BREAKING UP IS(N'T) HARD TO DO

CLOSELY-HELD BUSINESS DIVORCES

BY

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CLOSELY-HELD BUSINESS DIVORCES

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Business Divorce in the Closely Held Business

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MADELYN SPATT SHULMAN is a principal of the firm of Madelyn Spatt Shulman P.C. in Jericho, New York concentrating in business representation, tax law, real estate, estate planning and business and securities litigation. She obtained her Juris Doctor degree cum laude and L.L.M. degree in Taxation from New York University School of Law where she was a member of the Law Review and of the honorary society Order of the Coif. She is a graduate of the University of Michigan (B.A.) and holds a M.A. in Communications from Stanford University.

Ms. Shulman represents numerous closely held businesses [including venture capital and investment entities with dozens of shareholders] and their owners, in their transactional and general business matters, planning for the future of their companies and in estate and tax planning for individual owners and their families. She represents clients in N.A.S.D. and N.Y.S.E. securities arbitrations and before the Internal Revenue Service. She lectures frequently to professional and business groups on a wide variety of legal, business and tax topics.

Since 2002, Ms. Shulman has served as chair of the Corporation Law Committee of the Nassau County Bar Association. She also acts as co-chair of the NCBA Banking and Securities law committee and is a member of the Tax Committee, as well as a participant in the Internal Revenue Service for local representation. She is a member of the tax and business law sections of the American Bar Association [small business and unincorporated organization committees]. She is a long time member of the Board of Directors of Women Economic Developers of Long Island (AWEDLI@) and has also served on the boards of directors of the National Association of Women Business Owners-LI and several religious and community groups. She is listed in Who's Who in American Law.

General Considerations: **Business divorces often pose difficult challenges to the business lawyer. The parties often refuse to be in the same room with each other. This is an opportunity for the company lawyer to act as a mediator and to help develop a conflict resolution consensus. These disputes raise a variety of legal issues that must be considered and disposed of. Failure to consider all of these issues may result in a loss for the client and criticism (or worse) of the lawyer's work.**

This panel will deal with a variety of business entities, including closely held corporations (both "C" and "S"), limited liability companies ("LLCs"), limited liability partnerships ("LLPs"), general and limited partnerships. For purposes of reference, we will refer to the major participants as "Partners" regardless of whether they are officers or stockholders of a corporation, partners in a partnership, members of a LLC or other titles. We will refer to the corporation, partnership, LLC or LLP entity as the "Business." Despite this writer's obvious bias, we will refer to counsel as "he."

I. Ethical Issues for Counsel in the Business "Divorce."

1.1 Who is my client?

As Business counsel, the attorney should consider which parties he represents in the "breakup" transaction and what consents he must obtain. An attorney for a closely held Business may have represented the various Partners and members of their families in a variety of transactions. He will be privy to Business and Partner secrets. He/she may have performed other work for the individuals, including estate planning, real property and even family law matters. As soon as the conflict arises, counsel should sit down with each of the parties, explain the conflicts and determine which party(ies) he/she will represent. All parties should sign a consent to representation and "conflict" letter.

1.2 Discuss the need for Separate Counsel.

Counsel must discuss with each party the need for separate counsel for parties with diverse interests. It is likely the Business attorney will remain only in that role, with separate counsel retained by each of the disputing Partners and even by family members with adverse interests (such as divorcing spouses, children/parents with trust or contingent interests in the Business, etc.). The responsibilities of each counsel may be difficult to coordinate.

II. Research for Counsel.

2.1. Determine the "Necessary Parties."

.

The following parties may need to consent and/or participate in the "separation" or "buyout:"

All members, shareholders, partners, etc.
Business subsidiaries and parent entities.
Related entities owning real estate or other assets leased to the operating Business.
Guarantors of Business debt.
Major creditors and/or lessors Note that most Bank credit agreements and mortgages, and most commercial leases, require lender/lessor consent in the event of changes of control in the Business entity.

2.2 Compile, review and consider all Contracts between the parties and Contracts with Third Parties that affect the rights of the separating Partners.

Contracts among/between the Partners may include operating/partnership/shareholder, employment and confidentiality agreements.
Third party contracts include guarantees of corporate debt and leasehold interests and contracts with third parties with reference one or more of the Partners

2.3. Consider and analyze the Statutory Framework.

(1) The law of the organizational state can sometimes trump the operating/partnership/shareholder agreement.

(2) The date of entity organization may be relevant - e.g. grandfathering of certain stock corporation laws.

(3) How serious is the threat of statutory dissolution?

(4) What is the impact of trade secret laws and the accompanying "handcuffs."

2. 4. Common Law Issues.

- Are existing non-competes enforceable in a court-ordered buyout situation? Statutes and case law may govern this issue?
- Statutes and case law may govern issues of breach of fiduciary duty.
- loss of key employee may trigger loss of service contracts with

"key man" provisions
- Statute and case law may provide for minority owner cash-out mergers.
- Breakup (change of control) may trigger debt default.

2.5. Tax Issues at the Entity Level and Individual Income Taxes.

- dividend treatment of buyout price?
- allocation of buy-out payments
-s corp. retained earnings - who gets them?
- determining income tax allocation for mid-tax year break-ups
-estate and gift tax issues
- future tax returns and tax liabilities, including accounting fees

2. 6. Valuation Issues.

The method or formula for fixing the transfer price of shares is one of the key decisions made by participants in entering into a share transfer restriction or buy-out agreement.
All of the participants understand the lack of a market for shares of a close corporation. Unfortunately, the actual Business buy-out usually occurs many years after the agreement, at a time when the value of the interests may have greatly changed.

Buy-sell agreements are usually designed to keep strangers out and to provide liquidity upon the death or disability of a participant. Frequently, the agreements are funded with life or disability insurance, which funding sources become useless when a Partner is leaving due to dissension or other reason.

Valuation mechanisms used in buy-sell agreements include book values, adjustments to book value for goodwill or other items, setting a price in the agreement (hopefully with periodic revaluation as circumstances change), capitalized earnings, third party offers, appraisal by an expert or named individual, use of tax valuations or various combinations. Courts, usually deciding the issue under divisive circumstances, may use other criteria.

Hopefully, agreements will provide a basis for Partner negotiations, even if the payout methodology or other portions are inapplicable in the specific situation. The agreement may be enforceable in a potential court action.

III. Practical Issues to Consider in the Transaction.

3.1. Timing – Consider tax planning and loan covenant issues.

3.2. Data/Files.

Establish protocols for dividing and/or sharing, keeping in mind customer/client confidentiality agreements.

3.3. Ownership of Key Assets.

Does the departing Partner own important property that needs to be transferred to the Business and/or licensed to the Business as a condition of the buyout?

3.4. Personal Liabilities.

What Business liabilities are guaranteed by individuals? Departing Partner may be liable on third party financing and leases. Can they be released by the third parties? This is usually unlikely with banks. Discuss indemnifications and similar arrangements.

3.5. Company Liabilities.

Who will assume and/or pay company Business obligations? Will the remaining Partner(s) assume and pay all of the liabilities or are some of them to be paid off in the transition?

3.6. Insurance.

(1) You may by required to terminate or change business coverage.

(2) Obtain professional liability tail policies for departing professionals.

(3) Consider transfer or termination of health insurance and other group benefits. This is frequently a problem where departing Partners are in their 50s and early 60s and may find it difficult to obtain replacement coverage.

(4) Policies purchased to fund "buyout" agreements may have to be re-assigned to new owners. Be cognizant of tax laws dealing with transfer and/or sale of life insurance policies for value. A tax memo may be required.

3.7. Regulatory Issues.

Transfer/terminate permits or licenses.

3.8. Employees.

Protocol for separating parties offering employment to company employees. Question of "pirating" company employees. In addition, the separating Partner may also be an employee and trigger other liabilities. For example: In Connecticut, the buyout of an owner may trigger unemployment claim.

3.9. Customers/Clients.

Protocol for dividing and/or soliciting clients of the Business. Is this a straight "buyout" with no interference with Business clients or is this a separation with various parties taking their share of the customers or clients?.

3.10. Non-Competition, Non-Solicitation, Non-Disclosure and Non-Interference..

Will these be categorized by client, customer, referral source, line of business, geographic area. Non-interference clauses pertain to vendors, professionals, referral sources.

3.11. Contingent Business Liabilities.

One of the most contentious areas for negotiation is which contingent liabilities will remain the responsibility of the departing Partner. The most applicable potential contingencies are:

(1) Tax liabilities based upon audit or other governmental determination with respect to tax years during which the departing Partner was a participant. These may include income tax liabilities for the entity, disallowance of entity deductions which would increase individual tax liabilities, sales and/or use tax liabilities and others;

(2) Environmental liabilities arising out of the operation of the Business. Under federal and many state environmental statutes, prior owners are responsible for environmental liabilities. Businesses which own or lease real property, conduct manufacturing or other potentially environmentally difficult operations will face potential liability.

(3) Litigation and claims arising out of operation of the Business prior to the separation. Litigation may include employment claims by disgruntled employees, claims of sexual harassment, various discrimination claims. These are common in companies where prior Partners never became accustomed to these statutes.

3.12. Real estate issues.

(1) Sale of a 50% interest in an entity which owns real estate may trigger conveyance tax liability under state or local statutes. This can be substantial. Consider whose responsibility it will be to file transfer tax returns and to pay the applicable tax, or whether a smaller ownership percentage should be transferred to avoid this taxation.

(2) Consider the impact on Business leases and subleases among affiliated entities.

3.13. Future Revenue.

Collections and distribution.

3.14. Future accounting fees, tax returns, tax liability and expense reimbursement.

3.15. Bank Accounts.

Changing accounts and/or signatories.

3.16. Furniture, Fixtures and Equipment.

computers, equipment, machinery, tools, dies – division among parties

3.17. Miscellaneous Items to cover in the Separation Agreement.

These items do not necessarily require extensive negotiation, but should be dealt with

- **Non-Disparagement**
- **Confidentiality**
- **Unemployment Compensation – preclude retiring principals from filing**
- **Future filings with Secretary of State and other government subdivisions**
- **Company Line – Agreed script for employees, customers/clients and vendors**
- **Covenant by departing party to provide his/her continuing cooperation.**
- **Mutual releases?**
- **Resignation by departing party as officer and director**

- Representations and warranties regarding promises made by the departing party while a company officer.

sions.

diation and/or arbitration if negotiations fail?
ispute resolution provisions in existing stockholder/organizational/operating/partnership or similar

v Remedies for Stockholder Dissension.

ar with the statutory and case law governing involuntary dissolutions in the operative state. Although stockholder/partner disputes rarely go to litigation, operative statutes and law, along with the Business' internal contracts among the parties, provide the framework for negotiation, and/or the basis for valuation and payments.

rporate dissolution statutes.

statutes. These statutes, which provide for judicial dissolution upon the occurrence of an even division or
holders (sometimes with time requirements or requirements for irreparable injury.

lution by minority shareholders aggrieved by illegal, fraudulent or oppressive conduct of those in control
ay include frustration of reasonable economic expectations of shareholders.

waste or misapplication or corporate assets.

abandonment of corporate objectives.

f creditors or state officials.

emedies to involuntary dissolution.

f one or more shareholders by the corporation or other shareholders. In some states, including New York,
reholders are provided the right by statute to terminate an involuntary dissolution proceeding by buying
oning for dissolution at a price set by the court.
n Law ("BCL")§1104(a). [Note the strategic impact of these statutes. A shareholder who has a choice of
lock" provisions may be entitled to dissolution while the shareholder who petitions under the egregious
ter-petition to compel purchase of shares, the delay inherent in a long court proceeding a potential low

sional director or other means of breaking shareholder deadlock.

ian, interim receiver or similar official to continue to operate the corporation as a going concern until the

edies, such as rescinding stock issues, amending charter provisions.

for Close Corporations.

statutes in the various states usually require the corporation to be formed as a "close corporation" or at framework. See Delaware General Corporation Law ("DGCL") §§341 et.seq.(Close Corporations; ware model is found in fifteen states; the Model Statutory Close Corporation Supplement ("MSCCS") has issouri, Montana, South Carolina, Wyoming and Wisconsin. Other states, such as New York, build rovisions into various sections of the BCL.

n of remedy to the discretion of the courts. The MSCCS divides relief into three categories: (1) ordinary provisional director or custodian and other judicial orders; (2) mandatory share repurchase, considered ry dissolution. See MSCCS §§41, 42, 43.

provides a broader mandate to the courts.

Agreement on Statutory and Judicial Remedies.

will frequently set forth valuation criteria, requirements for sale or purchase of stock in specified equire arbitration of disputes. In addition, agreements may specifically limit a shareholder's right to seek nd statutes differ on whether a sale-purchase will be enforceable where the aggrieved party cites criteria s dissolution or receivership. Both statutes and case law appear to look at the reasonableness or ell in the specific circumstances. Gunderson v. Alliance of Computer Professionals, 628 NW2d 173, 190 shes employee who invests small percentage with shareholder who invested in company to procure stead & Assoc., Inc. 21 P3d 178 (Or App 2001) (death or disability provisions not controlling for claim ppression); In re Dissolution of Penepent Corp., Inc., 750 NE2d 47, 51 (NY 2001) (Rights of minority §1104-a petition where other shareholder elected to purchase survive the death of the original petitioner).

tutes and the case law to the question of Business "divorce" is that these situations rarely arise without one) of various types of misconduct or oppression in the Business which could trigger a dissolution or other e other party will analyze any existing agreements to determine their enforceability under the specific of practice, this practitioner has never seen the existing agreement(s), most of which were drafted years pdated, followed to the letter. At best, they provide guidelines to the rights of the parties and to their luation for purchase.

rning LLCs.

LLCs frequently take different positions from corporate cases and statutes, in some cases dealing with the intersection of partnership law.

uciary Duty.

anagers to discharge a duty in good faith or otherwise subject them to fiduciary duty. An LLC operating rate the fiduciary duty of the state. Some courts parallel the role of a member-managed LLC with the role corporation. See, however. Suntech Processing Systems, LLC v. Sun Communications, Inc., 2000 WL o fiduciary duty as a matter of law; remanded to trial court for a determination on the facts.

ay provide for derivative suits by members.

/ithdraw.

e been changed since the IRS adopted its "check the box" regulations in 1996 to make it more difficult for ng the 1980s and early 1990s, LLC statutes were based upon the "easy exit" and shared control provisions aracteristics were used by planners to defeat corporate tax treatment of the entities. [Remember the four connected pass through tax treatment from partnership governance, many states moved toward more imited Liability Company Act §801 was amended in 1996 to reflect this. The rights of a member may be C was formed prior to or after the statutory change. For example, NY Limited Liability Company Law Withdrawal of a Member" and provides that a member may withdraw as a member of a limited liability the operating agreement. Otherwise, the member may not withdraw prior to dissolution and winding up. t "A limited liability company whose original articles of organization were filed with the secretary of state ective date of this subdivision (in this case August 31, 1999) shall continue to be governed by this section as all not be governed by this section, unless otherwise provided in the operating agreement." Prior to the operating agreement provided otherwise, a member could withdraw upon six months notice.

dies.

y find judicial authority to provide equitable relief under the LLC statutes. In New York, for example, the orporation laws specifically provide for the invocation of a receivership; the LLCL does not. New York e a receivership on an LLC in applicable circumstances. Other state courts differ. In re KSI Rockville, ngrun (NYS 2d Dept. 2003-Slip Opinion) (Index No. 5332/99). This case and its predecessors grew out of a LLCL §702 for dissolution of a limited liability company which was consolidated with an action for an ppointed a receiver who managed the company's assets (46 apartments in a Nassau County cooperative re than two years pending resolution. The Appellate Division confirmed the interpretation by the trial efendant Eichengrun, who formed the LLC and recruited investors, had no interest in the assets or ontributed services rather than cash.

e" Agreements.

strife, where no arrangements have been made which anticipate the event (such as provisions in buyout agreements, arbitration arrangements, etc.) counsel may offer suggestions to divide the Business with least damage to the participants.

n or "spin off" of the assets of the Business.

ay be spun off into separate corporations or other entities so each Partner or group of Partners can remain "spinoff" corporations is governed by complex tax law requirements. Otherwise, the spinoff will be a " corporation. In some cases, the Partners may operate in a large, and potentially valuable, piece of real rovide liquidity for the ongoing business(es) or to purchase the interest of a departing Partner. Spinoff non in professional practices, especially those organized as partnerships, LLPs or PLLCs, where each f the clients or customers and the other Business assets can be easily divided. The Partners may agree that space, or each group may obtain smaller spaces.

siness Interests by the other Partner (s).

artners or shareholders purchases the Business interests of the other. These agreements are structured as r partnership interest purchase agreements, although many of the standard "representations and due to the close relationship of the departing Partner to the Business.

blem. A large percentage of the liquidation value of a Business is frequently more than the remaining For most owners of closely held Businesses, the value of the Business interest is the largest portion of their de wealth to fund a buy-out. The Business itself may not be capable of generating profits large enough to

siness Interests by the Entity or through Other Compensation.

e able to compensate a departing Partner by a combination of redemption of the Partner's interest, npensation, long term employment and/or consulting contracts, pensions or a "spin-off" of specific assets siness entity. The goal of the arrangement is frequently to compensate the departing Partner through tax- siness. The normal considerations of deductibility to the entity and taxable status to the individual apply.

Key to Success.

l above have advantages and disadvantages in each specific situation. Remember that no method is the t solution is to combine several of the methods listed above so that the parties can compensate the e best extent possible and reach a resolution. Skillfully utilizing tax considerations of various types of bridge" the gap between the parties. Few Business Partners are so estranged that they do not appreciate g their agreement by minimizing taxation to one party or the other. Research specific Partner or Business le tax loss carryforward opportunities, the ability to distribute "S" corporation retained earnings (not ner, who has already been taxed on his share), spin-offs of assets not integral to the business, employment ties, etc.

tiation.

r will have a better bargaining position than the other. In many situations a Partner is being forced out because other Partners have greater control, ability or access to institutional successors (such as adult children with business talent in the family business arena).

ess arena, counsel's most important goal may not be to maximize your client's economic benefit at the expense of the other party. Like the divorce arena, where feuding parties share mutual interests in family, children, etc., the Partners in a closely held Business may share close family and relationship ties. Other family members may be impacted by the Business divorce. You should discuss with your client that there should be fairness limits to the transaction.

will be more skilled than the others. Other times, negotiations will be stalled because counsel cannot agree on specific terms of the agreement which may be unintelligible to the parties.

o may have worked with various parties for years, should be cognizant of the long term toll of this transaction. It may be more important for the parties to believe that they dealt fairly with each other than to gain a specific advantage. Decisions are made in the heat of a dispute which the parties may regret later and for which they may blame the attorneys.

SAMPLE PURCHASE AGREEMENT FOR DEPARTING SHAREHOLDER OF NY "S" CORPORATION

AGREEMENT OF PURCHASE AND SALE OF SHARES

THIS AGREEMENT OF PURCHASE AND SALE OF SHARES, dated as of the ____ day of __________ (this "Agreement"), by and among JOHN SMITH, an individual residing at __________________________, New York ("Mr. Smith" or "Seller") and [AGCO LLC], a Delaware limited liability company ("Buyer"), and, with respect to Article 8 hereof, only Bob Ruby.

W I T N E S S E T H:

WHEREAS, Seller owns, of record and beneficially, _____ shares of common stock, par value $___ per share, of Carter Associates, Inc., an S-corporation incorporated under the laws of the State of New York (the "Shares");

WHEREAS, Buyer desires to purchase from Seller, and Seller desires to sell to Buyer, all the Shares, upon the terms and conditions of this Agreement; and

WHEREAS, certain capitalized terms used herein have the meanings specified in Article 9 of this Agreement;

NOW, THEREFORE, in consideration of the mutual covenants and agreements hereinafter set forth, the parties hereto hereby agree as follows:

ARTICLE 1

SALE OF SHARES

1.1 The Shares. Subject to and upon the terms and conditions of this Agreement, Seller hereby sells, transfers, conveys, assigns and delivers to Buyer, and Buyer hereby purchases, effective as of midnight, December 31, 2002 (the "Effective Time"), all the Shares.

ARTICLE 2

PURCHASE PRICE

2.1 Amount of Purchase Price. Subject to and upon the terms and conditions of this Agreement, Buyer hereby pays to Seller, in full payment for all the Shares, and in consideration of the covenants set forth in Article 6 hereof, and in reliance upon the representations and warranties made herein by Seller, an aggregate of $1,500,000 (one million and five hundred thousand dollars) (the "Purchase Price") payable by the delivery of a promissory note from Buyer to Seller in principal amount of $1,500,000 (one million and five hundred thousand dollars), in the form of Exhibit 2.1

attached hereto (the "Note"). The allocation of the Note between the purchase price for the Shares and the covenants set forth in Article 6 hereof is set forth in Schedule 2.1 attached hereto.

ARTICLE 3

CLOSING; DELIVERIES

3.1 Closing.

(a) The Closing under this Agreement (the "Closing") shall take place at the offices of counsel to Seller, Messrs. Jones, Jones & Jones, at 90 Broadway, Meadow, New York, concurrently with the execution and delivery hereof and effective as of the Effective Time.

3.2 Seller's Deliveries. At the Closing, Seller shall deliver to Buyer:

(a) certificates representing all the Shares, all of which shall be duly endorsed in blank or, in the alternative, with stock powers affixed thereto in proper form for transfer, accompanied by all requisite stock transfer stamps, and instruments, each in the form of Exhibit 3.2(a) attached hereto, executed by each of the Former Shareholders, acknowledging that he or she has irrevocably transferred all of the Shares ever owned by him or her to the Seller with full knowledge of the terms of this Agreement;

(b) duly executed resignations of Seller and each of the Former Shareholders from any and all positions as officers, employees and/or directors of the Company, and a general release executed by each of the Former Shareholders in favor of the Company, Buyer and Messrs. Bob Ruby and Alan Ruby;

(c) duly executed acknowledgments of the termination and satisfaction in full of all Shareholder Loans, in form and substance satisfactory to Buyer;

(d) a duly executed termination and cancellation of any and all agreements among the Company, Bob Ruby and any one or more of Seller and/or Former Shareholders, as may be requested by Buyer, including but not limited to the Shareholders Agreement, dated as of ________________, 1998, among the Company, Bob Ruby and Seller;

(e) the Mortgage in the form of Exhibit 3.2(e) attached hereto (the "Second Mortgage"), duly executed by Seller;

(f) the Intercreditor and Subordination Agreement in the form of Exhibit 3.2(f) attached hereto, duly executed by Seller;

(g) each of the Pledge Agreements in the form of Exhibit 3.2(g) attached hereto (the "Pledge Agreements"), duly executed by Seller;

(h) the Subordinated Security Agreement in the form of Exhibit 3.2(h) attached hereto (the "Security Agreement"), duly executed by Seller;

(i) a duly executed assignment of the B. Ruby Policies to Bob Ruby in the form of Exhibit 3.2(i)(i) attached hereto, and consents to the transfer of the B. Ruby Policies after the Closing, in the form of Exhibit 3.2(i)(ii) attached hereto, each duly executed by Seller;

(j) a duly executed Confidentiality and Non-competition Agreement in the form of Exhibit 3.2(j) attached hereto, duly executed by each Former Shareholder;

(k) counterparts of the instruments and agreements referred to in Section 3.3(f) hereof, duly executed by Seller and the Escrow Agent (as defined herein);

(l) the Agreement of the Company and Seller with respect to the allocation of taxable income of the Company, in the form of Exhibit 3.2(l) attached hereto (the "Taxable Income Allocation Agreement"), executed by Seller; and

(m) all other documents required by the terms of this Agreement to be delivered to Buyer at the Closing.

3.3 Buyer's Deliveries. At the Closing, Buyer shall deliver to or cause to be delivered to Seller:

(a) the Note, duly executed by Buyer;

(b) the Pledge Agreements, duly executed by the respective pledgors thereunder;

(c) the Security Agreement, duly executed by the Company;

(d) the Company Guaranty in the form of Exhibit 3.3(d)(i) attached hereto (the "Company Guaranty"), duly executed by the Company; the Bob Ruby Guaranty in the form of Exhibit 3.3(d)(ii) attached hereto (the "B. Ruby Guaranty"), duly executed by Bob Ruby; and the Alan Ruby Guaranty in the form of Exhibit 3.3(d)(iii) attached hereto (the "A. Ruby Guaranty"), duly executed by Alan Ruby;

(e) duly executed assignments of the Smith Policies to Seller or his designee, in form of Exhibit 3.3.(e) attached hereto;

(f) Collateral assignments of the B. Ruby Policies in the forms included as Exhibit 3.3(f)(i) attached hereto, duly executed by Bob Ruby, and the Life Insurance Collateral Assignment and Escrow Agreement related thereto in the form of Exhibit 3.3(f)(ii) attached hereto (the "Insurance Escrow Agreement"), and naming

[Certilman, Balin, Adler & Hyman, LLP,] as the escrow agent thereunder (the "Escrow Agent");

(g) the Taxable Income Allocation Agreement, executed by the Company; and

(h) all other documents required by the terms of this Agreement to be delivered to Seller at the Closing.

3.4 Further Assurances. At any time and from time to time after the Closing, at Buyer's request, and without further consideration, the Seller will execute and deliver such other instruments of sale, transfer, conveyance, assignment and confirmation, and take such actions, as Buyer may reasonably deem necessary or desirable in order more effectively to transfer, convey and assign to Buyer, and to confirm Buyer's title to, all the Shares and to assist Buyer in exercising all rights with respect thereto.

3.5 Possible Family Reorganization Transaction. It is expressly understood and agreed that the business of the Company may, through one or more transactions be liquidated and/or transferred to and assumed by a limited liability company or other entity (a "Successor Entity") controlled by one or more members of the Ruby family and/or one or more trusts or other entities primarily for the benefit of or primarily owned or controlled by one or more members of the Ruby family or any such trust(s) (each a "Family Entity"), and that title to some or all of the real estate, plants or buildings of the Company may be transferred to a Family Entity and leased back to the Company or any such Successor Entity (any such transaction(s), a "Family Reorganization Transaction"). All references in this Agreement, to the extent applicable to periods or matters after the Closing, shall be deemed to include any such Successor Entity.

ARTICLE 4

REPRESENTATIONS AND WARRANTIES OF SELLER

Seller hereby represents and warrants to Buyer as follows:

4.1 Title to Shares. Seller is the lawful record and beneficial owner of the Shares set forth opposite Seller's name on Schedule 2.1, free and clear of any and all Liens. The Shares constitute fifty percent (50%) of the issued and outstanding capital stock of the Company, excluding any shares of capital stock of the Company caused to be issued by Mr. Bob Ruby without the knowledge of Seller. Upon delivery of and payment for such Shares as herein provided, Buyer will acquire good and marketable title thereto, free and clear of all Liens. Upon the consummation of the Transactions (a) Buyer will own beneficially and of record all the Shares, free and clear of any and all Liens and (b) Buyer and Mr. Ruby will collectively own beneficially and of record all of the capital stock of the Company, excluding any shares of capital stock of the Company caused to be issued by Mr. Bob Ruby without the knowledge of Seller.

4.2 Authority of Seller. Seller has legal capacity and full power and authority to execute, deliver and perform this Agreement and any Schedules or Exhibits hereto and any other certificates or documents delivered by Seller to Buyer in connection with this Agreement (the "Seller Documents"), to the extent a party thereto. This Agreement constitutes, and, when executed and delivered at the Closing, each other Seller Document will constitute, the legal, valid and binding obligation of Seller, enforceable against Seller in accordance with its terms.

4.3 No Conflicts. The execution, delivery and performance of this Agreement and the Seller Documents and the consummation of the Transactions will not (i) with or without the giving of notice or the passage of time, or both, result in a breach of, or violate, or be in conflict with, or constitute a default under any agreement or instrument or any debt or obligation to which Seller is a party or to or by which he or any of his assets is subject or bound, (ii) require the consent, authorization or approval of any governmental authority or agency, or any spouse of Seller (such spouse's consent being set forth on the signature page of this Agreement) or any party to any agreement or commitment to which Seller is a party, or to or by which Seller is subject or bound, (iii) result in the creation or imposition of any Lien upon the Shares, or (iv) violate any law, rule or regulation.

4.4 Orders; Proceedings. There are no outstanding orders, judgments, injunctions, awards or decrees of any court, governmental authority or arbitration tribunal by which Seller or by which any of Seller's securities, assets, properties or business is bound or subject which will or could reasonably be expected to apply to or be affected by the execution, delivery or performance of this Agreement or the Seller Documents or the consummation of the Transactions. To Seller's knowledge, no suit, action, investigation, inquiry or other proceeding by any court, governmental authority, arbitration tribunal or other person or entity or legal or administrative proceeding has been instituted or threatened which questions the validity or legality of any of the Transactions.

4.5 Liabilities. Except as set forth on Schedule 4.5 hereto, to Seller's actual knowledge, (a) there are no Contingent Liabilities with respect to the Company or any of its properties, assets or business, other than such Contingent Liabilities as are actually known by Bob Ruby, and (b) there are no liabilities or obligations of the Company of any nature whatsoever (including but not limited to Contingent Liabilities) entered into or caused by Seller or any Former Shareholder directly or on behalf of the Company without the actual knowledge of Bob Ruby.

4.6 No Broker. Seller has not retained any broker in connection with the transactions contemplated by this Agreement.

ARTICLE 5

REPRESENTATIONS AND WARRANTIES OF BUYER

Buyer hereby represents and warrants to Seller as follows:

5.1 Organization and Standing. Buyer is a limited liability company duly formed, validly existing and in good standing under the laws of the State of [Delaware] and has the full limited liability company power and limited liability company authority to enter into this Agreement.

5.2 Authorization. The execution, delivery and performance by Buyer of this Agreement, and the consummation by Buyer of the Transactions, have been duly authorized by all necessary limited liability company action of Buyer. This Agreement has been duly executed and delivered by Buyer and constitutes the legal, valid and binding obligation of Buyer, enforceable against Buyer in accordance with its terms.

5.3 Breach or Violation. The execution, delivery and performance by Buyer of this Agreement, and the consummation of the Transactions shall not (a) conflict with, or result in a breach or violation of, (i) Buyer's certificate of formation or operating agreement, (ii) any lease, license, promissory note, conditional sales contract, indenture, mortgage, deed of trust or other agreement or instrument to which Buyer is a party or pursuant to which Buyer is obligated, or, result in the creation or imposition of any Lien on any of its properties, assets or business, or (b) conflict with or otherwise violate any court or administrative order or process by which Buyer or its properties, assets or business are bound.

5.4 Familiarity. Buyer is generally familiar with the business of the Company and, except for the representations set forth in this Agreement, is not relying on any representations of Seller with respect to the profitability of or prospects for such business.

5.5 No Broker. Buyer has not retained any broker in connection with the transaction contemplated by this Agreement.

5.6 Orders; Proceedings. There are no outstanding orders, judgments, injunctions, awards or decrees of any court, governmental authority or arbitration tribunal by which Buyer or by which any of Buyer's securities, assets, properties or business is bound or subject which will or could reasonably be expected to apply to or be affected by the execution, delivery or performance of this Agreement or the Buyer Documents or the consummation of the Transactions. To Buyer's knowledge, no suit, action, investigation, inquiry or other proceeding by any court, governmental authority, arbitration tribunal or other person or entity or legal or administrative proceeding has been instituted or threatened which questions the validity or legality of any of the Transactions.

5.7 Proposed Transactions. To Buyer's and Bob Ruby's actual knowledge, as of the date of execution hereof, neither of them nor the Company has entered into or is negotiating any agreement to sell all or substantially all of the Shares or all or substantially all the assets of the Company to any person other than (a) to members of Bob Ruby's family or (b) to family-related entities in connection with estate or family planning.

5.8 Investment Intent; Qualifications as Buyer.

(a) Buyer represents and warrants that the Shares to be acquired pursuant to the terms hereof are being acquired for Buyer's own account, for investment and not for distribution or resale to others (other than to members of the family of Bob Ruby or family-related entities).

(b) Buyer understands that the Shares are not being registered under the Securities Act and must be held indefinitely unless such stock is subsequently registered hereunder or an exemption from such registration is available.

(c) Buyer represents and warrants that (i) it alone or with its purchaser representative, if any, has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the acquisition of the Shares contemplated hereby; (ii) it's member is able to bear the economic risk of an investment in the Shares, including, without limitation, the risk of the loss of part or all of his investment and the inability to sell or transfer the Shares for an indefinite period of time; and (iii) it's member has adequate means of providing for current needs and contingencies and has no need for liquidity in its investment in the Shares.

(d) Buyer understands that the Shares are not being registered under the Securities Act in part on the ground that the issuance thereof is exempt under Section 4(2) of the Securities Act as a transaction by an issuer not involving any public offering and that Seller's reliance on such exemption is predicated in part on the foregoing representations and warranties of Buyer.

ARTICLE 6

CERTAIN COVENANTS OF SELLER

6.1 Non-Competition. For a period of five (5) years from the date of execution hereof (the "Limited Period"), Seller shall not and shall not permit any person or entity directly or indirectly (alone or together with others) controlling, controlled by, affiliated with or related to, Seller (collectively the "Seller Affiliates") to, directly or indirectly (including through ownership, management, operation or control of any other person or entity, or participation in the ownership, management, operation or control of any other person or entity, or by having any interest in, as a stockholder, agent, consultant, partner or otherwise, any other person or entity):

(a) own, manage, operate, control, invest in, participate in or be involved with any business anywhere in the United States of America which sells, licenses, distributes, markets or provides any product or service in respect of (i) any product, system or service, or any other product, system or service substantially similar to or competitive with any of the products, systems or services which have been or are intended to be manufactured, sold, licensed, distributed, marketed or provided by or for the Company (the "Company Business"), or (ii) any business which is competitive with any of the Company Business in any of the territories or markets in which any of the products or services of the Company are marketed or provided;

(b) solicit, induce or influence or attempt to solicit, induce or influence any person or entity which is or at any time during the Limited Period, or during the period of one (1) year period to the date of execution hereof, is a licensee, customer, supplier, distributor, representative or client of the Company or any of the Company's affiliates which engages in any business related or similar to any of the Company Business, to cease to be a licensee, customer, supplier or client of, or to reduce or alter the nature or extent of the business done by or any relationship of such person or entity with the Company or any such affiliate, or to become a licensee, customer, supplier or client of any other person or entity engaged in any business described in clause (a) above; or

(c) except for the persons set forth on Schedule 6.1(c) attached hereto, directly or indirectly employ or retain or attempt to employ or retain or knowingly arrange or solicit to have any other person or entity employ or retain, as an employee or consultant, any person who then is or during the preceding two-year period has been an employee of or consultant to the Company, or any of the Company's affiliates.

6.2 Confidential Information. (a) It is understood that Seller possesses and will continue to possess information that has been created, discovered or developed, or has otherwise become known to the Company, which information has commercial value in the business in which the Company is engaged and which is not in the public domain except through a breach by Seller or any of the affiliates of Seller (collectively the "Restricted Parties") or anyone else of a confidentiality duty. All of the aforementioned information is hereinafter called "Proprietary Information." By way of illustration, but not limitation, Proprietary Information includes developments, improvements, discoveries, trade secrets, technologies, processes, research, methods, formulae, uses of any of the foregoing, computer software and programs, test and/or experimental data and results, specifications, drawings and technical information and materials, and other techniques, data, know-how, marketing plans and opportunities, cost and pricing data, strategies, forecasts and customer lists. Seller agrees, and agrees to cause and instruct each of the Restricted Parties, to keep in strict confidence and trust all Proprietary Information, and not to use or disclose any Proprietary Information without the prior written consent of the Company. Proprietary Information shall not include information which comes into the public domain through no act or fault of Seller or any of the Restricted Parties, any member of his immediate family, or which Seller first obtains after the date of execution hereof other than from or by reason of his association with the Company. The restriction on disclosure set forth herein shall not prohibit disclosure pursuant to any court or administrative order, provided Seller gives the Company and Buyer reasonable prior written notice of such order and of any intended disclosure in order to enable the Company to object to the same.

(b) At any time upon the Company's request, Seller will deliver to the Company all materials, documents, data, physical property, memoranda, notes, records, rolodexes, customer mailing or contact lists and other material of any nature and in any form (electronic or otherwise) made or compiled by Seller or furnished to him or her, all of which shall be deemed the property of the Company.

(c) Seller covenants and agrees that he shall not (and shall not permit his affiliates or representatives to) disclose the existence of this Agreement or the Transactions to any agents, employees, suppliers, advertisers or customers of the Company to whom the Company has not already disclosed the existence of same, except, (i) subject to the prior approval of Buyer or Mr. Ruby, as may be necessary to obtain consents required pursuant to this Agreement in order to complete the Transactions, or (ii) as shall have been consented to in writing by Buyer or Mr. Ruby prior to such disclosure.

6.3 Injunctive Relief.

(a) Because the remedy at law for any breach of the provisions of Sections 6.1 or 6.2 would be inadequate, Seller hereby consents to the granting by any court of an injunction or other equitable relief, without the necessity of actual damage or irreparable harm being proved or the posting of any bond or security whatsoever, in order that any breach or threatened breach of any of such provisions may be effectively restrained.

(b) It is the desire and intent of the parties hereto that the provisions of this Article 6 shall be enforced to the fullest extent permissible under the laws and public policies applied in each jurisdiction in which enforcement may be sought. Accordingly, if any particular provision of this Article 6 shall be adjudicated to be invalid, illegal or unenforceable in any respect, such provision shall be deemed amended to delete therefrom the portion thus adjudicated to be invalid, illegal or unenforceable, such deletion to apply only with respect to the operation of such provision in the particular jurisdiction in which such adjudication is made, and the remaining provisions contained herein shall not in any way be affected thereby. Further, if any one or more of the provisions contained in this Article 6 shall for any reason be held to be excessively broad as to duration, geographical scope, activity or subject, such provision(s) shall be construed by limiting and reducing the same, so as to be enforceable to the maximum extent under the applicable law as it shall then exist.

ARTICLE 7

[RESERVED.]

ARTICLE 8

INDEMNIFICATION

8.1 Obligation to Indemnify.

(a) Subject to the limitations set forth in this Article 8, Seller hereby agrees to save, indemnify and hold harmless Buyer, the Company and their

respective directors, officers, shareholders, members, managers, agents, successors and assigns (collectively, the "Buyer Indemnitees") from, against and in respect of, and on demand to reimburse the Buyer Indemnitees for:

(i) any and all loss, liability, damage or deficiency suffered or incurred by any Buyer Indemnitee(s) by reason of any misrepresentation, breach of warranty or nonfulfillment of any covenant or agreement (other than under Section 8.1(b) hereof) to be performed or complied with by Seller under this Agreement;

(ii) any and all actions, suits, proceedings, claims, demands, assessments, judgments, settlement payments, awards, fines, penalties, costs and expenses, including, without limitation, reasonable attorneys' fees, incident to any of the foregoing or incurred in investigating or attempting to avoid the same or to oppose the imposition thereof, or in enforcing any of the obligations under this Section 8.1(a).

(b) Subject to the limitations set forth in this Article 8, Seller hereby agrees to save, indemnify and hold harmless the Buyer Indemnitees from and against and in respect of, and on demand to reimburse the Buyer Indemnitees for:

(i) fifty percent (50%) of:

(A) any and all liability, damage, cost or expense suffered or incurred by any and all Buyer Indemnitees in respect of or in connection with any and all third party claims arising from : (I) any net income, gross income, gross receipts, sales, use, ad valorem, transfer, franchise, profits, license, withholding, payroll, employment, excise, severance, stamp, occupation, premium, property or windfall profits tax, alternative or add on minimum tax, customs duty or other tax, fee, assessment or charge of any kind whatsoever, together with any interest and any penalty, addition to tax or additional amount imposed by any governmental authority (federal, state, local or foreign) responsible for the imposition of any such tax ("Taxes") which are due or payable to the extent such Taxes are allocable to any period (or portion of any period) ending on or prior to the Effective Time or arising out of the operation of the Company's business on or prior to the Effective Time; (II) any non-compliance with any environmental, health or safety law, rule or regulation, or the discharge, storage, or disposal of any hazardous waste or substance based on or arising from any act, transaction, state of facts or other condition or conduct which exists or takes place on or before the date of execution hereof; and (III) any and all suits, legal, administrative, arbitral or other actions or proceedings, pending or threatened, with respect to actual or alleged causes of action, breaches of contract, torts, violations or disputes arising out of any acts or omissions of Seller constituting or alleged to constitute gross negligence, willful misconduct, harassment or discrimination occurring on or prior to the date of execution hereof; and

(B) any and all actions, suits, proceedings, claims, demands, assessments, judgments, settlement payments, awards, fines, penalties, costs and expenses, including, without limitation, reasonable attorneys' fees, incident to

any of the foregoing or incurred in investigating or attempting to avoid the same or to oppose the imposition thereof; and

(ii) any and all costs and expenses, including, without limitation, reasonable attorneys' fees, suffered or incurred in enforcing any of the obligations under this Section 8.1(b).

(c) Subject to the limitations set forth in this Article 8, Buyer and Bob Ruby hereby jointly and severally agree to save, indemnify and hold harmless Seller and Seller's heirs, personal representatives, successors and assigns (collectively the "Seller Indemnitees") from, against and in respect of, and shall on demand reimburse the Seller Indemnitees for:

(i) any and all loss, liability, damage or deficiency suffered or incurred by any of the Seller Indemnitees by reason of any misrepresentation, breach of warranty or nonfulfillment of any covenant or agreement (other than under Section 8.1(d) hereof) to be performed or complied with by Buyer under this Agreement;

(ii) any payment required to be made and actually so made to JP Morgan Chase Bank by Seller pursuant to the Seller Guaranty; and

(iii) any and all actions, suits, proceedings, claims, demands, assessments, judgments, settlement payments, awards, fines, penalties, costs and expenses, including, without limitation, reasonable attorneys' fees, incident to any of the foregoing or incurred in investigating or attempting to avoid the same or to oppose the imposition thereof, or in enforcing any of the obligations under this Section 8.1(a)

(d) The maximum aggregate liability that Seller shall have under Section 8.1(b)(i) hereof shall in no event exceed the Section 8.1(b)(i) Cap (as hereinafter defined); provided further that, after the fifth anniversary of the date of execution hereof, Seller shall have no liability under Section 8.1(b) with respect to any claim not theretofore asserted against Seller pursuant to such Section 8.1(b). "Section 8.1(b)(i) Liability Cap" means an amount equal to the product of (i) one million dollars ($1,000,000) and (ii) a fraction, the numerator of which (which shall never be a negative number) is (A) twenty (20) less the number of entire calendar quarters elapsed after April 1, 2003 and prior to the date of assertion of any claim under Section 8.1(b) hereof and the denominator of which is (B) twenty (20) (it being understood and agreed that the first reduction of the Section 8.1(b)(i) Liability Cap shall occur on July 1, 2003 and that, through June 30, 2003, the Section 8.1(b)(i) Liability Cap shall be one million dollars ($1,000,000)).

(e) Buyer acknowledges that the Buyer Indemnitees shall resort to setting-off amounts payable to Seller under the Note to satisfy any indemnification obligation of Seller under Section 8.1(b) hereof in respect of Contingent Liabilities, in such order as the person or entity entitled to indemnification shall determine, before collecting any monies from Seller in respect of such indemnification obligation.

(f) Notwithstanding anything herein to the contrary, as to matters which are subject to indemnification pursuant to this Article 8, neither Seller, on the one hand, or Buyer and/or Bob Ruby, on the other hand, shall be liable under this Article 8 unless and until the aggregate claims, liabilities, losses, costs and expenses suffered or incurred by any one or more of the Buyer Indemnitees, or any one or more of the Seller Indemnitees, as the case may be, resulting from or attributable to any otherwise indemnifiable matters shall exceed a cumulative aggregate of Twenty-five Thousand ($25,000) Dollars (the "Indemnification Threshold") and then shall only be liable for the excess above the Indemnification Threshold; provided that this paragraph (f) shall not apply to any matter or claim relating to in any way title to any of the Shares.

(g) Any party's indemnity obligation under this Article 8 with respect of any matter giving rise thereto shall be reduced by the amount by which the net amount, after payment of or provision for all costs and expenses in connection with collecting the same and applicable taxes, of cash proceeds of any insurance recoveries actually received by the indemnified party in respect of such indemnified matter exceeds the present value of all actual and anticipated insurance premium increases resulting or likely to result from such matter.

(h) Except with respect to Article 6 hereof or as provided in Section 9.3 hereof, the indemnification rights of the parties hereto under this Section 8.1 shall be the exclusive rights and remedies that such parties have at law or in equity or otherwise with regard to matters subject to indemnification for any misrepresentation, breach of warranty or failure to fulfill any agreement or covenant hereunder on the part of any party hereto, including, without limitation, the right to seek specific performance, rescission or restitution.

8.2 Disclaimer. EACH PARTY HERETO ACKNOWLEDGES THAT, EXCEPT AS OTHERWISE PROVIDED IN THIS AGREEMENT, NO OTHER PARTY HERETO MAKES ANY REPRESENTATIONS OR WARRANTIES WHATSOEVER RELATING TO ANY OF THE SHARES TO BE TRANSFERRED TO BUYER HEREUNDER. EXCEPT FOR THE REPRESENTATIONS AND WARRANTIES PURSUANT TO THIS AGREEMENT, EACH PARTY HERETO EXPRESSLY REPRESENTS AND WARRANTS THAT HE OR IT HAS NOT RELIED ON ANY FINANCIAL DATA, PROJECTIONS OR REPRESENTATIONS WHICH SUCH PARTY HAS OBTAINED FROM ANY PERSON OR ENTITY, AND THAT SUCH PARTY HAS FORMED ITS INDEPENDENT JUDGMENT AS TO THE FUTURE PROSPECTS OF THE COMPANY. IN NO EVENT SHALL ANY PARTY HERETO BE LIABLE FOR CONSEQUENTIAL, EXEMPLARY, SPECIAL, INDIRECT, INCIDENTAL OR PUNITIVE DAMAGES, WHETHER SUCH DAMAGES ARE ALLEGED IN TORT, CONTRACT OR INDEMNITY, EVEN IF ANY PARTY HAS BEEN ADVISED OF THE POSSIBILITY THEREOF.

8.3 Sales, Transfer and Documentary Taxes. Buyer and Seller shall each bear 50% respectively, of all state and local sales, documentary and other transfer taxes, if any, due as a result of the purchase, sale and transfer of the Seller's Shares in accordance herewith whether imposed by law on Seller or Buyer. Notwithstanding the

foregoing, Seller shall bear 100% of all mortgage and other recording taxes arising out of or associated with the Second Mortgage, the Security Agreement and/or the Pledge Agreements.

ARTICLE 9

MISCELLANEOUS

9.1 Certain Definitions. The following terms, as used herein, have the following meanings:

"Affiliate" means with respect to any person or entity, any other person or entity directly or indirectly controlling, controlled by or under common control with such first person or entity.

"A. Ruby Guaranty" has the meaning specified in Section 3.3 of this Agreement.

"Agreement" has the meaning specified in the preamble of this Agreement.

"B. Ruby Guaranty" has the meaning specified in Section 3.3 of this Agreement.

"B. Ruby Policies" means, collectively, that certain [[universal life insurance policy Policy No. ________________________ on the life of Mr. Bob Ruby issued by _______________]] providing a death benefit of $______________; that certain [[universal life insurance policy Policy No. ________________________ on the life of Mr. Bob Ruby issued by _______________]] providing a death benefit of $______________; and that certain [[universal life insurance policy Policy No. ________________________ on the life of Mr. Bob Ruby issued by _______________]] providing a death benefit of $______________; or any policy or policies providing aggregate death benefits of $______________, issued in place of any such policy or policies.

"Business Day" means any day other than a Saturday, Sunday or other day on which banks in the State of New York are authorized or required by law to be closed..

"Buyer" has the meaning specified in the preamble of this Agreement.

"Buyer Indemnitees" has the meaning specified in Section 8.1 of this Agreement.

"Closing" has the meaning specified in Section 3.1 of this Agreement.

“Company” means Carter Associates, Inc., a corporation incorporated under the laws of the State of New York and/or any successor thereto (whether as contemplated by Section 3.5 hereof or otherwise).

“Company Business” has the meaning specified in Section 6.1 of this Agreement.

“Company Guaranty” has the meaning specified in Section 3.3 of this Agreement.

“Contingent Liabilities” (and individually a “Contingent Liability”) means any and all of the following liabilities of, obligations of and claims against the Company, whether fixed, contingent or otherwise, in each case to the extent existing or accrued at or as of the date of execution hereof or made, asserted or arising after the date of execution hereof but based upon or arising from any act, transaction, circumstance, sale or providing of goods or services, state of facts or other condition which occurred or existed on or before the date of execution hereof, in each case other than normal and customary accounts payable and accrued business expenses as of the date of execution hereof incurred in the ordinary course of business consistent with past practice:

(a) debts, liabilities, claims and obligations against or of the Company for or arising out of or in connection with indebtedness for borrowed money, extensions of credit, loans, advances, deferred purchase price, capitalized leases, and similar obligations;

(b) debts, liabilities, claims and obligations against or of the Company as a guarantor, co-obligor, indemnitor or surety of or with any other person, or entity other than Bob Ruby or any members of his family, including any affiliate of the Company;

(c) debts, liabilities, claims and obligations against or of the Company under or arising out of any stock option, stock purchase, equity-based incentive or similar plans or arrangements;

(d) debts, liabilities, claims and obligations in respect of brokerage or finder’s fees;

(e) debts, liabilities, claims and obligations for or in respect of any and all foreign, federal, state and local taxes of or imposed on the Company;

(f) debts, liabilities, claims and obligations with respect to any and all suits, legal, administrative, arbitral or other actions or proceedings, pending or threatened, with respect to actual or alleged causes of action, breaches of contract, violations or disputes arising out of any events occurring, or circumstances or state of facts existing, on or prior to the date of execution hereof, including without limitation, any of the foregoing involving or alleging breach of contract, default, violation of any

legal or administrative requirement, negligence, tort or deceptive or unfair or illegal trade practice; or

(g) debts, liabilities, charges, claims and obligations against or of the Company arising out of any non-compliance with any environmental, health or safety law, rule or regulation, or the discharge, storage, or disposal of any hazardous waste or substance based on or arising from any act, transaction, state of facts or other condition or conduct which exists or takes place on or before the date of execution hereof.

"Effective Time" has the meaning specified in Section 1.1 of this Agreement.

"Family Entity" has the meaning specified in Section 3.5 of this Agreement.

"Former Shareholder" and "Former Shareholders" means each of Scott Smith, Glenn Smith, Kim Brodsky, and Susan Smith, each a child of Seller.

"Indemnification Threshold" has the meaning specified in Section 8.1 of this Agreement.

"Lien" means any lien, pledge, charge, security interest, restriction, claim, encumbrance, right of first refusal, preference or right of others of every kind and description.

"Limited Period" has the meaning specified in Section 6.1 of this Agreement.

"Smith Policies" means those certain whole life insurance policies, Policy Nos. ______________________, issued by [__________________________], on the life of Seller.

"Material Adverse Effect" means any one or more events, occurrences, facts, conditions or circumstances which have had or are reasonably likely to have, in any single case or in the aggregate, a material adverse effect on the condition, business, properties, assets, prospects or operations of the Company.

"Mr. Ruby" means Mr. Bob Ruby, an individual residing at ______________.

"Notes" has the meaning specified in Section 2.1 of this Agreement.

"Pledge Agreements" has the meaning specified in Section 3.2 of this Agreement.

"Proprietary Information" has the meaning specified in Section 6.2 of this Agreement.

"Purchase Price" has the meaning specified in Section 2.1 of this Agreement.

"Restricted Parties" has the meaning specified in Section 6.2 of this Agreement.

"Second Mortgage" has the meaning specified in Section 3.2 of this Agreement.

"Security Agreement" has the meaning specified in Section 3.2 of this Agreement.

"Seller" has the meaning specified in the preamble of this Agreement.

"Seller Affiliates" has the meaning specified in Section 6.1 of this Agreement.

"Seller Documents" has the meaning specified in Section 4.2 of this Agreement.

"Seller Indemnitees" has the meaning specified in Section 8.1 of this Agreement.

"Seller Liabilities" has the meaning specified in Section 8.1 of this Agreement.

"Shareholder Loans" mean any and all loans, advances or other indebtedness for borrowed money in any form whatsoever owing by the Company to the Seller, any Former Shareholder, any affiliate of Seller or any Former Shareholder or member of the immediate family of Seller or any Former Shareholder.

"Shares" has the meaning specified in the recitals of this Agreement.

"Successor Entity" has the meaning specified in Section 3.5 of this Agreement.

"Transactions" has the meaning specified in Section 2.2 of this Agreement.

9.2 Publicity. Seller shall not directly or indirectly issue or make, or cause to have issued or made, any press release or other public announcement concerning this Agreement or the Transactions without the advance approval in writing of the form and substance thereof by Buyer.

9.3 Specific Performance. Seller agrees that the Shares are unique property that cannot be readily obtained on the open market and that Buyer will be

irreparably injured if this Agreement is not specifically enforced. Therefore, Buyer shall have the right specifically to enforce the performance of Seller's obligations under this Agreement regarding the sale and/or delivery of good and unencumbered title to the Shares, in any court or forum, without the necessity of posting any bond or other security and without the necessity of proving actual damages, and Seller hereby waives the defense in any such suit that Buyer has an adequate remedy at law and agree not to interpose any opposition, legal or otherwise, as to the propriety of specific performance as a remedy. The remedy of specifically enforcing provisions of this Agreement in accordance with this Section 9.3, and the provisions of Section 6.3 hereof, shall not be exclusive of any other rights or remedies which Buyer may otherwise have under this Agreement, all of which rights and remedies shall be cumulative.

9.4 Binding Agreement; Assignment. All of the terms and provisions of this Agreement shall be binding upon, inure to the benefit of, and be enforceable by, the parties hereto and their respective heirs, legal representatives, successors and assigns. Seller shall not assign any of his rights or delegate any of his duties or obligations hereunder without the prior written consent of each other party hereto.

9.5 Law To Govern; Jurisdiction. This Agreement shall be governed by, and construed and enforced in accordance with, the internal laws of the State of New York, without regard to principles of conflict of laws. The courts of the State of New York and of the United States of America for the Eastern Districts of New York shall have exclusive jurisdiction over any controversy arising out of or relating to this Agreement. The parties hereto acknowledge that they are each subject to the personal jurisdiction of such courts. The venue for any court or other proceeding in the United States shall be Nassau County, New York.

9.6 Notices. All notices shall be in writing and shall be deemed to have been duly given (a) if delivered personally, upon delivery, (b) one Business Day after being sent by recognized overnight courier and (c) three Business Days after being deposited in the mail if mailed via registered or certified mail, return receipt requested, postage prepaid, in each case to the other party hereto at the following addresses:

if to Buyer or Bob Ruby, to:

____
____
____
____

- and -

____
____
____
____

with a copy to each of (neither of which
copies shall constitute notice):

- and -

if to Seller, to:

____
____
____

with a copy to (which copy shall not
constitute notice):

or to such other address as any such party may designate in writing in accordance with this Section 9.6.

9.7 <u>Survival</u>. Subject to Section 8.1(e) hereof, each representation, warranty, indemnity, covenant and agreement of each of the parties hereto shall survive the Closing without time limit.

9.8 <u>Fees and Expenses</u>. Each of Buyer, on the one hand, and Seller, on the other hand, shall pay their own fees and expenses with respect to the Transactions.

9.9 <u>Entire Agreement</u>. This Agreement sets forth the entire agreement and understanding of the parties hereto in respect of the subject matter hereof. This Agreement cancels and supersedes any and all prior agreements, understandings and representations, whether written or oral, among the parties with respect to such subject matter.

9.10 No Third-Party Beneficiaries. Except with respect to any Buyer Indemnitee, nothing herein, express or implied, is intended or shall be construed to confer upon or give to any person or entity, other than the parties hereto, any rights, remedies or other benefits under or by reason of this Agreement or any documents executed in connection with this Agreement.

9.11 Counterparts. This Agreement may be executed in any number of counterparts, each of which shall be deemed an original but all of which shall constitute one and the same agreement.

9.12 Headings. The Article, Section and Paragraph headings contained herein (inclusive of the Schedules and Exhibits hereto) are for the purposes of convenience only and are not intended to define or limit the contents of said Articles, Sections and Paragraphs.

9.13 Amendments. No amendment or modification of any provision of this Agreement shall be valid unless the same shall be in writing and signed by all of the parties hereto.

9.14 Construction. The parties have participated jointly in the negotiation and drafting of this Agreement. In the event an ambiguity or question of intent or interpretation arises, this Agreement shall be construed as if drafted jointly by the parties and no presumption or burden of proof shall arise favoring or disfavoring any party by virtue of the authorship of any of the provisions of this Agreement.

IN WITNESS WHEREOF, the parties have duly executed this Agreement of Purchase and Sale of Shares as of the date first above written.

BUYER:

______________________________, LLC

By: ________________________________
Name: Alan Ruby
Title: Manager

SELLER:

____
John Smith

____
Spouse of John Smith, solely for purposes of consenting to the execution, delivery and performance by John Smith of this Agreement

The undersigned, Bob Ruby, hereby acknowledges his obligations under Article 8 above and shall be deemed a party to this Agreement solely for purposes of his obligations under said Article 8

____
Bob Ruby

Schedule 2.1

Name	Shares owned	Principal amount of Note	Portion of principal amount of Note allocated to Shares	Portion of principal amount of Note allocated to Article 6 covenant
John Smith		$1,500,000		

Schedule 8.1(a)(ii)

Excluded Liabilities

BREAKING UP IS(N'T) HARD TO DO – CLOSELY-HELD BUSINESS DIVORCES

OUTLINE OF ISSUES IN JOINT VENTURES AND STRATEGIC ALLIANCES

Gregory M. Giammittorio

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I. INTRODUCTION

This outline addresses some of the considerations that arise in connection with planning for joint venture entities and strategic alliance transactions involving equity investments. A joint venture often involves two or more companies that each contribute resources in pursuit of a common purpose, where each of the parties expects to reap benefits from the common pursuit. Joint ventures occur frequently in many industries such as the biotech, telecommunications, software, semiconductor, computer, media, satellite, chemical, automotive and medical device industries to name a few.

The term "strategic alliance" is probably broader in that a joint venture would be considered by most as a type of strategic alliance. However, strategic alliances can take many other forms too. This outline will focus on situations where either (i) two or more companies decide to form a joint venture entity to pursue the contemplated business objective or (ii) a company that has already been formed obtains a substantial investment from another company that is, or believes it will be, aligned with the objectives of the investee company.

Joint ventures can have many variables in structure and purpose. However, they typically involve a contribution of resources such as technology, cash, employees, regulatory licenses, marketing and distribution capabilities, and manufacturing capacity in various combinations by the participants.

A. Who Are the Parties (or Who Is on First)?

It is important to understand the basics, such as:

1. **What is the relative size of each of the parties? Is one a small company with an innovative product/solution and the other a large, well-funded company?**

2. **Where are the parties located – be aware of potential international issues (e.g., enforcement of remedies)? Where will the activities of the joint enterprise primarily occur?**

In addition, keep in mind special issues and complications raised by the use of special purpose entities. Intellectual property licenses need to reach the proper parties; non-competes need to address affiliates; obligations may need to be guaranteed by parties further up the corporate chain to better assure access to a viable remedy in the event of a breach.

3. **What are the objectives of the parties?**

    a. Increase market share (or create markets), revenue and earnings

    b. Risk sharing

c. Entry into new markets by product or geography

d. Access to technology and expertise

e. Access to a customer base/distribution channel

f. Access to regulatory expertise/licenses

g. Access to manufacturing and logistics capability/know-how

h. Creating critical mass/enhancing a competitive position/obtaining exclusivity

4. What are other key attributes of the parties?

a. Key capabilities/access to resources

b. Management style

c. Decision-making process

d. Reputation of key executives

e. Conduct due diligence on prior similar transactions

NOTE: If the other party is an SEC reporting company, carefully review its filings to obtain insight into its attributes. Other, similar agreements it has entered into in the past can help with negotiating some of the tough issues. If you can find approaches to dealing with certain issues that are satisfactory to your client and the other party has previously agreed to such provisions, it can be very helpful.

II. THE JOINT VENTURE AGREEMENT

A. Overview of Key Provisions

1. Organization of the Entity

a. Agreement to form a specified type of entity

b. If applicable, charter documents will be entered into in an agreed form (e.g., certificate of incorporation and bylaws)

c. For LLC's and partnerships, the operating agreement or partnership agreement will likely be the primary joint venture document.

2. **Contributions**

a. Equity

b. Debt

c. Future funding obligations (if any)

d. Consequences of a failure to fund

e. Unique contributions (e.g., intellectual property, facilities, management services)

3. **Equity Transfer Issues**

a. Restrictions on transfers and issuance of equity

b. Right of first refusal and right to join in sale

c. Prohibited transfers

d. Exceptions to prohibited transfers

e. Preemptive rights

f. Termination of restrictions (the JV grows up) (e.g., occurrence of a qualified initial public offering)

4. **Governance Issues**

a. Board of directors/board of managers

b. Meetings and notice of meetings

c. Who are the officers? Who may remove officers and appoint replacements?

d. Consider imposing limits on the scope of authority of officers

5. **Restricted Actions (Supermajority Vote Requirements)**

a. Liquidation, dissolution or winding up of JV's business operations or the filing of any bankruptcy petition

b. Sale, exchange or other disposition of all or substantially all of JV's assets, business or of any of the regulatory licenses

c. Exclusive intellectual property licensing transactions or other licensing outside the ordinary course

d. Any merger, spin-off, joint venture or other business combination, recapitalization or reorganization involving the JV or any subsidiary (certain exceptions may apply)

e. Any material change in the nature of the business conducted by JV

f. Creation of any subsidiary or investments (other than permitted investments)

g. Compensation of key executives

h. Amendment of JV's governing documents (e.g., certificate of incorporation or bylaws

i. Issuance of JV's equity to any person or entity (certain exceptions may apply)

j. Redemption of part or all of the equity outstanding or the prepayment of any debt securities

k. Incurring any indebtedness in excess of a specified dollar threshold in a single transaction or in excess of a specified dollar threshold in the aggregate

l. Granting of any mortgage or deed of trust or the placing of any other lien or encumbrance on the assets of the JV entity that exceeds a specified dollar threshold

m. Making of a single capital expenditure in excess of a specified dollar threshold or exceeding a specified annual capital expenditure budget

n. Approval of any dividend distribution to shareholders (subject to certain exceptions)

o. Approving benefit plans/incentive plans

p. Approving business plans and budgets

q. Commencing or settling any material litigation

r. Acquiring real property in excess of a specified dollar threshold

s. Any change in outside attorneys or auditors

t. Any transaction between the JV entity and related parties (subject to certain exceptions)

6. Special Exit Provisions

a. Buy/sell

b. Mandatory dissolution

c. Put rights

d. Call rights

7. Representations and Warranties

8. Covenants

a. Non-disclosure

b. Non-competition

c. Delivery of and access to information

d. D&O insurance and indemnification obligations (consider the issue of survival of these obligations if one of the joint venture parties exits)

e. Licenses in and licenses out (ownership of intellectual property) (consider survival issues)

9. Conditions to Closing

10. Dispute Resolution

a. Determination by designated experts (e.g., independent engineer or valuation experts)

b. Escalation to senior management of the parties

c. Mediation

d. Arbitration

e. Litigation

f. Combination of the foregoing

11. Default

12. Remedies

13. Termination

B. Numerous Choices/Room for Creativity

Joint venture agreements are truly unique transactions. This leads to the challenge of creating the appropriate structure and provisions, but it also creates an opportunity. As counsel, one can help the parties craft specific solutions to concerns that would otherwise be an impediment to the transaction. A review of a dozen random joint venture agreements will show many similarities, many of the same types of issues being addressed, but will also show a wide variety of approaches to the issues.

C. Reasons for and against Termination and/or Buy-Sell Provisions

Why should there be any exit or termination provisions? It may seem to encourage or at least make it easier for one party to unravel the joint venture, rather than forcing the parties to work through any tough issues. After all, shouldn't the parties be committing to make the relationship work? It may also appear to the client that a lot of time and effort is being spent on a remote possibility. No one has a crystal ball and it is impossible to predict the reasons at the outset of a joint venture for any failure to succeed. Therefore, one might argue, the parties will be in a better position to negotiate a satisfactory termination when they know the particular circumstances surrounding the need for termination.

It is possible that a client may believe it is advantaged by having the applicable documents remain silent as to exit and termination provisions. After careful assessment of the result that would be achieved by applicable law, this may occasionally be the course that is most likely to achieve the best result for a particular client in the specific circumstances.

However, in most cases the goal should be to create a fair and reasonable way to allow the parties to part ways without unduly harming the value that may have been created in the enterprise. So long as you have exit provisions that are properly constructed to ensure that your client is not on the short end of the bargaining and negotiating leverage, whether the provisions are actually used is less important. Often, because no one can predict the future with certainty, the parties will be able to negotiate a termination arrangement at the time an exit is desired that does not follow the provisions in the agreement, but is better for everyone in terms of creating certainty and a desirable conclusion to the relationship.

Just because the provisions were not used, however, does not mean they were not important. Having equitable provisions as a backdrop will help ensure the negotiations will be balanced. Clients fear being vulnerable. They are often concerned about scenarios where one party may have an advantage over them. For example, one party may be financially constrained and unable meaningfully to participate as a buyer in a buy/sell. This financially constrained party could be concerned that the other joint venture party would be tempted to create a deadlock and force a buy/sell at a time and in a manner intended to disadvantage the financially constrained party.

In addition to the basic financial terms of ending the relationship, there are numerous other issues such as:

- What happens to key employees
- What licenses survive and any modifications to their terms
- What distribution arrangements survive and any modifications to their terms
- Survival of non-competition agreements
- Ongoing rights with respect to confidential information
- Ownership and/or use of other key assets
- Impact of regulatory requirements such as HSR, FCC, foreign investment or ownership regulations or other key regulatory licensing issues

Accordingly, spending time on crafting well thought out exit and termination provisions will reduce uncertainty, level the playing field, and allow the parties to craft their own rules in ways that differs from letting applicable law fill the void of an agreement that is silent on these points. This should add value to the enterprise by encouraging less destructive changes in ownership when the parties no longer share a common vision.

III. TERMINATION PLANNING

A. Practical Consideration of Getting Client to Focus on Termination

Who wants to think about divorce at the same time you are planning the honeymoon? At the outset of a joint venture, some clients will not want to spend a lot of time thinking through the issues of how best to end the relationship if it is not working.

Nevertheless, it is a critical issue and does not need to represent a lack of faith in the success of the enterprise. Instead, time spent on contingency planning of this sort can add value to the enterprise. Some of the key questions are:

1. **Who is entitled to terminate?**

2. **Under what circumstance may a party terminate?**

3. **Are partial terminations of the relationship permitted?**

4. **What are the consequence of termination for each type of termination scenario? What licenses and other provisions survive and which ones terminate? Should any special rights and obligations spring from the termination?**

B. What are the Options?

1. Let Applicable Law Govern

This may occasionally be the best choice under the circumstances. In most cases, however, the parties can, with help from counsel, craft fair, reasonable provisions that are designed to create a level playing field, serve as a choice of last resort if exit negotiations are not successful, and thus encourage the protection of any value creation that has occurred.

2. Buy/Sell Provisions

Parties often include a buy/sell provision to address the potential deadlock of a JV entity. There are a number of different approaches that can be used. One party may be specified as the buyer and one may be specified as the seller. Pricing may be determined as an agreed price (this will need updating frequently), as a formula price (e.g., 7 times EBITDA), by one of the parties (the one party cuts the pie/the other chooses the piece method) or by appraisal. The provisions most often will address a deadlock situation where the parties simply cannot agree on a key issue relating to the operations of the company. The provisions may also address a default situation. In the default situation, the non-defaulting party is sometimes given the choice of being, at its option, the buyer or the seller.

In the deadlock scenario, where none of the parties are in default, one buy/sell arrangement that is frequently used provides that once certain defined triggering events indicating a deadlock have occurred, the parties must go through a dispute resolution process. The dispute resolution process can include escalation to senior management of the joint venture parties for a period of time. If this does not resolve the deadlock, a mediation process may also be used. In any event, after efforts at dispute resolution have not resolved the deadlock for a stated period of time, either party is free to institute the buy/sell by stating a price and offering to either buy or sell the other party's interest at that price. The uncertainty about who will buy and who will sell will often encourage the parties to reach a negotiated solution. If they do not, the provision will in many cases still produce a fair result -- under the theory of one party divides the

last piece of pie and the other gets to choose his piece. However, if one party has a large advantage in terms of access to capital, this provision may seem onerous to the less well financed entity.

One variation on this common buy/sell gives the parties more predictability, and adds some protection to a party with substantially fewer resources. It has the following key distinguishing features.

- An appraisal method sets a floor price on the buy/sell
- Both parties are given the chance to be whichever they prefer – the buyer or the seller
- If both wish to sell, they need to continue to work out the dispute (neither is so distressed with the deadlock that they are willing to step up and buy the other party out)
- If one party wishes to buy and the other wishes to sell, a good result is obtained because they each get what they want
- If both parties wish to buy, an auction process is commenced, the one who wants it the most (and is willing to pay for it) will get it

In the disproportionate financial wherewithal scenario, the smaller company is provided some protection with the floor set by the appraisal process. The smaller company may also want to try to build in sufficient time in the process prior to a closing taking place to give it the best chance to obtain outside financing. Also, consider the ability of each party to use a note with pre-defined terms for a portion of the purchase price.

3. Mandatory Termination/Unwind Provisions

Another approach that is sometimes used either as a substitute for the buy/sell or as an additional approach applicable in certain circumstances is a mandatory dissolution or unwinding of the joint venture. If one party is in default, this may be added as an additional choice for the non-defaulting party – i.e., the ability to choose between purchasing the other party's interest, selling to the other party, or causing a dissolution to occur. The non-defaulting party could control the dissolution. In some cases, it may be appropriate for specific assets to be transferred back to the joint venture parties. Typically, it will be best for the dissolution to be conducted with the goal of maximizing the return to all of the joint venture entities. One can specify that the preferred method of dissolution is a sale as a going concern and that the joint venture entities and their affiliates may participate in the auction process.

Some key issues to think about in a mandatory dissolution process are:

- Who controls the process and what standards should apply to the controlling party's conduct?

- Should an auction process be defined? If the auction does not produce a sale as a going concern, should the controlling party then use its best judgment to liquidate assets?
- Is it appropriate for certain key assets to be transferred back to specified parties – for example, facilities/intellectual property/etc.?
- Examine whether it makes sense for certain exclusive arrangements that may have been entered into to survive the sale/exit. For example, should exclusive license agreements, exclusive distribution agreements, and non-competition agreements remain in place? The JV entity may have the option of assigning an exclusive distribution agreement, terminating the agreement or converting it to a non-exclusive arrangement, whichever best facilitates the prospective sale transaction.
- What should happen to debt owed by the JV entity to its owners or vice versa? How about credit enhancement arrangements such as guarantees and letters of credit?
- If one party is in default, consider paying the dissolution proceeds into escrow pending determination of the damages flowing from the default.

IV. CONCLUSION

Joint ventures and strategic alliances can be extremely useful business tools for companies to achieve objectives they could not achieve alone. However, to do them correctly takes a lot of thought, time and effort. To be successful, they require a high level of cooperation. If that cooperation breaks down, it is important to have an efficient way to end the relationship in a manner that protects any value created in the enterprise to the maximum extent possible.

Joint venture companies often have a long list of items where either party will have blocking rights. Therefore, the operations of the JV entity can often become deadlocked. In the case of a substantial deadlock that continues or a material breach by one of the parties, it may be best to terminate the existing relationship. Having well crafted exit provisions will not ensure that every possible scenario is addressed. However, if fair, balanced provisions are in place and key issues such as those relating to whether ancillary agreements and provisions should survive, terminate or be modified in each scenario are addressed, the parties are more likely to reach a satisfactory negotiated solution.

Attachment 2

NOTE:

THE FOLLOWING IS A SAMPLE FOR DISCUSSION

PURPOSES AND IS NOT INTENDED

AS A MODEL.

BUY-SELL PROVISION 1

a. Upon the occurrence of a Deadlock Event, the Shareholders shall first use their good faith efforts during a period of forty-five (45) days (the "Referral Period") to resolve the dispute which resulted in the Deadlock Event in a mutually satisfactory manner. A "Deadlock Event" shall be deemed to have occurred in the event that (i) with respect to any proposed Significant Corporate Action contained in paragraphs (b), (d), (g), (h), (i), or (u) as it applies to any of the previously listed paragraphs in the definition thereof, the Board of Directors is unable to authorize the taking or rejection of such Significant Corporate Action by a Majority Vote, provided that, for a Deadlock Event to occur under clauses (b), (d), (g), (h), and (i), the dollar level shall be $50,000,000 or (ii) a Budget Deadlock has occurred and continued uninterrupted for two consecutive fiscal years;

b. If a Deadlock Event occurs, then while such Deadlock Event shall continue beyond the Referral Period, either Shareholder (the "Initiating Shareholder"), by written notice (the "Notice") to the other may initiate a buy-sell transaction as follows:

(i) Notice shall specify a price per share which the Initiating Shareholder is willing to pay or receive for the shares held by the other Shareholder (the "Determining Shareholder");

(ii) Within 20 days after receipt of the Notice from the Initiating Shareholder, the Determining Shareholder shall by written notice (the "Response") to the Initiating Shareholder decide whether to buy all of the Initiating Shareholder's shares at the price set forth in the Notice or to sell all of the Determining Shareholder's shares to the Initiating Shareholder at the price set forth in the Notice. The failure of the Determining Shareholder to deliver a Response within the said 20-day period shall be deemed to constitute the Determining Shareholder's election to sell;

(iii) The Initiating Shareholder and the Determining Shareholder shall thereupon act promptly to accomplish the buy-sell arrangement set forth herein; provided that the closing of such transaction shall take place on not less than five days' written notice from buyer to seller not later than 180 days following the receipt of the Response by the Initiating Shareholder. In the event the closing does not take place within such 180-day period on account of the inability of the buying Shareholder to buy, then the Shareholder that would have otherwise been the seller shall have the right, exercisable by written notice to the other Shareholder within 20 days after the end of such 180-day period, to elect to buy the other Shareholder's shares. In such event, the closing will take place on not less than 5 days' written notice from buyer to seller not later than 180 days following such elections.

BUY-SELL PROVISION 2

(a) In the event that the Board of Directors is not able to agree on a Significant Corporate Action as described in paragraphs ___________________________ within ten (10) Business Days following the date of the Board of Directors vote at issue, then either Party may initiate the buy-sell procedure described in this Section ___ ("Buy-Sell Procedure"); provided, however, that if the Party initiating the Buy-Sell Procedure (the "Initiating Party") does not deliver the Offering Notice described below to the other Party (the "Receiving Party") within the fifteen (15) day period described in Section (b) below; then its right to initiate such Buy-Sell Procedure shall irrevocably expire with respect to such Significant Corporate Action and no further action shall be taken without the Receiving Party's prior written consent (which may be withheld or granted in the Receiving Party's sole discretion) to implement, or cause to be implemented, such Significant Corporate Action.

(b) To exercise its buy-sell rights under this Section ___, the Initiating Party shall deliver written notice (the "Offering Notice") to the Receiving Party within fifteen (15) days after the expiration of the ten (10) day period described in Section (a) above. Such Offering Notice shall set forth a proposed **"Joint Venture Value."** The Offering Notice shall also direct that the Receiving Party make its election from the following two alternatives: (i) purchase the entire Joint Venture Interest of the Initiating Party at a purchase price equal to the product of the Initiating Party's then current Percentage Interest times the Joint Venture Value set forth in the Offering Notice (the "Initiating Party Purchase Price"); or (ii) sell to the Initiating Party the entire Joint Venture Interest of the Receiving Party at a purchase price equal to the product of the Receiving Party's then current Percentage Interest times the Joint Venture Value set forth in the Offering Notice (the "Receiving Party Purchase Price"). The Offering Notice shall also provide that the amount of all outstanding loans made by one Party to the other pursuant to Sections and __ and any interest accrued thereon shall be repaid in full at the closing of the purchase pursuant to the Offering Notice, and shall contain the other terms and conditions for the purchase or sale (which shall be reasonably equivalent for either purchase or sale), except that the terms of payment shall be all cash at settlement. Unless the Parties otherwise agree, the closing of the purchase or sale shall occur no earlier than forty-five (45) days, and no later than ninety (90) days, after receipt by the Receiving Party of the Offering Notice, at the Joint Venture's principal office at 10:00 a.m. local time. Within thirty (30) days after receipt of the Offering Notice, the Receiving Party shall notify the Initiating Party in writing of its election (the "Election Notice") whether to purchase or sell pursuant to the Offering Notice.

(c) If the Receiving Party elects to purchase the Joint Venture Interest of the Initiating Party, then upon the delivery of the Election Notice to the Initiating Party by Receiving Party, the Initiating Party shall be obligated to sell all of its Joint Venture Interest to Receiving Party or (at Receiving Party's option) to Receiving Party's designee (which may be any Person, including without limitation an Affiliate of Receiving Party) at the Initiating Party Purchase Price and on the terms and conditions stated in the Offering Notice.

(d) If (i) the Receiving Party either fails or refuses to make any election pursuant to the Offering Notice within the applicable thirty (30) day period, or elects to sell its Joint Venture Interest to the Initiating Party or (ii) the Receiving Party has elected to purchase the Initiating Party's Joint Venture Interest, but fails to do so by the closing date for such transaction as provided in this Section, and the Initiating Party so elects within fifteen (15) days after the date (and any extensions thereof) on which the Receiving Party was to close the purchase of the Joint Venture

Interest of the Initiating Party, then in either event, Receiving Party shall be obligated to sell, and the Initiating Party shall be obligated to purchase, all of the Joint Venture Interest of Receiving Party at the Receiving Party Purchase Price set forth in, and on the terms and conditions stated in, the Offering Notice.

BUY-SELL PROVISION 3

(a) If (i) more than ______ years shall have passed since the Closing, (ii) PARTY ONE and PARTY TWO shall disagree on any matter specified in any of paragraphs ____________ and (iii) such disagreement shall not have been resolved within a 60-day period, then either PARTY TWO or PARTY ONE may declare an impasse (an "Impasse") by written notice to the other party. Following declaration of an Impasse, either party may within five Business Days dissolve the Impasse by sending a written notice (a "Impasse Dissolution Notice") accepting the other party's position and irrevocably agreeing to accept such position in any resolution that is proposed within 30 days after such Impasse Dissolution Notice.

(b) (i) If an Impasse is not dissolved pursuant to paragraph (a) above, within 10 Business Days of the declaration of such Impasse, PARTY TWO and PARTY ONE shall each select an independent appraiser nationally recognized as qualified to appraise businesses in the satellite communications industry, each of whom shall deliver its appraisal of Fair Market Value to an independent person (to be agreed by PARTY TWO and PARTY ONE and, in the absence of such agreement, ________________) within 20 Business Days of its selection as an appraiser. If the higher appraisal is more than 20% greater than the lower appraisal, the independent person shall notify PARTY TWO and PARTY ONE and each appraiser of that fact (but not of the amounts). In such a case, the two appraisers shall within 10 Business Days of such notification from the independent person agree on a third independent appraiser nationally recognized as qualified to appraise businesses in the satellite communications industry, who shall deliver its appraisal of Fair Market Value to the independent person within 20 Business Days of the selection of such third appraiser, and Fair Market Value shall be the average of the two closest appraisals. If the higher of the first two appraisals is not more than 20% greater than the lower of the first two appraisals, Fair Market Value shall be the average of the first two appraisals and there shall not be any third appraisal. The independent person shall promptly give written notice of Fair Market Value to each of PARTY TWO and PARTY ONE.

(ii) If an Impasse is not dissolved pursuant to paragraph (a) above and the independent person has given a notice of Fair Market Value to PARTY TWO and PARTY ONE within the 90 days prior to the declaration of such Impasse with respect to an earlier Impasse, the Fair Market Value shall be as so notified by the independent person.

(c) PARTY TWO and PARTY ONE shall each submit a sealed notice (a "Section 3(c) Notice") to the independent person within 30 days of(i) if Section 3(b)(i) applies, notification from the independent person of Fair Market Value or (ii) if Section 3(b)(ii) applies, the declaration of the Impasse, stating that such party will or will not purchase for cash all the Shares beneficially owned by the other at the percentage of Fair Market Value represented by such Shares (calculated in accordance with Section 3(j)). Upon receipt of both PARTY TWO's and PARTY ONE's Section 3(c) Notice, and in any event no later than the end of such 30 day period, the independent person shall give written notice to PARTY TWO and PARTY ONE of the contents of each Section 3(c) Notice received by the independent person.

(d) If one party states in its Section 3(c) Notice that it will purchase and the other states in its Section 3(c) Notice that it will not purchase (or fails to submit a Section 3(c) Notice within the 30 day period), the former will purchase all the Shares beneficially owned by the latter, and the latter will sell all such Shares to the former, at the percentage of Fair Market Value represented by such Shares (calculated in accordance with Section 3(j)).

(e) If PARTY TWO and PARTY ONE each state in its respective Section 3(c) Notice that it will purchase, the party who declared the Impasse shall purchase all the Shares beneficially owned by the other, and the other party shall sell all such Shares, at the percentage of Fair Market Value represented by such Shares (calculated in accordance with Section 3(j)) unless within five Business Days such other party makes a written bid at least 1% in excess of Fair Market Value (a "Topping Bid"). A Topping Bid shall state an aggregate price in cash for all Shares. Thereafter, each party shall have one Business Day to make a Topping Bid of at least 1 % over the other party's immediately preceding Topping Bid (except that if the latest Topping Bid is more than 5% in excess of the immediately preceding Topping Bid, a party shall have five Business Days to make the immediately following Topping Bid). A Topping Bid shall be irrevocable once made. Failure to make such a Topping Bid within such period shall result in the last Topping Bid made being deemed accepted. To be effective, a Topping Bid must be delivered prior to 5:00 p.m. eastern standard time on the relevant Business Day to the individual specified in Section ___. A party may make a Topping Bid by telephone to the individual specified in Section ___ if such party promptly confirms such telephonic Toppings Bid in writing by telecopy and overnight delivery service to the individual specified in Section ___. Whether a Topping Bid is higher than another Topping Bid, and the extent to which it is higher, shall be determined by reference to the aggregate price stated in such Topping Bids and not by reference to the consideration payable if either of such Topping Bids were accepted. Once a Topping Bid is accepted, or deemed accepted, the party who made such Topping Bid shall be deemed to have agreed to purchase, and the other party shall be deemed to have agreed to sell, all the Shares beneficially owned by such other party at the percentage of such Topping Bid represented by such Shares (calculated in accordance with Section 3(j)).

(f) If PARTY TWO and PARTY ONE each state in its respective Section 3(c) Notice that it will not purchase, there shall be no purchase and sale of shares, the relevant Impasse shall be deemed dissolved and the parties shall have no other remedies under this Agreement with respect to the disagreement that caused the relevant Impasse.

(g) The closing of any purchase and sale of Shares pursuant to this Section shall take place on the date and at the location designated by the purchaser in a written notice to the selling party. Such date shall not be more than [60] nor less than ten days after the date on which the obligation under this Section to purchase and sell such Shares arose, except that such [60] day period shall be extended as necessary in order to comply with any Applicable Law. At any such closing (i) the selling party shall deliver to the purchaser certificates representing all Shares beneficially owned by the selling party, duly endorsed in favor of the purchaser, against payment of the applicable purchase price by wire transfer of same day funds and (ii) the selling party shall give representations and warranties comparable to Sections ___ and ____, and the purchaser shall give representations and warranties comparable to Sections ___ and _____. If the purchaser defaults in payment in full of the purchase price and such default is not cured within two Business Days following the date of the proposed closing, the selling party, in addition to any other right it may have, may by notice to the defaulting purchaser terminate the agreement for the sale of the Shares owned by the selling party and elect to purchase all the Shares beneficially owned by the defaulting purchaser at the per share price determined in accordance with Section 3(j) by reference to the previously selling (and now purchasing) party's last Topping Bid (or if the previously selling (and now purchasing) party has not made any Topping Bid, by reference to Fair Market Value), such transaction to be completed upon five Business

Days advance notice from the now purchasing party to the other party (but in no event later than [sixty] Business Days after such notice is given (subject to extension in order to comply with any Applicable Law)), and otherwise on the same terms and conditions as referred to in the previous sentence.

(h) If an Impasse is declared, if the party who declared the Impasse does not state in its Section 3(c) Notice that it will purchase, such party will pay all costs of the appraisals, otherwise, PARTY TWO and PARTY ONE will pay all costs of the appraisals on an equal basis.

(i) Section 3(a) (iii) shall be available only to resolve a bona fide disagreement regarding the conduct and direction of the business of the Company and not as a method of realizing value from an investment in the Company through a sale of Shares. Accordingly, from the date of the declaration of an Impasse to the conclusion of the procedures described in Section 3(c), the parties shall negotiate in good faith toward resolution of the Impasse.

(j) In this Section, the applicable amount due and payable for Shares required to be purchased shall be calculated as the product of (A) the quotient obtained when (x) the number of outstanding Shares beneficially owned by such party is divided by (y) the number of outstanding Shares and (B) the applicable Fair Market Value or Topping Bid.

(k) This Section shall terminate upon the completion of a Qualified Initial Public Offering.

Attachment 1

NOTE:

THE FOLLOWING IS A SAMPLE FOR DISCUSSION

PURPOSES AND IS NOT INTENDED

AS A MODEL DOCUMENT.

JOINT VENTURE AGREEMENT

BY AND AMONG

PARTY ONE

AND

PARTY TWO

DATED AS OF _______

JOINT VENTURE AGREEMENT

THIS JOINT VENTURE AGREEMENT (this "Agreement") is made as of the _________ day of ___________, 19 by and between ________ ("PARTY ONE") and ________ ("PARTY TWO").

WITNESSETH

[WHEREAS CLAUSES I

WHEREAS, the parties desire to set forth certain terms and conditions governing their relationship in connection with the joint venture and as shareholders of the JVC.

NOW, THEREFORE, the parties agree as follows:

ARTICLE 1
ORGANIZATION OF THE JOINT VENTURE COMPANY

1.1 **Certain Terms.** As used in this Agreement, the following terms shall have the following respective meanings:

"**Affiliate**" shall mean, with respect to any specified Person, a Person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the Person specified.

"**1st Anniversary Date**" shall mean the date that is the first anniversary of the Effective Date.

"2nd Anniversary Date" shall mean the date that is the second anniversary of the Effective Date.

"Appraised Value Per Share" shall mean the value per share of Ordinary Shares determined in accordance with Section 14.7.

"Associate" shall mean, with respect to any specified Person, (1) any corporation or organization of which such Person is an officer or partner or is, directly or indirectly, the beneficial owner of 10 percent or more of any class of equity securities, (2) any trust or other estate in which such Person has a beneficial interest or as to which such Person serves as trustee or in a similar fiduciary capacity, and (3) any relative or spouse of such Person, or any relative of such spouse.

"**Authorized Additional Shareholder**" shall mean any Person that PARTY ONE and PARTY TWO mutually agree in writing may, collectively with all other such Persons, subscribe for up to 24% of the aggregate amount of issued and outstanding Ordinary Shares as contemplated by Section 2.2; provided, however, that the parties hereby agree that [ ] shall be deemed an Authorized Additional Shareholder for up to 14% of the aggregate amount of issued and outstanding Ordinary Shares and the IFC shall be deemed an Authorized Additional Shareholder for up to 10% of the aggregate amount of issued and outstanding Ordinary Shares,

in each case without any further action on the part of any party hereto; provided further, that prior to becoming a Shareholder, any Authorized Additional Shareholder shall agree in writing to be bound by the terms and conditions of this Agreement by executing a consent letter in form and substance satisfactory to the parties hereto.

“Business Day” shall mean any day (other than a Saturday or Sunday) on which banking institutions in are not authorized or obligated by law to be closed.

“**Competitor**” shall mean any licensee or other provider of a mobile radio cellular telecommunications service in [ ].

“Concession” shall mean the Concession, substantially in the form of Exhibit A hereto, pursuant to which the JVC will be the licensee.

“**$**” or “**Dollars**” means, unless otherwise specified, United States dollars.

“**IFC**” shall mean the International Finance Corporation.

“Independent Person” shall mean any individual that is not currently, and has never been, an officer, employee, director, or holder of securities of any party or any Affiliate of any party and is not a relative, spouse, former spouse, or relative of a spouse or former spouse of any such officer, employee, director or holder of securities.

“Person” shall mean any individual, partnership, corporation, company, trust or any other entity.

“Shareholders” shall mean PARTY ONE and PARTY TWO (but only so long as they hold any Ordinary Shares), and any other Person who may subsequently become a holder of Ordinary Shares in accordance with the terms of this Agreement.

“Six Year Business Plan” shall mean the business plan of the JVC, including, without limitation, annual budgets relating to income, capital expenditures, operating expenses and cash flow, from time to time approved by the Shareholders as provided in Section 9.4.

1.2 **Formation.** On or before the effective date of this Agreement as set forth in Section 17.7 hereof (the “Effective Date”), the parties shall cause the JVC to be organized under the laws of [ ] as a limited liability company incorporated and registered under the](or any successor thereto).

1.3 **Name.** The JVC shall be named [ ].

1.4 **Registered Office.** The registered office of the JVC shall be located in [ ].

1.5 **Business Purpose.** The business purpose of the JVC shall be:

(a) to install, operate, maintain and otherwise provide public cellular mobile radio telephone services in Dares-Salaam and Zanzibar and to otherwise provide any services permitted or required under the Concession; and

(b) to engage in any other business activities incidental or relating to the foregoing.

1.6 **Memorandum and Articles of Association.** The Memorandum of Association (the "Memorandum") and Articles of Association (the "Articles") of the JVC shall be in form and substance consistent with the provisions of this Agreement and shall include such provisions as are necessary to effectuate the provisions of this Agreement, all in form and substance satisfactory to PARTY ONE and PARTY TWO.

ARTICLE 2
CAPITALIZATION

2.1 **Ordinary Shares.** All shares of the JVC shall be Ordinary Shares, _____________ par value per share, of the same class (the "Ordinary Shares") and each Shareholder of record shall be entitled at each meeting of Shareholders to cast one vote for each Ordinary Share held by such Shareholder.

2.2 Authorized and Issued Shares.

(a) The authorized share capital of the JVC shall be $[ ] divided into One Hundred Thousand (100,000) Ordinary Shares. No other shares of stock or other equity securities or instruments exercisable or convertible into stock or equity securities is authorized.

(b) At any time after the dates set forth below, PARTY TWO, PARTY ONE and any Authorized Additional Shareholders shall, within 90 days of a call by the Board of Directors of the JVC, purchase the number of Ordinary Shares set forth opposite its name below and shall pay by cash or wire transfer in immediately available funds to the JVC the subscription price of Fifty Dollars ($50) per share:

Date	Party	No. of Shares	Aggregate Price
Effective Date	PARTY ONE	5.100 shares	$
Effective Date	PARTY TWO	10,400 shares	$
Effective Date	Authorized Additional Shareholders	4.900 shares	$
1st Anniversary Date	PARTY ONE	2.560 shares	$
1st Anniversary Date	PARTY TWO	5.220 shares	$
1st Anniversary Date	Authorized Additional Shareholders	2,460 shares	$

Date	Party	No. of Shares	Aggregate Price
2nd Anniversary Date	PARTY ONE	960 shares	$
2nd Anniversary Date	PARTY TWO	1,960 shares	$
2nd Anniversary Date	Authorized Additional Shareholders	920 shares	$

2.3 **Share Certificates.** Upon payment in full by any Shareholder of the purchase price thereof, the JVC shall issue to such Shareholder a certificate representing the Ordinary Shares paid for by such Shareholder.

2.4 **Failure to Pay.** The failure of any Shareholder to pay for its subscribed Ordinary Shares within 90 days after a call from the Board of Directors of the JVC shall make the related Ordinary Shares available to the other Shareholders, pro rata based on their respective holdings of Ordinary Shares.

2.5 **No Change to Rights.** No change shall be made in the rights of the shares held by any Shareholder, except with the prior written consent of such Shareholder and in conformance with the Memorandum and the Articles and applicable laws.

2.6 **Preemptive Rights.** Except to the extent expressly provided to the contrary in Section 2.2, the Ordinary Shares shall have preemptive rights giving each Shareholder the right to purchase its proportionate share of any subsequent issues of shares of stock or other equity securities, if any.

ARTICLE 3
BOARD OF DIRECTORS

3.1 **Management.** The JVC shall be managed by a Board of Directors consisting of six (6) members, one of whom shall be selected as a chairman who shall preside at each meeting of the Board of Directors and at each meeting of Shareholders. Such chairman shall be nominated by PARTY TWO and each of the Shareholders shall take or cause to be taken all action required to elect as chairman of the Board of Directors any director so nominated by PARTY TWO Subsidiary. The Board of Directors shall also have a vice-chairman who shall be nominated by PARTY ONE and each of the Shareholders shall take or cause to be taken all action required to elect as vice-chairman of the Board of Directors any director so nominated by PARTY ONE.

3.2 **Election.** Members of the Board of Directors shall be elected at the annual meeting of Shareholders from candidates nominated by the Shareholders. PARTY ONE shall be entitled to nominate one (1) candidate to the Board of Directors, PARTY TWO Subsidiary shall be entitled to nominate three (3) candidates-to the Board of Directors, and [OTHER APPROVED SHAREHOLDER] shall be entitled to nominate one (1) candidate to the Board of Directors; provided, however, that until such time as [OTHER APPROVED SHAREHOLDER] shall have delivered the consent letter required pursuant to the definition of

Authorized Additional Shareholder, [OTHER APPROVED SHAREHOLDER] shall not be entitled to nominate a candidate to the Board of Directors and PARTY ONE shall be entitled to nominate two (2) candidates to the Board of Directors or, if PARTY TWO breaches Section 10.1(i), for so long as such breach remains uncured, [OTHER APPROVED SHAREHOLDER] shall not be entitled to nominate a candidate to the Board of Directors and PARTY ONE shall be entitled to nominate two (2) candidates to the Board of Directors. PARTY ONE and PARTY TWO Subsidiary shall mutually agree on the candidate who will be the sixth nominee; provided, however, that such nominee must be an Independent Person. Each Shareholder agrees to vote its respective shares to elect the respective nominees chosen in accordance with this Section 3.2.

3.3 **Term.** Subject to Section 3.5(b), the term of office of a member of the Board of Directors shall be for one (1) year and until his successor is elected and qualified. Members of the Board of Directors shall be eligible to serve successive terms.

3.4 **Authorization.** The Board of Directors shall manage the business of the JVC and may exercise all powers normally exercised by a Board of Directors, except for such powers as are required to be exercised by Shareholders, all in accordance with this Agreement, the Memorandum, the Articles and applicable laws.

3.5 **Vacancies of Directors.**

(a) If a vacancy in any directorship should occur, for whatever reason, the Shareholder or Shareholders who had nominated the former director shall nominate his replacement. The Shareholders agree to vote their respective Ordinary Shares for the election of any such nominee. Vacancies shall be filled by vote of the Shareholders as provided in the Memorandum and Articles and in accordance with this Agreement.

(b) A Shareholder or Shareholders may remove any director nominated by such Shareholder or Shareholders, with or without cause, and may nominate a replacement for such director and the other Shareholders shall vote their Ordinary Shares to effect such removal and replacement.

ARTICLE 4
BOARD OF DIRECTORS' MEETINGS

4.1 **Quorum; Majority Vote.** Four (4) directors shall constitute a quorum at all meetings of the Board of Directors, and all resolutions of the Board of Directors shall be adopted by the affirmative vote of at least four (4) directors.

4.2 **Board of Directors Meeting.** Meetings of the Board of Directors shall be held at least quarterly.

4.3 **Proxies.** Any director who is unable to attend a meeting of the Board of Directors shall be allowed to appoint a proxy who shall be allowed to vote in the appointing director's place and stead.

4.4 **Remuneration.** The Directors shall not be entitled to be paid fees but shall receive such remuneration for executive services performed as an officer of the Company as the Board of Directors may decide in accordance with Article 5.

ARTICLE 5
RESTRICTIONS ON CORPORATE ACTION

5.1 **Supermajority Vote Requirements.** Notwithstanding any other provision of this Agreement, the Memorandum or the Articles, action on the following matters shall only be taken pursuant to resolutions duly adopted by the affirmative vote of Shareholders holding not less than 76% of all issued and outstanding Ordinary Shares:

(a) Any sale, lease, transfer, or other disposition of all or substantially all any of the assets of the JVC or any subsidiary company of the JVC (other than a transfer solely for the purpose of serving as collateral for bona fide indebtedness);

(b) Any petition or resolution to dissolve, declare bankruptcy or insolvency, or wind up the JVC, except as required by this Agreement;

(c) Any loan by the JVC to any Shareholder or director or their Associates;

(d) Any amendment of the Memorandum or the Articles;

(e) Any amalgamation, consolidation or merger into or with, or acquisition of all or a part of the business of, another juridical person or entity;

(f) Providing loans, guarantees, or other extensions of credit other than in the ordinary course of business;

(g) Issuance, repurchase or redemption by the JVC of shares, bonds, debentures or other securities of the JVC (except as contemplated by Section 2.2(b);

(h) Fixing compensation, including, without limitation, bonuses, of officers and other employee whose aggregate annual compensation will exceed in any individual case $50,000, provided that in no event shall anyone who is not an Independent Person be or become a compensated officer or employee of the JVC;

(i) Taking any action that is materially inconsistent with the Six Year Plan (an action that is materially inconsistent with the Six Year Plan means any action that causes any amount set forth in the Six Year Plan to vary by 10% or more);

(j) Declaration of dividends, whether cash or non- cash, if such declaration could reasonably be expected to interfere with the provision of Cellular Service or the construction and expansion of the Cellular Network as described, contemplated and required in the Concession Agreement of even date herewith;

(k) Any material change in the business of the JVC from the purposes set out in Section 1.5 of this Agreement;

(l) Adoption of an updated Six Year Business Plan as contemplated by Section 9.4;

(m) Any transaction between the JVC and a Shareholder or Affiliate of a Shareholder (except for the provision by a Shareholder or Affiliate of a Shareholder of loans on terms no less favorable to the JVC than those in connection with any loan then being provided to the JVC by any Person that is not a Shareholder or Affiliate of a Shareholder);

(n) Any single or a series of related capital expenditures in excess of $500,000; and

(o) Any single borrowing or series of related borrowings in excess of $500,000, or any borrowing when outstanding debt exceeds $500,000.

None of the foregoing actions may be taken during the 90 day period following any call by the Board of Directors to purchase Ordinary Shares without the prior written consent of Shareholders holding not less than 76% of all the issued and outstanding Ordinary Shares immediately prior to such call.

5.2 **Resolution of Deadlocks.**

(a) In the event a resolution concerning matters in Section 5.1 has been proposed at a meeting of Shareholders and has not passed, upon the written request of any two (2) directors given to the Board of Directors or at the request of any Shareholder that holds 25% or more of the issued and outstanding Ordinary Shares, the matter shall be referred to a committee of representatives (the "Shareholders Representative Committee") Bach Shareholder shall nominate an individual, not being a director of the JVC, to serve on the Shareholders Representative Committee.

(b) As soon as practical, upon referral of said matter by the Board of Directors or any Shareholder that holds 25% or more of the issued and outstanding Ordinary Shares to the Shareholders Representative Committee, the Shareholders Representative Committee shall meet and attempt in good faith to resolve said dispute within 30 working days of the referral by a resolution accepted by individuals on the Shareholders Representative Committee who were appointed by Shareholders holding at least 76% of the issued and outstanding Ordinary Shares.

(c) In the event that any dispute referred to the Shareholders Representative Committee is not resolved at the end of such 30 day period any Shareholder that holds 25% or more of the issued and outstanding Ordinary Shares shall be free to institute mediation pursuant to Section 12.1.

ARTICLE 6
MEETINGS OF SHAREHOLDERS

6.1 **Annual Meetings**. An annual meeting of Shareholders shall be held within the first three months of each calendar year and in any event not later than 15 months after the date of the next preceding annual meeting for the purpose of:

(a) the election of members of the Board of Directors; and

(b) such other matters as may be properly brought before the annual meeting. All other matters to be decided by the Shareholders may be decided at extraordinary meetings called as provided in the Memorandum and Articles.

6.2 **Quorum.** The quorum for any meeting of Shareholders shall be the presence in person or by proxy of Shareholders holding not less than 76% of the issued and outstanding shares entitled to be voted at such meeting and each and every resolution shall be adopted by a majority of the votes cast while a quorum is present except that any resolution regarding a matter included in Section 5.1 above shall only be adopted upon the affirmative vote of Shareholders holding not less than 76% of all of the issued and outstanding Ordinary Shares while a quorum is present.

6.3 **Notice of Meeting.** Notice for meetings of Shareholders, procedures for resolutions at such meetings and any other necessary rules with respect thereto shall be as prescribed in the Memorandum and Articles.

6.4 **Proxy.** A Shareholder shall be entitled to exercise its right to vote by proxy at meetings of Shareholders as provided by the applicable laws of [ ].

ARTICLE 7
AUDIT COMMITTEE

7.1 **Appointment of Member of the Audit Committee.** The JVC shall have an Audit Committee comprised of one member of the Board of Directors who is nominated by PARTY TWO and one member of the Board of Directors who is nominated by PARTY ONE. Subject to Section 7.2(b), members of the Audit Committee shall serve for one (1) year and until their successors are elected and qualified, provided that any member of the Audit Committee may be reelected for successive terms. Members of the Audit Committee shall serve without compensation.

7.2 **Vacancies.**

(a) If a vacancy in the Audit Committee should occur, for whatever reason, the Shareholder who had nominated the former member of the Audit Committee shall nominate his replacement. The Shareholders agree to use their best efforts to cause the Board of Directors to elect any such nominee.

(b) A Shareholder may remove any member of the Audit Committee nominated by such Shareholder, with or without cause, and may nominate a replacement for such member and the other Shareholders shall use their best efforts to cause the Board of Directors to effect such removal and replacement.

7.3 **Duties of the Audit Committee.** The members of the Audit Committee shall have access to all of the books and records of the JVC, shall be entitled to monthly financial reports prepared by the chief financial officer of the JVC, which reports shall be in from and substance reasonably satisfactory to the members of the Audit Committee, and shall be

responsible for discussing financial control and accounting issues with the JVC's independent auditors.

ARTICLE 8
TRANSFER OF SHARES

8.1 **General Restrictions.** (a) No party shall sell, assign, pledge or otherwise transfer (a "Transfer") its Ordinary Shares of the JVC without the prior written consent of the other parties, except as provided in this Article and Article 14 hereof.

(b) Notwithstanding any other provision of this Agreement, no Transfer shall be allowed (i) to any Competitor or (ii) to any Person who is prohibited by law or regulation from owning an interest in the holder of the Concession or if the transfer would result in grounds for revocation of the Concession. Any Transfer of Ordinary Shares permitted by this Agreement shall be subject to whatever government or regulatory approvals may be necessary to ensure the continued validity of the Concession.

8.2 **Majority Ownership.** Notwithstanding any other provision of this Agreement, PARTY TWO shall not, prior to the fourth (4th) anniversary of the commencement of the JVC's operations, Transfer any of its Ordinary Shares if such Transfer would reduce the unencumbered Ordinary Shares owned by PARTY TWO to less than 51% of the aggregate amount of Ordinary Shares issued and outstanding.

8.3 **Right of First Refusal.**

(a) In the event a Shareholder (the "Seller") receives a bona fide offer from a third party (the "Third Party") to purchase any of its Ordinary Shares (the "Offered Shares"), and the Seller desires to sell the Offered Shares, the Seller shall disclose details of the offer to the other Shareholders and shall first offer the Offered Shares for purchase by the other Shareholders at the same price and upon the same terms and conditions offered by the Third Party. The Shareholders receiving the offer shall, within thirty (30) days elect by written notice to purchase the Offered Shares, at the price and upon the terms and conditions offered (subject to Section 8.3(b) below), in proportion to their respective shareholdings (exclusive of the Seller's shareholding), provided that if one or more of the parties declines or fails to give written notice of its election to purchase all of its proportion of the Offered Shares, the remaining Shareholders shall have the right for the next thirty (30) days to elect by written notice to purchase pro rata (exclusive of the shareholdings of the Seller and the Shareholder(s) declining or failing to give notice) any Offered Shares not purchased by the other Shareholder or Shareholders. Payment by and transfer to Shareholders electing to purchase Offered Shares shall be completed no later than thirty (30) days after the giving of notice of the election to purchase. In the event that all of the Offered Shares are not purchased pursuant to the above provisions, the Seller may sell the Offered Shares remaining unpurchased to the Third Party at the same price and upon the same terms and conditions offered by the Seller to the other Shareholders, provided that (a) the Third Party agrees in writing to be bound by the terms and conditions of this Agreement by executing a consent letter in form and substance reasonably satisfactory to the other parties hereto and (b) the payment for and transfer of the Offered Shares by and to the Third Party is effected no later than

thirty (30) days after the expiration of all periods during which the other Shareholders have the right to give notice of their election to purchase Offered Shares.

(b) If the Third Party offer and the Seller's notice provide in whole or in part for a consideration that is neither cash nor an obligation to pay cash in the future, then the other Shareholders, in lieu of such unique consideration, may substitute cash (i) in an amount agreed upon by the Seller and the other Shareholders within twenty (20) days of the date that all non-selling Shareholders have received notice from the Seller of the Third Party offer; or (ii) failing such agreement, the average of the amount of cash determined by each of two qualified appraisers (one selected by the Seller and the other by the non-selling Shareholders) to be equal to the fair market value of such unique consideration, which determination shall be final and binding; provided, however, that if their valuations are greater than ten percent apart, then the two appraisers shall appoint a third appraiser (if they are unable to do so within ten (10) days, a court of competent jurisdiction shall do so upon the request of any party). If the third appraiser's valuation is the same as either of the first two valuations, then such valuation shall be deemed the fair market value established by the appraisers, but if the third appraiser's valuation is not the same as either of the first two valuations, then the two closest appraised values shall be averaged and the result shall be deemed the price established by the appraisers. The appraisers shall each be instructed to report their results in writing within twenty (20) days of their respective appointments. The fees of the appraisers shall be borne equally by the Seller and the JVC. In the event that a determination of the fair market value of such unique consideration is made under clause (ii) above, the thirty (30) day period to consummate the transaction after exercise of the initial purchase option contained in subsection (a) above shall commence on the date the last report of the appraisers is issued.

8.4 **Legend**. Certificates representing Ordinary Shares shall have the following legend endorsed thereon:

> The ordinary shares represented by this Certificate are subject to the terms of a certain Joint Venture Agreement dated as of the _______ day of _____________, 19____, a copy of which is on file with the Secretary of the Company, which agreement, among other things, restricts the transfer of the shares, and copies of which will be made available without charge.
>
> The Articles of Association of the Company and the above-referenced Joint Venture Agreement provide for (i) an affirmative vote of a greater than majority proportion of votes of the shareholders of the Company in order to authorize certain actions and (ii) a greater proportion than a majority of ordinary shares held by shareholders of the Company to constitute a quorum for the transaction of certain business by such shareholders.
>
> The Memorandum of Association of the Company and the above-referenced Joint Venture Agreement provide that under certain circumstances a shareholder of the Company may request the dissolution of the Company.

8.5 **Change of Control.** Any Change of Legal Control (as hereafter defined) shall be deemed a Transfer subject to Section 8.3, whereby the Shareholder whose legal control is changed shall be deemed a Seller. A Change of Legal Control in any Shareholder shall have occurred when any of the voting securities (and rights to acquire voting securities) of the Shareholder are no longer held, directly of indirectly, by the entity ultimately controlling such Shareholder on the date it becomes a party to this Agreement. The parties agree that the entity ultimately controlling PARTY TWO on the date of this Agreement is [ ].

8.6 **Unauthorized Transfers Void.** Any Transfer of Ordinary Shares which is not in full compliance with the provisions of this Agreement shall be null and void.

ARTICLE 9
ACCOUNTING; FINANCIAL PLANNING

9.1 **Accounting Period and Standards.** The accounting period of the JVC shall be the twelve-month period commencing the 1st day of January and ending on the 31st day of December. Complete books of account and records shall be kept by the JVC according to generally accepted accounting principles, consistently applied, employing standards, procedures and forms conforming to established practice in [ ]. At the end of each accounting period, such books and records shall be audited at the expense of the JVC by a reputable experienced accounting firm selected by the Board of Directors of the JVC. Access to the books of account of the JVC shall be made available to each of the Shareholders at all times during normal business hours, and each Shareholder shall have the right to have such books of account audited by its representatives. The JVC and each of the Shareholders hereby agree and consent to the preparation by the JVC's auditors of such additional reports as any party may request, at the expense of the requesting party.

9.2 **Annual Financial Statements.** A balance sheet, a statement of income and retained earnings, and a cash flow statement shall be submitted by the JVC to each party on an annual basis, not later than ninety (90) days after the end of the fiscal year. Such financial statements shall be audited at the expense of the JVC by the JVC's independent auditors and shall be prepared in accordance with generally accepted accounting principles, in effect from time to time in [ ], on a basis consistently applied.

9.3 **Monthly Operating Reports.** Promptly after the end of each calendar month (and in any event within 15 days), the JVC shall submit to each Shareholder a report of its operations for such month, which report shall consist of at least a profit and loss statement, a balance sheet, a cash flow statement, and information concerning any other occurrence material to the JVC.

9.4 **Subsequent Plans.** The following procedure shall be followed in preparing the Six Year Business Plan: (60) days before the beginning of each fiscal year of the JVC, a Six Year Business Plan commencing with such fiscal year shall be prepared by the President and presented to the Shareholders for approval by Shareholders holding at least 76% of the issued and outstanding Ordinary Shares. If, at the beginning of any fiscal year, the Shareholders have not approved an updated, current Six Year Business Plan commencing with that fiscal year, the Six Year Business Plan previously approved shall continue in effect and shall

be used as the business plan for those fiscal years until the Shareholders approve a new Six Year Business Plan.

ARTICLE 10
REPRESENTATIONS AND WARRANTIES

10.1 **Representations and Warranties by PARTY TWO and PARTY TWO Subsidiary.** PARTY TWO and PARTY TWO Subsidiary jointly and severally represent and warrant to, and covenant with, each other party, as follows:

(a) PARTY TWO is a corporation duly organized and validly existing under the laws of Luxembourg and is in good standing in such jurisdiction, and as such has a minimum of ten (10) years experience in the establishment, operation, maintenance and exploitation of cellular mobile radio telephone services.

(b) PARTY TWO Subsidiary is a company duly organized and validly existing under the laws of the Netherlands Antilles, is in good standing in such jurisdiction, and is a wholly owned direct subsidiary of [ ].

(c) Each of PARTY TWO and PARTY TWO has the full right, power and authority to enter into this Agreement and will at all times have the full power and authority to perform its obligations under this Agreement. This Agreement has been duly authorized, executed and delivered by each, and this Agreement constitutes its valid and binding obligation, enforceable against it in accordance with its terms.

(d) Neither PARTY TWO nor PARTY TWO Subsidiary is, nor at any time will either be, a party to any contract or other arrangement of any nature that will materially interfere with its full, due and complete performance of this Agreement.

(e) There is no litigation or proceeding pending nor, to the best knowledge of PARTY TWO or PARTY TWO Subsidiary, is any investigation pending or litigation, proceeding, or investigation threatened involving PARTY TWO or PARTY TWO Subsidiary (or any of their Affiliates), which could, if adversely determined, materially and adversely affect the operation or financial condition of the JVC or the performance of PARTY TWO's or PARTY TWO Subsidiary's obligations under this Agreement.

(f) Neither PARTY TWO nor PARTY TWO Subsidiary is, nor at any time will either be, in violation of any existing law, by entering into and undertaking the performance of this Agreement.

(g) [ ] is a corporation duly organized and validly existing under the laws of Luxembourg, is in good standing in such jurisdiction, and is a wholly owned direct subsidiary of PARTY TWO.

(h) [ ] is a company duly organized and validly existing under the laws of Netherlands, is in good standing in such jurisdiction, and is a wholly owned direct subsidiary of [ ].

(i) PARTY TWO does not have any ownership interest, direct or indirect, in OTHER APPROVED SHAREHOLDER] or any Affiliate or Associate of [OTHER APPROVED SHAREHOLDER]; [OTHER APPROVED SHAREHOLDER] is not an Affiliate of PARTY TWO; the only project on which PARTY TWO and [OTHER APPROVED SHAREHOLDER] or any Affiliate or Associate of [OTHER APPROVED SHAREHOLDER] are co-venturers (whether as shareholders, partners or otherwise) is the cellular telephone project contemplated by this Agreement; and PARTY TWO agrees that it will not (1) acquire any ownership interest in [OTHER APPROVED SHAREHOLDER] or any Affiliate or Associate of [OTHER APPROVED SHAREHOLDER], (2) become an Affiliate of [OTHER APPROVED SHAREHOLDER], or (3) enter into any other-venture (whether as shareholders, partners or otherwise) with [OTHER APPROVED SHAREHOLDER] or any Affiliate or Associate of [OTHER APPROVED SHAREHOLDER].

10.2 **Representations and Warranties by PARTY ONE.** PARTY ONE represents and warrants to, and covenants with, each other party as follows:

(a) PARTY ONE is a corporation duly organized and validly existing under the laws of [ ] and is a corporation in good standing in such jurisdiction.

(b) PARTY ONE has the full right, power and authority to enter into this Agreement and will at all times have the full power and authority to perform its obligations under this Agreement. This Agreement has been duly authorized, executed and delivered by it, and this Agreement constitutes its valid and binding obligation, enforceable against it in accordance with its terms.

(c) PARTY ONE is not, nor at any time will it be, a party to any contract or other arrangement of any nature that will materially interfere with its full, due and complete performance of this Agreement.

(d) There is no litigation or proceeding pending nor, to the best of PARTY ONE's knowledge, is any investigation pending or litigation, proceeding, or investigation threatened involving PARTY ONE which could, if adversely determined, materially and adversely affect the operation or financial condition of the JVC or the performance of PARTY ONE's obligations under this Agreement.

(e) PARTY ONE is not, nor at any time will it be, in violation of any existing law by entering into and undertaking the performance of this Agreement.

ARTICLE 11

11.1 **Satisfaction of Conditions.** Each of the parties hereto covenants with each other party to use its best efforts to ensure that the conditions to the Effective Date set forth in Section 17.7 are satisfied, insofar as such matters are within its control.

ARTICLE 12
MEDIATION

12.1 **Mediation.** If a disagreement exists between or among the Shareholders concerning a matter that is not resolved pursuant to Section 5.2, any Shareholder may require the others to submit the reasons for its position in writing. Any Shareholder who holds 25% or more of the issued and outstanding Ordinary Shares may then elect to submit the disagreement to mediation under the UNCITRAL Conciliation Rules as currently in force. If any such Shareholder so elects, the other Shareholders shall submit to such mediation. There shall be one mediator who shall be appointed by [ ]. The mediator shall not have authority to impose a settlement upon the Shareholders, but will attempt to help them reach a satisfactory resolution of the disagreement. The mediator shall end the mediation whenever, in his judgment, further efforts at mediation would not contribute to a resolution of the submitted disagreement. If mediation ends and the disagreement in question has not been resolved, then any Shareholder who holds 25% or more of the issued and outstanding Ordinary Shares may become a Terminating Party pursuant to Section 14.4.

ARTICLE 13
INDEMNIFICATION

13.1 **Indemnification**. Any party that breaches any representation, warranty or covenant or other obligation set forth in this Agreement (the "Indemnifying Party") shall indemnify, defend, and hold harmless the JVC and each other party (including those who have been, but no longer are, parties) and its employees, officers, directors and agents (the "Other Indemnified Persons") from and against all loss, cost, liability and expense which may be imposed upon or reasonably incurred by the JVC or the other parties or the Other Indemnified Persons, including reasonable attorneys' fees and disbursements and reasonable settlement payments, in connection with any claim, action, suit or proceeding or threat thereof, made or instituted in which the JVC, the other parties or the Other Indemnified Persons may be involved or be made a party by reason of any such breach of the Indemnifying Party's representations or covenants or other obligations set forth in this Agreement.

13.2 **Procedure for Defense.** Promptly after receipt by a Person indemnified under any express provision of this Agreement (the "Indemnified Party") of notice of the commencement of any action against the Indemnified Party, such Indemnified Party shall give notice to the Indemnifying Party. The Indemnifying Party shall be entitled to participate in the defense of the action and, to the extent that it elects to do so by written notice to the Indemnified Party, to assume the control and defense and/or settlement of such action; provided, however, that (i) both the Indemnifying Party and the Indemnified Party must consent and agree to any settlement of any such action, except that if the Indemnifying Party has reached a bona fide settlement agreement with the plaintiff(s) in any such action and the Indemnified Party does not consent to such settlement agreement, then the dollar amount specified in the settlement agreement shall act as an absolute maximum limit on the indemnification obligation of the Indemnifying Party, and (ii) if the defendants in any such action include both the Indemnifying Party and the Indemnified Party and if the Indemnified Party shall have reasonably concluded that there are legal defenses available to it which are in conflict with those available to the Indemnifying Party, then the Indemnified Party shall have the right to select separate counsel to

assert such legal defenses and otherwise to participate in the defense of such action on its own behalf, and the fees and disbursements of such separate counsel shall be included in the amount which the Indemnified Party is entitled to recover under the terms and subject to the conditions of this Agreement.

ARTICLE 14
TERM AND TERMINATION

14.1 **Term.** This Agreement shall continue in effect for so long as any party hereto or their permitted transferees hold any Ordinary Shares in the JVC, unless earlier terminated as provided for in Sections 14.5 and 14.6 below.

14.2 **Termination for Bankruptcy.** Any party may trigger the rights set forth in Section 14.5 by giving notice to the other parties to this Agreement, upon the occurrence of any one or more of the following events:

(a) Appointment of a trustee or receiver for all or any part of the assets or property of one of the other parties;

(b) Insolvency or bankruptcy of one of the other parties;

(c) One of the other parties makes a general assignment for the benefit of creditors;

(d) Attachment of substantially all of the assets of one of the other parties; or

(e) Dissolution or liquidation of one of the other parties (any party described in any of clauses (a) through (e) is hereinafter referred to as the "Bankrupt Party").

14.3 **Termination for Breach.** If any party commits a material breach of this Agreement (such party is hereinafter referred to as the "Breaching Party"), any other party may give the Breaching Party (with copies to all other parties to this Agreement) a written notice describing such breach and stating that this Agreement will terminate unless such breach is corrected within the time prescribed in this Section 14.3. If such breach is not corrected within sixty (60) days after such notice is given, the rights set forth in Section 14.5 shall have been triggered.

14.4 **Termination for Deadlock.** If mediation pursuant to Section 12.1 has ended without resolving the disagreement that was the subject of the mediation, any Shareholder who holds 25% or more of the issued and outstanding Ordinary Shares (the "Terminating Party") may trigger the rights set forth in Section 14.5 by giving notice to the other parties to this Agreement.

14.5 **Transfer of Shares.** In the event the rights set forth in this Section 14.5 are triggered pursuant to Sections 14.2, 14.3 or 14.4 (the Bankrupt Party, the Breaching Party or the Terminating Party, hereinafter referred to collectively as the "Selling Shareholder") each non-Selling Shareholder shall have the right to purchase in proportion to their respective shareholdings (exclusive of the shareholding of the Selling Party) the shareholding of the Selling

Party. The purchase price per share for Ordinary Shares transferred pursuant to this Section shall be the Appraised Value Per Share. In the event that the non-Selling Shareholders fail to purchase all of the shares owned by the Selling Party within 180 days after a notice pursuant to Section 14.2, 14.3, or 14.4 has been delivered, the parties shall liquidate and dissolve the JVC pursuant to Section 14.6.

14.6 **Effect of Termination.** The termination of this Agreement shall not in any way operate to impair or destroy any of the rights or remedies of any party, or to relieve any party of its obligations to comply with any of the provisions of this Agreement, which shall have accrued prior to the effective date of termination. In the event that all of the Ordinary Shares of the Selling Party are not transferred pursuant to the provisions of paragraph 14.5, the Shareholders shall vote their respective Ordinary Shares in favor of and cause the Board of Directors to take such actions as are necessary to liquidate and dissolve the JVC in accordance with applicable laws, after which time this Agreement shall terminate.

14.7 **Appraisers: Dispute as to Appraiser.**

(a) Appraisers appointed in connection with the sale of Ordinary Shares under Section 14.5 shall in all instances be qualified in the appraisals of businesses such as the JVC. Appraisal shall be made on the basis of the JVC as an ongoing business, for a transaction between a willing buyer and willing seller.

(b) In the event the Shareholders cannot agree upon the selection of an appraiser within 30 days, the Selling Party shall select an appraiser and the non-Selling Shareholders shall select an appraiser within 15 days thereafter. The appraisers shall each determine a value for the Ordinary Shares within 30 days after they are appointed. Then, their valuations shall be averaged and the average shall be the valuation price; provided, however, that if their valuations are greater than ten percent apart, then the two appraisers shall appoint a third appraiser (if they are unable to do so within ten (10) days, a court of competent jurisdiction shall do so upon the request of any party). The two closest appraised values shall be averaged and the result shall be deemed the price established by the appraisers.

(c) The cost of one appraiser appointed jointly by the parties, or a third appraiser appointed by the first two appraisers, shall be divided with the Selling Party paying one-half and the JVC paying one-half. In the event the Selling Party appoints one appraiser and the non-Selling Shareholders appoint one appraiser, the Selling Party shall pay the cost of the one it appoints and the JVC shall pay the cost of the one the non-Selling Shareholders appoint.

ARTICLE 15
CONFIDENTIALITY

15.1 Confidential Information. Each party shall, and shall exercise its best efforts to assure that its Affiliates, directors, officers, agents and employees shall, keep confidential all trade secrets, know how and other confidential information of the JVC and of the other parties and shall not use any of such confidential information except as authorized in writing by the owner. This obligation shall survive termination of this Agreement for a period of two years but shall cease to apply to any information (i) after it has come into the public domain

through no fault of the party to whom such information was disclosed, (ii) if it is disclosed to others by the owner without any restrictions regarding confidentiality, (iii) if it was or becomes known to the recipient without breach of this or any other obligation of confidentiality, or (iv) if disclosure is required by judicial or prosecutorial action.

ARTICLE 16
NON COMPETITION

16.1 **During Term of This Agreement.** Except as otherwise agreed among the parties, until the termination of this Agreement, the parties shall not, and shall require that their Affiliates, directors, officers and employees and the directors, officers and employees of their Affiliates (so long as said directors, officers and employees remain employed by the party and/or its Affiliates, as the case may be) shall not engage in any business which operates, maintains, installs or provides a cellular mobile radio telephone service in [ ]; provided, however, that PARTY ONE shall be permitted to serve via any technology or configuration rural areas of [ ]; and provided further that a party shall be deemed to have complied with this provision if it terminates the employment of any offending director, officer or employee after learning of a violation of this provision by such offender.

16.2 **After Termination of Agreement.** If any party ceases to be a Shareholder (directly or indirectly through one or more subsidiaries) in the JVC for any reason other than the liquidation of the JVC, that party shall not, and shall require that its Affiliates, directors, officers or employees (so long as said directors, officers and employees remain employed by the party and/or its Affiliates, as the case may be) shall not, for six months from the date of such cessation directly or indirectly carry on or own an interest in a business which operates, maintains, installs or provides a cellular mobile radio telephone service in [ ]; provided, however, that PARTY ONE shall be permitted to serve via any technology or configuration rural areas of [ ]; and provided, further, that a party shall be deemed to have complied with this provision if it terminates the employment of any offending director, officer or employee after learning of a violation of this provision by such offender. This Section shall survive termination of this Agreement.

ARTICLE 17
MISCELLANEOUS

17.1 **No Agency or Partnership.** Nothing contained in or relating to this Agreement shall or shall be deemed to constitute a partnership or agency relationship between any of the parties.

17.2 **Waiver.** No waiver by any party at any time of any breach of any of the terms and conditions of this Agreement shall be interpreted as a waiver of any subsequent breach, whether of the same or of any other term or condition of this Agreement.

17.3 **Notices.** All communications and notices required or permitted under this Agreement shall be in writing and shall be deemed to have been sent and received when delivered by hand or sent by telefacsimile or other wire transmission (with assurance of receipt in a manner typical with respect to communication of that type) or five Business Days after being

sent by registered or certified mail, postage prepaid, or two Business Days after being sent by recognized overnight courier service, all charges prepaid, addressed as follows:

If to PARTY ONE:

copy to:

If to PARTY TWO:

copy to:

or at such other address as a party may designate by notice to the other parties hereto in accordance with this Section.

17.4 **Inconsistency.** In the event of any conflict between the Memorandum or Articles and any provisions of this Agreement, the provisions of this Agreement shall, as among the parties, prevail.

17.5 **Specific Performance; Other Rights.** The parties recognize that various of the rights granted under this Agreement are unique and, accordingly, the parties shall, in addition to such other rights and remedies as may be available to them at law or equity, have the right to enforce their rights under this Agreement by actions for injunctive relief and specific performance.

17.6 **No Right of Third Parties.** This Agreement sets forth the relationship between the parties and shall not confer any rights or privileges on any third parties, except the Other Indemnified Persons.

17.7 **Effective Date.** Except for Section 1.2 and Articles 11, 13 and 15 which shall become effective upon execution hereof, this Agreement shall not become effective until and unless:

(a) each party obtains such governmental approvals, if any, as are necessary under any applicable laws for the acquisition of shares of the JVC in accordance with this Agreement;

(b) the Concession shall have been issued to the JVC by the appropriate authority;

(c) PARTY ONE and PARTY TWO shall have approved in writing a Six Year Business Plan covering the period ending on December 31, 1999; and

(d) an Interconnection Agreement substantially in the form of Exhibit B hereto shall have been executed and be in effect. The date when clauses (a), (b), (c) and (d) above have been satisfied shall be the "Effective Date" of this Agreement.

17.8 **Assignment.** This Agreement, and the rights and obligations under this Agreement, shall not be transferred, assigned or encumbered, in whole or in part, by any of the parties, except to the extent permitted by Articles 8 and 14 of this Agreement.

17.9 **Applicable Law.** It is mutually understood and agreed that this Agreement shall be deemed to have been made in [ ], and that any and all performance hereunder, or breach hereof, shall be interpreted, governed and construed pursuant to the laws of [ ] applicable to agreements made and to be performed in [ ], without regard to its principles of conflicts of law.

17.10 **Entire Agreement.** This Agreement, including the Exhibits attached hereto, sets forth the entire understanding between the parties relating to the subject matter contained herein, and all prior discussions and writings between the parties with respect thereto are superseded by this Agreement.

17.11 **Modification.** No amendment, modification or addition to this Agreement shall be effective or binding on any party unless set forth in writing and executed by each party. Action taken in reliance on a writing not signed by each party shall not be entitled to compensation on the basis of equitable estoppel or any other equitable theory.

17.12 **Severability.** The provisions of this Agreement shall be deemed to be severable, and the invalidity of any provision of this Agreement shall not affect the validity of the remaining provisions of this Agreement.

17.13 **Survival of Obligations.** Notwithstanding any termination of this Agreement for any cause, the parties hereto shall not be released from any liability which at the time of such termination has already accrued to such party or which thereafter may accrue to such party in respect of any act or omission prior to such termination.

17.14 **Further Assurances.** Each of the parties shall cooperate fully with the other parties in order to realize the purposes of this Agreement. Each of the parties and any permitted transferees shall, at any time and from time to time after the execution of this Agreement, upon the request of any other party, take such further action and execute, acknowledge and deliver such additional documents and instruments as may be necessary to carry out this Agreement.

17.15 **Counterparts.** This Agreement may be executed in one or more counterparts, all of which shall be considered one and the same agreement and shall become effective when one or more counterparts shall have been signed by each of the parties hereto and delivered to the other parties hereto.

17.16 **Headings.** The table of contents and the descriptive headings to the Articles and Sections of this Agreement are to facilitate reference only, do not form a part of this Agreement, and shall not in any way effect the interpretation hereof.

17.17 **Ratification.** Within 30 days following the Effective Date, the parties shall cause the Board of Directors of the JVC to ratify this Agreement by duly adopting a resolution in form acceptable to the parties, and pursuant to which the JVC shall execute and

deliver a counterpart of this Agreement and the JVC shall be entitled to the benefits of this Agreement and shall be subject to the obligations of this Agreement insofar as such benefits and obligations relate to the JVC.

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed by their duly authorized officers as of the date first above written.

[PARTY ONE]

By ______________________________

___________________________________, ______________________

[PARTY TWO]

By________________________________

___________________________________, ______________________

BREAKING UP IS(N'T) HARD TO DO – CLOSELY-HELD BUSINESS DIVORCES

TAX CONSIDERATIONS

Pinney L. Allen
Alston & Bird LLP

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TAX CONSIDERATIONS

By: Pinney L. Allen[*]
Alston + Bird LLP
July, 2004

INTRODUCTION

There is no area of tax law in which the tax advisor has a greater opportunity to earn his pay than the purchase or sale of a business. In addition, there is no area for the business law practitioner when negotiating the purchase or sale of a business that is more likely to require the assistance of the tax advisor. Since time immemorial, sellers and their advisors have sought capital gains treatment (though recent law changes on taxation of dividends are changing that dynamic) while purchasers and their advisors have sought allocation of purchase price to depreciable and amortizable assets. The Service has sought to deny capital gains treatments to sellers through judicially created concepts such as the assignment of income doctrine and the tax benefit rule. At the same time, the Service has contested the deductions of purchasers through challenges to allocations. This paper will give an overview of Code provisions that govern the sale of a business and related legal issues.

I. TAXABLE V. TAX-FREE TRANSACTIONS

A. INTRODUCTION

1. The Tax Stakes From The Seller's Point of View.

a). Recognition or nonrecognition of gain or loss by selling shareholders.

i. Differences in shareholders' positions: potential gains *vs.* potential losses; corporation *vs.* individual.

ii. Older individual shareholders may want to hold shares for "step-up" in basis at death. Under Sec. 1014(a), the basis of property acquired by beneficiaries of a decedent is equal to the fair market value at the date of death (or alternate valuation date). If an individual holds onto shares with a low basis until he dies, no capital gains tax is ever paid on pre-death appreciation, by reason of the "step-up" in basis.

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[*] Ms. Allen is a partner in the law firm of Alston & Bird LLP practicing in its Atlanta office and co-chairs its Tax Section. The author gratefully acknowledges the assistance of her colleagues L. Andrew Immerman, Saba Ashraf, and Bret Bogenschneider in the preparation of this outline.

b). Recognition or nonrecognition of gain or loss by Target company.

i. Recognition of gain on appreciated assets, including (but not limited to) depreciation recapture.

ii. Payments for noncorporate assets (e.g., covenants not to compete from shareholders important to the business, intangibles or other assets held by shareholders).

iii. Allocation of cost of recognition between buyer and seller.

2. The Tax Stakes From The Buyer's Point Of View.

a). Basis of assets, especially depreciable assets, in the buyer's hands.

b). Preservation of net operating losses and other desirable tax attributes.

c). Avoiding liability for existing tax—and other—liabilities of the Target company.

3. Structuring The Transaction To Meet The Parties' Objectives: The Three Basic Methods Of Acquisition.

a). The "taxable" transaction.

i. To the acquiring company, a purchase of the shares or assets of the Target company—normally for cash (or cash and debt instruments).

ii. To the shareholders of the Target company (or to the Target company itself), a sale resulting in taxable gain or allowable loss.

b). The "tax-free" (more properly, tax-deferred) transaction.

i. To the acquiring company, an acquisition of the shares or assets of the Target company, in exchange for shares (and, in some cases, debt securities) of the acquiring company or a parent; treated for income tax purposes as a kind of "pooling" in which the tax characteristics of the Target company are carried forward.

ii. To the Target company and its shareholders "tax-free exchange" involving no currently taxable gain or allowable loss, but the shareholders must carry over their existing tax cost, or "basis", for their shares to the consideration received, thus in general recognizing gain or loss upon their subsequent disposition of that consideration.

c). “Mixed” transactions that have elements of both the traditional "taxable" and "tax-free" approaches.

B. TAXABLE ASSET PURCHASES

1. Generally.

Generally, a sale of assets will lead to taxation at two levels. The sale of assets gives rise to gain or loss and related taxation, at the corporate level. A subsequent liquidation of the corporation or distribution of proceeds (now more feasible with lowered dividend tax rates) results in a second tax, at the shareholder level. This can result in an effective tax rate of over 50 percent. For the Purchaser, the asset sale gives a fair market value basis, most or all of which can be recovered over time through amortization and depreciation deductions.

2. When Used.

a). Asset acquisitions will occur despite the two-level tax.

i. Where the purchase price results in little or no taxable gain, i.e., where the purchase price approximates the tax book value of the assets.

ii. Where there is taxable gain, but where there is no feasible alternative to an asset disposition. The most common example will be the sale of a division under circumstances in which the seller will not liquidate and will continue its remaining businesses.

iii. Even where there is a gain on the asset disposition, sellers with net operating losses or those organized as S corporations or partnerships and LLCs will be willing to sell assets because this effectively will be one tax, asset transactions can work.

b). Section 1060 provides guidance on methods of allocating purchase price in the context of asset acquisitions.

3. Unintentional Asset Acquisitions.

As noted, the name of the game in many instances will be to avoid an asset acquisition like the plague because it triggers a double tax. There are, however, pitfalls where a transaction may be deemed to be a taxable asset acquisition even though it does not appear to carry such status on its face:

a). A forward merger that does not qualify as a tax-free reorganization is considered for tax purposes to be a purchase of the assets of T followed by liquidation of T. See Rev. Rul. 69-6.

b). An acquisition structured as a reverse merger will not be deemed a taxable asset acquisition if it fails to qualify under Section 368, but rather will be treated as a taxable stock sale and there will be no General Utilities tax unless a 338 election is made. In that situation, the sole consequence of failure to

satisfy the reorganization requirements will be a potential tax on the T shareholders.

C. TAXABLE STOCK SALES

1. Stock Purchases.

The stockholder of a valuable enterprise can avoid the C corporation double tax by selling stock rather than assets. A taxable, reverse merger where S, a transitory subsidiary of P, mergers into T with T surviving, is treated as a sale of stock and will be the most common form for effecting a stock purchase. An actual stock purchase followed by a "squeeze out" reverse merger can be used to acquire T through a two-step process. For example, if there is little basis in the stock or assets of a company, and the company's assets have a taxable gain of $10 million, a sale of the assets to purchasing corporation and liquidation results in a tax liability of roughly $4.4 million. A sale of the stock results in a tax liability of $1.5 million. Obviously, the selling entrepreneur desires to sell stock.

a). While the lack of writeup is a loss to the buyer, that amount—taxed immediately to the seller—is recovered by the buyer through depreciation only over some period of time generally ranging from 5 to 15 years. Only where these are NOLs (or Target is an S corporation or LLC) will the asset sale likely be possible.

b). Obviously, in many types of transactions, the buyer, fearful of contingent liabilities, would prefer an asset acquisition to a stock acquisition.

2. Redemptions as Part of an Acquisition.

T may redeem some of its own shareholders as part of an acquisitive transaction in which T's remaining stock is being purchased by P, and the distribution will be treated as a redemption and not a dividend. Such transactions were commonly referred to as Zenz transactions (after the case approving this treatment). If T uses appreciated property to redeem a shareholder, however, T will recognize gain on the appreciated property as though it had been sold to the shareholder for its fair market value. I.R.C. §311(b). With reductions of dividend rates to match capital gains rates, these redemption structures are less important.

3. Section 338.

a). The basics of Section 338.

i. General rule. With a "regular" 338(g) election, a corporation ("purchasing corporation" or "P") that acquires the stock of another corporation ("Target" or "T") in a qualified stock purchase (as defined in § 338(d)(3)) may elect (or may be deemed to elect under the consistency rules of § 338) to have T treated as if it (1) sold all of its assets (as "old T") at fair

market value at the close of the day on which the qualified stock purchase occurred ("acquisition date") and (2) purchased those assets as a new corporation ("new T") at the beginning of the following day for an amount generally equal to the price paid by P for T stock plus the liabilities of T and other relevant items. The net effect of a § 338 election is that P obtains a basis in T assets that generally reflects the price it paid for T stock including liabilities assumed. A § 338 election is available in a direct stock purchase, in a reverse cash (or debt) merger, or any other transaction treated for tax purposes as a purchase of stock where at least 80% of the total combined voting power of all classes of stock and 80% of the total number of all other classes of stock (except nonvoting, limited dividend preferred stock) is acquired by P.

ii. Gain on sale of Target shares. Seller still recognizes gain on sale of Target shares. Because there are two taxes much like an asset sale and liquidation, “regular” 338 elections are uncommon.

iii. Basis of assets. New T is treated as purchasing the assets of old T for an amount equal to the sum of the grossed-up basis of P's recently purchased T stock, the basis of P's nonrecently purchased Target stock (T stock owned by P but acquired prior to the 12-month look back period ending on the date 80% ownership is achieved), T's liabilities, and "other relevant items." Thus, there is a "step-up."

iv. Tax reporting. Taxable year of T ends on acquisition date and it does not become a member of the affiliated P group until the next day.

[a] Generally, if a § 338 election is made for a T that is includible in a consolidated return filed by the selling group for a period that includes the acquisition date, then T is disaffiliated from that group immediately before its deemed sale of assets under § 338, and must file a final return including only the items resulting from the deemed sale or certain carryover items ("deemed sale return"). The deemed sale occurs on the close of the acquisition date and is the last transaction of old T. If a deemed sale return must be filed, any transactions of old T occurring on the acquisition date prior to the deemed sale are reported in the selling group's consolidated return.

[b] New T does not succeed to any of the tax attributes of old T, although such tax attributes may be carried over to and back from the deemed sale return of old T under applicable rules.

[c] Recapture income will be taxed to T and not to new affiliated group, thus the recapture income and tax cannot be offset by P NOLs or credit carryovers.

v. Generally used.

[a] Where Target NOLs, capital losses and credits can offset.

[b] Where stock of a foreign corporation is acquired.

b). Section 338(h)(10).

i. Generally. Section 338(h)(10) permits a selling affiliated group—and S corporations—to report the 338 election gain on its tax return as opposed to having the gain reportable by Target. The transaction is treated as though the Target sold its assets while a member of the group and then liquidated under § 332. Accordingly, the tax attributes of the Target remain with the group under § 381. Both parties must agree. Sellers will agree to this or can be "paid" effectively where the gain on the assets is less than the tax on a sale of shares sale, i.e., outside/inside basis differences will likely govern. This will be advantageous to stock sellers when the basis in the assets is higher than the basis in the stock to be sold.

ii. S corporations. S corporation shareholders can also elect this form. The deemed asset sale followed by deemed liquidation generates S corporation income that steps up basis and permits deemed liquidation generally to be tax free. Still can have some difference from stock sale because asset sale may have some amounts taxed at ordinary rates.

D. TAX FREE TRANSACTIONS

1. Generally.

The reorganization provisions of § 368 allow certain corporate acquisitions and adjustments to be effected without the recognition of gain or loss. The different types of reorganizations can be broadly classified as either requiring "solely voting stock" ("B" and "C" reorganizations) or permitting other consideration besides voting stock ("A" reorganizations, including forward and reverse subsidiary mergers).

a). Tax results of reorganization treatment. The general focus of reorganization treatment is that the transaction is treated on a tax-free basis. Since it is truly only tax deferral, however, the use of this form of transaction should be carefully considered. Purchaser gets no tax benefits and seller's tax deferral may not be that valuable, especially when measured against risks of stock ownership, particularly stock that may not be actively traded or on which there may be trading restrictions.

i. Target shareholders. The impact to the Target shareholders is as follows:

[a] No gain or loss is recognized (so long as they receive no boot; see discussion below). § 354(A)(1).

[b] The basis of stock received is the same as the basis of the stock surrendered in the exchange. § 358(A)(1).

[c] The holding period of the stock received includes the period during which the stock surrendered was held, assuming the stock was held as a capital asset. § 1223(1).

[d] Any payment of cash in lieu of fractional shares is treated as a distribution in full payment in exchange for the shares redeemed under § 302(a). See Rev. Proc. 77-41, 1977-2 C.B. 574. Any shareholder exercising appraisal rights and receiving cash is similarly treated as having redeemed his shares and will receive capital gain treatment assuming that redemption fulfills the requirement of § 302.

ii. Target. No gain or loss is recognized by Target upon the transfer of its asset or the assumption of liabilities. §§ 357(a) and 361(a).

iii. Acquiring. The tax impact to Acquiring of reorganization treatment is as follows:

[a] No gain or loss is recognized by Acquiring (or its parent if its stock is used) in the exchange of stock and assumption of liabilities and assets. § 1032(a); Rev. Rul 57-278, 1957-1 C.B. 124.

[b] The basis of assets acquired is the same as the basis of the assets in the hands of Target immediately prior to the exchange. § 362(b).

[c] The holding period of the Target assets in the hands of Acquiring includes the period during which the assets were held by Target. § 1223(2).

[d] Under §§ 381(a) and 381(c)(2) in any acquisitive reorganization other than a "B" reorganization (stock for stock where original corporation continuing in existence) the tax attributes set forth in § 381(c) become attributes of Acquiring. Most notably these include net operating loss carryovers, earnings and profits, capital loss carryovers, method of accounting, inventories, method of depreciation, and miscellaneous other items. The precise method for carryover and many other special rules

apply here. The treatment of net operating losses in particular is discussed in more detail below.

b). Receipt of boot. Gain will be recognized to the extent of the fair market value of boot, i.e., non-qualifying consideration such as cash, securities in excess of securities surrendered, etc., received in a transaction which otherwise qualifies as a reorganization. (§ 356(a)(1)).

i. Capital gain. This gain generally will be capital gain unless the exchange has the effect of a distribution of a dividend. (§ 356(a)(2)). *See Comm'r v. Clark*, 109 S. Ct. 1455 (1989) (holding that will judge whether is equivalent to a dividend with reference to acquiring and not Target corporation). With capital gains and dividend tax rates now the same, this is less important though basis will affect the calculation of gain and no loss is recognized.

ii. Securities. Where the principal amount of securities received exceeds the principal amount of securities surrendered, the fair market value of such excess principal amount will be boot. (§ 356(d)(2)(B)).

iii. § 306 Stock. If boot is received in exchange for § 306 stock, an amount equal to the fair market value of such boot will be treated as a § 301 distribution. (§ 356(e)).

iv. No loss. No loss will be recognized upon the receipt of boot. (§ 356(c)).

v. Assumption of liabilities. Generally, the assumption of a liability will not be considered boot in a transaction otherwise qualifying as a reorganization. (§ 357(a)).

[a] Tax avoidance. However, an assumption will result in the receipt of boot where there is a tax avoidance purpose for the assumption. (§ 357(b)). For example, debt incurred in anticipation of reorganization that has potential for bail-out.

[b] Excess over basis. Also, if the amount of the liabilities assumed exceeds the total basis of the assets transferred in a D reorganization, such excess will be treated as gain from a sale or exchange. (§ 357(c)).

2. Types of Reorganizations.

a). "A" reorganization: Merger (§ 368(a)(1)(A).

i. Methods.

[a] Straight merger. Target corporation is merged into Acquiring corporation and Target shareholders exchange their Target stock for Acquiring stock. After the merger, Target's assets can be put into a subsidiary of Acquiring.

((§ 368(a)(2)(C)).

[b] Triangular merger. A merger of Target into Acquiring in exchange for stock of Acquiring's parent corporation. (§ 368(a)(2)(D)). Acquiring must acquire "substantially all" of Target's assets in the merger. "Substantially all" has the same meaning as it has in § 368(a)(1)(C). (Reg. § 1.368-2(b)(2)). Service guide-lines say: at least 90% of the fair market value of the net assets, and at least 70% of the fair market value of the gross assets held by Target corporation immediately prior to the exchange. (Rev. Proc. 77-37, 1977-2 C.B. 568).

Potential issues here are redemptions, dividends or other transactions that reduce the Target's assets in anticipation of the merger. Also, dissenters electing appraisal rights will be counted.

No stock of Acquiring can be used; however, other property, such as cash or securities, of either Acquiring or its parent, or both, may be used. Also, the parent of Acquiring may assume liabilities of Target. Any property other than the Acquiring parent's stock will be boot, but its receipt will not cause the stock consideration to be taxable so long as sufficient parent stock is used.

If fails, is construed to be a sale of assets by Target to Acquiring and liquidation of Target. Due to double tax imposed on this structure, there is a high premium placed on being certain the structure works.

[c] Reverse triangular merger (§ 368(a)(2)(E)). Acquiring merges its controlled subsidiary into Target with Target shareholders exchanging their stock for stock of Acquiring. After the merger, Target must hold substantially all of its assets and the assets of the subsidiary merged into it. Shareholders of Target must receive voting stock of Acquiring in exchange for stock representing control of Target. May want to use where Target has a valuable franchise (such as a bank charter) or other assets which cannot be transferred and Acquiring wants to keep Target in existence. Looks very similar to a "B" reorganization (stock for stock), but limited amount of non-qualifying consideration does not taint transaction (see below). If fails, is treated as a stock purchase by Acquiring of Target and §338 will be available.

ii. "B" reorganization: stock solely for voting stock (§ 368(a)(1)(B)).

[a] Definition. "[T]he acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of stock of another corporation is, immediately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition)...."

Acquiring can use its own stock or stock of its parent, but not a combination of the two.

[b] Transfer assets. After the initial reorganization transaction, the stock or assets of Target can be transferred to a subsidiary of Acquiring. (§ 368(a)(2)(C)).

[c] Creeping. "Creeping" B reorganizations are permitted, i.e., preliminary cash acquisitions followed by a stock acquisition resulting in control (or even after control exists) will qualify so long as the first transaction is old and cold. (Reg. § 1.368-2(c)).

[d] Solely voting stock. Because of the "solely" for voting stock" requirement, if Target shareholders receive any consideration in addition to voting stock of Acquiring, the transaction will not qualify as a reorganization. Redemptions of less than 50% of Target shareholders by Target are permitted, but must be able to trace funds to Target and not Acquiring. Rev. Rul. 55-540, 1955-2 C.B. 226; Rev. Rul. 79-100, 1979-1 C.B. 152. Same result for dissenters. Purchase or exchange of debentures is a separate transaction, but if Target shareholders also hold debentures be careful to have proper values so does not violate "solely" requirement; the Target shareholders will recognize gain not only on the non-stock consideration, but also on the value of the Acquiring stock received. Target shareholders must pay their own expenses and must be careful that any salaries under employment contracts entered into at the time of the transaction are solely for services to be rendered, and would not be deemed by the Service to be part of the consideration for the shareholders' Target stock. Any other benefit, such as registration rights or the right to convert to another type of stock, must be carefully analyzed for its potential disqualifying effect in a "B" reorganization so that any rights are structured as an attribute of stock and not a separate right not flowing from stock. See, Rev. Rul. 75-33, 1975-1 C.B. 115 (right to dividend based on dividends paid by unrelated corporation that

made competing offer is O.K.); but compare, Rev. Rul 69-265, 1969-1 C.B. 109.

iii. "C" reorganization: assets for voting stock (§ 368(A)(1)(C)).

[a] Definition. "[T]he acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of substantially all of the properties of another corporation, but in determining whether the exchange is solely for stock the assumption by the acquiring corporation of a liability of the other, or the fact that the property is subject to a liability, shall be disregarded...."

Acquiring may use its parent's stock. Acquiring can transfer the acquired assets to a subsidiary following the initial acquisition. (§ 368(a)(2)(C)).

[b] "Substantially all". "Substantially all" is not defined in the regulations. See Rev. Proc. 77-37.

[c] Boot. This is not literally a solely for voting stock reorganization. Acquiring can pay cash or other boot and the transaction (except the boot) will still qualify for nonrecognition of gain as long as Acquiring pays for at least 80% of the value of the total assets of Target with its voting stock. (§ 368(a)(2)(B)).

[d] Liquidation. The stock of Acquiring received by Target must be distributed to Target's shareholders within 12 months.

[e] Subsidiaries. A "C" reorganization may be more remote because can use stock of corporation in control and drop assets down to its subsidiary. § 368(a)(2)(C).

iv. "G" reorganization. Title 11 (§ 368(a) (1)(G)). The "G" reorganization was added by the Bankruptcy Tax Act (P.L. 96-589) and applies to reorganizations in a bankruptcy context. It allows for greater flexibility by eliminating or modifying many of the technical steps ("control", "solely voting stock", "continuity of interest") to allow non-taxable reorganization provisions to apply.

b). Judicial tests.

i. Business purpose. There must be an affirmative business purpose, not merely a lack of tax avoidance. Typically this requirement does not pose

any problem. It is not clear whether the business purpose must be a corporate business purpose as opposed to a business purpose of a shareholder. Cases indicate, however, that probably only a shareholder purpose will suffice. (Note estate freeze recapitalizations and certain D reorganizations rely only on a shareholder purpose.)

ii. Continuity of proprietary interest. As a general rule, the judicially created continuity of interest ("COI") require-ment requires that some or all of the owners of Target corporation should end up with an equity interest in Acquiring or its parent.

[a] Ruling. For advance ruling purposes, this test will be met "if there is a continuing interest through stock ownership in the acquiring or transferee corporation (or a corporation in 'control' thereof within the meaning of section 368(c) of the Code) on the part of the former shareholders of the acquired or transferor corporation which is equal in value, as of the effective date of the reorganization, to at least 50 percent of the value of all of the formerly outstanding stock of the acquired or transferor corporation as of the same date." (Rev. Proc. 77-37, 1977-2 C.B. 568, 569). Because stock can change value between signing and closing, there is some concern that ratio erodes. The Service has this issue as an area for study on its business plan.

[b] Case law. Case law has found sufficient continuity of proprietary interest with substantially less than 50% of the value of the Target stock being exchanged for Acquiring stock. Practitioners typically are comfortable so long as at least 40% of the consideration is stock.

[c] Pre- and Post-Reorganization Transactions. The law regarding post reorganizations sales or dispositions of the Acquiror stock received in a reorganization by the Target share-holders used to be much more complex before the issuance of Treas. Reg. Section 1.368-1(e) on January 23, 1998 in T.D. 8760 and T.D. 8761, and amended on August 30, 2000 in T.D. 8898 ("New COI Regulations"). The New COI Regulations substantially simplified the COI doctrine. Under prior law, various post-reorganization sales by the Target shareholders of the Acquiror stock counted against COI. The focus under prior law was on whether the historic shareholders of Target received and continued to own the continuity preserving the Acquiror stock. Under the New COI Regulations, post-reorganization sales and dispositions of the Acquiror stock by the Target shareholders are ignored for purposes of COI for the most part. The only time that they are taken into consideration and count against COI is when they are dispositions back to the Acquiror, or to certain corporations related to the Acquiror. See Treas. Reg. Section 1.368-1(e)(2).

The IRS has ruled that stock purchases pursuant to certain stock repurchase programs will not count against COI if there is no understanding between the Target shareholders and Acquiror that the Target shareholders' ownership of the Acquiror shares will be transitory. See Rev. Rul. 99-58, 1999-52 I.R. B. 701.

The Target stock purchases by Acquiror or a person related to Acquiror for non-stock consideration prior to and in connection with the reorganization will count against continuity. In addition, redemptions of the Target stock by Target, or distributions with respect to the Target stock by Target with consideration that somehow comes from the Acquiror will count against COI.

iii. Continuity of business enterprise ("COBE"). The Regulations provide that "[c]ontinuity of business enterprise requires that the [transferee] either (i) continue [the transferor's] historic business or (ii) use a significant portion of [the transferor's] historic business assets in a business." Treas. Reg. § 1.368-1(d).

[a] Business continuity. The Regulations require only that a "significant line" of business be continued. Examples show retaining one out of three lines as sufficient.

[b] Asset continuity. The Regulations require that a "significant portion" of the assets be used. Generally "significant" is based on relative importance, though "facts and circumstances" will be considered.

[c] Partnership. Rules permit COBE to be satisfied when assets move to a partnership so long as Purchaser or its qualified group hold a "significant interest" or one or more of such parties has substantial management functions as a partner. (33% or 20% with active and substantial management both OK under the Regulations).

c). Planning considerations.

i. Statutory merger. One of the statutory merger forms will almost always be most desirable from the standpoint of the Target shareholders - the straight "A", the triangular or the reverse triangular.

[a] Consideration. Provided the continuity of proprietary interest test is met, the Target shareholders in a straight "A" reorganization may receive consideration other than Acquiring stock without disqualifying the transaction for non-recognition purposes (although any such non-stock

consideration will be "boot" and the Target shareholders receiving such consideration will be taxed on it).

[b] Different consideration. Straight "A" (merger of Target directly into Acquiring) permits some Target shareholders to receive cash for all or part of their Target stock while other Target shareholders may receive Acquiring stock and avoid gain recognition. Thus, in one transaction, some shareholders may "take their profit" and recognize their gain, while other defer recognition until they sell their Acquiring stock. Maybe (but not certainly) merger price for different shareholders can be different. (Risk is that consideration is for something other than stock.)

[c] Preferred and non-voting. In both a straight A and triangular merger, the use of preferred and/or non-voting stock is permitted (as opposed to "B" reorganizations, which require that sellers receive "solely voting stock", and "C" reorganizations, which require that "substantially all" assets of Target be transferred "solely for voting stock" of Acquiring). This is another desirable feature because it permits a shareholder who wishes to "peg" the consideration for his Target stock (rather than taking the market risk inherent in receiving Acquiring's common stock) to receive preferred stock which is redeemable at a fixed price in the future.

[d] Preferred dividend. If the purchaser will agree, the Target shareholders receiving preferred stock may also have fixed dividends which are higher than Acquiring's current common dividend rate and, in addition, the preferred can be convertible into common at or before time for redemption.

[e] Conversion. If a conversion feature is included, the shareholder may, in effect, defer the recognition of gain, receive a higher dividend return than he was getting from Target and decide in the future, after observing the performance of Acquiring, whether to convert his preferred into Acquiring common (and continue to defer gain) or to have his preferred redeemed and recognize his gain. (Note, cannot have convertible debt because debt in excess of debt exchanged is boot.)

[f] Redemption. The purchaser may be willing to grant favorable terms for conversion, redemption, dividends, etc. in return for Target shareholders taking non-voting preferred or agreeing to postpone redemption for long period. (In any event, there should be no redemption earlier than 5 years after closing in order to satisfy he continuity of interest test.)

[g] Use of cash. For ruling purposes, the Service requires that at least 50% of Target's stock be exchanged for stock (common or preferred, voting or non-voting) of Acquiring. (Rev. Proc. 77-37, supra) Thus, even under Service guidelines, at least one-half of consideration for Target may be cash without endangering the non-recognition status of the Target shareholders who receive Acquiring stock. Case law appears to permit even more cash.

[h] Cash election. Cash election merger permits Target shareholders to choose the type of consideration they want (cash or stock) within overall 50% limitation on amount of cash.

[i] Substantially all. The straight A merger—but not either form of triangular merger—avoids the “substantially all” requirement.

ii. Stock swap. The "B" reorganization should be avoided if at all possible for the reasons mentioned earlier. An inadvertent slip can cause the Target shareholder to be taxed on his gain based on the value of Acquiring stock received, even though he may not be able to sell the Acquiring stock (because of securities law restrictions) and has no cash to pay tax. The failed “B” will be treated as a stock purchase, so no corporate gain is triggered. It does, however, avoid the “substantially all” requirement.

iii. Unwanted assets. "C" permits you to leave unwanted assets behind (subject to substantially all rule which will also apply in subsidiary mergers); however, triggers tax to Target and its shareholders on liquidation distribution of those assets and concern about failure to qualify under continuity of business enterprise doctrine. In "A" reorganization can sell, distribute as dividend, use to redeem or use "D" spin-off.

E. MERGERS WITH DISREGARDED ENTITIES

1. Generally

Certain wholly owned entities, that are respected as entities under state law, are disregarded as entities separate from their owners for federal tax purposes. For example, a limited liability company (“LLC”) that is wholly owned by a single owner is disregarded as having an existence separate from its sole owner; the sole owner is treated as owning outright the assets and liabilities of the LLC. Qualified S corporation subsidiaries, and Qualified REIT Subsidiaries are other examples of disregarded entities.

2. Prior Law

Most states have statutes that permit the mergers of these single member entities with and into corporations. Since single member entities are disregarded for all federal

income tax purposes, most tax practitioners believed, until recently, that a merger of a Target corporation with and into a disregarded entity wholly owned by a corporation would qualify as a merger under Section 368(a)(1)(A). The IRS had actually issued several private letter rulings that seemed to confirm this result.

3. 2000 Proposed Regulations

On May 16, 2000, the IRS and Treasury released proposed regulations regarding the treatment of certain mergers involving disregarded entities under Section 368(a)(1)(A). See Prop. Treas. Reg. Section 1.368-2(b)(2). The 2000 proposed regulations consider two situations:

a). Merger of Disregarded Entity with and into Acquiror ("Reverse DE Merger")

i. The 2000 proposed regulations first consider the merger of a disregarded entity, that is wholly owned by a corporation ("Owner"), with and into an Acquiror corporation. The 2000 proposed regulations state that this is not a merger that qualifies under Section 368(a)(1)(A) because the Owner's assets (other than those held in the Disregarded Entity) are not transferred to the Acquiror and the Owner does not cease to exist as a result of the state law merger transaction. Further, the merger of a Disregarded Entity into an Acquiror corporation, in which the Owner's assets and liabilities are divided between the Owner and the Acquiror corporation after the transaction, is a divisive transaction, not a transaction in which the assets of the Owner and the acquiring corporation are combined. Congress intended that Section 355 be the sole means under which divisive transactions will be afforded tax-free status. Accordingly, the 2000 proposed regulations provide that for a merger to qualify as a reorganization under Section 368(a)(1)(A), it must, by operation of the merger statute of the relevant jurisdiction, result in one corporation acquiring the assets of the merging corporation and the merging corporation ceasing to exist. Thus, the merger of a Disregarded Entity into an Acquiror corporation cannot qualify as a reorganization under Section 368(a)(1)(A).

ii. The transaction may be treated as another type of reorganization, such as a C, D or F reorganization if all applicable requirements are met (including the liquidation of the Owner). The transaction may also be described in Section 351.

iii. This aspect of the 2000 proposed regulations came as no surprise to most practitioners.

b). Merger of Target with and into a Disregarded Entity ("Forward DE Merger")

i. Next, the IRS considered the merger of Target corporation with and into a Disregarded Entity that is wholly owned by Acquiror corporation ("Owner"). Most practitioners believed that because the Disregarded

Entity is disregarded for federal tax purposes, the transaction would be treated for federal tax purposes as a merger directly into the Owner, so that so long as the Owner was a corporation the transaction could have qualified under Section 368(a)(1)(A).

ii. However, under the proposed regulations, the merger of a Target corporation into a Disregarded Entity wholly owned by Acquiror corporation does not qualify under Section 368(a)(1)(A). The preamble to the proposed regulations explains that Treasury and the IRS believe that it is inappropriate to treat the state or Federal law merger of a Target corporation into a Disregarded Entity as a statutory merger because the Owner, the only potential party to a reorganization, is not a party to the state or Federal law merger transaction. The preamble further states that a merger of a Target corporation into a Disregarded Entity differs from a merger of a Target corporation into the Owner because the Target corporation and the owner have combined their assets and liabilities only under federal tax rules concerning Disregarded Entities, and not under state or Federal merger law, the law on which Congress relied in enacting section 368(a)(1)(A). This aspect of the proposed regulations was widely criticized.

iii. The parties may attempt to have the transaction qualify as another type of a reorganization.

iv. There were indications that Treasury may reconsider its position in this regard. See Lee A. Sheppard, ABA Tax Section Affiliated and Related Committee Considers Insolvent Subsidiaries, 91 Tax Notes 1215 (May 21, 2001) (quoting Mark Pravano, special assistant to Assistant Treasury Secretary (Tax Policy) as saying "Treasury and the IRS are giving serious consideration to treating a merger of a Target into a disregarded entity as a statutory merger under Section 368(a)(1)(A).").

4. 2001 Proposed Regulations

a). Generally. The 2000 proposed regulations, as predicted, were withdrawn by the IRS, and newer proposed regulations were published on November 15, 2001. Generally, the IRS reversed its position with respect to mergers of corporations into disregarded entities by adopting the position that they may qualify as statutory mergers under Section 368(a)(1)(A) of the Code; however, it maintained its previous position with respect to mergers of disregarded entities with and into corporations.

Currently, Treas. Reg. Section 1.368-2(b)(1) provides:

"In order to qualify as a reorganization under section 368(a)(1)(A) the transaction must be a merger or consolidation effected pursuant to the

corporation laws of the United States or a State or Territory of the District of Columbia."

The 2001 proposed regulations achieve their desired result by amending the definition of statutory merger. Under the proposed regulations, Treas. Reg. Section 1.368-2(b)(1) would be revised to read as follows:

i. Definitions. For purposes of this paragraph (b)(1), the following terms shall have the following meanings:

[A] Disregarded entity. A disregarded entity is a business entity (as defined in 301.7701-2(a) of this chapter) that is disregarded as an entity separate from its owner for Federal tax purposes. Examples of disregarded entities include a domestic single member limited liability company that does not elect to be classified as a corporation for Federal tax purposes, a corporation (as defined in 301.7702-2(b) of this chapter) that is a qualified REIT subsidiary (within the meaning of section 856(i)(2)), and a corporation that is a qualified subchapter S subsidiary (within the meaning of section 1361(b)(3)(B)).

[B] Combining entity. A combining entity is a business entity that is a corporation that is not a disregarded entity.

[C] Combining unit. A combining unit is comprised solely of a combining entity and all disregarded entities, if any, the assets of which are treated as owned by such combining entity for Federal tax purposes.

ii. Statutory merger or consolidation generally. For purposes of section 368(a)(1)(A), a statutory merger or consolidation is a transaction effected pursuant to the laws of the United States or a State or the District of Columbia, in which, as a result of the operation of such laws, the following events occur simultaneously at the effective time of the transaction –

[a] All of the assets (other than those distributed in the transaction) and liabilities (except to the extent satisfied or discharged in the transaction) of each member of one or more combining units (each a transferor unit) become the assets and liabilities of one or more members of one other combining unit (the transferee unit); and

[b] The combining entity of each transferor unit ceases its separate legal existence for all purposes.

iii. Statutory merger or consolidation involving disregarded entities. A transaction effected pursuant to the laws of the Untied States or a State or the District of Columbia in which any of the assets and liabilities of a

combining entity of a transferor unit become assets and liabilities of one or more disregarded entities of the transferee unit is not a statutory merger or consolidation within the meaning of section 368(a)(1)(A) and paragraph (b)(1)(ii) of this section unless such combining entity, the combining entity of the transferee unit, such disregarded entities, and each business entity through which the combining entity of the transferee unit holds its interests in such disregarded entities is organized under the laws of the United States or a State or the District of Columbia.

b). Merger of Corporation into Disregarded Entity. Under the 2001 proposed regulations, the merger of a corporation into a disregarded entity would qualify under Section 368(a)(1)(A) so long as (1) "all of the assets and liabilities" of the combining corporation become the assets and liabilities of the acquiring corporation (including through its wholly owned disregarded entity), and (2) the transferor corporation ceases its separate legal existence for all purposes.

i. <u>All the Assets and Liabilities</u>. It appears that the IRS was trying to avoid the taking place of divisive transactions by imposing a requirement that all the assets and liabilities of the Target corporation be transferred. However, unfortunately, there is no real guidance as to what "all the assets and liabilities" means. The 2001 proposed regulations are silent on this point. The preamble to the regulations contains the statement that "the IRS and Treasury do not intend for the requirement that all of the assets of one of the transferor units be transferred in the statutory merger or consolidation to be interpreted in the same manner as the "substantially all" requirement of Section 368(a)(1)(C), 368(a)(1)(D), 368(a)(2)(D), and 368(a)(2)(E). However, the IRS and Treasury do intend this requirement to ensure that divisive transactions do not qualify as statutory mergers or consolidations under section 368(a)(1)(A)." It is unclear, however, what short of the "substantially all" requirement is required. Note that a regular Section 368(a)(1)(A) has no such "all the assets and liabilities" requirement.

c). Merger of Disregarded Entity into Corporation. As under the 2000 proposed regulations, under the 2001 proposed regulations, the merger of disregarded entity into a corporation would not qualify under Section 368(a)(1)(A). This is because (1) the existence of the owner of the disregarded entity would not cease, and (2) all the assets and liabilities of the owner of the disregarded entity do not become the assets and liabilities of the acquiror.

F. "MIXED" TRANSACTIONS

1. General Characteristics.

a). Designed to compromise conflicting objectives of participants, e.g., some of Target company's shareholders want cash, others want a tax-free transaction; e.g., shareholders of Target company want tax-free transaction but acquiring company wants to purchase for cash.

b). Structured to embody some features of a taxable transaction and some features of tax-free.

2. The "Cash Option" Merger.

a). Generally. Target company merges into acquiring company or subsidiary in merger or "forward triangular" merger, under terms where shareholders of Target company will receive shares of acquiring company or, to the extent they so elect, cash. Used where acquiring company is willing to issue some shares and some Target company shareholders wants shares, while others want cash. Aggregate cash payable limited to less than 50% of total consideration payable, to assure compliance with continuity of interest test. This requires provision for proration of cash, if honoring all elections would require more than specified maximum. Sometimes acquiring company insists on paying cash for minimum percentage of shares to prevent excessive dilution or limit added dividend requirement.

b). Tax effects.

i. As to all parties other than shareholders of Target company who receive cash, tax consequences identical with those of an all-shares merger.

ii. As to shareholders of Target company who receive cash, if they receive only cash and no shares, simply a taxable transaction. But if they receive shares plus cash, cash is treated as "boot" under Sec. 356, with result that the cash is treated as dividend, to extent of gain, if the cash distribution has the effect of a distribution of a dividend; otherwise, cash is treated as capital gain. See discussion above. No loss is recognized under Sec. 356(c).

c). Points to remember. Acquiring company pays cash but gets no corresponding "step-up" (or "step down") in basis of Target company assets because carryover basis rule applies. For financial reporting purposes, GAAP will treat it as a "purchase" rather than a "pooling", so have earnings charge but no tax relief.

3. The "Funded Subsidiary Preferred Stock" Merger.

a). Nature of transaction. Target company merges into subsidiary of acquiring company in "A" reorganization in which shareholders of Target company receive non-convertible preferred stock of subsidiary.

i. Preferred normally has rights to optional redemption at some future date, subsidiary may have option to call for redemption and there may be a mandatory redemption schedule.

ii. Acquiring company may "fund" the dividend and redemption obligations of the subsidiary (which of course will own operating assets of Target company - or put them in subsidiary whose stock it owns) by contributing cash to its capital, allowing the subsidiary to hold liquid, income-producing assets. Alternatively, these obligations may be funded by the subsidiary itself, in effect accomplishing a "bootstrap" acquisition of the Target company.

iii. Alternatively, acquiring corporation can guarantee dividend and redemption obligations, but does that guaranty turn it into debt that is boot?

b). Usefulness. Where acquiring company essentially wishes to purchase for cash or to accomplish a "bootstrap" acquisition and does not wish to issue its own securities, but shareholders of Target company insist on tax-free transaction -- e.g., to preserve "carryover" basis. Redemption features may be tied to death and need of estate for cash to pay death taxes.

c). Tax effects:

i. An "A" reorganization to all parties. No gain recognized.

ii. Preferred is not Section 306 stock, because they acquire no other shares. Ultimate redemption can produce capital gain under Sec. 302 (Rev. Rul. 77-426, 1977-2 C.B. 87), but original issue discount type rules now apply to determine if redemption price hides amounts to be accrued and taxed as dividends each year.

iii. Note that subsidiary does not get "step-up" in basis for assets upon redemption of shares.

iv. May be attractive where older shareholders seek to avoid gain and to permit shares to pass through estate and secure basis step-up.

4. The "Funded Subsidiary Preferred Stock with a Cash Option" Merger.

Like the transaction discussed in 3 above, but with the "cash option" feature discussed in 2 above. This may be useful where the considerations discussed above are

present, but some shareholders of Target company prefer taxable transaction for cash. Note, however, that 50% of shares must be acquired for shares to be sure of satisfying the continuity of interest requirement. The tax affects are as described above.

5. Recapitalization Of Target Company Followed By Cash Purchase Of Shares.

a). Pursuant to agreement, Target company adopts plan of recapitalization calling for (disproportionate) exchange of a new preferred stock (having redemption features like those described above) for shares of its common stock; then acquiring company purchases remaining common stock for cash.

b). Usefulness. Where considerations referred to above apply, but 50% or more of the shareholders of the Target company want cash, so that continuity of interest test cannot be met. In this structure, it is difficult to assure acquiring company that it will acquire 100% of common stock, and there may be problems of valuation of preferred stock.

c). Tax effects. The recapitalization exchange of preferred for common is tax-free transaction under Sec. 368(a)(1)(E); the continuity of interest requirement is not applicable, so that exchange itself is tax-free, even though shares are thereafter sold as part of same plan. Rev. Rul. 77-479, 1977-2 C.B. 119. If undervalued, shareholders taking preferred may be deemed to have made a gift or paid compensation to shareholders who sell for cash. Rev. Rul. 74-269, 1974-1 C.B. 87. Preferred stock is Section 306 stock to a shareholder who retains preferred and common but not to shareholder who exchanges all common for preferred. Rev. Rul. 59-84, 1959-1 C.B. 71. Shareholders who sell common recognize taxable gain. To acquiring company, the transaction is a taxable purchase of common shares for cash. However, if Target preferred remains outstanding, this may preclude eligibility to make a Section 338 election.

6. Exchange Offer By Subsidiary Followed By "Freeze Out" Cash Merger.

a). Nature of transaction:

i. Acquiring company forms subsidiary, agreeing to contribute cash in return for all common shares.

ii. Simultaneously subsidiary offers to exchange shares of its preferred stock for shares of Target company.

iii. Upon completion of i. and ii., subsidiary forms second-tier subsidiary, which is merged into Target company in a cash merger, eliminating remaining minority shareholders of Target company.

b). Usefulness. This structure achieves the effect of the subsidiary preferred stock with cash option merger without requiring 50% of Target company's shares to be acquired for stock; improves on recapitalization structure because non-exchanging shareholders can be forced out in the merger.

c). Tax effects. Steps i. and ii. constitute a tax-free incorporation of subsidiary under Sec. 351. See Rev. Rul. 84-71, 1984-1 C.B. 106. This is a non-reorganization provision which provides for non-recognition of gain or loss when one or more persons transfer property (a term which includes shares) to a corporation in return for shares and, immediately after the transfers, those persons control the corporation within the meaning of Sec. 368(c) (the 80% test). Section 351 has a kind of "continuity of interest" feature since dispositions of stock received in the incorporation transaction can disqualify it; but this rule looks only to those participating in the incorporation. Effect is that participating shareholders exchange shares of Target company for preferred stock of acquiring subsidiary without recognition of taxable gain

i. Shareholders "frozen out" in succeeding cash merger will recognize taxable gain or loss.

ii. No gain or loss recognized by any of the participating corporations.

G. ACQUISITIONS INVOLVING S CORPORATIONS

The closely held corporation frequently is an S corporation, i.e., a corporation that has elected to be taxed on a flow-through basis to its shareholders, similar to but not identical to a partnership. Such Targets present their own unique opportunities and considerations when structuring their acquisition or structuring an acquisition by them.

1. Taxable Sale Transactions.

a). Stock sale. The sale of stock of an S corporation is exactly the same as the sale of stock of a C corporation. The Target has no gain and the shareholders are taxed at capital gains rates. Unlike a partnership through a Section 754 election or other device, there is no opportunity for a basis step up in the assets of an S corporation without either an asset sale or a Section 338(h)(10) election (discussed above).

i. Stock basis is adjusted for gain/loss passed through, including gain/loss in last year, affecting gain computation.

ii. May terminate S status.

b). Asset sales. The gain or loss on a sale of assets is like any other S corporation income or loss. This passes through to the shareholders, adjusts basis and generally permits distribution of proceeds without additional gain.

i. Gain is ordinary or capital depending on nature of assets and character passes through.

ii. While S corporations are not generally subject to tax, Section 1374 imposes a "built in gain" tax, i.e., a regular corporate tax, on gain inherent in assets of an S corporation at the time it converts from C to S status realized on a sale of assets. Any corporation that has always been an S corporation is not subject to these rules. This continues for 10 years following the conversion to S status and then goes away. Alternatives include a lease with purchase option or simply deferring the sale until this rule does not apply. Will apply in case of Section 338(h)(10) election, too.

2. Taxable Purchase Transactions.

S corporations as purchasers need to be careful that the transaction does not adversely affect qualification. S corporations can now buy the stock of other corporations without losing S status.

a). Can liquidate Target but may bring in earnings and profits (triggering passive investment income rules) and built in gain rules.

b). Election to treat as qualified subchapter S subsidiary treated as 332 liquidation also with same possible adverse effect.

3. Tax Free Reorganizations

Subchapter S corporations can be parties to tax-free reorganizations as either Target or acquiring just like a C corporation.

a). S corporation as Acquiror. S status typically continues unless there are too many or non-permitted shareholders. Care needs to be taken regarding income allocation pre- and post-transaction and bringing into the S corporation earnings and profits and built in gain.

b). S corporation as Target. S status typically ends as corporation goes away.

4. Other Issues

a). Distribute accumulated earnings in post-termination transition period (but not to new shareholders). Distribution in merger may be taxable boot in contrast.

b). Pre-reorganization distributions may affect ability to satisfy "substantially all the assets" test.

H. USE OF ESCROWS, CONTINGENT CONSIDERATION AND DEFERRED PAYOUTS

1. Contingent Consideration.

a). Portion of consideration is withheld and paid on deferred basis only if specified conditions are satisfied. Used when hard to value company or in circumstances where want to retain existing shareholders to work for the company post transaction.

b). Typical conditions:

i. Earnings of Target company reach specified goals;

ii. Sales, product development or other goals are met;

iii. Contingent liabilities are resolved (e.g., major litigation).

c). Often used to bridge gaps between buyer's and seller's views of value of Target company.

2. Use in Taxable Transactions.

a). No effect on basic tax consequences.

b). Payments later received treated as additional proceeds of sale, increasing gain or decreasing loss.

c). But, unless adequate interest paid, interest can be imputed.

d). Election of installment method to report gain.

3. Use in Tax-Free Transactions.

a). Additional issuance of "contingent" shares.

i. In general, before suspending reorganization rulings, IRS ruled favorably on tax-free nature of transaction only if at least 50% of maximum amount of stock which may be issued was issued at the outset. Rev. Proc. 77-37, 1977-2 C.B. 568.

ii. Deferred issuance of shares treated as installment transaction subject to imputed interest rules, so that some of shares later received will give rise to ordinary income inclusion to selling shareholder even though underlying transactions remain tax-free. Rev. Rul. 70-300, 1970-1 C.B. 125. Original issue discount rules do not apply here, since the contingent

agreement to issue shares is not a "debt instrument"; result is that Section 483 applies and there is no accrual of interest prior to receipt of shares.

b). Issuance of shares in escrow.

i. IRS ruling policy here again required that at least 50% of maximum number of shares be issued unconditionally. Rev. Proc. 77-37, 1977-2 C.B. 568.

ii. Since stock is issued as of closing date (and exchanging shareholders are entitled to dividends) no interest is imputed on shares issued into escrow. Rev. Rul. 70-120, 1970-1 C.B. 124. Exchanging shareholder may recognize gain or loss upon later forfeiture and cancellation of shares when stated condition is not fulfilled. Compare Rev. Rul. 78-376, 1978-2 C.B. 149 (gain or loss recognized if recaptured stock satisfied shareholder obligation -- e.g., breach of representation -- and appreciation in stock is applied to satisfy obligation) with Rev. Rul. 76-42, 1976-1 C.B. 102 (no gain or loss recognized if mere adjustment to purchase price -- e.g., failure to meet earnings level).

4. Escrows and Deferred Payouts.

Similar to contingent consideration to address uncertain value of the Target, Purchasers commonly seek to have some portion of the consideration set aside either in the form of an escrow or deferred payout to ensure a source of funds for indemnity payments for breaches of representations and warranties of the Target shareholders (stock sale) or the Target (asset sale). Interestly the rules are not entirely clear as to how these arrangements work. Deferred payouts, whether structured with a note or simply contractually rights to later payments are judged under the installment sale rules. Installment sales are discussed below.

a). Generally. The seller's goal is to use installment reporting on the escrow or deferred payout. The purchaser will not be affected by this.

b). Structuring. Strive to make the purchaser the "tax owner" of the escrow, making it a "grantor trust" with purchaser as owner. This means earnings of escrow are income to purchaser but paid to sellers as interest, giving purchaser and interest deduction. This income and deduction for the purchase are similar but will not necessarily precisely offset.

c). Tax Free Transactions. See discussion above regarding contingent shares.

I. LLC AND PARTNERSHIP ACQUISITIONS

LLCs and to a lesser extent partnerships (both general and limited) are a common form of business organization, especially for closely held businesses. They also are vehicles that can be used to facilitate transactions when other approaches are cumbersome or present difficult business issues. LLCs for tax purposes are treated as a partnership (most common),

as "disregarded" or as a "tax nothing," or as a corporation (least common outside of the foreign context). Their uses and forms for acquisition vary with each characterization.

1. The "Disregarded" LLC.

The purchase and sale of a single member LLC (that remains single member) for tax purposes is a sale of assets. Thus, such a transaction can to some extent substitute for either an asset sale or a stock sale with a Section 338(h)(10) election (where seller is a corporation).

a). Use where Target is a corporate subsidiary by converting to LLC prior to sale. Conversion is a Section 332 liquidation that is nontaxable and selling parent is treated as selling assets.

i. Typically avoids state transfer taxes and states otherwise respect the transaction.

ii. May be advantageous to buyer to have a disregarded entity as well, e.g., if debt is at parent level then operating income can be offset by interest deductions. Consider advantages/disadvantages from state tax perspective of being disregarded.

b). Where Target itself is an LLC simply remember that sale is a sale of assets by owner and all that means, e.g., ordinary *v.* capital gain.

2. The Partnership or "Partnership" LLC

An LLC that has more than one member is typically treated as a partnership for tax purposes.

Acquisition of a partnership interest is not the same as an acquisition of stock. Some income may be ordinary, there will be issues as to how basis in assets is computed depending on whether 50% or more of the interests are sold, whether there is an election to adjust the basis of partnership assets to reflect the sale (a Section 754 election), and whether the LLC remains a "partnership" for tax purposes or becomes disregarded because it has only one member.

a). Generally. Section 741 provides the starting point for analysis: "In the case of a sale or exchange of an interest in a partnership, gain or loss shall be recognized to the transferor partner. Such gain or loss shall be considered as gain or loss from the sale or exchange of a capital asset, except as otherwise provided in section 751 (relating to unrealized receivables and inventory items)."

i. Section 453 installment method reporting is available to the seller of the partnership interest.

b). Basis. The buyer of a partnership interest acquires a basis in the partnership interest equal to the amount paid. Inside basis in the partnership assets carries over from the seller to the buyer.

c). Section 751 Property. Section 751 provides that amounts received for unrealized receivables or inventory items on the sale of a partnership interest are treated as ordinary income. The regulations under section 751 explain that the gain or loss from 751 property is determined by the amount that would have been allocated to the selling partner if the partnership sold all of its assets for their fair market value immediately prior to the sale of the partnership interest.

i. "Unrealized receivables" is defined in section 751(c) and includes rights to payments for delivered goods, rights to payment for services rendered and recapture amounts under sections 1245 and 1250 of the Code.

ii. "Inventory" is defined in section 751(d) by reference to sections 1221(a)(1), 1231 and 1246(a) and generally includes "stock in trade of the taxpayer…held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."

d). Section 754 Election. The partnership can make an election to adjust basis under section 743(b) on the sale of a partnership interest. If the 754 election is in place, the partnership's basis in its assets is adjusted to reflect the difference between the buyer's basis in its partnership interest and the partnership's basis in its assets.

i. Section 704(c) allocations are taken into account in determining the 743(b) adjustment.

ii. Section 755 provides special rules for allocating the adjustment among the partnership assets.

e). Relief of Liabilities. The assumption of a partner's share of liabilities on the transfer of a partnership interest is treated as an additional cash payment for the partnership interest.

i. The use of debt by partnerships raises special issues for tax practitioners because liabilities generally increase a partner's outside basis.

3. LLC as Corporation.

If the LLC is treated as a corporation for tax purposes, the typical issues of asset and stock acquisitions of a corporation apply.

4. Mixing Bowl LLC's

a). Generally. In the typical mixing bowl transaction: the Seller contributes the property it wants to dispose of (the "Old Property") to a business entity classified for tax purposes as a partnership ("Newco") in a § 721 transaction. The Buyer contributes either cash, or perhaps other property that the Seller is interested in acquiring (the "New Property"). The New Property, like the Old Property, may constitute a distinct line of business.

b). Partnership Allocations. The partnership is a "mixing bowl" in the sense that two separate properties -- the Old Property and the New Property -- are "mixed" into one partnership. Newco's partnership agreement or operating agreement will be drafted so that each partner's interest in Newco approximates, to a significant extent, the ownership of the property that it wishes to acquire. The Buyer often will be given the right to manage the Old Property, and will be allocated most of the income, gain or loss generated by the operation of the Old Property. The Seller will be allocated most of the tax items (income, gain or loss) generated by the New Property.

c). Sharing Ratios. Sharing ratios vary from deal to deal between the Buyer and the Seller. A 90/10 split would be typical. In that case, the Seller would be allocated 10% from the Old Property, and 90% from the New Property. Buyer's allocations of course would be the reverse -- 90% from the Old Property and 10% from the New Property. Distributions typically will be in the same ratios as allocations.

d). Exit Strategy. After seven years, Newco may distribute the New Property to the Seller and the Old Property to the Buyer.

i. If 704(c) property is distributed, directly or indirectly, to any partner other than the contributing partner, within seven years of the contribution, the contributing partner recognizes gain or loss equal to the amount that would have been allocated to him if the property had been sold to the distributee for market value at the time of the distribution. Treas. Reg. § 1.704-4(a).

ii. The character of the gain or loss as ordinary or capital also is determined as if the property had been sold. Treas. Reg. § 1.704-4(b).

5. Leveraged Partnership Transaction

a). Generally. In the typical leveraged partnership or leveraged LLC transaction: Seller contributes property to a newly formed LLC ("Newco"), and receives back both a large amount of cash -- perhaps as much as the full $100 value of the property -- and an interest in Newco. To keep the cash from being taxable to the Seller, the distribution of cash is funded by a Newco-level borrowing that is properly "allocated," in accordance with Code

§ 752 and the regulations, back to the Seller. Newco borrows money from a third-party, and the Seller -- or an affiliate of the Seller -- guarantees that the debt will be paid if the assets of Newco are insufficient for repayment. The Buyer contributes cash or other property to Newco.

b). The Debt Guarantee. The debt guarantee by the Seller or a related party is intended to avoid a disguised sale (see below). Treas. Reg. §§ 1.707-5(b). The debt is intended to be allocated to the Seller, and to give the Seller sufficient basis that it can receive the debt proceeds tax-free. *See* Treas. Reg. § 1.752-2(b)(1). Allocation of the debt to the Seller may require the Seller to maintain an interest greater than 10% in each item of Newco income, gain, loss, deduction, or credit. Treas. Reg. § 1.752-2(d)(2). Any reduction in the amount of debt allocated to S is treated as a cash distribution to S. Code § 752(b). S will not want the debt to be paid off quickly. *See* Immerman at Alston & Bird, *Disposing of Appreciated Property Through Partnerships: Mixing Bowls and Other Techniques* at 8.

6. The Disguised Sale Rules

a). Generally. Under the disguised sale rules, if a partner transfers property to the partnership, and there is a related transfer of other property by the partnership to the partner, the transactions may be characterized as a taxable sale or exchange, if the transfers viewed together are "properly characterized" as a sale or exchange. If the transaction is treated as a sale, it is treated as a sale for all purposes of the Code, and the sale is treated as taking place when the partnership is considered the owner of the property. Treas. Reg. § 1.707-3(a)(2).

b). Transfers. The regulations provide that transfers to and from a partnership will be viewed as a sale if:

i. The transfer of money or other consideration would not have been made but for the transfer of property;

ii. In cases in which the transfers are not made simultaneously, the subsequent transfer is not dependent on the entrepreneurial risks of partnership operations. Treas. Reg. § 1.707-3(b)(1).

c). Facts and Circumstances. To determine whether transfers constitute a disguised sale, all the facts and circumstances are considered. Treas. Reg. § 1.707-3(b)(2) lists ten nonexclusive factors that may tend to prove the existence of a sale.

d). Presumptions for Disguised Sale. Two rebuttable presumptions help parties determine whether transactions constitute a disguised sale:

i. If the transfers occur within two years of each other, they are presumed to be a sale. Reg. 1.707-3(c)(1);

ii. If the transfers occur more than two years apart, they are presumed not to be a sale. Reg. 1.707-3(d).

iii. Each of the presumptions can be overcome if the facts and circumstances "clearly establish" otherwise.

iv. Transfers made within two years may be subject to special disclosure to the IRS. Treas. Reg. § 1.707-3(c)(2).

II. PRESERVATION OF NET OPERATING LOSSES

The treatment of net operating losses is addressed by more provisions of the Internal Revenue Code ("Code") and court developed doctrines than probably any other item affecting computation of federal income tax. At least ten Code sections address the computation and utilization of net operating losses. Section 382 is one of the most complex and lengthy section in Subtitle A of the Code and the length and complexity of the regulations under Section 382 make the task of understanding these rules even more daunting. Thus, the job of the practitioner to understand and effectively apply the myriad rules affecting net operating losses is difficult.

A. SECTION 382

1. Generally.

a). The statute. The operative limitation of Section 382 is simple and direct:

"The amount of the taxable income of any new loss corporation for any post-change year which may be offset by pre-change losses shall not exceed the Section 382 limitation for such year." Section 382(a).

There is a "pre-change" loss when there has been an ownership change of more than 50% over the prescribed period of time. Only if there is this ownership change will the limitations on NOL utilization that are the focus of Section 382 apply.

b). Ownership changes. Section 382(g)(1) defines an ownership change as follows:

"There is an ownership change if, immediately after any owner shift involving a 5% shareholder or any equity structure shift –

[A] the percentage of the stock of the loss corporation owned by one or more 5% shareholders has increased by more than 50 percentage points, over

[B] the lowest percentage of stock of the loss corporation (or any predecessor corporation) owned by such shareholders at any time during the testing period."

2. Application of Section 382.

a). Generally. Section 382 does not bar utilization of the pre-change NOL itself; rather, it restricts annually the amount of post-change income that may be offset by an NOL from before the change. The general thrust of Section 382 is to limit utilization of losses to the annual income stream that, if capitalized on a tax-free basis, equals the value of the loss corporation as determined immediately before the ownership change. Section 382(b)(1). The "382 limitation" is the "(A) value of the old loss corporation, multiplied by (B) the long-term tax-exempt rate." Once this limitation (the "Section 382 limitation") is determined, it generally does not change during the life of the NOLs. To the extent an NOL is not utilized by virtue of the Section 382 limitation, it will expire at its normal termination under Section 172.

b). Determining value.

i. <u>Generally</u>. The value of the old loss corporation is the value of its stock, including any stock not treated as stock for purposes of determining an ownership change, such as Section 1504(a)(4) stock or stock treated as non-stock. Section 382(e)(1). Thus, the measuring rod is net asset value, not gross asset value. This may hurt the leveraged company that incurred its debt prior to the ownership change.

ii. <u>Timing</u>. The value of the old loss corporation generally is determined immediately before the ownership change. Section 382(e)(1). However, if a redemption occurs in connection with an ownership change, the value is determined after taking the redemption into account. Section 382(e)(2).

iii. <u>Anti-abuse provisions</u>. Congress provided special rules to guard against efforts to increase or avoid the Section 382 limitation by inflating the value of the old loss corporation through capital contributions and excess non-business assets.

c). Long-term tax exempt rate. The Section 382 limitation is determined by multiplying the value of the old loss corporation by the "long term tax exempt rate." Section 382(f)(1) provides that this rate is the highest of the "adjusted Federal long term rates" under Section 1274 for any month in the three-month calendar period ending with the month in which the change of ownership occurs. The rate is "properly adjusted" to account for the difference between taxable and tax-exempt obligations. Section 382(f)(2)(B). These are published monthly.

d). Carryover of unused limitation. If the actual amount of income available to be offset by a utilizable net operating loss is less than the Section 382 limitation amount, the new loss corporation may carry over any unused portion of the limitation to the next year. Section 382(b)(2). While this carryover is indefinite, the NOLs do eventually expire according to their general terms under Section 172.

e). Built-in gains and losses. In order to prevent trafficking in corporations that may not have NOL carryforwards but nonetheless have economically accrued losses, Congress provided special rules that apply if the old loss corporation has a "net unrealized built-in gain or loss." Generally, built-in gains may be offset by the entire amount of pre-change losses, but built-in losses are subject to the same limitations as NOLs. Section 382(h).

f). Continuity of business enterprise. While Section 382(a) provides a general rule limiting the availability of pre-change losses to offset post-change income, Section 382(c) completely disallows the post-change use of pre-change NOLs (and built-in losses) if the "business enterprise" of the loss corporation is not continued for at least two years following the ownership change. Section 382(c) creates this disallowance by providing that the Section 382 limitation will be zero if the continuity requirement is not met. Section 382(c)(1). The standard of the tax-free reorganization rules under Treas. Reg. §1.368-1(a) apply.

B. SECTION 383

Section 383 limits the ability of a corporation to use "excess credits," net capital losses, and foreign tax credits where there has been a Section 382 change in ownership.

C. SECTION 384

1. Background.

While Section 382 limits the use of NOLs and built-in losses to offset income when there has been a change in control of the loss corporation, the purpose of Section 384 was to bar the use by one corporation of losses incurred by it prior to the acquisition of another corporation (or its assets) to shelter gains of the other corporation that were built in at the time of the transaction but recognized after the transaction. In other words, Section 384 can apply and limit losses where there has not been a change in control of the loss corporation, but rather an infusion of gain assets. It also can apply in circumstances when Section 382 already applies to the transaction.

2. The Statute.

If

a). A corporation acquires (directly or through one or more other corporations) control of another corporation, or

b). Assets of a corporation are acquired by another corporation in an A, C, or D reorganization, and

c). Either the acquired, transferor, or acquiring corporation is a gain corporation, then

d). Income for any recognition period taxable year attributable to recognized built-in gains shall not be offset by any preacquisition loss (unless the gain and loss are of the same corporation).

Section 384(a). In other words, upon the combination of two corporations through an 80% stock acquisition or certain reorganizations, either one of which has built-in gains, Section 384 applies to disallow the use of any preacquisition losses to offset built-in gains recognized within five years of the acquisition. Section 384(a), 382(h)(7). Note that the presence and recognition of net unrealized built-in gains, while potentially beneficial to a taxpayer under Section 382, may be harmful to a taxpayer under Section 384.

Example: Assume L with NOL carryovers acquires G, with net unrealized built-in gain in excess of the threshold amount, and they subsequently file a consolidated return. Income of G attributable to built-in gains may not be offset by L's NOL.

Example: Assume G with built-in gain merges with L with NOLs, G being the survivor. Assume that 382 is not triggered (or that the annual limitation is not exceeded). A recognized built-in gain of G may not be offset by L's historic losses.

D. SECTION 269

Providing yet another hoop for losses to jump through, Section 269 gives the Secretary of the Treasury authority to disallow NOLs when there is an acquisition of control of a corporation, an acquisition by one corporation of assets of another corporation, or a liquidation of a corporation in certain contexts and the purpose of the acquisition or liquidation was to evade or avoid federal income tax. Thus, in marked contrast to Section 382 and its historical counterparts, Section 269 has provided a subjective standard and broad authority in the Service to regulate trafficking in net operating losses.

1. Application.

a). The statute. If

i. A person acquires direct or indirect control of a corporation, or

ii. A corporation acquires, directly or indirectly, control of property in a carryover basis transaction, or

iii. Following a Section 338 qualified stock purchase, the Target is liquidated but no Section 338 election is made, and

iv. The principal purpose of such acquisition or liquidation was the evasion or avoidance of federal income tax by securing the benefit of a deduction, credit, or other allowance which the acquiror would not otherwise be entitled to utilize,

v. The Secretary may disallow such deduction, credit or allowance.

b). Principal purpose. The principal purpose is a purpose that exceeds any other purpose in importance; it is not necessary that it be the only purpose, however. Treas. Reg. § 1.269-3(a). Contrariwise, if one could establish another purpose of greater importance, Section 269 would not apply. The determination of purpose involves a facts and circumstances, case-by-case inquiry. The presence of such a subjective standard makes it difficult for an acquiring corporation ever to feel comfortable that it will succeed to the net operating losses of an acquired corporation.

c). Control. Control means ownership of stock possessing at least 50% of the total combined voting power of all classes of stock entitled to vote or at least 50% of the total value of shares of all classes of stock of the corporation. Section 269(a).

d). Liquidations. In addition to acquisitions of control, Section 269 addresses the liquidation of a corporation when there has not been a Section 338 election made after a qualified stock purchase if the plan of liquidation is adopted not more than two years after the acquisition date. Section 269(b). This is intended to cover circumstances where control of a corporation is acquired but losses cannot be utilized without the liquidation. The focus in this instance is whether there is a tax avoidance purpose for the liquidation. The adoption of a plan of liquidation following the two-year period apparently would permit the utilization of SRLY losses, thereby infusing a bright line test in an otherwise subjective Code provision.

E. NET OPERATING LOSS CARRYOVERS AND CARRYBACKS FROM SRLYS TO CONSOLIDATED RETURN YEARS

NOLs are one of the tax characteristics accounted for on a consolidated basis when an affiliated group files a consolidated return, however, an NOL is also one of the items that is limited in its use by other members if it arose in a "separate return limitation year" ("SRLY"), i.e., a year in which the "loss" member did not file a consolidated return with the other members. Regulations have generally eliminated the SRLY restrictions to the extent they overlap with Section 382. See, T.D. 8823 (July 2, 1999); and Treas. Reg. §1.1502-15(g), -21(g) and –22(g).

III. GOLDEN PARACHUTES AND OTHER COMPENSATION ISSUES

A. OVERVIEW

1. Background.

The purpose of the golden parachute tax provisions is to strongly discourage excessive payments by corporations to its key employees as a result of a change in its control or ownership. Whether right or wrong, Congress believed that large payments to executives in a change in control discouraged mergers and acquisitions or might encourage executives to accept a change in control that would not be in the best interest of the shareholders. Parachute payments are compensation payments that are related to a change in control of a corporation, and made to a "disqualified individual." If a disqualified individual receives parachute payments which equal or exceed 300% of his "Base Amount" (average annual compensation for the past 5 years), then payments that exceed the Base Amount (so-called "excess parachute payments") are subject to a tax penalty.

Example. X, a disqualified individual, received parachute payments totaling $500,000. X's average annual compensation for the past 5 years is $100,000 (the "base amount"). Accordingly, the safe harbor amount is $300,000 (300% of $100,000) and the excess parachute payment is $400,000 ($500,000 - $100,000).

2. Tax Consequences.

The corporation making the payment loses its deduction for the excess parachute payment, and the disqualified individual receiving the excess parachute payment must pay a 20% excise tax (Code §4999). The 20% excise tax is not deductible (Code §275).

B. EXEMPTION FROM GOLDEN PARACHUTE RULES

1. In General.

The following payments are not parachute payments:

a). Payments with respect to a small business corporation.

b). Payments with respect to a closely-held business.

c). Payments from a tax-qualified retirement plan.

d). Certain payments of reasonable compensation.

2. Small Business Corporations (S Corporations).

A payment to a disqualified individual with respect to a corporation that is a "small business corporation" as described in Code Section 1361(b) (e.g., an "S" corporation) is

not a parachute payment. The corporation does not have to elect "S" corporation status to fall within the exception. Thus, the entity could be a regular "C" corporation that otherwise satisfies the conditions for a small business corporation.

3. Closely-Held Corporations.

a). General rules. Any payment to a disqualified individual will not be a parachute payment if immediately prior to the change in control, no stock of the corporation is readily tradable on an established securities market or otherwise, and certain shareholder approval requirements are satisfied. A publicly held corporation cannot, however establish a wholly-owned subsidiary or even a partially controlled subsidiary to avoid the golden parachute rules.

b). Shareholder approval. Shareholders who own, immediately prior to the change in control, more than 75% of the voting power of all outstanding shares of stock must approve the parachute payment. Adequate disclosure must be made to all persons entitled to vote of all material facts concerned in the parachute payments. Stock owned directly or indirectly by a disqualified person or by a person related (under Code § 318) to the disqualified person is ignored when determining the 75% group. However, if 100% of the stock of a closely-held corporation is owned by a disqualified individual or by related persons, then such stock is counted. Generally, if a shareholder is an entity and a substantial portion of the assets of such entity is the stock of the closely-held corporation, the entity-shareholder may give its approval of the parachute payment only if 75% or more of the persons owning such entity give its approval of the parachute payments.

4. Reasonable Compensation.

Reasonable compensation for personal services to be rendered by a disqualified individual on or after a change in control is not a parachute payment. Whether the payment is reasonable compensation must be shown by clear and convincing evidence.

5. Payments From Qualified Plans.

Payments from a tax-qualified retirement plan are not parachute payments. One concern among executives is the ability of a raider to takeover the company, terminate its over-funded defined benefit pension plan, and use the reversion from the pension plan to reduce the acquisition-related debt. Some employers have reacted by amending their pension plans to provide that in the event of a change in control, the retirement benefits of all participants will be increased by the amount of the overfunding. This increase in future retirement benefits is not a parachute payment.

C. WHAT IS A PARACHUTE PAYMENT?

1. General.

A parachute payment is any payment that:

a). Is in the nature of compensation;

b). Is paid to or on behalf of a disqualified individual;

c). Is contingent on a "change in ownership or control"; and

d). Equals or exceeds the safe harbor amount (300% of the Base Amount).

2. Disqualified Individual.

A disqualified individual is an employee or independent contractor who with respect to the corporation is a shareholder, an officer, or a highly compensated employee. The term shareholders includes only those individuals owning stock in the company having a fair market value equal to or greater than $1 million dollars or, if less, 1% or more of the fair market value of all the outstanding shares of the company stock. The stock attribution rules of Code Section 318 apply. Corporations are deemed to have a number of officers equal to the lesser of 50 and 10% of the corporation's employees. Each corporation will be deemed to have a minimum of 3 officers. Highly compensated employees are those employees or independent contractors whose compensation during the "applicable period" puts the individual in the top 1% of the highest paid employees of the corporation or, if less, the highest paid 250 employees. A minimum $75,000 must be received.

3. Change in Ownership or Control.

a). General rule. A change in control occurs if there is:

i. A change in the ownership of the corporation;

ii. A change in the effective control of a corporation; or

iii. A change in the ownership of a substantial portion of the assets of a corporation.

In addition, the parachute payment must be "contingent" on the change in ownership or control.

b). Change in ownership of a corporation. A change in ownership of a corporation occurs when a person (or persons acting as a group) acquire stock that (together with all stock previously acquired by such person or persons) totals more than 50% of the total fair market value of the corporation's stock or more than 50% of the total voting power of the

corporation's stock. After the 50% threshold is met, the acquisition of additional shares by such person or persons will not trigger a change in ownership of the corporation. The Regulations provide rules for when persons are deemed to act as a group. The constructive stock ownership rules of Code Section 318 apply.

c). Change in effective control. A change in effective control is presumed to occur when a person (or persons acting as a group) acquires 20% or more of the total voting power of the stock in any 12 month period; or a majority of the Board is replaced during any 12 month period by directors whose appointment or election was not endorsed by a majority of the Board as composed prior to the first such change. The presumption that an effective change in control has occurred will be rebutted if it can be established that the acquisition of stock or replacement of members on the Board does not transfer the power (either directly or indirectly) to control the management and policies of the corporation from one person (or persons acting as a group) to another person (or group). Again, the constructive stock ownership rules of Code Section 318 apply.

d). Change in ownership of a substantial portion of a corporation's assets. A change in control or ownership occurs if any person (or persons acting as a group) acquires, within a 12 month period, one-third or more of the fair market value of the corporation's assets as determined immediately prior to the initial acquisition. A limited exception applies to certain transfers to shareholders and certain controlled entities.

e). "Contingent" on change in control. A payment is not contingent on a change in control (i.e., not a parachute payment) if it is substantially certain that the payment would have been made whether or not the change in control occurred. Certain events closely associated with a change in control will be considered to render the payments contingent on the change in control. Nonetheless, the following payments are presumed to be contingent on a change in control: (i) any payment made pursuant to an agreement entered into within one year before the change in control occurred; (ii) or any payment pursuant to an amendment that modifies a previous agreement in a significant respect, if the amendment is made within one year before the change in control. (Only that portion of the payment that exceeds the amount that would have been paid without the amendment is deemed to be made contingent on the change in control.).

The presumption can be rebutted by clear and convincing evidence that the payments were not contingent on a change in control. Relevant factors include the contents of the agreement or amendment and the circumstances surrounding the execution of the agreement or amendment.

f). Vesting on change in control. If property becomes vested on account of a change in control or the payment of benefits is accelerated on account of a

change in control, the benefit will be treated as contingent on a change in control even if it is likely that the payments would have been made or property would have become vested at sometime in the future had no change in control occurred.

i. Only the portion of the accelerated payment that exceeds the present value of the future flow of payments absent the acceleration is deemed to be contingent on a change in control.

ii. If the monetary benefit or property is subject to a vesting schedule and such vesting schedule is accelerated upon a change in control, only a portion of such accelerated benefit will be treated as "contingent" on a change in control. The portion treated as a parachute payment is equal to (1) the difference between the accelerated benefit and the present value of the benefit that was expected to be earned (assuming the employee remained in employment) plus (2) an amount to reflect the fact that the employee is relieved of his obligation to perform future services in order to receive the benefit. The amount in (2) depends on the facts and circumstances but in any event will be at least equal to 1% of the accelerated payment times the number of complete months between the date of the accelerated payment and the date full vesting would normally have occurred without a change in control.

D. COMPUTING THE EXCESS PARACHUTE PAYMENT.

1. Safe Harbor Amount.

The safe harbor equals three times the "base amount." If the aggregate present value of all parachute payments is less than the safe harbor amount, the parachute payments will not be subject to the golden parachute rules and tax consequences. The base amount is the disqualified individual's average annual compensation which is includible in his or her gross income for the "base period." The base period is the five most recent taxable years of the disqualified individual ending before the date of the change in control. If the disqualified individual has worked for the corporation for less than five full taxable years, the base period is the employee's length of employment.

2. Computing the Excess Parachute Payment.

The excess parachute payment equals the parachute payment minus the portion of the base amount allocated to such parachute payment. If there is more than one payment, the base amount will be allocated among them.

3. Reducing the Excess Parachute Payment by Reasonable Compensation.

a). Services before the change in control. The excess parachute payment is reduced by any portion of the parachute payment that the disqualified individual can show is reasonable compensation for personal services

rendered by the disqualified individual before the change in control. However, the reasonable compensation first reduces the "base amount" and then reduces the excess parachute payment. As a result, unless the reasonable compensation exceeds the base amount, the deduction for reasonable compensation will not reduce the tax consequences applicable to the excess parachute payment. If payments are to be made in the future, the future flow of payments is reduced to its present value.

b). Reasonable compensation for services after the change in control. Reasonable compensation for services after a change in control is not a parachute payment. (See Section III(E) of this outline).

c). What is reasonable compensation? Reasonable compensation is determined on a facts and circumstances basis. The standard for showing the payment is reasonable compensation for personal services by the disqualified individual is "clear and convincing evidence." Severance payments are not treated as reasonable compensation for personal services rendered by the disqualified individual.

E. SPECIAL RULE FOR SECURITIES VIOLATIONS

Securities violations parachute payments are parachute payments regardless of whether such payments are greater than or less than the safe-harbor (300% of the base amount). Securities violations parachute payments are payments that are: in the nature of compensation; paid to (or on behalf of) a disqualified individual; paid pursuant to an agreement that violates any generally enforced federal or state securities law; and paid in connection with a potential or actual change in control. Securities violations parachute payments may, but do not need to be, contingent on a change in control. If the securities violations parachute payments are contingent on a change in control, the security violations parachute payment can be aggregated with the other parachute payments and compared against the safe harbor amount. The IRS will use this alternative only if it results in a larger excise tax.

IV. NONCOMPETITION AND CONSULTING AGREEMENTS AND OTHER SHAREHOLDER HELD ASSETS

A. INTRODUCTION

In either a tax-free transaction or a taxable stock purchase, the buyer receives effectively no tax benefits in the form of amortization or depreciation from the amount he pays. In structuring these types of transactions, it is helpful if "other" assets that create deductions can be found and paid for. One example is covenants not to compete, and another is shareholder level goodwill. In both Martin Ice Cream Co. v. Comm'r, 110 T.C. 189 (1998) and Norwalk v. Comm'r, 76 T.C.M. 208 (1998), payments to shareholders for goodwill they held separate and apart from the business were respected and created amortizable assets for the buyer. With the current, fairly-significant difference between ordinary and capital gains tax rates, the seller will suffer a significant tax rate disadvantage by virtue of an allocation of

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consideration to the covenant not to compete, but the goodwill is a capital asset and would be taxed the same as a stock sale.

B. THE TAX LAW OF COVENANTS NOT TO COMPETE

1. General.

Where a covenant is purchased in connection with the purchase of the stock or assets of a business, the allocation of purchase price made by the parties in the agreement will ordinarily govern the value of the covenant. However, the government is not bound by the taxpayer's allocation, and may look to the substance of the transaction, especially where the allocation of the parties lacks "economic reality." An extensive body of case law exists to determine whether, on all the facts and circumstances, an allocation to a covenant contains or lacks economic reality.

2. Effect of Allocations in the Purchase Agreement.

The case law places enormous importance on the parties' allocation of purchase price to the covenant not to compete in the purchase agreement. Most of the case law on covenants not to compete has arisen in the context of inconsistent positions taken by the buyer and the seller as to the tax treatment of the covenant. In these so-called "whipsaw" cases, the government has generally taken inconsistent positions adverse to the taxpayers in each case. The courts have generally refused to allow either party to subsequently challenge that allocation without a showing of "strong proof" that the contract as written did not conform to the intent of the parties. Schulz v. Commissioner, 294 F.2d 52, 55 (9th Cir. 1961). In addition, the buyer of a business that wished to amortize amounts paid for a covenant not to compete had to be especially concerned to secure an allocation of purchase price in the purchase agreement. Out of the hundreds of cases dealing with covenants not to compete, only a handful have allowed the buyer to amortize payments for a covenant that were not specifically allocated in the agreement. Moreover, these cases typically have involved special facts or otherwise are dubious as authority. Wilson Athletic Goods Manufacturing, Inc. v. Comm'r, 222 F.2d 355 (7th Cir. 1955).

3. Court Review of Allocation.

Despite the normal deference given by the courts to the allocation of the parties, many cases hold that "the Government is not bound by a taxpayers' allocation, but may look to the substance of a transaction." Dixie Finance Co. Inc. v. United States, 474 F.2d 501 (5th Cir. 1973). Despite this general admonition that the courts may inquire into the substance of allocations, the courts have rarely done so except in situations in which the parties have taken inconsistent positions in their tax treatment of the same transaction.

4. Factors Relevant to Economic Reality of Covenant.

Courts and the IRS will look at the economic reality of the covenant.

a). Likelihood of competition in fact. If the practical likelihood that the grantor would compete in fact is low, this is a factor indicating that the covenant

lacks economic reality. Krug v. Commissioner, 42 T.C.M. (CCH) 1114 (1981) (lack of financial capability to compete made actual competition unlikely). On the other hand, if the seller would be a formidable competitor, courts have viewed this fact as significant evidence that the covenant has economic reality. Illinois Cereal Mills, Inc. v. Commissioner, 46 T.C.M. (CCH) 1001, 1021 (1983) (grantor of covenant was formidable competitor with significant commercial relationships). The courts have also identified a number of subsidiary factors that relate to the likelihood of competition in fact:

i. Age. The advanced age of the grantor of the covenant may indicate lack of economic reality.

ii. Health. Similarly, poor health or a serious illness of the grantor is an indicia of lack of economic reality.

iii. Absence of legal capacity to compete. If the grantor of the covenant will lack the legal capacity to compete, this is evidence of lack of economic reality.

iv. Intention to compete. While a clearly documented absence of intention to compete may be viewed as evidence of lack of economic reality, a number of courts have held that such a factor is not necessarily fatal since the buyer is entitled to protection against the possibility that the seller may change his mind.

b). Negotiations as an evidentiary factor. A large number of cases have inquired into the negotiation process for the sale of the business and found the facts illuminating in determining economic reality.

i. Absence of negotiations. Several courts have held that a lack of negotiations for the covenant at the time of acquisition is evidence that the covenant lacked economic reality. Conversely, vigorous negotiations concerning the covenant will ordinarily indicate that it has economic reality.

ii. Covenant had no effect on price negotiations. Courts have held that the fact that a price was preliminary agreed upon and was not altered once the covenant was added was evidence that the covenant had no economic reality.

c). Pro rata versus non pro rata payments. Where the covenant is paid pro rata according to stockholdings, courts have held that this is a factor tending to indicate lack of economic reality.

d). Payments conditioned on the survival of the grantor. A provision that the payments to the grantor will terminate in the event of his death is good evidence of the economic reality of the covenant.

e). The effectiveness of the covenant in form and substance. A number of courts have focused on the apparent effectiveness of the covenant as an indicator of economic reality.

i. Right to withhold payments in the event of breach. If the covenant is structured to provide for payments over time that may be withheld in the event of breach, some courts have held that this was evidence of economic reality. On the other hand, one court has intimated that a lump sum payment for the covenant that would require the buyer to resort to a law suit to enforce the covenant may be emblematic of absence of economic reality.

ii. Scope of the covenant as drafted. Courts have held that whether the covenant as drafted has sufficient scope to effectively preclude competition bears on economic reality. A covenant that is narrow as to geographic scope so as to be patently inadequate to protect the buyer will be indicative of lack of economic reality.

iii. Efforts to police the covenant. The presence or absence of efforts to police the covenant may be indicative of economic reality.

5. Percentage of Purchase Price Allocable to the Covenant.

How much may be allocated to the covenant? This is the most frequently asked question of the tax lawyer. One court stated:

"The Court, in reading a number of the cases that have been dealt with by the tax court, and the other federal courts, has found rarely that there has been value attributed to a covenant of more than fifty percent of the total purchase price. In fact, we have found only one case out of the dozens that we have read that have, cited by both parties, wherein more than fifty percent of the purchase price has been recognized and held to be attributable to a covenant not to sue, and that case involved, I believe, approximately fifty-five percent of the purchase price attributable to a covenant not to sue, and was a district court decision.

Most of the other cases have set forth a covenant in the range of approximately twenty-five percent up to forty-five to fifty percent."

Servicemaster of Memphis, Inc. v. United States, 74-2 U.S. Tax Cas. (CCH) ¶9626 (W.D. Tenn. 1974).

In fact, however, the Service has frequently argued for much higher percentages allocable to a covenant where it would cause a taxpayer to recognize ordinary income. In Nelson Weaver Realty Company v. Commissioner, 35 T.C. 937 (1961) aff'd in part, rev'd in part, 307 F.2d 897 (5th Cir. 1962), the Tax Court and the Fifth Circuit held that in the absence of an allocation, one hundred percent of the purchase price paid for a particular business was allocable to the covenant not to compete. There have been a number of other cases in which very high percentages of the total purchase price was allocated by the courts to the covenant not to compete. Unfortunately, virtually all of those cases are ones in which a shareholder was trying to escape ordinary income

treatment as a result of an allocation entered into in connection with the sale of the business.

C. SHAREHOLDER-LEVEL GOOD WILL

Shareholders may hold certain assets separate from the Target company and direct purchase of those assets may be important to the transaction and the source of tax benefits. Assume that the value of the business is $10 million, but $3.0 million can be attributed to a shareholder held intangible.

Example:

Proceeds:	$7 million, less
Basis:	$1 million, equals
Taxable Gain:	$6 million
Tax at 35%:	$2.1 million
After-Tax Total Proceeds:	$4.9 million

Liquidate

Proceeds:	$4.9 million, less
Basis:	$2.0 million, equals
Taxable Shareholder Gain	$2.9 million
Tax at 15%:	$0.44 million
After Tax:	$4.46 million

Plus Individual Sale of Goodwill

Proceeds:	$3.0 million, less
Basis:	0
Taxable Gain:	$3.0 million
Tax at 15%:	$0.45 million
Net Proceeds:	$2.55 million

Total Proceeds to Shareholders

$4.46 million
2.55 million
$7.01 million

Compare to

Stock Sale Proceeds

(without goodwill sale):	$8.8 million
Asset Sale and Liquidation:	$6.85 million

If that same $10 million had been paid purely for assets, there would have been $9.0 of gain, tax of $3.15, gross proceeds to shareholders of $6.85 million, shareholder tax of $.73 million and net shareholder proceeds of $6.12. A stock sale would net $8.8 million, $10 million less $2.0 shareholder basis for gain of $8, and tax of $1.2. Selling individual goodwill gives an advantage to the seller and effectively "splits the difference" between the asset sale the buyer wants and the stock sale the seller wants.

Will need to examine circumstances to determine whether these are any shareholder assets such as goodwill. May occur where shareholders are key to business or where key assets like patents or know how are owned by them individually.

D. PLANNING CONSIDERATIONS

Prior law has always indicated that the Commissioner is free to inquire into the economic reality of allocations made by the parties and gives the Service tools with which to make that inquiry. It seems likely that courts will continue to rely upon the factors identified in prior law to determine whether covenants or purchases of shareholder held intangibles have economic reality.

1. Non Pro Rata Payments.

Non pro rata payments Targeted to the "right" shareholders almost always are strong evidence of economic reality if the sellers are dealing at arms length. Shareholders have important remedies if the payments cannot be justified. This is especially true where shareholders not receiving the payments are owed a special fiduciary responsibility such as ESOPs, etc.

2. Payments Conditioned on Non-competition in Fact.

With covenants, payments over time are subject to potential rate disparity. Additionally, if payments are conditioned on not competing in fact, this factor strongly supports the economic reality of the covenant.

3. Reliance on Expert Appraisals.

The community of business appraisal experts have developed methodology for valuing intangibles and covenants not to compete. These methodologies are frequently needed where fiduciary or other concerns mandate that opinions be obtained that payments under the covenants are fair from the viewpoint of shareholders not receiving the payments. The same methodologies can be used in any setting in which tax documentation is prudent.

4. Emphasis on Documenting the Buyer's Business Needs.

Contemporaneous documentation is always helpful. These need not be strained since the covenant or other intangible asset is often one of the most critical business needs on the buyer's list.

5. Prudence.

For the tax planner today, some simple caution is in order. Reasonable allocations that bear a reasonable proportionality to economic value should continue to be respected. Outrageous allocations may well make bad law.

V. FINANCING THE TRANSACTION

A. SALES FROM THE SELLER'S PERSPECTIVE: SECTION 453 AND INSTALLMENT SALES

1. Requirements.

a). Generally installment reporting will be available in a sale of stock or assets. § 453(b).

b). Under the installment method, the income recognized for any taxable year is that proportion of the payments received which the "gross profit" (realized or to be realized when payment is completed) bears to the total "contract price." § 453(c). Thus, the income portion is determined by multiplying each payment received by the gross profit percentage.

2. Effect of § 453.

a). Installment reporting occurs unless one affirmatively elects out. § 453(d)(1). An election out must be made on or before the due date (including extensions) for filing the taxpayer's return for the taxable year of the installment sale.

b). The installment method will not change the character of the gain on the sale. For example, the depreciation and cost recovery recapture rules apply to installment sales. Reg. §§ 1.1245-6(d), 1.1250-1(c)(6).

c). All depreciation and cost recovery recapture income is recognized in the year of the sale or disposition. § 453(i).

3. Contingent Selling Price.

Installment treatment is now allowed in transactions where gross profit, total contract price, or both cannot be readily ascertained. § 453(j)(2).

4. Resales by Related Parties.

Certain resales by a related party purchaser to the installment purchaser will trigger recognition of gain by the initial seller to the extent the amount realized from the second disposition exceeds actual payments made under the installment sale. If property is marketable securities, taint never stops; other property can be resold without impact after two years. §§ 453(e) and (g).

5. Disposition of Installment Obligations; Liquidations.

When a seller under the installment method sells or otherwise disposes of the installment obligations there generally will be a recognition of gain or loss. See Section 453B for rules. Certain generally tax-free transactions, such as 351, 361, and 332, do not trigger gain. Modification of installment obligations, if sufficiently significant, can be considered a taxable disposition. See, for example Rev. Rul. 82-188, 1982-2 C.B. 90.

B. IMPUTED INTEREST

If there is not adequate interest on a purchase obligation, a portion of the payments will be treated as interest. The original issue discount ("OID") rules apply to cover debt instruments that are not publicly traded and that are issued for nontraded property, for example, where a purchase money note is issued in exchange for closely-held stock or for assets. OID is the excess of the "stated redemption price at maturity" over the "issue price". § 1273(a)(1).

a). "Stated redemption price at maturity" is the principal amount due at maturity plus unpaid accrued interest and other amounts payable at that time, other than any interest based on a fixed rate and payable unconditionally at fixed periodic intervals of one year or less during the entire term of the debt instrument. § 1273(a)(2).

b). Where instruments are publicly traded in an established securities market, the "issue price" is the initial offering price at which substantial amounts are sold. Thus, one would look to opening trading price.

c). Where neither the debt instrument nor the property sold (e.g., stock) is publicly traded, the "issue price" and OID will be determined by testing to see if an adequate interest rate is being charged. If so, the issue price will be equal to the stated principal amount. If not, the issue price will be determined using the applicable federal rate ("AFR"). Based on this redetermined issue price OID will be determined.

i. AFR is a rate based on the average yield for marketable obligations of the U.S. government with a comparable maturity. AFR is determined for three categories: short-term maturity (3 years or less); mid-term maturity (over 3 years but not over 9 years); and long-term maturity (over 9 years).

ii. The AFR is determined on a monthly basis and one may select the lowest rate for the 3-month period ending with the month in which there is first a binding contract for sale. § 1274(d)(2).

d). The OID rules will apply (subject to a de minimis exception) where either (i) the principal amount of all payments due under the instrument, discounted at the AFR, or (ii) the principal amount stated in the debt instrument, is less than the stated redemption price. § 1274(c).

e). The OID rules will not apply so long as interest has been provided at a fixed rate equal to at least the AFR compounded semiannually and is payable unconditionally at the stated rate on an annual basis.

1. Reporting OID.

If there is OID, the amount of periodic interest to be recognized by both lender and borrower is computed on a compounding of interest basis, regardless of their methods of accounting. § 1272. This means cash basis sellers can have interest which they must recognize and report but not have received. Complex rules govern the actual computation of OID and address a variety of situations such as contingent consideration. A full discussion of these rules is beyond the scope of this paper.

2. Section 483.

Section 483 (imputed interest) applies to deferred payment transactions involving a sale of property exempt from the OID rules (generally transactions involving total payments less than $250,000).

a). The maximum § 483 interest rate is 9%. The maximum imputed rate that applies to real estate transactions between related parties involving $500,000 or less is 6%. § 483(f).

b). The imputed interest is included in the income of the seller and deducted by the buyer in accordance with their respective methods of accounting, i.e., cash basis seller or buyer reports when paid or received.

c). Assumptions. If an existing debt instrument is assumed in connection with the sale or exchange of property (or if the property is acquired subject to an existing debt instrument), §§ 1274 and 483 will not apply unless the terms of the existing debt instrument are modified in connection with the transaction or the nature of the transaction is changed (e.g., where the initial transaction was excepted from § 483 but the subsequent transaction was not). § 1274(c)(4).

3. Section 279.

Section 279 provides that no deduction is allowed for any interest paid or incurred by a corporation on "corporate acquisition indebtedness" during the taxable year to the

extent that such interest exceeds $5,000,000 reduced for certain other interest and in specified circumstances. Corporate acquisition indebtedness is debt:

a). Issued to provide consideration for the acquisition of stock or assets from another corporation; and

b). The obligation is subordinate to claims of trade creditors or some substantial amount of unsecured debt; and

c). The debt is convertible directly or indirectly into stock or is part of an investment unit including an option or stock; and

d). Causes the ratio of debt to equity to exceed 2 to 1 or projected earnings do not exceed 3 times the annual interest to be paid or incurred.

While application of these rules to an "average" acquisition is unlikely, it is always prudent to keep them in mind, given lenders' demands for conversion rights, warrants and equity enhancement features.

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Ms. Allen works to structure and effect complex business transactions. Specifically she has worked in a variety of settings to use joint ventures, partnerships and LLCs to achieve business objectives in "non-traditional" acquisition contexts. She structured the largest acquisition of cellular towers in history, representing GTE (now Verizon) in its joint venture with Crown Castle involving over $1 billion in cellular telephone tower sites. She also worked in representing a major real estate investor in creating a $500 million "mixing bowl" structure for ownership of mature real estate assets. She has also been involved in numerous transactions involving the use of partnerships and LLCs to achieve individual corporate goals in moving and re-deploying assets.

Ms. Allen also maintains an active corporate tax practice, having secured a one-of-a-kind ruling (in less than three months) from the Internal Revenue Service for Arcadis, NV, a Dutch public company when making its first U.S. acquisition on the characterization of its stock that was not voting in the traditional sense as voting stock for purposes of the reorganization provisions. She has been involved in numerous other transactions in recent years, leading the firm one year in issuing over 100 opinions in taxable and tax-free transactions.

Ms. Allen is a frequent author and speaker on the topics of corporate, partnership, and real estate income tax problems and has spoken to numerous professional organizations, including the Southern Federal Tax Institute, American Bar Association, Atlanta Tax Forum, Georgia Tax Conference, National Business Institute, Duke University Urban Property Development Council, State Bar of Georgia, and Atlanta Bar Association. In 1999, Ms. Allen was recognized by *Atlanta Magazine* and Georgia Public Television as one of twenty-one "Women Making a Mark" on Atlanta, honoring powerful women who have made a permanent, positive mark on lives in Atlanta.

Ms. Allen received her J.D. degree, cum laude, in 1979 and her A.B. degree, summa cum laude, in 1976 from Harvard University. She is identified in *The Best Lawyers in America* for her tax expertise. She is a

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Gregory M. Giammittorio is a partner in the Tysons Corner, Virginia office of Shaw Pittman LLP, where his practice focuses on mergers and acquisitions, joint ventures, strategic alliances, emerging company counseling and corporate finance.

Mr. Giammittorio has recently worked on several mergers and acquisitions for software, information technology, medical device, media and bioinformatics companies. He has also worked on an acquisition program involving closing the acquisition of six target companies in a two year period for a rapidly growing satellite service provider and on a series of acquisition agreements for sellers of government contracting businesses.

In addition, Mr. Giammittorio has worked on a variety of strategic commercial relationships involving arrangements such as teaming agreements, joint development agreements, licensing arrangements, and OEM, reseller, service provider and distribution agreements. Mr. Giammittorio spent several years representing Motorola, Inc. in connection with satellite and terrestrial wireless transactions. He has also handled transactions relating to the XM satellite radio system, the Inmarsat satellite system and VSAT (very small aperture terminals) and DBS (direct broadcast satellite) systems.

Mr. Giammittorio currently serves as the Chairman of the Emerging Companies Subcommittee of the American Bar Association's Small Business Committee and is an active member of the American Bar Association's Negotiated Acquisitions Committee. He is also active in the Technology Council of Maryland, the Northern Virginia Technology Council, the Washington Space Business Roundtable, and the Society of Satellite Professionals International.

Moderator and Program Organizer

THOMAS J. WALSH, JR. is a principal of Brody, Wilkinson and Ober, P.C. of Southport, Connecticut and chair of its business practice group. Representation of closely held businesses, particularly start-up and emerging growth companies, is one of his primary practice areas, along with commercial real estate transactions, commercial lending and municipal law. Mr. Walsh serves on the Executive Committee of the Business Law Section of the Connecticut Bar Association and is Co-Chair of the Bridgeport Bar Association's Business Law Committee. He received his B.A. Degree from the University of Connecticut cum laude and J.D. from the University of Connecticut School of Law.