Preliminary Note

The second edition of the Model Stock Purchase Agreement with Commentary ("Model Agreement") revises and updates the first edition of the Model Stock Purchase Agreement with Commentary (1995), which was prepared by the Committee on Negotiated Acquisitions (now known as the Committee on Mergers and Acquisitions) of the Section of Business Law of the American Bar Association. The first edition of the Model Stock Purchase Agreement was used as a guide for the Model Asset Purchase Agreement with Commentary (2001). The Model Agreement is intended for use as a reference in acquisitions structured as a stock purchase.

PERSPECTIVE

The Model Agreement has been prepared as a resource for a buyer’s first draft of a stock acquisition agreement. In a buyer’s first draft, the provisions generally favor the buyer and are not necessarily typical of the final language in a fully negotiated agreement and consummated transaction. A buyer ordinarily would not include all the provisions of the Model Agreement in a first draft, but would instead tailor the document to the size and nature of the business to be acquired. Sellers usually will not agree to all the proposed provisions, and their counsel can be expected to negotiate for language more favorable to them. The commentary identifies some sections of the Model Agreement that are likely to prompt objections by a seller, but most, if not all, provisions are negotiable.

The buyer’s counsel usually prepares the first draft unless the seller is conducting an auction with multiple potential buyers. The buyer’s counsel may have rather superficial information regarding the target at the time the acquisition agreement is drafted. The inclusion of extensive representations and warranties in the first draft forces the seller to disclose significant information about the target. This will aid the buyer in assessing the benefits and risks of the acquisition and in pricing the transaction. In this respect, the buyer’s first draft also serves as a request for information and a disclosure device.

The first draft will also deal with the allocation of risk among the parties for such contingencies as environmental, pension, and tort liability. The buyer typically will ask the seller to bear most of the risk associated with discoveries that directly or indirectly relate to the target’s business prior to the closing—issues that may be material to pricing the acquisition. The seller may counter that unknown contingencies are inherent in operating any business and should be borne by the owner of the business at the time they arise.

No form of acquisition agreement is “standard” or suitable for all transactions, and every provision in the Model Agreement is subject to change, reflecting the facts...
and circumstances of the particular transaction. The Fact Pattern was developed so that a host of issues could be covered by the Model Agreement and discussed in the accompanying commentary. Because it is unlikely that all these issues would be presented in any single acquisition, the Model Agreement is more comprehensive than most stock acquisition agreements. Factors that may influence the scope and content of an acquisition agreement include the following:

- the size of the transaction (The acquisition agreement will likely be shorter and far less comprehensive for a smaller transaction.)
- the relative negotiating positions of the parties (Where the target is highly sought-after and there are competing offers, a seller may view some of the provisions of the Model Agreement as too aggressive or otherwise inappropriate. If the buyer anticipates delicate negotiations with the seller, the buyer’s counsel may not use some of these stronger provisions or may temper them with qualifying language, even in the first draft. On the other hand, if the target is financially distressed or the seller is otherwise in a weak bargaining position, the buyer might be even more demanding in the draft it presents to the seller.)
- whether the target is a subsidiary of another corporation or is owned by individual shareholders.

Given the numerous variations in the facts and circumstances involved in any acquisition, the Model Agreement should not be considered as establishing any standards of general practice or constitute legal advice. The Model Agreement is not a substitute for a lawyer’s careful exercise of judgment in a specific transaction and does not purport to measure the reasonableness of a lawyer’s judgment in any situation. While the commentary to the Model Agreement includes a discussion of some U.S. federal and state tax considerations in structuring and negotiating a stock purchase transaction, the discussion is not intended to constitute tax advice. Tax statutes and regulations are subject to amendment and their application is fact-sensitive, and so the discussion in the commentary is no substitute for tax advice from a qualified tax advisor familiar with the then current tax law and the facts at hand. In no event is the tax discussion intended to be used, nor should it be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing, or recommending to another party any transaction or matter discussed in the commentary to the Model Agreement.

**CONSIDERATIONS IN SELECTING A STOCK PURCHASE**

There are three basic structures for business acquisitions: a statutory business combination, a purchase of shares, and a purchase of assets. A statutory combination usually is structured as a merger, but, as permitted by applicable law in some jurisdictions, might be a consolidation or a “share exchange,” whereby all shareholders can be bound to exchange their shares under a plan of exchange approved by holders of the requisite percentage of shares.
An acquisition might be structured as an asset purchase for a variety of reasons. It may be the only structure that can be used where the buyer is interested in purchasing only a portion of the company’s assets or assuming only certain of its liabilities. If the stock of a company is widely held or it is likely that one or more of the shareholders will not consent, a sale of stock (except perhaps by way of a statutory merger or share exchange) may be impractical. In many cases, however, an acquisition can be structured as a merger, a purchase of stock, or a purchase of assets.

From tax and liability perspectives, it will often be in the buyer’s best interests to purchase assets, but in a seller’s best interests to sell stock or to merge. Because of these competing interests, it is important that counsel for both parties be involved at the outset in weighing the various legal and business considerations in an effort to arrive at the optimum, or at least a mutually acceptable, structure. Some of these considerations are specific to the business in which a company engages, some relate to the particular corporate or other structure of the buyer and the seller, and others are more general in nature.

The following are some of the matters to be addressed in evaluating a stock purchase as an alternative to an asset purchase or a statutory combination.

**Assets.** Asset transactions are typically more complicated and time-consuming than stock purchases and statutory combinations. In contrast to a stock purchase, the buyer in an asset transaction will acquire only the assets described in the acquisition agreement. Accordingly, the assets to be purchased are often described with specificity in the agreement and the transfer documents.

A purchase of assets also is cumbersome because the transfer of the target’s assets to the buyer must be documented, and separate filings or recordings may be necessary to effectuate the transfer. This often will involve separate real property deeds, lease assignments, patent, trademark, and other intellectual property assignments, motor vehicle registrations, and other evidences of transfer that cannot simply be covered by a general bill of sale and assignment. Moreover, these transfers may involve assets in a number of jurisdictions, each with different forms and requirements for filing and recording.

**Contractual Rights.** Among the assets to be transferred are the target’s rights under contracts pertaining to its business. These contractual rights often cannot be assigned without the consent of other parties. The most common examples are leases that require consent of the lessor and joint ventures or strategic alliances that require consent of the joint venturer or partner. A required consent can afford the third party an opportunity to request confidential information regarding the acquisition and the financial or operational capability of the buyer and to extract concessions in return for granting its consent. Although this can sometimes be avoided by a purchase of stock or statutory combination, many leases and other agreements require consent to any change in ownership or control, however
accomplished. Many government contracts cannot be assigned and require a novation with the buyer.

**Governmental Authorizations.** Transfers of licenses, permits, or other authorizations granted to a target by governmental or quasi-governmental entities may be required in an asset transaction. In some cases, an application for a transfer or, if the authorization is not transferable, for new authorization may involve hearings or other administrative delays in addition to the risk of losing the authorization. Many businesses may have been “grandfathered” under regulatory schemes and thereby be exempt from any need to make costly improvements to their properties; the buyer in an asset purchase may forfeit the grandfathered benefits and be subject to additional compliance costs.

**Liabilities.** In a stock transaction, the buyer takes ownership of the target subject to all of its liabilities. An important reason for structuring an acquisition as an asset transaction is a buyer’s desire to limit its responsibility for liabilities of the target, particularly unknown or contingent liabilities. Unlike a stock purchase or statutory combination, where the target retains all its liabilities and obligations, known and unknown, the buyer in an asset purchase has an opportunity to determine which liabilities of the target it will contractually assume. Accordingly, one of the most important issues to be resolved is what liabilities incurred by the target prior to the closing are to be assumed by the buyer.

**Income Taxes.** In most acquisitions, the income tax consequences to the buyer and the seller are among the most important factors in determining the structure of the transaction. A seller will prefer a structure that will generate the highest after-tax proceeds, whereas the buyer will seek ways to minimize taxes after the acquisition. The ability to reconcile these goals will depend largely upon whether the target is a C or an S corporation or is an entity taxed as a partnership.

In a taxable asset purchase, the buyer’s tax basis in the purchased assets will be equal to the purchase price (including assumed liabilities). An important advantage to the buyer of an asset purchase is the ability to allocate the purchase price among the purchased assets on an asset-by-asset basis to reflect their fair market value, often increasing the tax basis from that of the target. This “step-up” in basis can allow the buyer greater depreciation and amortization deductions in the future and less gain (or greater loss) on subsequent disposition of those assets.

A C corporation will generally recognize gain on a sale of assets to a third party. Thus, if a buyer purchases assets, the selling corporation will recognize gain or loss on an asset-by-asset basis, which will be treated as ordinary income or loss or capital gain or loss, depending upon the character of each asset. Unlike individuals, corporations do not receive the benefit of a lower rate on long-term capital gains. Upon subsequent liquidation of the corporation, its shareholders will be taxed as if they had sold their stock for the proceeds received in liquidation. Gain or loss to a shareholder is measured by the difference between the cash received and the tax basis of that shareholder’s stock.
A sale of stock would avoid this double tax. A buyer purchasing stock of a C corporation, however, will obtain a stepped-up basis only in the stock, which is not an asset it will be able to amortize or depreciate for tax purposes, and the buyer generally will not want to succeed to the seller’s presumably low tax basis in the underlying assets.

If the target is an S corporation, a buyer’s purchase of stock can be treated for tax purposes as a purchase of assets by making a joint election with the selling shareholder under Section 338(h)(10) of the Internal Revenue Code. The same result can be achieved in a purchase of stock out of a consolidated group through a joint election with the seller under Section 338(h)(10), as well as in other contexts but often is not cost effective.

The tax treatment to the target and its shareholders in an S corporation’s sale of assets will depend upon the form of consideration, the relationship of the tax basis in the target’s assets (the “inside basis”) to the tax basis of its shareholders in their stock (the “outside basis”), whether there is “built-in gain” (i.e., fair market value of assets in excess of tax basis at the effective date of the S corporation election) and whether the target’s S status will terminate. Generally, the amount and character of the gain or loss at the corporate level will pass through to the shareholders and be taken into account on their individual tax returns, thereby avoiding a double tax. However, the purchase price will be allocated among the S corporation’s assets and, depending upon the relationship of the inside basis and the outside basis, the amount of the gain or loss passed through to the shareholders for tax purposes may be more or less than if the same price had been paid for the stock of the S corporation. An S corporation that was formerly a C corporation also must recognize built-in gain at the corporate level, generally for tax years beginning after 1986, on assets it held at the time of its election of S status, unless 10 years have elapsed since the effective date of the election.

The preceding discussion relates to federal income taxes under the Internal Revenue Code. Consideration should also be given to state and local tax consequences of the proposed transaction.

**Transfer Taxes.** Many state and local jurisdictions impose sales, documentary, or similar transfer taxes on the sale of certain types of assets. For example, a sales tax might apply to the sale of tangible personal property, other than inventory held for resale, or a documentary tax might be required for recording a deed for the transfer of real property. In some jurisdictions, these taxes are imposed even in a sale of stock where there is a change of control. Some states impose a stamp tax on the sale of stock (or interests in other forms of entities).

**Employment Issues.** A sale of assets may have more employment or labor issues than a stock sale or statutory combination because the target will typically terminate its employees, who may then be re-employed by the buyer. Both the target and the buyer run the risk that employee dislocations from the transition will result in litigation or adversely affect employee morale. The financial liability and risks
associated with employee benefit plans, including funding, withdrawal, excise taxes, and penalties, may differ depending upon the structure of the transaction. Responsibility under the Worker Adjustment and Retraining Notification Act (“WARN Act”) can vary between the parties, depending upon whether the transaction is structured as an asset purchase, stock purchase, or statutory combination. In a stock purchase or statutory combination, any collective bargaining agreements generally remain in effect. In an asset purchase, the status of collective bargaining agreements will depend upon whether the buyer is a “successor,” based upon the continuity of the business and work force or on the provisions of the target’s collective bargaining agreement. If it is a successor, the buyer must recognize and bargain with the union, but may not be subject to existing collective bargaining agreements.

ETHICAL CONSIDERATIONS
A stock acquisition, like many other legal transactions involving multiple parties with differing goals and interests, can raise ethical issues for the lawyers involved. For a discussion of these issues, see Chapter 2 of the Committee on Negotiated Acquisitions, The M&A Process—A Practical Guide for the Business Lawyer (2005).

MODEL AGREEMENT
The structure of the Model Agreement generally reflects prevailing practice. The text follows the Fact Pattern, which assumes a fairly straightforward sale of stock involving a single buyer and multiple sellers. No attempt has been made to give effect in the text of the Model Agreement to, or to discuss in the commentary, practice outside the United States, or changes that might be proposed in cross-border transactions.

Article 1 contains a glossary of defined terms as well as general guides to construction and interpretation. This article enhances ease of usage and organization of the Model Agreement and includes cross references to definitions in various sections in the Agreement.

Article 2 contains the economic and operative terms of the acquisition, including the consideration to be paid and the mechanics of the closing.

Articles 3 and 4 set forth the representations and warranties of Sellers and Buyer, respectively. The representations and warranties are statements of fact that existed, exist at the date of signing of the Model Agreement, and/or will exist at the time of the closing. Sellers’ representations and warranties, which contain detailed statements about the business of the target, are often much more comprehensive than Buyer’s and include extensive provisions regarding such matters as environmental concerns, employee benefits, and intellectual property, which could result in significant liabilities for Buyer after the closing if not covered by adequate representations and warranties (and the corresponding indemnification obligations) by Sellers. Buyer’s
representations and warranties deal mainly with its ability to enter into the Model Agreement and to consummate the acquisition. They may be more extensive if all or part of the consideration consists of Buyer’s obligations or securities.

Articles 5 and 6 contain covenants in which the parties commit to perform (affirmative covenants) or not to perform (negative covenants) certain acts during the period between signing the Model Agreement and closing the acquisition. The heaviest burden of the covenants falls on Sellers, who, after signing, must take steps to consummate the acquisition and operate the business in the manner provided until the closing.

Article 7 contains post-closing covenants of the parties, including restrictive covenants.

Articles 8 and 9 contain conditions precedent to the obligations of Buyer and Sellers, respectively, to consummate the acquisition. These articles specify what each party is entitled to expect from the other at the closing. If a condition is not satisfied by one party, the other party may be able to elect not to complete the acquisition.

Article 10 outlines the circumstances in which each party may terminate the Model Agreement and the effects of such termination.

Article 11 contains indemnification provisions which afford each party specific remedies for the other’s breach of certain representations and obligations under the acquisition agreement. These provisions cover such matters as calculation of damages, recovery of expenses and costs, including legal fees, in addition to damages and procedures for claiming damages.

Article 12 contains general provisions such as notice, severability, and choice of law.

In some transactions, the parties do not sign a binding agreement until closing. If a letter of intent has been executed that includes an exclusivity provision and provides the buyer adequate opportunity to conduct due diligence, the buyer may resist becoming contractually bound until it is ready to close. Conversely, the seller has an interest in not permitting extensive due diligence until the buyer is contractually bound. This is especially so in circumstances where the buyer is a competitor or where the seller is concerned that the due diligence process will necessitate or risk disclosure to employees, customers, or competitors that the business is for sale.

Occasionally, a seller is reluctant to sign before closing. This may be the case, for example, if the seller has announced that the business is for sale and does not want to preclude talking to other prospective buyers until it is certain that the transaction will close.
Sometimes, a simultaneous signing and closing occurs because the transaction simply evolves that way. The parties may be negotiating an agreement that contemplates a period between signing and closing, but the due diligence may proceed more rapidly than the negotiations, and it may develop that a waiting period would be pointless or even harmful to the transaction. In such circumstances, counsel should consider whether it is appropriate to remove from the agreement the pre-closing covenants, conditions to the parties’ obligations to close, and other provisions that are rendered unnecessary by the decision to sign and close simultaneously. Care must be taken to ensure that no post-closing contractual obligation is affected by these changes.

COMMENTARY

The commentary to the Model Agreement consists of preliminary notes, general comments, comments, and sellers’ responses. Preliminary notes present an overview of the Articles of the Model Agreement, with, in some cases, a separate sellers’ perspective, and general comments serve the same function for many of the sections. Most of the sections include comments that describe the provisions, provide some background of the subjects covered, and set forth some of the considerations that could apply to drafting. The sellers’ responses are an attempt to separately discuss some concerns and objections that a seller might have regarding the sections or other provisions as drafted. In many cases, alternative language is suggested to deal with particular issues discussed. All cross-references to the commentary are intended to include any sellers’ responses that pertain to that same section or provision of the Model Agreement. The absence of a seller response for a particular provision should not be taken to mean that there is no possible seller response to that section or clause.

EXHIBITS, ANCILLARY DOCUMENTS, AND APPENDICES

The Exhibits to the Model Agreement are forms of the promissory notes, legal opinions, and other documents to be delivered at closing. The Ancillary Documents include various agreements that may be executed before or in conjunction with a stock purchase agreement, such as a confidentiality agreement and a letter of intent.

Appendices A through C discuss special considerations that arise in stock transactions. Appendix A treats special problems that arise when a transaction involves the purchase of a subsidiary. Appendix B deals with the receipt of publicly traded stock in the sale of a company. Appendix C deals with negotiations of employment agreements. Appendix D contains nine hypothetical scenarios, demonstrating the operation of the Model Agreement in certain circumstances. Appendix E contains alternative dispute resolution language that might be added to Article 12 in lieu of Sections 12.13 and 12.14.
RELATED RESOURCE MATERIALS

**Texts.** Lawyers engaged in acquisitions may want to consult the following texts, which are cited throughout the commentary to the Model Agreement and supplemental materials. For ease of reference, a short citation form is specified:

- Negotiating and Drafting Contract Boilerplate (Stark, ed., 2003) ("Stark").

**Deal Points Studies.** The Private Target Deal Points Studies produced by the M&A Market Trends Subcommittee of the Committee on Mergers and Acquisitions provide a statistical breakdown of the use of certain provisions in publicly available acquisition agreements that involved private targets being acquired by public companies. The 2009 Study, for example, covered a sample of 106 of these acquisition agreements for U.S. transactions completed in 2008, with estimated values ranging from $25 million to $500 million. Previous Studies published in 2007 and 2006 analyzed agreements from transactions completed in 2006 and 2004, respectively. Much of the data in the 2009 Study is compared with data from these earlier Studies. The Subcommittee also published Studies in 2008 on continental European and Canadian agreements for the acquisition of private targets.

The 2009 Study is available to members of the Committee and is posted on the Subcommittee’s webpage, http://www.abanet.org/dch/committee.cfm?com=CL56003. It is anticipated that future Studies will also be made available to Committee members in this manner. The Subcommittee has usually posted on its extranet site the full text of the acquisition agreements that were reviewed in producing its Studies.

These Studies can be a useful resource for determining the extent to which certain provisions are used, the language of those provisions, and various exceptions and carve-outs. A comparison of the data from the Studies also provides helpful insight into evolving trends. The data points, however, should be viewed with a critical eye in negotiations. In considering whether the data reflects “market,” it should be kept in mind that there are many factors that can affect the data, including the sample from which the agreements are drawn, the economic and business climate at the time, the relative bargaining power and size of the parties, the size of the transactions, and the types of businesses and industries in which the parties are
engaged. In addition, only the final, fully negotiated agreements were reviewed, so the Studies do not reflect the starting points in the drafts or the tradeoffs in the evolution of the changes negotiated.

Annual Survey of Judicial Developments. The Annual Survey of Judicial Developments Pertaining to Mergers and Acquisitions is prepared by the Annual Survey Task Force of the M&A Jurisprudence Subcommittee of the Committee on Mergers and Acquisitions and is published in the February issue of the Business Lawyer. The primary charge of the Annual Survey Task Force is to summarize annually significant judicial decisions in the area of mergers and acquisitions ("M&A") and to publish the summary as a service to American Bar Association members who practice in the M&A area. The Annual Survey is written from the perspective of the practicing M&A lawyer. The summarized cases are limited to those believed to be of greatest interest and significance to a wide range of M&A practitioners. Cases discussed in the Annual Survey are frequently cited in the commentary to the Model Agreement.