Asset Purchase Agreement

This Asset Purchase Agreement ("Agreement") is dated _____, 20___, by and among _____, a _____ corporation ("Buyer"); _____, a _____ corporation ("Seller"); _____, a resident of _____ ("A"); and _____, a resident of _____ ("B") (A and B are referred to herein as "Shareholders").

COMMENT

The two principal Shareholders are included as parties to the Model Agreement because they indemnify Buyer and are responsible for certain covenants. Sometimes some or all of the shareholders are made parties to a separate joinder agreement rather than to the acquisition agreement.

RECITALS

Shareholders own _____ (_____) shares of the common stock, par value _____ dollars ($_____) per share, of Seller, which constitute _____ percent (_____%) of the issued and outstanding shares of capital stock of Seller. Seller desires to sell, and Buyer desires to purchase, the Assets of Seller for the consideration and on the terms set forth in this Agreement.

COMMENT

Although there is no legal requirement that an acquisition agreement contain recitals, they can help the reader understand the basic context and structure of the acquisition. Recitals are typically declarative statements of fact, but these statements normally do not serve as separate representations or warranties of the parties. The parties and their counsel should, however, be aware of the possible legal effect of recitals. *See, e.g.,* CAL. EVID. CODE § 622 ("The facts recited in a written instrument are conclusively presumed to be true as between the parties thereto . . . .").

The parties, intending to be legally bound, agree as follows:

1. Definitions and Usage

COMMENT

It is useful, both to reduce the length of other sections and to facilitate changes during negotiations, to list in a section of the acquisition agreement all defined terms that appear in more than one section of the agreement. A common dilemma in drafting definitions is whether to include long lists of terms with similar but slightly different meanings. If the goal is to draft a comprehensive, all-inclusive definition, the tendency is to list every term that comes to mind. If too many terms are listed, however, the absence of a particular term may be accorded more significance than intended, even if phrases such as "without limitation" or "any other" are used. (The Model Agreement avoids repetitive use of such phrases and contains a general disclaimer in Section 1.2(a)(vii) instead.) Long lists of terms with similar meanings perpetuate a cumbersome and arcane style of drafting that many lawyers and clients find annoying at best and confusing at worst. The Model Agreement resolves this dilemma in favor of short lists of terms that are intended to have their broadest possible meanings.

There are alternative methods of handling the definitions in acquisition agreements. They may be placed at the end of the document as opposed to the beginning, they may be placed in a separate ancillary document referred to in the agreement or they may be incorporated in the earliest section of the agreement where they appear followed by initial capitalization of those defined terms in the subsequent sections of the agreement. There are proponents for each of these alternatives, and probably no one of them is preferable, although the drafters of the Model Agreement felt that reference would be easier if most of the principal definitions were in one place. It was also recognized, however, that where relatively brief definitions are set out in one section of the Agreement and are not used outside of that section, those definitions would not generally be listed in the Definitions in Section 1.1. Every definition, however, is listed in the Index of Definitions following the Table of Contents. The Model Agreement does not attempt to incorporate definitions from the various agreements and documents that are exhibits or ancillary to the Agreement.

1.1 DEFINITIONS

For purposes of this Agreement, the following terms and variations thereof have the meanings specified or referred to in this Section 1.1:

"Accounts Receivable"—(a) all trade accounts receivable and other rights to payment from customers of Seller and the full benefit of all security for such accounts or rights to payment, including all trade accounts receivable representing amounts receivable in respect of goods shipped or products sold or services rendered to customers of Seller, (b) all other accounts or notes receivable of Seller and the full benefit of all security for such accounts or notes and (c) any claim, remedy or other right related to any of the foregoing.

COMMENT

The term "Accounts Receivable" appears in Sections 2.1 and 3.11.

"Adjustment Amount"—as defined in Section 2.8.

COMMENT

The term "Adjustment Amount" appears in Sections 2.3, 2.8 and 2.9.

"Appurtenances"—all privileges, rights, easements, hereditaments and appurtenances belonging to or for the benefit of the Land, including all easements appurtenant to and for the benefit of any Land (a "Dominant Parcel") for, and as the primary means of access between, the Dominant Parcel and a public way, or for any other use upon which lawful use of the Dominant Parcel for the purposes for which it is presently being used is dependent, and all rights existing in and to any streets, alleys, passages and other rights-of-way included thereon or adjacent thereto (before or after vacation thereof) and vaults beneath any such streets.

COMMENT

The term "Appurtenances" appears in the definition of "Real Property" in Section 1.1 and in Section 5.11.

"Assets"—as defined in Section 2.1.

"Assignment and Assumption Agreement"—as defined in Section 2.7(a)(ii).

COMMENT

The term "Assignment and Assumption Agreement" appears in Sections 2.2, 2.3, 2.7, 2.10 and 4.2.

"Assumed Liabilities"—as defined in Section 2.4(a).

COMMENT

The term "Assumed Liabilities" appears in Sections 2.1, 2.3, 2.4, 2.7, 2.9, 5.3, 5.11, 11.2 and 11.4.

"Balance Sheet"—as defined in Section 3.4.

COMMENT

The term "Balance Sheet" appears in Sections 2.9, 3.4, 3.11, 3.12, 3.13, 3.14, 3.15 and 3.19.

"Best Efforts"—the efforts that a prudent Person desirous of achieving a result would use in similar circumstances to achieve that result as expeditiously as possible, *provided, however,* that a Person required to use Best Efforts under this Agreement will not be thereby required to take actions that would result in a material adverse change in the benefits to such Person of this Agreement and the Contemplated Transactions or to dispose of or make any change to its business, expend any material funds or incur any other material burden.

COMMENT

The term "Best Efforts" appears in Sections 2.10, 5.2, 5.7, 5.11, 6.2 and 11.9.

Case law provides little guidance for interpreting a commitment to use "best efforts." *See generally* Farnsworth, *On Trying to Keep One's Promises: The Duty of Best Efforts in Contract Law*, 46 U. PITT. L. REV. 1 (1984). Some courts have held that best efforts is equivalent to "good faith" or a type of good faith. *See, e.g.,* Gestetner Corp. v. Case Equip. Co., 815 F.2d 806, 811 (1st Cir. 1987); Western Geophysical Co. of Am. v. Bolt Assocs., Inc., 584 F.2d 1164, 1171 (2d Cir. 1978); Kubik v. J. & R. Foods of Or., Inc., 577 P.2d 518, 520 (Or. 1978). Other courts view best efforts as a more exacting standard than good faith. *See, e.g.*, Bloor v. Falstaff Brewing Corp., 601 F.2d 609, 614–15 (2d Cir. 1979); Grossman v. Lowell, 703 F. Supp. 282, 284 (S.D.N.Y. 1989). The standard is not definable by a fixed formula but takes its meaning from the circumstances. *See, e.g.,* Triple-A Baseball Club Assoc. v. Northeastern Baseball, Inc., 832 F.2d 214, 225 (1st Cir. 1987), *cert. denied*, 485 U.S. 935 (1988); Joyce Beverages of N.Y., Inc. v. Royal Crown Cola Co., 555 F. Supp. 271, 275 (S.D.N.Y. 1983); Polyglycoat Corp. v. C.P.C. Distrib., Inc., 534 F. Supp. 200, 203 (S.D.N.Y. 1982).

The Model Agreement definition requires more than good faith but stops short of requiring a party to subject itself to economic hardship. Because best-efforts duties apply most often to Seller, a high standard of what constitutes best efforts favors Buyer. Some attorneys, particularly those representing a seller, prefer to use the term "commercially reasonable efforts" rather than "best efforts." A sample definition of the former follows:

> **For purposes of this Agreement, "commercially reasonable efforts" will not be deemed to require a Person to undertake extraordinary or unreasonable measures, including the payment of amounts in excess of normal and usual filing fees and processing fees, if any, or other payments with respect to any Contract that are significant in the context of such Contract (or significant on an aggregate basis as to all Contracts).**

The parties may wish to provide for a specific dollar standard either in specific provisions where "best efforts" are required or in the aggregate.

"Bill of Sale"—as defined in Section 2.7(a)(i).

COMMENT

The term "Bill of Sale" appears in Sections 2.2 and 2.7.

"Breach"—any breach of, or any inaccuracy in, any representation or warranty or any breach of, or failure to perform or comply with, any covenant or obligation, in or of this Agreement or any other Contract, or any event which with the passing of time or the giving of notice, or both, would constitute such a breach, inaccuracy or failure.

COMMENT

The term "Breach" appears in Sections 2.4, 3.2, 3.20, 5.5, 9.1, 9.2, 11.2, 11.4, 11.5, 11.6, 11.7, 13.1 and 13.5.

"Bulk Sales Laws"—as defined in Section 5.10.

COMMENT

The term "Bulk Sales Laws" appears in Sections 5.10, 7.6, 11.2 and 11.11.

"Business Day"—any day other than (a) Saturday or Sunday or (b) any other day on which banks in _____ are permitted or required to be closed.

COMMENT

The term "Business Day" appears in Sections 2.6 and 5.11. The blank in the definition of Business Day is usually filled in with the city in which the closing will occur and may also include the locations of other parties or the institutions that are providing funding for the transaction.

"Buyer"—as defined in the first paragraph of this Agreement.

"Buyer Indemnified Persons"—as defined in Section 11.2.

COMMENT

The term "Buyer Indemnified Persons" appears in Sections 11.2, 11.3 and 11.9.

"Closing"—as defined in Section 2.6.

"Closing Date"—the date on which the Closing actually takes place.

COMMENT

It is important to distinguish among the date on which the closing is scheduled to occur, the date on which the closing actually occurs (defined as the "Closing Date") and the time as of which the closing is effective (defined as the "Effective Time"). See the definition of "Effective Time" and the related Comment and Sections 2.6 and 9.1 and the related Comments.

"Closing Financial Statements"—as defined in Section 2.9(b).

COMMENT

The term "Closing Financial Statements" appears in Sections 2.9 and 3.11.

"Closing Working Capital"—as defined in Section 2.9(b).

COMMENT

The term "Closing Working Capital" appears in Sections 2.8 and 2.9.

"COBRA"—as defined in Section 3.16(f).

COMMENT

The term "COBRA" appears in Sections 3.16 and 10.1.

"Code"—the Internal Revenue Code of 1986.

COMMENT

The term "Code" appears in Sections 2.5, 3.14, 3.16, 5.2, 5.10 and 5.11.

"Confidential Information"—as defined in Section 12.1.

COMMENT

The term "Confidential Information" appears in Sections 11.9, 12.1, 12.2, 12.3, 12.4, 12.5, 12.6 and 13.2.

"Consent"—any approval, consent, ratification, waiver or other authorization.

COMMENT

The term "Consent" appears in Sections 2.10, 3.2, 4.2, 5.3, 6.1, 7.3, 7.4, 8.3, 11.9 and 13.3.

"Contemplated Transactions"—all of the transactions contemplated by this Agreement.

"Contract"—any agreement, contract, Lease, consensual obligation, promise or undertaking (whether written or oral and whether express or implied), whether or not legally binding.

COMMENT

The term "Contract" appears in Sections 2.1, 2.4, 3.3, 3.11, 3.19, 3.20, 3.21, 3.23, 3.25, 3.29, 4.2, 5.1, 5.3 and 10.1.

This definition includes all obligations, however characterized, whether or not legally binding. The buyer may want to know about statements by the seller to its distributors that the seller will look favorably upon a request for a return for credit of unsold products when the seller introduces a replacement product. The buyer may also want to encompass established practices of the seller within this definition. Similarly, the buyer may want the definition to encompass "comfort letters" confirming the seller's intention to provide financial support to a subsidiary or other related person and assurances to employees regarding compensation, benefits and tenure, whether or not such letters or assurances are legally binding. A representation that certain specified Contracts are legally binding is included in Section 3.20(c)(i).

"Copyrights"—as defined in Section 3.25(a)(iii).

COMMENT

The term "Copyrights" appears in Sections 2.7 and 3.25.

"Damages"—as defined in Section 11.2.

COMMENT

The term "Damages" appears in Sections 5.11, 7.5, 11.2, 11.3, 11.4, 11.5 and 11.6.

"Disclosure Letter"—the disclosure letter delivered by Seller and Shareholders to Buyer concurrently with the execution and delivery of this Agreement.

COMMENT

The form and content of the disclosure letter (sometimes called a disclosure schedule) should be negotiated and drafted concurrently with the negotiation and drafting of the acquisition agreement. The disclosure letter is an integral component of the acquisition documentation and should be prepared and reviewed as carefully as the acquisition agreement itself. Ancillary Document 3 contains a sample format for the disclosure letter. A buyer may prefer to attach multiple schedules or exhibits to the acquisition agreement instead of using a disclosure letter.

"Effective Time"—[The time at which the Closing is consummated.] [_____ on the Closing Date.]

COMMENT

The term "Effective Time" appears in Sections 2.1, 2.4, 2.9, 10.1, 10.6 and 11.2.

Under the Model Agreement, if the Closing occurs, the Effective Time fixes the time at which the transfer to Buyer of the assets and the risks of the business and the assumption by Buyer of Liabilities are deemed to have taken place, regardless of the actual time of consummation of the transaction.

Normally, the effective time will be the time when payment for the assets is made, at the consummation of the closing. Sometimes acquisition agreements specify an effective time at the opening or closing of business on the closing date or even (in the case of a business, such as a hospital, that operates and bills on a twenty-four hour basis) 12:01 A.M. on the closing date. This must be done with care, however, to avoid unintended consequences, such as the buyer having responsibility for an event that occurs after the effective time but before the closing or the seller having responsibility for an event that occurs after the closing but before the effective time.

Many drafters do not use a general definition of effective time and simply treat the closing as if it occurred at a point in time on the closing date. If the parties agree on an effective time for financial and accounting purposes that is different from the time of the closing, this can be accomplished by a sentence such as the following: "For financial and accounting purposes (including any adjustments pursuant to Section 2.8), the Closing shall be deemed to have occurred as of _____ on the Closing Date."

"Employee Plans"—as defined in Section 3.16(a).

COMMENT

The term "Employee Plans" appears in Sections 2.2, 2.4, 3.16, 3.19, 3.23, 5.2, 10.1 and 11.2.

"Employment Agreement"—as defined in Section 2.7(a)(vi).

COMMENT

The term "Employment Agreement" appears in Sections 2.7, 3.2 and 4.2.

"Encumbrance"—any charge, claim, community or other marital property interest, condition, equitable interest, lien, option, pledge, security interest, mortgage, right of way, easement, encroachment, servitude, right of first option, right of first refusal or similar restriction, including any restriction on use, voting (in the case of any security or equity interest), transfer, receipt of income or exercise of any other attribute of ownership.

COMMENT

The term "Encumbrance" appears in Sections 2.1, 3.2, 3.3, 3.9, 3.14, 3.19, 3.20, 3.22, 3.25, 5.11 and 7.4.

"Environment"—soil, land surface or subsurface strata, surface waters (including navigable waters and ocean waters), groundwaters, drinking water supply, stream sediments, ambient air (including indoor air), plant and animal life and any other environmental medium or natural resource.

COMMENT

The term "Environment" appears in the definitions of "Environmental Law," "Hazardous Activity," "Release," and "Threat of Release" in Section 1.1 and in Section 3.22.

This definition comes primarily from the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA), 42 U.S.C. § 9601–9626, 9651–9657. It has been modified to include a reference to indoor air, which is not covered under CERCLA but may be subject to regulation under other environmental statutes.

"Environmental, Health and Safety Liabilities"—any cost, damages, expense, liability, obligation or other responsibility arising from or under any Environmental Law or Occupational Safety and Health Law, including those consisting of or relating to:

(a) any environmental, health or safety matter or condition (including on-site or off-site contamination, occupational safety and health and regulation of any chemical substance or product);

(b) any fine, penalty, judgment, award, settlement, legal or administrative proceeding, damages, loss, claim, demand or response, remedial or inspection cost or expense arising under any Environmental Law or Occupational Safety and Health Law;

(c) financial responsibility under any Environmental Law or Occupational Safety and Health Law for cleanup costs or corrective action, including any cleanup, removal, containment or other remediation or response actions ("Cleanup") required by any Environmental Law or Occupational Safety and Health Law (whether or not such Cleanup has been required or requested by any Governmental Body or any other Person) and for any natural resource damages; or

(d) any other compliance, corrective or remedial measure required under any Environmental Law or Occupational Safety and Health Law.

The terms "removal," "remedial," and "response action" include the types of activities covered by the United States Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA).

COMMENT

The term "Environmental, Health and Safety Liabilities" appears in Sections 2.4, 3.22 and 11.3.

This definition is quite broad in scope and uses other broad definitions. A seller will likely want to limit its responsibilities under the representations and warranties and indemnification provisions that use these definitions, and the logical first step in doing so is to narrow the definition. The seller may want to add a materiality qualification either to the entire definition (for example, by limiting the definition to "material" damages, as that term would be further defined, or to damages in excess of a specified amount) or to each clause ((a) through (d)) separately. Because the latter requires a case-by-case analysis of whether a specific paragraph should be qualified, the buyer will usually prefer that option to a general qualification of the entire definition.

"Environmental Law"—any Legal Requirement that requires or relates to:

(a) advising appropriate authorities, employees or the public of intended or actual Releases of pollutants or hazardous substances or materials, violations of discharge limits or other prohibitions and the commencement of activities, such as resource extraction or construction, that could have significant impact on the Environment;

(b) preventing or reducing to acceptable levels the Release of pollutants or hazardous substances or materials into the Environment;

(c) reducing the quantities, preventing the Release or minimizing the hazardous characteristics of wastes that are generated;

(d) assuring that products are designed, formulated, packaged and used so that they do not present unreasonable risks to human health or the Environment when used or disposed of;

(e) protecting resources, species or ecological amenities;

(f) reducing to acceptable levels the risks inherent in the transportation of hazardous substances, pollutants, oil or other potentially harmful substances;

(g) cleaning up pollutants that have been Released, preventing the Threat of Release or paying the costs of such clean up or prevention; or

(h) making responsible parties pay private parties, or groups of them, for damages done to their health or the Environment or permitting self-appointed representatives of the public interest to recover for injuries done to public assets.

COMMENT

The term "Environmental Law" appears in the definition of "Environmental, Health and Safety Liabilities" in Section 1.1 and in Sections 3.22 and 11.1.

A short form of this definition is: "Legal Requirements designed to minimize, prevent, punish or remedy the consequences of actions that damage or threaten the Environment or public health and safety." Using other environmental terms such as "Hazardous Materials" in the definition of "Environmental Law" would make the definition of "Environmental Law" circular and should be avoided.

A seller may object to obligations regarding future environmental laws and concomitant liabilities arising from common law decisions interpreting such laws. From a buyer's perspective, however, the reference to future laws is needed, at least for indemnification purposes, to account for strict liability statutes such as CERCLA that impose liability retroactively. The seller may insist that the representations in Section 3.22 clearly be limited to existing or prior laws. The issue or concern regarding "retroactivity" can be addressed in the indemnity by tying it to pre-closing operations versus pre-closing liability. The seller may also seek to limit these definitions to exclude such areas as occupational health and safety and materials not considered hazardous under CERCLA. Such limitations may be acceptable to the buyer depending upon the nature of the seller's business.

A broad definition of "Environmental Law" is important to a buyer for several reasons. For example, the buyer may be a public company or may want to become a public company in the future. SEC disclosure rules relating to environmental issues use a broad definition that includes federal, state and local laws regulating the discharge of materials into the environment or otherwise enacted primarily to protect the environment. *See* SEC Regulation S-K, Item 103, Instruction 5, 17 C.F.R. § 229.103. Therefore, to meet applicable disclosure requirements under federal securities law, the buyer would need comprehensive disclosures from the seller.

Although the definitions of "Legal Requirement" and "Order" encompass most of what is included in the definition of "Environmental Law," the latter term includes additional elements such as common law and governmental permits, compliance with which may be important to the buyer. In addition, a separate "Environmental Law" definition is necessary when there are separate environmental representations and indemnifications. If the buyer relies upon the representations in Sections 3.17 and 3.18 and the general indemnification provisions of Section 11.3, the buyer's counsel should review those provisions carefully to ensure that the additional elements addressed here are adequately covered.

Some states, such as Connecticut and New Jersey, require that certain filings be made, and possibly remedial measures be taken, prior to the transfer of property in the state from one "owner" or "operator" to another. *See, e.g.,* Connecticut Transfer Act, CONN. GEN. STAT. ANN. § 22a–134g; Industrial Site Recovery Act, N.J. STAT. ANN. § 13:1K–13. New Jersey regulations require the filing of a "cleanup plan" to be implemented by the owner or operator. The seller generally will be responsible for implementing the cleanup plan, although that responsibility may be assumed by the buyer. Because the New Jersey environmental agency has the ability to void a sale if no cleanup plan or "negative declaration" has been filed, and because there are significant fines for failure to comply with these regulations, the buyer should identify such regulations and require that their compliance be a condition to the closing. If the buyer assumes the cleanup responsibility, it should negotiate for an adjustment to the purchase price or a right to terminate the acquisition agreement if its due diligence reveals the plan to be too costly.

"ERISA"—the Employee Retirement Income Security Act of 1974.

COMMENT

The term "ERISA" appears in Sections 3.16, 5.2 and 10.1.

"Escrow Agreement"—as defined in Section 2.7(a)(viii).

COMMENT

The term "Escrow Agreement" appears in Sections 2.2, 2.3, 2.7, 3.2, 4.2, 11.8, 13.1 and 13.16.

"Exchange Act"—the Securities Exchange Act of 1934.

COMMENT

The term "Exchange Act" appears in the definition of "Related Person" in Section 1.1 and in Sections 3.5 and 10.8.

"Excluded Assets"—as defined in Section 2.2.

COMMENT

The term "Excluded Assets" appears in Sections 2.1, 2.2, 10.5 and 10.10.

"Facilities"—any real property, leasehold or other interest in real property currently owned or operated by Seller, including the Tangible Personal Property used or operated by Seller at the respective locations of the Real Property specified in Section 3.7. Notwithstanding the foregoing, for purposes of the definitions of "Hazardous Activity" and "Remedial Action" and Sections 3.22 and 11.3, "Facilities" shall mean any real property, leasehold or other interest in real property currently or formerly owned or operated by Seller, including the Tangible Personal Property used or operated by Seller at the respective locations of the Real Property specified in Section 3.7.

COMMENT

The term "Facilities" appears in Sections 3.10, 3.22, 3.24, 5.11, 7.10, 10.1, 10.5 and 11.3.

The seller may attempt to limit its responsibilities to those facilities for which the buyer can demonstrate a real basis for concern based upon their character and use or that of the adjoining property.

The buyer may view such limitations as more appropriate in representations and warranties than in indemnification provisions. CERCLA liability, however, extends to previous owners of a facility. Therefore, if a problem with any of the facilities formerly owned by the seller is discovered before the closing and is not covered by the representations and warranties, the buyer may not have the right to terminate the acquisition agreement because of this problem. The buyer may consider conducting extensive environmental investigation of facilities not included in this definition and hence not included in the Assets, although this may be impossible for facilities no longer owned by the seller. Furthermore, if a transaction is an asset sale, like this one, a seller is likely to object to diligence on former facilities on the grounds that the seller is retaining the liabilities. This may be an adequate response where the seller will remain in existence following the closing. Where the seller will cease to exist shortly after the closing or be left with little in the way of operations, however, some limited investigation may be warranted out of a concern for successor liability. For a discussion of successor liability issues in respect of facilities formerly owned or operated by a seller, see Appendix A.

"GAAP"—generally accepted accounting principles for financial reporting in the United States, applied on a basis consistent with the basis on which the Balance Sheet and the other financial statements referred to in Section 3.4 were prepared.

COMMENT

The term "GAAP" appears in Sections 1.2, 2.9, 3.4, 3.12 and 3.14.

The American Institute of Certified Public Accountants defines GAAP as:

> a technical accounting term that encompasses the conventions, rules, and procedures necessary to define accepted accounting practice at a particular time. It includes not only broad guidelines of general application, but also detailed practices and procedures. . . . Those conventions, rules, and procedures provide a standard by which to measure financial presentations.

CODIFICATION OF ACCOUNTING STANDARDS AND PROCEDURES, *Statement on Auditing Standards No. 69,* § 2 (American Inst. of Certified Pub. Accountants 1992).

The use of this term in an acquisition agreement is customary. Although the requirement that financial statements be prepared in accordance with GAAP provides some comfort to the buyer, the buyer should understand the wide latitude of accepted accounting practices within GAAP. GAAP describes a broad group of concepts and methods for preparing financial statements. GAAP thus represents a boundary of accepted practice but does not necessarily characterize a "good" financial statement.

GAAP is not a static concept—a financial statement will change as GAAP changes. The principal authority determining the "conventions, rules, and procedures" that constitute GAAP is the Financial Accounting Standards Board (FASB), although custom and usage also play a role. The FASB often issues Financial Accounting Standards (FAS) bulletins, which present guidelines for financial accounting in special circumstances or changes in accepted practices. The adoption of FAS 106, for example, changed the presentation of retiree health costs by requiring these costs to be recorded as a liability rather than expensed as incurred.

GAAP permits the exercise of professional judgment in deciding how to fairly present financial results. GAAP permits different methods of accounting for such items as inventory valuation (FIFO, LIFO or average cost), depreciation (straight-line or accelerated methods) and accounting for repairs and small tools. Changes in these alternative methods can substantially affect reported results even though there has been no change in the underlying economic position of the seller. The buyer may want to examine the seller's financial statements from previous years to ensure their consistency from year to year. The buyer also may want to determine whether there are any pending FAS bulletins that would require a change in the seller's accounting practices, and the buyer may want the seller to represent and covenant that there have been (within the past five years, for example) and will be (prior to the closing) no voluntary changes in the seller's accounting practices. For a further discussion of these issues, see the Comment to Section 3.4.

Although GAAP is the standard used in the preparation of nearly all financial statements, the SEC reserves the right to mandate specific accounting methods for public companies. When dealing with financial statements of public companies, the buyer may want to amend the definition of GAAP to include compliance with SEC accounting standards.

In international transactions, the parties should be aware that there are important differences between GAAP standards and accounting standards used in other nations. The buyer sometimes requires that foreign financial statements be restated to conform to GAAP or be accompanied by a reconciliation to GAAP.

"Governing Documents"—with respect to any particular entity, (a) if a corporation, the articles or certificate of incorporation and the bylaws; (b) if a general partnership, the partnership agreement and any statement of partnership; (c) if a limited

partnership, the limited partnership agreement and the certificate of limited partnership; (d) if a limited liability company, the articles of organization and operating agreement; (e) if another type of Person, any other charter or similar document adopted or filed in connection with the creation, formation or organization of the Person; (f) all equityholders' agreements, voting agreements, voting trust agreements, joint venture agreements, registration rights agreements or other agreements or documents relating to the organization, management or operation of any Person or relating to the rights, duties and obligations of the equityholders of any Person; and (g) any amendment or supplement to any of the foregoing.

COMMENT

The term "Governing Documents" appears in Sections 2.7, 3.1, 3.2, 3.19, 4.2 and 5.9.

"Governmental Authorization"—any Consent, license, registration or permit issued, granted, given or otherwise made available by or under the authority of any Governmental Body or pursuant to any Legal Requirement.

COMMENT

The term "Governmental Authorization" appears in Sections 2.1, 3.2, 3.17, 5.1, 5.2, 5.3 and 7.9.

"Governmental Body"—any:

(a) nation, state, county, city, town, borough, village, district or other jurisdiction;
(b) federal, state, local, municipal, foreign or other government;
(c) governmental or quasi-governmental authority of any nature (including any agency, branch, department, board, commission, court, tribunal or other entity exercising governmental or quasi-governmental powers);
(d) multinational organization or body;
(e) body exercising, or entitled or purporting to exercise, any administrative, executive, judicial, legislative, police, regulatory or taxing authority or power; or
(f) official of any of the foregoing.

COMMENT

The term "Governmental Body" appears in Sections 2.4, 2.7, 3.2, 3.14, 3.16, 3.17, 3.18, 3.22, 3.24, 3.27, 7.6, 10.1 and 12.4.

The buyer may want to make specific reference to the political or governmental entities that exist in the jurisdictions in which the seller is located or does business (such as commonwealths, provinces and parishes).

"Ground Lease"—any long-term lease of land in which most of the rights and benefits comprising ownership of the land and the improvements thereon or to be constructed thereon, if any, are transferred to the tenant for the term thereof.

COMMENT

The term "Ground Lease" appears in the definitions of "Real Property" and "Real Property Lease" in Section 1.1.

A seller may have plans, warehouses, offices or other facilities which are neither owned by the seller nor the subject of a space lease. The buyer may want to confirm that the seller is in compliance with the terms of the ground lease, that the ground lease is not in danger of termination or expiration and that neither the owner of the underlying fee nor the seller have caused the inception of any liens or permitted any encumbrances that could interfere with the buyer's intended use of the facility. Thus, the buyer may wish to conduct the same due diligence with respect to these properties as it does for other property owned in fee by the seller and space that is leased by the seller pursuant to a space lease.

"Ground Lease Property"—any land, improvements and appurtenances subject to a Ground Lease in favor of Seller.

COMMENT

The term "Ground Lease Property" appears in the definition of "Real Property" in Section 1.1 and in Section 5.11.

"Hazardous Activity"—the distribution, generation, handling, importing, management, manufacturing, processing, production, refinement, Release, storage, transfer, transportation, treatment or use (including any withdrawal or other use of groundwater) of Hazardous Material in, on, under, about or from any of the Facilities or any part thereof into the Environment and any other act, business, operation or thing that increases the danger, or risk of danger, or poses an unreasonable risk of harm, to persons or property on or off the Facilities.

COMMENT

The term "Hazardous Activity" appears in Sections 3.22 and 11.3.

The latter portion of this definition, beginning with "and any other act," is quite expansive, and the seller may seek to limit the definition to activities that pose only environmental risks.

"Hazardous Material"—any substance, material or waste which is or will foreseeably be regulated by any Governmental Body, including any material, substance or waste which is defined as a "hazardous waste," "hazardous material," "hazardous substance," "extremely hazardous waste," "restricted hazardous waste," "contaminant," "toxic waste" or "toxic substance" under any provision of Environmental Law, and including petroleum, petroleum products, asbestos, presumed asbestos-containing material or asbestos-containing material, urea formaldehyde and polychlorinated biphenyls.

COMMENT

The term "Hazardous Material" appears in Sections 3.22 and 11.3.

The definition includes petroleum, even though many state and federal laws exclude it, because it can cause significant environmental problems. The definition also includes asbestos. In certain circumstances, carefully defined exceptions or threshold quantities may be used to limit materials governed by environmental law. For example,

asbestos might be limited to friable asbestos, or polychlorinated biphenyls might be limited to those in excess of fifty parts per million.

The seller will likely object to the inclusion of substances that, in the future, could be determined to be hazardous and attempt to limit its responsibility to substances that are considered hazardous at the date of signing the acquisition agreement or the date of the closing. If the seller's representations are so limited, the buyer may want to be sure that the representations, and the definition, are updated through the closing.

"HSR Act"—the Hart-Scott-Rodino Antitrust Improvements Act.

COMMENT

The term "HSR Act" appears in Sections 2.6, 5.4, 6.1 and 13.1.

The HSR Act requires that the parties to a proposed acquisition subject to the Act give prior notice of the proposed acquisition to the Federal Trade Commission and the Assistant Attorney General in charge of the Antitrust Division of the Department of Justice and delay consummation of the acquisition until expiration (or early termination) of the specified waiting period. The purpose of the HSR Act is to allow the government an opportunity to evaluate the anticompetitive aspects of a proposed acquisition and to seek to enjoin its consummation in appropriate circumstances. Subject to certain statutory exemptions, the HSR Act's premerger notification filing and waiting period requirements apply to acquisitions in which a party is engaged in commerce or in any activity affecting commerce, and the acquisition itself, and in certain cases the parties to the acquisition, satisfy certain size requirements.

Under changes to the HSR Act that became effective February 1, 2001, no filing is required for acquisitions that would result in the acquiror holding voting securities or assets valued at $50,000,000 or less. For transactions that would result in holdings valued at between $50,000,000 and $200,000,000, filing is generally required if one party to the transaction has annual net sales or total assets in excess of $100,000,000 and the other in excess of $10,000,000. The size of the parties is determined with regard to the ultimate parent entity and all entities that it controls (generally fifty percent or more) directly or indirectly. *See* 16 C.F.R. § 801.1(a)(1). As a result, sales and assets of a party's entire business enterprise must be considered when evaluating the size of the parties. Filing is also required for transactions that would result in holdings valued at greater than $200,000,000, without regard to the size of the parties. In asset transactions, liabilities assumed by the buyer are generally included in the calculation of transaction size. All of these dollar thresholds are to be adjusted each fiscal year, beginning with fiscal 2005, for the percentage change in the gross national product compared with fiscal 2003. *See* 15 U.S.C. § 18a(a)(2).

Once filings have been made, the parties must wait for the expiration of a mandatory thirty-day waiting period before completing the acquisition. The parties can consummate the acquisition upon expiration of the thirty-day waiting period unless the government determines that further investigation is necessary and requires submission of additional information and documents relevant to the acquisition (the "Second Request"). If the government issues a Second Request, the mandatory waiting period is extended until thirty days following substantial compliance with the Second Request. Unless the government obtains an order from a federal district court enjoining the acquisition, the parties can consummate the acquisition upon expiration of the thirty-day waiting period.

The government may grant early termination of any waiting period either sua sponte or upon the written request of any person filing notification. *See* 16 C.F.R. § 803.11.

Early termination is effective upon notice to any requesting person by telephone. The government must give such notice as soon as possible after a request is made (and confirm the notice in writing) and must publish its decision to grant early termination in the Federal Register, which prevents the parties from keeping the existence of the acquisition confidential. The FTC also makes this information available on its web site (www.ftc.gov) and on a prerecorded telephone line.

Filings are made by each party on a Notification and Report Form, which includes a description of the proposed acquisition, a description of the parties, copies of their most recent regularly prepared financial statements, copies of studies or evaluations conducted by the parties in connection with their analysis of the acquisition's competitive effects, detailed revenue information, lists of subsidiaries, shareholders and shareholdings and lists of geographic overlaps in competing products or services. All information filed pursuant to the HSR Act is confidential and exempt from disclosure under the Freedom of Information Act, except as may be relevant to any administrative or judicial action or proceeding. *See* 15 U.S.C. § 18a(h).

Copies of the form may be obtained by writing to the Premerger Notification Office, Room 303, Federal Trade Commission, Washington, D.C. 20580 or downloaded from the FTC's web site. The buyer must pay a filing fee at the time of the filing. The amount of the fee is based upon a graduated scale applied to the value of the voting securities or assets to be held as a result of the transaction. Currently, for transactions valued at less than $100,000,000, the fee is $45,000; for transactions valued at $100,000,000 or more but less than $500,000,000, the fee is $125,000; and for transactions valued at $500,000,000 or more, the fee is $280,000. The tiers for the filing fees are to be adjusted each fiscal year, beginning with fiscal 2005, for the percentage change in the gross national product compared with fiscal 2003. The parties may agree to reallocate responsibility for the cost of the filing fee (see Section 13.1).

Failure to comply with any provisions of the HSR Act may cause the imposition of a civil penalty of up to $10,000 per day. *See* 15 U.S.C. § 18a(g) (since increased to $11,000 per day and subject to further annual increases). Any device used to avoid the requirements of the HSR Act will be disregarded, and the HSR Act will be applied to the substance of the acquisition. *See* 16 C.F.R. § 801.90. There have been over thirty instances in which civil penalties have been imposed under the HSR Act, in most cases for consummating a transaction without making a filing. The penalties paid have ranged from a low of $122,000 (United States v. Lonrho, PLC, 1988-2 Trade Cas. ¶ 68,232 (D.D.C. July 18, 1988)) to a high of $5.6 million (United States v. Mahle GmbH, 1997-2 Trade Cas. ¶ 71,868 (D.D.C. June 24, 1997)). In most cases, the government and the parties negotiate an amount below the full daily penalty accrued. A chart summarizing HSR civil penalty cases is available on the Internet at www.morganlewis.com/penalty.htm.

The leading treatise on the HSR Act is Axinn, Fogg, Stoll, & Prager, Acquisitions Under the Hart-Scott-Rodino Antitrust Improvements Act (1998). Summaries of certain of the FTC's informal interpretations of the HSR Act and regulations have been collected in Premerger Notification Practice Manual, Section of Antitrust Law, American Bar Association (1991). The full text of many of these informal interpretations has been collected on the Internet in the HSRScan database created by Morgan, Lewis & Bockius LLP (www.morganlewis.com/hsr.htm). The HSRScan web site also includes other information regarding the HSR Act. Other useful web sites relating to HSR include those of the Federal Trade Commission (www.ftc.gov), the Antitrust Division of the Department of Justice (www.usdoj.gov/atr), the American Bar Association Section of Antitrust Law (www.abanet.org/antitrust/), the American Antitrust Institute (www.antitrustinstitute.org) and the Antitrust Policy Site (www.antitrust.org). Many of these web sites contain links to still other relevant web sites.

"Improvements"—all buildings, structures, fixtures and improvements located on the Land or included in the Assets, including those under construction.

COMMENT

The term "Improvements" appears in the definition of "Real Property" in Section 1.1 and in Sections 3.10 and 5.11.

"Indemnified Person"—as defined in Section 11.9.

COMMENT

The term "Indemnified Person" appears in the definition of "Third-Party Claim" in Section 1.1 and in Sections 11.9 and 13.16.

"Indemnifying Person"—as defined in Section 11.9.

COMMENT

The term "Indemnifying Person" appears in Section 11.9.

"Initial Working Capital"—as defined in Section 2.9(a).

COMMENT

The term "Initial Working Capital" appears in Sections 2.8 and 2.9.

"Intellectual Property Assets"—as defined in Section 3.25(a).

COMMENT

The term "Intellectual Property Assets" appears in Sections 2.1, 2.7, 3.19 and 3.25.

"Interim Balance Sheet"—as defined in Section 3.4.

COMMENT

The term "Interim Balance Sheet" appears in Sections 2.4, 3.4, 3.11, 3.12, 3.13 and 3.14.

"Inventories"—all inventories of Seller, wherever located, including all finished goods, work in process, raw materials, spare parts and all other materials and supplies to be used or consumed by Seller in the production of finished goods.

COMMENT

The term "Inventories" appears in Sections 2.1, 3.12, 3.19 and 5.3.

"IRS"—the United States Internal Revenue Service and, to the extent relevant, the United States Department of the Treasury.

COMMENT

The term "IRS" appears in Sections 2.5, 3.14, 3.16 and 10.1.

"Knowledge"—an individual will be deemed to have Knowledge of a particular fact or other matter if:

(a) that individual is actually aware of that fact or matter; or

(b) a prudent individual could be expected to discover or otherwise become aware of that fact or matter in the course of conducting a reasonably comprehensive investigation regarding the accuracy of any representation or warranty contained in this Agreement.

A Person (other than an individual) will be deemed to have Knowledge of a particular fact or other matter if any individual who is serving, or who has at any time served, as a director, officer, partner, executor or trustee of that Person (or in any similar capacity) has, or at any time had, Knowledge of that fact or other matter (as set forth in (a) and (b) above), and any such individual (and any individual party to this Agreement) will be deemed to have conducted a reasonably comprehensive investigation regarding the accuracy of the representations and warranties made herein by that Person or individual.

COMMENT

The term "Knowledge" appears in Sections 3.14, 3.16, 3.18, 3.20, 3.22, 3.23, 3.24, 3.25, 3.33, 4.3, 11.1, 11.5 and 11.6.

The seller will attempt to use the caveat of knowledge to qualify many of its representations and warranties. A knowledge qualification concerning threatened litigation has become accepted practice; otherwise, there is no standard practice for determining which representations, if any, should be qualified by the seller's knowledge. Ultimately, the issue is allocation of risk—should the buyer or the seller bear the risk of the unknown? The buyer will often argue that the seller has more knowledge of and is in a better position to investigate its business and therefore should bear the risk. The seller's frequent response is that it has made all information about the seller available to the buyer and that the buyer is acquiring the assets as part of an ongoing enterprise with the possibility of either unexpected gains or unexpected losses. Resolution of this issue usually involves much negotiation.

If the buyer agrees to a knowledge qualification, the next issue is whose knowledge is relevant. The buyer will seek to have the group of people be as broad as possible, to ensure that this group includes the people who are the most knowledgeable about the specific representation being qualified, and to include constructive and actual knowledge. The broader the group and the greater the knowledge of the people in the group, the greater the risk retained by the seller. An expansive definition of knowledge can return to haunt the buyer, however, if an "antisandbagging" provision is proposed by the seller and accepted by the buyer. This provision would preclude a buyer's claim for indemnity if it closes the transaction notwithstanding its knowledge of the inaccuracy of a representation by the seller (normally acquired between the signing of the acquisition agreement and closing). See the Comment to Section 11.1.

The final issue is the scope of investigation built into the definition. Some acquisition agreements define knowledge as actual knowledge without any investigation requirement. Others may require some level of investigation or will impute knowledge to an individual who could be expected to discover or become aware of a fact or matter by virtue of that person's position, duties or responsibilities. If the actual knowledge standard is used, the buyer may want to expand the scope to the actual knowledge of key employees of the seller and list the titles or names of these employees.

"Land"—all parcels and tracts of land in which Seller has an ownership interest.

COMMENT

The term "Land" appears in the definitions of "Real Property" and "Space Lease" in Section 1.1 and in Sections 3.10 and 5.11.

"Lease"—any Real Property Lease or any lease or rental agreement, license, right to use or installment and conditional sale agreement to which Seller is a party and any other Seller Contract pertaining to the leasing or use of any Tangible Personal Property.

COMMENT

The term "Lease" appears in the definition of "Contract" in Section 1.1 and in Sections 3.8 and 3.21.

If the Assets to be acquired also include options to purchase or lease real property, the buyer may wish to include the options in the definition of "land" or "lease," respectively, in order to receive the benefit of the representations contained in Sections 3.7, 3.8 and 3.10, as applicable with respect to the option property as well as the assignment provisions of Section 2.7.

"Legal Requirement"—any federal, state, local, municipal, foreign, international, multinational or other constitution, law, ordinance, principle of common law, code, regulation, statute or treaty.

COMMENT

The term "Legal Requirement" appears in Sections 1.2, 2.1, 2.4, 3.2, 3.3, 3.10, 3.14, 3.16, 3.17, 3.20, 3.21, 3.23, 3.24, 3.25, 4.2, 5.2, 5.4, 6.1, 7.6, 8.5, 10.1, 10.2, 10.6, 11.2, 11.9 and 11.11.

"Liability"—with respect to any Person, any liability or obligation of such Person of any kind, character or description, whether known or unknown, absolute or contingent, accrued or unaccrued, disputed or undisputed, liquidated or unliquidated, secured or unsecured, joint or several, due or to become due, vested or unvested, executory, determined, determinable or otherwise, and whether or not the same is required to be accrued on the financial statements of such Person.

COMMENT

The term "Liability" appears in Sections 2.1, 2.4, 2.10, 3.13, 3.32, 5.10, 10.3, 11.2 and 11.11.

"Marks"—as defined in Section 3.25(a)(i).

COMMENT

The term "Marks" appears in Sections 2.7 and 3.25.

"Material Consents"—as defined in Section 7.3.

COMMENT

The term "Material Consents" appears in Sections 2.10, 5.4 and 7.3.

"Occupational Safety and Health Law"—any Legal Requirement designed to provide safe and healthful working conditions and to reduce occupational safety and health hazards, including the Occupational Safety and Health Act, and any program, whether governmental or private (such as those promulgated or sponsored by in-

dustry associations and insurance companies), designed to provide safe and healthful working conditions.

COMMENT

The term "Occupational Safety and Health Law" appears in the definition of Environmental, Health and Safety Liabilities in Section 1.1. The definition includes private programs because some industries have been more extensively regulated in this area by their insurers than by the government. Such requirements may be introduced into any legal proceeding to establish a known hazard and negligence by management and, hence, are an independent source of liability.

"Order"—any order, injunction, judgment, decree, ruling, assessment or arbitration award of any Governmental Body or arbitrator.

COMMENT

The term "Order" appears in Sections 2.4, 3.2, 3.18, 3.22, 4.2, 7.6 and 8.5.

"Ordinary Course of Business"—an action taken by a Person will be deemed to have been taken in the Ordinary Course of Business only if that action:

(a) is consistent in nature, scope and magnitude with the past practices of such Person and is taken in the ordinary course of the normal, day-to-day operations of such Person;

(b) does not require authorization by the board of directors or shareholders of such Person (or by any Person or group of Persons exercising similar authority) and does not require any other separate or special authorization of any nature; and

(c) is similar in nature, scope and magnitude to actions customarily taken, without any separate or special authorization, in the ordinary course of the normal, day-to-day operations of other Persons that are in the same line of business as such Person.

COMMENT

The term "Ordinary Course of Business" appears in Sections 2.4, 3.10, 3.11, 3.12, 3.13, 3.19, 3.20, 3.29, 5.2, 5.6, 5.10 and 12.2.

When the acquisition agreement is signed, the buyer obtains an interest in being consulted about matters affecting the seller. The seller, however, needs to be able to operate its daily business without obtaining countless approvals, which can significantly delay ordinary business operations. This tension is analogous to that found in other areas of the law that use the concept of "in the ordinary course of business":

(a) Under bankruptcy law, certain transactions undertaken by the debtor "other than in the ordinary course of business" require approval of the Bankruptcy Court. *See* 11 U.S.C. § 363(b)(1).

(b) Most states' general corporation laws require shareholder approval for a sale of all or substantially all of a corporation's assets other than in the regular course of business.

(c) A regulation under the Securities Exchange Act of 1934 allows management to omit a shareholder proposal from a proxy statement "[i]f the proposal deals with a matter relating to the company's ordinary business operations." *See* 17 C.F.R. § 240.14a-8(i)(7).

An important consideration in drafting this definition is the relevant standard for distinguishing between major and routine matters: the past practices of the seller, common practice in the seller's industries or both. In one of the few cases that have interpreted the term "ordinary course of business" in the context of an acquisition, the jury was allowed to decide whether fees paid in connection with obtaining a construction loan, which were not reflected on the seller's last balance sheet, were incurred in the ordinary course of business. *See* Medigroup, Inc. v. Schildknecht, 463 F.2d 525, 529 (7th Cir. 1972). In *Medigroup*, the trial judge defined "ordinary course of business" as "that course of conduct that reasonable prudent men would use in conducting business affairs as they may occur from day to day," and instructed the jury that the past practices of the company being sold, not "the general conduct of business throughout the community," was the relevant standard. *Id.* at 529; *cf. In re* Fulghum Constr. Corp., 872 F.2d 739, 743 & n.5 (6th Cir. 1989) (stating that, in the bankruptcy context, the relevant standard is "the business practices which were unique to the particular parties under consideration and not to the practices which generally prevailed in the industry," but acknowledging that "industry practice may be relevant" in arriving at a definition of "ordinary business terms"). *But see In re* Yurika Foods Corp., 888 F.2d 42, 44 (6th Cir. 1989) (noting that it might be necessary to examine industry standards as well as the parties' prior dealings to define "ordinary course of business"); *In re* Dant & Russell, Inc., 853 F.2d 700, 704 (9th Cir. 1988) (applying, in the bankruptcy context, a "horizontal dimension test" based upon industry practices); *In re* Hills Oil & Transfer, Inc., 143 B.R. 207, 209 (Bankr. C.D. Ill. 1992) (relying on industry practices and standards to define "ordinary course of business" in a bankruptcy context).

The Model Agreement definition distinguishes between major and routine matters based upon the historic practices of both the seller and others in the same industry and on the need for board or shareholder approval. The definition is derived primarily from the analysis of "ordinary course of business" in bankruptcy, which examines both the past practice of the debtor and the ordinary practice of the industry. *See, e.g., In re* Roth Am. Inc., 975 F.2d 949, 952–53 (3d Cir. 1992); *In re* Johns-Manville Corp., 60 B.R. 612, 616–18 (Bankr. S.D.N.Y. 1986). No standard can eliminate all ambiguity regarding the need for consultation between the buyer and the seller. In doubtful cases, the seller should consult with the buyer and obtain its approval.

The buyer should be aware that its knowledge of transactions the seller plans to enter into before the closing may expand the scope of this definition. One court has stated:

> If a buyer did not know the selling corporation had made arrangements to construct a large addition to its plant, "the ordinary course of business" might refer to such transactions as billing customers and purchasing supplies. But a buyer aware of expansion plans would intend "the ordinary course of business" to include whatever transactions are normally incurred in effectuating such plans.

Medigroup, 463 F.2d at 529. Thus, the buyer should monitor its knowledge of the seller's plans for operations before the closing, and, if the buyer knows about any plans to undertake projects or enter into transactions different from those occurring in the past practice of the seller and other companies in the same industry, the buyer may want specifically to exclude those projects or transactions, and all related transactions, from the definition of "ordinary course of business."

Clause (b) of the definition has special significance in a parent-subsidiary relationship. State law does not normally require parent-company authorization for actions taken by subsidiaries. Unless the certificate or articles of incorporation provide otherwise, most state laws require shareholder approval only for amendments to the charter, mergers, sale of all or substantially all of the corporation's assets, dissolution and

other major events. Therefore, the Model Agreement definition excludes any action requiring authorization by the parent of a seller not only for actions requiring shareholder authorization under state law but also for actions requiring parent authorization under the operating procedures in effect between the parent and the subsidiary.

A seller may object to clause (c) of the definition on the ground that it does not know the internal approval processes of other companies in its industries.

"Part"—a part or section of the Disclosure Letter.

"Patents"—as defined in Section 3.25(a)(ii).

COMMENT

The term "Patents" appears in Sections 2.7 and 3.25.

"Permitted Encumbrances"—as defined in Section 3.9.

COMMENT

The term "Permitted Encumbrances" appears in Sections 2.1, 3.9 and 7.4.

"Person"—an individual, partnership, corporation, business trust, limited liability company, limited liability partnership, joint stock company, trust, unincorporated association, joint venture or other entity or a Governmental Body.

"Proceeding"—any action, arbitration, audit, hearing, investigation, litigation or suit (whether civil, criminal, administrative, judicial or investigative, whether formal or informal, whether public or private) commenced, brought, conducted or heard by or before, or otherwise involving, any Governmental Body or arbitrator.

COMMENT

The term "Proceeding" appears in Sections 2.4, 2.5, 3.16, 3.18, 3.24, 3.25, 4.3, 5.2, 7.5, 10.7, 11.3, 11.9, 12.4, 12.6 and 13.4.

"Promissory Note"—as defined in Section 2.7(b)(ii).

COMMENT

The term "Promissory Note" appears in Sections 2.2, 2.3, 2.7, 2.8, 3.31, 4.2, 10.3 and 11.8.

"Purchase Price"—as defined in Section 2.3.

COMMENT

The term "Purchase Price" appears in Sections 2.3, 2.5, 5.11, 7.8 and 13.16.

"Real Property"—the Land and Improvements and all Appurtenances thereto and any Ground Lease Property.

COMMENT

The term "Real Property" appears in Sections 2.1, 2.7, 3.9, 3.10, 5.1, 5.11, 7.8 and 10.5.

"Real Property Lease"—any Ground Lease or Space Lease.

COMMENT

The term "Real Property Lease" appears in the definition of "Lease" in Section 1.1 and in Section 3.8.

"Record"—information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

COMMENT

The term "Record" appears in Sections 2.1, 2.2, 3.4, 3.5, 3.11, 3.12, 3.27, 5.1, 5.2, 10.1, 10.7 and 10.10.

"Related Person' —

With respect to a particular individual:

(a) each other member of such individual's Family;
(b) any Person that is directly or indirectly controlled by any one or more members of such individual's Family;
(c) any Person in which members of such individual's Family hold (individually or in the aggregate) a Material Interest; and
(d) any Person with respect to which one or more members of such individual's Family serves as a director, officer, partner, executor or trustee (or in a similar capacity).

With respect to a specified Person other than an individual:

(a) any Person that directly or indirectly controls, is directly or indirectly controlled by or is directly or indirectly under common control with such specified Person;
(b) any Person that holds a Material Interest in such specified Person;
(c) each Person that serves as a director, officer, partner, executor or trustee of such specified Person (or in a similar capacity);
(d) any Person in which such specified Person holds a Material Interest; and
(e) any Person with respect to which such specified Person serves as a general partner or a trustee (or in a similar capacity).

For purposes of this definition, (a) "control" (including "controlling," "controlled by," and "under common control with") means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a Person, whether through the ownership of voting securities, by contract or otherwise, and shall be construed as such term is used in the rules promulgated under the Securities Act; (b) the "Family" of an individual includes (i) the individual, (ii) the individual's spouse, (iii) any other natural person who is related to the individual or the individual's spouse within the second degree and (iv) any other natural person who resides with such individual; and (c) "Material Interest" means direct or indirect beneficial ownership (as defined in Rule 13d-3 under the Exchange Act) of voting securities or other voting interests representing at least ten percent (10%) of the outstanding voting power of a Person or equity securities or other equity interests representing at least ten percent (10%) of the outstanding equity securities or equity interests in a Person.

COMMENT

The term "Related Person" appears in Sections 2.4, 3.29, 6.1, 7.5, 7.6, 10.1, 11.2 and 11.9.

The main purpose of the representations concerning relationships with related persons (see Section 3.29) is to identify "sweetheart" deals benefiting the seller (which may disappear after the closing), transactions with related persons on terms unfavorable to the seller (which the buyer may not be able to terminate after the closing) and possibly diverted corporate opportunities. Thus, the buyer will want a broad definition of "Related Person." For individuals, the Model Agreement definition focuses on relationships with and arising from members of an individual's family; depending upon the circumstances, a broader definition may be necessary to capture other relationships. In the definition of "Material Interest," the appropriate percentage of voting power or equity interests will depend upon the circumstances. The objective is to identify the level of equity interest in a related person that may confer a significant economic benefit on a seller or a seller's shareholder; this may be an interest well short of control of the related person. Tax and accounting considerations may also be relevant to determining the appropriate percentage.

"Release"—any release, spill, emission, leaking, pumping, pouring, dumping, emptying, injection, deposit, disposal, discharge, dispersal, leaching or migration on or into the Environment or into or out of any property.

COMMENT

The term "Release" appears in the definitions of "Environmental Law" and "Remedial Action" in Section 1.1 and in Sections 3.22 and 11.3.

This definition is a short version of the CERCLA definition found at 42 U.S.C. § 9601(22). The seller may object to the inclusion of escaping, leaching and dumping because it may not be able to observe or control those events. Because federal law may impose liability for those activities on the seller and because those matters are hard to evaluate, however, the buyer may resist modifications to this definition.

"Remedial Action"—all actions, including any capital expenditures, required or voluntarily undertaken (a) to clean up, remove, treat or in any other way address any Hazardous Material or other substance; (b) to prevent the Release or Threat of Release or to minimize the further Release of any Hazardous Material or other substance so it does not migrate or endanger or threaten to endanger public health or welfare or the Environment; (c) to perform pre-remedial studies and investigations or post-remedial monitoring and care; or (d) to bring all Facilities and the operations conducted thereon into compliance with Environmental Laws and environmental Governmental Authorizations.

COMMENT

The term "Remedial Action" appears in Section 11.3.

The seller likely would object to the use of this definition, particularly the voluntary nature of any actions, insisting, instead, that the action be specifically required by Environmental Laws.

"Representative"—with respect to a particular Person, any director, officer, manager, employee, agent, consultant, advisor, accountant, financial advisor, legal counsel or other representative of that Person.

COMMENT

The term "Representative" appears in Sections 3.27, 3.30, 3.31, 4.4, 5.1, 5.4, 10.10, 10.11, 11.2, 12.1, 12.2, 12.3, 13.1 and 13.2.

"Retained Liabilities"—as defined in Section 2.4(b).

COMMENT

The term "Retained Liabilities" appears in Sections 2.4, 10.3, 10.9 and 11.2.

"SEC"—the United States Securities and Exchange Commission.

"Securities Act"—as defined in Section 3.3.

COMMENT

The term "Securities Act" appears in the definition of "Related Person" in Section 1.1 and in Sections 3.3 and 3.31.

"Seller"—as defined in the first paragraph of this Agreement.

"Seller Contract"—any Contract (a) under which Seller has or may acquire any rights or benefits; (b) under which Seller has or may become subject to any obligation or liability; or (c) by which Seller or any of the assets owned or used by Seller is or may become bound.

COMMENT

The term "Seller Contract" appears in Sections 2.1, 2.2, 2.4, 2.10, 3.1, 3.2, 3.20, 3.21 and 3.25. For a discussion of the scope of this definition and examples of the types of contracts that could be included within this term, see the Comment to Section 3.2.

"Shareholders"—as defined in the first paragraph of this Agreement.

"Software"—all computer software and subsequent versions thereof, including source code, object, executable or binary code, objects, comments, screens, user interfaces, report formats, templates, menus, buttons and icons and all files, data, materials, manuals, design notes and other items and documentation related thereto or associated therewith.

COMMENT

The term "Software" appears in Sections 3.25, 3.26, 3.28 and 12.1.

"Space Lease"—any lease or rental agreement pertaining to the occupancy of any improved space on any Land.

COMMENT

The term "Space Lease" appears in the definition of "Real Property Lease" in Section 1.1.

"Subsidiary"—with respect to any Person (the "Owner"), any corporation or other Person of which securities or other interests having the power to elect a majority of that corporation's or other Person's board of directors or similar governing body, or

otherwise having the power to direct the business and policies of that corporation or other Person (other than securities or other interests having such power only upon the happening of a contingency that has not occurred), are held by the Owner or one or more of its Subsidiaries.

COMMENT

The term "Subsidiary" appears in Sections 3.1, 3.14 and 13.9.

"Tangible Personal Property"—all machinery, equipment, tools, furniture, office equipment, computer hardware, supplies, materials, vehicles and other items of tangible personal property (other than Inventories) of every kind owned or leased by Seller (wherever located and whether or not carried on Seller's books), together with any express or implied warranty by the manufacturers or sellers or lessors of any item or component part thereof and all maintenance records and other documents relating thereto.

COMMENT

The term "Tangible Personal Property" appears in Sections 2.1, 2.7, 3.10, 5.1 and 5.11.

"Tax"—any income, gross receipts, license, payroll, employment, excise, severance, stamp, occupation, premium, property, environmental, windfall profit, customs, vehicle, airplane, boat, vessel or other title or registration, capital stock, franchise, employees' income withholding, foreign or domestic withholding, social security, unemployment, disability, real property, personal property, sales, use, transfer, value added, alternative, add-on minimum and other tax, fee, assessment, levy, tariff, charge or duty of any kind whatsoever and any interest, penalty, addition or additional amount thereon imposed, assessed or collected by or under the authority of any Governmental Body or payable under any tax-sharing agreement or any other Contract.

COMMENT

The term "Tax" appears in Sections 2.2, 2.4, 2.5, 2.7, 3.2, 3.9, 3.14, 3.16, 3.24, 7.4, 10.2 and 10.3.

In addition to the governmental impositions applicable to a seller's business, the term "Tax" includes sales taxes and other charges imposed upon the sale of the assets. Such taxes are sometimes levied in the form of fees, which may be payable by buyer and measured by the value of particular assets being transferred, for the registration of the transfer of title to aircraft, vehicles, boats, vessels, real estate and other property. See Sections 7.4(f) and 10.2 and the related Comments.

"Tax Return"—any return (including any information return), report, statement, schedule, notice, form, declaration, claim for refund or other document or information filed with or submitted to, or required to be filed with or submitted to, any Governmental Body in connection with the determination, assessment, collection or payment of any Tax or in connection with the administration, implementation or enforcement of or compliance with any Legal Requirement relating to any Tax.

COMMENT

The term "Tax Return" appears in Section 3.14.

"Third Party"—a Person that is not a party to this Agreement.

COMMENT

The term "Third Party" appears in the definition of Third-Party Claim in Section 1.1 and in Sections 3.21, 3.25, 3.26, 3.27 and 12.3.

"Third-Party Claim"—any claim against any Indemnified Person by a Third Party, whether or not involving a Proceeding.

COMMENT

The term "Third-Party Claim" appears in Sections 11.2, 11.9 and 11.10.

"Threat of Release"—a reasonable likelihood of a Release that may require action in order to prevent or mitigate damage to the Environment that may result from such Release.

COMMENT

The term "Threat of Release" appears in the definitions of "Environmental Law" and "Remedial Action" in Section 1.1 and in Section 3.22.

The seller will often seek to exclude this phrase from the representations in Section 3.22 because it wants to make representations only with respect to actual releases. A possible compromise is to add a knowledge qualification to representations concerning future releases.

"WARN Act"—as defined in Section 3.23(d).

COMMENT

The term "WARN Act" appears in Sections 3.23, 7.11, 10.1 and 11.2.

1.2 USAGE

(a) ***Interpretation.*** **In this Agreement, unless a clear contrary intention appears:**

- **(i) the singular number includes the plural number and vice versa;**
- **(ii) reference to any Person includes such Person's successors and assigns but, if applicable, only if such successors and assigns are not prohibited by this Agreement, and reference to a Person in a particular capacity excludes such Person in any other capacity or individually;**
- **(iii) reference to any gender includes each other gender;**
- **(iv) reference to any agreement, document or instrument means such agreement, document or instrument as amended or modified and in effect from time to time in accordance with the terms thereof;**
- **(v) reference to any Legal Requirement means such Legal Requirement as amended, modified, codified, replaced or reenacted, in whole or in part, and in effect from time to time, including rules and regulations promulgated thereunder, and reference to any section or other provision of any**

Legal Requirement means that provision of such Legal Requirement from time to time in effect and constituting the substantive amendment, modification, codification, replacement or reenactment of such section or other provision;

(vi) "hereunder," "hereof," "hereto," and words of similar import shall be deemed references to this Agreement as a whole and not to any particular Article, Section or other provision hereof;

(vii) "including" (and with correlative meaning "include") means including without limiting the generality of any description preceding such term;

(viii) "or" is used in the inclusive sense of "and/or";

(ix) with respect to the determination of any period of time, "from" means "from and including" and "to" means "to but excluding"; and

(x) references to documents, instruments or agreements shall be deemed to refer as well to all addenda, exhibits, schedules or amendments thereto.

(b) ***Accounting Terms and Determinations.*** **Unless otherwise specified herein, all accounting terms used herein shall be interpreted and all accounting determinations hereunder shall be made in accordance with GAAP.**

(c) ***Legal Representation of the Parties.*** **This Agreement was negotiated by the parties with the benefit of legal representation, and any rule of construction or interpretation otherwise requiring this Agreement to be construed or interpreted against any party shall not apply to any construction or interpretation hereof.**

COMMENT

Clauses (v), (vii), (viii) and (x) of Section 1.2(a) are designed to eliminate the need for repetitive and cumbersome use of (a) the phrase "as amended" after numerous references to statutes and rules, (b) the phrase "including, but not limited to," or "including, without limitation," in every instance in which a broad term is followed by a list of items encompassed by that term, (c) "and/or" where the alternative and conjunctive are intended and (d) a list of all possible attachments or agreements relating to each document referenced in the Model Agreement. The Revised Model Business Corporation Act, Section 1.40(12), contains a similar definition: "'Includes' denotes a partial definition." In certain jurisdictions, however, the rule of ejusdem generis has been applied to construe the meaning of a broad phrase to include only matters that are of a similar nature to those specifically described. *See, e.g.,* Forward Indus., Inc. v. Rolm of N.Y. Corp., 506 N.Y.S.2d 453, 455 (App. Div. 1986) (requiring the phrase "other cause beyond the control" to be limited to events of the same kind as those events specifically enumerated); *see also* Buono Sales, Inc. v. Chrysler Motors Corp., 363 F.2d 43 (3d Cir.), *cert. denied,* 385 U.S. 971 (1966); Thaddeus Davids Co. v. Hoffman-LaRoche Chem. Works, 166 N.Y.S. 179 (App. Div. 1917).