No interest is included on the deferred payments under this Agreement. A seller may wish to bargain for interest from the closing date on the basis that the earnout payments represent deferred purchase price. See a discussion on tax principles in the commentary following Article IV.

ARTICLE III. COMPUTATION OF EBITDA

3.1 *Manner of Computation.* For purposes of this Agreement, "EBITDA" of the Acquired Business for any fiscal year shall mean its earnings from operations before interest, taxes, depreciation and amortization, calculated as if it were being operated as a separate and independent corporation. EBITDA shall be determined in accordance with generally accepted accounting principles (GAAP) as consistently applied by Seller as determined by the firm of independent certified public accountants engaged by Buyer for purposes of its own audit ("Buyer's Accountants"). In determining such EBITDA:

(a) EBITDA shall be computed without regard to "extraordinary items" of gain or loss as that term shall be defined in GAAP;

(b) EBITDA shall not include any gains, losses or profits realized from the sale of any assets other than in the ordinary course of business;

(c) No deduction shall be made for any management fees, general overhead expenses or other intercompany charges, of whatever kind or nature, charged by Buyer to the Acquired Business, except that Buyer may charge interest on any loans or advances made by Buyer to the Acquired Business in connection with its business operations at a rate of ____________;

(d) No deduction shall be made for legal or accounting fees and expenses arising out of this Agreement or the Purchase Agreement;

(e) The purchase and sales prices of goods and services sold by the Acquired Business to Buyer or its affiliates or purchased by the Acquired Business from Buyer or its affiliates shall be adjusted to reflect the amounts that the Acquired Business would have realized or paid if dealing with an independent party in an arm's-length commercial transaction.

3.2 *Time of Determination.*

(a) The EBITDA of the Acquired Business shall be determined promptly after the close of each fiscal year by an audit conducted by Buyer's Accountants. Copies of its report setting forth its computation of the EBITDA of the Acquired Business shall be submitted in writing to Seller and Buyer and, unless either Seller or Buyer notifies the other within forty-five (45) days after receipt of the report that it objects to the computation of EBITDA set forth therein, the report shall be binding and conclusive for the purposes of this Agreement. Seller shall have access to the books and records of the Acquired Business and to Buyer's Accountants' workpapers during regular business hours to verify the computation of EBITDA made by Buyer's Accountants.

(b) If either Seller or Buyer notifies the other in writing within forty-five (45) days after receipt of Buyer's Accountants' report that it objects to the computation of EBITDA set forth therein, the amount of EBITDA for the fiscal

year to which such report relates shall be determined by negotiation between Seller and Buyer. If Seller and Buyer are unable to reach agreement within thirty (30) business days after such notification, the determination of the amount of EBITDA for the period in question shall be submitted to a mutually agreeable third-party firm of independent certified public accountants ("Special Accountants") for determination, whose determination shall be binding and conclusive on the parties. If the Special Accountants determine that the EBITDA has been understated by ____________ (___%) percent or more, then Buyer shall pay the Special Accountants' fees, costs and expenses. If EBITDA has not been understated or has been understated by less than ____________ (___%) percent, then Seller shall pay the Special Accountants' fees, costs and expenses.

COMMENT:

An earnout can complicate the transition by setting up natural barriers between the buyer and the seller. A buyer will generally focus on changing certain aspects of the business in order to properly integrate it into the buyer's business. On the other hand, the seller has a need to control the carryover functions of the Acquired Business to maximize the earnout or to make its computation easier.

Disputes resolving the calculation of the earnout base may relate to the application of "generally accepted accounting principles." For example, a change in inventory accounting to bring the seller's accounting for operations into line with the buyer's accounting methods would generally be recognized as a substantial change. Other accounting "method" changes can just as easily affect the calculation without constituting changes in the particular generally accepted accounting "principles." For example, changes in the method for accounting for bad debts may not violate a "GAAP" standard or represent a change in principles. The seller may also desire that its "generally accepted accounting principles" be applied in Section 3.1 as opposed to the buyer's, as is done in Section 3.1 of this Agreement.

Section 3.2(b) provides for the appointment of "Special Accountants" to resolve disputes between Seller and Buyer in the determination of EBITDA. It is best to name the actual firm to be used during the negotiation of the agreement. As an alternative, the matter can be referred to the American Arbitration Association or a similar body for resolution.

If the seller is to continue in substantial control of operations of the Acquired Business as a division of the buyer, it may be desirable to set up a dispute-resolution mechanism regarding the effect on EBITDA of operational changes. Although the buyer will, in any event, want to implement the changes from an overall business standpoint, with such a mechanism, the seller will be in a position to identify those changes it feels will have an impact on the Earnout Payment.

If the seller is not to remain in substantial control of the Acquired Business, then it may be possible to structure a series of "not to exceed" percentages to be applied to the revenues of the business to determine cost of goods sold, SG&A expenses and the like for purposes of the determination of the Earnout Payment.

If the Acquired Business is substantially unrelated to the business activities of the buyer, there may be no disputes as to the allocation of revenues. However, where it is anticipated that the Acquired Business will provide a synergistic effect on the buyer's operations, there frequently will be disputes as to allocation of additional revenues to the total enterprise. New orders in the same product line from existing customers of the seller are readily allocated to the continuing operations of the Acquired Business. Orders for the seller's products from prior customers of the buyer that were not serviced by the seller and orders from completely new customers need to be dealt with. Notwithstanding any attention given to these potential problem areas in the agreement, disputes can still arise over failed or deferred deliveries at the end of the earnout term.

The seller may request a provision in this Agreement that the seller can prevent the buyer from effecting a subsequent acquisition that would jeopardize the accounting for the continuing operations of the Acquired Business. For example, the seller may insist on a provision which requires the buyer to maintain the Acquired Business as a separate subsidiary during the earnout period. Obviously, the buyer will resist such a provision where it would substantially interfere with its business strategy. This may ultimately force the buyer to buy out the seller's interest in the earnout arrangement.

Section 3.1 requires an audit of the Acquired Business. There are practical issues to dealing with such an audit, especially if the Acquired Business is a very small part of the buyer. Financial results of the Acquired Business may be nonmaterial within the scope of a normal audit of the buyer; therefore, requiring an audit to verify the earnout results may require significant additional work by the buyer's accountants.

The buyer should consider a "kick-out" provision if the seller is to remain in control of the Acquired Business but does not meet certain minimum performance objectives. Those minimum objectives would be lower than those necessary to meet the earnout.

If the seller is to control the continuing operations of the Acquired Business, it will need to be concerned with the financing which will be made available by the buyer. Furthermore, the seller will need protection under any employment agreement with the buyer so that its full attention to the Acquired Business will not constitute a breach of such an agreement.

The seller and the buyer may have agreed upon an earnout after a substantial due diligence period by both and after developing a working relationship. This relationship would be jeopardized if there is a change in control of the buyer. Accordingly, the seller may insist on acceleration and full vesting of the earnout payment if there is a buyer change in control. In addition, certain "liquidity events," such as an IPO, a leveraged recapitalization or other events that change the basic financial face of the buyer or the Acquired Business may justify the seller, the buyer or both in accelerating the final earnout calculation; in such event, it may be best to negotiate in advance the terms of such accelerated payment.

ARTICLE IV. MISCELLANEOUS

4.1 *Benefit of Parties.* All of the terms and provisions of this Agreement shall be binding upon and inure to the benefit of the parties and their respective permitted successors and assigns. This Agreement shall not be assignable by Buyer, but it shall be assignable by Seller to its shareholders or legal successor.

4.2 *Entire Agreement.* This Agreement contains the entire understanding of the parties with respect to the subject matter hereof and supersedes all prior agreements and understandings between the parties with respect thereto.

4.3 *Counterparts.* This Agreement may be executed simultaneously in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

4.4 *Cooperation.* During the Term, each party will cooperate with and assist the other party in taking such acts as may be appropriate to enable all parties to effect compliance with the terms of this Agreement and to carry out the true intent and purposes hereof.

4.5 *Notices.* All notices, elections, requests, demands or other communications hereunder shall be in writing and shall be deemed given at the time delivered personally or by fax or upon receipt if deposited in the United States mail, certified or registered, return receipt requested, postage prepaid addressed to the parties as follows (or to such other person or place, written notice of which any party hereto shall have given to the other):

(a) If to Seller:
Facsimile No: ____________________
____
____
____
____

(b) If to Buyer:
Facsimile No: ____________________
____
____
____
____

4.6 *Waiver of Compliance.* The party for whose benefit a warranty, representation, covenant or condition is intended may, in writing, waive any inaccuracies in the warranties, representations, covenants or conditions contained in this Agreement or waive compliance with any of the foregoing and so waive performance of any of the obligations of the other party hereto and any defaults hereunder, provided, however, that such waiver shall not affect or impair the waiving party's rights in respect to any other warranty, representation, covenant, condition or default hereunder.

4.7 *Index and Captions.* The captions of the Articles and Sections of this Agreement are solely for convenient reference and shall not be deemed to affect the meaning or interpretation of any Article or Section hereof.

IN WITNESS WHEREOF, the parties have hereunto caused this Agreement to be executed in multiple original counterparts as of the date set forth above.

SELLER

By:________________________________

BUYER

By:________________________________

COMMENT

Both the buyer and the seller may wish to consider setting aside a portion of the earnout for those management personnel who, in addition to the seller's shareholders, will continue with the Acquired Business and who are in a position to assist both the buyer and the seller's shareholders in attaining the economic objective.

This agreement has been structured as additional consideration for the purchase of the Acquired Business by Seller. It is not unusual for earnout agreements to be structured as additional compensation for ongoing management. If such management includes nonshareholders of the seller, or if fewer than all of the shareholders of the seller benefit from the agreement,

(a) it is more likely that the recipients of the payments will be treated as having ordinary income treatment for such payments than capital gain,
(b) it is less likely that the seller, if a [C] Corporation, will also have a taxable event by reason of such payments and
(c) it is more likely that the buyer will be entitled to a compensation deduction rather than being required to amortize the payment amount over the useful life of the acquired assets.

The tax effects of the Earnout Payments need to be considered.

With respect to otherwise tax-free transactions, the Original Issue Discount Rules of Section 483 of the Internal Revenue Code require that some portion of the deferred consideration, if made in stock, must be allocated to interest, reportable as such by the seller and deductible as such by the buyer. The remaining portion of the stock is generally treated as additional tax-free consideration emanating from the original purchase. The IRS has issued ruling guidelines relating to the treatment of this contingent stock in Rev. Proc. 84-42, 1984-1 C.B. 52.

In the case of a taxable transaction, the regulations dealing with installment sale transactions require not only the same interest computation (if none is stated) as in the case of a stock transaction but also require that, if deferral of gain recognition is permitted, for purposes of determining the timing of recognition of gain, the seller's basis in the assets originally transferred is to be allocated, in part, to the potential contingent payments to be received in the future. Regulation § 1.453-1(c). When the total amounts of payments are finally determined at the end of the Term, the basis is reallocated and adjustments are made to the seller's taxable income in the final year of the Term.

During the period from December 17, 1999, to December 28, 2000, an accrual basis taxpayer was not permitted to use the installment method of reporting income on the sale of assets. Accordingly, in the case of payments to be received by an accrual basis taxpayer pursuant to a transaction entered into during that period of time and which were represented by a promissory note or which were held in escrow, the tax on the portion of the consideration represented by such payments was not deferrable unless the contingencies associated with the receipt of such payments were such as to make the value of such payments "not reasonably ascertainable." However, this prohibition on the use of the installment method by accrual basis taxpayers was retroactively repealed by the Installment Tax Correction Act of 2000, thus allowing accrual taxpayers who sold assets in contingent price deals during the period when installment reporting was unavailable to file amended returns using the installment method.

Amounts to be received under a normal earnout agreement may be so incapable of being valued as of a closing date that they meet the "not reasonably ascertainable" test. In that case, the "open transaction" theory of *Burnet v. Logan*, 283 U.S. 404 (1931), would apply to defer income recognition until the year in which the amount of the payment becomes ascertainable or, possibly, until the year of receipt.

The very nature of an earnout agreement coupled with measures for determining the seller's continuing interest in the enterprise suggests that there is an enhanced risk that the buyer will be deemed a successor to the seller's liabilities as they relate to third parties, notwithstanding language in the Asset Purchase Agreement which attempts to shelter Buyer from those liabilities. A good discussion of this successor liability issue, although in the context of the purchase of a division, can be found in *Successor Liability in Asset Acquisitions Involving the Purchase of a Division* by Charles H. Brownman from the materials of the ABA Second Annual National Institute on Negotiating Business Acquisitions, November 13–14, 1997. Throughout the Model

Asset Purchase Agreement, reference to the "business" of Seller is avoided where possible to minimize the potential of encountering this issue. By the very nature of an earnout agreement, however, there must be some measure associated with the "business" of the seller.

The structure of a post-closing earnout payment must be considered particularly carefully in health-care transactions, as it could violate federal fraud and abuse laws. These laws are designed to prevent certain activities under Medicare and Medicaid, including, in part, improperly receiving remuneration for patients referrals or the provision of items or services. If an earnout payment is linked to the undertaking of these types of activities, it would be prudent to specifically confirm with health-care law counsel that they do not pose fraud and abuse concerns.

Contribution Agreement

COMMENT

The purpose of a contribution agreement is to insure to those principal shareholders of a seller that have to sign an asset purchase agreement and make representations and warranties regarding the seller and its assets and business to the buyer that all of the seller's shareholders bear their proportionate share of responsibilities and liabilities in the event of claims by the buyer that must be satisfied by the seller's shareholders. Absent a contribution agreement, if, subsequent to the closing and the distribution by a seller of the sale proceeds to its shareholders, the buyer had a right to receive an indemnification payment, the principal shareholders of seller, by virtue of the fact that they are often jointly and severally liable with the seller for breaches of representations and warranties, could be forced to make the payment to the buyer, thus receiving a smaller net pro rata return from the deal than the smaller shareholders of the seller who were lucky enough to avoid having to sign the asset purchase agreement and be jointly and severally liable with the seller for breaches of representations and warranties. A contribution agreement avoids that disparity by, in such event, making the smaller shareholders pay over to the principal shareholders their pro rata share of any indemnification payment made by the principal shareholders to the buyer.

Unlike other ancillary documents contained herein, for a variety of reasons (some of which are discussed below), contribution agreements are probably not used in the majority of asset sales. Therefore, unlike some of the other ancillary documents included herein, there is less of a "standard" form that can be used when one is called for. The following contribution agreement should not be viewed as a "standard" form that minority shareholders should be willing to sign in all (or even most) circumstances. Rather, it should be viewed only as an example of such a form in conjunction with the discussion of various issues set forth below.

Should a Contribution Agreement Be Used? The answer to that question will depend upon, inter alia, the following factors. First, is it possible to get the buyer to agree that each shareholder will sign the Purchase Agreement and be severally responsible for their pro rata share of any indemnification liability and no more? This is better for the principal shareholders because it protects them from having to enforce a contribution agreement against their fellow shareholders, but is less desirable to a buyer who would be taking both a credit risk as to each shareholder and suffering the inconvenience of having to sue each shareholder in whatever jurisdiction they can be found. Second, is it possible and practical to get each and every shareholder to sign a contribution agreement? Although it may be "fair" for majority shareholders to refuse to sign an asset purchase agreement if all other shareholders will not sign a Contribution Agreement, if a smaller shareholder won't sign, the majority shareholder will often have only the Hobbsian choice of turning down what might be a good deal or accepting more than his share of the risk (often where he doesn't perceive the risk to be material at the time) and proceeding.

Relationship with the Law of Corporate Liquidations. Related to whether a contribution agreement should be used is the issue of what will happen to the net proceeds of the transaction after the closing. Ignoring restrictions that may be placed upon the seller with respect to its liquidation by the purchase agreement itself, the seller, under the corporate laws of most states, would be able to distribute the proceeds of the asset sale to its shareholders after (and only after) establishing a reserve for actual and contingent liabilities and the costs of winding up its affairs. Depending upon both the state of the seller's incorporation and the procedures that the seller follows in implementing its liquidation, it is not inconceivable that liquidating distributions made to the seller's shareholders could be recovered by a creditor of the seller in the event that the seller is not able to satisfy its obligations to such creditor.

Ethical/Conflict-of-Interest Issues. Counsel for the seller in an asset sale will usually feel free to represent the principal shareholders in their role as parties to the asset purchase agreement as well on the theory that there are not any unwaivable conflicts between the seller and the principal shareholders. The issues become much more complex and problematic, however, with respect to a Contribution Agreement. If counsel advises the principal shareholders that they should consider seeking a Contribution Agreement, whom is he representing? It is not of any interest to the seller itself whether or not a Contribution Agreement exists. Can the seller's counsel represent the principal shareholders in negotiations with the minority shareholders? If it does, who will represent the minority shareholders? Will they be relying on the same counsel to advise them what is "fair" and "market?" Even if the seller's counsel can get the minority shareholders to pay for separate counsel, there may not be time to bring in a new counsel and negotiate all of these issues without holding up the deal, which, often, no one is willing to do. It is therefore good practice to focus early in an asset sale on the relative responsibilities of the majority and minority shareholders of the seller.

This Contribution Agreement ("Agreement"), dated as of ____________ ___, 20___ (the "Closing Date"), among ____________, an individual resident in ________ ("Significant Shareholder"); _______, an individual resident in ________ ("Retiring Shareholder"), these parties being sometimes referred to individually as "Principal Shareholder" or collectively as "Principal Shareholders", and ____________, an individual resident in ____________ ("C"); ____________, an individual resident in ____________ ("D"); ____________, an individual resident in ____________ ("E"); ____________, an individual resident in ____________ ("F"); ____________, an individual resident in ____________ ("G"); ____________, an individual resident in ____________ ("H"); ____________, an individual resident in ____________ ("I"); ____________, an individual resident in ____________ ("J", parties C, D, E, F, G, H, I and J being sometimes referred to individually as a "Minority Shareholder" or collectively as "Minority Shareholders"); and ____________, a ____________ corporation ("Seller"). The Minority Shareholders and the Principal Shareholders are sometimes referred to herein individually as a "Shareholder" and collectively as the "Shareholders."

This Agreement is ancillary to the Asset Purchase Agreement, dated ______________, 20___ (the "Asset Purchase Agreement"), among Seller, Buyer and Principal Shareholders, pursuant to which Seller has sold substantially all of its assets to Buyer. All capitalized terms used and not defined herein are used herein as defined in the Asset Purchase Agreement.

Buyer has deposited, in accordance with the terms of Section 2.3 of the Asset Purchase Agreement an amount equal to _______ dollars ($_______) with the Escrow Agent pursuant to the Escrow Agreement.

COMMENT

This recital will need to be carefully tailored to both the restrictions placed upon the seller's liquidation in the Asset Purchase Agreement (if any) and the manner in which purchase price is "held back" at the closing.

The Principal Shareholders have negotiated the Asset Purchase Agreement with Buyer and have made certain representations and warranties to Buyer, and the Minority Shareholders hereby agree to indemnify the Principal Shareholders, in each case pro rata to the respective shareholdings of each of the Minority Shareholders in Seller immediately prior to the Closing, against certain liabilities incurred by the Principal Shareholders by virtue of the Breach (or alleged Breach) of certain representations and warranties under the Asset Purchase Agreement, all claims subject to and in accordance with the terms of this Agreement.

The Parties, intending to be legally bound, hereby agree as follows:

1. BENEFICIAL OWNERSHIP

Each Principal Shareholder and Minority Shareholder represents and warrants to each other Shareholder that he is the registered and beneficial owner of such of the shares of Seller that are indicated on Schedule A annexed hereto as being owned by such Shareholder immediately prior to the Closing.

2. INDEMNIFICATION OF PRINCIPAL SHAREHOLDERS

Subject to the terms of this Agreement, (a) each Minority Shareholder shall be liable for and shall bear his "Pro Rata Share" (as defined below) of any liability ("Indemnifiable Liability") that may be incurred by a Principal Shareholder as a result of any action or claim made against such Principal Shareholder as a result of an actual or alleged breach of the representations and warranties made by the Principal Shareholders in the Asset Purchase Agreement (an "Indemnity Claim"), and (b) each Principal Shareholder shall be liable for and shall bear his Pro Rata Share of any Indemnifiable Liability which may be incurred by the other Principal Shareholder as a result of an Indemnity Claim in the case of both (a) and (b) arising by way of judgment, compromise, settlement or otherwise.

"Pro Rata Share" means a fraction, the numerator of which is the number of shares of Seller owned by such Shareholder immediately prior to the Closing and the denominator of which is the total number of issued and outstanding shares of Seller immediately prior to the Closing, as set forth on Schedule A annexed hereto, provided, however, that in no event will the maximum aggregate liability of any Minority Shareholder hereunder exceed the aggregate amount of liquidating dividends and distributions paid to the Minority Shareholder by Seller subsequent to the date hereof.

Any amount payable as aforesaid by a Shareholder to a Principal Shareholder pursuant to this Agreement shall be paid within thirty (30) days of receipt by such Shareholder of due notice hereunder given by a Principal Shareholder to the effect that such Principal Shareholder has become obligated to and will make a payment in respect of an Indemnity Claim for which he is entitled to receive contribution hereunder.

COMMENT

Section 2 raises a number of issues as to the allocation of risk between the principal shareholders and the minority shareholders. First, by making each shareholder only liable to pay over his pro rata share, the principal shareholders alone take the entire risk of a default by one or more minority shareholders. Theoretically, there is no reason why each nondefaulting shareholder should not bear his share of the burden left unpaid by the defaulting shareholder. Second, minority shareholders may object to not having their liability under Section 2 limited to monetary payments made by the principal shareholders, rather than the less tangential phrase "all liabilities," or to payments made by the principal shareholders because of actual, rather than alleged, breaches. Neither of these comments is unreasonable given that the principal shareholders have more control over what the indemnification provisions of the asset purchase agreement are; however, from the principal shareholders' standpoint, either of these changes would increase the risk that they receive less pro rata net benefit from the sale than would the minority shareholders. Finally, note that Section 2 limits the liability of a minority shareholder to its net proceeds from the liquidation of the seller. From the principal shareholders' position, it may be unfair that the principal shareholders end up with a net loss after fulfilling their indemnification obligations to the buyer, whereas the minority shareholders end up with only a loss of their investment in the seller. The response of a minority shareholder, however, presumably would be that, if there is any risk of even a total loss of the sales proceeds, they would rather the principal shareholders find another transaction.

Section 2 raises other issues with respect to its coverage. As drafted, Section 2 only makes the minority shareholders liable for breaches of representations and warranties. The minority shareholders are not asked to share any other liabilities the principal shareholders might have for the seller's obligations or liabilities, whether under the purchase agreement, by law or regulation, through the piercing of the corporate veil or otherwise. Examples could include liabilities for a breach by the seller of a covenant in the purchase agreement imposed upon the principal shareholders by virtue of the purchase agreement, environmental liability imposed upon the principal shareholders by law as persons who "own or operate" seller, post-closing liabilities of seller imposed upon the principal shareholders through the piercing of the corporate veil, etc. In certain instances, it may be appropriate for the principal shareholders to consider expanding the liabilities for which some or all of the minority shareholders will have to bear their pro rata share.

3. RESPONSIBILITY FOR CERTAIN INDEMNITY CLAIMS

(a) Notwithstanding any provision of the Asset Purchase Agreement or any other provision of this Agreement, the parties hereto expressly agree that the Minority Shareholders shall bear no liability whatsoever for the payment of any Indemnity Claim, nor shall any contribution hereunder be obtainable by the Principal Shareholders from any Minority Shareholder in respect of an Indemnity Claim relating to, arising or resulting from or otherwise attributable to any of the following eventualities:

(i) a breach or default by a Principal Shareholder of any restrictive or affirmative covenant, agreement or other obligation by which he is personally bound to Buyer (other than a covenant to indemnify and hold harmless Buyer from and against representations and warranties under the Asset Purchase Agreement not excluded by clause (iii) below);

(ii) any Damages resulting, whether directly or indirectly, from any equitable remedy obtained by Buyer and enforced against either of the Principal Shareholders; or

(iii) the breach of any representation and/or warranty made by the Principal Shareholders under the Asset Purchase Agreement (A) that the Principal Shareholder seeking contribution hereunder knew to be false at the time he made it, or (B) relating to the Principal Shareholder seeking contribution himself, rather than as to Seller or its properties, assets, prospects and/or business.

COMMENT

Section 3(a) is a critical part of the Contribution Agreement because it sets forth exceptions to the scope of coverage set forth in Section 2. The most controversial issued raised by these Section 3(a) exceptions is whether the principal shareholder may seek contribution in an instance where he knew that the representation was false when he made it. The minority shareholders may argue that such an exclusion is too narrow and that they should not have to contribute where the principal shareholder should have known, by the exercise of due diligence, that the representation was, or that there was a reasonable likelihood that the representation was, false at the time it was made. On the other hand, the principal shareholders will argue both that the burden of even an intentional falsehood that got the seller a better price should be borne equally by all of the shareholders and that the standard "knew" is unfair to them because they might have to defend against a claim that they "knew" when they did not and could be unable to receive contribution where a finder of fact incorrectly decides that the principal shareholders "must have" known of the falsehood. The principal shareholder will often argue that he would be acting against his own best interest to ever make a knowingly false representation where he will be sued for the consequences of the same before being able to turn to the minority shareholders for contribution.

In addition, where the scope of Section 2 is expanded to include liabilities other than those arising for breaches of representations and warranties under the purchase agreement, consideration should be given to whether any additional exceptions are appropriate under Section 3(a). For example, if Section 2 provided the principal shareholders protection against liability of the seller imposed upon them by law or regulation, counsel for the minority shareholders may want to exclude known (by the principal shareholders) but undisclosed (to the minority shareholders) liabilities at the time this agreement is signed and/or liabilities caused by acts and/or omissions (possibly tied into a standard of care) of the principal shareholders.

(b) The Shareholders agree to use their reasonable efforts to cause any Indemnity Claim for which the Minority Shareholders will be liable hereunder to be satisfied out of funds held by the Escrow Agent, or the assets of Seller, to the extent either is then available, rather than by the Shareholders.

COMMENT

In an asset deal, unlike a stock deal, the best way to avoid many of these issues and the need for a Contribution Agreement entirely is to agree among the shareholders to keep an adequate reserve in the seller to cover both indemnification claims and the costs of defending and/or resolving such claims for an adequate period of time. Selling shareholders, however, will often (if not usually) be anxious to "get what is theirs" quickly. The proposed Section 3(b) is principally a reminder to counsel to address this issue. Whether the section as drafted has any meaning is dependent upon how much money will be retained in the seller as well as whether the buyer has access to an escrow account or a promissory note to offset with its indemnification claims.

4. NOTICE AND DEFENSE OF THIRD-PARTY CLAIMS

Promptly after becoming aware of any Third-Party Claim that any Principal Shareholder has reason to believe may result in an Indemnity Claim and a claim for contribution pursuant to this Agreement, such Principal Shareholder shall give notice thereof to each other Shareholder and Seller setting forth in reasonable detail the nature of such action or claim for Damages, including copies of any written correspondence relating thereto that such Principal Shareholder has sent or received; provided, however, that the failure to provide such notice shall not be actionable by, or provide an affirmative defense in favor of, any party entitled to receive such notice, unless such failure actually prejudices such party.

The Retiring Shareholder shall assume and control the defense with respect to any such Indemnity Claim or action with counsel to be chosen by him. The Significant Shareholder and the Minority Shareholders hereby constitute and appoint for such purpose the Retiring Shareholder as their representative and true and lawful attorney in fact, with full power to act in their respective names and on their respective behalves to take all measures, to do such acts and to execute such documents as may be necessary or desirable to give full and complete effect to the foregoing mandate with which the Retiring Shareholder is hereby charged. All acts and decisions of the Retiring Shareholder in respect of the defense as aforesaid of any such claim shall be final and binding upon the Principal Shareholders and the Minority Shareholders.

The reasonable costs and expenses, including legal fees and disbursements, incurred in connection with such defense shall be allocated among and borne by the parties hereto based upon their respective Pro Rata Share. The Significant Shareholder and any Minority Shareholder shall be entitled to participate in such defense at their respective expense.

COMMENT

Section 4 proposes that the retiring shareholder be put in charge of all Indemnity Claims and that both the significant shareholder and the minority shareholder shall be bound by whatever results he produces. Such a provision may not be acceptable to any party. Given the instant facts (specifically that the significant shareholder will be continuing with the buyer and may not have the same incentive as the retiring shareholder to vigorously contest all claims), however, it may be the best resolution to a complicated problem. For other fact patterns, entirely different indemnification procedures may be appropriate. In addition, the parties may want to integrate this provision with Section 13.16 of the Model Asset Purchase Agreement (and, in any event, the commentary to said section is relevant to this determination).

5. NOTICES

All notices, consents, waivers and other communications under this Agreement must be in writing and will be deemed to have been duly given when:

(a) delivered by hand (with written confirmation of receipt);

(b) sent by telecopier (with written confirmation of receipt), provided that a copy is mailed by registered mail, return receipt requested; or

(c) received by the addressee, if sent by a nationally recognized overnight delivery service (receipt requested),

in each case to the appropriate addresses and telecopier numbers set forth below (or to such other addresses and telecopier numbers as a party may designate by notice to the other parties):

Significant Shareholder:

Retiring Shareholder:

Minority Shareholder:

Any party hereto may change his address for the purpose of notice by due notice hereunder to all of the other parties hereto.

6. DISPUTE RESOLUTION

Any action or proceeding seeking to enforce any provision of, or based upon any right arising out of, this Agreement shall be settled by binding arbitration by a panel of [three (3) arbitrators] in accordance with the Commercial Arbitration Rules of the American Arbitration Association and governed by the laws of the State of _______ (without regard to the choice of law rules or principles of that jurisdiction). Judgment upon the award may be entered in any court located in the State of _______, County of ____________, and all the parties hereto hereby consent to submit to the jurisdiction of such courts and expressly waive any objections or defense based upon lack of personal jurisdiction or venue.

[Each of the plaintiff and defendant party to the arbitration shall select one (1) arbitrator (or where multiple plaintiffs and/or defendants exist, one (1) arbitrator shall be chosen collectively by such parties comprising the plaintiffs and one (1) arbitrator shall be chosen collectively by those parties comprising the defendants) and then the two (2) arbitrators shall mutually agree upon the third arbitrator. Where no agreement can be reached on the selection of either a third arbitrator or an ar-

bitrator to be named by either a group of plaintiffs or a group of defendants, any implicated party may apply to a judge of the courts of the State of _______, County of ____________, to name an arbitrator. The location of any arbitration shall be ____________, in the State of _______.] Process in any such action or proceeding may be served on any party anywhere in the world.

COMMENT

Even where disputes under the Model Asset Purchase Agreement are governed by judicial proceedings, it may be more appropriate for the Contribution Agreement to be governed by arbitration. An arbitration may be better because of the large amount of parties, the fact that the speed of a remedy may be paramount if the dispute is over how to defend the buyer's claim and the fact that minority shareholders may be more sensitive to litigation costs than the buyer and the seller under the Asset Purchase Agreement. Of course, not all practitioners would agree that arbitration would better address these concerns. See the commentary to Section 13.4 of the Model Asset Purchase Agreement for an alternative, and more detailed, arbitration provision. If arbitration is used, however, the parties will need to consider whether one arbitrator, rather than a three-arbitrator panel, would make more sense.

7. COUNTERPARTS

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

8. SECTION HEADINGS

The headings of this Agreement are provided for convenience only and will not affect its construction or interpretation.

9. WAIVERS AND OMISSIONS

The rights and remedies of the parties to this Agreement are cumulative and not alternative. Neither the failure nor any delay by any party hereto in exercising any right, power or privilege under this Agreement or the documents referred to in this Agreement will operate as a waiver of such right, power or privilege will preclude any other or further exercise of such right, power or privilege or the exercise of any other right, power or privilege. To the maximum extent permitted by applicable law:

(a) No claim or right arising out of this Agreement or the documents referred to in this Agreement can be discharged by a party hereto, in whole or in part, by a waiver or renunciation of the claim or right unless in writing signed by the other parties hereto;

(b) no waiver that may be given by a party hereto will be applicable except in the specific instance for which it is given; and

(c) no notice to or demand on one party hereto will be deemed to be a waiver of any obligation of such party or of the right of the party giving such notice or demand to take further action without notice or demand as provided in this Agreement or the documents referred to in this Agreement.

10. EXCLUSIVE AGREEMENT AND MODIFICATION

This Agreement supersedes all prior agreements among the parties hereto with respect to its subject matter and constitutes (along with the documents referred to in this Agreement) a complete and exclusive statement of the terms of the agreement between the parties hereto with respect to its subject matter. This Agreement may not be amended except by a written agreement executed by the Principal Shareholders and the Minority Shareholders.

11. GOVERNING LAW

This Agreement shall be governed by the laws of the State of ___________ without regard to conflicts of law principles.

IN WITNESS WHEREOF, the parties hereto have executed and delivered this Agreement as of the date first written above.

Significant Shareholder

____

Retiring Shareholder

____

Minority Shareholders

____

____

____

____

____

____

____

____

SCHEDULE A

Name of Shareholder	Number of Shares Held	Pro Rata Share
[Significant Shareholder]		45%
[Retiring Shareholder]		45%
C		1.25%
D		1.25%
E		1.25%
F		1.25%
G		1.25%
H		1.25%
I		1.25%
J		1.25%