laws of the applicable jurisdiction.

S Corporation Due Diligence. Where the target is an S corporation, including with respect to asset acquisitions, the buyer will want to conduct a thorough due diligence of the bona fides of the S election including adherence to the eligibility rules and related elections, such as the, qualified Subchapter S subsidiary (“QSUB”) election(s), qualified Subchapter S Trust (“QSST”) election(s) and electing small business trust (“ESBT”) election or elections. In many cases buyer’s counsel may negotiate for seller’s counsel to issue an opinion on the issue.

In a stock acquisition, whether taxable or not, the buyer will assume the unpaid tax liabilities of the seller. Where the target is an S corporation, then federal income tax liability will be borne, generally, at the S corporation level, except for the passive investment income tax and built-in gains tax. There may also be state income taxes imposed at the entity level. If the “purported” S corporation is not in fact eligible then the buyer may be subject to liability for any and all unpaid taxes of the “de jure” C corporation masquerading as an S corporation. This can of course be an enormous exposure. In certain instances, the buyer will insist on a straight asset acquisition, especially in instances where a §338(h)(10) election for S corporations is unavailable for state income tax purposes. Still, the assets purchase will be subject to unrecorded tax liens of the Service. The buyer’s defense in such instance will be the transfer for full value defense. See, e.g., §6901.

Among the items that should be requested for disclosure include:
(1) Articles of incorporation of target S corporation, and every amendment thereto (as certified);

(2) By-laws of corporation and all amendments;

(3) Shareholder resolutions and minutes of meetings (from inception);

(4) Board of Directors resolutions and minutes of meetings (from inception)

(5) Executive, audit or other committee resolutions and minutes from meetings (from inception);

(6) Copy of filing of S election(s) and proof of filing;

(7) Confirmation notices of S elections by IRS or state taxing authority. Copy of the filed Form 2553, Election by a Small Business Corporation.

(8) A list of the shareholders of the target S corporation and their residence and country of nationality;

(9) Certified copy of stock ledger of the S corporation and list of authorized, issued and outstanding shares of stock owned by the S corporation shareholders and the classes of outstanding shares of stock of the S corporation, and the relative rights and preferences of such classes of stock;

(10) List of all outstanding indebtedness (including convertible debt) of the S corporation, including loans or advances made by shareholders and records of payments and outstanding balances;

(11) List of any outstanding options or warrants, both compensatory and investment based, and the terms of such options or warrants;

(12) Copies of stock powers, other stock transfer documents, and stock certificates of the S corporation (both presently outstanding stock certificates and cancelled stock certificates);

(13) Copies of any trust documents with respect to shareholders of the S corporation that are trusts or trust that once owned stock in the target when it was reporting for federal and state income tax purposes as an S corporation;
(14) Copies of any QSUB elections (and proof of filing);

(15) Copies of any QSST elections made by QSST beneficiary

(16) Copies of any ESBT election made by trustee on behalf of ESBT and list of all beneficiaries of the trust, both "potential income beneficiaries" and remainder beneficiaries, and each beneficiary's tax attributes, e.g., individual, trust, tax exempt organization, and nationality or place of residence or management.

(17) Copies of IRS and state tax authorities acknowledgment of receipts (and acceptances) of various required elections by shareholders of S corporation;

(18) A list of all subsidiaries of the S corporation and the amounts and classes of stock or other equity interests held by the S corporation in such subsidiaries;

(19) Whether any stock owned in a C corporation is a member of a consolidated group of corporations, such as a wholly owned subsidiary which is the common parent of a consolidated group of corporations.

(20) History of distributions made by corporation as a "dividend" for state law purposes and corresponding resolutions, including non-pro rata distributions;

(21) Calculation of C year earnings and profits;

(22) Calculation of accumulated adjustment accounts;

(23) Filings of all state income tax and franchise tax reports;

(24) Production of any and all built-in gains tax filings and workpapers;

(25) Production of any tax-free reorganizations that the S corporation has been the "acquiring corporation" or is a "successor corporation" for purposes of §381 and C year tax attributes in general. See, e.g., §1374(d)(8).

(26) Where built-in gains tax is applicable for certain S years during the "recognition period" that is still in place or is "open" for statute of limitation purposes;
(a) Production of C to S conversion appraisals for each asset, including goodwill and going concern value;

(b) Production of list of all assets owned by the S corporation as of the effective date of the C to S conversion;

(c) Production of list of all accounts receivable of S corporation as of the effective date of the C to S conversion;

(d) Production of list of any and all other items that could affect the computation of “recognized built-in gain” or “recognized built in loss”.

(27) Calculation of potential passive investment income tax under §1375 and related workpapers and filings;

(28) All agreements or plans concerning outstanding or proposed stock options, warrants, or rights, including any employee stock ownership plans;

(29) Any shareholder agreements, investor rights agreements, voting trusts, proxy agreements, or similar arrangements;

(30) Any stock purchase agreements with shareholders;

(31) Any agreements relating to preemptive rights or other preferential rights of shareholders;

(32) Any agreements restricting the sale or other disposition of stock;

(33) Any phantom stock, stock appreciation rights, or similar deferred benefit plan; and

(34) Any agreements relating to registration rights of shareholders;

(35) Tax elections filed with respect to adoption or change of permitted year. See §§1378, 444, 7519.

(36) Any loans made to persons or individuals ineligible to own stock in an S corporation including loan documents, security agreements and history of repayments.

(37) Copies of any revocation of shareholder elections; and
(38) Copies of any termination of S status filed by S corporation with the IRS or any state tax authority;

(39) Consider, production of tax reserves and FIN 48 analysis from accounting firm (outside) on S corporation status.

Note: There is no statute of limitations on S corporation status.

Comment: S corporation due diligence requires that the other due diligence document requests be made.


(1) Business Overview. See discussion above.

(2) Tax Base Implications and Apportionment Factor Implications.

(3) Tax Filings and Audits. Jurisdictions filed and where there are risks associated from non-filing; taxes paid timely, outstanding liabilities or assessments.

(4) Required Filings After Acquisition.

(5) Record Retention Policies.

(6) Production of Records Related to Nexus Issues, Licensing. May be prudent to have accounting firm or comptroller to answer or respond to a detailed questionnaire covering a wide variety of SALT issues.

(a) Nexus Under the Commerce Clause; Art.1, §8, cl. 3 of U.S. Constitution.


(i) Internet sales

(ii) Drop-shipping arrangements.

(iii) Sales offices, warehouses
(c) Nexus Factors. Includes (i) owning or leasing tangible personal or real property; (ii) maintaining permanent employees or subcontractors; (iii) number of visits to state to visit customers or perform services

X. TAX PROVISIONS AND CONSIDERATIONS IN NEGOTIATING ACQUISITION AGREEMENT

A. Tax Indemnification Provision.

It is customary for a buyer to want contractual protection against tax liabilities which relate to pre-closing periods that may be assessed after the closing. The buyer's counsel must be sensitive to the period of time during which the indemnification provision is "open". The statute of limitations on the particular tax involved may not run or expire until well after the warranties and indemnification provision expire. Seller's counsel will of course be motivated to limit or shorten the post-closing claim period, including the period for indemnification of tax claims. This will put pressure on the buyer's due diligence team to make a careful and exhaustive review of potential tax liabilities of the seller. The buyer should want the LOI as well as the Acquisition Agreement to provide that buyer will have full access to all properties, books records or returns of the target whether in the possession of target, seller or third party advisors or representatives to give buyer full opportunity to make a full and complete due diligence investigation.


Taxes on operations after the closing date are, of course, the buyer's responsibility and provision must be contained in the Acquisition Agreement reflecting this obligation. Typically, a purchase price is based on financial statements dated as of some specified date prior to the closing, and all operations through that date, including related tax liabilities, will have been reflected in those financial statements. Thus, taxes for periods prior to the financial statement date are effectively for the seller's or target corporation's account. But what about interim taxes leading up the closing.

1. Seller's or Target Corporation's Obligation for Interim Period Taxes. The more commonly accepted approach is that responsibility for all pre-closing period taxes must be borne by the seller. Alternatively, the parties may agree that taxes on operations in the in the ordinary course of business after the date of the financial statements will be borne by the buyer. An argument for this latter alternative can be made where the interim period prior to closing requires the seller to not withdraw cash or make dividend or bonus payments prior to closing. In such case, the
interim period operations economically inure to the benefit of the buyer. On the other hand, where the seller or its owners are able to distribute cash during the interim period prior to closing, perhaps subject to certain working capital limitations set forth in the Acquisition Agreement, then the seller should bear the tax burden for interim period operations. If the seller is held responsible for the payment of interim period taxes, there must be a representation and warranty to such effect and an indemnification provision inserted in the agreement. This would not cover taxes that are not due until after the closing on income generated prior to the closing. Still, the buyer may insist on a “true up” or “deemed closing of the books” on the date of closing or the day prior to the date of closing and compute the projected tax as if the year end occurred on such date. Where there are other financial or economic ratios that are required to be in place on the date of closing, seller’s counsel should be alert to whether the seller’s obligation to pay interim period taxes will result in an adverse double-count against his or her client.

2. **Buyer’s or Acquiring Corporation’s Obligation to Pay Interim Period Taxes.** In this case, the seller’s representation and warranty on taxes should be expressly stated to be limited to: (i) all taxes for which payment is due before the closing date have been paid; (ii) all taxes accrued as of the financial statement date, but as to which payment is not yet due, have been reserved against on the financial statements; and (iii) all taxes for which payment is not yet due and which relate to the period between the financial statement date and the closing have been incurred in the ordinary course of business. Even in this situation, however, it is not uncommon for indemnification to be independent of the tax representation.

3. **Other Possibilities.** Consider what the seller’s rights should be if a pre-closing year is audited and results in the denial of a large loss or set of deductions. Suppose the amount involved is $10M and the resulting federal (and state) income tax assessment is $4M. Seller is obligated to pay the tax where the payment is made pre-closing (of course) or post-closing. But what if the $10M in losses or other deductions are allowed to be taken in a post-closing year and inure to the buyer’s benefit? Should the buyer reimburse the seller for the tax benefit associated with the postponed or deferred deduction? Where the buyer acquires target stock in a transaction described under § 382 and the buyer losses loss carryovers that should not be an indemnification event. But what if the NOLs were incorrect, i.e., overstated? Consider also what the result should be if a seller adopted an erroneous method of accounting that resulted in a § 481 adjustment post-closing and a resulting tax assessment. Should the buyer be estopped to recover for the acceleration of the tax adjustment when it had examined the books and records, i.e., tax returns of the seller. See, e.g., Marathon E.G. Holding Ltd. v. CMS Enterprises, Co. No. H-07-2990 (S.D. Tex. 7/30/08), aff’d, 597 F. 3d 311 (5th Cir. 2010).
4. **Characterization of Tax Indemnification Payment.** Generally will be treated as a purchase price reduction (and corresponding reduction to basis).

5. **Merger and Acquisition Transactions Costs: Allocation.** This generally will require evaluation of compensation related deductions and professional fees and who is given the right to claim the expense and who gets the economic benefit of the deduction. Alternatively, certain costs will have to be capitalized in accordance with Treas. Regs. §§1.263-4, -5. Generally compensation based payments, bonuses, etc., are charged and allocated to and deducted by the target corporation or seller. Transactions costs in the nature of professional services, i.e., legal, accounting, investment banking fees, “success” fees, involve more inspection. Under §263(a), costs to facilitate transactions are generally required to be capitalized including costs incurred in the process of investigating or otherwise pursuing a covered transaction. Treas. Reg. §1.263(a)-5(a). Whether an amount is paid in the process of investigating or otherwise pursuing the transaction is determined based on all of the facts and circumstances of the case. Treas. Reg. §1.263(a)-5(b)(1) provides that an amount paid to determine ‘the value or price of a transaction is an amount paid in the process of investigating or otherwise pursuing that transaction.’ In applying the facts and circumstances to the costs, a ‘but for’ transaction analysis is relevant albeit not controlling in and of itself.

a. **Sale of Stock of Target to Consolidated Group.** Where the target incurs deductible expenses in a stock acquisition resulting in the target joining the acquiring group's consolidated tax return, the target and acquiring group need to determine to which tax return the deductions belong (i.e., short period target return or post-transaction consolidated tax return). The so-called ‘next day rule’ provides that if, on the day of S's change in status as a member, a transaction occurs that is properly allocable to the portion of S's day after the event resulting in the change, S and all persons related to S under §267(b) immediately after the event must treat the transaction for all Federal income tax purposes as occurring at the beginning of the following day. A determination as to whether a transaction is properly allocable to the portion of S's day after the event will be respected if it is reasonable and consistently applied by all affected persons. Treas. Reg. §1.1502-76(b)(1)(ii)(B). Under a “bright line” rule, if the costs were incurred prior to such date, the target can allocate the costs to its last return year.

b. **Party Claiming the Deduction.**

C. **Tax Indemnification and Caps, Baskets and Deductibles.**
Consideration has to be given to having different limitations for tax indemnification payments versus general liability indemnification payments. A tax liability under an tax indemnification provision may also be treated as a reduction in purchase price (which will reduce the buyer’s cost basis).

D. Control over Audit, Appeals, Tax Litigation Process.

Buyers of stock or ownership interests will presumably want control over post-closing audits, including audits which involve pre-closing taxes. This can become a problem for sellers of S corporation stock or even interests in a partnership subject to the entity level audit rules under TEFRA. Seller’s counsel should try to have “control” to represent the buyer with respect to pre-closing issues. Expect buyer’s counsel to resist and perhaps only allow a right to participate. The problem is that the buyer may be indifferent or perhaps motivated to pay off an alleged additional amount owed for pre-closing taxes knowing it has access to the tax indemnification provision or even an escrow. Minimally the seller should insist on a right to participate at the expense of hiring its own tax counsel or accountants. Seller may also want settlement authority over the buyer with respect to pre-closing taxes assessed post closing.

E. Taxable Asset Purchase Agreements.

Asset purchase agreements are far less problematic and involved than stock acquisitions, whether taxable or non-taxable. This is due in part, to the fact that the buyer is not liable for the prior tax liabilities of the target corporation. Therefore, the target corporation generally remains liable for its own income, sales, ad valorem or other non-income taxes as well as the taxes allocable to the sale and transfer of its assets. Exception may be encountered where, for example, the transaction constitutes a fraudulent conveyance or the parties have not complied with local bulk sales law. Thus, tax representations and warranties should still be insisted upon by the buyer.

1. Asset Purchase Agreements.

a. No Outstanding Tax Lien. Representation by the target is made that its assets are not subject to any tax liens. Frequently this requirement survives the closing as the target agrees to indemnify the buyer for any pre-closing taxes, e.g., withholding, FICA, FUTA, business, franchise, real and personal property taxes, etc. The language can extend to target’s having timely filed all required returns, including income, payroll, sales and use tax, both state and federal, as well as require information returns.

b. Required Prorations. Property tax liabilities are generally allocated pro rata on a per day basis through the date of closing.
c. **Refunds or Credits of Taxes.** Non-income tax refunds and credits attributable to the purchased assets or business are generally allocated to pre- and post-closing periods, with seller receiving the benefit of any pre-closing period credits or refunds.

d. **Nonapplicability of FIRPTA.** Target is required to furnish the buyer with a non-foreign affidavit for purposes of the FIRPTA rules.

e. **Purchase Price Allocation.** In accordance with the residual method of allocation under §1060, the target corporation and purchase should be encouraged to agree on an allocation of the purchase price in executing the contract or provide that they will agree on such an allocation prior to the closing, or, alternatively, by the required filing date of the §1060 form.

f. **Subsidiary Stock.** The agreement should recite that the assets being acquired do not include the stock of any subsidiary company which is or has been a member of a consolidated group of corporations.

g. **Accounting for Applicable State Law.** Some states may cause the buyer of business assets to assume the target's state tax liabilities unless the target obtains a tax clearance certificate. Otherwise, the buyer will be left with an indemnification. See Fla. Stat. §212.10.

**F. Taxable Stock Acquisitions Involving Privately Held Corporations.**

1. **Tax Representations and Warranties.**

   a. **Purpose.** It is critical for the buyer to receive a full set of tax representations and warranties in a stock acquisition (taxable or non-taxable) in order to: (i) identify the potential tax liabilities and tax attributes of the target; (ii) permit the buyer, at its option, to rescind or cancel the transaction if there is a material defalcation or misrepresentation as to the tax liability or attributes of the target between the contract date and the closing date; (iii) to allocate tax liabilities and benefits of the target and the acquiring corporation. Because the tax representations and warranties are made as of the closing date, agreements will typically include a "bring down" provision reaffirming the representations and warranties as of the closing date.

   (1) **Disclosure Schedules.** Buyer provided with schedules prior to contract or closing, including tax accrual workpapers. Seller may attempt to limit representations and warranties to matters outside of those set forth in the disclosure schedule. Such schedules would be available to the IRS in
the event of audit; is something counsel for each party should be aware of.

b. Consolidated Groups. Where the target is a member of a consolidated group, it will have joint and several liability for all federal (and certain state, local and foreign) tax liabilities of the selling consolidated group for the years during which it was a member. The acquisition agreement should require the target to represent the (i) extent of target's liability for its own pre-closing taxes, and for pre-closing taxes of other members of the consolidated group, and target's ability to negotiate with taxing authorities on such matters, (ii) carrybacks and carryforwards of losses or credits between pre-closing and post-closing periods, and (iii) issues arising because the target's group remains liable for the target's taxes up to the date of closing, even where the buyer is allocated the economic benefits and burdens of business operations between the contract and closing dates. Where the parent is being sold, then the entire consolidated group liability must be evaluated, including the tax liabilities of any previously sold subsidiaries within the applicable limitations period. The buyer will want to inquire about the extent of the potential liability of the target for group activities, which may be matters that the officers of the target may not be fully aware.

XI. TAX REPRESENTATIONS AND WARRANTIES; THE TAX INDEMNIFICATION PROVISIONS

A. Typical Representations and Warranties. The following sets forth a checklist of the various representations and warranties that are commonly used in negotiating the acquisition of target stock.

Note: There is some duplication of material between this § and that contained in other parts of this Outline, including the Due Diligence §. Note, however, that the Due Diligence § is more extensive and therefore issues and matters contained in that part of this Outline could be part of the Tax Representations and Warranties provision in the Acquisition Agreement and part of the Tax Indemnification provision.

1. Buyer's Perspective. The buyer will want the broadest and most inclusive set of representations and warranties even though it has been provided with an extensive amount of due diligence material. The buyer will want the seller to: (i) disclose any problems with the business and therefore, this will include any and all tax problems, i.e., outstanding assessments, liens, disputes, audits, litigation and other potential tax problems; (ii) will want to have a “walk away” provision if the representations and warranties are proven to be “untrue” or “materially defective” or “false”
prior to or at closing in its discretion; and (iii) provide a basis for recovery, a tax indemnification agreement to apply after closing if a material breach occurs and the buyer incurs or has the potential to incur economic damages, including fees and costs. The seller’s counsel will want to negotiate a limitation on tax claims, both on the aggregate amount and perhaps a “deductible” or basket; the seller’s counsel should want to keep the indemnification to a shorter period that would expire prior to the running of the statute of limitations, to the post-closing survival of the tax representation and warranties, as well as the tax indemnification provisions. Buyer’s counsel (and buyer) should be expected to negotiate the tax representations, warranties and of course, the tax indemnification.

The walk-away provision allows the buyer with leverage to renegotiate the purchase price if problems are found in the due diligence process.

2. The Seller’s Perspective. As previously alluded to, the seller will want, in contrast to the buyer, the narrowest and most protective set of representations and warranties. In many cases the degree of leverage between the parties will be controlling as an “all cash” buyer will frequently dictate the representation and warranties provisions as well as the indemnification and hold-back provisions. Where the seller, however, wants to avoid the buyer from having it both ways, i.e., strict and absolute guaranties and a full indemnification on the one hand and a “walk-away” before, on or even for a prescribed period post-closing (“unwind provision”), the seller may insist on a materiality out restriction or limitation. As mentioned, the seller’s counsel will want to limit the post-closing survival of representations and warranties of the seller in general, and that includes tax warranties and indemnifications.

3. Tax Representations and Warranties of the Seller. Unlike the “materiality” standard used in determining whether the financials of the seller are not a fairly representative statement of the seller’s financial position as of the applicable date(s), tax warranties and indemnifications are triggered by a lower threshold of liability in many cases. In addition, financial statements reflect only certain liabilities. Many unasserted tax claims, including potential tax audit items, may not be reflected in the seller’s or target’s financial statements and the buyer will want to be protective from such risks and will want to be apprised of such risks.

a. Filing and Furnishing of Tax Returns. The selling shareholders of the target will be required to represent and warrant that the target has timely filed all required tax returns and copies of all the subject returns are warranted as having been furnished to the buyer, e.g., income, franchise, payroll returns. Buyer should also require seller to warrant that the target has filed all reports and retained records to the extent required under §6038A, i.e., domestic corporation
which is 25% or more foreign owned and all other types of informational filings required with respect to interests in foreign financial instruments or investments, bank accounts, joint ventures, NFFEes, as discussed above in the Due Diligence (document request) part of this Outline.

b. Computation of Taxes Due. The buyer will presumably insist that seller warrant that all required tax return and information returns are true and accurate and that no additional tax liabilities will be outstanding perhaps as early as the date the execution of the Acquisition Agreement but certainly on the date of closing. There may, for example, be state tax returns which may not have been filed based on an aggressive position taken by the target despite the possible presence of “nexus” in such other jurisdictions. The seller, on the other hand, may wish to limit the representation to only material tax returns or otherwise incorporate a materiality standard. As to providing tax return information, a target of a consolidated group may refrain from providing tax and financial information relevant to other subsidiaries and operations of the group. The seller should be required to disclose what returns are presently on extension.

c. Representation of Payment of All Taxes. As to this type of seller representation that the target has paid all taxes due, the seller will attempt to limit the warranty to only those taxes "shown as due" on a return or that are subsequently assessed prior to the closing. The buyer should be expected to insist the warranty to cover all "taxes due" regardless of whether the target was required to file a return or what the return, as filed, indicates as the tax liability of the target. This should include a representation that all other taxes for which the target is or may otherwise be liable (e.g., by virtue of a tax indemnity or tax sharing agreement) have also been paid. Again, the seller may attempt to limit the amount or standard used to guaranty that there are no taxes owed, i.e., materiality standard. The same obligation to recite all taxes required to be paid have been applies to state and local taxes as well, including ad valorem, income, payroll, sales and use tax, excise tax, etc.

d. Representation of Proper Withholding of All Taxes Required to be Withheld. This representation would include payroll FICA, FUTA and withholding taxes, as well as any FIRPTA or any withholding required under §§1441-1446 or backup withholding. It is important to include, for example, the wage withholding warranty since the seller may otherwise argue that such amounts are not “taxes” of the target corporation.
e. **Liens.** The buyer will should require a warranty from the seller that no liens for taxes exist with respect to its assets being acquired.

f. **Tax Reserves.** The buyer may wish to receive a representation and warranty that the tax reserves established by the company are sufficient to pay taxes that have accrued but are not yet due, with allowance for extraordinary gains.

   (1) **Deferred Taxes.** Generally those are backed out of the tax reserves so as to properly account for timing differences; deferred tax reserves are backed out of the representation.

   (2) **New Matters.** Where the buyer, through its due diligence, determines that there are additional tax exposures not contained in the tax reserves, it may require a downward adjustment to the purchase price.

g. **Subchapter S Status.** Where the target is an S corporation, it is important that the buyer receive a clear and unequivocal representation and warranty as to Subchapter S status of the target corporation. Buyer's counsel should inspect all stock certificates, including those retired, K-1s, Form 2553s, etc. and such other information reflecting on such representation and warranty.

   (1) **REIT Status.** Where the target is a REIT, it qualifies for conduit treatment similar to mutual funds. §§856-859 (REITs); §851-855 (mutual funds). Thus, a purchaser of a REIT target will insist on meeting the four groups of tests to ensure REIT status for each year including: (1) organization (domestic) and ownership requirements; (2) predominately passive income and income from real property requirements; (3) asset requirements, e.g., real estate, cash, receivables and government securities, and (4) distribution requirements. If a company satisfies these conditions and elects to be a REIT, its distributed income is taxed to its shareholders rather than to the REIT, and the capital gain portion retains its character in the shareholder's hands. The REIT itself is taxed only on undistributed income and certain income from foreclosure property.

h. **Acknowledgment of Target's Audit History.** The buyer should require the seller to disclose its (and the consolidated groups, if applicable) tax history, any proposed or threatened audits and any actual or proposed tax deficiencies or adjustments. The seller may balk at warranting "threatened" audits or may qualify the extent of the warranty. As deficiencies, the seller may wish to limit the
warranty to a specific schedule of proposed deficiencies or as to only certain types of taxes not all taxes. The buyer may want a disclosure concerning the types of issues that have previously been audited which could apply to a later, yet unaudited, period.

(1) **Disclosure Statements/Substantial Authority.** Buyer should obtain a representation and warranty as to any position on a tax return (statute of limitations still open) for which the target believed it had "substantial authority" or otherwise filed a disclosure statement to mitigate any penalty under §6662.

(2) **Intercompany Pricing Agreements.** The seller should disclose whether it has filed any advance pricing agreements with the Service. Rev. Proc. 96-53, 1996-2 CB 375 (generally effective for requests received after 1996).

i. **Affiliated Group.** Seller lists any affiliated, consolidated, combined, unitary or aggregate group of which target is or has ever been a member.

j. **Tax Sharing Agreements.** Where the target is a party to any tax sharing or indemnification agreements, the buyer will want to receive all terms and conditions of such agreements, and the pending status of the same. Buyer will also want to receive information relating to any prior acquisition that the target has made of another company and the tax liability and attribute profile of such prior acquired company. Buyer will want to determine whether the protection of that agreement will be available to it following the purchase of target. Seller may attempt to limit the scope and extent of such disclosure. The seller, as part of its tax disclosure schedule, should provide all combined, consolidated or unitary groups of which the seller, or any of its subsidiaries, including target, has been a member, and which has filed a combined, consolidated or unitary return for federal, state, local or foreign tax purposes. Similar schedules should provide whether the seller, target or any applicable subsidiary is (or has been) subject to any venture which is treated as a partnership for federal income tax purposes or has any formed any "defective entities" (and provide the necessary elections if required).

(1) **Allocation of Consolidated Tax Liability.** As mentioned below, the common parent and each subsidiary that join in filing a consolidated return are severally liable for the consolidated tax liability, including deficiencies. See Treas. Reg. § 1.1502-6(a); Mississippi River & Bonne
Terre Ry., 39 BTA 995 (1939); Turnbull, Inc. v. Comm'r, 373 F2d 91 (5th Cir.), cert. denied, 389 US 842 (1967). For bankruptcy purposes, each member of the group is a separate tax entity with the portion of the consolidated tax liability attributable to the income of other members is viewed as a secondary liability, e.g., type of surety arrangement, and not a direct or primary obligation. In re Imperial Corp. of Am., 91-2 USTC ¶ 50,342 (Bankr. SD Cal. 1991). It is critical to understand, as buyer's counsel (as well as the buyer understand of course) that if the subsidiary's stock is sold, it still may be liable for more than its share of the consolidated income tax for open years. Globe Prods. Corp., 72 TC 609 (1979)(payment by subsidiary of secondary liability for taxes non-deductible per §275); acq., 1980-1 CB 1, 1980-2 CB 1. Items addressed in a TSA include: (1) tax benefits associated with use of NOLs, business credits; (2) tax benefits associated with foreign tax credit carryovers; and (3) other tax benefits.

(2) See Treas. Reg. §1.1502-33(d)(1)(charging earnings and profits by share of member's tax liability as allocated in accordance with §1552).

(a) TSA May Not Be Limited in Scope. A pertinent TSA may apply to other taxes other than income tax, such as withholding and social securities taxes, state income and franchise taxes, excise taxes, §4999 tax, etc.

(b) TSAs Concerning Foreign Taxes.

(3) § 1552. For purposes of determining the earnings and profits of each member of an affiliated group included in a consolidated income tax return (post 1954), the tax liability of the group must be allocated in accordance with one of three methods set forth in the regulations or under any other method selected by the group and approved by the Commissioner. See Treas. Reg. §1.1552-1(a). Under Treas. Reg. §1.1552-1(c)(1), once the election is made (or default election is applied by the Service) it is irrevocable and binding upon the group for the year made and all future years in which a consolidated return is filed or required to be filed. Where the consolidated group does not select a method of allocating income tax liability, the IRS will apply the taxable income ratios allocation method under

(4) Treas. Reg. §1.1502-6: Joint and Several Liability. In general, the common parent corporation and each subsidiary which was a member of the group during any part of the consolidated return year shall be severally liable for the tax for such year computed in accordance with the regulations under §1502 prescribed on or before the due date (not including extensions of time) for the filing of the consolidated return for such year. Treas. Reg. §1.1502-6(a).

(5) Liability After Subsidiary Withdrawal. Where a subsidiary has ceased to be a member of the group and if such cessation resulted from a bona fide sale or exchange of its stock for fair value and occurred prior to the date upon which any deficiency is assessed, the Commissioner may, if he believes that the assessment or collection of the balance of the deficiency will not be jeopardized, make assessment and collection of such deficiency from such former subsidiary in an amount not exceeding the portion of such deficiency which the Commissioner may determine to be allocable to it. If the Commissioner makes assessment and collection of any part of a deficiency from such former subsidiary, then for the purposes of any credit or refund of the amount collected from such former subsidiary the agency of the common parent under the provisions of Treas. Reg. §1.1502-77 shall not apply. See Treas. Reg. §1.1502-6(b). This provision in the regulations refers to a “bona fide sale or exchange” for fair value; query does it apply to spin-off or split-off transactions?

(6) Treas. Reg. §1.1502-6(c). Effect of Intercompany Agreements. The regulations provide that no agreement entered into by one or more members of the consolidated group or with any other person will in any case have the effect of reducing the liability set forth in the regulations. See T.D. 9002 (6/27/2002), am’nd’g T.D. 6894 (9/7/1966).

(7) Tax Allocation Agreement and Treas. Regs. §§1.1502-6, 1.1552. A tax allocation agreement is a contract which is
enforceable by each member of the group against the breaching or non-conforming members. Arguably, a dissenting minority shareholder could through a derivative action, claim that the corporation in which such shareholder owns share is being allocated to much tax liability or too little earnings or that the actual allocations being made are inconsistent with the agreement.

(8) Impact of Sale of Target Stock Which is a Member of Consolidated Group. Whether as part of a tax-free organization, taxable sale of stock, spin-off of subsidiary stock, termination of consolidated return status, where more than 20% of target stock is sold so that target "deconsolidates", the seller of target stock will want to have a final reconciliation of the target's liabilities or claims under any outstanding TSA or otherwise revise the agreement. Otherwise, the tax allocation should continue to apply in accordance with its terms.

(a) Allocation of tax liabilities in the year of closing to the seller for target's taxable income, including any income generated in the acquisition itself, such as with respect to a § 338(h)(10) election.

(b) Impact of future tax liabilities between seller or buyer with respect to assessments in the consolidated group's tax in which the target is primarily liable, secondarily liable under the regulations or charged with an obligation to make or receive payments under the TSA.

(c) Impact of NOL carryovers and carrybacks from either the pre-closing or post-closing period?

(d) Specific provision in Acquisition Agreement and Modified Tax-Sharing Agreement. Buyer's counsel and seller's counsel or either may insist on contractual protection for tax-sharing costs and liabilities as a condition precedent to closing. This agreement should not only take into account the existing TSA but also potential outcomes with respect to all "open years" and any pending audits, or tax appeals or litigation. Because of the potential for expanded tax statutes of limitations, buyer's counsel may want to have the representation and
warranties of seller with respect to this issue to continue indefinitely.

k. **Powers of Attorney.** The buyer will want to know which representatives are currently authorized to represent the target corporation with respect to its taxes. The buyer may wish to immediately cause new powers to be issued and filed superseding the previously filed powers.

l. **Anti-Morris Trust Disclosure.** Under §355(e), if one or more persons acquire a 50% or greater interest in the distributing or controlled corporation pursuant to a plan or arrangement of which the spin-off is a part, the distributing corporation must recognize gain as if the distributing corporation sold the stock of the spinnee for its fair market value as of the date of distribution. Unless a presumption of a “plan” is rebutted, §311 will apply to the prior spin-off and the burden of such tax could be borne by the buyer. See Treas. Reg. §1.355-7T, T.D. 8960, 66 Fed. Reg. 40590 (8/3/01). Due to the potentially adverse impact under §355(e), the buyer will want a full disclosure as to all transactions which could be part of a “plan” or “series of related transactions” in conjunction the acquisition, as described within §355(e). This could cause a prior Type D reorganization or §355 transaction to fail (although not at the shareholder level). The statute also embodies a presumption, albeit rebuttable, that augments the normal step-transaction analysis one commonly would employ in assessing the existence of a plan: any such acquisition, which occurs during the four-year period beginning two years prior to the date of the distribution, is, under § 355(e)(2)(B), presumed to be part of a prohibited plan or series of related transactions. See Willens, The Re-Proposed “Anti–Morris Trust” Regs. Are Vastly Improved, but Some Aspects Remain Vague, 94 J. Tax’n 69 (2001).

m. **Parachute Payments.** Seller discloses any potential golden parachute payments under §280G as well as the potential for treatment of the same as excess parachute payments (nondeductible) and subject to a 20% excise tax per §4999. Buyer may therefore want a warranty that neither the target (or the group, if applicable) has entered into any compensation arrangements which would result in a nondeductible expense to the target (or the group) under §§162(m) and 280G or result in an excise tax under §4999.

n. **Rulings and Revenue Agent Reports.** The seller is required to disclose any and all outstanding RARs on existing audits and all ruling requests and their status.
o. **Accounting.** The buyer will want to receive information as well as a warranty from the seller regarding any pending adjustments under §481 which could give rise to a tax liability after the closing. This could extend to a representation that the target has not adopted any "erroneous" method of accounting.

p. **Nexus Warranty.** Seller lists each state, county, local, municipal or foreign jurisdiction in which target files, has ever filed, may be required to file or may ever have been liable for tax on a "nexus" basis. Again, the seller may only wish to reveal those jurisdictions in which the target has actually filed returns.

q. **FIRPTA.** The buyer should require the target to represent and warrant that neither it nor any member of the consolidated group of which the target is a subsidiary is not, and has not been for the 5 year period prior to the closing(§897(c)(1)(A)(ii)), a "United States real property holding corporation" within the meaning of §897(c)(2) or, alternatively, that no shareholder of the target is a foreign person (per §1445).

r. **Other Representations.** Seller may also be required to make representations regarding (a) target’s net operating losses, tax credit carryforwards, tax basis or other tax attributes and (b) deferred intercompany amounts and excess loss accounts (if target is the parent of a consolidated group); (c) target’s earnings and profits, and, (d) if the target is an S corporation, its accumulated adjustment account as well as earnings and profits from prior C years.

s. **Portability of Carryovers.** If seller makes a representation as to the amount of net operating losses or credit carryforwards, seller should also disclose any §§382-384 or SRLY limitations to which such losses or credits may be subject. See Treas. Reg. §1.1502-95T(c)(apportionment of consolidated §382 limitation).

t. **Survival.** The buyer will require that the tax representations and warranties survive the closing and through the expiration of all relevant statute of limitations.

u. **Miscellaneous Tax Representations.** Seller may be required to disclose (a) any previously filed consent under §341(f); (b) any "tax-exempt use property" (within the meaning of §168(h)) held by target; c) warrant that target (or the group) has not participated in an international boycott per §999; (d) any assets of target subject to a lease under §7701(h); (e) presence of any overall foreign loss per §904(f).
4. **Tax Covenants For Pre-Closing Activities.**

a. **Typical Tax Covenants.** Pre-closing tax covenants are generally necessary (i) to protect the buyer from adverse changes in the target's tax liabilities or attributes between signing and closing and (ii) to allocate certain rights and responsibilities with respect to target tax matters.

b. **Preparation and Filing of Tax Returns.** Seller generally prepares (or causes to be prepared) target's returns for taxable periods ending on or before the closing date. Buyer generally prepares returns for periods beginning before the closing date and ending after the closing date ("Straddle Periods"). Frequently, a clause in the agreement will recite that such returns must be prepared on a basis consistent with previously filed returns or the other party must consent to a different treatment.

c. **Payment of Taxes.** The seller (parent) or the target corporation will generally be required to pay all taxes of the target through the closing date; with the buyer paying all target's taxes thereafter. This calculation can be made by a closing of the target's books on the date of the closing. When buyer pays the taxes for the year, they will be credited by the seller against the purchase, or by charging an escrow established for such purpose. Other taxes, such as property taxes, may be allocated on a per diem basis.

d. **Tax Elections and Other Actions.** A covenant should preclude the seller or target from making any tax election or taking any other action (including filing an amended tax return) between signing and closing that would adversely impact the target's post-closing tax liabilities or tax attributes without the prior written consent of the buyer. The seller may want to limit this restriction to only material items. Such a clause would be important, for example, where the target's NOLs are an important part of the deal.

e. **Mutual Cooperation.** Seller and buyer agree to cooperate in preparing and filing returns and in resolving any tax disputes, including by making records available. Unless the buyer receives this type of assurance of cooperation, it may be difficult or impossible for it to obtain information regarding the target from its accountants and lawyers.

f. **Refunds and Credits.** Assuming the seller agrees to indemnify the buyer for any taxes accruing on or before the date of closing, then the seller should be entitled to any refund or credit for pre-closing tax periods. As to refunds or credits occurring during the "straddle
period”, the parties may arrive at an equitable formula for apportioning such amount.

g. **Transfer Taxes.** The payment of transfer taxes is a business point and will often be shared equally by seller and buyer.

h. **Termination of Tax Sharing Agreements.** Any tax sharing, indemnification, or similar agreements, should be required to be terminated as of the closing date.

5. **Tax Indemnification and Tax Contests.**

a. **Indemnity.** In unusual situations, the sellers of the target stock may not be required to indemnify buyer for any pre-closing taxes of the target, or its indemnification may be part of a general indemnification for breaches of representations and covenants, including tax reps and covenants. More frequently, acquisition agreements contain stand-alone tax indemnification provisions whereby the buyer is to be indemnified for pre-closing and relevant straddle period taxes of the target, taxes of the selling consolidated group, where relevant, and other taxes, as well as costs and expenses attributable thereto. In many cases, seller will also be required to indemnify buyer for damages attributable to breach of tax representations and covenants. Separate tax indemnification provisions should specifically override general indemnification provisions.

1. **“Baskets” and “Deductibles.”** So-called “basket” or “deductible” provisions place limits on general indemnification payments are common. The question arises as to whether only the first $1 over the hurdle is the only amount for which the seller is liable, or whether passing the threshold triggers liability for the entire amount.

2. **“Caps.”** Seller may also bargain for a “cap” on the tax indemnification, unless fraud or wilful misconduct is present. The buyer should proceed cautiously in agreeing to a cap where the target is a member of a consolidated group, since it is severally liable for the entire consolidated tax liability of the former group of which it was a member. See Treas. Regs. §1.1502-6, 1.338(h)(10)-1(e)(5). Still, buyer can reduce its exposure by causing the target to remain a stand alone subsidiary.

3. **Buyer’s Conduct.** Seller will generally not indemnify buyer for increases in target's tax liabilities resulting from acts
taken by buyer after the closing (e.g., an unagreed §338 election or a sale of target assets out of the ordinary course of business). Buyers generally indemnifies sellers for any increased tax liability attributable to such acts.

b. Reduction for Tax Reserves. The seller should insist that the amount of the tax indemnification be reduced by the amount of tax reserves shown on the balance sheet, presumably on the date of closing.

c. Treatment of Indemnification Payments. The parties should characterize the payments as a reduction in the selling price.

d. Offsetting Benefits. The agreement may also address who bears the costs or reaps the benefits of timing differences arising from an adjustment to tax items in a pre-closing period that affects the target's tax liabilities in a post-closing period, or vice versa. Tax costs and benefits may be determined using assumed tax rates for simplicity, or may be based on the tax costs or benefits actually realized by the relevant party. Buyers should try to avoid “tax effecting” indemnification payments due to their complexity.

e. Survival of Indemnification Agreement. The tax indemnification should extent to the end of any relevant periods of limitation, plus any periods for which assessment has been or will be extended.

f. Tax Audits and Tax Contests. Most agreements have special provisions addressing tax audits and tax contests. Assuming that seller has agreed to indemnify buyer for pre-closing taxes, seller will generally retain control of tax contests relating to pre-closing tax periods and will be entitled to determine the strategies and tactical decisions relevant to tax contests. Buyer will want to be careful, however, that the seller cannot take control over issues or years that are not the subject of the indemnification. Seller frequently is prohibited from entering into a settlement of tax contests without buyer's consent, subject perhaps, to a reasonableness standard. Such a clause should also contain a notice requirement, the breach of which, would relieve the seller of its obligation to indemnify buyer (with respect to such issues contained in the audit) but only where such failure actually prejudices seller. The seller may permit the buyer to participate in the conduct of a tax audit or contest at buyer's expense, or they may mutually agreed in good faith as to the conduct of tax contest.

g. Escrow or Retainage. It is somewhat common for the seller’s indemnification to be backed up by the establishment of an escrow
or hold-back of part of the purchase price. See §468B(f). See also Rev. Proc. 77-37, 1977-2 C.B. 568, modified by Rev. Proc. 84-42, 1984-1 C.B. 521. The agreement should recite which party is treated as the owner of the escrowed funds for income tax purposes.

B. Taxable Stock Acquisitions Involving § 338(h)(10) Elections

1. Eligibility Representation. The seller should represent that it is eligible to make a §338(h)(10) election. See Temp. Treas. Reg. §1.338(h)(10)-1T(b)(3. Note, that where the buyer unilaterally wants to make a regular §338(g) election, i.e., the target has available net operating losses, it should be held liable for any income or business tax which follows from the making of such election. This would include a situation where the target is a member of a consolidated group and buyer makes a §338(g) election. See Treas. Reg. §1.338-10(a)(2). Therefore, the seller in such instance, will want a representation (and possibly indemnification) from any tax liability attributable to buyer’s making such election.

2. Covenants. The parties will agree to make any and all relevant elections required to be made under the Code, as well as any comparable elections required under state, local or foreign tax law, and will further agree to cooperate in the making of such elections.

3. Purchase Price Allocation. Since a §338(h)(10) election is treated as an asset sale for tax purposes, the acquisition agreement may include provisions allocating the purchase price to the “aggregate deemed sales price” (as well as computing the “adjusted grossed up price”) to the different classes of target assets (or providing that seller and buyer will agree on an allocation prior to the closing). Temp. Treas. Regs. §§1.338-4T, -6T, -7T. In such instance the parties will mutually prepare Form 8023, including all materials required to be submitted with the Form. See Temp. Treas. Reg. §1(h)(10)-1T. The agreement may require the parties to use their good faith best efforts to agree to the required allocations and in the event that they can’t, each will agree to the selection of an independent accounting firm to make such determination or by a similar selection process. The agreement should recite that the parties will take no action inconsistent with, or fail to take any action necessary for the validity of, the §338(h)(10) election, and shall adopt and utilize the asset values determined from such allocation for the purpose of all tax returns filed by them, and shall not voluntarily take any action inconsistent therewith upon examination of any tax return, in any refund claim, in any litigation, or otherwise, with respect to such tax returns.

4. Tax Liability. The seller will agree that it remains liable for any federal income taxes and state, local or foreign taxes, resulting from the
§338(h)(10) election. If the seller is contractually liable for taxes attributable to the sale, while the buyer will own the target company and will prepare and file the old target's stand-alone final return following closing, the buyer and seller must negotiate a process for preparing and filing the return, paying taxes and handling audits.

5. Special Considerations With S Corporation Target. Where an S corporation is the target corporation in a §338(h)(10) transaction, special issues come into play including the requirement that non-selling shareholders must consent to the election and are taxed on their pro rata shares of the deemed sale gain, the use or applicability of §453, state income tax impacts and withholding requirements, and whether premiums can be paid to certain shareholders for either consenting to the election or who otherwise control the corporation. See Treas. Reg. § 1.338(h)(10)-1(c)(2). See August & Anderson, “Conversions From C to S to C Status,” NYU 60th IFT, 2001).

C. Tax Representations In Connection With A Tax-Free Reorganization

1. Acknowledgment of Tax Free Reorganization. Where the seller is receiving buyer stock in a tax free reorganization, the buyer will also be required to make some or most of the tax representations and warranties that the seller is required to make. Both parties will warrant that each is presently unaware of any facts, or has not taken any action, that would make the transaction ineligible for tax-free treatment.

a. Historic and Continued Line of Business Representation. The target should represent and warrant that it has an historic line of business that is being acquired by the buyer and the buyer should represent and warrant that it will continue to operate such historic line of business after the closing for a minimum period of time, i.e., 3 or more years. The buyer should further covenant that it will not make certain post-closing dispositions of acquired assets or stock and will not redeem any stock issued in the reorganization. Consideration also should be given to receiving a buyer representation that it will not make certain post-reorganization dispositions of acquired assets or stock, and will not redeem stock issued in the reorganization. The seller will covenant that the target will not make any unusual pre-closing distributions to its shareholders.

2. Reasonable or Best Efforts. The parties, as an additional covenant, will agree to make their reasonable or best efforts to have the transaction qualify as tax-free.
3. **Tax Opinions.** Counsel (or possibly a CPA firm) for the parties are generally required to issue a clean opinion as to the tax-free status of the transaction. See SEC Reg. S-K, 17 CAF §229.601(b)(8). Consideration should also be given to whether outside legal counsel should give the opinion when there may be disputed issues. See §7525. See *Chevron Corp. v. Pennzoil Corp.*, 974 F. 2d 1156 (9th Cir. 1992) (tax advice of attorney advising investor in another corporation's stock was privileged as to part not made public, but privilege was waived by client on other grounds); *Apex Municipal Fund v. --Group Securities*, 841 F. Supp. 1423 (S.D. Tex. 1993) (surveying authorities on privilege as to information gathered by attorney for underwriter and finding privilege waived only as to part published); see also Comment on "Disclosure of Confidences in an Evaluation Report Results in Loss of Confidentiality," Rule 2.3, ABA, Annotated Model Rules of Professional Conduct 711-712 (2d ed.).


   b. **No Opinion.** In a reorganization under §368(a)(1)(B), or §368(a)(2)(E), the buyer's counsel may not be required to issue an opinion since, if the transaction does not qualify as tax free, only the target shareholders will be subject to tax.
EXHIBITS

1. Short Form Confidentiality Agreement
2. Long Form Confidentiality Agreement
3. Draft Letter of Intent – Stock Purchase
5. Draft Letter of Intent – Asset Purchase
6. Draft Letter of Intent – Purchase of LLC – Membership Interest
7. Letter of Intent – Merger
8. Acquisition Agreement – Section 338(h)(10)
EXHIBIT

1. Short Form Confidentiality Agreement
1. Confidential Information; Exclusions.

(a) "Confidential Information" shall mean all financial, technical, strategic and other information relating to the Disclosing Party or its actual or prospective business, products, or technology that may be furnished or disclosed to Recipient by, or acquired by Recipient directly or indirectly from, the Disclosing Party. Such term shall also include all copies and extracts of Confidential Information and all computer-generated studies and data containing Confidential Information. Information considered to be Confidential Information by the Disclosing Party may be disclosed orally or in writing.

(b) For purposes of this Agreement, Confidential Information shall not include, and the obligations herein shall not apply to, information that: (a) is now or subsequently becomes generally available to the public through no fault of Recipient; (b) Recipient can demonstrate was rightfully in its possession prior to disclosure to Recipient by the Disclosing Party; (c) is independently developed by Recipient without the use of any Confidential Information provided by the Disclosing Party; or (d) Recipient rightfully obtains from a third party who, to Recipient's knowledge, has the right, without obligation to the Disclosing Party, to transfer or disclose such information.

2. Confidentiality Obligations.

(a) Recipient shall use its best efforts to protect the confidentiality of the Confidential Information it receives from the Disclosing Party.

(b) Recipient may use the Confidential Information only for the purpose of exploring an investment in or other business relationship with the Disclosing Party (the "Purpose") and may make no other use of the Confidential Information.

(c) Recipient may provide the Confidential Information it receives from the Disclosing Party only to those of its employees who (i) have a "need to know" such Confidential Information in order to enable Recipient to use such Confidential Information for the Purpose and (ii) are legally bound to use and disclose such Confidential Information for no other purpose.

(d) Recipient may, in addition, use or disclose, as applicable, the Confidential Information if: (a) required by any request or order of any government authority, provided that Recipient shall first attempt to notify the Disclosing Party of such requirement and, to the extent reasonable, permit the Disclosing Party to contest such requirement; (b) otherwise required by law; or (c) necessary to establish its rights under this Agreement.

(e) Recipient shall notify the Disclosing Party immediately in the event of loss or compromise of any Confidential Information.
3. Right to Disclose. The Disclosing Party warrants that it has the right to disclose the Confidential Information to Recipient. Except as otherwise provided, all information is provided "AS IS" and without any warranty, express, implied, or otherwise, regarding its accuracy or performance.

4. Return. Promptly upon the Disclosing Party's request, Recipient will either return or, if requested by the Disclosing Party, destroy all copies of any media or materials containing Confidential Information, including but not limited to all computer programs, documentation, notes, plans, drawings, and copies thereof to the extent that such contain Confidential Information.

5. Term. The term of this Agreement shall commence on the date of this Agreement and shall extend indefinitely.

6. No Implied License. No rights or licenses under copyright, patent, or trademark, or other intellectual property rights of the Disclosing Party are granted or implied by either a confidential or non-confidential disclosure.

7. Relief. Recipient agrees that, in the event of any breach of any provision hereof, the Disclosing Party may or will not have an adequate remedy in money or damages. Recipient therefore agrees that, in such event and without limiting any other remedies, the Disclosing Party shall be entitled to obtain injunctive relief against such breach in any court of competent jurisdiction. No failure or delay by a party hereto in enforcing any right, power or privilege created hereunder shall operate as an implied waiver thereof, nor shall any single or partial enforcement thereof preclude any other or further enforcement thereof or the enforcement of any other right, power, or privilege.

8. Miscellaneous. This Agreement will be governed by and construed in accordance with the laws of the State of _____________.

Agreed:

Xyz, INC.

Name of Company

__________________________________________

By: __________

(Signature)

By: __________

(Signature)

Date: __________
EXHIBIT

2 Long Form Confidentiality Agreement
October 7, 2013

DRAFT CONFIDENTIALITY AGREEMENT

Attention:

Ladies and Gentlemen:

In connection with your consideration of a possible negotiated transaction ("Transaction") with [ ], a Pennsylvania limited liability company doing business as [ ] (the "Company"), we may provide information to you concerning our business, financial condition, operations, assets, and liabilities. As a condition to any such information being furnished to you or your Representatives, you agree to treat any such information in accordance with, and to otherwise comply with, the terms and conditions set forth in this Agreement.

1. CERTAIN DEFINED TERMS

As used in this Agreement,

(a) the term "Representative" means, as to any person, such person’s affiliates, and its and their directors, officers, managers, general partners, members, employees and agents, advisors (including without limitation, financial advisors, legal counsel, and accountants), and controlling persons; the term "affiliate" has the meaning given to that term in Rule 12b-2 of the General Rules and Regulations under the Securities Exchange Act of 1934, as amended (the "Exchange Act"); and the term "person" means natural persons and all legal persons, including, without limitation, any corporation, general or limited partnership, limited liability company, trust, or other entity or company.

(b) the term "Evaluation Material" means all information concerning the Company (whether furnished before or after the date hereof, whether prepared by the Company, its Representatives, or otherwise, whether or not marked as being confidential and regardless of the form of communication, including oral as well as written and electronic communications) that is furnished to you or to your Representatives by or on behalf of the Company. The term "Evaluation Material" also includes all notes, analyses, compilations, studies, interpretations, and other documents prepared by you or your Representatives that contain, reflect, or are based upon, in whole or in part, the information that the Company or the Company’s Representatives furnish to you or your Representatives. The term "Evaluation Material" does not include information that (i) has become generally known to the public other than as a result of a disclosure by the Company or the Company’s Representatives, (ii) was within your possession prior to its being furnished to you by or on behalf of the Company, provided that the source of such information was not bound by a confidentiality agreement with, or other contractual, legal, or fiduciary obligation of confidentiality to, the Company or any other person with...
respect to such information, or (iii) has become available to you on a non-confidential basis from a source other than the Company or any of the Company’s Representatives if such source was not bound by a confidentiality agreement with, or other contractual, legal, or fiduciary obligation of confidentiality to, the Company or any other person with respect to such information.

2. USE OF EVALUATION MATERIAL AND CONFIDENTIALITY

You will use the Evaluation Material solely for the purpose of evaluating and negotiating the terms of a Transaction, will keep the Evaluation Material strictly confidential, and will not disclose any of the Evaluation Material in any manner whatsoever without the prior written consent of the Company; provided, however, that you may disclose the Evaluation Material to your Representatives who agree to use the Evaluation Material solely for the purpose of evaluating and negotiating the terms of a Transaction, to keep the Evaluation Material strictly confidential, and not to disclose any of the Evaluation Material in any manner whatsoever without the prior written consent of the Company; provided, further, that such Representatives are provided with a copy of this Agreement and agree to be bound by the terms of this Agreement to the same extent as if they were parties hereto. In any event, you will be responsible for any breach of this Agreement by any of your Representatives and you agree, at your sole expense, to take all reasonable measures to assure that your Representatives do not make any prohibited or unauthorized disclosure or use (including in legal proceedings) of the Evaluation Material.

3. NONDISCLOSURE OF TRANSACTION

Except as set forth in Paragraph 4, you agree that, without our prior written consent, neither you nor any of your Representatives will disclose to any other person the fact that the Evaluation Material has been made available, the fact that discussions or negotiations concerning any Transaction are or may be taking place, or have taken place, or any of the terms, conditions, or other matters discussed with respect thereto. Without limiting the generality of the foregoing, you agree that neither you nor any of your Representatives will enter into any discussions or any agreement, understanding, or arrangement with any person regarding participation by that person or others in any Transaction.

4. LEGALLY COMPELLED DISCLOSURE

If you or any of your Representatives is required, in the written opinion of its legal counsel who has been informed of the relevant facts, by law or the rules of any securities exchange to which you or any such Representative is subject, or in any judicial, administrative, or other legal proceeding, or pursuant to subpoena, civil investigative demand, or other compulsory process, to disclose any of the Evaluation Material or any Transaction, you and your Representative shall provide the Company with prompt written notice of any such requirement, to the extent you and it may legally do so, so that the Company may seek a protective order or other appropriate remedy, and will consult with the Company with respect to the Company or you (or such Representative) taking steps to resist or narrow the scope of such required
disclosure. If, in the absence of a protective order or other remedy or the receipt of a waiver by the Company, you or any of your Representatives are nonetheless, in the further written opinion of legal counsel, legally compelled to disclose Evaluation Material to any tribunal or other authority or else stand liable for contempt or suffer other censure or penalty, you (or such Representative) may disclose only that portion of the Evaluation Material that such counsel advises is legally required to be disclosed, provided that you (or such Representative) exercise best efforts to preserve the confidentiality of the Evaluation Material, including, without limitation, by cooperating with the Company to obtain an appropriate protective order or other reliable assurance that confidential treatment will be accorded the Evaluation Material by such tribunal or other authority.

5. TERMINATION OF DISCUSSIONS; RETURN OF EVALUATION MATERIAL

(a) If you determine that you do not wish to proceed with a Transaction, you will promptly inform the Company in writing of that determination. In that case, or at any time upon the request of the Company for any reason, you will promptly, and in any event no later than thirty (30) days after the request, deliver to the Company or, at the Company’s option, destroy all Evaluation Material (and all copies, extracts, or other reproductions thereof), whether in paper, electronic, or other form or media. In the event of such a determination or request, all Evaluation Material prepared by you or your Representatives will be destroyed within such thirty (30) day period and no copy, extract, or other reproduction thereof will be retained, whether in paper, electronic, or other form or media.

(b) Notwithstanding the foregoing, you may retain data or electronic records containing Evaluation Material for the purposes of backup, recovery, contingency planning, or business continuity planning so long as such data or records, to the extent not permanently deleted or overwritten in the ordinary course of business, are not accessible in the ordinary course of business and are not accessed except as required for backup, recovery, contingency planning, or business continuity purposes. If such data or records are restored or otherwise become accessible, you agree to permanently delete them.

(c) Through an authorized supervising officer, you shall certify in writing to the Company the destruction of the Evaluation Material, including that prepared by you or your Representatives, promptly after such destruction occurs. Notwithstanding the return or destruction of the Evaluation Material, you and your Representatives will continue to be bound by obligations of confidentiality and other obligations hereunder.
6. PRIVILEGED INFORMATION

Neither party intends that the provision of any Evaluation Material will be deemed to waive or in any manner diminish any attorney-client privilege, attorney work product protection, or other privilege or protection applicable to any such Evaluation Material. The parties acknowledge and agree that they (a) share common legal, as well as commercial, interests in all of the Evaluation Material, (b) are or may become joint defendants in legal proceedings to which such Evaluation Material relates, and (c) intend that all such privileges and protections remain intact should either party become subject to any legal proceedings to which such Evaluation Material is relevant. In furtherance of the foregoing, each party agrees not to claim or contend that the other party has waived any attorney-client privilege, attorney work product protection, or other privilege or protection by providing information pursuant to this Agreement, or any subsequent definitive agreement regarding a Transaction into which the parties may enter.

7. COMPLETENESS AND ACCURACY OF EVALUATION MATERIAL

We reserve the right, in our sole discretion, to determine what information we will provide or withhold, as well as the times at which we will make such information available. Neither we nor any of our Representatives have made or will make any representation or warranty, express or implied, as to the accuracy or completeness of the Evaluation Material. You agree that none of the Company or any of its Representatives will have any liability to you or to your Representatives relating to or resulting from the use of the Evaluation Material or any errors therein or omissions therefrom. You also agree that you are not entitled to rely on the accuracy or completeness of any Evaluation Material and that you will be entitled to rely solely on such representations or warranties regarding the Evaluation Material or the subject matter thereof as may be made in any definitive agreement relating to a Transaction, when, as, and if entered into by the parties, and subject to such limitations and restrictions as may be specified therein.

8. EFFECT OF AGREEMENT

No agreement providing for any Transaction currently exists and none will be deemed to exist between the parties unless and until a definitive written agreement with respect to a Transaction is negotiated, executed, and delivered with the intention of legally binding the parties and any other necessary parties. The parties agree that, unless and until a definitive agreement between them with respect to a Transaction has been executed and delivered by them and any such other parties with the intention of being legally bound, neither party nor any of their respective affiliates will be under any obligation of any kind with respect to a Transaction, including any obligation to commence or continue negotiations, by virtue of this Agreement or any other written or oral expression with respect to such a Transaction by the parties or any of their Representatives.
9. DESIGNATED CONTACT PERSON

All communications regarding any Transaction, requests for additional information, requests for facility tours or management meetings, and discussions or questions regarding procedures will be directed exclusively to [__________], and neither you nor any of your Representatives will initiate or cause to be initiated any communication with any manager, officer, or employee of the Company, or their Representatives, other than [__________], concerning the Evaluation Material (including any requests to obtain or discuss any Evaluation Material) or any Transaction.

10. NON-SOLICITATION

You agree that, for a period of two (2) years from the date hereof, neither you nor any of your affiliates will, directly or indirectly, solicit or hire for employment any person who is currently, or at any time during the period commencing on the date hereof through the date you inform the Company that you do not wish to proceed with a Transaction becomes, an officer or employee of the Company.

11. REMEDIES

You acknowledge and agree that money damages would not be a sufficient remedy for breach of this Agreement by you or any of your Representatives and that the Company will be entitled to equitable relief, including injunctions and specific performance, as a remedy for any such breach without the necessity of posting any bond or other security and without proof of irreparable harm or of any actual damages. Such remedies will nonetheless not be deemed to be the exclusive remedies for a breach of this Agreement and will be in addition to all other remedies available at law or in equity.

12. MISCELLANEOUS

(a) Entire Agreement. This Agreement supersedes all prior agreements, whether written or oral, between the parties with respect to its subject matter and constitutes a complete and exclusive statement of the terms of the agreement between the parties with respect to its subject matter.

(b) Modification. This Agreement may only be amended, supplemented, or otherwise modified by a writing executed by the parties.

(c) Governing Law. All matters relating to or arising out of this Agreement or any Transaction and the rights of the parties (sounding in contract, tort, or otherwise) will be governed by and construed and interpreted under the laws of the Commonwealth of Pennsylvania, without regard to conflicts of laws principles that would require the application of any other law.
(d) Jurisdiction; Service of Process. Any proceeding arising out of or relating to this Agreement or any Transaction shall be brought in the courts of the Commonwealth of __________, County of ____, or, if it has or can acquire jurisdiction, in the United States District Court for the Eastern District of __________, and each of the parties irrevocably submits to the exclusive jurisdiction of each such court in any such proceeding, waives any objection it may now or hereafter have to venue or to convenience of forum, agrees that all claims in respect of such proceeding shall be heard and determined only in any such court, and agrees not to bring any proceeding arising out of or relating to this Agreement in any other court. Each party acknowledges and agrees that this Paragraph 12(d) constitutes a voluntary and bargained-for agreement between the parties. Process in any proceeding referred to in the first sentence of this paragraph may be served on any party anywhere in the world.

(e) No Waiver. Neither any failure nor any delay by any party in exercising any right, power, or privilege under this Agreement will operate as a waiver of such right, power, or privilege, and no single or partial exercise of any such right, power, or privilege will preclude any other or further exercise of such right, power, or privilege or the exercise of any other right, power, or privilege. To the maximum extent permitted by applicable law, (i) no claim or right arising out of this Agreement can be waived by a party, in whole or in part, unless made in a writing signed by such party; (ii) a waiver given by a party will only be applicable to the specific instance for which it is given; and (iii) no notice to or demand on a party will (A) waive or otherwise affect any obligation of that party or (B) affect the right of the party giving such notice or demand to take further action without notice or demand as provided in this Agreement or the documents referred to in this Agreement.

(f) Severability. If any provision of this Agreement is held invalid or unenforceable by any court of competent jurisdiction, the other provisions of this Agreement will remain in full force and effect. Any provision of this Agreement held invalid or unenforceable only in part or degree will remain in full force and effect to the extent not held invalid or unenforceable.

(g) Counterparts/Electronic Signatures. This Agreement may be executed in one or more counterparts, each of which will be deemed to be an original copy and all of which, when taken together, will be deemed to constitute one and the same agreement and will be effective when counterparts have been signed by each of the parties and delivered to the other parties. A manual signature whose image shall have been transmitted electronically will constitute an original signature for all purposes. The delivery of copies of this Agreement, including executed signature pages, by electronic transmission will constitute effective delivery of this Agreement for all purposes.
Please confirm your agreement with the foregoing by signing and returning one copy of this letter to the undersigned, whereupon this letter will become a binding agreement between you and us.

Very truly yours,

[________________________]

By: ______________________
Name: ____________________
Title: _____________________

By: ______________________
Name: ____________________
Title: _____________________

By: ______________________
Name: ____________________
Title: _____________________

Accepted and agreed as of the date first written above.

[RECIPIENT]

By: ______________________
Name: ____________________
Title: _____________________
3. Draft Letter of Intent – Stock Purchase
DRAFT LETTER OF INTENT

Date

[Name and Address]

Re:

Dear:

The purpose of this letter ("Letter of Intent") is to set forth the principal terms and conditions with respect to the proposed purchase, by ______________________ and ______________________ (collectively, "The Buying Group"), all of the issued and outstanding capital stock of ______________________, Inc. ("___________") currently owned by ______________________ ("___________"). This transaction is a stock sale by ______________________ of all of __________'s stock. ______________________ is to receive long-term capital gain tax treatment under a stock sale agreement, and is not making, nor will be required to make a Section 338 or equivalent tax election. Further, __________ will not be required to comply with any such election made by The Buying Group. This Letter of Intent is not a legally binding agreement, and is simply a term sheet of the parties' discussion points. The only binding provision is that provision which states __________ will not solicit certain other offers as specified in paragraph 3, below. The sale of stock is subject to the underlying entity's liabilities. The Buying Group is sometimes referred to as the "Buyer."

Purchasing Entity:

The Buying Group intends to jointly own ______________________ Benefit Solutions, Inc., a Pennsylvania corporation or create a new legal entity (collectively, "Buyer") to purchase the stock of ______________________.

Transaction Components:

Buyer would purchase all of the stock of ______________________, Inc., a ________ corporation ("___________") owned by ______________________ (the "___________ Stock"). The sale is subject to all of the liabilities of ______________________. The Buying Group may purchase or not purchase ______________________ 20% stock ownership of ______________________, but any such purchase shall not affect the purchase price paid to ______________________.

The following paragraphs reflect The Buying Group's and ______________________'s understanding of the matters described therein, and neither constitutes a complete statement of, nor a legally binding or enforceable agreement or commitment on the part of, ______________________ or The Buying Group (except for paragraph 3).

1. Purchase Price and Other Consideration.
(a) Purchase Price for __________ Stock. As consideration for the purchase of the __________ Stock, Buyer would pay to __________ a purchase price of:

(i) $________ in the form of an initial cash payment of $____ due and payable upon the closing date of the transaction, and a promissory note, payable in ten (10) annual installment payments of $____, the first such payment due on __________, and __________ of each year thereafter until paid in full (the "Note"); and

(ii) a payment equal to ___ percent (%) of all new credit union client or credit union related business generated by the entities referred to as __________ and its affiliated entities, __________ or other entity that is formed by The Buying Group as a party to this Letter of Intent. Such payments ("Payments") will be paid to __________ for a ____ year period commencing upon the closing of proposed transaction (the "Payment Period"). For the avoidance of doubt, the Payment would only be paid with respect to policies with a policy date that falls after the closing of the proposed transaction. Also, in the avoidance of doubt, it would be preferable to warrant that all new credit union business reside in a single designated entity.

(iii) In addition to the stated Purchase Price, The Buying Group will pay to __________ within ____ days of the closing, the cash sum of $____. __________ agrees to pay to The Buying Group at such time, and only at that time when __________ is able to liquidate all, or any portion of the __________ shares of __________ currently holds as an individual, in an amount up to $__ per share of such dollar amount liquidated. The $____ paid by the Buying Group would be paid to __________ within ____ days of the closing of the proposed transaction. Such return of monies by __________ to The Buying Group shall not be any amount in excess of the liquidation price ____ dollars of ($_) per share of the __________, Inc. stock. Further, __________ shall, to the extent, and within methodologies permitted by __________ and by law, pay over to The Buying Group any dividends __________ receives on said stock after the closing date hereunder of a final agreement between The Buying Group and __________ for the purchase of all of the __________’s __________ shares. __________ shall be made tax neutral by the Buying Group in any return of monies or dividends to the Buying Group. The purchase price of the __________ stock to be paid by the Buying Group at the closing includes the $____ of __________, Inc. stock that is currently owned by The __________. The Buying Group will assume all responsibility for the transfer, utilization, or liquidation of the ____ shares owned by __________. The Buying Group recognizes that __________, Inc. may not issue dividends, allow a transfer or provide a liquidity event for such shares.

(b) Assumption of Note. __________ is the payee under that certain promissory note from __________ (the "Note"). As further consideration for the purchase of the __________ Stock, Buyer would assume the payment obligations under the __________ Note, and same would be guaranteed by the guarantees described herein.

(c) Personal Guarantees. __________, __________, and the spouses of __________ and __________, will jointly and severally guarantee the amount owed under the proposal. Further, __________ shall provide guarantees from all entities that he owns, in whole or in part, including __________ Corp. and any affiliate or other entity associated with
Corporation. Further, __________ will provide financial statements of such entities.

(d) Potential Adjustment. If both: (i) ______ fails to generate at least $__________ of total revenue from new business in a calendar year; and (ii) in the immediate next calendar year renewals on all insurance business of ______ drops to $__________ or less, then:

(i) ___% of all commissions payable on the existing business as of the closing date of the proposed transaction that were payable to (aa) ______________________, or (bb) ______________________ or any other of its affiliates (the "Commissions Payable"), would immediately be transferred to ______________________ at ___________’s written election (the "Election"). ______________________ would continue to provide administrative services for this ______________________ business in the same manner as prior to the election;

(ii) the personal guarantees would as of such date of the Election cease to apply;

(iii) all amounts under the Note and the ______________________ Note would continue to be paid to ______________________; and if and to the extent that __________ realizes proceeds from the percentage of gross new Commissions Payable that exceed the amount owed to ______________________ on the transaction proposed hereunder (including amounts under the ___________ Note), __________ would immediately transfer such excess proceeds to Buyer without further demand by Buyer. This Election is at the sole discretion of __________ to make.

(e) Benefits. Buyer agrees that, to the extent permissible, Buyer would cause __________ to keep ______________________ on its medical benefit plan thru __________. If, for any reason, __________ was found to be ineligible to participate in __________’s medical benefit plan during the foregoing period, __________ would contribute toward Ms. __________’s premiums for a policy of medical coverage or coverage provided under COBRA, with benefits comparable to those that would have been provided to Ms. __________ under __________’s medical benefit plan, in an amount at least equal to the monthly premium that __________ would have paid toward Ms. __________’s participation in __________’s medical benefit plan or, if greater, pay to ______________________ the cash-equivalent of such amounts that are incurred for medical care and would have been covered under her existing COBRA coverage, but for cancellation of said coverage. The objective is to get to the date (January 1, 2014) where Ms __________ is eligible for an individual policy under an exchange as provided in the Affordable Care Act.

(f) Sale of Buyer. If Buyer sells ______________________, or the entity ultimately owned by the Buying Group, or a parent of such entity prior to payment in full of the Note and the ______________________ Note, all outstanding obligations to ______________________ under the Note and the ______________________ Note would be due at closing of the transaction. Additionally, the remaining Payments that otherwise would be due and payable during the Payment Period would be due at closing of the transaction. Any amounts due ______________________ as a percentage of all new commission revenue would also be due at closing of the transaction and would be an amount equal to the average of such payments paid during the previous two years, multiplied by the remaining Payment Period and fractions thereof. In the
event there is a sale of _________ in the first two years after the closing, the formula would be $_________ x ___% x ___ years, less any revenue percentage payments (for new policies) previously made after the closing to _________ by The Buying Group.

2. Contingencies. It would be a condition to the proposed transaction that the parties hereto negotiate and enter into one or more mutually acceptable and definitive forms of Stock Purchase Agreements (collectively, the "Agreement") at the earliest practicable date. The Buying Group contemplates entering into the Agreement on or before _________, and it further contemplates closing the proposed transaction no later than December 1, 2013. The Agreement would contain closing conditions that are customary for transactions of this nature. _________ and _________ have been involved in running _________ and The New _________, LLC and are aware of their respective operations and the details thereof and thus any representations shall be limited to the title to the stock being sold hereunder. In particular, the transaction would be conditioned upon:

(a) Relinquishment of rights. _________ would relinquish any and all rights that he, or any business or person with whom he is affiliated, may have to receive a commission or other compensation from _________ following the closing of the proposed transaction;

(b) Credit lines. _________ would cause that certain line of credit from _________ Bank to _________ to be paid off completely and closed on or before the closing of the proposed transaction. The Buying Group is responsible for obtaining any credit lines that The Buying Group deems necessary after the closing;

(c) Debt to. _________, of The Buying Group, would confirm and provide evidence satisfactory to The Buying Group that all debts to _________ have been paid in full, or are de minimis, on or prior to the closing of the proposed transaction;

(d) Interference. _________ would not after the closing in any way interfere with The Buying Group's efforts to become the broker of records on all accounts as of the closing of the proposed transaction;

(e) Due diligence. The Buying Group would complete a final and reasonable due diligence investigation of _________ and _________, to The Buying Group's sole satisfaction, in its discretion, including, without limitation accounting and operations. Such due diligence to be completed by _________;

(f) No material adverse change. There would be no material change in the operation of _________ or _________ between the date of execution of this Letter of Intent and the date of execution of the Agreement, except for items caused by a member of the Buying Group. _________ nor _________ will pay out any unpaid commissions earned prior to _________ to _________ or _________.

___________ will not payout to _________ or _________ any bonuses after _________ Further, _________ will not pay out any other amounts to _________
except for the regularly scheduled salaries and ________________'s regularly scheduled payments on the __________________ Note. However, ________________ will not be responsible for changes caused by unauthorized or negligent actions of members of The Buying Group who are currently employees of The New __________________ LLC.

(g) Third party consents. The receipt of any (i) necessary governmental consents to the assignment of all approvals, authorizations, certifications, consents, franchises, licenses, notifications, orders, permits, registrations, variances and similar rights in connection with any governmental authority, whether foreign, federal, state or local, necessary for the present conduct or operation of the business of ________________ and ________________, and (ii) any third-party consents necessary as a result of The Buying Group purchasing the __________________ Stock;

3. No Other Transactions. With the exception of the Permitted Parties described in paragraph (a), below, following the date of execution of this Letter of Intent, ________________ and his legal advisors will not solicit offers from, negotiate with any other party for the purpose of acquiring the __________________ Stock or substantially all the assets of The New __________________ LLC, and ________________ will cease any current discussions with any third parties concerning such an acquisition transaction and other than with those Permitted Parties described in paragraph (a) below, ________________ will negotiate exclusively with Buyer in connection therewith.

(a) ________________ may continue discussions regarding the sale and transfer to, or continuation of, ________________ and The New ________________ LLC or certain of their respective assets with ________________s, its parent, ________________, Inc., and/or ________________s and their respective affiliates. These parties are currently known to ________________ and ________________ who are members of The Buying Group. As described in this paragraph these parties are referred to as "Permitted Parties."

(b) This paragraph 3 shall terminate and have no force in the event of the termination of this Letter of Intent by any party at any time, and in all events will terminate on

4. Operating agreements. The Buying Group shall be satisfied that any and all requirements under any shareholders' or operating agreement, and any such shareholders' or operating agreement that it must enter into, which the Buying Group shall have until ________________ to raise any and all issues of dissatisfaction. With the exception of the Permitted Parties described in paragraph (a), below, following the date of execution of this Letter of Intent, ________________ and his legal advisors will not solicit offers from, negotiate with any other party for the purpose of acquiring the __________________ Stock or substantially all the assets of The New ________________, LLC, and ________________ will cease any current discussions with any third parties concerning such an acquisition transaction and other than with those Permitted Parties described in paragraph (a) below, ________________ will negotiate exclusively with Buyer in connection therewith.

5. Binding Provision. This Letter of Intent constitutes merely an outline of the principal intended terms of the proposed transaction to facilitate the negotiation and preparation of the
Agreement. Neither this Letter of Intent, nor any negotiations or understandings prior to the execution of the Agreement are intended to be or shall constitute a binding and legally enforceable agreement of the parties hereto, except for paragraph 3. Without limiting the foregoing, the parties acknowledge that either party may abandon negotiations and terminate this Letter of Intent for any reason whatsoever at any time. Each party covenants not to institute or participate in any proceeding seeking to establish a contrary interpretation.

6. Effectiveness. This Letter of Intent must be accepted by __________________________ no later than seven (7) days from the date of this Letter of Intent, and, except as provided in this Section 5, shall terminate and be of no further force or effect if not accepted by such date. The effective date of this Letter of Intent shall be its acceptance date. If the parties enter into this Letter of Intent, but fail to enter into the final purchase Agreement on or before __________________________, the provisions contained in this Letter of Intent shall terminate and be of no further force or effect as of such date.

7. Access and Cooperation. Commencing upon execution of this Letter of Intent, __________________________ will provide Buyer and its employees, auditors, legal counsel and other authorized representatives with all reasonable opportunity and access, during normal business hours, to inspect and investigate __________________________’s and __________________________’s assets, books and records, contracts, commitments, facilities, liabilities and operations and to interview and submit requests for information to __________________________’s and __________________________’s key personnel, independent accountants, actuaries and legal counsel for the purpose of completing its due diligence review.

8. Expenses. Each side will be responsible for its respective expenses in connection with the transactions contemplated by this Letter of Intent. It is understood that __________________________’s expenses are expenses of __________________________ and will be paid by __________________________.

9. Conduct of Business. From and after this date until termination of this Letter of Intent, __________________________ (and the members of The Buying Group who currently work for The New __________________________, LLC) shall conduct __________________________’s and __________________________’s respective businesses only in the normal and ordinary course and shall use their best efforts to preserve their respective business organization intact, and to preserve the goodwill of their respective customers and suppliers. In addition, without Buyer’s prior consent and prior to termination of this Letter of Intent, __________________________ shall not transfer, sell or dispose, or cause the transfer, sale or disposal, of any of the assets of, of, any additional assets relating to, __________________________, and __________________________, except in the ordinary course of business.

10. Confidentiality. The parties agree to keep this Letter of Intent and the proposed transaction and agreements (including drafts of such agreements) strictly secret and confidential until such time as they mutually agree that a public announcement shall be made, provided that if in the written opinion of counsel for either of the parties public disclosure is required under the applicable law, and if reasonable prior written notice (not less than twenty-four hours) of such required disclosure is given to the other party, then the consent of the other party shall not be required. In all events, the parties shall consult with each other and use all reasonable efforts to agree on the content and manner of any disclosure permitted or required under this Section 9. The provisions of this Section 9 shall survive any termination of this Letter of Intent. Notwithstanding, Buyer may disclose this Letter of Intent and the proposed transaction and agreements (including drafts of such agreements) to its employees, auditors,
potential lenders, legal counsel and other authorized representatives, provided such persons also agree to keep this Letter of Intent confidential.

11. Remedies. It is understood and agreed that money damages would not be a sufficient remedy for any breach of the enforceable provisions of paragraph 3 of this Letter of Intent by either party hereto and that the parties shall be entitled to equitable relief, including injunction and specific performance, as a remedy for any such breach. Such remedies shall not be deemed to be the exclusive remedies for a breach by either party of paragraph 3 of this Letter of Intent but shall be in addition to all other remedies available at law or equity to the non-breaching party. In the event of litigation relating to paragraph 3 of this Letter of Intent, the nonprevailing party shall pay the prevailing party's reasonable legal fees and disbursements incurred in connection with litigation relating thereto, including any appeal therefrom.

12. Governing law. This Letter of Intent shall be governed, construed and interpreted in accordance with the laws of the State of__________.

13. Counterparts. This Letter of Intent may be executed in counterparts, each of which will be deemed an original, but all of which taken together will constitute one and the same instrument.

Kindly acknowledge your agreement to this Letter of Intent by signing and returning a copy to the undersigned. Should Buyer not receive a fully executed copy of this Letter of Intent within seven (7) days of the date hereof, this Letter of Intent shall be rendered null and void.

Sincerely,

(Signatures on following page)
EXHIBIT

Re: Letter of Intent

Gentlemen:

This letter, when executed by you (the “Letter of Intent”), will confirm the various discussions that we have had with you with respect to the proposed issuance of certain shares of the common stock of ________________, an _______________ corporation (“Company”), to ______________________, a Delaware limited liability company (“Investor”). In particular, the following is proposed:

1. Stock Issuance. Company would issue an aggregate of _______________ (_____________) shares of the common stock of Company (the “Shares”) in exchange for the payment by Investor of the sum of $ ______________ (the “Purchase Price”). The Purchase Price would be payable in full at the Closing (as defined below). (All dollar amounts set forth in this Letter of Intent are expressed in United States Dollars.)

2. Percentage. As of the Closing, the Shares would be equal to ____ percent (%%) of the aggregate shares of the capital stock of Company then issued and outstanding. For the purpose of calculating this percentage, all options, subscriptions, warrants and other rights or commitments to purchase or acquire from Company any shares of any class or series of the capital stock of Company that are then issued and outstanding would be deemed to have been exercised or converted.

3. Closing. The closing on the transactions contemplated by this Letter of Intent (the “Closing”) would take place at the offices of Investor’s legal counsel in ______ by no later Friday, ________________.
4. **Condition to Closing.** The following would be express conditions to the Closing:

   (a) The receipt of all consents and approvals required under applicable law in connection with the transactions described in this Letter of Intent, including without limitation the approval of the ___________________.

5. **Due Diligence.** Promptly following the execution of this Letter of Intent, Company will give Investor’s employees, agents, representatives, accountants and counsel such opportunity, from time to time during normal business hours, as they may reasonably request to inspect, review, investigate and audit Company’s business, including without limitation all liabilities, financial statements, contracts, commitments, operations, material and labor costs, accounting information, books, records and data of Company. Investor intends to commence its due diligence investigation immediately after this Letter of Intent has been signed.

6. **Definitive Stock Purchase Agreement.** Promptly following the completion of their due diligence, the parties will (assuming that they still desire to proceed with the arrangement contemplated by this Letter of Intent) negotiate a Definitive Stock Purchase Agreement and related documents and instruments (collectively, the “Definitive Stock Purchase Agreement”) containing the terms of the proposed arrangement. The parties agree to work diligently toward the execution of a mutually acceptable Definitive Stock Purchase Agreement. The Definitive Stock Purchase Agreement would contain representations, warranties, covenants, conditions and indemnities that are customary in transactions of this nature. It is contemplated that the Definitive Stock Purchase Agreement would be executed as soon as reasonably possible, but not later than Saturday, ____________.

7. **Confidentiality.**

   (a) During the term of this Letter of Intent and at all times thereafter, each party (the “Receiving Party”) will, and will direct its employees, officers, directors and agents to, hold and maintain the confidentiality of any and all Confidential Information (as hereinafter defined) previously or subsequently disclosed by either party to the other party or otherwise obtained by one party from the other party and, except as permitted under this Letter of Intent, will not, without the prior written consent of the disclosing party (the “Disclosing Party”), use any such Confidential Information for its own benefit, or publish, disclose, communicate, reveal or divulge any such Confidential Information to, or use any such Confidential Information for the direct or indirect benefit of, any person, corporation or other entity other than the Disclosing Party, and will use the same degree of care to avoid publication or dissemination of any such Confidential Information as the Receiving Party employs with respect to its own information which it does not desire to have published or disseminated. Confidential Information may be disseminated within the Receiving Party’s own organization only to the extent reasonably necessary in connection with the performance of their duties for the Receiving Party. This restriction is not intended to and will not prevent Investor from undertaking appropriate due diligence activities, including, but not limited to, meeting with Company’s key customers and vendors.

   (b) As used herein, the term “Confidential Information” means any agreements or contracts entered into between the Disclosing Party and any third party, any materials relating to any such agreements or contracts, as well as any trade secrets, writings,
databases, documents, specifications, drawings, sketches, diagrams, designs, charts, models, marketing studies, and other knowledge and processes of or developed by the Disclosing Party, advertising and sales materials, data processing reports, customer sales analyses, invoices, price lists and information, samples, process descriptions, manufacturing processes, business methods, business policies, procedures, techniques, research and development projects and results, projections, financial information, and information relating to customers, suppliers, distributors, projects under consideration or bid, profits, costs, pricing or tooling, any names and addresses of customers or clients and any data on or relating to past, present and prospective customers or clients, and any and all other materials and information relating to or dealing with the business operations or activities of the Disclosing Party, whether disclosed at, through or in connection with any inspection, demonstration or presentation or otherwise, whether written or oral, tangible or intangible, whether machine readable or otherwise, which the Disclosing Party holds confidential. Notwithstanding the foregoing, the term “Confidential Information” will not include information that is readily available in the public domain.

(c) All Confidential Information will be and remain the sole and exclusive property of the Disclosing Party. All physical representations of such information and materials will be returned to the Disclosing Party promptly upon its request therefor, together with all copies made thereof. Upon receiving such a request, the Receiving Party will also erase or destroy any Confidential Information stored in computer memory or any other data storage media or apparatus. All such information and materials will be returned with, or, if destroyed will be followed by, a letter, executed by a duly authorized officer of the Receiving Party, confirming that all such information and materials, whether in original or copied form, has been returned to the Disclosing Party or destroyed.

(d) The Receiving Party will use its best efforts to insure that all of its employees, officers, directors, affiliates and agents who have access to Confidential Information comply in all respects with the terms of this Letter of Intent.

8. Exclusivity. Between the date of this Letter of Intent and the date that is 60 days after the date on which this Letter of Intent terminates, neither Company nor nor any person or entity acting on behalf of either or both of them will solicit or encourage, directly or indirectly, any inquiries, discussions or proposals, or enter into any discussions, negotiations or agreements, with any person or entity other than Investor with respect to his issuance, sale or other transfer or disposition of any of the stock or assets of Company, other than transactions in the ordinary course of Company’s business. Company will immediately advise Investor of any inquiry or proposal that Company may receive or become aware of with respect to any of the foregoing.

9. No Obligation. Nothing contained in this Letter of Intent will be construed as obligating either party to transact any business with the other party as a result of the execution of this Letter of Intent, the disclosure of Confidential Information hereunder or otherwise, nor will anything contained herein be construed as granting or conferring any rights on the Receiving Party, whether by license or otherwise, whether expressly, impliedly or otherwise, in or to any Confidential Information, patents, copyrights, trademarks or other intellectual properties of the Disclosing Party, or any portion thereof.

10. Letter of Intent Not Binding. This Letter of Intent is not meant to contain all of the terms of the proposed transactions, is an expression of intent only and, except for
Paragraph 5 (Due Diligence), Paragraph 7 (Confidentiality), Paragraph 8 (Exclusivity), Paragraph 9 (No Obligation), Paragraph 10 (Letter of Intent Not Binding), Paragraph 11 (Costs and Expenses) and Paragraph 12 (Governing Law) hereof, does not constitute a legally binding obligation of either Investor or Company and remains subject to the completion of additional due diligence by the parties. Except for Paragraphs 5 and 7 through 12 hereof, this Letter of Intent is merely intended to serve as a guide for the preparation of the Definitive Stock Purchase Agreement and as evidence of the parties’ intent to achieve the Definitive Stock Purchase Agreement if all the terms and conditions thereof are fully satisfactory to each party hereto. Paragraphs 7 through 12 hereof constitute a legally binding agreement, in consideration of their respective undertakings, of each of Company and Investor, and the rights and obligations set forth in Paragraphs 7 through 12 hereof will survive any expiration or termination of this Letter of Intent. Except as otherwise provided in the preceding sentence, the parties hereto will be bound only upon the execution of the Definitive Stock Purchase Agreement.

11. Costs and Expenses. Company will pay all costs and expenses incurred in connection with the transactions contemplated by this Letter of Intent and the Definitive Stock Purchase Agreement, including without limitation all costs and expenses of Investor’s legal counsel (both in the United States and in India) and the travel expenses of Investor’s personnel related to this Letter of Intent and the Definitive Stock Purchase Agreement. Such costs and expenses will be paid by Company whether or not the Closing occurs, unless Investor refuses to close on substantially the same terms as are set forth in this Letter of Intent other than because of the disclosure of information not currently known to Investor.

12. Governing Law. The terms of this Letter of Intent will be governed by and construed in accordance with the laws of the State of _________ and, to the extent applicable, the federal law of the United States of America. The terms of the Definitive Stock Purchase Agreement will be governed by the State of _________ and, to the extent applicable, the federal law of the United States of America; provided, however, that, if and to the extent required by applicable law, one or more of the documents to be executed in connection with the Closing may be governed by the laws of _________.

Please indicate your acceptance of and concurrence with the terms and conditions set forth in this Letter of Intent by signing the acknowledgment set forth below and returning the same to Company. The proposal set forth herein will expire at 5:00 p.m., Eastern Time, on
Friday, _________ if Company has not executed this Letter of Intent and delivered it to Investor by that date. If signed by you, this Letter of Intent will terminate at 5:00 p.m., Eastern Time, on Saturday, _________ if the Definitive Stock Purchase Agreement has not been executed by both parties on or before that date.

Very truly yours,

COMPANY NAME
AND ADDRESS

By: ____________________________

Title: __________________________

Read, Approved and Agreed To this ______ day of __________, _____:

___________________________

By: ____________________________
NAME

___________________________

NAME [individually]
EXHIBIT

5. Draft Letter of Intent – Asset Purchase
Letter of Intent

____, 20____

Company
[Address]

Re: Proposal to Purchase Assets of the Company

Dear [Chairman/President]:

This letter will confirm that Buyer is interested in acquiring substantially all of the assets of the Company, and assuming certain of its liabilities and obligations, on terms that would be mutually agreeable. In this letter, (a) Buyer and the Company are sometimes called singularly a "Party" and collectively the "Parties;" (b) the shareholders of the Company are sometimes called the "Shareholders;" and (c) Buyer's possible acquisition of the assets of the Company is sometimes called the "Possible Acquisition."

[PART ONE]

The Parties wish to commence negotiating a definitive written acquisition agreement providing for the Possible Acquisition (a "Definitive Agreement"). To facilitate the negotiation of a Definitive Agreement, the Parties request that Buyer's counsel prepare an initial draft. The execution of any such Definitive Agreement would be subject to the satisfactory completion of Buyer's ongoing investigation of the Company's business and would also be subject to approval by Buyer's board of directors.

Based upon the information currently known to Buyer, it is proposed that the Definitive Agreement include the following terms:

[BASIC TRANSACTION]

1. The Company would sell all of its operating assets, property, rights, good-will and business to Buyer at the price (the "Purchase Price") set forth in Paragraph 2 below. The closing of this transaction (the "Closing") would occur as soon as possible after the termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act").

[PURCHASE PRICE]
2. The Purchase Price would be ______ dollars ($______) (subject to adjustment as described below) and would be paid in the following manner:

(a) at the Closing, Buyer would pay the Company the sum of $______ in cash;
(b) at the Closing, Buyer would deposit with a mutually acceptable escrow agent the sum of ______ dollars ($______), which would be held in escrow for a period of at least ______ (______) years in order to secure the performance of the Company's obligations under the Definitive Agreement and related documents; and
(c) at the Closing, Buyer would execute and deliver to the Company an unsecured, nonnegotiable, subordinated promissory note. The promissory note to be delivered to the Company by Buyer would have a principal amount of ______ dollars ($______), would bear interest at the rate of ______ percent (______%) per annum, would mature on the ______ (______) anniversary of the Closing, and would provide for ______ (______) equal [annual] [quarterly] payments of principal along with [annual] [quarterly] payments of accrued interest.

The Purchase Price assumes that the Company will transfer working capital at the Closing at least equal to ______ dollars ($______), its working capital as of its most recent balance sheet prior to execution of this letter. For this purpose, working capital shall be determined by subtracting current liabilities to be assumed (consisting of accounts and notes payable, accrued expenses, provisions for taxes and current maturity on long-term debt) from current assets to be acquired (consisting of cash and cash equivalents, accounts receivable, inventory and pre-paid expenses). The Purchase Price would be increased or decreased based upon the amount by which the working capital transferred at the Closing exceeds or falls short of the initial working capital as reflected on the Company's most recent balance sheet on a dollar-for-dollar basis.

[EMPLOYMENT AND NONCOMPETITION AGREEMENTS]

3. At the Closing:

(a) Buyer and A would enter into a ______-year (______) year) employment agreement under which A would agree to serve as Buyer's [Vice President and Chief Operating Officer] and would be entitled to receive a salary of ______ dollars ($______) per year; and
(b) each Shareholder would execute a ______-year (______) year) noncompetition agreement in favor of Buyer.

[OTHER TERMS]

4. The Company and the Shareholders would make comprehensive representations and warranties to Buyer and would provide comprehensive covenants, indemnities and other protections for the benefit of Buyer. The consummation of the contemplated transactions by Buyer would be subject to the satisfaction of various conditions, including:

(a) _______
(b) _______
[PART TWO]

The following paragraphs of this letter (the "Binding Provisions") are the legally binding and enforceable agreements of Buyer, the Company and the Shareholders.

[ACCESS]

5. During the period from the date this letter is signed on behalf of the Company and the Shareholders (the "Signing Date") until the date on which either Party provides the other Party with written notice that negotiations toward a Definitive Agreement are terminated (the "Termination Date"), the Company will afford Buyer full and free access to the Company, its personnel, properties, contracts, books and records and all other documents and data, subject to the confidentiality provisions referred to or described in paragraph 9 of this letter.

[EXCLUSIVE DEALING]

6. Until the later of (a) [90] days after the Signing Date or (b) the Termination Date:

(a) Neither the Company nor the Shareholders will, directly or indirectly, through any representative or otherwise, solicit or entertain offers from, negotiate with or in any manner encourage, discuss, accept or consider any proposal of any other person relating to the acquisition of the Company, its assets or business, in whole or in part, whether directly or indirectly, through purchase, merger, consolidation or otherwise (other than sales of inventory in the ordinary course); and

(b) Either the Company or any Shareholder will, as the case may be, immediately notify Buyer regarding any contact between the Company, such Shareholder or their respective representatives and any other person regarding any such offer or proposal or any related inquiry.

[BREAK-UP FEE]

7. If (a) either the Company or any Shareholder breaches Paragraph 6 of this letter or the Company provides to Buyer written notice that negotiations toward a Definitive Agreement are terminated, and (b) within [six] months after the date of such breach or the Termination Date, as the case may be, either the Company or any Shareholder signs a letter of intent or other agreement relating to the acquisition of a material portion of the Company or its capital stock, assets or business, in whole or in part, whether directly or indirectly, through purchase, merger, consolidation or otherwise (other than sales of inventory or immaterial portions of the Company's assets in the ordinary course) and such transaction is ultimately consummated, then, immediately upon the closing of such transaction, the Company will pay to Buyer the sum dollars ($). This fee will not serve as the exclusive remedy to Buyer under this letter in the event of a breach by the Company or any Shareholder of Paragraph 6 of this letter or
any other of the Binding Provisions, and Buyer will be entitled to all other rights and remedies provided by law or in equity.

[CONDUCT OF BUSINESS]

8. During the period from the Signing Date until the Termination Date, the Company shall operate its business in the ordinary course and refrain from any extraordinary transactions.

[CONFIDENTIALITY]

9. Except as expressly modified by the Binding Provisions, the Confidentiality Agreement entered into between the Company and Buyer on ______, 20______, shall remain in full force and effect.

or

9. Except as and to the extent required by law, Buyer will not disclose or use, and will direct its representatives not to disclose or use to the detriment of the Company, any Confidential Information (as defined below) with respect to the Company furnished, or to be furnished, by either the Company or the Shareholders or their respective representatives to Buyer or its representatives at any time or in any manner other than in connection with its evaluation of the transaction proposed in this letter. For purposes of this Paragraph, "Confidential Information" means any information about the Company stamped "confidential" or identified in writing as such to Buyer by the Company promptly following its disclosure, unless (a) such information is already known to Buyer or its representatives or to others not bound by a duty of confidentiality at the time of its disclosure or such information becomes publicly available through no fault of Buyer or its representatives; (b) the use of such information is necessary or appropriate in making any filing or obtaining any consent or approval required for the consummation of the Possible Acquisition; or (c) the furnishing or use of such information is required by or necessary or appropriate in connection with legal proceedings. Upon the written request of the Company, Buyer will promptly return to the Company or destroy any Confidential Information in its possession and certify in writing to the Company that it has done so.

[DISCLOSURE]

10. Except as and to the extent required by law, without the prior written consent of the other Party, none of Buyer, the Company or its Shareholders will, and each will direct its representatives not to make, directly or indirectly, any public comment, statement or communication with respect to, or otherwise to disclose or to permit the disclosure of the existence of discussions regarding, a possible transaction between the Parties or any of the terms, conditions or other aspects of the transaction proposed in this letter. If a Party is required by law to make any such disclosure, it must first provide to the other Party the content of the proposed
disclosure, the reasons that such disclosure is required by law, and the time and place that the disclosure will be made.

[COSTS]

11. Buyer and the Company will be responsible for and bear all of their respective costs and expenses (including any broker's or finder's fees and the expenses of its representatives) incurred at any time in connection with pursuing or consummating the Possible Acquisition. Notwithstanding the preceding sentence, Buyer will pay one-half and the Company will pay one-half of the HSR Act filing fee.

[CONSENTS]

12. During the period from the Signing Date until the Termination Date, Buyer and the Company will cooperate with each other and proceed, as promptly as is reasonably practical, to prepare and to file the notifications required by the HSR Act.

[ENTIRE AGREEMENT]

13. The Binding Provisions constitute the entire agreement between the Parties and supersede all prior oral or written agreements, understandings, representations and warranties and courses of conduct and dealing between the Parties on the subject matter thereof. Except as otherwise provided herein, the Binding Provisions may be amended or modified only by a writing executed by all of the Parties.

[GOVERNING LAW]

14. The Binding Provisions will be governed by and construed under the laws of the State of ______ without regard to conflicts-of-laws principles.

[JURISDICTION; SERVICE OF PROCESS]

15. Any action or proceeding seeking to enforce any provision of, or based on any right arising out of, the Binding Provisions may be brought against any of the Parties in the courts of the State of ______, County of ______, or, if it has or can acquire jurisdiction, in the United States District Court for the ______ District of ______, and each of the Parties consents to the jurisdiction of such courts (and of the appropriate appellate courts) in any such action or proceeding and waives any objection to venue laid therein. Process in any action or proceeding referred to in the preceding sentence may be served on any Party anywhere in the world.
16. The Binding Provisions will automatically terminate on ______, 20______, and may be terminated earlier upon written notice by either Party to the other Party unilaterally, for any reason or no reason, with or without cause, at any time, provided, however, that the termination of the Binding Provisions will not affect the liability of a Party for breach of any of the Binding Provisions prior to the termination. Upon termination of the Binding Provisions, the parties will have no further obligations hereunder, except as stated in Paragraphs 6, 7, 9, 10, 11, 13, 14 and 15, which will survive any such termination.

17. This letter may be executed in one or more counterparts, each of which will be deemed to be an original of this letter and all of which, when taken together, will be deemed to constitute one and the same letter.

18. The provisions of paragraphs 1 through 4 of this letter are intended only as an expression of intent on behalf of Buyer, are not intended to be legally binding on Buyer, the Company or the Shareholders and are expressly subject to the execution of an appropriate Definitive Agreement. Moreover, except as expressly provided in paragraphs 5 through 18 (or as expressly provided in any binding written agreement that the Parties may enter into in the future), no past or future action, course of conduct or failure to act relating to the Possible Acquisition, or relating to the negotiation of the terms of the Possible Acquisition or any Definitive Agreement, will give rise to or serve as a basis for any obligation or other liability on the part of Buyer, the Company or the Shareholders.

If you are in agreement with the foregoing, please sign and return one copy of this letter, which thereupon will constitute our understanding with respect to its subject matter.

Very truly yours,

BUYER:
By: __________________________
  Name: ______________________
  Title: _______________________  

COMPANY:
By: __________________________
  Name: ______________________
  Title: _______________________
EXHIBIT

6. Draft Letter of Intent – Purchase of LLC – Membership Interest
LETTER OF INTENT

NAME AND ADDRESS

Re:

Dear __________:

You have advised that: (a) ________________, a ______ limited liability company (together with any other person or entity now or hereafter having an interest in the captioned properties, the “Seller”) is a party to a certain Membership Interest Purchase Agreement (the “Purchase Agreement”) with ________________ (“ _____________ ”); (b) pursuant to the Purchase Agreement, Seller has the right to purchase from ________________ all of the outstanding membership interests issued by ________________ (“ _____________ ”), a ______ limited liability company that is wholly-owned by ________________; (c) ________________ owns and operates certain casino hotel assets, including without limitation, the Properties (defined below); and (d) Seller desires, upon its acquisition of the ownership of ________________, to cause ________________ to sell the Properties.

Please have this Letter Agreement outline the basic terms and conditions on which Seller is willing to sell (or to cause to sell), and ________________, a ______ limited liability company and/or one or more affiliated entities designated by us (together, the “Buyer”) is willing to purchase, substantially all of the assets comprising the captioned properties and their respective businesses (collectively, the “Properties”). Such basic terms and conditions are as follows:

I. THE PROPERTIES. The Properties will include good and marketable title, free and clear of liens and encumbrances except as agreed to by Buyer, to the land, buildings and other improvements, all easements and other rights benefiting the land, all purchase options and rights of first refusal on other real estate, and all other personal property, tangible or intangible, that is located at, related to or used or intended for use in connection with any of the Properties, include, without limitation, the following:

1. All hotel rooms and suites; bars, lounges, entertainment venues; conference, convention, dining and banquet facilities; recreation facilities; arcade; RV and other parking facilities; casinos, gaming equipment and gaming devices; and all facilities related to any of the foregoing.

2. All furniture, fixtures, equipment, furnishings, vehicles and other items of tangible personal property that are used or intended for use in connection with any of the Properties.

3. All trade names, trademarks and other intellectual property rights, telephone numbers, websites, internet (URL) addresses, website content, codes,
combinations, software, licenses, permits and/or approvals, and other intangible assets, in each case related to or used or intended for use in connection with the operation of any of the Properties.

4. All conference, convention, tour and banquet room contracts and deposits; and all guest room reservations, contracts and deposits.

5. All leases, concessions and other occupancy agreements with third parties that are disclosed to and approved by Buyer as part of the Due Diligence Review (as defined below).

6. All inventories of durable or consumable supplies, parts or equipment of any type, located at, or used or intended for use in the operation of, any of the Properties, and all unopened merchandise, food and beverage items held for sale in connection with the operation of any of the Properties.

7. All service and/or supply contracts or agreements, and warranties, in each case relating to any of the Properties or the operation thereof, to the extent such contracts or agreements are disclosed to and approved by Buyer as part of its Due Diligence Review.

8. All books and records, files, reports, promotional materials and similar items, in each case related to or used or usable in connection with any of the Properties.

II. PURCHASE PRICE.

The Purchase Price for the Properties will be the sum of ____________________ Dollars ($__________). The Purchase Price is subject to customary adjustments for prepaid and/or to-be-paid items such as real property taxes, utility charges, and other expenses, as well as adjustments to reflect Seller's liability for amounts shown on progressive slot machine meters, unpaid winnings from keno and racebook activities, and similar casino items.

Except for post-Closing liability under those contracts, leases, licenses and agreements approved and accepted by Buyer, Buyer is not assuming any liabilities or obligations of Seller or the Properties.

III. PAYMENTS. Buyer shall pay the Purchase Price to Seller as follows:

1. Upon the full execution of this Letter Agreement, Buyer will make an initial deposit (“Initial Deposit”) with ____________________ Title Company, as escrow agent (“Escrow Agent”) in the amount of ____________________ Dollars ($__________). 

2. Within three (3) business days after the expiration of the Inspection Period (defined below), if this Letter Agreement has not been terminated under Section IV(1)(Final Agreement) or V(3)(Due Diligence) below, then Buyer will make an additional deposit of ____________________ ($__________) with Escrow Agent (the “Additional Deposit”). Upon payment of the Additional
Deposit, both the Initial Deposit and the Additional Deposit shall automatically be and become nonrefundable except upon Seller’s default or failure of a condition on Buyer’s obligations under the provisions of this Letter Agreement or the Final Agreement (defined below), and such deposits, together with any interest accrued thereon, will be applied against the Purchase Price at Closing.

3. The balance of the Purchase Price shall be payable in full at Closing, by wire transfer or other immediately available funds.

IV. FINAL AGREEMENT; EXCLUSIVITY.

1. Promptly after the complete execution of this Letter Agreement, Buyer’s counsel will prepare for Seller’s review a final and binding agreement for the purchase and sale of the Properties (“Final Agreement”). Seller and Buyer will negotiate the Final Agreement in good faith, consistent with (but not limited to) the provisions of this Letter Agreement. If Seller and Buyer are unable, despite such good faith negotiations, to reach a mutually acceptable Final Agreement by the end of the Inspection Period (defined below), then either party may cancel this Letter Agreement by written notice to the other, whereupon all deposit(s) shall be refunded to Buyer, and neither party shall have any liability or obligation to the other hereunder.

2. During the Inspection Period, Seller shall not directly or indirectly market the Properties or the owner thereof for sale, lease or other disposition (nor permit any other person or entity to do so) to any person or entity other than Buyer, nor enter into any discussions for same with any person or entity other than Buyer. Seller acknowledges that the foregoing provision is binding upon it and its successors and assigns, and may be enforced by injunction or specific performance.

3. The Final Agreement shall contain customary covenants, conditions, representations, warranties, indemnifications, escrows and prorations, and will be in form and substance satisfactory to both parties.

V. DUE DILIGENCE.

1. For a period commencing on the date of complete execution and delivery of this Letter Agreement and ending sixty (60) days thereafter (or if such date is not a business day in ———, then on the next following business day) (the “Inspection Period”): (a) Buyer and Seller will negotiate and enter into the Final Agreement as provided above; and (b) Buyer will inspect and review the Properties, and all documents, reports, books and records included in or relating to the Properties or the operation thereof (the “Due Diligence Review”). Buyer may, as part of the Due Diligence Review, conduct or cause to be conducted environmental, structural, mechanical, electrical, engineering and similar inspections and assessments with respect to the Properties, as Buyer deems appropriate in its sole discretion. Seller will cooperate with and assist Buyer in the Due Diligence Review, and will provide to Buyer all existing materials in Seller’s possession for Buyer’s review.
2. Buyer hereby agrees to indemnify and hold Seller harmless from loss or damage for personal injury or property damage resulting from such on-site inspections, tests, inspections and assessments. Before entering upon the property, Buyer will provide to Seller evidence of general liability insurance coverage with limits of at least $1________________. The provisions of this Section V(2) shall survive the termination of this Letter Agreement.

3. Buyer will have the right to terminate this Letter Agreement by written notice to Seller at or before 5:00 PT on the last day of the Inspection Period, if Buyer determines, in its sole discretion, that any of the Properties or the operation or financial performance thereof is not acceptable to Buyer. Upon such termination Buyer will receive back any deposit(s) previously made, with interest accrued thereon, and thereupon neither party shall have any rights or obligations with respect to the other (except for those that expressly survive such termination).

VI. OTHER CONDITIONS. Seller acknowledges that Buyer’s obligation to complete Closing and purchase the Property will be contingent on the satisfaction of various conditions, including but not limited to the following unless the same are waived by Buyer:

1. All necessary governmental and regulatory approvals are received, including without limitation approvals from the ________________ State Gaming Control Board, the ________________ Gaming Commission and the ________________ County Gaming and Liquor Board (collectively, the “Regulatory Authorities”). Seller and Buyer acknowledge that absent the requisite approvals by the gaming regulatory bodies of the State of ________________, Buyer is strictly prohibited from obtaining any interest whatsoever in Seller’s gaming devices, slot machines and associated gaming devices, or any revenues derived therefrom.

2. Buyer shall have completed its Due Diligence Review, and shall not have terminated the this Letter Agreement within the time provided in Section V hereof.

3. Buyer and Seller shall have entered into the Final Agreement within the time provided in Section IV hereof.

VII. CLOSING. The transaction contemplated by this Agreement shall be consummated (the “Closing”) by execution and delivery of documents and other closing deliveries into escrow with Escrow Agent, such Closing to take place at the offices of Escrow Agent at 10:00 a.m. PT on the earlier of: (a) three (3) business days after approval by the Regulatory Authorities of Buyer’s consummation of the transactions contemplated hereby, and satisfaction of all other conditions to Closing as set forth in the Final Agreement; and (b) the date that is six (6) months after the execution of the Final Agreement.

VIII. EFFECT OF AGREEMENT.

1. This Letter Agreement represents a statement of the general intent of the parties only and, except for the provisions of Paragraphs IV, V(2) and VIII hereof, does
not purport to be and does not constitute a binding agreement between the parties. Except for such binding provisions, neither party shall have any binding obligation with respect to the sale and purchase of the Property, unless and until the Final Agreement is fully executed and delivered.

2. This Letter Agreement will be governed by and interpreted under the laws of the State of ____________________.

3. This Letter Agreement may be executed in counterparts, and by fax transmission of signature pages. This Letter Agreement supersedes all prior oral and written agreements and understandings of the parties regarding the subject matter hereof.

Subject to the foregoing, if this Letter Agreement is acceptable to you, kindly countersign a copy hereof where indicated in the space below, and return it to the undersigned. The proposal set forth in this Letter Agreement shall be effective until 5:00 p.m. PST on ___________. If this Letter Agreement is not fully countersigned and returned to us by such deadline, then the proposal set forth herein shall be deemed withdrawn and this Letter Agreement shall be of no further force or effect whatsoever.

[continued on following page]
We look forward to working with you on this transaction.

Sincerely,

NAME OF COMPANY

By: ____________________________
   NAME

Agreed to and accepted this ______ day of __________, ____:

BY: ____________________________
By: ____________________________
By: ____________________________

By: ____________________________
Name: __________________________
Title: __________________________
7. Draft Letter of Intent – Merger
LETTER OF INTENT MERGER

Date

NAME AND ADDRESS

Re: Letter of Intent

Dear __________:

Company ("______"), a Pennsylvania Limited Liability Company, is pleased to submit this letter of intent ("Letter of Intent") to merge with _____ (_____ or "the Company"), for the purpose of establishing management, funding and the subsequent commercial development of low cost technology, products and services to needs that are now served by existing technology, products or services at a higher cost, resulting in their availability to a larger population, subject to the following terms and conditions:

1. Proposed Transaction. Subject to the conditions contained in Section 3, the Parties merge all of their outstanding capital stock ("the Shares") pursuant to the terms of a merger agreement to be entered into between the persons identified as "Officers" on the signature page hereto (who by executing below represent and warrant that they are the President or Managing Member and authorized to enter into such transaction ("the Proposed Transaction")).

2. Consideration.

(a) As consideration for the merger of the Shares, _____ would cause the following consideration to be transferred to _____ or the following actions to occur:

(i) At the closing of the Proposed Transaction (the "Closing"), the Company would authorize the increase in its capital stock from _________ Shares to _________ Shares, enabling the issuance of new shares to investors in an anticipated Reg. D Offering (Reg. B for European investors) to be subsequently undertaken to raise the capital necessary to implement the business plan of the Parties; and

(ii) At the Closing, the Company and _____ will each own ______ (___%) Percent of the Company with the remaining ______ (___%) Percent owned by new investors; and
(iii) The Company will use up to $_________________ (________________) Dollars of new financing to pay off its liabilities, thereby presenting a clean balance sheet.

(b) Definitive Agreements; Timing. The Proposed Transaction would be consummated pursuant to mutually acceptable definitive documentation to be entered into between _______ and ______, as applicable, such Definitive Agreements to include a merger agreement, mutually acceptable employment agreements between the Company and senior executives of the Company, and other requisite documents (collectively, the “Definitive Agreements”). The Definitive Agreements would contain terms consistent with this Letter of Intent and would contain other customary representations and warranties, covenants, closing conditions, indemnities, escrows, and other terms customary for an acquisition of this type. We are prepared to move quickly to execute these Definitive Agreements and, subject to the conditions set forth in Section 3 below, we anticipate that we would be able to enter into Definitive Agreements and close the Proposed Transaction within ninety (90) days from the date hereof.

3. Conditions to Closing. The Closing contemplated by this Letter of Intent will be conditioned upon: (i) ______’s satisfaction with the results of its due diligence review of the Company, (ii) the execution of Definitive Agreements and (iii) customary closing conditions including: (A) accuracy in all material respects of the Shareholders’ representations and warranties and performance in all material respects of the Shareholders’ covenants and agreements as reflected in the Definitive Agreements, (B) no material adverse change in and no occurrence of any material adverse effect with respect to the Company’s business, financial condition or results of operation, (C) receipt of customary closing documents, including a legal opinion of Company counsel, (D) receipt of audited annual financial statements for the periods ending __________ and ____________ so as to allow ______ to comply with applicable securities laws and other information with respect to the Company to allow ______ to comply with applicable securities laws, (E) completion of all necessary governmental filings and receipt of all consents from third parties required to consummate the Proposed Transaction on terms satisfactory to __________, (F) no pending or threatened litigation that may be reasonably expected to result in a material adverse effect to the Company’s business, (G) a certified Stockholder list for ______ as of __________ (H) ______’s satisfaction that all patents and licenses held by Dr. ______, the Company or any other company owned in whole or part by Dr. ______ or the Company are properly held by the Company and reflect the technology described more fully in my letter to Dr. ______ of __________, (I) Execution of an Employment Agreement by Dr. ______, (J) ______’s satisfaction that all warrants and options issued by ______ have been properly cancelled, and (K) the sale by Dr. ______ of __________ (_______) Shares of ______ at the current 0.01 cent price.

4. Exclusivity Period. In consideration of the substantial time and expense to be incurred by ______ in conducting due diligence and completing the Proposed Transaction, from the date hereof until the later of (i) ninety (90) days following the date hereof or (ii) if earlier, when Definitive Agreements have been executed (such period, the “Exclusivity Period”), neither the Shareholders nor the Company will, and the Company will cause any of its directors, officers, employees, agents and other affiliates, if any, (such persons collectively, the “Covered Persons”) not to, directly or indirectly, (A) solicit, encourage, initiate or conduct any discussions
or enter into negotiations with any person (whether such discussions or negotiations are initiated by them or otherwise), other than _____ and its representatives, with respect to the issuance or sale of the Purchased Shares or other investment in the Company or any portion of the assets of the Company (a “Potential Transaction”), (B) provide any information to any person, other than _____ and its representatives, in connection with a Potential Transaction or (C) enter into any contract, agreement, understanding or arrangement with any person, other than _____ and its representatives, concerning or relating to a Potential Transaction (the actions specified in (A), (B) and (C), the “Prohibited Activities”). If you or any of the other Covered Persons receive any unsolicited offer, proposal or expression of interest to make a Potential Transaction or negotiations or discussions relating to a Potential Transaction, you shall immediately notify _____ of such fact and the terms of, and the identity of the person or persons making, such offer, proposal or expression of interest. You recognize and acknowledge that a breach by you or any of your agents of this Section 4 will cause irreparable and material loss and damage to _____ as to which will not have an adequate remedy at law or in damages and that, accordingly, you agree that the issuance of an injunction or other equitable remedy shall be an appropriate remedy for any such breach.

5. **Interim Contracts.** During the Exclusivity Period, neither the Company nor the Shareholders shall enter into any contracts, agreements, understandings or otherwise with respect to the business of the Company, or modify the terms of, amend, or terminate any of the Company’s material contracts (including any employment, severance, termination or similar agreements with the Company’s directors, officers, employees, consultants or agents), outside the ordinary course of business without the prior consent of _____, such consent not to be unreasonably withheld, conditioned or delayed.

6. **Negative Covenants.** During the Exclusivity Period, the Shareholders shall not sell, assign, or otherwise transfer, or issue or grant any option to any person to purchase or acquire, any of the Shares. During the Exclusivity Period, the Company shall not: (i) declare or pay any dividends or distribution in respect of the Shares or redeem the Shares if such dividends or distributions would cause the difference between the Company’s current assets and its current liabilities to be less than an amount equal to the prior three (3) calendar months of working capital used by the Company, (ii) effectuate any change in the Company’s current equity capitalization, whether by issuance of additional equity securities or by the sale, pledge or other transfer of the Shares, (iii) acquire (by merger, consolidation or acquisition of stock or assets) any business entity or an equity interest therein, (iv) sell, lease, transfer or assign any of the properties or assets of the Company, tangible or intangible, (v) amend any of its organizational documents, including its articles of incorporation or bylaws, (vi) incur any indebtedness, guaranty or other obligation for borrowed money, or make any capital expenditures, (vii) advance any loans to the Company’s officers, directors, consultants, employees, or members, other than, other than reimbursement of expenses of employees of the Company in the ordinary course in accordance with existing written policies of the Company, or (viii) authorize any of the foregoing or enter into any agreement to do the foregoing.

7. **Access to Information.** During the Exclusivity Period, _____ and its authorized agents and other representatives shall have the right, upon reasonable notice and at reasonable times and without undue interruption, to examine and inspect all of the assets, properties, facilities, books and records of the Company and shall be furnished with such other information and data concerning the Company as _____ and its authorized agents and representatives may
reasonably request. _____ will provide the Company with reasonable notice and obtain the Company’s consent prior to visiting any of the Company’s facilities. _____ agrees that any information provided to it and its authorized agents and representatives by the Company in the course of negotiating the Proposed Transaction and the Definitive Agreements shall be kept confidential, and, except as otherwise provided in this Letter of Intent, _____ will not disclose or use such information other than to their representatives, officers, directors, investors and agents in connection with negotiating the Proposed Transaction and the Definitive Agreements.

8. Confidentiality. “Confidential Information” includes all proprietary or confidential information of the party disclosing such information (for this purpose, a “Disclosing Party”), including but not limited to business plans, financial information, pricing information, customer contact lists, marketing plans, and employee information, whether oral, written, electronic, or other format, including but not limited to all reports, plans, studies, and evaluations prepared by the Disclosing Party or its representatives that contain or reflect any Confidential Information. For one (1) year from the date hereof, the parties hereto shall, and shall direct their respective representatives, officers, directors, investors, and agents to, hold the Confidential Information in strictest confidence, using the same degree of care they use to protect their own confidential information, and at least a reasonable degree of care, and not disclose the Confidential Information without the prior written consent of the Disclosing Party, such consent not to be unreasonably withheld, conditioned or delayed, except as may be required by law, in which event the party intending to disclose Confidential Information will provide the Disclosing Party with prior written notice and a reasonable opportunity to seek a protective order and such party will furnish only that portion of the Confidential Information that its counsel advises is required to be disclosed by law; provided, however, that _____ shall be able to provide Confidential Information to its stockholders and potential investors as necessary to raise financing for the Proposed Transaction. If the parties do not close the Proposed Transaction, then the parties shall either (x) return all Confidential Information to the Disclosing Party or (y) certify the actual or requested destruction of such Confidential Information, and in either event shall not retain any copy thereof. Confidential Information does not include any information that (i) at the time of disclosure is generally available to and known to the public, (ii) is or was available on a non-confidential basis from a source other than the Company or its representatives, or (iii) is or was independently acquired or developed without violating any obligations under this Letter of Intent.

9. Public Announcements. Except as may be required by applicable law, the parties hereto agree that no public release or announcement concerning the Proposed Transaction shall be issued or made by or on behalf of any party without the prior written consent of the other party, such approval not to be unreasonably withheld, conditioned or delayed.

10. Prohibition on Trading in Common Stock of _____ . The Company and the Shareholders acknowledge the existence and content of this Letter of Intent constitutes material non-public information under United States federal securities laws, and that United States federal securities laws prohibit any person who has received material non-public information relating to _____ from purchasing or selling securities of _____ , or from communicating such information to any person under circumstances in which it is reasonably foreseeable that such person is likely to purchase or sell securities of _____ . Accordingly, until such time as any such non-public information has been adequately disseminated to the public, neither the Company nor the Shareholders shall purchase or sell any securities of _____ , communicate such information to
any other person, or resell the securities (or the Common Shares and, if any, the Preferred Shares) on any stock exchange or over-the-counter market.

11. Fees and Expenses on the one hand, and the Company and the Shareholders on the other hand, will be responsible for their own fees and expenses (including legal, due diligence, accounting, and investment banking fees and expenses, with the Shareholders responsible for the foregoing incurred by the Company) incurred in connection with the Proposed Transaction.

12. Governing Law. Any dispute arising out of this Letter of Intent shall be governed by the internal laws (without regard to choice of law principles) of the State of _____________. Any judgment in favor of a party pursuant to this Letter of Intent shall include the reasonable attorneys’ fees and expenses of the prevailing party.

13. Termination. This Letter of Intent will terminate upon the earlier of: (i) ninety (90) days from the date hereof; (ii) the date of the execution of the Definitive Agreements; (iii) the date of written notification by _____ to the Company of _____’s termination of this Letter of Intent; or (iv) the mutual written consent of _____ and Company. Upon such termination, this Letter of Intent shall be null and void, unenforceable, and of no effect and the parties shall have no further obligation or liability to each other as of the date of such termination, except as stated in Sections 8, 9, 10, 11 and 12 which shall survive any such termination.

14. Binding Effect. Except as set forth in this Section 14, this Letter of Intent is not intended to be, and shall not constitute, a binding or enforceable agreement between the parties hereto until such time at ___________ (_____________) thousand of signed subscription agreements are presented to ___. Until such time as the required subscription agreements are executed, this Letter of Intent merely sets forth the present intentions and mutual understandings of the parties hereto with respect to the proposed terms set forth herein, which terms may or may not become part of the Definitive Agreements relating to the Proposed Transaction. Except for the provisions of Section 4-13 and this Section 14 (which are intended to and shall bind and inure to the benefit of the parties hereto and their respective successors and permitted assigns), no legal or equitable rights, responsibilities or duties are created by this Letter of Intent. The binding provisions of this Letter of Intent are intended to and shall bind and insure to the benefit of the parties hereto and their respective successors and permitted assigns.

15. Counterparts; Assignment. This Letter of Intent may be signed in two or more counterparts, any one of which need not contain the signature of more than one party, but all such counterparts taken together will constitute one and the same agreement. This Letter of Intent may not be assigned by any party without the other parties’ prior written consent.

16. Expiration. The terms and conditions described in this Letter of Intent expire on ____________ at 5:00 p.m. Eastern time (the “Expiration Date”) unless this Letter of Intent is executed by all parties prior to the Expiration Date.
If you are in agreement with the terms of this Letter of Intent, please date and sign in the space provided below and return a signed copy.

Very truly yours,

COMPANY

By: ________________________________
    NAME
    Managing Member

Agreed to and Accepted
this ___ day of __________, :

    ___ NAME OF COMPANY

By: ________________________________
    NAME
    President
EXHIBIT

8. Draft Acquisition Agreement – Section 338(h)(10)
STOCK PURCHASE AGREEMENT

Among

THE SHAREHOLDERS LISTED ON SCHEDULE I ATTACHED HERETO

And
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STOCK PURCHASE AGREEMENT

This Stock Purchase Agreement (this “Agreement”) made as of the _____ day of ____, 2006, by and among _____________, a __________ corporation with its principal office at ______________________ (the “Buyer”), and _____________, a __________ corporation with its principal office at ______________________ (the “Company”), and the shareholders of the Company listed on Schedule I attached hereto (individually, a “Shareholder” and collectively, the “Shareholders”), who own all of the issued and outstanding capital stock of the Company.

Preliminary Statement

1. Each of the Shareholders owns the number of the issued and outstanding shares (collectively, the “Shares”) of the common stock, $______ par value per share (the “Common Stock”), of the Company set forth opposite its name on Schedule I attached hereto, which Shares in the aggregate represent all of the issued and outstanding shares of capital stock of the Company.

2. ____________________, who is designated herein as the Shareholders’ Representative, is currently a director of the Company and has been an integral part of, and is knowledgeable about, the business operations of the Company.

3. The Buyer desires to purchase, and the Shareholders desire to sell, the Shares for the consideration set forth below, subject to the terms and conditions of this Agreement.

4. The index of defined terms beginning on page (vi) of this Agreement is hereby incorporated by reference and made a part of this Agreement.

NOW, THEREFORE, in consideration of the mutual promises hereinafter set forth and other good and valuable consideration, the receipt of which is hereby acknowledged, the parties hereby agree as follows:

1. Purchase and Sale of the Shares

1.01 Purchase of the Shares from the Shareholders. Subject to and upon the terms and conditions of this Agreement, at the closing of the transactions contemplated by this Agreement (the “Closing”), each Shareholder shall sell, transfer, convey, assign and deliver to the Buyer, and the Buyer shall purchase, acquire and accept from each Shareholder, all the Shares owned by such Shareholder, as set forth opposite such Shareholder’s respective name on Schedule I attached hereto free and clear of any and all Liens. At the Closing, each Shareholder shall deliver to the Buyer certificates evidencing the Shares owned by such Shareholder duly endorsed in blank or with stock powers duly executed by such Shareholder.

1.02 Further Assurances. At any time and from time to time after the date hereof, at the Buyer’s reasonable request, each of the Shareholders shall promptly execute and deliver such instruments of sale, transfer, conveyance, assignment and confirmation, and take all such other action as the Buyer may reasonably request, more effectively to transfer, convey and assign to
the Buyer, and to confirm the Buyer’s title to, all of the Shares owned by such Shareholder, to
put the Buyer in actual possession and operating control of the assets, properties and business of
the Company, to assist the Buyer in exercising all rights with respect thereto and to carry out the
purpose and intent of this Agreement.

1.03 Purchase Price for the Shares.

(a) The aggregate purchase price (the “Purchase Price”) to be paid by the
Buyer shall be an amount equal to:

(i) ___________ Dollars ($_________)(the
“Base Purchase Price”); plus

(ii) the Estimated Net Cash Amount; plus

(iii) the amount, if any, by which the Estimated Net Working Capital
exceeds the Target Net Working Capital; less

(iv) the aggregate payoff amount of all Indebtedness of the Company
as of immediately prior to the Closing; less

(v) the Estimated Transaction Expenses; less

(vi) the amount, if any, by which the Target Net Working Capital
exceeds the Estimated Net Working Capital.

(b) At the Closing, the Buyer shall deliver:

(i) to the Shareholders’ Representative, the Purchase Price less the
Escrow Amount in cash, by wire transfer of immediately available funds to an account
designated by the Shareholders’ Representative, for distribution to the Shareholders by the
Shareholders’ Representative in the amounts set forth opposite each Shareholder’s name on
Schedule I attached hereto; and

(ii) to [____________________], as escrow agent (the “Escrow
Agent”), the sum of ___________ Dollars ($_________) (the “Escrow
Amount”), representing ____% of the Base Purchase Price, to be held in an interest-bearing
account as a reserve (the “Reserve Account”), pursuant to the terms of the escrow agreement
attached hereto as Exhibit A (the “Escrow Agreement”), for any and all adjustments pursuant to
Subsection 1.04 hereof and to satisfy all or part of any claims for indemnity pursuant to Section
10 hereof.

(c) For purposes of this Agreement, the following terms shall be defined as
follows:

(i) “Closing Net Cash Amount” shall mean the aggregate amount of
the Company’s cash and cash equivalents and marketable securities on hand or in bank accounts
as of the opening of business on the Closing Date, immediately prior to giving effect to the transactions contemplated hereby, including the amounts represented by any checks, money orders or similar instruments that have been received by the Company or the Company’s agents on such date, but not actually deposited on such date, or which have been deposited, but have not yet cleared or been credited to the Company’s bank accounts (in each case, subject to clearance before final determination of Closing Net Cash Amount pursuant to Section 1.04), less (x) the amount of dividends declared, but not yet paid and (y) checks drawn against such accounts, but not yet presented to the issuing bank for payment;

(ii) “Closing Net Working Capital” shall mean the aggregate amount of the current assets of the Company as of the opening of business on the Closing Date, immediately prior to giving effect to the transactions contemplated hereby, including accounts receivable, inventories and other receivables and prepaid expenses, but excluding the aggregate amount of the Company’s cash and cash equivalents and marketable securities included in the Closing Net Cash Amount less deferred Tax assets and excluding any and all accruals for employee bonuses for fiscal year __________ or bonuses to be paid in connection with the transactions contemplated hereby, less the aggregate amount of the current liabilities of the Company, consisting of accounts payable and accrued expenses and security and territorial deposits, but excluding (A) any current portion of long-term debt, (B) any liability, if any, for federal, state or local Taxes or any deferred Tax liability, if any, and (C) any amounts that relate to Transaction Expenses and Indebtedness (to the extent accounted for in determining the Purchase Price as provided in Section 1.03(a)(iv) or (v)). For illustration purposes, attached hereto as Schedule 1.03(c)(ii) is the working capital analysis setting forth the basis for the determination of the Closing Net Working Capital as contemplated hereby. To the extent the parties mutually agree to modify or make additional adjustments to the working capital analysis attached hereto, the parties agree that corresponding adjustments will be made to this definition of Closing Net Working Capital to reconcile any such adjustments;

(iii) “Estimated Net Cash Amount” shall mean an estimate of the Closing Net Cash Amount as proposed in good faith by the Shareholders’ Representative and agreed to by the Buyer no later than five business days prior to the Closing (based upon the Company’s most recent financial information available). In the event the Shareholders’ Representative and the Buyer are unable to agree on the Estimated Net Cash Amount prior to the Closing, such amount shall be deemed to be zero;

(iv) “Estimated Net Working Capital” shall mean an estimate of the Closing Net Working Capital as proposed in good faith by the Shareholders’ Representative and agreed to by the Buyer no later than five business days prior to the Closing (based upon the Company’s most recent financial information available). In the event the Shareholders’ Representative and the Buyer are unable to agree on the Estimated Net Working Capital prior to the Closing, such amount shall be deemed to be equal to the Target Net Working Capital;

(v) “Estimated Transaction Expenses” shall mean an estimate of the Transaction Expenses as proposed in good faith by the Shareholders’ Representative and agreed to by the Buyer no later than five business days prior to the Closing. In the event the Shareholders’ Representative and the Buyer are unable to agree on the Estimated Transaction

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Expenses prior to the Closing, such amount shall be reasonably determined by the Shareholders’ Representative;

(vi) “Indebtedness” shall mean, without duplication, all (A) indebtedness of the Company for borrowed money (whether by loan or the issuance of debt securities) or for the deferred purchase price of property or services (other than current trade payables incurred in the ordinary course of business and payable in accordance with customary practices), including all principal, accrued and unpaid interest, prepayment and redemption premiums or penalties (if any) and unpaid fees, (B) any other indebtedness of the Company which is evidenced by a note, bond, debenture or similar instrument, (C) all obligations of the Company related to any lease of property, real or personal, which are required to be capitalized in accordance with U.S. generally accepted accounting principles (“GAAP”), (D) all obligations of the Company in respect of letters of credit, acceptances or similar instruments issued or created for the account of the Company, (E) all obligations of the Company under interest rate or currency swap transactions (valued at the termination value thereof), (F) all other items which, in accordance with generally accepted accounting principles, would be included as liabilities on the liability side of the Company’s balance sheet as of the date which Indebtedness is to be determined, (G) all guarantee obligations of the Company in respect of any of the foregoing, and (H) all obligations in respect of any of the foregoing secured by any Lien on any property or asset of the Company;

(vii) “Target Net Working Capital” shall mean [$(_________)]2; and

(viii) “Transaction Expenses” shall mean all fees and expenses incurred by the Company and the Shareholders in connection with the preparation, negotiation and execution of this Agreement and the transactions contemplated hereby, including, without limitation, the fees and expenses of their investment bankers, attorneys and accountants.

(d) On the business day immediately preceding the Closing Date, the Shareholders’ Representative shall confirm in writing to the Buyer the Estimated Net Cash Amount, Estimated Net Working Capital and Estimated Transaction Expenses or propose in good faith any update to such estimates. If any updates are proposed and agreed to by the Buyer, then such updated estimates shall be used in the determination of the Purchase Price at Closing.

1.04 Closing and Post-Closing Adjustment. The Purchase Price set forth in Subsection 1.03 hereof shall be subject to adjustment after the date of the Closing (the “Closing Date”) as follows: As promptly as practicable following the Closing Date, the Buyer shall cause the independent public accountants for the Company selected by the Buyer (the “Company Auditors”), to conduct an audit of the books and records of the Company as of the Closing Date. Not later than 60 days after the Closing Date, the Buyer shall cause the Company Auditors to prepare and deliver to the Shareholders’ Representative a balance sheet of the Company as of the open of business on the Closing Date, including a calculation of the Closing Net Working Capital, the Closing Net Cash Amount and the Transaction Expenses actually paid by or on behalf of the Company at or following the Closing (the “Closing Balance Sheet”). Except as expressly set forth herein, the Closing Balance Sheet shall be prepared in accordance
with generally accepted accounting principles applied consistently with the Company's past practice, without any adjustments applicable solely as a result of the consummation of transactions contemplated hereby, and shall be certified without qualification by the Company Auditors. The Closing Balance Sheet shall be accompanied by a statement prepared by the Company Auditors setting forth the basis for the determination of the items and values reflected on the Closing Balance Sheet, including the Closing Net Working Capital, the Closing Net Cash Amount and the Transaction Expenses actually paid by or on behalf of the Company at or following the Closing. The parties hereby agree that the payments related to the Company's change of control, severance and retention bonus obligations shall be allocated among the Company, the Shareholders and the Buyer in accordance with Schedule 1.04(a) attached hereto.

(a) The Shareholders' Representative and ____________, the independent public accountants for the Shareholders' Representative (the "Shareholders' Auditors"), shall have the right to review the work papers of the Company's Auditors used in preparing the Closing Balance Sheet, and shall have reasonable access to the books, records and properties of the Company for purposes of verifying the accuracy and fairness of the presentation of the Closing Balance Sheet. The Shareholders' Representative and Buyer shall work in good faith and cooperate in the resolution of any dispute in connection therewith pursuant to paragraph (c) below.

(b) The values or amounts for each item reflected on the Closing Balance Sheet, including the Closing Net Working Capital, the Closing Net Cash Amount and the Transaction Expenses actually paid by or on behalf of the Company at or following the Closing, shall be binding upon the Shareholders, unless the Shareholders' Representative gives written notice within 60 days after receipt of the Closing Balance Sheet, of disagreement with any of such values or amounts specifying as to each such item in reasonable detail, the nature and extent of such disagreement (the "Dispute Notice"). If the Buyer and the Shareholders' Representative are unable to resolve any such disagreement within 60 days after the date of the Dispute Notice, the disagreement shall be submitted to arbitration in accordance with the provisions of Subsection 13.03 hereof. If as a result of the resolution of any disputes by agreement pursuant to this Subsection 1.04 or by arbitration pursuant to Subsection 13.03, any amount shown in the Closing Balance Sheet, including the Closing Net Working Capital, the Closing Net Cash Amount and the Transaction Expenses actually paid by or on behalf of the Company at or following the Closing, is determined to be erroneous, such erroneous amount shall be deleted from the Closing Balance Sheet, as applicable, and the correct amount shall be inserted in lieu thereof. The Closing Balance Sheet, as so corrected, shall constitute the Closing Balance Sheet for purposes of this Agreement.

(c) The Buyer shall pay the fees and disbursements of the Company Auditors. The fees and disbursements of the Shareholders' Auditors incurred in the preparation of the Closing Balance Sheet shall be paid by the Shareholders, in proportion to their ownership of Shares as set forth on Schedule I attached hereto.

(d) Upon the final determination pursuant to this Subsection 1.04 of the Closing Balance Sheet, the Closing Net Working Capital and the Closing Net Cash Amount (A) the final Purchase Price (the "Adjusted Purchase Price") shall be determined by recalculating the
Purchase Price pursuant to the formula contained in Subsection 1.03 hereof using (i) the Closing Net Working Capital in lieu of the Estimated Net Working Capital used in the calculation of the Purchase Price, (ii) the Closing Net Cash Amount in lieu of the Estimated Net Cash Amount used in the calculation of the Purchase Price; and (iii) the Transaction Expenses in lieu of the Estimated Transaction Expenses.

1.05 Payments on Account of Adjustments.

(a) The difference between the Adjusted Purchase Price and the Purchase Price, together with interest thereon at the rate of ___% per annum from the Closing Date to the payment of such deficiency or excess, as applicable, shall be paid to the Buyer or to the Shareholders’ Representative, as the case may be, immediately upon the expiration of the 60 day period for giving the Dispute Notice, if no Dispute Notice is given, or immediately upon final resolution, in accordance with Section 13 hereof, of any dispute in connection with the determination of the Adjusted Purchase Price.

(b) Any amounts payable to the Buyer, or to the Company (if the Closing occurs), or to the Shareholders, in connection with any claim for indemnification pursuant to Section 10 hereof, shall be paid to the Buyer, the Company or the Shareholders’ Representative, as the case may be, promptly upon the resolution, by agreement or arbitration, of such indemnification claim.

(c) Subject to the last sentence of Subsection 1.03(b)(ii), if an amount is payable to the Buyer pursuant to paragraph (a) or (b) of this Subsection 1.05, such amount shall be paid to the Buyer by the Escrow Agent from the Reserve Account. Any balance remaining in the Reserve Account, after any payment to the Buyer pursuant to the preceding sentence, and subject to the provisions of paragraph (d) hereof, shall be paid by the Escrow Agent to the Shareholders. All payments to the Shareholders by the Escrow Agent shall be distributed by the Escrow Agent to each of the Shareholders in the proportion to their ownership of Shares as set forth opposite their respective names on Schedule I attached hereto.

(d) Except for payments permitted pursuant to paragraphs (a) and (b) above, all amounts in the Reserve Account shall be held in such Reserve Account, until the later of (i) the 18-month anniversary of the Closing Date, (ii) the final determination of the Adjusted Purchase Price, whether by agreement or arbitration, or (iii) the final resolution, whether by agreement or arbitration, of any claims for indemnification under Section 10 hereof which are asserted in writing by the Buyer, or the Company (if the Closing occurs), prior to the 18-month anniversary of the Closing Date; provided, however, that any amounts in the Reserve Account which are not subject to a claim for indemnification shall be released to the Shareholders’ Representative for distribution to the Shareholders in accordance with this Subsection 1.05.

1.06 Shareholders’ Representative.

(a) In order to efficiently administer (i) the determination of the Closing Balance Sheet and the Adjusted Purchase Price, (ii) the distribution of the Purchase Price to the Shareholders, (iii) the waiver of any condition to the obligations of the Shareholders to
consummate the transactions contemplated hereby, and (iv) the defense and/or settlement of any claims for which the Shareholders may be required to indemnify the Buyer or the Company (if the Closing occurs), or for which the Buyer or the Company (if the Closing occurs) may be required to indemnify the Shareholders, in each case pursuant to Section 10 hereof, the Shareholders hereby designate __________ as their representative (the “Shareholders’ Representative”).

(b) The Shareholders hereby authorize the Shareholders’ Representative (i) to make all decisions relating to the determination of the Closing Balance Sheet and the Adjusted Purchase Price, (ii) to take all actions necessary to distribute the Purchase Price to the Shareholders, (iii) to take all action necessary in connection with the waiver of any condition to the obligations of the Shareholders to consummate the transactions contemplated hereby, or the defense and/or settlement of any claims for which the Shareholders may be required to indemnify the Buyer or the Company, or for which the Buyer or the Company (if the Closing occurs) may be required to indemnify the Shareholders, in each case pursuant to Section 10 hereof, (iv) to give and receive all notices required to be given under the Agreement, and (v) to take any and all additional action as is contemplated to be taken by or on behalf of the Shareholders by the terms of this Agreement.

(c) In the event that the Shareholders’ Representative dies, becomes unable to perform his or her responsibilities hereunder or resigns from such position, Shareholders holding, prior to the Closing, a majority of the Shares as set forth on Schedule I attached hereto shall select another representative to fill such vacancy and such substituted representative shall be deemed to be the Shareholders’ Representative for the purposes of this Agreement authorized to act for the Shareholders in accordance with Subsection 1.06(b) hereof.

(d) All decisions and actions by the Shareholders’ Representative, including, without limitation, any agreement between the Shareholders’ Representative and the Buyer relating to the determination of the Closing Balance Sheet or the Adjusted Purchase Price, the distribution of the Purchase Price to the Shareholders or the defense or settlement of any claims for which the Shareholders may be required to indemnify the Buyer and/or the Company, or for which the Buyer or the Company (if the Closing occurs) may be required to indemnify the Shareholders, in each case pursuant to Section 10 hereof, shall be binding upon all of the Shareholders, and no Shareholder shall have the right to object, dissent, protest or otherwise contest the same.

(e) By their execution of this Agreement, the Shareholders agree that the Buyer shall be able to rely conclusively on the instructions and decisions of the Shareholders’ Representative as to the determination of the Closing Balance Sheet or the Adjusted Purchase Price, the distribution of the Purchase Price to the Shareholders, or the settlement of any claims for indemnification by the Buyer, the Company or the Shareholders’ Representative pursuant to Section 10 hereof or any other actions required to be taken by the Shareholders’ Representative hereunder, and no party hereunder shall have any cause of action against the Buyer for any action taken by the Buyer in reliance upon the written instructions or decisions of the Shareholders’ Representative.
(f) All fees and expenses incurred by the Shareholders' Representative shall be paid by the Shareholders in proportion to their ownership of Shares as set forth on Schedule I attached hereto.

1.07 Closing. The Closing shall take place at the offices of ____________________________ at _______ m., _______ Time, on the later of (i) the fifth business day following the expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the "HSR Act"), and (ii) the date on which the conditions set forth in Sections 8 and 9 shall be satisfied or duly waived, or at such other place, time or date as may be mutually agreed upon in writing by the parties. The transfer of the Shares by the Shareholders to the Buyer shall be deemed to occur at 9:00 a.m., Eastern Time, on the Closing Date. All conditions to the obligations of the Buyer and the Shareholders to proceed with the Closing under this Agreement shall be deemed to have been fully and completely satisfied or waived for all purposes upon the Closing.

2. Representations of the Shareholders Regarding the Shares. Each Shareholder severally, and not jointly, represents and warrants to the Buyer as follows:

(a) Such Shareholder is a trust duly organized and validly subsisting under the laws of the state of its creation. This Agreement has been duly executed by such Shareholder and this Agreement and all other agreements and obligations entered into and undertaken in connection with the transactions contemplated hereby to which such Shareholder is a party constitutes the valid and legally binding obligations of the Shareholder enforceable against such Shareholder in accordance with their respective terms, except as such enforceability may be limited by bankruptcy, insolvency or other laws affecting generally the enforceability of creditors' rights, by general principles of equity and by limitations on the availability of equitable remedies.

(b) Such Shareholder has good and marketable title to the Shares which are to be transferred to the Buyer by such Shareholder pursuant hereto, free and clear of any and all covenants, conditions, restrictions, voting trust arrangements, Liens, options and adverse claims or rights whatsoever ("Restrictions"). Schedule I attached hereto sets forth a true and correct description of all Shares owned by such Shareholder.

(c) Such Shareholder has the full right, power and authority to enter into this Agreement and the agreements contemplated herein, to consummate the transactions contemplated hereby and to transfer, convey and sell to the Buyer at the Closing the Shares to be sold by such Shareholder hereunder and, upon consummation of the purchase contemplated hereby, the Buyer will acquire from such Shareholder good and marketable title to such Shares, free and clear of all Restrictions.

(d) Such Shareholder is not a party to, subject to or bound by any agreement or any judgment, order, writ, prohibition, injunction or decree of any court or other governmental body which would prevent the execution or delivery of this Agreement by such Shareholder or the transfer, conveyance and sale of the Shares to be sold by such Shareholder to the Buyer pursuant to the terms hereof and the execution, delivery and performance by such Shareholder of
this Agreement and the consummation of the transactions contemplated hereby will not (a) violate the provisions of any law, ordinance, rule, regulation, order or common law (collectively, "Law") or (b) result in the breach of, or constitute a default under any agreement to which such Shareholder is a party or by which such Shareholder or any of its properties is or may be bound, which would adversely affect the ability of such Shareholder to perform its obligations hereunder and consummate the transactions contemplated hereby.

(e) Schedule 2(e) attached hereto sets forth a true, correct and complete list of all consents and approvals of third parties that are required in connection with the consummation by the Shareholders of the transactions contemplated by this Agreement. All consents, approvals and authorizations which must be obtained or satisfied by such Shareholder and which are necessary for the consummation of the transactions contemplated by this Agreement have been, or will be prior to the Closing Date, obtained and satisfied.

(f) Except as set forth in Section 14 hereof, no broker or finder has acted for such Shareholder in connection with this agreement or the transactions contemplated hereby, and no broker or finder is entitled to any brokerage or finder's fee or other commissions in respect of such transactions based upon agreements, arrangements or understandings made by or on behalf of such Shareholder.

(g) Except as set forth on Schedule 2(g), such Shareholder is not a party to any legal action, suit or other proceeding by or before any court, arbitrator or administrative agency (i) with respect to which an adverse determination would have a material adverse effect on the ability of such Shareholder to consummate the transactions contemplated hereby or (ii) which challenges or otherwise relates to the transactions contemplated by this Agreement, and such Shareholder is not aware that any such legal action, suit or other proceeding has been threatened. Except as set forth on Schedule 2(g), on the date hereof, there are no outstanding orders, rulings, decrees, judgments or stipulations to which such Shareholder or any of its affiliates is a party or by which any of them is bound by or with any court, arbitrator or administrative agency which (i) have had or could reasonably be expected to have material adverse effect on the ability of such Shareholder to consummate the transactions contemplated hereby or (ii) challenge or otherwise relate to the transactions contemplated by this Agreement.

3. Representations of the Company Regarding the Company. The Company hereby represents and warrants to the Buyer that:

3.01 Organization. The Company is a corporation duly organized and validly subsisting under the laws of the Commonwealth of Pennsylvania, and has all requisite corporate power and authority to own its properties, to carry on its business as now being conducted, to execute and deliver this Agreement and the agreements contemplated herein, and to consummate the transactions contemplated hereby and thereby. The Company is duly qualified to do business and in good standing in all jurisdictions in which its ownership of property or the character of its business requires such qualification, except for such jurisdictions in which the failure to be so qualified would not have a material adverse effect on the business, operations or financial condition of the Company taken as a whole (a "Material Adverse Effect"). Certified copies of the Articles of Incorporation and Bylaws of the Company, each as amended to date, have been
previously made available to the Buyer, and no amendments have been made thereto or have been authorized since the date thereof.

3.02 Capitalization of the Company. The Company’s authorized capital stock consists of _______ shares of Common Stock, of which ______ shares are issued and outstanding on the date hereof and held of record and beneficially by the Shareholders as set forth on Schedule I. All such issued and outstanding shares of Common Stock have been, and on the Closing Date will be, duly and validly issued and are fully paid and non-assessable. There are not, and on the Closing Date there will not be, outstanding (i) any options, warrants or other rights to purchase from the Company any capital stock of the Company, (ii) any securities convertible into or exchangeable for shares of such stock, or (iii) any other commitments of any kind for the issuance of additional shares of capital stock or options, warrants or other securities of the Company. There are no issued and outstanding shares of Common Stock held in the treasury of the Company.

3.03 Subsidiaries. The Company does not own, directly or indirectly, any capital stock or other equity interests in any other corporation, limited liability company, partnership, joint venture or other entity.

3.04 Authority. The execution and delivery by the Company of this Agreement and the agreements provided for herein, and the consummation by the Company of all transactions contemplated hereunder and thereunder by the Company, have been duly authorized by all requisite corporate action. This Agreement has been duly executed by the Company and the Shareholders. This Agreement and all other agreements and obligations entered into and undertaken in connection with the transactions contemplated hereby to which the Company is a party constitutes the valid and legally binding obligations of the Company enforceable against it in accordance with their respective terms, except as such enforceability may be limited by bankruptcy, insolvency or other laws affecting generally the enforceability of creditors’ rights, by general principles of equity and by limitations on the availability of equitable remedies. The execution, delivery and performance by the Company of this Agreement and the agreements provided for herein, and the consummation by the Company of the transactions contemplated hereby and thereby, will not, with or without the giving of notice or the passage of time or both, (a) violate the provisions of any Law applicable to the Company, (b) violate the provisions of the Articles of Incorporation or Bylaws of the Company, each as amended to date, (c) violate any judgment, decree, order or award of any court, governmental body or arbitrator applicable to the Company, or (d) result in the breach of, or constitute a default under, or result in the acceleration under, or result in the creation of any Lien upon the properties or assets of the Company pursuant to, any indenture, mortgage, deed of trust or other instrument or agreement to which the Company is a party or by which the Company or any of its properties is or may be bound, which would result in a Material Adverse Effect. Schedule 3.04 attached hereto sets forth a true, correct and complete list of all consents and approvals of third parties that are required in connection with the consummation by the Company of the transactions contemplated by this Agreement.

3.05 Financial Statements.
(a) The Company has previously made available to the Buyer the audited balance sheet of the Company as of (the “Audited Balance Sheet”), and the related statements of income, shareholders’ equity, retained earnings and changes in financial condition of the Company for the fiscal year then ended (collectively, the “Audited Financial Statements”). The Company has also previously made available to the Buyer the unaudited balance sheet of the Company as of (the “Current Balance Sheet”) and the related unaudited statements of income, shareholders’ equity, retained earnings and changes in financial condition of the Company for the 12-month period then ended (collectively, with the Current Balance Sheet, the “Current Financial Statements”). The Audited Financial Statements and, except as set forth on Schedule 3.05 attached hereto, the Current Financial Statements (collectively, the “Financial Statements”) were prepared in accordance with GAAP applied consistently with past practices, subject, in the case of the Current Financial Statements, to normal recurring year-end adjustments and the absence of footnotes customarily included in audited financial statements. The Audited Financial Statements have been certified without qualification by the Company’s independent public accountants. The Current Financial Statements have been certified by the Company’s Chief Financial Officer. The date of the Current Balance Sheet is hereinafter referred to as the “Balance Sheet Date.”

(b) The Financial Statements fairly present, in all material respects, as of their respective dates, the financial condition, retained earnings, assets and liabilities of the Company and the results of operations of the Company’s business for the periods indicated.

3.06 Absence of Undisclosed Liabilities. Except as and to the extent (a) reflected and reserved against in the Current Balance Sheet, (b) set forth on Schedule 3.06 attached hereto, or (c) incurred in the ordinary course of business after the date of the Current Balance Sheet and not material in amount, either individually or in the aggregate, the Company has no liability or obligation, secured or unsecured, whether accrued, absolute, contingent, unasserted or otherwise, which is material to the condition (financial or otherwise) of the assets, properties or business of the Company. For purposes of this Subsection 3.06, “material” means any amount in excess of $______.

3.07 Litigation. Except as set forth on Schedule 3.07 attached hereto, (a) there is no action, suit or proceeding to which the Company is a party (either as a plaintiff or defendant) pending or, to the knowledge of the Company, threatened before any court or governmental agency, authority, body or arbitrator which, in the event of an adverse outcome, would result in a Material Adverse Effect, and, to the knowledge of the Company, there is no basis for any such action, suit or proceeding, (b) neither the Company nor, to the knowledge of the Company, any officer, director or employee of any of the Company, has been permanently or temporarily enjoined by any order, judgment or decree of any court or any governmental agency, authority or body from engaging in or continuing any conduct or practice in connection with the business, assets or properties of the Company, and (c) there is not in existence on the date hereof any order, judgment or decree of any court, tribunal or agency enjoining or requiring the Company or to take any action of any kind with respect to its business, assets or properties.

3.08 Insurance. Schedule 3.08 attached hereto sets forth a true, correct and complete list of all fire, theft, casualty, general liability, workers compensation, business interruption,
environmental impairment, product liability, automobile and other insurance policies maintained by the Company and of all life insurance policies maintained on the lives of any of their employees, specifying the type of coverage, the amount of coverage, the premium, the insurer and the expiration date of each such policy (collectively, the “Insurance Policies”) and all claims made under such Insurance Policies since ______________. True, correct and complete copies of all Insurance Policies have been previously made available by the Company to the Buyer. The Insurance Policies are in full force and effect and, to the knowledge of the Company, are in amounts of a nature which are adequate and customary for the Company’s business. All premiums due on the Insurance Policies or renewals thereof have been paid, and there is no material default under the Insurance Policies. Except as set forth on Schedule 3.08, the Company has not received any written notice from any issuer of the Insurance Policies since ______________ canceling or materially amending any of the Insurance Policies, materially increasing any deductibles or retained amounts thereunder, or materially increasing the annual or other premiums payable thereunder, and, to the knowledge of the Company, no such cancellation, amendment or increase of deductibles, retainages or premiums is threatened. Except as set forth on Schedule 3.08, the Company has no outstanding claims or disputes with any insurance carrier regarding claims, settlements or premiums, and the Company has not failed to give any notice or present any claim under any Insurance Policy in due and timely fashion. The Insurance Policies will remain in full force and effect immediately following the consummation of the transactions contemplated hereby unless terminated by the Company after the Closing Date.

3.09 Personal Property. Schedule 3.09 attached hereto sets forth a true, correct and complete list of all items of tangible personal property owned by the Company as of the date hereof having either a net book value or an estimated fair market value in excess of $_______; or not owned by the Company but in the possession of or used in the business of the Company and having rental payments therefor in excess of $________ per year (collectively, the “Personal Property”). Except as disclosed in Schedule 3.09:

(a) the Company has good and marketable title to each item of Personal Property described as owned on Schedule 3.09, free and clear of all liens, leases, mortgages, encumbrances, pledges, security interests, charges and restrictions (collectively “Liens”), except for those (i) reflected in the Current Balance Sheet, (ii) for Taxes not yet due or payable or being diligently contested in good faith by appropriate proceedings for which adequate reserves have been established in accordance with GAAP, (iii) that constitute mechanics’, carriers’, workers’ or other like liens incurred in the ordinary course of business, or (iv) that individually or in the aggregate are not material to the Company in character, amount or extent and do not otherwise materially impair the business of the Company (collectively, “Permitted Liens”).

(b) to the knowledge of the Company, no officer, director, Shareholder or employee of the Company, nor any spouse, child or other relative or affiliate thereof, owns directly or indirectly, in whole or in part, any of the Personal Property described in Schedule 3.09;

(c) the Personal Property is in satisfactory operating condition and repair, normal wear and tear excepted, is currently used by the Company in the ordinary course of its
business; and is sufficient for the continued operation of the business of the Company as the business is currently conducted;

(d) the Company owns or otherwise has the right to use all of the Personal Property now used in the operation of its business or the use of which is necessary for the performance of any material contract or agreement to which it is a party.

3.10 Intangible Property. Schedule 3.10 attached hereto sets forth: (i) a true, correct and complete list, all items of intangible property owned by or used in connection with the business of the Company, including, but not limited to, trade secrets, know-how, any other confidential information of the Company, United States and foreign patents, trade names, trademarks, trade name and trademark registrations, copyrights and copyright registrations, and applications for any of the foregoing (the "Intangible Property"); and (ii) a true, correct and complete list of all licenses or similar agreements or arrangements to which the Company is a party, either as licensee or licensor, with respect to the Intangible Property. Except as otherwise disclosed in Schedule 3.10:

(a) the Company is the sole and exclusive owner of all right, title and interest in and to the Intangible Property and all designs, permits, labels and packages used on or in connection therewith, free and clear of all Liens, except for Permitted Liens;

(b) to the extent applicable, the registration of the Intangible Property listed on Schedule 3.10 is currently effective;

(c) the Company has the right to use the Intangible Property in connection with the conduct of its business in the manner presently conducted, and, to the knowledge of the Company, such use does not conflict with, infringe upon or violate any rights of any other person, corporation or entity;

(d) the Intangible Property is sufficient to enable the Company to conduct its business as presently conducted and, to the knowledge of the Company, the Company's present and currently proposed business practices, methods and operations do not infringe, violate or constitute an unauthorized use or misappropriation of any Intangible Property or other similar right of any Person;

(e) the Company has not received notice of, or has any knowledge of, a pleading or threatened claim, interference action or other judicial or adversarial proceeding against the Company that any of the operations, activities, products, services or publications of the Company or any of its Franchisees infringes or will infringe any patent, trademark, trade name, copyright, trade secret or other property right of a third party, or that it is illegally or otherwise using the trade secrets, formulae or property rights of others which would result in a Material Adverse Effect;

(f) there are no outstanding, nor to the knowledge of the Company, any threatened disputes or other disagreements with respect to any licenses or similar agreements or arrangements described in Schedule 3.10 or with respect to infringement by a third party of any of the Intangible Property;
(g) the Company has taken all steps reasonably necessary to protect its right, title and interest in and to the Intangible Property; and

(h) neither the Company nor any Shareholder has any knowledge that any third party is infringing or otherwise violating any of the Intangible Property in which the Company has ownership rights.

3.11 Real Property.

(a) Schedule 3.11 attached hereto sets forth a true, correct and complete list as of the date hereof of all leases of real property, identifying separately each ground lease, to which the Company is a party (collectively, the “Real Property Leases”). True, correct and complete copies of all Real Property Leases, and all amendments, modifications and supplemental agreements thereto, have previously been made available by the Company to the Buyer. To the knowledge of the Company, the Real Property Leases are in full force and effect and are binding and enforceable against each of the parties thereto in accordance with their respective terms, except as such enforceability may be limited by bankruptcy, insolvency, or other laws affecting generally the enforceability of creditors’ rights, by general principles of equity and by limitations on the availability of equitable remedies. No party to any Real Property Lease has sent written notice to the other claiming that such party is in default thereunder and that such default remains uncured. Except as set forth on Schedule 3.11, on the date hereof, there are no defaults on the part of the Company or, to the knowledge of the Company, on the part of any of the lessors under the provisions of any of the Real Property Leases, except, in either case, for defaults which, individually or in the aggregate, would not have a Material Adverse Effect.

(b) The Company does not and has not owned any real property and, except as set forth on Schedule 3.11, does not and has not for the past five years, leased or operated any real property.

3.12 Franchise Matters.

(a) Except as set forth on Schedule 3.12(a), the Company does not have any subsidiary or affiliate offering or selling franchises, master franchises, area development agreements, subfranchises, licenses, business opportunities or seller-assisted marketing plans (collectively, “Franchises”), domestically or internationally.

(b) The Company has provided the Buyer with a true and complete copy of the Company’s currently effective uniform franchise offering circular(s) (the “UFOC”) dated August 2005 and the uniform franchise offering circular(s) in effect between January 1, 2003 and the effective date of the UFOC (the “Previous UFOCs”), in each case, used by the Company to offer and sell Franchises in the United States and Canada. Other than the UFOCs and the Previous UFOCs, the Company does not and has not, in the past three years, used or distributed any other uniform franchise offering circular for the offer and sale of Franchises.

(c) Schedule 3.12(c) attached hereto sets forth a true and complete list of all franchise agreements by location to which the Company is a party (collectively, together with all
ancillary agreements related thereto, the “Franchise Agreements”), including for each Franchise Agreement (i) the name, address and telephone number of each and every subfranchisee, area developer, franchisee, licensee, master licensee, or master franchisee (any of which is hereinafter referred to as a “Franchisee”), and (ii) the effective dates and expiration dates.

(d) Schedule 3.12(d) attached hereto identifies each current Franchisee that, to the knowledge of the Company, is (i) currently in material default under any Franchise Agreement, or (ii) the subject of a case under the United States bankruptcy code or any other bankruptcy, insolvency, receivership or similar case or proceeding under state or federal Law, of which the Company has been notified.

(e) Schedule 3.12(e) attached hereto sets forth a true and complete list of all written agreements with independent sales representatives, contractors, brokers or consultants under which the Company has authorized any person to sell or promote Franchises on behalf of the Company or agreed to rebate or share amounts receivable under any Franchise Agreement and indicating which of such agreements, if any, are in default and may be terminated by the Company by notice to the other party. The Company has made available to the Buyer true, correct and complete copies of all written agreements described in Schedule 3.12(e).

(f) Except as set forth on Schedule 3.12(f), the Company has prepared and maintained each of its UFOCs in accordance with applicable Law, have filed UFOCs in all jurisdictions requiring registration and approval prior to any offers or sales of Franchises in such jurisdictions (except for those jurisdictions in which the Company properly qualified for an exemption from such jurisdictions’ registration requirements) and have filed all material changes, amendments, renewals thereto on a timely basis as required by applicable Law, except when the failure to do so would not be material to the Company. The UFOCs were prepared in compliance in all material respects with applicable UFOC Disclosure Guidelines, and, to the knowledge of the Company, there were no material misrepresentations or material omissions of information in any UFOC at the time the Company was using such UFOC.

(g) To the knowledge of the Company, except as disclosed in Schedule 3.12(g), (i) each Franchise Agreement complies, and the offer and sale of such Franchise complied at the time such offer and sale was made, with all Laws of the Federal Trade Commission or any state, foreign country or other jurisdiction relating to the offer and sale of Franchises (collectively “Franchise Laws”), except where the failure to so comply would not be material to the Company, (ii) there were no material misrepresentations or material omissions of information in connection with the sale of any franchise license and (iii) all franchise advertising by the Company was conducted in compliance with applicable Franchise Law.

(h) Except as listed or described in Schedule 3.12(h):

(i) no Franchise Agreement has been subordinated and no provision regarding the calculation and payment of royalty fees in any Franchise Agreement has been waived, altered or modified in any material respect adverse to the Company thereunder; and
(ii) no right of rescission, set-off, counterclaim or defense has been asserted or, to the knowledge of the Company, is threatened, with respect to any Franchise Agreement which would have a Material Adverse Effect.

(i) Except as set forth on Schedule 3.12(i):

(ii) no orders, consents or decrees (other than routine comment letters from regulators, orders approving registrations, renewals of registrations or registration exemptions) have been issued by any foreign or domestic (federal or state) administrative or regulatory agency to the Company nor have letters of inquiry, investigation or the like been issued to the Company by such foreign or domestic administrative or regulatory agencies relating, directly or indirectly, to the Company’s offer and sale of Franchises; and

(ii) the Company has made available to the Buyer correct and complete copies of all UFOCs, disclosure documents or agreements filed since _______________ with any foreign or domestic administrative or regulatory agency or otherwise used by the Company in connection with the offer, sale and operation of Franchises in any jurisdiction (domestic or international).

(j) Except as specified on Schedule 3.12(j), there is no action or proceeding pending, or to the knowledge of the Company, threatened against or involving any of its domestic or international Franchises and, to the knowledge of the Company, there is no basis for any such action or proceeding, except for actions or proceedings that would not, in any individual case or in the aggregate, reasonably be expected to be material to the Company. The Company is not subject to any judgment, order or decree entered in any lawsuit or proceeding which has or may have a Material Adverse Effect on its rights and interests in any Franchise Agreement.

(k) To the knowledge of the Company, the Company’s files with respect to its Franchise operations, including state registration and compliance files and individual Franchise files (i) contain all material records and documents the Company is required to maintain under applicable Franchise Laws, (ii) contain sufficient information in the case of each Franchise to verify (A) compliance with the United States Federal Trade Commission or state UFOC and Franchise Agreement disclosure requirements in the sale of such Franchise and (B) the effectiveness, at the time of offer and sale of such Franchise, of any state Franchise registration or registration exemption required in connection with such offer and sales, and (iii) contain in all material respects a complete documentary record of the Company’s contractual relations and other material dealings with all current Franchisees and all former Franchisees (other than former Franchisees who ceased to be Franchisees prior to _______________).

(l) Except as set forth on Schedule 3.12(l), there is no action or proceeding pending or, to the knowledge of the Company, threatened involving the Company with any franchisee listed on Schedule 3.12(c). To the knowledge of the Company, no currently operating franchisee listed on Schedule 3.12(c) has notified the Company in writing that it intends to terminate its franchise agreement or cease paying royalties or other amounts under such franchisee’s franchise agreement as they become due.
Except as set forth on Schedule 3.12(m), to the knowledge of the Company, no Franchisee (i) is in material default under the terms of the real property lease for the premises on which such Franchisee operates a service center, (ii) has received written notice claiming that such Franchisee is in material default under such lease and that such default remains uncured or (iii) is operating a service center without a valid and enforceable lease.

3.13 Tax Matters. [NOTE: To be reviewed by tax counsel.]

(a) Except as set forth on Schedule 3.13 attached hereto:

(i) within the times and in the manner prescribed by Law, the Company has filed or caused to be filed all income, franchise and other material federal, state and local Tax Returns and all income, franchise and other material Tax Returns required for foreign countries, provinces and other governing bodies having jurisdiction to levy Taxes upon the Company (including Puerto Rico and Canada) which are required to be filed on or before the date hereof, and the Company has not engaged in any “reportable transactions” as defined in Treasury Regulation Section 1.6011-4(b);

(ii) the Company has paid or caused to be paid, or made provision for the payment of, all Taxes which have become due or which have been claimed to be due (whether or not shown on a Tax Return) and has complied in all material respects with all applicable Laws relating to the payment and withholding of Taxes and has duly and timely withheld and paid over to the appropriate taxing authority all amounts required to be so withheld and paid under all applicable Laws;

(iii) the Company has not waived or extended any applicable statute of limitations relating to the assessment of federal, state, local or foreign Taxes;

(iv) no examination of the federal, state, local or foreign Tax Returns of the Company is currently in progress nor, to the knowledge of the Company, threatened, and no deficiencies have been asserted or assessed against the Company as a result of any audit by the Internal Revenue Service or any state, local or foreign taxing authority and no such deficiency has been proposed or threatened;

(v) the Company has made available to the Buyer complete copies of (A) all federal, state, local and foreign income or franchise Tax Returns filed by the Company relating to the taxable periods since _________________ and (B) any audit report issued within the last three years relating to any Taxes due from or with respect to the Company;

(vi) Schedule 3.13 lists (A) all types of Taxes paid, and all types of Tax Returns filed by or on behalf of the Company, and (B) all of the jurisdictions that impose such Taxes or with respect to which the Company has a duty to file such Tax Returns. No claim has been made by a taxing authority in writing or, to the knowledge of the Company, otherwise in a jurisdiction where the Company does not file Tax Returns such that it is or may be subject to taxation by that jurisdiction;
(vii) neither the Company nor any other person on its behalf has (A) agreed to or is required to make any adjustments pursuant to Section 481(a) of the Code or any similar provision of Law or has any knowledge that any taxing authority has proposed any such adjustment, or has any application pending with any taxing authority requesting permission for any changes in accounting methods that relate to the Company or (B) executed or entered into or applied for a closing agreement pursuant to Section 7121 of the Code or any similar provision of Law with respect to the Company. The Company is not subject to nor has it applied for any private letter ruling of the IRS or comparable rulings of any taxing authority;

(viii) no Shareholder is a foreign person within the meaning of Section 1445 of the Code;

(ix) the Company (A) is not a party to any tax sharing, allocation, indemnity or similar agreement or arrangement (whether or not written) pursuant to which it will have any obligation to make any payments after the Closing and (B) has never been a member of any consolidated, combined, affiliated or unitary group of corporations for any Tax purposes;

(x) there is no contract, agreement, plan or arrangement covering any person that, individually or collectively, could give rise to the payment of any amount that would not be deductible by the Buyer, the Company or any of their respective Affiliates by reason of Section 280G of the Code;

(xi) the Company has not constituted either a “distributing corporation” or a “controlled corporation” (within the meaning of Section 355(a)(1)(A) of the Code) in a distribution of stock qualifying for tax-free treatment under Section 355 of the Code (A) in the two years prior to the date of this Agreement or (B) in a distribution which could otherwise constitute part of a “plan” or “series of related transactions” (within the meaning of Section 355(e) of the Code) in conjunction with the transactions contemplated by this Agreement;

(xii) the Company does not have, and since ___________ has not had, a permanent establishment in any country other than the United States, and has not engaged in a trade or business in any country other than the United States that subjected it to Tax in such country;

(xiii) since ___________, the Company has been a validly electing “S” corporation within the meaning of Sections 1361 and 1362 of the Code, and under each provision of state or local law analogous to Sections 1361 and 1362 of the Code in each jurisdiction where the Company is required to file an income or franchise Tax Return, provided however that each such jurisdiction recognizes federal Subchapter S for its purposes, and the Company will be an “S” corporation for any purpose up to and including the Closing Date. As a result, except for a cumulative amount of state Taxes of less than $________ per taxable year, the Company will not owe, or if owed, will pay, any federal, state, local or foreign income or franchise Tax through the Closing Date. The Company has no potential liability for any Tax under Section 1374 of the Code. The Company has not, in the past ten years, (i) acquired assets from another corporation in a transaction in which the Company’s tax basis for the acquired asset was determined, in whole, or in part, by reference to the Tax basis of the acquired assets (or any

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other property) in the hands of the transferor or (ii) acquired the stock of any corporation which
is a "qualified subchapter S subsidiary" within the meaning of Section 1361 of the Code;

(xiv) the Company has not, within the scope of Section 999 of the Code, participated in or cooperated with any international boycott, and has not been requested to do so in connection with any transaction or proposed transaction; and

(xv) none of the currently owned assets of the Company was acquired from a "related person" as defined in Section 197 of the Code.

(b) Schedule 3.13 attached hereto sets forth those taxable years for which the Tax Returns of the Company have been reviewed or audited by applicable federal, state, local and foreign taxing authorities and those Tax years for which said Tax Returns have received clearances or other indications of approval from applicable federal, state, local and foreign taxing authorities.

(c) For purposes of this Subsection 3.13, Subsection 3.14, Subsection 3.19(a)(xiii) and Subsection 10.01(c), any reference to the Company shall be deemed to include any person that merged with or was liquidated into the Company. For purposes of this Agreement, "Taxes" means (i) all federal, state, local or foreign taxes, charges, fees, imposts, levies or other assessments, including, without limitation, all net income, gross receipts, capital, sales, use, ad valorem, value added, transfer, franchise, profits, inventory, capital stock, license, withholding, payroll, employment, social security, unemployment, excise, severance, stamp, occupation, property and estimated taxes, customs duties, fees, assessments and charges of any kind whatsoever, (ii) all interest, penalties, fines, additions to tax or additional amounts imposed by any taxing authority in connection with any item described in clause (i) and (iii) any liability in respect of any items described in clauses (i) and/or (ii) payable by reason of contract, assumption, transferee liability, operation of law including by reason of a combined, unitary or consolidated tax obligation such as Treasury Regulation Section 1.1502-6 (or any predecessor or successor thereof or any analogous or similar provision under Law), or otherwise; and "Tax Return" means any return, report or statement required to be filed with respect to any Tax (including any attachments thereto, and any amendment thereof) including, but not limited to, any information return, claim for refund, amended return or declaration of estimated Tax, and including, where permitted or required, combined, consolidated or unitary returns for any group of entities that includes the Company or any of its Affiliates.

3.14 Books and Records. The general ledgers and books of account of the Company and all federal, state and local income, franchise, property and other Tax Returns filed by the Company are complete and correct and have been maintained in accordance with all applicable procedures required by Law in all material respects.

3.15 Contracts and Commitments.

(a) Schedule 3.15 attached hereto contains a true, complete and correct list and description of the following contracts and agreements, whether written or oral (collectively, the "Contracts"): 19
(i) all loan agreements, indentures, mortgages and guaranties to which the Company is a party or by which the Company or any of its property is bound;

(ii) all pledges, conditional sale or title retention agreements, security agreements, equipment obligations, personal property leases and lease purchase agreements to which the Company is a party or by which the Company or any of its property is bound;

(iii) all contracts, agreements, commitments, purchase orders or other understandings or arrangements to which the Company is a party or by which the Company or any of its property is bound which involve payments or receipts by the Company of more than $ in the case of any single contract, agreement, commitment, understanding or arrangement under which full performance (including payment) has not been rendered by all parties thereto;

(iv) all collective bargaining agreements, employment and consulting agreements, executive compensation plans, bonus plans, deferred compensation agreements, pension plans, retirement plans, employee stock option or stock purchase plans and group life, health and accident insurance and other employee benefit plans, agreements, arrangements or commitments to which the Company is a party or by which the Company or any of its property is bound;

(v) all contracts providing for severance, retention or change in control;

(vi) all agency, distributor, sales representative, franchise or similar agreements to which the Company is a party or by which the Company or any of its property is bound;

(vii) all contracts, agreements or other understandings or arrangements between the Company and any of the Shareholders or their affiliates;

(viii) all leases, whether operating, capital or otherwise, under which the Company is lessor or lessee or under which the Company has provided any partial or full guaranty;

(ix) all contracts, agreements and other documents or information relating to past disposal of waste (whether or not hazardous);

(x) all contracts, agreements or other arrangements imposing a non-competition or non-solicitation obligation on the Company;

(xi) all contracts for the sale of any of the assets of the Company other than in the ordinary course of business or for the grant to any Person of any preferential rights to purchase any of its assets;

(xii) all contracts for joint ventures, strategic alliances, partnerships, licensing arrangements, or sharing of profits or proprietary information;
(xiii) all contracts regarding national account, fleet and warranty programs;

(xiv) all contracts regarding vendor programs for franchisees;

(xv) all advertising or promotional contracts, which individually require the Company to spend in excess of $______;

(xvi) all contracts relating to any rebates, allowances or discounts to customers or from suppliers; and

(xvii) any other material agreements or contracts entered into by the Company.

(b) Except as set forth on Schedule 3.15:

(i) each Contract is in full force and effect and is a valid and binding agreement of the Company, enforceable against the Company in accordance with its terms, except as such enforceability may be limited by bankruptcy, insolvency or other laws affecting generally the enforceability of creditors’ rights, by general principles of equity and by limitations on the availability of equitable remedies, and the Company does not have any knowledge that any Contract is not a valid and binding agreement of the other parties thereto;

(ii) the Company is not in material breach of or material default under any Contract, and, to the knowledge of the Company, no event has occurred which with the passage of time or giving of notice or both would constitute such a default, result in a loss of rights or result in the creation of any Lien, thereunder or pursuant thereto, other than Permitted Liens; and

(iii) to the knowledge of the Company, there is no existing breach or default by any other party to any Contract, and no event has occurred which with the passage of time or giving of notice or both would constitute a default by such other party.

(c) True, correct and complete copies of all Contracts have previously been made available by the Company to the Buyer.

3.16 Compliance with Laws.

(a) The Company has and is in compliance with all licenses, permits and certificates, including environmental, health and safety permits, from federal, state and local authorities (collectively, the “Permits”) that are material to the conduct of its business and the ownership and operation of its assets, except where the failure to have such Permits would not be material to the Company. Schedule 3.16 attached hereto sets forth a true, correct and complete list of all such Permits, copies of which have previously been made available by the Company to the Buyer.
(b) Except as set forth on Schedule 3.16, the Company is and has been for the past three years, in compliance with all Laws (other than those pertaining to pollution or protection of the environment or exposure or persons to toxic or hazardous substances, raw materials or chemicals) of governmental authorities, domestic or foreign, applicable to them, except where the failure to so comply would not be material to the Company.

(c) Except as set forth on Schedule 3.16, the Company has not had notice or communication from any federal, state or local governmental or regulatory authority or otherwise since January 1, 2003 of any violation or noncompliance with Laws or Permits.

(d) Except as set forth on Schedule 3.16, and except as would not have a Material Adverse Effect:

(i) the Company has complied since ________________, and is in compliance, with applicable Environmental Requirements;

(ii) since ________________, the Company has not received any written (A) notice, report or other information regarding any actual or alleged violation of any Environmental Requirement, (B) claim, notice, complaint or other assertion that the Company is liable to any other person concerning any environmental, health or safety matter, or (C) request for information from any governmental authority concerning any environmental, health or safety matter;

(iii) the Company has not treated, stored, disposed of, transported, handled, released, or arranged for or permitted the disposal of, any Hazardous Substances except in compliance with applicable Environmental Requirements;

(iv) no events or conditions existing on or prior to the Closing Date and related to the assets of the Company will give rise to remedial or corrective obligations of the Company pursuant to applicable Environmental Requirements; and

(v) the Company has furnished to the Buyer all written audits, reports and other documents prepared since [_______________] concerning environmental, health or safety matters related to the assets of the Company.

(e) For purposes of this Subsection 3.16:

(i) "Environmental Requirement" means any federal, state, county or municipal authority law, ruling, order, decree, regulation, permit or other requirement relating to health, safety, pollution, hazardous waste, environmental or other similar matters; and

(ii) "Hazardous Substance" means any substance, chemical or other material that is defined, classified or regulated as "contaminant", "hazardous", "pollutant", "pollution", "toxic" or "waste" pursuant to an Environmental Requirement.

3.17 Employee Relations.
(a) The Company, to its knowledge, is in compliance in all material respects with all federal, state and municipal laws respecting employment and employment practices, terms and conditions of employment, and wages and hours, and, to its knowledge, is not engaged in any unfair labor practice, and there are no arrears in the payment of wages or social security taxes.

(b) Except as set forth on Schedule 3.17 attached hereto:

(i) the Company is not party to any labor or collective bargaining agreement;

(ii) to the knowledge of the Company, none of the employees of the Company is represented by any labor union and no labor organization or group of employees has made a pending demand for recognition, and there are no representation proceedings or petitions seeking a representation proceeding presently pending or, to the knowledge of the Company, threatened to be brought or filed, with the National Labor Relations Board or any state or local agency. To the knowledge of the Company, there is no organizing activity involving the Company pending or threatened by any labor organization or group of employees;

(iii) there is no unfair labor practice complaint against the Company pending before the National Labor Relations Board or any state or local agency;

(iv) there is no pending labor strike affecting the Company; and

(v) there are no pending arbitration proceedings arising out of or under any collective bargaining agreement to which the Company is a party.

(c) Schedule 3.17 sets forth a true, correct and complete list of the current employees of the Company, including the current job descriptions and salary or wage rates of each of such employees, showing separately for each such person who received an annual salary in excess of $ the maximum amounts paid or payable as salary and bonus payments for the fiscal year ended _____________.

3.18 Employee Benefit Plans.

(a) Schedule 3.18 sets forth each employee benefit plan, as that term is defined in Section 3(3) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), to which the Company, as of the date hereof, is required to contribute or which the Company, as of the date hereof, sponsors, and under which employees of the Company (or their beneficiaries) are, or may become, entitled to benefits (collectively, the "Employee Plans"). For the previous five years and as of the date hereof, the Company is not a party to, and has not incurred any unpaid withdrawal liability under, any "multiemployer plan," as defined in Section 3(37) of ERISA. All Employee Plans have been operated and maintained in compliance in all material respects with their terms and with the provisions of ERISA, the Internal Revenue Code of 1986, as amended (the "Code"), and rules and regulations promulgated thereunder.
(b) As of ____________ and ____________, there was no accumulated funding deficiency within the meaning of Section 4.12 of the Code for which an excise tax is due with respect to any Employee Plan. No Employee Plan has engaged in a "prohibited transaction" (as defined in Section 406 of ERISA and Section 4975 of the Code) with a "party in interest" (as defined in Section 4975(e)(2) of the Code) for which an exemption has not been received from the Department of Labor and/or the Internal Revenue Service, as applicable. No "reportable event" (as defined in Section 4043 of ERISA) has occurred with respect to any Employee Plan subject to Title IV of ERISA which would subject the Company to any liability material to the business of the Company.

(c) The Company has previously made available to the Buyer (i) true, correct and complete copies of all Employee Plans which have been reduced to writing, (ii) written descriptions of all Employee Plans which have not been reduced to writing, (iii) all agreements, including trust agreements and insurance contracts, related to such Employee Plans, (iv) the Summary Plan Description and all modifications thereto for each Employee Plan communicated to employees, (v) the most recent Forms 5500 and all schedules thereto and (vi) the most recent actuarial report, if any.

(d) Each Employee Plan intended to qualify under Section 401(a) of the Code has been determined by the Internal Revenue Service to so qualify, and the trusts created thereunder have been determined to be exempt from tax under the provisions of Section 501(a). Copies of all determination letters with respect to each such Employee Plan have been previously made available by the Company to the Buyer. To the knowledge of the Company, no such Employee Plan has been operated in a manner which would cause it to be disqualified in operation, and all such Employee Plans have been administered in compliance with and consistent with all applicable requirements of the Code and ERISA, including, without limitation, all reporting, notice and disclosure requirements.

(e) Schedule 3.18 describes which Employee Plans are intended to be continued by the Company following the Closing Date and which are intended to be terminated. At the Buyer's election, the Company shall take any actions as may be necessary or appropriate under all applicable laws and the terms of the Employee Plans to establish the Buyer, or an affiliate of the Buyer, as having all rights and obligations with respect to any of the Employee Plans which are to be continued including, without limitation, rights with respect to all annuity or insurance contracts which form a part of any of such Employee Plans, together with all other Employee Plan assets. The Company shall obtain as of the Closing Date any and all consents from trustees required to effect any transfer of any trust(s) related to such assumed Employee Plans to such trustee(s) as may be appointed by the Buyer. Nothing expressed or implied herein shall confer upon any past or present employee of the Company, his or her representatives, beneficiaries, successors and assigns, nor upon any collective bargaining agent, any rights or remedies of any nature, including, without limitation, any rights to employment or continued employment with the Company, the Buyer, or any successor or affiliate.

3.19 Absence of Certain Changes or Events.
(a) Except as set forth on Schedule 3.19 attached hereto, since the Balance Sheet Date, the Company has not entered into any transaction which is not in the usual and ordinary course of business, and, without limiting the generality of the foregoing, the Company has not:

(i) incurred any material obligation or liability for borrowed money in excess of $_____________________;

(ii) discharged or satisfied any lien or encumbrance or paid any obligation or liability other than current liabilities reflected in the Current Balance Sheet;

(iii) failed to promptly pay and discharge current liabilities except where disputed in good faith by appropriate proceedings;

(iv) made any loans, advances or capital contributions to, or investments in, any Person or paid any fees or expenses to any Shareholder or any director, officer, partner, shareholder, beneficiary or Affiliate of any Shareholder;

(v) mortgaged, pledged or subjected to lien, charge or other encumbrance any of its properties or assets;

(vi) sold or purchased, assigned or transferred any of its tangible assets or cancelled any debts or claims, except for inventory sold and raw materials purchased in the ordinary course of business;

(vii) made any material amendment to or termination of any material Contract, including any Franchise Agreement;

(viii) suffered any losses of personal or real property, whether insured or uninsured, and whether or not in the control of the Company in excess of $______ in the aggregate;

(ix) authorized any declaration or payment of dividends by the Company or paid any such dividends, authorized or made (a) any transfer of assets of any kind whatsoever by the Company to any of the Shareholders or (b) any redemption or repurchase, in each case, with respect to any shares of their capital stock;

(x) made any material change in the terms, status or funding condition of any Employee Plan;

(xi) engaged any new employee for a salary in excess of $____________ per annum;

(xii) made, or committed to make, any changes in (a) the compensation payable to any officer, director, employee or agent of the Company or (b) any bonus payment or similar arrangements made to or with any of such officers, directors, employees or agents in excess of $___________________ in any instance or $________ in the aggregate;
(xiii) incurred any capital expenditure in excess of $_________ in any instance or $________________ in the aggregate;

(xiv) made any material alteration in the manner of keeping the books, accounts or records of the Company or in the accounting practices therein reflected other than those required by generally accepted accounting principles;

(xv) made any change in its Tax reporting principles, methods or policies, made or rescinded any material election relating to Taxes, amended any Tax Return, surrendered any right to claim a refund of any Taxes or settled or compromised any claim relating to Taxes;

(xvi) granted any license or sublicense of any rights under or with respect to any Intangible Property, except in the ordinary course of business; or

(xvii) instituted or settled any legal proceeding resulting in a loss of revenue in excess of $_________ in the aggregate.

(b) Since the Balance Sheet Date, there has not been any change in the business, operations or financial condition of the Company, taken as a whole, which has had or would reasonably be expected to have a Material Adverse Effect, other than changes relating to the economy in general or changes resulting from industry-wide developments affecting other companies in similar businesses.

3.20 Conflicts of Interest. Except as set forth on Schedule 3.20 attached hereto, no officer, director, Shareholder, beneficiary of any Shareholder of the Company nor, to the knowledge of the Company, any affiliate of such person, now has, or within the last three years had, either directly or indirectly:

(a) an equity or debt interest in any corporation, partnership, joint venture, association, organization or other person or entity which furnishes or sells or during such period furnished or sold such services or products to the Company, or which purchases or during such period purchased from the Company any goods or services, or which otherwise does or during such period did business with the Company;

(b) a beneficial interest in any contract, commitment or agreement, including a franchise agreement or license, to which the Company is or was a party or under which any of them is or was obligated or bound or to which any of their respective properties may be or may have been subject, other than stock options and other contracts, commitments or agreements between the Company and such persons in their capacities as employees, officers or directors of the Company; or

(c) has any claim or cause of action against the Company.

3.21 Indebtedness to and from Officers, Directors and Shareholders. Except as set forth on Schedule 3.21 attached hereto, the Company is not indebted, directly or indirectly, to any person who is an officer, director, Shareholder or beneficiary of a Shareholder of the
Company in any amount whatsoever other than for salaries for services rendered or reimbursable business expenses, all of which have been reflected on the Current Financial Statements, and no such officer, director, Shareholder, beneficiary of such Shareholder or affiliate is indebted to the Company except for advances made to employees of the Company in the ordinary course of business to meet reimbursable business expenses anticipated to be incurred by such obligor.

3.22 Powers of Attorney, Suretyships and Bank Accounts. Except as set forth on Schedule 3.22 attached hereto, the Company does not have any general or special powers of attorney outstanding (whether as grantor or grantee thereof) or any obligation or liability (whether actual, accrued, accruing, contingent or otherwise) as guarantor, surety, co-signer, endorser, co-maker, indemnitor or otherwise in respect of the obligation of any person, corporation, partnership, joint venture, association, organization or other entity, except as endorser or maker of checks or letters of credit, respectively, endorsed or made in the ordinary course of business. Schedule 3.22 contains a complete and correct list of the names and locations of all banks in which Company has accounts or safe deposit boxes and the names of all persons authorized to draw thereon or to have access thereto.

3.23 Assets of the Company. The assets held by the Company constitute all of the material assets and rights which are used in and are sufficient for the current and ongoing operation of the business of the Company as conducted on the date hereof.

3.24 Suppliers. Schedule 3.24 sets forth a list of the ten (10) largest suppliers of the Company, as measured by the dollar amount of purchases therefrom or thereby, during each of the fiscal years ended and , showing the approximate total purchases by the Company from each such supplier and the amount of revenue recorded by the Company with respect to any rebates from each supplier during such periods.

(a) Since December 31, 2004, no supplier listed on Schedule 3.24 has terminated its relationship with the Company or materially reduced or changed the pricing or other terms of its business with the Company and, to the knowledge of the Company, no supplier listed on Schedule 3.24 has notified the Company in writing that it intends to terminate or materially reduce or change the pricing or other terms, including rebate terms, of its business with the Company.

3.25 Accounts and Notes Receivable and Payable. The accounts and notes receivable of the Company have arisen from bona fide transactions and represent amounts due with respect to arm's length transactions entered into in the ordinary course of business. All reserves for returns or doubtful accounts reflected on the Current Balance Sheet were calculated in a manner consistent with past practice and in accordance with GAAP consistently applied. None of the accounts or the notes receivable of the Company are subject to any setoffs or counterclaims.

3.26 Brokers. Except as set forth in Section 14 hereof, no broker or finder has acted for the Company in connection with this agreement or the transactions contemplated hereby, and no broker or finder is entitled to any brokerage or finder's fee or other commissions in respect of such transactions based upon agreements, arrangements or understandings made by or on behalf of the Company.

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4. **Representations of the Buyer**

The Buyer represents and warrants to the Company and each Shareholder as follows:

4.01 **Organization and Authority.** The Buyer is a corporation duly organized, validly existing and in good standing under the laws of the State of Delaware, and has all requisite corporate power and authority to own its properties and to carry on its business as now being conducted. The Buyer has full power to execute and deliver this Agreement and the agreements contemplated herein, and to consummate the transactions contemplated hereby and thereby. Certified copies of the governing documents of the Buyer, as amended to date, have been previously delivered to the Company, are complete and correct, and no amendments have been made thereto or have been authorized since the date thereof.

4.02 **Authorization.** Except as set forth in Schedule 4.02 attached hereto, the execution and delivery of this Agreement by the Buyer, and the agreements provided for herein, and the consummation by the Buyer of the transactions contemplated hereby and thereby, have been duly authorized by all requisite corporate action. This Agreement and all such other agreements and written obligations entered into and undertaken in connection with the transactions contemplated hereby constitute the valid and legally binding obligations of the Buyer, enforceable against the Buyer in accordance with their respective terms, except as such enforceability may be limited by bankruptcy, insolvency or other laws affecting generally the enforceability of creditors’ rights, by general principles of equity and by limitations on the availability of equitable remedies. The execution, delivery and performance of this Agreement and the agreements provided for herein, and the consummation by the Buyer of the transactions contemplated hereby and thereby, will not, with or without the giving of notice or the passage of time or both, (a) violate the provisions of any Law applicable to the Buyer, (b) violate the provisions of the Buyer’s Certificate of Incorporation or Bylaws, each as amended to date, (c) violate any judgment, decree, order or award of any court, governmental body or arbitrator, or (d) except as set forth on Schedule 4.02, result in the breach of, or constitute a default under, or result in the acceleration under, or result in the creation of any lien, charge or encumbrance upon the properties or assets of the Buyer pursuant to, any indenture, mortgage, deed of trust or other agreement or instrument to which the Buyer is a party or by which the Buyer is or may be bound. Schedule 4.02 attached hereto sets forth a true, correct and complete list of all consents and approvals of third parties that are required in connection with the consummation by the Buyer of the transactions contemplated by this Agreement.

4.03 **Regulatory Approvals.** Other than approvals required under the HSR Act, all consents, approvals, authorizations and other requirements prescribed by any Law which must be obtained or satisfied by the Buyer and which are necessary for the consummation of the transactions contemplated by this Agreement have been, or will be prior to the Closing Date, obtained and satisfied.

4.04 **Litigation.** Except as set forth on Schedule 4.04, none of Buyer or its affiliates is a party to any legal action, suit, investigation or other proceeding by or before any court, arbitrator or administrative agency (i) with respect to which an adverse determination would have a material adverse effect on the ability of Buyer to consummate the transactions.
contemplated hereby or (ii) which challenges or otherwise relates to the transactions contemplated by this Agreement, and Buyer is not aware that any such legal action, suit, investigation or other proceeding has been threatened. Except as set forth on Schedule 4.04, on the date hereof there are no outstanding orders, rulings, decrees, judgments or stipulations to which Buyer or any of its affiliates is a party or by which any of them is bound by or with any court, arbitrator or administrative agency which (i) have had or could reasonably be expected to have material adverse effect on the ability of Buyer to consummate the transactions contemplated hereby or (ii) challenge or otherwise relate to the transactions contemplated by this Agreement.

4.05 Information. The Company has provided Buyer with such access to all the facilities, books, records and personnel of the Company as Buyer has deemed necessary and appropriate in order for Buyer to investigate to its satisfaction the business and properties of the Company sufficiently to make an informed investment decision to purchase the Shares and to enter into this Agreement. Buyer has such knowledge and experience in financial and business matters that Buyer is capable of evaluating the merits and risks of the purchase of Shares.

4.06 Investment Representation. The Buyer is acquiring the Shares from each Shareholder for its own account for investment and not with a view to, or for sale in connection with, any distribution thereof, nor with any present intention of distributing or selling the same; and, except as contemplated by this Agreement and the agreements contemplated herein, the Buyer has no present or contemplated agreement, undertaking, arrangement, obligation, indebtedness or commitment providing for the disposition thereof.

4.07 Funds. Buyer will have on the Closing Date sufficient funds available to it to pay the Purchase Price and to consummate the other transactions contemplated by this Agreement to be consummated by the Buyer.

5. Access to Information; Public Announcements

5.01 Access to Management, Properties and Records. From the date of this Agreement until the Closing Date, the Company shall afford the officers, attorneys, accountants and other authorized Representatives of the Buyer reasonable access upon reasonable notice and during normal business hours to the offices, properties, books and records of the Company, so that the Buyer may have full opportunity to make such investigation as it shall desire to make of the business, properties and affairs of the Company, and the Buyer shall be permitted to make abstracts from, or copies of, all such books and records. All requests for such access shall be directed to the Company’s General Counsel, _____________. The Shareholders and the Company shall furnish to the Buyer such financial and operating data and other information as to the business of the Company as the Buyer shall reasonably request.

5.02 Confidentiality.

(a) The Company and the Shareholders have furnished and will continue to furnish the Buyer with certain information which is either non-public, confidential or proprietary in nature and which (i) is identified in writing as being proprietary and confidential, (ii) is not
already known to persons other than the Company, the Shareholders, their Representatives and third parties which have entered into written non-disclosure agreements with the Company, and (iii) has not been independently developed by the Buyer. All such information furnished to the Buyer, its directors, officers, employees, agents or representatives, including, without limitation, attorneys, accountants, consultants, potential lenders, investors and financial advisors (collectively “Representatives”), by the Company, the Shareholders, or any of their respective Representatives, and all analyses, compilations, data, studies or other documents prepared by the Buyer or its Representatives to the extent containing or based on any such furnished information or reflecting the Buyer’s review of, or interest in, the Company is hereinafter referred to as “Confidential Information.”

(b) Subject to the requirements of applicable Law, prior to the Closing, the Buyer hereby agrees to use the Confidential Information solely in connection with the consummation of the transactions contemplated by this Agreement and to transmit the Confidential Information only to those Representatives of the Buyer who need to know the Confidential Information.

5.03 Public Announcements. The parties agree that prior to the Closing Date any and all general public pronouncements or other general public communications concerning this Agreement and the purchase and sale of the Shares by the Buyer, and the timing, manner and content of such disclosures, shall be subject to the prior mutual agreement of the Company, the Shareholders’ Representative and the Buyer. After the Closing Date, none of the Shareholders nor the Shareholders’ Representative shall make any general public pronouncements or other general public communications concerning this Agreement or the transactions contemplated hereby without the prior consent of the Buyer, except as may be required by applicable Law.

6. Pre-Closing Covenants of the Shareholders, the Company and the Buyer

From and after the date hereof and until the Closing Date:

6.01 Conduct of Business. The Company shall carry on its business substantially in the same manner as heretofore and shall not make or institute any unusual or new methods of manufacture, purchase, sale, shipment or delivery, lease, management, accounting or operation, except as agreed to in writing by the Buyer. All of the property of the Company shall be used, operated, repaired and maintained in a normal business manner consistent with past practice. The Company will continue to accept prospective Franchises and will continue to perform all obligations and provide all services required by the Franchise Agreements, in each case, in the ordinary course of business and consistent with past practice.

6.02 Absence of Material Changes. Without the prior written consent of the Buyer, the Company shall not:

(a) take any action to amend its charter documents or bylaws;

(b) issue any stock, bonds or other corporate securities or grant any option or issue any warrant to purchase or subscribe for any of such securities or issue any securities convertible into such securities;
(c) incur any obligation or liability (absolute or contingent) in excess of $_____, except current liabilities incurred and obligations under contracts entered into in the ordinary course of business;

(d) make any loans, advances or capital contributions to, or investments in, any Person or pay any fees or reimburse any expenses to any Shareholder or any director, officer, partner, stockholder, beneficiary or Affiliate of any Shareholder, except in the ordinary course of business;

(e) fail to pay and discharge its current liabilities consistent with past practice, except where disputed in good faith by appropriate proceedings;

(f) declare or make any payment or distribution to its Shareholders with respect to its stock or purchase or redeem any shares of its capital stock, except to the extent necessary to provide funds to Shareholders to pay Taxes on income reported by them and attributable to their ownership interests in the Company;

(g) mortgage, pledge, or subject to any lien, charge or any other encumbrance any of its material assets or properties, other than Permitted Liens;

(h) sell, assign, or transfer any of its assets, except for inventory sold in the ordinary course of business;

(i) cancel any debts or claims in excess of $_____, except in the ordinary course of business;

(j) merge or consolidate with or into any corporation or other entity;

(k) make, accrue or become liable for any bonus, profit sharing or incentive payment, except for accruals under existing plans, if any, or increase the rate of compensation payable or to become payable by it to any of its officers, directors or employees, other than increases in the ordinary course of business consistent with past practice or disclosed on the Schedules attached hereto;

(l) waive any rights of material value in excess of $_____

(m) other than the Franchise Agreements, modify, amend, alter or terminate any of its executory contracts of a material value in excess of $_____

(n) take or permit any act or omission constituting a material breach or material default under any Contract by which it or its properties are bound;

(o) fail to operate its business and maintain its books, accounts and records in the customary manner and in the ordinary course of business and maintain in good repair its business premises, fixtures, machinery, furniture and equipment;
(p) enter into any lease, contract, agreement or understanding, other than those entered into in the ordinary course of business calling for payments which in the aggregate do not exceed $_______ for each such lease, contract, agreement or understanding;

(q) incur any capital expenditure in excess of $_______ in a single instance or $_______ in the aggregate;

(r) engage any new employee for a salary in excess of $_______ per annum;

(s) materially alter the terms, status or funding condition of any Employee Plan;

(t) grant any license or sublicense of any rights under or with respect to any Intangible Property, except in the ordinary course of business;

(u) institute or settle any legal proceeding resulting in a loss of revenue in excess of $_______ in the aggregate;

(v) amend or alter any Franchise Agreement in any material respect;

(w) enter into any franchise agreement containing any terms or provisions materially different from those in the Current Standard Form, except for standard modifications made in the ordinary course of business and consistent with the description set forth in paragraph 1 of Schedule 3.12(c);

(x) grant any exclusive rights to any customer or supplier of the Company; or

(y) commit or agree to do any of the foregoing in the future.

6.03 Compliance with Laws. Each of the Company and the Buyer will comply in all material respects with all Laws which are applicable to it or to the conduct of its business and will perform and comply in all material respects with all contracts, commitments and obligations by which they are bound or which are necessary to consummate the transactions contemplated hereby.

6.04 Continued Truth of Representations and Warranties. Neither the Shareholders nor the Company nor the Buyer will take any actions which would result in any of their respective representations or warranties set forth in Sections 2, 3 and 4, as the case may be, hereof being untrue or inaccurate in any material respect.

6.05 Exclusive Dealing. Neither the Shareholders, the Shareholders’ Representative, nor the Company will (a) solicit, initiate or encourage submission of proposals or offers from any person relating to an acquisition or purchase of all or a material portion of the assets of or an equity interest in the Company or any merger, consolidation or business combination with the Company, or (b) participate in any discussions or negotiations regarding, or furnish to any other person, any non-public information with respect to or otherwise cooperate in any way with, or
assist or participate in, facilitate or encourage, any effort or attempt by any other person to do or seek any of the foregoing. The Shareholders, the Shareholders' Representative and the Company agree to promptly notify the Buyer of any such proposal or offer, or any inquiry or contact with respect thereto received by the Company or the Shareholders. Such notice shall indicate the identity of the Person making an acquisition proposal, or intending to make an acquisition proposal or requesting non-public information or access to books and records of the Company, the material terms of any such acquisition proposal, or modification or amendment to such acquisition proposal and copies of any written proposals or offers or amendments or supplements thereto. The Shareholders' Representative and the Company shall keep Buyer informed, on a current basis, of any material changes in the status and any material changes or modifications in the material terms of any such acquisition proposal or request. The Shareholders' Representative and the Company shall (and shall cause their Representatives to) immediately cease and cause to be terminated any existing discussions or negotiations with any Persons (other than Buyer) conducted heretofore with respect to any acquisition proposals. The Shareholders and the Company shall not release any third party from the confidentiality and standstill provisions of any agreement to which the Company is a party. The Buyer hereby acknowledges that the Company and the Shareholders have disclosed substantial non-public information to other potential acquirers of the Shares and that such disclosures do not constitute a breach of this Agreement, including, without limitation, this Subsection 6.05.

6.06 Reports; Taxes. In connection with this transaction, the Company will duly and timely file all reports or returns required to be filed with federal, state, local and foreign authorities and will promptly pay all federal, state, local and foreign Taxes, assessments and governmental charges levied or assessed upon them or any of their properties (unless diligently contesting such Taxes in good faith by appropriate proceedings and adequate provision has been made therefor in accordance with GAAP); provided that any such Tax Returns shall be prepared in a manner consistent with past practice (unless there is no reasonable basis for such positions) and the Company shall provide the Buyer a copy thereof (together with supporting work papers) at least ten (10) business days prior to the due date thereof for the Buyer to review and approve (such approval not to be unreasonably withheld or delayed).

6.07 No Solicitation or Hiring of the Company's Employees. From the date hereof until the Closing or, in the event the Closing does not occur, for a period of one year after the date of termination of this Agreement, neither the Buyer nor any of its Affiliates shall directly or indirectly (a) solicit any person who was an employee of the Company as of the date hereof or on the date of termination of this Agreement to terminate his or her employment with the Company or to become an employee of the Buyer or any of its Affiliates, or (b) hire any person who was an employee of the Company on the date hereof or on the date of termination of this Agreement. Nothing herein shall prohibit the Buyer from hiring any person that was terminated by the Company or any person responding to a general advertisement that is not directed to the employees of the Company.

6.08 No Solicitation of Franchisees. From the date hereof until the Closing or, in the event the Closing does not occur, for a period of one year after the date of termination of this Agreement, neither the Buyer nor any of its Affiliates shall directly or indirectly solicit, attempt to solicit, or cause to be solicited any Franchisee of the Company as of the date hereof.
6.09  **No Inducement to Cease Doing Business with the Company.** From the date hereof until the Closing or, in the event the Closing does not occur, for a period of one year after the date of termination of this Agreement, neither the Buyer nor any of its Affiliates shall directly or indirectly induce or attempt to induce any Franchisee to cease doing business with the Company.

6.10  **Consents; HSR Act Compliance.** The Shareholders, the Company and the Buyer shall each use its commercially reasonable efforts to obtain at the earliest practical date all consents, waivers, approvals, orders, Permits, authorizations and declarations from, make all filings with, and provide all notices to, all governmental entities which are required to consummate, or in connection with, the transactions contemplated by this Agreement, including the consents, waivers, approvals, orders, Permits, authorizations, declarations, filings and notices referred to in Sections 2(e), 3.04 and 4.02. The Company and the Buyer shall each promptly, and in any event within ten days after execution and delivery of this Agreement, make all filings or submissions as are required under the HSR Act and to obtain any approval, consent, license, clearance, exemption, waiver or registration of or with any governmental authority necessary in order to consummate the transactions contemplated hereby. Each of the Company and the Buyer shall promptly 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 or to obtain any other governmental approval. The Company and the Buyer shall promptly provide the other with copies of all written communications (and memoranda setting forth the substance of all oral communications) between each of them or their representatives, on the one hand, and any governmental agency or authority, on the other hand, with respect to this Agreement or the transactions contemplated hereby. Without limiting the generality of the foregoing, the Company and the Buyer shall each promptly notify the other of the receipt and the content of any inquiries or requests for additional information made by any governmental agency or authority in connection therewith and shall (i) comply promptly with any such inquiry or request and (ii) promptly provide the other with a description of the information provided to any governmental agency or authority with respect to any such inquiry or request. In addition, the Company and the Buyer shall each keep the other apprised of the status of any such inquiry or request. The Buyer hereby agrees to pay all filing fees related to all filings or submissions under the HSR Act.

7.  **Commercial Best Efforts to Obtain Satisfaction of Conditions**

The Shareholders, the Company and the Buyer covenant and agree to use their commercial best efforts to obtain the satisfaction of the conditions specified in this Agreement within 30 days from the date hereof and shall not knowingly take any action that would materially and adversely affect the ability of any of the parties hereto to satisfy any of the conditions set forth herein or that would materially impair the ability of any such party to consummate the transactions contemplated hereby or that would materially delay such consummation. At the request of any party hereto, at any time and from time to time following the execution of this Agreement promptly execute and deliver, or cause to be executed and delivered, to the requesting party, all such further instruments and take all such further action as may be reasonably necessary to consummate the transactions contemplated by this Agreement.
8. Conditions to Obligations of the Buyer

The obligations of the Buyer under this Agreement are subject to the fulfillment, at the Closing Date, of the following conditions precedent, each of which may be waived in writing in the sole discretion of the Buyer:

8.01 Continued Truth of Representations and Warranties of the Shareholders and the Company; Compliance with Covenants and Obligations. The representations and warranties of the Shareholders and the Company qualified as to materiality shall be true and correct, and those not so qualified shall be true and correct in all material respects on and as of the Closing Date as though such representations and warranties were made on and as of such date, except to the extent such representations and warranties are by their express provisions made as of the date of this Agreement or another specific date and except for any changes permitted by the terms hereof or consented to in writing by the Buyer. The Shareholders and the Company shall have performed and complied in all material respects with all of their respective terms, conditions, covenants, obligations, agreements and restrictions required by this Agreement to be performed or complied with by each of them prior to or at the Closing Date.

8.02 Performance by the Shareholders and the Company. At the Closing, the Shareholders and the Company shall have delivered to the Buyer a certificate signed by each such Shareholder or the President or Chief Financial Officer of the Company, as the case may be, as to their compliance with Subsection 8.01 hereof.

8.03 Adverse Proceedings. No action or proceeding by or before any court or other governmental body shall have been instituted or threatened by any governmental body or person whatsoever which shall seek to restrain, prohibit or invalidate the transactions contemplated by this Agreement or which might affect the right of the Buyer to own the Shares.

8.04 Absence of Material Adverse Effect. There shall not have been or occurred any event, change, occurrence or circumstance that has had a Material Adverse Effect.

8.05 Opinion of Counsel.

(a) The Buyer shall have received an opinion of ________, counsel to the Shareholders, dated as of the Closing Date, in substantially the form attached hereto as Exhibit B.

(b) The law firm of ________ must also deliver an opinion of counsel that: each trust owning stock in ________ is validly formed in accordance with state law and that the trustee(s) of each trust are authorized to sign the stock purchase agreement and other attendant documents; that each trust owns _______ number of the shares of issued and outstanding common stock of ________, and that at all times from the date it first acquired such shares the trust was eligible to own stock in an S corporation for federal income tax purposes and will maintain such status through the date of closing.

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(c) The Buyer shall have received an opinion of counsel to the Company, dated as of the Closing Date, in substantially the form attached hereto as Exhibit C.

8.06 **HSR Act.** The applicable waiting period under the HSR Act shall have expired or terminated.

8.07 **Closing Deliveries.** The Buyer shall have received at or prior to the Closing such documents, instruments or certificates as the Buyer may reasonably request including, without limitation:

(a) the stock certificates representing the Shares duly endorsed in accordance with Subsection 1.01 of this Agreement;

(b) such certificates of the Company’s officers and of the Shareholders and such other documents evidencing satisfaction of the conditions specified in this Section 8 as the Buyer shall reasonably request;

(c) a certificate of the Secretary of the Commonwealth of the Commonwealth as to the subsistence of the Company in a certificate of the Secretary of the Company attesting to the incumbency of the Company’s officers, the authenticity of the resolutions authorizing the transactions contemplated by this Agreement, and the authenticity and continuing validity of the charter documents delivered pursuant to Subsection 3.01;

(d) where required by the applicable Lease, estoppel certificates from each lessor from which the Company leases real or personal property that consents to the acquisition of the Shares by the Buyer and the other transactions contemplated hereby;

(e) written resignations of all members of the Company’s Board of Directors;

(f) the original corporate minute books of the Company and all corporate seals;

(g) a cross receipt executed by the Buyer and the Shareholders;

(h) affidavits of non-foreign status from each of the Shareholders that comply with Treasury Regulation Section 1.144S-2(b)(2);

(i) evidence of the repayment of all amounts owed to the Company, if any, by any officer, director, Shareholder or beneficiary of any Shareholder;

(j) documentation reasonably satisfactory to the Buyer of all third party consents set forth on Schedule 3.04; and

(k) a new short-term lease on arm’s length terms reasonably acceptable to the Buyer for the Company’s offices located in Bala Cynwyd, Pennsylvania.
9. **Conditions to Obligations of the Shareholders and the Company**

The obligations of the Shareholders and the Company under this Agreement are subject to the fulfillment, at the Closing Date, of the following conditions precedent, each of which may be waived in writing in the sole discretion of the Shareholders’ Representative, who shall have the power and authority to bind all of the Shareholders, and the Company:

9.01 **Continued Truth of Representations and Warranties of the Buyer; Compliance with Covenants and Obligations.** The representations and warranties of the Buyer qualified as to materiality shall be true and correct, and those not so qualified shall be true and correct in all material respects as of the Closing Date as though such representations and warranties were made on and as of such date, except to the extent such representation and warranties are by their express provisions made as of the date of this Agreement or another specific date and except for any changes consented to in writing by the Shareholders’ Representative. The Buyer shall have performed and complied in all material respects with all terms, conditions, covenants, obligations, agreements and restrictions required by this Agreement to be performed or complied with by it prior to or at the Closing Date.

9.02 **Performance by the Buyer.** At the Closing, the Buyer shall have delivered to the Shareholders and the Company a certificate signed by the President or Chief Financial Officer of the Buyer as to its compliance with Subsection 9.01 hereof.

9.03 **Corporate Proceedings.** All corporate and other proceedings required to be taken on the part of the Buyer to authorize or carry out this Agreement shall have been taken.

9.04 **Adverse Proceedings.** No action or proceeding by or before any court or other governmental body shall have been instituted or threatened by any governmental body or person whatsoever which shall seek to restrain, prohibit or invalidate the transactions contemplated by this Agreement or which might affect the right of the Shareholders to transfer the Shares.

9.05 **Opinion of Counsel.** The Shareholders shall have received an opinion of Weil, Gotshal & Manges LLP, counsel to the Buyer, dated as of the Closing Date, in substantially the form attached hereto as Exhibit D.

9.06 **HSR Act.** The applicable waiting period under the HSR Act shall have expired or terminated.

9.07 **Closing Deliveries.** The Shareholders shall have received at or prior to the Closing such documents, instruments or certificates as the Company or the Shareholders’ Representative may reasonably request including, without limitation:

(a) such certificates of the Buyer’s officers and such other documents evidencing satisfaction of the conditions specified in this Section 9 as the Shareholders’ Representative or the Company shall reasonably request;

(b) a certificate of the Secretary of State of the State of Delaware as to the legal existence and good standing (including tax) of the Buyer in Delaware;
(c) a certificate of the Secretary of the Buyer attesting to the incumbency of the Buyer's officers, the authenticity of the resolutions authorizing the transactions contemplated by this Agreement, and the authenticity and continuing validity of the charter documents and by-laws delivered pursuant to Subsection 4.01;

(d) payment of the Purchase Price to the Shareholders' Representative for distribution to the Shareholders (other than the Escrow Amount); and

(e) a cross receipt executed by the Buyer and the Shareholders.

10. Indemnification

10.01 By the Shareholders and the Company. If the Closing occurs, subject to Subsection 10.08(d) hereof, the Shareholders hereby jointly and severally indemnify and hold harmless the Buyer and the Company and if the Closing does not occur, the Company hereby indemnifies and holds harmless the Buyer, from and against all claims, damages, losses, liabilities, costs and expenses (including, without limitation, settlement costs and any reasonable legal, accounting or other expenses for investigating or defending any actions or threatened actions) (collectively, the "Losses"), whether or not a third party claim, in connection with each and all of the following:

(a) any misrepresentation or breach of any representation or warranty made by the Shareholders or the Company in this Agreement (as qualified by the Schedules attached hereto) as of the date made or as of the Closing Date;

(b) any breach of any covenant, agreement or obligation of the Shareholders or the Company contained in this Agreement; and

(c) (i) all Taxes of the Company (or any predecessor thereof), and, the extent of the business, assets or operations of the Company, of the Shareholders (A) for any taxable period ending on or before the Closing Date and (B) for the portion of any Straddle Period ending at the close of business on the Closing Date (determined as provided in Subsection 11.04(e)), (ii) any Taxes imposed on the Company or the Shareholders resulting from, arising out of or based on the Section 338(h)(10) Election and (iii) any increase in Taxes by the Company resulting from (x) any deduction or credit that is shifted as a result of any Final Determination from a taxable year beginning after the Closing Date to a taxable year ending on or before the Closing Date or (y) any income that is shifted as a result of any Final Determination from a taxable year ending on or before the Closing Date to a taxable year ending after the Closing Date. The Buyer acknowledges and agrees that, its sole and exclusive remedy with respect to any and all claims relating to the subject matter of this Agreement shall be pursuant to the indemnification provisions set forth in this Subsection 10.01, except for equitable relief or in the case of fraud or willful misrepresentation. In furtherance of the foregoing, except as aforesaid, the Buyer hereby waives, to the fullest extent permitted under any and all applicable Laws, any and all rights, claims and causes of action it or any of its subsidiaries or affiliates (including the Company after the Closing) may have against any of the Shareholders or any of their respective
Affiliates arising under or based upon any federal, state, provincial, local or foreign statute, law, ordinance, rule, regulation or common law.

10.02 By the Buyer. The Buyer hereby indemnifies and holds harmless the Shareholders and the Company (if the Closing does not occur) from and against all Losses in connection with each and all of the following:

(a) any misrepresentation or breach of any representation or warranty made by the Buyer in this Agreement (as qualified by the Schedules attached hereto); as of the date made or as of the Closing Date;

(b) any breach of covenant, agreement or obligation of the Buyer contained in this Agreement;

(c) any increase in Taxes payable by the Shareholders resulting from (x) any deduction or credit that is shifted as a result of any Final Determination to a taxable year beginning after the Closing Date from a taxable year ending on or before the Closing Date or (y) any income that is shifted as a result of any Final Determination to a taxable year ending on or before the Closing Date from a taxable year ending after the Closing Date, in either case to the extent that the Company (or, if applicable, the consolidated group of which the Company is a member) actually recognizes any Tax benefit (measured by (A) a reduction in the Taxes they are required to pay for a taxable period ending on or before the taxable period in which the indemnity payment is received or (B) a refund of Taxes already paid) as a result of such adjustment; and

(d) any obligations or liabilities of the Company, whether incurred before or after the Closing (other than those for which the Shareholders have agreed to indemnify the Buyer pursuant to this Agreement).

10.03 Claims for Indemnification. Whenever any claim which may give rise to indemnity under this Section 10 shall arise, the Buyer, the Company or the Shareholders, as the case may be, as the party seeking indemnification (the “Indemnified Party”), shall promptly notify the Shareholders’ Representative, the Company or the Buyer, as the case may be, as the party from whom indemnification is sought (the “Indemnifying Party”), of the claim and, when known, the facts constituting the basis for such claim, but failure to so notify shall not affect indemnification hereunder, except to the extent that the Indemnifying Party is actually prejudiced thereby, it being understood that in no event shall such failure extend the indemnification period beyond 15 months. In the event of any such claim for indemnification hereunder resulting from or in connection with any claim or legal proceedings by a third party, the notice shall specify, if known, the amount or an estimate of the amount of the liability arising therefrom. The Indemnified Party shall not settle or compromise any claim by a third party for which it is entitled to indemnification hereunder without the prior written consent, which shall not be unreasonably withheld or delayed, of the Indemnifying Party; provided, however, that if suit shall have been instituted against the Indemnified Party and the Indemnifying Party shall not have taken control of such suit after notification thereof as provided in Subsection 10.04 of this
Agreement, the Indemnified Party shall have the right to settle or compromise such claim upon giving notice to the Indemnifying Party as provided in Subsection 10.04.

10.04 Defense by the Indemnifying Party. In connection with any claim which may give rise to indemnity hereunder resulting from or arising out of any claim or legal proceeding by a person other than the Indemnified Party, the Indemnifying Party, at the sole cost and expense of the Indemnifying Party, may, upon written notice to the Indemnified Party, assume the defense of any such claim or legal proceeding. If the Indemnifying Party assumes the defense of any such claim or legal proceeding, the Indemnifying Party shall select counsel reasonably acceptable to the Indemnified Party to conduct the defense of such claims or legal proceedings and at the sole cost and expense of the Indemnifying Party shall take all steps necessary in the defense or settlement thereof. The Indemnifying Party shall not consent to a settlement of, or the entry of any judgment arising from, any such claim or legal proceeding, without the prior written consent of the Indemnified Party (which consent shall not be unreasonably withheld or delayed; provided, that the Indemnified Party shall not be obligated to consent to a settlement imposing any injunction, obligation or restriction upon the Indemnified Party or requiring the Indemnified Party to admit or acknowledge to any fact or event, including any violation of Law). The Indemnified Party shall be entitled to participate in (but not control) the defense of any such action, with its own counsel and at its own expense; provided, however, that such Indemnified Party shall be entitled to participate in any such defense with separate counsel at the expense of the Indemnifying Party if (i) so requested by the Indemnifying Party to participate or (ii) in the reasonable written opinion of counsel delivered to the Indemnified Party, a conflict or potential conflict exists between the Indemnified Party and the Indemnifying Party that would make such separate representation advisable; and provided, further, that the Indemnifying Party shall not be required to pay for more than one such counsel for all Indemnified Parties in connection with any third party claim. If the Indemnifying Party does not assume the defense of any such claim or litigation resulting therefrom within 30 days after the date such claim is made: (a) the Indemnified Party may defend against such claim or litigation in such manner as it may deem appropriate, including, but not limited to, settling such claim or litigation, after giving notice of the same to the Indemnifying Party, on such terms as the Indemnifying Party may deem appropriate; and (b) the Indemnifying Party shall be entitled to participate in (but not control) the defense of such action, with its counsel and at its own expense. If the Indemnifying Party thereafter seeks to question the manner in which the Indemnified Party defended such third party claim or the amount or nature of any such settlement, the Indemnifying Party shall have the burden to prove by a preponderance of the evidence that the Indemnified Party did not defend or settle such third party claim in a reasonably prudent manner.

10.05 Payment of Indemnification Liability Obligation. Except as set forth in Subsection 10.08(b) hereof, each of the Shareholders, the Buyer and the Company hereby agrees that any amounts owed to the Buyer, or the Company (if the Closing occurs), arising out of any claim for indemnification by the Buyer, or the Company (if the Closing occurs), under this Section 10 will be solely payable from any amounts remaining in the Reserve Account following any adjustment pursuant to Subsection 1.04 hereof.
10.06 Survival of Representations; Claims for Indemnification.

(a) Except for the representations and warranties of each of the Shareholders set forth in paragraphs (a) through (g) of Section 2 hereof (collectively, the “Special Shareholder Representations”) and the representations and warranties of the Company set forth in Subsections 3.01, 3.02, 3.03, 3.04 and 3.26 hereof (collectively, the “Special Company Representations”) and Subsections 3.13, 3.14 and 3.19(a)(xv) hereof (collectively, the “Tax Representations”), all representations and warranties made by the Shareholders, the Company and the Buyer in this Agreement, or in any instrument or document furnished in connection with this Agreement or the transactions contemplated hereby, shall survive the Closing for a period of 15 months. All such representations and warranties shall expire on the 15-month anniversary of the Closing Date, except for claims, if any, asserted in writing prior to such 15-month anniversary identified as a claim for indemnification pursuant to this Section 10.

(b) The Special Shareholder Representations, the Special Company Representations and the Tax Representations shall survive the Closing and continue in full force and effect until the earlier of (i) the expiration of the applicable statute of limitations or (ii) 60 days following the sixth anniversary of the date of this Agreement.

10.07 Insurance Proceeds. The amount of any Losses for which indemnification is provided under this Agreement shall be net of any amounts recovered by the Indemnified Party under insurance policies with respect to such.

10.08 Limitation on Indemnification Liability Obligations.

(a) No monetary amount shall be payable by an Indemnifying Party to the Indemnified Party with respect to the indemnification of any claims pursuant to Subsection 10.01(a), 10.01(b), 10.02(a) or 10.02(b) until the aggregate amount of Losses actually incurred by the Indemnified Party with respect to such claims exceeds, on a cumulative basis, an amount equal to 1.0% of the Adjusted Purchase Price (the “Basket”), in which event the Indemnifying Party shall be responsible only for the amount in excess of 0.5% of the Adjusted Purchase Price, provided that in no event shall the Indemnifying Party be responsible for any payment or aggregate payments with respect to Losses in excess of the Escrow Amount (the “Cap”) and provided further that neither the Basket nor the Cap shall apply to Losses related to a breach of a Special Shareholder Representation, a Special Company Representation or a Tax Representation.

(b) In the event any Losses arise out of a breach of a Special Shareholder Representation, a Company Special Representation or a Tax Representation, in each case, subject to Subsection 10.08(d), the Shareholders shall be jointly and severally responsible for making any payment or aggregate payments with respect to such Losses up to an aggregate amount not to exceed the Base Purchase Price. For the avoidance of doubt, any Losses arising both out of a breach of a Tax Representation and pursuant to Subsection 10.01(d) shall be treated, first and foremost, as arising pursuant to Subsection 10.01(d).
(c) For purposes of calculating Losses hereunder, any materiality or Material Adverse Effect qualifications in the representations, warranties, covenants and agreements shall be disregarded.

(d) Notwithstanding anything contained herein to the contrary, no Shareholder shall be responsible for making any payment or aggregate payments with respect to any Losses or any other claims that may arise out of or otherwise relate to this Agreement in an amount in excess of the portion of Adjusted Purchase Price allocated to such Shareholder.

10.09 Tax Treatment of Indemnity Payments.

The Shareholders and the Buyer agree to treat any indemnity payment made pursuant to this Section 10 as an adjustment to the Purchase Price for all income Tax purposes.

11. Post-Closing Agreements

The Shareholders, the Shareholders’ Representative and the Buyer agree that from and after the Closing Date:

11.01 Proprietary Information.

(a) Each of the Shareholders, the Shareholders’ Representative and each of their affiliates (as such term is defined in the Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder) (individually, an “Affiliate” and collectively “Affiliates”) shall and shall cause their respective beneficiaries to hold in confidence all knowledge and information of a secret or confidential nature with respect to the business of the Company and shall not disclose, publish or make use of the same without the consent of the Buyer, except to the extent that such information shall have become public knowledge other than by breach of this Agreement by the Shareholders. For the avoidance of doubt, as used in this Agreement, “Affiliate” shall not include any franchisees of the Company or the Buyer, as the case may be.

(b) From and after the Closing Date, the Shareholders’ Representative and the Shareholders shall not, and shall cause their respective beneficiaries and Affiliates not to, directly or indirectly, make any public or private derogatory or disparaging comments, written or oral, about the Buyer or the Company or any of their respective employees, officers, directors, Affiliates, shareholders, members or managers, or act in any such manner than would reasonably be expected to result in damage to the goodwill or business reputation of the Buyer or the Company or any of their respective employees, officers, directors, Affiliates, shareholders, members or managers.

(c) The Shareholders’ Representative and each Shareholder agrees that the remedy at law for any breach of this Subsection 11.01 would be inadequate and that the Buyer shall be entitled to injunctive relief in addition to any other remedy it may have upon breach of any provision of this Subsection 11.01.
11.02 No Solicitation or Hiring of Former Employees. Except as set forth in Schedule 11.02 attached hereto and except as provided by law, (a) for a period of three years after the Closing Date, no Shareholder shall (and shall cause its Affiliates including any beneficiary of such Shareholder not to) and the Shareholders’ Representative shall not (i) solicit any person who was an employee of the Company on the date hereof or the Closing Date to terminate his or her employment with the Buyer (or the Company) or to become an employee of such Shareholder, beneficiary of such Shareholder or Affiliate, or (ii) hire any person who was such an employee on the date hereof or on the Closing Date and (b) for a period of five years after the Closing Date, no Shareholder shall (and shall cause its Affiliates including any beneficiary of such Shareholder not to) and the Shareholders’ Representative shall not cause, induce or encourage any customer, supplier or franchisee of the Company (including any existing or former customer, supplier or franchisee of the Company and any Person that becomes a customer, supplier or franchisee of the Company after the Closing Date), to terminate or modify any relationship with the Company.

11.03 Non-Competition Agreement.

(a) For a period of five years after the Closing Date, no Shareholder shall (and shall cause its Affiliates including any beneficiary of such Shareholder not to) and the Shareholders’ Representative shall not, except as an officer or employee of the Company, engage in any business competitive with the business of the Company as conducted on the date hereof or on the Closing Date, in the United States or any other country in which the Company conducts its business on the date hereof or on the Closing Date. For purposes hereof, a “business competitive with the business of the Company” shall mean transmission repair or general repair work in the automotive aftermarket, including the franchising of any such business or any other business engaged in by the Company on or at any time within one (1) year prior to Closing and any business proposed by the Company at the time of Closing to be engaged in thereafter; provided, however, that the foregoing shall not prohibit any Shareholder from owning up to 5% of any class of equity securities of a company whose securities are publicly traded on a national securities exchange or in a national market system.

(b) The parties hereto agree that the duration and geographic scope of the non-competition provision set forth in this Subsection 11.03 are reasonable. In the event that any court of competent jurisdiction determines that the duration or the geographic scope, or both, are unreasonable and that such provision is to that extent unenforceable, the parties hereto agree that the provision shall remain in full force and effect for the greatest time period and in the greatest area that would not render it unenforceable. The Shareholders agree that damages are an inadequate remedy for any breach of this provision and that the Buyer shall, whether or not it is pursuing any potential remedies at law, be entitled to equitable relief in the form of preliminary and permanent injunctions upon any actual or threatened breach of this non-competition provision.

11.04 Tax Matters. The Shareholders’ Representative and the Company shall prepare and timely file or shall cause to be prepared and timely filed all appropriate and material federal, state, provincial, local and foreign Tax Returns in respect of the Company, its assets or activities that are required to be filed after the Closing Date and are with respect to and are required to be
filed on a separate Tax Return basis for any Tax period ending on or before the Closing Date. The Buyer shall prepare or cause to be prepared and shall file or cause to be filed all other Tax Returns required of the Company in respect of its assets or activities. Any such Tax Returns that include periods ending on or before the Closing Date or that include the activities of the Company prior to the Closing Date shall, insofar as they relate to the Company or any of the Shareholders, be on a basis consistent with the last previous such Tax Returns filed in respect of the Company or any of the Shareholders, as the case may be, unless the Company or any of the Shareholders, as the case may be, concludes that there is no reasonable basis for such position; provided that the Shareholders' Representative shall provide the Buyer with copies of such Tax Returns that he has the right to prepare (together with supporting work papers) at least twenty (20) days prior to the due date thereof for the Buyer to review and approve (such approval not to be unreasonably withheld or delayed). The Shareholders' Representative and the Buyer shall attempt in good faith to resolve any disagreements regarding such Tax Returns prior to the due date for filing. In the event that the Shareholders' Representative and the Buyer are unable to resolve any dispute with respect to such Tax Return at least ten (10) days prior to the due date for filing, such dispute shall be resolved pursuant to Subsection 11.04(g), which resolution shall be binding on the parties. Neither the Buyer nor, after the Closing Date, the Company, shall file any amended Tax Returns for any periods for or in respect of the Company with respect to which the Buyer is not obligated to prepare or cause to be prepared pursuant this Subsection 11.04(a) without the prior written consent of the Shareholders' Representative (which shall not be unreasonably withheld or delayed), unless required by applicable Law.

(a) The Shareholders shall pay or cause to be paid (i) all income Taxes and all Taxes other than income Taxes shown as due with respect to Tax Returns which the Company or the Shareholders, as the case may be, are obligated to prepare and file or cause to be prepared and filed pursuant to Subsection 11.04(a) hereof, (ii) all Taxes other than income Taxes due on or before the Closing Date for which no Tax Return is required to be filed and (iii) the amount of Taxes as determined pursuant to Subsection 11.04(e). The Buyer shall pay or cause to be paid all income Taxes shown as due with respect to separate Tax Returns which the Buyer is obligated to prepare and file or cause to be prepared and filed pursuant to Subsection 11.04(a) hereof (other than the amount of Taxes as determined pursuant to Subsection 11.04(e)). No payment pursuant to this Subsection 11.04(b) shall excuse the Shareholders from their indemnification obligations pursuant to Subsection 10.01 if the amount of Taxes as ultimately determined (on audit or otherwise) for which the Shareholders are liable exceeds the amount of the Shareholders' payment under this Subsection 11.04(b).

(b) The Shareholders shall be entitled to retain, or receive immediate payment from the Buyer or any of its subsidiaries or affiliates (including the Company), any refund or tax credits with respect to income Taxes (including, without limitation, refunds or tax credits arising by reason of amended Tax Returns filed after the Closing Date or otherwise) with respect to any Tax period ending on or before the Closing Date relating to the Company or any of the Shareholders, except to the extent (i) included in the reserve for Taxes on the Current Balance Sheet, (ii) attributable to a carryback (including for this purpose, as a result of an audit adjustment) from a taxable period (or portion thereof) beginning after the Closing Date of a loss, credit or deduction or (iii) attributable to an audit adjustment that reduces the income for a taxable period (or portion thereof) ending on or prior to the Closing Date and increases income
of a taxable period (or portion thereof) beginning after the Closing Date. The Buyer shall be entitled to retain any refund or credit with respect to income Taxes with respect to any taxable period beginning after the Closing Date relating to the Company. The Buyer and the Shareholders shall equitably apportion any refund or credit with respect to income Taxes with respect to any taxable period that includes (but does not end on) the Closing Date.

(c) Each of the Buyer and the Shareholders shall provide the other party with such information and records as may be reasonably requested by such other party in connection with the preparation of any Tax Return or any audit or other proceeding that relates to the Company or any of the Shareholders. The party requesting assistance hereunder shall reimburse the other for reasonable out-of-pocket expenses incurred in providing such assistance. To the extent in their respective possession, the Buyer and the Shareholders shall (i) preserve and cause to be preserved all information, returns, books, records and documents relating to any liabilities for Taxes of the Company with respect to a taxable period until the later of 60 days after the expiration of all applicable statutes of limitation and extensions thereof, or the conclusion of all litigation with respect to Taxes for such period and (ii) give reasonable written notice to the other party prior to transferring, destroying or discarding any such information, returns, books, records or documents and, if the other party so requests, allow the other party to take possession of such information, returns, books, records or documents. The Buyer shall prepare or cause the Company to prepare, within 30 days after the Closing Date, in a manner consistent with the Company’s past practice, the Tax work paper preparation package or packages necessary to enable the Shareholders to prepare all Tax Returns the Shareholders are obligated to prepare or cause to be prepared. Each of the Buyer and the Shareholders shall provide the other party with written notice of the commencement of any examination by a taxing authority that could give rise to a claim for indemnity under Section 10.

(d) The Company will close the taxable year of the Company as of the close of business on the Closing Date. If applicable Law does not permit the Company to close its taxable year on the Closing Date or in any case in which a Tax is assessed with respect to a taxable period which includes the Closing Date (but does not begin or end on that day) (a “Straddle Period”), the Taxes, if any, attributable to a Straddle Period shall be allocated (i) to the Shareholders for the period up to and including the close of business on the Closing Date, and (ii) to the Buyer for the period subsequent to the Closing Date. Any allocation of income or deductions required to determine any Taxes attributable to a Straddle Period shall be made pursuant to the following methodology: (x) Taxes, other than those referred to in clause (y) below, shall be allocated by means of a closing of the books and records of the Company as of the close of the Closing Date, provided that exemptions, allowances or deductions that are calculated on an annual basis (including, but not limited to, depreciation and amortization deductions) shall be allocated between the period ending on the Closing Date and the period after the Closing Date in proportion to the number of days in each such period, and (y) property Taxes and ad valorem Taxes shall be allocated between the period ending on the Closing Date and the period after the Closing Date in proportion to the number of days in each such period.

(e) (i) If notice of any legal proceeding with respect to Taxes of the Company (a “Tax Claim”) shall be received by either party for which the other party may reasonably be expected to be liable pursuant to Section 10, the notified party shall notify such
other party in writing of such Tax Claim in accordance with Subsection 10.03; provided, however, that the failure of the notified party to give the other party notice as provided herein shall not relieve the other party of its obligations under Section 10 except to the extent that the other party is actually and materially prejudiced thereby.

(ii) To the extent such Tax Claim is subject to indemnification by the Shareholders or the Buyer pursuant to Section 10, as applicable, the Indemnifying Party shall have the right, at its sole cost and expense, to represent the interests of the Company in any Tax Claim, as provided in Subsection 10.04; provided, however, that if the Tax Claim covers a Straddle Period or involves an issue that recurs in taxable periods beginning on or after the Closing Date, both the Shareholders’ Representative and the Buyer shall equally represent the Company, and in all cases consent to settlement, which shall not be unreasonably withheld.

(iii) In the event of a conflict between the provisions of this Subsection 11.04(f), on the one hand, and the provisions of Section 10, on the other, the provisions of this Subsection 11.04(f) shall control.

(iv) Notwithstanding any provision contained herein to the contrary, in the event that the Company is audited by any taxing authority with respect to any year or period ending on or before the Closing Date ("Pre-Closing Tax Periods"), then the Buyer must, in any event, receive the written permission by the Shareholder’s Representative prior to its agreeing to any adjustment, correction, modification or other change of any kind with such taxing authority for one or more Pre-Closing Tax Periods. Buyer must immediately notify the Shareholder’s Representative of the notice of the commencement of the audit of any return related to a Pre-Closing Tax Period and Shareholder’s Representative, at his cost and expense, shall have the right to hire such legal counsel, accountant, experts or other representatives to participate in such audit, administrative appeal or trial (through all levels of appellate review) and determine the appropriate resolution of such dispute.

(f) Any dispute as to any matter covered hereby shall be resolved by the arbitration procedure set forth in Subsection 13.03. The fees and expenses of the arbiter shall be borne equally by the Shareholders, on the one hand, and the Buyer, on the other. If any dispute with respect to a Tax Return is not resolved prior to the due date of such Tax Return, such Tax Return shall be filed in the manner which the party responsible for preparing such Tax Return deems correct.

(i) The Shareholders shall join with the Buyer in making an election under Section 338(h)(10) of the Code and the Treasury regulations and any corresponding or similar elections under state, local or foreign Tax law (collectively, the “Section 338(h)(10) Election”) with respect to the Company. For the purpose of making the Section 338(h)(10) Election, on or prior to the Closing Date, the Shareholders shall deliver to the Buyer a completed IRS Form 8023 (or successor form) and any similar state, local or foreign forms for signature of the Buyer. The Buyer, subject to its review and approval, will file the Form 8023 with the IRS at least 10 days prior to the due date of such form, and the Buyer will provide the Shareholders a copy of such filing. If such Form 8023 is not reasonably acceptable to the Buyer, the parties will
negotiate in good faith to resolve any differences therein, and any differences that cannot be agreed upon by the parties will be resolved in accordance with Subsection 11.04(g).

(ii) Except as provided in subsection (i) and (iv), the Buyer shall be responsible for the preparation and filing of all forms and documents required to effectuate the Section 338(h)(10) Election. In addition to the Form 8023, the Shareholders shall execute (or cause to be executed) and deliver to the Buyer such additional completed documents or forms as are reasonably requested to complete properly the Section 338(h)(10) Election, and reasonably acceptable in form and substance to the Shareholders, as soon as is reasonably practicable. If any such forms or documents are not reasonably acceptable to the Shareholders, the parties will negotiate in good faith to resolve any differences therein, and any differences that cannot be agreed upon by the parties will be resolved in accordance with Subsection 11.04(g).

(iii) The Buyer and the Shareholders shall file, and shall cause their Affiliates to file, all Tax Returns and statements, forms and schedules in connection therewith in a manner consistent with the Section 338(h)(10) Election and shall take no position contrary thereto unless required to do so by applicable Law.

(iv) The Shareholders and the Buyer further agree, in reporting the deemed asset sales as a result of the Section 338(h)(10) Election, to allocate the deemed purchase price in the manner set forth on Exhibit E. The Buyer and the Shareholders agree to make reasonable and equitable adjustments thereto as may be necessary to reflect the actual assets at Closing, including as a result of the determination of Closing Net Working Capital, Closing Net Cash Amount and Transaction Expenses, and all Tax Returns and reports filed by the Buyer, the Shareholders and their respective Affiliates shall be prepared consistently with such allocation.

(v) For the avoidance of doubt, all management bonuses, severance payments and deductible financing costs and expenses accrued by the Company on the Closing Date shall be treated as incurred in the taxable period (or portion thereof) ending on the Closing Date; provided that all Tax deductions relating to management bonuses and severance payments accrued by the Company after the Closing Date (the “Post-Closing Management Deductions”) shall, to the extent permitted by applicable Law, be considered to be in the taxable period (or portion thereof) beginning on the day after the Closing Date. To the extent that applicable Law does not permit the Post-Closing Management Deductions to be taken in the taxable year (or portion thereof) beginning on the day after the Closing Date, the parties shall take such action as may be required to provide the Buyer with the same net economic benefit as the Buyer would have enjoyed if the Post-Closing Management Deductions could be so taken, including, if necessary, the making of cash payments from the Shareholders on a several, not joint, basis in proportion to their ownership of Shares as set forth opposite their respective names on Schedule I attached hereto, to the Buyer in the amount of such benefit at such time (or times) as such benefit would have been realized by the Buyer.

12. Termination of Agreement; Option to Proceed

12.01 Termination by Lapse of Time. This Agreement may be terminated by any party hereto at 5:00 p.m., Eastern Time, on _____________, 2006, (the “Termination Date”) if the
transactions contemplated hereby have not been consummated, provided such party is not in breach of any of its representations, warranties, covenants or agreements contained in this Agreement. Such date may be extended by the written consent of the Company, the Buyer and the Shareholders’ Representative (whose consent shall bind each of the Shareholders).

12.02 Termination by Agreement of the Parties. This Agreement may be terminated by the mutual written agreement of the parties hereto. In the event of such termination by agreement, the Buyer shall have no further obligation or liability to the Shareholders or the Company under this Agreement, except for the obligations under Subsections 5.02, 6.07, 6.08 and 6.09 hereof, and the Shareholders and the Company shall have no further obligation or liability to the Buyer under this Agreement.

12.03 Termination due to Material Adverse Effect. This Agreement may be terminated by the Buyer upon written notice to the Shareholders’ Representative that there has been a breach of this Agreement by the Company or the Shareholders that has had a Material Adverse Effect, provided that such breach has continued without cure for period of 15 days after receipt of written notice of such breach to the Shareholders’ Representative.

12.04 Effect of Termination. In the event that this Agreement is validly terminated as provided herein, then each of the parties shall be relieved of their duties and obligations arising under this Agreement after the date of such termination and such termination shall be without liability to Buyer, any Shareholder or the Company; provided, however, that nothing in this Section 12 shall relieve Buyer, or the Company of any liability for a breach of this Agreement prior to the effective date of termination.

13. Dispute Resolution

13.01 General. In the event that any dispute should arise between the parties hereto with respect to any matter covered by this Agreement, including, without limitation, the calculation of the Closing Balance Sheet or the Adjusted Purchase Price, the parties hereto shall resolve such dispute in accordance with the procedures set forth in this Section 13. Notwithstanding anything contained in this Agreement to the contrary, the parties hereto shall be entitled to seek injunctive or other equitable relief from any court of competent jurisdiction for the enforcement of any provisions herein.

13.02 Consent of the Parties. In the event of any dispute between the parties with respect to any matter covered by this Agreement, the parties shall first use their best efforts to resolve such dispute among themselves. If the parties are unable to resolve the dispute within 30 days after the commencement of efforts to resolve the dispute, the dispute will be submitted to arbitration in accordance with Subsection 13.03 hereof.

13.03 Arbitration.

(a) Either the Buyer or the Shareholders’ Representative may submit any matter referred to in Subsection 13.02 hereof to arbitration by notifying the other party hereto, in writing, of such dispute. Within 10 days after receipt of such notice, the Buyer and the Shareholders’ Representative shall designate in writing one arbitrator to resolve the dispute;
provided, that if the parties hereto cannot agree on an arbitrator within such 10-day period, the arbitrator shall be selected in accordance with the Commercial Arbitration Rules. The arbitrator so designated shall not be an employee, consultant, officer, director or shareholder of any party hereto or any Affiliate of any party to this Agreement.

(b) Within 15 days after the designation of the arbitrator, the arbitrator, the Buyer and the Shareholders’ Representative shall meet, at which time the Buyer and the Shareholders’ Representative shall be required to set forth in writing all disputed issues and a proposed ruling on each such issue.

(c) The arbitrator shall set a date for a hearing, which shall be no later than 30 days after the submission of written proposals pursuant to paragraph (b) above, to discuss each of the issues identified by the Buyer and the Shareholders’ Representative. Each such party shall have the right to be represented by counsel. The arbitration shall be governed by the Commercial Arbitration Rules of the American Arbitration Association; provided, that the arbitrator shall have sole discretion with regard to the admissibility of evidence.

(d) The arbitrator shall use his or her best efforts to rule on each disputed issue within 30 days after the completion of the hearings described in paragraph (c) above. The determination of the arbitrator as to the resolution of any dispute shall be binding and conclusive upon all parties hereto. All rulings of the arbitrator shall be in writing and shall be delivered to the parties hereto.

(e) The prevailing party in any arbitration shall be entitled to an award of reasonable attorneys’ fees incurred in connection with the arbitration. The non-prevailing party shall pay such fees, together with the fees of the arbitrator and the costs and expenses of the arbitration. In the event the non-prevailing party is a Shareholder, such fees shall be satisfied first from the Escrow Amount.

(f) Any arbitration pursuant to this Subsection 13.03 shall be conducted in Philadelphia, Pennsylvania. Any arbitration award may be entered in and enforced by any court having competent jurisdiction thereof and the parties hereby consent and commit themselves to the jurisdiction of the courts of the Commonwealth of Pennsylvania and the United States District Court for the Eastern District of Pennsylvania for purposes of the enforcement of any arbitration award.

14. Brokers

14.01 For the Shareholders and the Company. Each of the Shareholders and the Company represent and warrant that, other than __________ (“______”), no person, firm or corporation has acted in the capacity of broker or finder on its behalf to bring about the negotiation of this Agreement. The Shareholders jointly agree to pay all fees, expenses and other amounts owed to ______________; provided, that such fees, expenses and other amounts may be paid by the Company prior to the Closing in the sole discretion of the Shareholders’ Representative. The Shareholders jointly agree to indemnify and hold harmless the Buyer
against any claims or liabilities asserted against it by any person acting or claiming to act as a broker or finder on behalf of the Shareholders or the Company.

14.02 For the Buyer. The Buyer agrees to pay all fees, expenses and compensation owed to any person, firm or corporation who has acted in the capacity of broker or finder on its behalf to bring about the negotiation of this Agreement. The Buyer agrees to indemnify and hold harmless the Shareholders against any claims or liabilities asserted against it by any person acting or claiming to act as a broker or finder on behalf of the Buyer.

15. Notices

Any notices or other communications required or permitted hereunder shall be sufficiently given if delivered personally (including by overnight courier or express mail service) or sent by registered or certified mail, postage prepaid, addressed as follows or to such other address of which the parties may have given notice:

To the Buyer: ____________________________________________
____________________________________________________________________
____________________________________________________________________
____________________________________________________________________
____________________________________________________________________
With a copy to: ____________________________________________
____________________________________________________________________
____________________________________________________________________
____________________________________________________________________

To the Company: ____________________________________________
____________________________________________________________________
____________________________________________________________________
____________________________________________________________________
With a copy to: ____________________________________________
____________________________________________________________________
____________________________________________________________________
____________________________________________________________________

To the Shareholders: [..]
With a copy to: [..]
Unless otherwise specified herein, such notices or other communications shall be deemed received (a) on the date delivered, if delivered personally, or (b) three business days after being sent, if sent by registered or certified mail.

16. **Successors and Assigns**

This Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns, except that the Buyer, on the one hand, and the Shareholders and the Company, on the other hand, may not assign their respective obligations hereunder without the prior written consent of the other party. Any assignment in contravention of this provision shall be void. No assignment shall release the Buyer, the Shareholders or the Company from any obligation or liability under this Agreement.

17. **Entire Agreement; Amendments**

(a) This Agreement, all Schedules and Exhibits hereto, and all agreements and instruments to be delivered by the parties pursuant hereto represent the entire understanding and agreement between the parties hereto with respect to the subject matter hereof and supersede all prior oral and written and all contemporaneous oral negotiations, commitments and understandings between such parties.

(b) The Buyer and the Company, by the consent of their respective Board of Directors or officers authorized by such Board, and the Shareholders holding a majority of the Shares (who shall have the authority to bind all of the Shareholders) may amend or modify this Agreement, in such manner as may be agreed upon, by a written instrument executed by the Buyer, the Company and such majority of the Shareholders.

18. **Exhibits and Schedules**

All Exhibits and Schedules attached hereto or referred to herein are hereby incorporated in and made a part of this Agreement as if set forth in full herein. Matters reflected on any Schedule to this Agreement are not necessarily indicative of whether such matter is or is not “material” for purposes of this Agreement. Matters disclosed by the Company and the Shareholders to the Buyer pursuant to any section of or Schedule to this Agreement (or any section of any Schedule to this Agreement) shall be deemed to be disclosed with respect to all sections of and Schedules to this Agreement (and all sections of all Schedules to this Agreement) to the extent this Agreement requires such disclosure and it is readily apparent from such disclosure. Capitalized terms used in any Schedule to this Agreement but not otherwise defined therein shall have the respective meanings assigned to such terms in this Agreement.

19. **Captions**

All section titles or captions contained in this Agreement or in any Exhibit or Schedule referred to herein and the table of contents of this Agreement are for convenience only and shall not be deemed a part of this Agreement or affect the meaning or interpretation of this Agreement. Unless otherwise specified, all references herein to numbered sections are to
sections of this Agreement and all references herein to numbered Schedules or Exhibits are to Schedules and Exhibits to this Agreement.

20. **No Representations or Warranties**

   The Buyer acknowledges that neither the Company nor any of the Shareholders nor any other person has made any representation or warranty, expressed or implied, as to the accuracy or completeness of any information regarding the Company or any of the Shareholders not included in this Agreement, and neither the Company nor any of the Shareholders nor any other person will have or be subject to any liability to the Buyer or any other person resulting from the distribution to the Buyer, or the Buyer’s use of, any such information. The Buyer further acknowledges that, except as expressly set forth in this Agreement, there are no representations or warranties of any kind, expressed or implied, with respect to the Company or any of the Shareholders or the business, operations or financial condition of the Company.

21. **Severability**

   Any provision of this Agreement which is invalid, illegal or unenforceable in any jurisdiction shall, as to that jurisdiction, be enforced to the maximum extent permitted by Law, without affecting in any way the remaining provisions hereof in such jurisdiction or rendering that or any other provision of this Agreement invalid, illegal or unenforceable in any other jurisdiction.

22. **Definition of “Knowledge”**

   For the purposes of this Agreement, “knowledge” or “aware of” or a similar phase with respect to the Company shall mean the actual knowledge after reasonable inquiry of ____________, ______________ and ____________ in each case as of the date of this Agreement and not any constructive or imputed knowledge of the Company or any of its other directors, officers or employees or any of its counsel, accountants, financial advisors, consultants or other agents.

23. **Expenses**

   Except as otherwise expressly provided herein, the Buyer and the Company, on the one hand, and the Shareholders, in proportion to their ownership of Shares as set forth opposite their respective names on Schedule I attached hereto, on the other hand, to the extent not paid prior to the Closing by the Company, will pay all fees and expenses (including, without limitation, legal and accounting fees and expenses) incurred by them in connection with the transactions contemplated hereby. Each Shareholder shall be responsible for payment of all sales or transfer Taxes arising out of the conveyance of the Shares owned by such Shareholder.

24. **Governing Law**

   This Agreement shall be governed by and construed in accordance with the laws of the Commonwealth of Pennsylvania.
25. **No Third-Party Beneficiaries**

   With the exception of the parties to this Agreement, there exists no right of any person to claim a beneficial interest in this Agreement or any rights occurring by virtue of this Agreement.

26. **Counterparts**

   This Agreement may be executed in one or more counterparts, each of which shall be deemed to be an original, but all of which shall be one and the same document.

   [Signature pages follow]
IN WITNESS WHEREOF, this Agreement has been duly executed by the parties hereto as of and on the date first above written.

(Buyer)

ATTEST

________________________________________
Secretary

(Corporate Seal)

(ATTEST)

Company

ATTEST:

________________________________________
Secretary

(Buyer)

By: __________________________
Name: _________________________
Title: _________________________

Company

ATTEST:

________________________________________
Secretary

(Corporate Seal)

(Corporate Seal)

Shareholders:

Address: __________________________
____________________________________
____________________________________
Address: __________________________
____________________________________
____________________________________
Address: __________________________
____________________________________
____________________________________

[Signature Page to Stock Purchase Agreement]

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ACTIVE 23000265v2 10/21/2013
Address: __________________________

Address: __________________________

Address: __________________________

SHAREHOLDERS’ REPRESENTATIVE

Address: __________________________

[Signature Page to Stock Purchase Agreement]

ACTIVE 23000265v2 10/21/2013
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Schedule I