7. Conditions Precedent to Buyer's Obligation to Close

Buyer's obligation to purchase the Assets and to take the other actions required to be taken by Buyer at the Closing is subject to the satisfaction, at or prior to the Closing, of each of the following conditions (any of which may be waived by Buyer, in whole or in part):

COMMENT

Article 7 sets forth the conditions precedent to Buyer's obligation to consummate the acquisition of the Assets. If any one of the conditions in Article 7 is not satisfied as of the Closing, Buyer may decline to proceed with the acquisition (without incurring liability to Seller or Shareholders) and may terminate the acquisition agreement in accordance with Article 9. A party's right to refuse to consummate the acquisition when a closing condition remains unsatisfied is often referred to as a "walk right" or an "out."

It is critical for the parties and their attorneys to appreciate the fundamental differences between closing conditions on the one hand and representations and covenants on the other. Although every representation and covenant of Seller also operates as a Closing condition (subject, in most cases, to a materiality qualification) through Sections 7.1 and 7.2, some of the Closing conditions in Article 7 do not constitute representations or covenants of Seller and Shareholders. If Seller fails to satisfy any of these closing conditions, Buyer will have the right to terminate the acquisition, but, unless there has also been a separate breach by Seller and Shareholders of a representation or covenant, Seller and Shareholders will not be liable to Buyer for their failure to satisfy the condition. Because of Seller's and Shareholders' obligation (in Section 5.7) to use their Best Efforts to satisfy all of the conditions in Article 7 and Section 8.3, however, and their undertaking in clause (v) of Section 2.7(a) and Section 10.11 to provide at Closing such instruments and take such actions as Buyer shall reasonably request, they will be liable if they fail to use their Best Efforts to satisfy those conditions or fail to satisfy the requirements of Sections 2.7(a)(v) and 10.11, even if a particular Closing condition does not constitute a representation or covenant of Seller and Shareholders.

The importance of the distinction between conditions and covenants can be illustrated by examining the remedies that may be exercised by Buyer if Seller and Share-

holders fail to obtain the releases referred to in Section 7.4(e). Because the delivery of the releases is a condition to Buyer's obligation to consummate the acquisition, Buyer may elect to terminate the acquisition as a result of the failure to procure the releases. The delivery of the releases, however, is not an absolute covenant of Seller. Accordingly, Seller's failure to obtain the releases will not, in and of itself, render Seller and Shareholders liable to Buyer. If Seller and Shareholders made no attempt to obtain the releases, however, they could be liable to Buyer under Section 5.7 for failing to use their Best Efforts to satisfy the applicable Closing condition even though they lack the power to obtain the Releases without the cooperation of a third party. For discussions of the relationships and interplay between the representations, pre-closing covenants, closing conditions, termination provisions and indemnification provisions in an acquisition agreement, see FREUND, ANATOMY OF A MERGER 153–68 (1975) and BUSINESS ACQUISITIONS ch. 31, at 1256 (Herz & Baller eds., 2d ed. 1981).

Although Section 7 includes many of the closing conditions commonly found in acquisition agreements, it does not provide an exhaustive list of all possible closing conditions. A buyer may want to add a "due diligence out" (making the buyer's obligation to purchase the assets subject to the buyer's satisfactory completion of a "due diligence" investigation relating to the business of the seller).

A buyer may find it difficult to persuade the seller to include such an additional condition because it would give the buyer very broad walk rights and place the buyer in a position similar to that of the holder of an option to purchase the assets. For a discussion of due diligence outs and "financing outs" such as that in Section 7.13, see KLING & NUGENT SIMON, NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES AND DIVISIONS §§ 14.10, 14.11[4] (1992). A number of other closing conditions that the buyer may seek to include in Article 7 are discussed in the Comments to Sections 7.1 and 7.4.

The buyer may waive any of the conditions to its obligation to close the acquisition. The buyer will not be deemed to have waived any of these conditions, however, unless the waiver is in writing (see Section 13.6). This requirement avoids dispute about whether a particular condition has actually been waived.

7.1 ACCURACY OF REPRESENTATIONS

(a) All of Seller's and Shareholders' representations and warranties in this Agreement (considered collectively), and each of these representations and warranties (considered individually), shall have been accurate in all material respects as of the date of this Agreement, and shall be accurate in all material respects as of the time of the Closing as if then made, without giving effect to any supplement to the Disclosure Letter.

(b) Each of the representations and warranties in Sections 3.2(a) and 3.4, and each of the representations and warranties in this Agreement that contains an express materiality qualification, shall have been accurate in all respects as of the date of this Agreement, and shall be accurate in all respects as of the time of the Closing as if then made, without giving effect to any supplement to the Disclosure Letter.

COMMENT

Pursuant to this section, all of Seller's representations function as Closing conditions. Thus, Seller's representations serve a dual purpose: they provide Buyer with a possible

basis not only for recovering damages against Seller and Shareholders (see Section 11.2(a)) but also for exercising walk rights.

Materiality Qualification in Section 7.1(a). Section 7.1(a) allows Buyer to refuse to complete the acquisition only if there are material inaccuracies in Seller's representations. A materiality qualification is needed in Section 7.1 because most of Seller's representations do not contain any such qualification. The materiality qualification in Section 7.1(a) prevents Buyer from using a trivial breach of Seller's representations as an excuse for terminating the acquisition (see Appendix D, scenarios 2.4, 2.7, 2.8, 3.4, 3.8 and 3.9).

Section 7.1(a) provides that the materiality of any inaccuracies in Seller's representations is to be measured both by considering each of the representations on an individual basis and by considering all of the representations on a collective basis. Accordingly, even though there may be no individual representation that is materially inaccurate when considered alone, Buyer will be able to terminate the acquisition if several different representations contain immaterial inaccuracies that, considered together, reach the overall materiality threshold.

The materiality qualification in Section 7.1 can be expressed in different ways. In some acquisition agreements, the materiality qualification is expressed as a specific dollar amount, which operates as a cumulative "basket" akin to the indemnification "basket" in Section 11.5.

Absence of Materiality Qualification in Section 7.1(b). A few of Seller's representations (such as the "no-material-adverse-change" representation in Section 3.15 and the "disclosure" representation in Section 3.33) already contain express materiality qualifications. It is appropriate to require that these representations be accurate "in all respects" (rather than merely "in all *material* respects") in order to avoid "double materiality" problems. Section 7.1(b), which does not contain a materiality qualification, accomplishes this result. Section 3.4 is included because GAAP contains its own materiality standards. For a further discussion of double materiality issues, see FREUND, ANATOMY OF A MERGER 35–36, 245–46 (1975) and KLING & NUGENT SIMON, NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES AND DIVISIONS § 14.02[3] (1992).

In addition, some of the seller's representations that do not contain express materiality qualifications may be so fundamental that the buyer will want to retain the ability to terminate the acquisition if they are inaccurate in *any* respect. Consider, for example, Seller's representations in Section 3.2(a), which state that the acquisition agreement constitutes the legal, valid and binding obligation of Seller and Shareholders, enforceable against them, that Seller has the absolute and unrestricted right, power, authority and capacity to execute and deliver the acquisition agreement and that Shareholders have all requisite legal capacity to enter into the agreement and to perform their respective obligations thereunder. In order to avoid a dispute about the meaning of the term "material" in such a situation, the buyer may seek to include the representations in Section 3.2(a) (and other fundamental representations made by the seller) among the representations that must be accurate in all respects pursuant to Section 7.1(b).

To the extent that there is no materiality qualification in the representations identified in Section 7.1(b), a court might establish its own materiality standard to prevent a buyer from terminating the acquisition because of a trivial inaccuracy in one of those representations. *See* BUSINESS ACQUISITIONS ch. 31, n.24 (Herz & Baller eds., 2d ed. 1981).

Time as of Which Accuracy of Representations Is Determined. The first clause in Section 7.1(a) focuses on the accuracy of Seller's representations on the date of the acquisition agreement, whereas the second clause refers specifically to the time of Closing. Pursuant to this second clause—referred to as the "bring-down" clause—Seller's representations are "brought down" to the time of Closing to determine whether they would be accurate if then made.

Although it is unlikely that a seller would object to the inclusion of a standard bring-down clause, it may object to the first clause in Section 7.1, which requires Seller's representations to have been accurate on the original signing date. This clause permits Buyer to terminate the acquisition because of a representation that was materially inaccurate when made, even if the inaccuracy has been fully cured by the Closing (see Appendix D, scenarios 2.3 and 3.3). If a seller objects to this clause, the buyer may point out that the elimination of this clause would permit the seller to sign the acquisition agreement knowing that their representations are inaccurate at that time (on the expectation that they will be able to cure the inaccuracies before the closing). This possibility could seriously undermine the disclosure function of the seller's representations (see the introductory Comment to Article 3 under the caption "Purposes of the Seller's Representations"). *See generally* KLING & NUGENT SIMON, NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES AND DIVISIONS § 14.02[1] (1992).

Effect of Disclosure Letter Supplements. Section 7.1 specifies that supplements to the Disclosure Letter have no effect for purposes of determining the accuracy of Seller's representations. This ensures Buyer that its walk rights will be preserved notwithstanding any disclosures made by Seller after the signing of the acquisition agreement.

The importance of the qualification negating the effect of supplements to the Disclosure Letter can be illustrated by a simple example. Assume that a material lawsuit is brought against Seller after the signing date and that Seller promptly discloses the lawsuit to Buyer in a Disclosure Letter supplement as required by Section 5.5. Assume further that the lawsuit remains pending on the scheduled Closing Date. In these circumstances, the representation in Section 3.18(a) (which states that, except as disclosed in the Disclosure Letter, there are no legal Proceedings pending against Seller) will be deemed accurate as of the Closing Date if the Disclosure Letter supplement is taken into account but will be deemed materially inaccurate if the supplement is not taken into account. Because Section 7.1 provides specifically that supplements to the Disclosure Letter are not to be given effect, Buyer will be able to terminate the acquisition in this situation (see Appendix D, scenario 3.5). Although supplements to the Disclosure Letter are not given effect for purposes of determining whether the Buyer has a walk right under Section 7.1, such supplements are given limited effect (in one circumstance) for purposes of determining whether Buyer has a right to indemnification after the Closing (see Section 11.2(a) and Appendix D, scenario 3.5).

Operation of the Bring-Down Clause. It is important that the parties and their counsel understand how the bring-down clause in Section 7.1 operates. Consider, for example, the application of this clause to the representation in Section 3.4 concerning Seller's financial statements. This representation states that the financial statements "fairly present . . . the financial condition and the results of operations, changes in shareholders' equity and cash flows of Seller as at the respective dates of and for the periods referred to in such financial statements. . . ." Does the bring-down clause in Section 7.1 require, as a condition to Buyer's obligation to close, that these historical financial statements also fairly reflect Seller's financial condition as of the Closing Date?

The answer to this question is "no." The inclusion of the phrase "as at the respective dates of and for the periods referred to in such financial statements. . . ." in the Section 3.4 representation precludes the representation from being brought down to the Closing Date pursuant to Section 7.1. Nevertheless, in order to eliminate any possible uncertainty about the proper interpretation of the bring-down clause, a seller may insist that the language of this clause be modified to include a specific exception for representations "expressly made as of a particular date."

A seller may also seek to clarify that certain representations speak specifically as of the signing date and are not to be brought down to the closing date. For example, the

seller may be concerned that the representation in Section 3.20(a)(i) (which states that the Disclosure Letter accurately lists all of Seller's Contracts involving the performance of services or the delivery of goods or materials worth more than a specified dollar amount) would be rendered inaccurate as of the closing date if the seller were to enter into a significant number of such contracts as part of its routine business operations between the signing date and the closing date. (Note that, because Section 7.1 does not give effect to supplements to the Disclosure Letter, Seller would not be able to eliminate Buyer's walk right in this situation simply by listing the new Contracts in a Disclosure Letter supplement.) Because it would be unfair to give a buyer a walk right tied to routine actions taken in the normal course of the seller's business operations, the seller may request that the representation in Section 3.20(a)(i) be introduced by the phrase "as of the date of this Agreement" so that it will not be brought down to the closing date. *See* FREUND, ANATOMY OF A MERGER 154 (1975). The buyer may respond that, if the new contracts do not have a material adverse effect on the seller's business, the representation in Section 3.20(a)(i) would remain accurate in all *material* respects, and the buyer, therefore, could not use the technical inaccuracy resulting from the bring down of this representation as an excuse to terminate the acquisition.

A seller may also request that the bring-down clause be modified to clarify that the buyer will not have a walk right if any of the seller's representations is rendered inaccurate as a result of an occurrence specifically contemplated by the acquisition agreement. The requested modification entails inserting the words "except as contemplated or permitted by this Agreement" (or some similar qualification) in Section 7.1.

The buyer may object to the qualification requested by the seller because of the difficulty inherent in ascertaining whether a particular inaccuracy arose as a result of something "contemplated" or "permitted" by the acquisition agreement. *See* KLING & NUGENT SIMON, NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES AND DIVISIONS § 14.02[4] (1992). The buyer may argue that, if the seller is truly concerned about technical inaccuracies in its representations, it should bear the burden of specifically disclosing these inaccuracies in its disclosure letter rather than relying on a potentially overbroad qualification in the bring-down clause.

Bring Down of Representations That Include "Adverse Effect" Language. See the introductory Comment to Article 3.

Bring Down of Representations Incorporating Specific Time Periods. See the introductory Comment to Article 3.

Desirability of Separate "No-Material-Adverse-Change" Condition. Some acquisition agreements contain a separate closing condition giving the buyer a walk right if there has been a material adverse change in the seller's business since the date of the agreement. The Model Agreement does not include a separate condition of this type because Buyer receives comparable protection by virtue of Seller's no-material-adverse-change representation in Section 3.15 (which operates as a closing condition pursuant to Section 7.1).

There is, however, a potentially significant difference between the representation in Section 3.15 and a typical no-material-adverse-change condition. Although the representation in Section 3.15 focuses on the time period beginning on the date of the most recent audited Balance Sheet of Seller (see Section 3.4), a no-material-adverse-change condition normally focuses on the period beginning on the date on which the acquisition agreement is signed (which may be months after the balance sheet date). Because of this difference, the buyer can obtain broader protection in some circumstances by adding a separate no-material-adverse-change condition to Article 7.

The following example describes circumstances in which a buyer can obtain extra protection by including a separate no-material-adverse-change condition. Assume that the seller's business has improved between the balance sheet date and the signing date

but has deteriorated significantly between the signing date and the closing date. Assume further that the net cumulative change in the seller's business between the balance sheet date and the closing date is *not* materially adverse (because the magnitude of the improvement between the balance sheet date and the signing date exceeds the magnitude of the deterioration between the signing date and the closing date). In this situation, the buyer *would* have a walk right if a separate no-material-adverse-change condition (focusing on the time period from the signing date through the scheduled closing date) were included in the acquisition agreement but would not have a walk right if left to rely exclusively on the bring down of the representation in Section 3.15.

Supplemental Bring-Down Representation. A buyer may seek to supplement the bring-down clause in Section 7.1 by having the seller make a separate bring-down representation in Article 3. By making such a representation, the seller would be providing the buyer with binding assurances that the representations in the acquisition agreement will be accurate as of the closing date as if made on that date.

The seller will likely resist the buyer's attempt to include a bring-down representation because such a representation could subject the seller and its shareholders to liability for events beyond their control. For example, assume that there is a major hurricane a short time after the signing date and that the hurricane materially and adversely affects the seller's properties within the meaning of Section 3.19(e). If there were a bring-down representation in Article 3 (in addition to the bring-down clause in Section 7.1), the buyer not only would be permitted to terminate the acquisition because of the destruction caused by the hurricane but also would be entitled to sue and recover damages from the seller and its shareholders for their breach of the bring-down representation. Although the seller would presumably consider this an inappropriate result, the buyer may defend its request for a bring-down representation by arguing that the buyer is entitled to the benefit of its original bargain—the bargain that it struck when it signed the acquisition agreement—notwithstanding the subsequent occurrence of events beyond the seller's control. Thus, the buyer would argue, the seller and the shareholders should be prepared to guarantee, by means of a bring-down representation, that the state of affairs existing on the signing date will remain in existence on the closing date.

If the buyer succeeds in its attempt to include a bring-down representation in the acquisition agreement, the seller may be left in a vulnerable position. Even when the seller notifies the buyer before the closing that one of the seller's representations has been rendered materially inaccurate as of the closing date because of a post-signing event beyond the seller's control, the buyer would retain the right to "close and sue"—the right to consummate the purchase of the assets and immediately bring a lawsuit demanding that the seller and its shareholders indemnify the buyer against any losses resulting from the breach of the bring-down representation. The buyer should be aware, however, that courts may not necessarily enforce the buyer's right to close and sue in this situation (see the cases cited in the Comment to Section 11.1).

Effect of "Knowledge" Qualifications in Representations. See the introductory Comment to Article 3.

7.2 SELLER'S PERFORMANCE

All of the covenants and obligations that Seller and Shareholders are required to perform or to comply with pursuant to this Agreement at or prior to the Closing (considered collectively), and each of these covenants and obligations (considered individually), shall have been duly performed and complied with in all material respects.

COMMENT

Pursuant to Section 7.2, all of Seller's pre-Closing covenants function as Closing conditions. Thus, if Seller materially breaches any of its pre-Closing covenants, Buyer will have a walk right (in addition to its right to sue and recover damages because of the breach).

7.3 CONSENTS

Each of the Consents identified in Exhibit 7.4 (the "Material Consents") shall have been obtained and shall be in full force and effect.

COMMENT

Under Section 7.3, Buyer's obligation to purchase the Assets is conditioned upon the delivery of certain specified Material Consents (see the Comment to Section 2.10) (which may include both governmental approvals and contractual Consents). For a discussion of the types of consents that might be needed for the sale of all or substantially all of a seller's assets, see the Comments to Sections 2.10, 3.2(b) and 5.4. The condition in Section 7.3 does not overlap with the bring down of Seller's representation in Section 3.2 because Section 3.2(b) contains an express carve-out for Consents identified in the Disclosure Letter.

Part 3.2 of the Disclosure Letter picks up all material and nonmaterial Consents, without differentiating between the two (a different approach might also be taken), because it is essential to disclose all consents that must be obtained from any person in connection with the execution and delivery of the agreement and the consummation and performance of the transactions contemplated by the agreement. The parties are obligated to use their Best Efforts to obtain all Consents listed on Exhibits 7.3 and 8.3 prior to the Closing. (See Section 5.7 and the related Comment.) The failure to obtain such a scheduled Consent will relieve the appropriate party of the obligation to close (see the Comment to Section 2.10). Thus, before the acquisition agreement is signed, the parties must determine which of the various Consents identified in Part 3.2 of the Disclosure Letter are significant enough to be a Material Consent and, in turn, which of these is important enough to justify allowing Buyer to terminate the acquisition if the Consent cannot be obtained.

Exhibit 7.3 specifically identifies the Material Consents that are needed to satisfy this condition on Buyer's obligation to close. Exhibit 8.3 identifies those required to satisfy the condition imposed by Section 8.3 on Seller's obligation to close. Some of those consents may be listed on both Exhibits 7.3 and 8.3 because of their importance to both the buyer and the seller.

Part 3.2 of the Disclosure Letter might include as material consents, for example, a consent required to be obtained by a seller from a third-party landlord under a lease containing a "nonassignability" provision or a consent required from a lender with respect to an indebtedness of the seller that the buyer wishes to assume (because of favorable terms) or that the buyer may be required to assume as a part of the arrangement between the buyer and the seller. These consents would be needed because of contractual requirements applicable to the seller. There may be other consents that need to be identified in Exhibit 7.3 because of legal requirements applicable to the seller. These might include certain governmental approvals, consents or other authorizations. Some of these consents might show up on Exhibit 8.3 as well because of their importance to the seller.

There is no need to refer to the HSR Act in Section 7.3 because Section 2.6 already specifies that the Closing cannot take place until the waiting period prescribed by that Act has been terminated.

7.4 ADDITIONAL DOCUMENTS

Seller and Shareholders shall have caused the documents and instruments required by Section 2.7(a) and the following documents to be delivered (or tendered subject only to Closing) to Buyer:

(a) an opinion of _____, dated the Closing Date, in the form of Exhibit 7.4(a);

(b) The [certificate] [articles] of incorporation and all amendments thereto of Seller, duly certified as of a recent date by the Secretary of State of the jurisdiction of Seller's incorporation;

(c) If requested by Buyer, any Consents or other instruments that may be required to permit Buyer's qualification in each jurisdiction in which Seller is licensed or qualified to do business as a foreign corporation under the name "_____" or "_____" or any derivative thereof;

(d) A statement from the holder of each note and mortgage listed on Exhibit 2.4(a)(vii), if any, dated the Closing Date, setting forth the principal amount then outstanding on the indebtedness represented by such note or secured by such mortgage, the interest rate thereon and a statement to the effect that Seller, as obligor under such note or mortgage, is not in default under any of the provisions thereof;

(e) Releases of all Encumbrances on the Assets, other than Permitted Encumbrances, including releases of each mortgage of record and reconveyances of each deed of trust with respect to each parcel of real property included in the Assets;

(f) Certificates dated as of a date not earlier than the [third] business day prior to the Closing as to the good standing of Seller and payment of all applicable state Taxes by Seller, executed by the appropriate officials of the State of _____ and each jurisdiction in which Seller is licensed or qualified to do business as a foreign corporation as specified in Part 3.1(a); and

(g) Such other documents as Buyer may reasonably request for the purpose of:

- **(i) evidencing the accuracy of any of Seller's representations and warranties;**
- **(ii) evidencing the performance by Seller or either Shareholder of, or the compliance by Seller or either Shareholder with, any covenant or obligation required to be performed or complied with by Seller or such Shareholder;**
- **(iii) evidencing the satisfaction of any condition referred to in this Article 7; or**
- **(iv) otherwise facilitating the consummation or performance of any of the Contemplated Transactions.**

COMMENT

Pursuant to Section 7.4, Buyer's obligation to purchase the Assets is conditioned upon Seller's delivery to Buyer of certain specified documents, including a legal opin-

ion of Seller's counsel and releases of Encumbrances upon the Assets and various other certificates and documents.

Section 7.4 works in conjunction with Section 2.7. Section 2.7 identifies various documents that Seller and Shareholders have covenanted to deliver at the Closing. These documents include various instruments signed by Seller and Shareholders (such as the Escrow Agreement, the Employment Agreements and the Noncompetition Agreements). The delivery of these documents is separately made a condition to Buyer's Closing obligation in Section 7.2(b).

In contrast, the documents identified in Section 7.4 are executed by parties other than Seller and Shareholders. Because Seller cannot guarantee that these other parties will deliver the specified documents at Closing, the delivery of these documents is not made an absolute covenant but rather is merely a Closing condition. (For a discussion of the differences between covenants and conditions, see the introductory Comment to Article 7.) Pursuant to Section 5.7, however, Seller and Shareholders are obligated to use their Best Efforts to obtain all of the documents identified in Section 7.4.

A buyer may deem it appropriate to request the delivery of certain additional documents as a condition to its obligation to consummate the acquisition. These additional documents may include, for example, an employment agreement signed by a key employee of the seller (who is not a shareholder), resignations of officers and directors of any subsidiary the stock of which is among the assets to be acquired and a "comfort letter" from the seller's independent auditors. For a discussion of the use of "comfort letters" in acquisitions, see FREUND, ANATOMY OF A MERGER 301–04 (1975); KLING & NUGENT SIMON, NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES AND DIVISIONS § 14.06[2] (1992) and Statement on Auditing Standards No. 72 ("Letters for Underwriters and Certain Other Requesting Parties"). Although the buyer might be able to demand various additional documents after the signing of the acquisition agreement under the "catch-all" language of Section 7.4(g), it is better to identify specifically all-important closing documents in the acquisition agreement.

Section 7.4(f) calls for a certificate as to Seller's good standing and payment of taxes from the appropriate officials of its domicile and any state in which it is licensed or qualified to do business as a foreign corporation. The availability of a certificate, waiver or similar document, or the practicality of receiving it on a timely basis, will vary from state to state. For example, provision is made in California for the issuance of certificates by (a) the Board of Equalization, stating that no sales or use taxes are due (CAL. REV. & TAX. CODE § 6811), (b) the Employment Development Department, stating that no amounts are due to cover contributions, interest or penalties to various unemployment funds (CAL. UNEMP. INS. CODE §§ 1731–32) and (c) the Franchise Tax Board, stating that no withholding taxes, interest or penalties are due (CAL. REV. & TAX. CODE § 18669). In the absence of such a certificate, a buyer may have liability for the seller's failure to pay or withhold the sums required. These agencies must issue a certificate within a specified number of days (varying from thirty to sixty days) after request is made or, in one case, after the sale. Because it usually is not practical to wait, or it may not be desirable to cause the agency to conduct an audit or other examination in order for such a certificate to issue, most buyers assume the risk and rely on indemnification, escrows or other protective devices to recover any state or local taxes that are found to be due and unpaid.

There may be other certificates or documents that a buyer may require as a condition to closing, depending upon the circumstances. For example, it may require an affidavit under the Foreign Investment in Real Property Tax Act of 1980 to avoid the obligation to withhold a portion of the purchase price under Section 1445 of the Code.

7.5 NO PROCEEDINGS

Since the date of this Agreement, there shall not have been commenced or threatened against Buyer, or against any Related Person of Buyer, any Proceeding (a) involving any challenge to, or seeking Damages or other relief in connection with, any of the Contemplated Transactions or (b) that may have the effect of preventing, delaying, making illegal, imposing limitations or conditions on or otherwise interfering with any of the Contemplated Transactions.

COMMENT

Section 7.5 contains Buyer's "litigation out." This provision gives Buyer a walk right if any litigation relating to the acquisition is commenced or threatened against Buyer or a Related Person.

Section 7.5 relates only to litigation against Buyer and its Related Persons. Litigation against Seller is separately covered by the bring down of Seller's litigation representation in Section 3.18(a) pursuant to Section 7.1(a). Seller's litigation representation in Section 3.18(a) is drafted very broadly so that it extends not only to litigation involving Seller but also to litigation brought or threatened against other parties (including Buyer) in connection with the acquisition. Thus, the bring down of Section 3.18(a) overlaps with Buyer's litigation out in Section 7.5. A seller may object, however, to the broad scope of the representation in Section 3.18(a) and may attempt to modify this representation so that it covers only litigation against the seller (and not litigation against other parties). If the seller succeeds in so narrowing the scope of Section 3.18(a), the buyer will not be able to rely on the bring down of the seller's litigation representation to provide the buyer with a walk right if a lawsuit relating to the acquisition is brought against the buyer. In this situation, a separate litigation out (such as the one in Section 7.5) covering legal proceedings against the buyer and its related persons will be especially important to the buyer.

The scope of the buyer's litigation out is often the subject of considerable negotiation between the parties. The seller may seek to narrow this condition by arguing that threatened (and even pending) lawsuits are sometimes meritless or by suggesting the possibility that the buyer might be tempted to encourage a third party to threaten a lawsuit against the buyer as a way of ensuring that the buyer will have a walk right. Indeed, the seller may take the extreme position that the buyer should be required to purchase the assets even if there is a significant pending lawsuit challenging the buyer's acquisition of the assets. In other words, the seller may seek to ensure that the buyer will not have a walk right unless a court issues an injunction prohibiting the buyer from purchasing the assets. If the buyer accepts the seller's position, Section 7.5 will have to be reworded to parallel the less expansive language of Section 8.5.

There are many possible compromises that the parties may reach in negotiating the scope of the buyer's litigation out. For example, the parties may agree to permit the buyer to terminate the acquisition if there is acquisition-related litigation pending against the buyer but not if such litigation has merely been threatened. Alternatively, the parties may decide to give the buyer a right to terminate the acquisition if a governmental body has brought or threatened to bring a lawsuit against the buyer in connection with the acquisition but not if a private party has brought or threatened to bring such a lawsuit.

For Buyer to terminate the acquisition under Section 7.5, a legal Proceeding must have been commenced or threatened "since the date of this Agreement." The quoted phrase is included in Section 7.5 because it is normally considered inappropriate to

permit a buyer to terminate the acquisition as a result of a lawsuit that was originally brought before the buyer signed the acquisition agreement. Indeed, Buyer represents to Seller in the Model Agreement that no such lawsuit relating to the acquisition was brought against Buyer before the signing date (see Section 4.3).

A buyer may, however, want to delete the quoted phrase so that it can terminate the acquisition if, after the signing date, there is a significant adverse development in a lawsuit previously brought against the buyer in connection with the acquisition. Similarly, the buyer may want to add a separate closing condition giving the buyer a walk right if there is a significant adverse development after the signing date in any legal proceeding that the seller originally identified in its disclosure letter as pending against the seller or either shareholder as of the signing date.

7.6 NO CONFLICT

Neither the consummation nor the performance of any of the Contemplated Transactions will, directly or indirectly (with or without notice or lapse of time), contravene or conflict with or result in a violation of or cause Buyer or any Related Person of Buyer to suffer any adverse consequence under (a) any applicable Legal Requirement or Order or (b) any Legal Requirement or Order that has been published, introduced or otherwise proposed by or before any Governmental Body, excluding Bulk Sales Laws.

COMMENT

Section 7.6 allows Buyer to terminate the acquisition if Buyer or any Related Person would violate any law, regulation or other Legal Requirement as a result of the acquisition. This section supplements Seller's "no conflict" representation in Section 3.2(b)(ii) and Seller's "compliance with legal requirements" representation in Section 3.17(a), both of which operate as Closing conditions pursuant to Section 7.1(a). Unlike the representations in Sections 3.2(b)(ii) and 3.17(a), however (which focus exclusively on Legal Requirements applicable to Seller), Section 7.6 focuses on Legal Requirements applicable to Buyer and its Related Persons. For example, environmental agencies in some states, e.g., New Jersey, have the ability to void a sale if no clean-up plan or "negative declaration" has been filed. Because there are significant fines for failure to comply with these regulations, a buyer should identify such regulations or, if any are applicable in the state in which the agreement is to be performed, require that their compliance (including the seller's cooperation with such compliance) be a condition to the closing. The requirement for the seller's cooperation should be inserted as a covenant (Article 5) or a representation and warranty of the seller (Article 3).

Section 7.6 refers to proposed Legal Requirements as well as to those already in effect. Thus, if legislation is proposed that would prohibit or impose material restrictions on Buyer's control or ownership of the Assets, Buyer will be able to terminate the acquisition, even though the proposed legislation might never become law. A seller may seek to limit the scope of Section 7.6 to legal requirements that are in effect on the scheduled closing date and to material violations and material adverse consequences.

Buyer may exercise its walk right under Section 7.6 if the acquisition would cause it to "suffer any adverse consequence" under any applicable law, even though there might be no actual "violation" of the law in question. Thus, Buyer, for example, would be permitted to terminate the acquisition under Section 7.6 because of the enactment of a statute prohibiting Buyer from using or operating the Assets in substantially the same manner as they had been used and operated prior to the Closing by Seller, even

though the statute in question might not actually impose an outright prohibition on using or operating the Assets or any of them.

Section 7.6 does not allow Buyer to terminate the acquisition merely because of an adverse change in the general regulatory climate in which Seller operates. Buyer cannot terminate the acquisition under Section 7.6 unless the acquisition itself (or one of the other Contemplated Transactions) would trigger a violation or an adverse consequence under an applicable or proposed Legal Requirement.

A seller may take the position that Section 7.6 should extend only to legal requirements that have been adopted or proposed since the date of the acquisition agreement, arguing that the buyer should not be entitled to terminate the acquisition as a result of an anticipated violation of a statute that was already in place (and that the buyer presumably knew to be in place) when the buyer signed the agreement. The buyer may respond that, even if a particular statute is already in effect as of the signing date, there may subsequently be significant changes in the statute or in the regulations under the statute and that such changes should be sufficient to justify the buyer's refusal to complete the acquisition. Indeed, the buyer may seek to expand the scope of Section 7.6 to ensure that the buyer will have a walk right if any change in the interpretation or enforcement of a legal requirement creates a mere risk that such a violation might occur or be asserted, even though there may be some uncertainty about the correct interpretation of the legal requirement in question.

7.7 SUPPLY AGREEMENT

Buyer shall have entered into a supply agreement with _____ in form and substance satisfactory to Buyer.

COMMENT

It is important that a buyer and its counsel identify through the representations and warranties and through due diligence any nonassumable contracts that are, from the buyer's point of view, essential to the business that the buyer expects to conduct following the closing. The supply agreement referred to in Section 7.7 is the one identified in the Fact Pattern under the heading "Contracts." Alternatively, this agreement could be listed as an ancillary agreement. See Section 7.12 and the related Comment.

7.8 TITLE INSURANCE

Buyer shall have received unconditional and binding commitments to issue policies of title insurance consistent with Section 5.11, dated the Closing Date, in an aggregate amount equal to the amount of the Purchase Price allocated to the Real Property, deleting all requirements listed in ALTA Schedule B-1, amending the effective date to the date and time of recordation of the deed transferring title to the Real Property to Buyer with no exception for the gap between closing and recordation, deleting or insuring over Title Objections as required pursuant to Section 5.11, attaching all endorsements required by Buyer in order to ensure provision of all coverage required pursuant to Section 5.11 and otherwise in form satisfactory to Buyer insuring Buyer's interest in each parcel of Real Property or interest therein to the extent required by Section 5.11.

COMMENT

At the closing, the seller may be required to furnish to the buyer a title commitment, which has either been marked and initialed by the title insurer or otherwise endorsed by the title insurer to reflect all matters required to be addressed by title insurance pursuant to the provisions of Section 5.11. Gap coverage is important because it shifts to the title insurer the risk of matters affecting title recorded subsequent to the issuance of the title commitment but prior to recordation of the deed.

Because in some jurisdictions title insurance commitments expire after a specified period of time, it may be necessary for the buyer to require post-closing delivery of the title policy within a fairly short period of time. In these jurisdictions, if the policy has not been issued in a timely fashion, the buyer may lose coverage it is relying upon and be forced to proceed against the seller for a breach of the agreement and recovery of any damages resulting from a claim that otherwise would have been covered by the title insurance policy (also an undesirable situation for the seller). Under these circumstances, the buyer may wish to include in the contract the right to declare a breach and pursue its remedies long before the expiration of the title commitment.

7.9 GOVERNMENTAL AUTHORIZATIONS

Buyer shall have received such Governmental Authorizations as are necessary or desirable to allow Buyer to operate the Assets from and after the Closing.

COMMENT

In some circumstances, the seller will want to limit this condition to material governmental authorizations or require that those governmental authorizations intended to be closing conditions be listed.

7.10 ENVIRONMENTAL REPORT

Buyer shall have received an environmental site assessment report with respect to Seller's Facilities, which report shall be acceptable in form and substance to Buyer in its sole discretion.

COMMENT

A buyer may decide to require, as a condition to closing, receipt of a satisfactory environmental evaluation of the seller's real property, or at least its principal properties, by a qualified consultant. These evaluations generally are categorized as either Phase I or Phase II environmental reviews. A Phase I review is an assessment of potential environmental contamination on the property resulting from past or present land use. The assessment usually is based upon site inspections and interviews, adjacent land use surveys, regulatory program reviews, aerial photograph evaluations and other background research. The scope usually is limited to an analysis of existing data, excluding core samples or physical testing. A Phase II review is a subsurface investigation of the property through selected soil samples, laboratory analysis and testing. These reviews are then reduced to writing in a detailed report containing the consultant's conclusions and recommendations. The seller may resist subsurface testing. See the Comment to Section 5.1.

Assuming that the buyer knows little about the seller's real property at the time of drafting the acquisition agreement, a Phase I report would be appropriate requirement. Once the work is completed and the Phase I report issued, the buyer could then delete

the condition or require a Phase II report, depending upon the conclusions and recommendations of the consultant.

7.11 WARN ACT NOTICE PERIODS AND EMPLOYEES

(a) All requisite notice periods under the Warn Act shall have expired.
(b) Buyer shall have entered into employment agreements with those employees of Seller identified in Exhibit 7.11.
(c) Those key employees of Seller identified on Exhibit 7.11, or substitutes therefor who shall be acceptable to Buyer, in its sole discretion, shall have accepted employment with Buyer with such employment to commence on and as of the Closing Date.
(d) Substantially all other employees of Seller shall be available for hiring by Buyer, in its sole discretion, on and as of the Closing Date.

COMMENT

As indicated in the Comment to Section 3.23, the WARN Act contains an ambiguous provision that deals with the sale of a business. This provision has two basic components: (a) it assigns the responsibility, respectively, to the seller for giving WARN Act notices for plant closings or mass layoffs that occur "up to and including the effective date of the sale" and to the buyer for giving WARN Act notices for plant closings or mass layoffs that occur thereafter, and (b) it deems, for WARN Act purposes, any non-part-time employee of the seller to be "an employee of the purchaser immediately after the effective date of the sale." 29 U.S.C. § 2101(b)(1).

A buyer seeking to avoid WARN Act liability may require that the seller permanently lay off its employees on or before the effective date of the sale so that the WARN Act notice obligations are the seller's. Of course, a seller seeking to avoid these notice obligations (or any WARN Act liability) may seek a representation from the buyer that it will employ a sufficient number of seller's employees so that the WARN Act is not triggered. Alternatively, the seller may seek to postpone the closing date so as to allow sufficient time to provide any requisite WARN notice to its employees. In those circumstances, the seller would ordinarily insist that a binding acquisition agreement be executed (with a deferred closing date) before it gives the WARN notice. Furthermore, the buyer may agree to employ a number of the seller's employees on substantially similar terms and conditions of employment such that an insufficient number of the seller's employees will experience an "employment loss," thereby relieving the seller of WARN notice obligations or any other WARN liability. The buyer may consider this option if it desires to close the transaction promptly without the delay, business disruption and adverse effect on employee morale that may occur if the seller provides the WARN notice. This approach is often utilized if there is a concurrent signing and closing of the acquisition agreement. Once the buyer employs the seller's employees, it is then the buyer's responsibility to comply with WARN in the event that it implements any layoffs after the closing date.

It is not uncommon in acquisition transactions for the seller and buyer to "design around" the statutory provisions so that the WARN notice is not legally required. It is important to note, however, that if the buyer represents that it will hire most of the seller's employees, it may become a "successor employer" under the National Labor Relations Act if the seller's employees are covered by a collective bargaining agreement. See the Comment to Section 3.24.

7.12 ANCILLARY AGREEMENTS

The relevant Persons shall have entered into ancillary agreements in form and substance as set forth in Exhibit 7.12 hereto.

COMMENT

This is a place in the Model Agreement to provide for a transition services agreement and similar agreements, especially any agreements that are to be entered into with parties or nonparties prior to closing.

7.13 FINANCING

Buyer shall have obtained on terms and conditions satisfactory to it all of the financing it needs in order to consummate the Contemplated Transactions and to fund the working capital requirements of the Buyer after the closing.

COMMENT

This section permits broad discretion to Buyer in determining the manner and nature of its financing. The section is sufficiently broad as to permit a seller to argue that the condition turns the agreement into a mere option to purchase. This argument is even more compelling where a general due diligence condition to closing is inserted. See the introductory Comment to Article 7. Where the buyer does not, in fact, have the necessary financing in place, either the agreement should not be executed or some condition of this sort should be inserted. An alternative that might be satisfactory to both parties is the forfeiture of a substantial earnest money deposit should the transaction fail because of the absence of financing.

A number of options are available to the seller who objects to such a broad condition. The buyer might be given a relatively short period, such as thirty or sixty days, in which the condition must either be satisfied or waived. Time periods for the buyer to reach various stages, such as a term sheet and a definitive credit agreement, might be specified. The terms of the financing might be narrowly defined so as to permit the buyer little leeway in using this condition to avoid the closing of the transaction, or the seller might require presentation by the buyer of any existing term sheet or proposal letter.

A more extreme position on the part of the seller would be to require a representation by the buyer to the effect that financing is in place or that it has sufficient resources to fund the acquisition. See the introductory Comment to Article 4.