Acquisition of the Corporate Division

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ACQUISITION OF THE CORPORATE DIVISION

A corporate division can be described, touched, operated, and even sold, while at all times having no legal identity separate and apart from that of the other elements of the corporation. The contrast between the business reality of corporate divisions and the total absence of any legal significance to the division gives rise to a number of challenges in drafting acquisition documents and in otherwise closing the purchase of a corporate division. This outline will raise issues to be considered by counsel in drafting acquisition documents and in closing a divisional purchase.

I. The Nature of the Corporate Division.

For purposes of our discussion we will assume that "division" is used in its traditional sense, namely, to refer to a portion of a corporation which, while separated for certain business purposes, is totally part and parcel of the corporation for legal purposes. Its assets are not separately titled, and its liabilities not separately allocated, and it is for all legal purposes indistinguishable from the other parts of the corporate entity. This is not to say that the division may not have a different name (such as a fictitious name), a separate plant site (which would necessarily be titled in the name of the corporation), separate employees (who think of themselves solely as employees of the division but who must receive paychecks from the corporation) or any number of other factors that would suggest a separate business. This is all well and good and has great significance for the corporate president or other executive, but the law simply does not recognize it. The first step in approaching the purchase of a division is to consider why the business activities being acquired are considered by the Seller to be a separate division, and secondly, to determine what implications that separation has for the acquisition transaction.

A. Geographical Separation. Many corporations separate plants and facilities according to geographical location, designating each as a "division". Divisions might separate activities in one state from another or might distinguish between operations in one country from another.

B. Marketing Strategies. Certain aspects of corporations are organized according to marketing strategies and products lines. A division might bear the same name as a trademarked product that is produced by the corporation and might therefore distinguish itself from other branches of the corporation. Similarly, a division might reflect the acquisition at some point in the past of a product line or a separate business entity.

C. Manufacturing. Where a corporation is engaged in vertically integrated manufacturing, a division might reflect a single step in the manufacturing process or might distinguish the actual manufacture of a product from its design or its marketing. Where the corporation is a diversified manufacturer or provider of services, divisions might separate one product line from another.

D. Human Resources. Divisional lines might separate different classes of employees, might delineate different pay plans and benefits schemes, or might constitute separate profit centers on which bonus compensation is based.

E. Functional Distinctions. Divisions can separate research and development functions from manufacturing activities or from sales efforts. Where there are several sorts of business activity within the corporation, a single division might house all the support activities, such as accounting and computer support.

F. Historical Anachronisms. Quite frequently a division exists for no reason other than that it has once existed as a separate subsidiary or affiliate and the historical lines of separation have been followed without thought for whether there is a reason for it.

II. Similarities and Differences.

While the acquisition of a division is in many respects different from the acquisition of a stand-alone corporation, there are more similarities than differences. This outline will not focus on those elements that are substantially the same as for any other asset acquisition, and we refer you to other speakers and literature for a general overview of the elements of the acquisition transaction. Our focus on distinguishing features of divisional purchases should not, however, eliminate the need to include in the acquisition documentation all those provisions customary for an asset acquisition. Indeed, acquiring a division does not eliminate any of the customary asset purchase language, but merely either (1) renders certain elements of that language more critical and/or (2) requires the inclusion of additional provisions addressing the peculiarities of the divisional purchase.

III. The Approval Process.

Early in the process the practitioner should inquire as to extent to which the sale of the division constitutes the sale of "all or substantially all" of the assets of the Seller. Such an action by the Seller would, under the Model Business Corporation Act as adopted in most states, require shareholder approval. Case law has analyzed a wide array of factors to determine whether stockholder approval is required. Generally, where the value of the assets being sold, whether on the basis of book value or fair market value, exceeds half of those owned by the selling corporation, a further analysis should be made under relevant case law to determine whether shareholder approval should be sought. Even where shareholder approval is not required, the parties should be mindful of the need for the directors to comply with basic fiduciary obligations to the shareholders, and care should be given to following procedures which establish a record supporting compliance by the directors with the business judgment rule. In addition, certain approvals of franchisors, third-party suppliers, customers, and employees may be required and may affect the logistics of the transaction.

IV. Identification of Assets.

Were this a straight-forward asset acquisition, the asset purchase agreement would ordinarily include a five-fold approach to a description of assets: (1) a catch-all statement describing all assets owned by Seller, (2) a second general description of the assets being conveyed based on the concept of the Seller's "business", (3) a listing of certain categories of assets (real property, equipment, inventory, accounts receivable, etc.), (4) reference to Seller's balance sheet to further identify assets, and (5) a series of schedules confirming that those specific assets listed in the schedules are included in the assets conveyed. These would be accompanied by provisions and related schedules excluding certain assets described to be retained by the Seller, but the whole thrust of the transaction would be to put in the hands of the Seller substantially all assets of every description owed by the Seller.

Because this is a purchase of only a portion of Seller's business, we are not able to use such a broad approach. The catch-all statement of "all assets owned by Seller" will not work at all. The second approach, hinging as it does on the definition of Seller's divisional "business", might

work, but requires a very clear understanding of what the "business" is. In light of this, the last three methods, namely, descriptive categories, financial statement references, and the listing of assets on schedules, assume critical importance in insuring that our Purchaser gets the benefit of the bargain he negotiated and in insuring that the Seller retains all those assets not intended to be sold.

A. General Descriptions. The first reaction of the acquisition lawyer in drafting divisional acquisition documentation is to modify customary asset purchase language to provide for the purchase of not "all the assets of Seller" but of "all of the assets of the Alpha Division of Seller". Drafting in this manner puts a great burden on the description of the division and that description will necessarily vary widely depending on the specific facts. Many of the descriptive methods relate to the reasons for the division itself. Consider the following approaches:

1. Geographical References. Where all the assets and business of the division are located in a specific site and that site is separate and apart from Seller's other operations, a description using that criteria works well. Consider the following description: "'Division' shall mean all that business and activity of Seller engaged in the design, marketing and sale of goods and products located at 100 Turnpike West, Chicago, Illinois".

2. Product Descriptions. If the manufacture of a product is the sole function of a division and no other portions of the Seller are involved in that work, a description based on the product itself works: "'Division' shall mean all that business and activity of Seller engaged in the design, marketing, and sale of widgets wherever said business and activity shall be located."

3. Trade Names. The name under which the business is being operated (where that name is separate from Seller's other trade names) works in some circumstances: "'Division' shall mean all that business and activity of Seller engaged in under the name Alpha Division or Alpha Products Company, wherever said business and activity shall be located."

4. Seller's Own Descriptions. Somewhat less sound is simply relying on the Seller's own designation, such as "all assets and business of the West Coast Division" of the corporation. Unless there are other records which will easily designate which assets are included in that division, there is a possibility that the Purchaser could be at the Seller's mercy at closing time, for only the Seller will have a precise idea of which assets might be included in such a description.

B. Categorical Descriptions. Even where an adequate description of the division is developed, it is common for Purchaser's counsel to go beyond the blanket statement "all assets of the Division" and to include a categorical list of assets to be included in the assets purchased. Such a list might include the following:

> (i) all real property, leaseholds and subleaseholds, improvements, fixtures and fittings, (ii) all tangible personal property, machinery, equipment, inventories, parts, work in process and finished goods, furniture, automobiles, rolling stock, tools and dies, (iii) all intellectual property, including patents, trademarks, trade names, trade secrets and copyrights, (iv) all contacts, indentures, agreements, guaranties and rights, (iv) all accounts, notes, receivables, and other rights to receive money, (v) all causes of action, claims, demands, rights of recovery, and suits, (vi) all franchises, approvals, permits and licenses, and (vii) all other assets, rights and possessions of Seller of every description used in the business of the Division.

The listings of categories, while helpful from a procedural standpoint in making the parties focus on the various types of assets that are being transferred, would not appear to have more legal significance than the statement "all assets of the Division". However, in several instances where

disputes have arisen as to whether goods were conveyed or were intended to be conveyed, the courts have used specific categories to find that the assets contained in the category were intended to be conveyed.

C. Balance Sheet Descriptions. Balance sheets or other financial statements may be used as a descriptive device by use of language such as "all assets included on lines 22 through 46 of Seller's balance sheet dated as of November 31, 1997, together with all additions thereto from the date hereof until the closing date". The use of such descriptions is only as good as the financial statements themselves, and care should be taken to sweep into the assets purchased tangible assets that might not be reflected on the financial statements for one reason or another, such as assets that have been fully depreciated or which, while essential to the success of the business, are assigned no balance sheet value. In relying on financial statements at any point in the acquisition process, counsel should bear in mind the informal relationship that typically exists between a division and the rest of the corporation, which relationship may well give rise to casual accounting methods that would not properly reflect the operations of the division. A more conservative approach for the Purchaser is to use balance sheet descriptions as an additional means of describing the assets, such as would be the case with the following clause:

> Without limiting the generality of the foregoing, the Assets conveyed shall include all such assets as are included on the balance sheet of the Alpha division of Seller bearing even date herewith as amended to reflect the condition of the Alpha division as of the closing date

D. Use of Schedules. In most cases, the Purchaser will want to make extensive use of schedules to be sure that the assets conveyed include all assets of which it is aware which are part of the division being purchased. Preparation of schedules is one of the most tedious aspects of the asset acquisition but the schedules can be of critical importance in the event of a subsequent dispute. This is especially true in the divisional purchase where the Seller might have good use for certain of its assets in the future. Schedules describing purchased assets might include the following: (i) real property leaseholds and subleaseholds; (ii) tangible property, such as machinery, equipment, inventories of raw materials and supplies, manufactured and purchased parts, work in process and finished goods, furniture, and automobiles, (iii) intellectual property; (iv) personal property leases; (v) contracts, agreements, security interests, and mortgages, and (vi) franchises, approvals, permits.

E. Timing of Schedules; Amendment. The Purchaser will likely press for early preparation of the schedules with the objective of tying down the details of the purchase transaction at an early date. However, the sooner the schedules are prepared, the more likely they are to become inaccurate by the time of closing. Also, the more detailed the schedules the greater the likelihood that they will become inaccurate by the time of closing. One solution is to state that the schedules will remain materially accurate at the closing, and to then establish (if you represent the Seller) the most liberal materiality standard possible. A sounder approach is for the parties to confer upon the Seller the right to amend the schedules up to and including the closing (and possibly during the post-closing adjustment process) with amendments themselves being subject to a materiality standard. Such provisions might be integrated with "bring down" language contained elsewhere in the agreement. Because the details of the schedules can be important both to Seller and to Purchaser, it is not unusual for approval of the schedules to be a condition to closing, such that if the parties are unable to agree on schedules, the transaction will not close.

F. Reverse Description. One safe approach for the Purchaser is to reverse the conveyance process by describing a purchase of "all assets of the Seller" excepting only those assets which are specifically listed on a schedule. This approach shifts the burden to the Seller to

describe which assets are not in the division and decreases the Purchaser's concern as to whether it is getting all the assets.

G. Integrated Facilities. Where the division is not physically separated in any sense from the rest of the Seller, special problems arise. Purchaser's counsel will need to make use of each of the methods set forth above but must understand the need for the greatest specificity possible when drafting both category descriptions and the accompanying schedules. Asset purchase agreement provisions might include identification by serial numbers or some detailed inventory process to bring about a successful separation of the assets without any resulting dispute as to ownership. From the Seller's perspective, a tightly-worded excluded assets section, accompanied by a very detailed schedule, would be equally important.

H. Assets Remotely Located. Attention should be given to those assets being purchased or which are necessary to the operations of the division which are not physically located at the same place as the other divisional assets. First, care should be made to include, by way of schedule or otherwise, those assets in the assets being conveyed, and second, the Purchaser should consider any transportation, construction or installation costs associated with moving those assets to the location of the remainder of the division.

I. Changes in Assets. Any approach to the description of assets must take into account the constantly changing nature of the business and must from the Purchaser's perspective both (1) provide that after-acquired assets of the same type as described in the agreement or in the schedules will be conveyed on the closing date and (2) restrict the Seller's ability to sell, retire or convey any assets of the division or to transfer assets from one division to another while the purchase agreement is pending.

J. The Role of Representations. No matter what method or methods are used for the description of the assets, the descriptions should be accompanied by separate and specific representations by the Seller to the effect that the assets include (i) all assets presently used in the operations of the division and (ii) necessary to the operations of the division. This representation puts the onus on the Seller to be sure the descriptions are accurate and complete but there is no assurance that the Purchaser would ever discover any resulting breach of the representation. The Seller will very likely endeavor to limit such representations by stating that the assets conveyed are limited to those which Seller owns or has a right to convey.

K. A Comprehensive Approach. The best approach for Purchaser's counsel is to use a comprehensive approach which includes as many of the techniques listed above as are applicable to the circumstances of the acquisition. Purchaser's counsel should (i) include a comprehensive statement regarding conveyance of the assets which is based on a well-worded description of the business in which the division is engaged (based on factors such as geography, product line, or trade name), (ii) follow the general description with a non-exclusive description of the categories of assets that will be conveyed, (iii) make use of balance sheet descriptions where appropriate to supplement the category descriptions, and (iv) tie the categorical descriptions (as well as the representations of the agreement) in to schedules listing specific assets or classes of assets that will be conveyed. A sample of an asset description using these multiple approaches is attached as Appendix I.

V. Assumption of Liabilities.

The description of liabilities to be assumed requires a reversal of the respective roles of Purchaser and Seller, with the Seller having as a critical objective the assumption by Purchaser of all

of those ongoing liabilities of Seller associated with the division. The major difference from the asset description is that while some assets are intangible, all liabilities have that characteristic, and do not have a physical home from which they can be distinguished from other liabilities of the Seller. To a greater or lesser degree they may be separated from liabilities of other divisions but the degree of separation will depend on the integrity of the Seller's financial statements. Nevertheless, some of the methods used for descriptions of assets can be used with equal effectiveness here.

A. Generic Descriptions. A typical general description of liabilities associated with the division would include "all liabilities of the division arising out of or relating to the business and operations of the division." Such language will depend heavily on a tightly-worded description of the division. As a general rule, any attempt at generic liability descriptions is thwarted by the intangible nature of liabilities. There is typically a strong need for some concrete description of what is and what is not included to act as guidance for the parties and their accountants in the future.

B. Balance Sheet References. Depending on the extent to which post-closing adjustments have been adopted (see discussion below), the balance sheet reference may be an effective means of describing classes and categories of liabilities to be assumed. In the event of a dispute as to the liabilities assumed, the balance sheet permits reference to the division's past history and relationships to determine which liabilities in fact relate to its operations.

C. Liabilities Related to Assumed Contracts. Liabilities related to assumed contracts, leases and other commitments related to the business of the division can be handled on an item by item basis, with appropriate prorations to reflect matters billed after closing. This approach can be combined with estoppel letters and certificates confirming no default under these agreements and setting forth the amounts payable from time to time.

D. Schedules. Since the divisional acquisition is a form of asset acquisition, absent express action of the parties, no liabilities of any description will be transferred. The Purchaser will likely try to maintain the asset purchase character of the transaction to the greatest extent possible and may insist on the scheduling of specific payables and other liabilities as a condition to assuming any of them. This approach requires meticulous attention by the Seller to the accurate listing of liabilities. The listing may be made by on a creditor-by-creditor basis or through more generic listing of categories of liabilities.

E. Litigation and Customer Claims. Rarely will the Purchaser assume litigation and customer claims pertaining to the division, but such claims might easily follow the assets by operation of law. These issues can be addressed through reliance on existing insurance coverage and on careful drafting of indemnities, and in more extreme cases by escrow deposits and pledging of assets to secure any liability arising from these claims. The party retaining responsibility for pending litigation will likely request provisions requiring the other to cooperate with it in defending such claims. Whether there is compensation for time and expenses expended in such cooperation will be a negotiated point.

F. Work in Process and Ongoing Business of Seller. Where the objective is to maintain the ongoing nature of the business with as little disruption as possible, the Purchaser will likely purchase and assume the existing customer orders of the division and its work in process. Work in process can be valued based on percentage of completion at the time of closing and can be separately treated in a closing statement or closing balance sheet. A point of contention is whether the work in process is valued based on Seller's cost or whether a prorated profit element is included.

G. Assumption of Obligations. Even where the Purchaser has agreed to assume certain obligations of the Seller in connection with the divisional purchase, the transfer and assumption of those liabilities by Purchaser will not automatically act to relieve Seller of any liability with respect thereto. This could be addressed with specific indemnities, and, where the Seller is particularly concerned about payment of those obligations, with collateral or guarantees.

H. Post-Closing Adjustments. Given the fact that liabilities fluctuate on a daily basis, making it very difficult to have an accurate listing as of the closing date, very often the best approach for both parties to use in handling liabilities is to use a post-closing balance sheet adjustment mechanism. This is discussed in detail below.

VI. Assumption of Liabilities by Operation of Law.

In addition to those liabilities expressly assumed by the Purchaser in the acquisition agreement, a number of theories of law will impose on the Purchaser of the assets of a division the liabilities of the Seller pertaining to that division (as well, in certain cases, as liabilities pertaining to non-divisional activities). These cases are inconsistent with the basic premise that an asset purchase does not in and of itself carry with it any of the corporate liabilities. Theories used by courts to avoid this well-established rule include the following:

A. Implicit Assumption of Liabilities. Certain cases hold that even where liabilities are not expressly outlined and provided to be assumed in asset acquisition documentation, they may be impliedly assumed. Cases in this area often rely on general language in the assumption section of the acquisition document as evidence of the parties' intention that various specific (and often far-reaching) liabilities of the Seller be assumed by the Purchaser.

B. Product Line Exception. In the field of products liability, courts in certain jurisdictions have developed a line of exceptions based on the theory that when a Purchaser acquires a product-line and the good will that is associated with it, the liabilities associated with that line should follow.

C. Environmental Issues. In interpreting the environmental laws, primarily CERCLA, the courts have found that where the transaction takes place primarily for the purpose of avoiding environmental liability, the purchaser can be held liable for such liabilities notwithstanding the transfer of assets. This doctrine, known as the doctrine of successor liability, has been expanded into the "mere continuation" theory to permit the imposition of liability on the Purchaser of corporate assets where the Purchaser retains the same employees, manufactures the same products, remains in the same location, retains the same name, and generally holds itself out as the successor of the Seller. While one would not ordinarily expect this rule to apply to a divisional purchase, it is quite possible, given the potential to purchase a division maintaining a separate geographical location and the extent to which many of the court cases track product lines, that this line of cases could become a major problem for the draftsman.

D. Taxes. Liabilities arising out of the division's operations might include not only the Seller's basic tax burden but also liabilities shared in common by the Seller with other members of its consolidated group, which, under current tax laws, share joint and several liability for those taxes. This is an area for careful drafting of indemnities, and may also impact post-closing adjustment mechanisms.

E. Bulk Sales. The practitioner should bear in mind that the purchase of a division may invoke provisions of bulk sales laws which are still on the books in many states.

F. General Liability for Operations of the Seller. A small number of cases have found the Purchaser of assets responsible not only for environmental and product liabilities of the Seller relating to the products or the assets being purchased, but also for other unrelated liabilities of the Seller. Such cases, which must be reviewed on a jurisdiction-by-jurisdiction basis, put a high premium both on drafting of indemnity language and on conducting due diligence activities not only with respect to the division being purchased but on the Seller as a whole.

A more detailed discussion of these and other successor-liability issues is contained in a separate paper included in these materials.

VII. Separation of the Businesses.

Aside from the business of identifying those assets that constitute the division, one of the most complex pieces of the divisional acquisition is the identification of shared relationships which are critical to the division's operations. These relationships come in two types: First, those relationships between the division and the rest of the Seller which will either be severed or must be contractually continued for the division's business to proceed, and second, those relationships with third parties that are shared by the division and the remainder of the Seller. These third-party shared relationships must also either be severed or continued contractually (with contractual agreements between Seller and Purchaser or with agreements with the third-parties) in order for the division's business to continue.

A. Relationships between the Division and the Seller.

1. Shared Services. The most obvious area for concern is in the area of services being rendered by the Seller to the division, which services must either be provided elsewhere post-closing or must be continued by contractual agreement with the Seller. Such services include managerial activities as well as the furnishing of goods and services:

a. Human Resources. Hiring and firing of certain employees may have been handled outside the division in the past, as may the administration of employee practices and policies, the investigation of employee misconduct, and the handling of litigation relating to the same.

b. Accounting and Taxes. It is very common for corporate enterprises to share a single accounting system and to administer tax issues for the corporation as a whole. Tax allocations will play a major role in other aspects of the purchase agreement.

c. Information Systems; Software. Computer systems will very likely be linked between all areas of the Seller and the critical question is the extent to which the information systems of the division can function on their own without the rest of the Seller's enterprise. The same issue holds true for telephone systems, customer communications systems, vendor purchasing computers, satellite communications, and any number of other information processing systems. These systems can be addressed either by the Purchaser purchasing such services elsewhere or by continuing support agreements between the Seller and the Purchaser to provide for the services to be continued after closing, either for an interim period or on a permanent basis. Special care should be given to the need to obtain computer source codes from the Seller and on difficulties to be encountered in converting important data bases of the Seller for the use by Purchaser in the activities of the division after closing. Proprietary software of the Seller which is

critical to the activities of the division may be purchased outright and included in the assets conveyed or may be subjected to a perpetual license from Seller to Purchaser.

d. Telephones. Ownership of the main telephone number through which calls come into the division ought to be specifically referenced in the acquisition agreement. Where there is a single number for all of Seller's operations, an obligation to cooperate by referring divisional callers to the new number should be included.

e. Joint Support Arrangements. Each of these issues can be addressed in some fashion through a joint support agreement covering the services that will be furnished by the Seller to the division after the closing. In some circumstances, it might be the Seller that needs continued services from the division for a period of time after closing.

2. Insurance. Because insurance underwriters, like the legal profession, view a single corporate entity as a single person, it is likely that insurance coverages for the Seller are not segregated according to the division, and the separation of those coverages at the time of closing requires careful planning. With respect to products liability and other liability coverages, care should be given to whether existing policies provided coverage based on the time when the claim arose or the time when it was asserted. Particularly given the law in the products liability and environmental areas, the Purchaser will want to make certain both that it has adequate coverage at the date of closing and that the Seller maintains any coverage it has with respect to activities of the division for a period of time after closing through the Purchaser of "tail" insurance. Surety or performance bonds might need to be transferred to the Purchaser as part of the divisional sale as might employee fidelity coverages for employees to be hired by the Purchaser after the closing. Due diligence in any event should include a careful study of historical insurance coverages, claims experience, and costs.

3. Records. Inevitably there will be records of past activities of the division which will be retained in some central location by Seller and which will not be transferred to the Purchaser. These records should be the subject of careful drafting in several respects. The Purchaser should impose strict confidentiality on any Seller-retained records which contain business or trade secrets and should provide for continuing access to those records in the future.

4. Common Facilities. Where facilities of the division are located adjacent to those of the remaining Seller enterprises, provisions must be made for continuing easements and access in the post-closing period. Storage yards and areas might be used in common, and either perpetual easements should be negotiated or some partition undertaken so that there is a clear division of areas. Joint transportation facilities, such as a rail head, may be subject to a perpetual easement agreement and may or may require sharing of maintenance costs and access fees. In some circumstances, Seller may continue to provide transportation services for the division after closing according to negotiated terms.

5. Intellectual Property. Where the divisional name is separate and distinct from that of the Seller, the name can be transferred outright to the Purchaser at closing. Such should also be the case with divisional names that are associated with a product line being purchased. Jointly used names should be made the subject of a perpetual license agreement. The same can be done with patents and trademarks that are registered. In order to prevent the pledge and assignment of intellectual property that is subject to a license agreement, an informational filing should be made with appropriate recording offices. Conversely, in some circumstances it might be important to the Seller to prohibit the subsequent use of the divisional name or there may be some need to separate product lines by having either Seller or the division alter an existing tradename.

6. Trade Secrets. Trade secrets may constitute assets being transferred as well as assets jointly to be shared after the closing. Both Purchaser and Seller will want to impose strict confidentiality requirements on the other to be sure that no unauthorized disclosure occurs while at the same time assuring that either party who needs or is entitled to trade secret material has access to it after closing.

7. Supplier Relationships. Attention should be focused on whether any of the products used by the division in its manufacturing operation are furnished by the Seller or generated in the course of its other manufacturing operations. Purchaser should either arrange for the products to be obtained elsewhere or negotiate provisions to insure Purchaser of a supply of the products post-closing. Also an integral part of the transaction might well be a commitment by the Seller to purchase products and/or services from the division post-closing or vice versa.

8. Drafting Solutions. All of these issues involving relationships between the Seller and the division should be subject to extensive representations from the Seller. To the extent practical, i.e., assuming the Seller and its division are not so intertwined as to make such distinctions meaningless, a separate schedule should list significant relationships in each area. In addition, an agreement provision should require the Seller to disclose not only relationships between the Seller and its division, but also relationships between the division and any affiliate, officer or shareholder of the Seller. Once disclosed, these relationships can be dealt with as appropriate.

B. Relationships with Third Parties. Often overlooked in the rush to ferret out relationships between the Seller and its division is the importance of relationships shared jointly by the Seller and its division with third parties. Those relationships will continue after the closing but must be carefully managed so that both Seller and Purchaser will be able to continue their business activities without disruptions.

1. Supply Sources. Where Seller and its division share joint suppliers, Purchaser must either impose the renegotiation (and separation) of those agreements as a condition to closing or obtain a separate source of supply. An alternative approach is to obtain the commitment of the Seller to continue reselling the product to the division after the closing, but this approach risks the loss of the source of supply by the Purchaser after the closing as a result of negligence of the Seller, a condition beyond the control of the Purchaser.

2. Joint Facilities. Where plant and facilities are leased from a joint landlord, Purchaser may arrange a sublease for the divisional properties, or (better) require that the property be partitioned and that separate lease agreements be entered into between the landlord and the division.

3. Customer Goodwill. The body of customers being served by the division prior to closing may continue as customers of both Seller and the division after the closing. Assuming that areas of enterprise are properly spelled out through use of a noncompetition agreement, this should not be a source of controversy between Purchaser and Seller, but each should commit to the other to cooperate fully in the transition of customers from Seller to Purchaser after closing. Such cooperation might include joint mailings at closing as well as referrals of customers to the appropriate entity after closing, depending on the services or product needed. Each should commit not to disparage the name or goodwill or products of the other after closing.

4. Contracts and Franchise Agreements. The easiest contracts and agreements to deal with are those that either will clearly stay with the Seller (in which event the Purchaser need only rely on a representation of the Seller to the effect that they are not needed in the division and on the Purchaser's own due diligence with respect to the contracts) and those which will clearly be

assumed in whole by the Purchaser. In the latter case, the Purchaser will need to undertake normal due diligence by reviewing the contract for assignability and follow through with an appropriate estoppel certificate and/or consent from the third party. Attention must be focused in each case on whether the party ending up with the contract actually has the resources to perform it or must rely in whole or in part on the resources or efforts of the other. Contracts which will be assumed in part by the Purchaser and retained in part by the Seller will require renegotiation by the parties. If the third party is unwilling to do so, the parties might consider a subcontract arrangement similar to that suggested in the real estate area. Even in contracts being retained by the Seller, the sale of a large portion of Seller's assets may constitute a default which could injure Seller, and restrictive agreements like franchises might be unassignable in any event so that approval of the franchisor would need to be a condition to closing. Conditions to closing for the Purchaser might include not only these matters but also any modifications that are considered desirable in those agreements.

5. Licenses and Permits. Licensing is an issue for the Purchaser in any asset transaction and will depend on the specific businesses involved and the regulatory framework. The Seller's cooperation in any regulatory procedures should be required by the asset purchase agreement, and where the license is location-specific, the Seller might well have to resign its rights in order to permit the Purchaser to obtain a proper license.

C. Competition after the Closing. Covenants not to compete, which are frequently found in asset acquisitions, become all the more important where only a portion of the Seller's assets are being purchased and the organization that remains is an ongoing business entity capable of engaging in any number of activities. No matter how separate and apart the Seller and the division appear to be, some knowledge of the business of the division will remain with personnel of the Seller, and the principals of the Seller might retain important business contacts that, if used competitively, could seriously damage the value of the division. In drafting noncompetition language, attention must be focused on the hostility with which many jurisdictions approach such covenants, and specific enumeration of covenants accompanied by severability language should be used.

VIII. Employees.

More so than other third-party relationships, the employees of the division, while critical to the success of the division and to the ability of the Purchaser after closing to proceed with the business and affairs of the division, are often well beyond the control of either the Seller or the Purchaser. Employee issues are complicated by the existence of collective bargaining agreements, executive compensation plans, employee benefits, and shared responsibilities.

A. Purchaser's Objective. The Purchaser's clear objective is to have the option, but not the obligation, to hire such of the employees of the division as it elects to do so at closing. The Purchaser will want to couple this right with a condition to closing which states that if for any reason it is not comfortable that it will be able to hire such of the employees at it desires, it will not be required to close.

B. Executive Employees. Certain of the upper echelons of management of the division may have written employment contracts which contain benefits which are triggered upon the event of the sale of the division. Seller and Purchaser must allocate among themselves the liability for such benefits, and Purchaser must consider the extent to which similar contracts should be entered into with the Purchaser as a condition to closing. The hiring of key employees by Purchaser may be a condition to closing, and such hiring might be accompanied by "stay put" agreements which reward those key employees for staying with Purchaser for a period of time after the closing. Such

employees not wanted by the Purchaser will likely pose either a managerial burden or a monetary burden or both for the Seller and should be factored into the cost of sale.

C. Shared Employees. Certain employees will be the subject of case by case negotiations, with a schedule possibly setting forth the employees that Seller is absolutely entitled to retain or who will work partially for Seller and partially for Purchaser after the closing. Shared employees create a great danger of conflicts of interest, and contract provisions should receive special drafting consideration.

D. Remaining Employees. Employees remaining with the Seller, particularly in managerial positions, might be required to agree to cooperate in the transition and to furnish support to Purchaser in any number of contexts in the early months following closing. The considerations set forth above regarding competition by the Seller with the division after closing apply equally to key employees of the Seller who remain with the Seller, and a condition to closing might be the obtaining of noncompetition commitments from each of these.

E. Bulk Resignations. While the Seller should commit that it will not seek to retain employees of the division sought to be hired by the Purchaser, the Purchaser should protect itself by adding as a closing condition the fact that there shall have occurred no massive resignation of employees and it shall be satisfied that the employees will remain after the closing.

F. Labor Unions. Collective bargaining agreements might cover only the division employees or the Seller's wage-earners as a whole and should be examined carefully during the due diligence, and all such agreements should be separately scheduled. In cases where the union is not desired by the Purchaser after closing, Purchaser should follow proper application and hiring procedures at closing. Such procedures might require termination by the Seller of all employees of the division and might result in liability to Seller under its collective bargaining agreement or under applicable laws, and that liability will be subject to negotiations between the Seller and Purchaser.

G. Statutory Compliance. The parties should also bear in the mind the possible need to comply with regulatory statutes, such as the Worker Adjustment and Retraining Notification Act (WARN Act), 29 U.S.C. § 2101, et. seq. A divisional purchase might also require compliance with the Hart-Scott-Rodino Antitrust Improvements Act of 1976 or other relevant statutes.

H. Qualified Employee Benefit Plans. The disposition of qualified employee benefit plans benefiting divisional employees is largely a matter for negotiation between Seller and Purchaser. Such plans may be retained completely by the Seller and administered separately after closing or terminated, or may be transferred in whole or in part to the Purchaser for administration after closing. This decision, which must be made after careful reference to the provisions of the Internal Revenue Code governing qualified plans, will likely be based primarily on business issues such as the impact of the various actions on the employees of the division, the desires of the employees, the future benefits to be offered by the Purchaser, and the transactional costs of the transfers.

1. Retention by the Seller. If no separate action is taken in connection with the closing, the existing qualified employee benefit plans of the Seller will continue in force and effect after closing and the employees of the division, to the extent they resign employment with the Seller and accept jobs with the Purchaser, will be treated as any other resigning employees under the plans. Depending on plan provisions, the Seller may have the option to distribute plan assets directly to the employees or may freeze the assets and maintain them for the benefit of the employees at retirement. Technical provisions of the Internal Revenue Code and related regulations govern the circumstances and manner in which this may be done.

2. Transfer to the Purchaser. The parties may provide for plan assets to be transferred to an existing plan maintained by the Purchaser or to a newly-formed plan to be administered for the benefit of the division. In such circumstances, the parties must comply with provisions of the Internal Revenue Code governing the recognition of prior service and nondiscrimination among plan participants.

I. Other Benefits. In the absence of specific assumption by the Purchaser, all other employee benefits, such as vacation pay, disability, reimbursement of expenses, sick pay, extended sick leave, insurance benefits, or other employee benefits or reimbursements, will be retained by the Seller and must be dealt with according to whatever obligations Seller has to the divisional employees. It is not uncommon for these benefits to be assumed by Purchaser at closing in order to smooth the transition from Seller to Purchaser and to maintain the goodwill of the employees with the assumption being reflected by appropriate adjustments to the purchase price.

IX. Environmental Issues.

While issues of successor liability are addressed elsewhere, the Purchaser should make note of the obvious need for a careful due diligence inquiry with respect to environmental matters and should be ever mindful of the fact that notwithstanding the fact that the agreement excludes assumption of environmental liabilities, many of those liabilities will transfer to the Purchaser by operation of law. Due diligence activities should include not only a review of the condition of the properties being purchased (as is the case in a typical Phase I Site Assessment) but also a historical review of the operations of the division over the period of its existence to determine, for example, whether there exists liability for off-site disposal of hazardous wastes. In some jurisdictions, this review should be expanded to include not only activities of the division but also other activities of the Seller for the reason that certain cases have acted to impose on the Purchaser of assets liabilities of the Seller totally unrelated to the assets being purchased. The contract should also address by way of schedule or otherwise a listing of all permits and licenses that are required from environmental and other regulatory authorities for the operation of the division. Seller will likely need to retain its permits for the operation of the remainder of its business leaving Purchaser with the obligation to obtain on its own (but as a condition to closing) whatever permits and licenses are needed.

X. Indemnities, Post-Closing Actions and Remedies.

While at first observation it would appear that indemnities appearing in the asset purchase agreement would be more valuable in the case of the divisional purchase than in the ordinary asset purchase because the Seller will remain in business as a viable entity, the Purchaser should nevertheless carefully draft that language to take into account the multitude of issues that have been raised elsewhere in this paper and should give serious thought to whether the Seller will in fact remain in existence over the long term.

A. Indemnity Language. The basic indemnity language contained in an ordinary purchaser-oriented asset purchase agreement will usually work nicely in a divisional purchase provided particular attention is paid to liabilities being assumed by one party or the other and provided the division itself is described with sufficient precision such that use of indemnities against “liabilities arising out of the activities of the division prior to closing” are capable of enforcement.

B. Indemnification Procedures and Limits. The indemnification covenant will take into account a number of procedural matters, such as the obligation to notify the indemnitor of the claim and permit an opportunity to defend, and the use of baskets and materiality standards to limit trivial indemnity requests.

C. Credit Issues; Fraudulent Transfers; Bankruptcy. The extent to which the Purchaser is willing to rely on indemnities will in turn depend on the Purchaser's own evaluation of the creditworthiness of the Seller after the closing. In the rare case where the division represents the only profitable area of the Seller's operations, serious doubts may arise as to the continued viability of the Seller after the closing. The Purchaser should consider the possibility that the Seller may at closing or thereafter be or become insolvent and the impact of fraudulent transfer and bankruptcy laws on the effectiveness of the sale and the possibility that any portion of the transaction may be set aside after closing. Bankruptcy laws could wreak havoc with many of the ongoing commitments of the Seller to assist in transition matters, to share intellectual property, to supply products, and to do any number of the activities which may be critical to the Purchaser under the various analyses set forth above. Where possible, the Purchaser should protect itself against such occurrences, by, for example, taking security interests in shared assets, perfecting its position in intellectual property, taking possession of critical records, and requiring the escrow of shared materials.

D. Subsequent Sale of the Seller. One critical element to examine in light of many of the concerns raised above is what happens if, after the sale of the division, the Seller then sells the rest of its assets to an unrelated entity. Such a development might render the Seller incapable of fulfilling many of its commitments to the Purchaser, such as transition services, sharing of intellectual property rights, supply arrangements, etc. The obvious answer is to prohibit such action on the part of the Seller. A safer alternative is to take many of the same actions set forth in the preceding paragraph to protect against bankruptcy of the Seller.

E. Alternatives to Indemnities. There are a number of means by which either party can protect itself against the risk of a worthless indemnity. Indemnities may be backed up by (i) letters of credit issued by reputable financial institutions, (ii) pledges of corporate stock and/or assets, and (iii) personal guarantees of shareholders or affiliate corporations. Set off rights against purchase money notes or the escrow of portions of the purchase price are also good means by which to hedge against the possibility of insolvency by a Seller or Purchaser.

XI. Valuation Controls and Adjustments.

Throughout the process of identifying assets, untangling relationships, and engaging in detailed due diligence, the overriding objective of Purchaser and its counsel is to obtain the value they bargained for. In the case of a cash transaction, once this valuation is determined, there is no further discussion on the topic and the objective of all parties is to use representations, warranties, covenants and indemnities to see that the value negotiated at the time of the purchase is realized at closing. This method, however, is ill suited to an ongoing business enterprise with constant inflows and outflows of cash, with management decisions constantly affecting the bottom line and with risks too numerous to list impacting the business either positively or negatively. In such cases, a purchase price adjustment mechanism is a good vehicle to use to take into account the ongoing actions of the business and to assure the Purchaser that the anticipated value will be there at closing.

A. Bring Down Covenants. In any event, every asset purchase agreement will contain the customary covenants against changes in the operations of the business or transfers of assets without the consent of the Purchaser. In the divisional purchase, covenants restricting the relationship between the division and the rest of the Seller during that period are important. A more

extreme approach would be to require a listing of transactions or conveyances between the division and the remainder of the Seller so that those transactions or conveyances may be subjected to special scrutiny as a condition to closing. Bring down covenants become more important as the period of delay between execution and delivery of the closing increases.

B. Post-Closing Adjustment. The purpose of the post-closing adjustments is to conform the purchase price to the intention of the parties at the time of execution of the acquisition agreement. The adjustment process can focus on any of a number of elements of the division's condition at closing, but the most frequent condition is a financial one, and that comparison is typically made based on one or more line items in the closing balance sheet, conforming figures in a preliminary balance sheet presented at closing and forming the basis of the purchase price with the same balance sheet adjusted by subsequent audit. The process of drafting and implementing a post-closing adjustment mechanism, particularly one based on financial condition, must necessarily be the joint effort of lawyer, accountant, and businessman.

1. Adjustment Items. The selection of balance sheet items should be made by the Purchaser based on the business elements of the transaction. The purchase price is then fixed based on those figures, and should a post-closing audit show the figures to be inaccurate, an appropriate upward or downward adjustment to the purchase price will be made. This would be the case, for example, where price was based in large measure on the book value of the division's assets. A post-closing audit would conform the closing balance sheet, on which cash passed hands at closing, to the conditions actually found to exist at that time.

2. Standards for Preparation. Generally accepted accounting principles consistently applied are the customary standard for computation of adjustments. Care should be taken, and inquiry made of accountants for both Seller and Purchaser, as to whether historical financial statements have been prepared according to GAAP. Adjustments to GAAP or adoption of other accounting standards must be specifically spelled out so that an objective third party reviewing the language can reach a determination without further reference to the intention of the parties. Even with adjustments to the particulars of the division and its accounting practices, GAAP encompasses a number of important choices, and the better the due diligence activities of Purchaser and the disclosure activities of Seller, the more likely the parties are to arrive at a formulation which will result in a fair reflection of the parties' intention.

3. Procedures. The process of negotiating the post-closing adjustment clause pits the Seller and Purchaser against each other in a contest for who controls the accounting and adjustment process. Ultimately, the numbers must be satisfactory to both, but many parties put great emphasis on who gets first shot at producing them. Some adjustment clauses provide that the Seller will present to Purchaser a closing balance sheet which will then be audited by Seller's accountants after closing with appropriate adjustments to the purchase price to be based on the audit. Other clauses require preparation of the balance sheet by Seller, but put the auditing process in the hands of Purchaser's accountants. Either way, at some point both Seller's and Purchaser's accountants must be comfortable with the final figures, and in the absence of such comfort, the parties are forced to resort to a neutral arbitrator to resolve the issue (see discussion below).

4. Dispute Resolution. At its best, the post-closing adjustment procedure covers an abundance of sins, and makes it possible for both Purchaser and Seller to worry less about detailed descriptions of assets and liabilities and strict constraints on interim operation of the business and more about a smooth transition at closing. At its worst, the post-closing adjustment procedure can result in a costly dispute that deprives either Purchaser or Seller or both of the intended result. The post-closing adjustment accordingly presents a compelling case for alternative dispute resolution. A frequent method is for the Purchaser's accountant to undertake the post-

closing auditing process, with Seller's accountants having the right to dispute the results. If Purchaser's and Seller's accountants are unable to resolve any dispute, the dispute will then be settled by an independent firm of certified public accountants selected jointly by Seller and Purchaser, whose decision will be final and binding. Such provisions can be incorporated into other more general arbitration provisions in asset purchase agreements, but any such incorporation should not alter the critical role of accountants in making this final determination.

C. Special Classes of Assets. Even where there is no general purchase price adjustment based on a balance sheet or other comprehensive financial description of the business, certain classes of assets present compelling cases for purchase price adjustments. These asset classes generally consist of current assets of the division that fluctuate daily based on business operations.

1. Inventory. It is very common for that portion of the asset purchase price based on inventory values to be based on an actual physical inventory conducted jointly by Seller and Purchaser or by their accountants. The purpose of such an inventory is not only to insure the physical presence of the inventory being purchased at closing, but also to confirm the quality of that inventory. Quality standards would exclude from the inventory count inventory that is not current, is not of merchantable quality, is damaged or defective, is obsolete, or does not meet other standards set by Purchaser for operations after closing. A major point of contention can be what to do with inventory that does not meet Purchaser's standards. Purchaser will likely want it thrown in for free. Seller, if it has any salvage value, will argue that inventory to which no purchase price has been allocated should be excluded from the sale. While inventory adjustments are common as a post-closing adjustment item, it is also possible in some organizations to perform inventories prior to closing with the results brought current as of the closing date. This avoids, at least as to the inventory, the need for a post-closing adjustment mechanism.

2. Receivables. Receivables can be handled in a number of ways depending on the dynamics of the business and the objectives of the parties.

a. Exclusion of Receivables. The Purchaser will frequently prefer to exclude the receivables altogether and leave them with the Seller for collection. In a divisional purchase, Seller is unable to argue that it has no remaining business organization with which to collect its receivables, and by excluding them from the purchase price, the parties avoid both the need to account for them in post-closing adjustments and the need for a commitment by the Purchaser to help collect them. Even in such cases, the asset purchase agreement should require cooperation by the Purchaser in the receipt of funds and transfer of those funds to the Seller. Where payment is made by a customer without designating invoice numbers or job orders, Seller and Purchaser should agree upon a method of determining who receives the payment. (For example, a provision that the oldest receivables are paid first would not be unusual).

b. Sale of Receivables. If the receivables are transferred to the Purchaser, the parties will likely value them at closing based on face value with reserves established to account for uncollectible items. If the Purchaser assumes the risk of the receivables, that is the end of the process and it is up to the Purchaser to do the best it can in realizing on the receivables. More frequently, however, since the receivables are basically a cash item for which Seller receives dollar for dollar value (subject to the reserves), there are continuing assurances given by Seller to Purchaser regarding the collectibility of the receivables, and after a period of time the uncollected receivables may be "put" back to the Seller at face value with the Seller having the responsibility for any further collection activities. Even where the Seller ultimately bears the risks of noncollection, an asset purchase agreement may impose upon Purchaser the obligation to use reasonable efforts in the collection and handling of receivables.

3. Cash. Much debate has been had among practitioners as to the advisability of purchasing divisional cash at closing. Accountants might have some input on this issue in connection with the closing balance sheet or post-closing adjustment mechanisms. In any event, once the decision has been made, the inclusion or exclusion of cash from the closing is a simple matter of bookkeeping entry.

D. Earn-Outs. A more involved process exists where the parties elect to have the purchase price adjusted not based on the condition of the division at closing but on the basis of activities which occur after the closing as measured by the earnings of the division. Not only must the parties relate the prospective earnings to the purchase price or some designated portion of it, but they must furnish a myriad of details concerning the computation of earnings, such as the impact of taxes, the impact of extraordinary gains and losses, the impact of additional lines of business, the consideration of transactional taxes, the manner in which the business is operated after closing, etc. A dispute resolution mechanism is also critical to the use of earn-out clauses.

XII. Pre-Packaging of the Division.

The Purchaser should bear in mind as it structures the acquisition the form in which it desires to operate the division after the closing. If the assets of the division are to be integrated into the operations of the Purchaser rather than being operated separately, the use of an ordinary asset purchase transaction will work. However, where the Purchaser knows in advance that it will operate the divisional assets in a separate corporate subsidiary, the Purchaser should consider requiring the Seller to separate the divisional assets into a separate corporate subsidiary, the stock of which Purchaser could purchase at closing. Prior to closing, the Seller can be required to undertake the various actions that are necessary to separate the divisional assets into a separate corporation, and the Purchaser's auditors can then audit the books and records of a free-standing corporation at closing rather than an artificially separated set of assets. If a period of months is permitted to pass from the time of separation of the assets into a separate corporation into the closing transaction, this can make the job of separation the two businesses much easier. This procedure also puts the burden on the Seller of handling employee benefit issues, tax issues, accounting issues, and many other items that are outlined above. Purchaser will still need to monitor the transfer of the assets to the new corporate subsidiary and to perform due diligence in the same manner as before, but the actual act of closing, rather than involving a complex series of efforts to separate assets that had been freely commingled before, will consist of the mere transfer of stock of a separate corporation.

XIII. Ten Suggestions for Drafting Division Acquisition Agreements.

While the outline set forth above is intended to be a general summary of issues to consider in the purchase of a division, each acquisition transaction is unique, and the practitioner will want to alter these principles freely to meet the particulars of each transaction. There is no substitute for extracting from the client each and every important element of the deal and acting to preserve the benefit of those elements through appropriate contract language. With that reservation, you might want to consider the following "top ten" list of things to keep in mind as you go through the acquisition process:

A. Define the Division. The off-hand description of the "business" or the "division" in introductory areas of the acquisition agreement has a profound impact on the remainder of the document and can limit or enhance the effectiveness of any number of agreement provisions, ranging from representations and schedules to indemnities. The Purchaser will want to make certain that the definition covers in concept virtually everything that is intended to be purchased. The Seller

will conversely need to carefully avoid an overly broad definition that may obligate it to sell more than was intended.

B. Use Multiple Definitions of Assets to Insure a Comprehensive Description. Once the definition of "division" is worked out, it is best to use both generic descriptions and specific schedules to describe the assets that are being conveyed. Reference to balance sheets or other financial statements are fine but beware important assets that may not be reflected on the financial statements.

C. Provide for Short-Term Transition Needs. Seemingly minor matters like computer systems and conversion of data bases can turn a smooth transition into a customer-relations nightmare. Examine these issues carefully in the due diligence phase and make advance plans for Seller to furnish needed transition services.

D. Plan for the Long-Term Relationship (if any) of Seller and Purchaser. Drafting of the Agreement requires complete knowledge of the interrelationships between the division and the Seller, with particular attention to those that might continue on a long-term basis. Give careful consideration to the need for perpetual license agreements, easements, supply agreements, and other cooperation agreements that will continue to be important to both Seller and Purchaser as the businesses go their separate ways.

E. Do Not Assume the Continued Existence of the Seller. Set up the Purchaser's rights in such a manner that they are protected whether the Seller remains in business or not, and give particular thought to what ongoing rights of the Purchaser might be jeopardized if the Seller were to sell the remainder of its assets to someone else.

F. Make Good Use of Adjustment Mechanisms. Rely on a post-closing adjustment mechanism where appropriate to insure that both Seller and Purchaser get the deal that they bargained for, but make liberal use of accountants and business-people in drafting the parameters of the adjustment mechanism. The mechanism should be tested hypothetically over and over again in advance to be sure it works in a variety of settings. Never use a post-closing adjustment without providing a dispute resolution mechanism.

G. Assumed Liabilities Must Be Narrowly Defined. The Purchaser who undertakes to assume "all on-going liabilities of the division" does so at its risk.

H. Back Up Your Asset Descriptions with the Seller's Representations. Consider the need for confirmation by the Seller of these facts:

1. that the assets being purchased are all the assets of every description used in the course of business of the division;

2. that the assets being purchased constitute all assets of every description that are necessary to the business of the division;

3. that all assets used in or necessary to the business of the division are physically located on site and none are contained at other facilities owned by Seller;

4. that the mere sale of the assets of the division to Purchaser will not create defaults under important documents or disrupt customer or supplier relationships;

5. that except as listed on a separate schedule, all functions of the division are handled within the division with no support services or managerial time coming from other areas of the Seller; and

6. that all interrelationships between the division and the Seller are carefully described in the schedules.

The highlighting of these representations does not by any means eliminate the need to include all such other representations as are appropriate to asset acquisitions generally.

I. Human Resource "Assets" Must be Allocated as Well. Give careful attention to the need to keep the employees happy during the transition. Closing conditions must provide for hiring of those employees needed by the Purchaser after the closing, but Seller may also need to bargain for retention of certain of its key employees.

J. Consider the Adequacy of the Indemnities. The value of the indemnities depends on the credit-worthiness of the Seller after the transaction closes. Thought should be given to whether additional security, in the form of set-off rights, personal guaranties, or pledged assets, should be obtained, and the impact a Seller bankruptcy would have on the transaction should be considered.

APPENDIX I

SAMPLE DESCRIPTION OF ASSETS

Purchaser hereby agrees to purchase from Seller and Seller hereby agrees to sell to Purchaser, all the assets, tangible and intangible, of Seller, wherever located, used by the Seller or usable by the Seller in its business of designing, manufacturing, and selling Alpha widgets or otherwise related to the design, manufacture and sale of Alpha widgets, and all business and activities of Seller carried out under the name "Alpha Division", (all of the foregoing being herein referred to as the "Division"), all of said assets being herein referred to as the "Assets". Without limiting the generality of the foregoing, the Assets shall include the following:

1. good and marketable title in fee simple to full, undivided ownership in all real property used in the work of the Division, including, without limitation, the real property more particularly described in Schedule 1 attached hereto (collectively, the "Real Estate"), and all buildings, improvements, other constructions, construction-in-progress and fixtures (collectively, the "Improvements") now or hereafter located on the Real Estate, together with, as they relate to the Real Estate, all right, title and interest of Seller or the Seller Affiliates in all options, easements, servitudes, rights-of-way and other rights associated therewith;

2. all tangible personal property (collectively, the "Personal Property") of every kind and nature used in the Division (other than (i) items of tangible personal property that are consumed, disposed of or held for sale or are inventoried in the ordinary course of business and (ii) fixed assets transferred in compliance with [the bring-down provisions] of this Agreement), including, without limitation, all furniture, fixtures, machinery, vehicles, owned or licensed computer systems, and equipment, including, without limitation, the Personal Property listed in Schedule 2 hereto;

3. all those inventories of supplies, office supplies, maintenance and shop supplies, and other disposables, which are used in connection with the operation of the Division and which are existing as of the closing date, the current categories and amounts of which are set forth on Schedule 3 (the "Inventory");

4. all accounts, notes, receivables, and other rights to receive money, arising out of or relating to the operations of the Division, including, without limitation, all those categories and classes of accounts receivable listed on Schedule 4 (the "Receivables");

5. all intangible property (collectively, the "Intangible Property") of every kind and nature which exists as of the closing date and is related to the business of the Division, including, without limitation, the following:

a. all patents, trademarks, trade names, service marks, logos, trade secrets, copyrights, and all applications and registrations therefor that are used in the business of the Division, and licenses thereof pursuant to which Seller has any right to the use or benefit of, or other rights with respect to, any of the foregoing

(the “Intellectual Property”), including, without limitation, the items identified in Schedule 5 attached hereto;

b. all telephone numbers;

c. all licenses, permits, certificates, franchises, registrations, authorizations, filings, consents, accreditations, approvals and other indicia of authority relating to the operation of the Division as presently conducted by Seller, (collectively, the “Licenses and Permits”), which Licenses and Permits are listed in Schedule 5 attached hereto;

d. all benefits, proceeds or any other amounts payable under any policy of insurance maintained by Seller with respect to destruction of, damage to or loss of use of any of the Assets, but excluding all benefits, proceeds or any other amounts payable under any policy of insurance maintained by Seller with respect to the business and operations of the Division;

e. all deposits held by Seller in connection with future services to be rendered by Division; and

f. all warranties, guarantees, and covenants not to compete with respect to any of the activities of the Division.

6. all the books, records, forms and files relating to the operations of the Division or reflecting the operations thereof, but excluding therefrom records reflecting the operations of the Seller as a whole or records to which Seller and Purchaser shall have joint access thereto pursuant to other provisions of this Agreement.

Without limiting the generality of the foregoing, the Assets shall include all such assets as are included on the balance sheet of the Alpha division of Seller bearing even date herewith as amended to reflect the condition of the Alpha division as of the closing date.