SHAREHOLDERS AGREEMENTS:
TAG ALONGS, DRAG ALONGS AND MORE

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Shareholders Agreements: Tag Alongs, Drag Alongs and More

I. GENERAL

A. Introduction

Clients that are starting a new privately-held business often carefully consider the form of entity they will use, the capital structure and the tax implications. However, clients may be reluctant to spend time and money on agreements that will govern the potential termination of their business relationship. At the time of formation, the owners are excited about doing business together and may not want to discuss sensitive topics such as whether an owner will be kicked out of the business if the owner becomes disabled and what price will the owner receive for his or her equity interest. On the other hand, clients that have been through the cycle of business ownership before may focus intently on the terms of any shareholders agreement because they have experienced the difficulties of exiting a business relationship.

Thoughtful drafting can provide a smooth transition in the event that the business relationship terminates as a result of death, disability, retirement, deadlock or other reasons and can provide benefits to minority shareholders that are not provided by statute. Agreements among owners of a business are used in a variety of situations, including with respect to a closely held corporation, limited liability company or partnership. In addition, shareholders agreements are used by a private equity fund when investing in a corporation along with management. The agreements have various names, including shareholders agreement and buy-sell agreement. This article will focus on typical provisions in a shareholders agreement entered into among a small group of individuals, some of whom may be family members, who start a new business venture as a Texas corporation.

Why do the shareholders of a closely-held, privately owned corporation need a shareholders agreement? While there can be many benefits to a shareholders agreement, below are five primary benefits:

1. *Limit who can be a shareholder*. Without contractual restrictions on the transfer of stock, a shareholder has no assurance as to who the other shareholders will be in the future. In a closely held corporation, knowing who the other owners are and their percentage ownership are often very important to each shareholder. A shareholders agreement can help ensure that a shareholder will not find himself or herself in business with someone they did not choose.

2. *Establish a buy-out mechanism following a trigger event*. A shareholders agreement can assure an owner that if certain events occur with respect to other shareholders, there will be a mechanism to buy out that shareholder. For example, a shareholder may not want to be in business with someone who has filed bankruptcy. A shareholder may want to buy out another shareholder's interest if the other shareholder was an employee whose employment has been terminated.

3. *Provide liquidity to shareholders in specified circumstances*. A shareholders agreement may give a shareholder assurance that when the shareholder dies, the estate will have a mechanism to liquidate the interest for the benefit of the beneficiaries.

4. *Provide greater certainty as to the price paid for transferred shares*. Because the shares of a privately held company are illiquid, a shareholders agreement that sets forth the method to determine the value of the shares can be helpful in avoiding valuation disputes. However, valuation issues may nevertheless be subject to dispute. The parties can also specify whether a minority discount or discount for lack of marketability should be taken into account with the valuation.

5. *Grant protections to minority shareholders*. A shareholders agreement can provide contractual protections that are greater than those available under the Texas Business Organizations Code ("TBOC") to a minority shareholder in a privately-held corporation, such as rights to designate a director or rights to veto certain fundamental transaction.

A shareholders agreement may be likened to a prenuptial agreement where the parties work out the terms of a separation in the future if it occurs. This can be especially useful because businesses can be very difficult to value and emotions can make decision-making difficult if the relationship deteriorates.

One of the most difficult challenges for the corporate lawyer advising a start-up business is convincing the parties to give careful thought to a shareholders agreement tailored for the particular situation. The provisions that will be most helpful depend on a variety of factors, including, among others, the objectives of the parties, the number of owners and the relative percentage ownership among them, other contractual or pre-existing relationships, the relative age of the shareholders and their contributions to the corporation.

Each shareholder should have his or her own legal counsel review the draft shareholders agreement. Parties who are not familiar with the specific details of corporate governance, methods of freezing out

minority shareholders and corporate control may overlook provisions in a shareholders agreement that could be used against a shareholder, especially minority shareholders. Keep in mind also that the buyout provisions may not be triggered for several years and if the business is successful, the value of the shares may have increased significantly and the facts and circumstances may be quite different.

Please note that this article does not address tax implications in any manner and you are encouraged to seek tax counsel with respect to the matters discussed herein.

Below are hypothetical situations highlighting the importance of a shareholders' agreement.

Hypothetical 1: Mary and Dianne formed a new corporation to launch their business of baking pecan pies. Mary was an excellent baker and supervised all the baking. Dianne did not know how to cook but she was great at marketing, and she had a large pecan tree in her yard that provided many of the pecans for the pies. The ladies owned the corporation 50/50. They were so excited to start their business that they did not want to "waste" time thinking about the future and did not enter into any shareholders agreement. Twenty years later, the business has grown substantially. Mary unexpectedly dies, and her son John inherits her equity interests in the corporation. John is 19 and has never had a job or baked a pie. Dianne is unhappy because she did not go into business with John but now he owns half of the business.

Hypothetical 2: Frank and Linda form a business providing tax advice to individuals. They hire Michael as an employee to manage the bookkeeping, and they pay him a salary but also grant him a few shares of stock each year during the holiday. After Michael has worked there five years, Frank and Linda discover that Michael has been embezzling funds from the company. They terminate his employment and they demand that he turn in his shares of stock, but he refuses and says he did not sign any agreement requiring him to give up him stock. He remains a minority shareholder for several years until finally the parties agree to a price to buy Michael out of the business.

Hypothetical 3: Sam, Linda, Anne and Scott form a corporation and enter into a shareholders agreement with a general transfer restriction and a right of first refusal. They own the business as follows: Sam-20%; Linda-20%; Anne-30% and Scott-30%. Sam, Linda and Anne determine five years later that they want to sell the business to another corporation, but Scott refuses to sell. If the shareholders agreement had included a "drag along," then Sam, Linda and Anne may have been able to force Scott to sell with them without having to go through the process of the right of first refusal. Keep in mind that under the TBOC, the default shareholder vote for a merger or sale of all or substantially all of the assets is a two-thirds affirmative vote.

B. Overview of Provisions in a Shareholders Agreement

Depending on the objectives of the parties, a shareholders agreement may include many types of provisions, or it may contain only a few.

Most provisions fall into one of two categories:

1. provisions relating to the transfer of shares; and
2. corporate governance provisions, including provisions to protect minority shareholders.

Provisions relating to the transfer of shares generally include a restriction on the transfer of stock except as expressly permitted by the agreement. Permitted transfers may include transfers to certain family affiliates or transfers that do not have adverse tax consequences. The agreement may include buy-sell provisions that are triggered by specified events such as death, disability, divorce, bankruptcy, deadlock and termination of employment. Other provisions, such as a right of first refusal, tag along and drag along right, may apply when a shareholder voluntarily determines to sell his stock to a third party. Drafting these provisions can raise complex issues, including how to define the trigger event, who will purchase the stock, whether a purchase/sale right is optional or mandatory with respect to each party, what are the mechanics of the transfer and relevant time periods, how the stock will be valued, and what is the source of funds for the purchase.

A shareholders agreement may also set forth the shareholders' agreements on corporate governance matters, including voting for directors of the corporation and special voting rights granted to the shareholders in connection with certain events and transactions. Minority shareholders may receive contractual preemptive rights that will protect them from dilution of their ownership. The shareholders may include noncompetition and confidentiality provisions to protect the corporation from one of the shareholders investing in a competing business.

The challenges in drafting a shareholders agreement include:

1. determining which provisions are necessary to meet the shareholders' objectives;
2. making sure that all of the provisions will work together and not conflict with each other; and
3. considering whether the provisions will work as intended many years in the future.

For example, if it is important that the corporation maintain its Subchapter S status under regulations of the Internal Revenue Code of 1986, as amended, the agreement must include appropriate transfer restrictions to achieve this objective. If the parties want to have both a right of first refusal and a tag-along right, which process should occur first and how do the time periods work in relation to each other? If the buy-sell provisions set value based on book value and the provisions are triggered in twenty years, at a time when the corporation's value has increased significantly and includes substantial goodwill, does the valuation provision provide the intended result?

C. Questions to Consider Before Drafting

When an attorney advises a client that a shareholders agreement is advisable, the client may say, "Don't you have a form for that?" The answer, of course, is "Yes, but . . . ." To produce a thoughtful shareholders agreement that will meet the objectives of the shareholders, the shareholders should meet with their respective attorneys and discuss the facts and circumstances as well as the objectives to give the attorney representing the corporation a better idea of how to draft the agreement.

Some of the questions to discuss include:

- How many owners are there in the business today and is that number expected to change in the future?
- Are the shareholders individuals or is one or more an entity?
- What are the relative ages and health of the shareholders?
- Do any of the shareholders want the ability to pledge their shares or will the corporation's lender require the pledge of their shares?
- If the shareholders can pledge their shares, what happens in a foreclosure?
- Will some or all of the shareholders be directors or officers of the corporation?
- Will some or all of the shareholders be employees of the corporation?
- Will any of the shareholders be contributing money to the corporation?
- Will any of the shareholders be lending money to the corporation?
- Is there a planned liquidity event in the future?
- Are any of the owners married or do they have other family relationships?
- Do you expect to be a buyer or seller or is it possible you could be either?
- What are the relative financial positions of the owners?
- Will the corporation have any special tax benefits?
- Do the shareholders want to require mandatory contributions of capital to the corporation?
- Do any of the shareholders have a pre-existing relationship?
- Do the current shareholders anticipate bringing in other shareholders in the future?
- What will be the various percentages of ownership? Approximately equal or will there be disparity?
- Will there be one class of equity or more than one and if so, what will be the different terms, rights and preferences?
- Will there be minority shareholders who want veto rights on certain transactions?
- Do the shareholders want to set forth a voting agreement with respect to directors?
- If there is a voting agreement, what level of ownership must be maintained?
- Do the shareholders want contractual preemptive rights to protect against dilution in the future?

Below are some examples of how the answers to the questions above can impact the agreement.

If one shareholder is a corporation, then consider whether one of the buy-sell triggers should be a change in control of the corporate shareholder. Otherwise, a third party could become the controlling person of the corporate shareholder and effect an indirect transfer of the shares. Alternatively, consider whether the "transfer" definition, if broadly worded enough, covers this.

If some shareholders contribute cash to the corporation in exchange for their stock, but another shareholder that is an employee will be granted shares in exchange for services rendered to the corporation, consider whether the agreement should include a right for the corporation to call the employee's shares on termination of employment. This would result in the corporation having the option to require the employee to sell the shares back to the corporation. In addition, consider whether the employee shareholder should be treated differently in other provisions of the agreement. Should they have the right to participate in the buy-sell provisions? Should they have special

voting rights? Clients often distinguish investors who contribute dollars from those who earn equity through services.

If the shareholders include relatives from two different families, should the shareholders that are members of one family have buy-sell options where the members of that family have the first right to buy shares upon a trigger event, and after that the corporation and/or other shareholders could have the right to buy the shares.

If one shareholder has greater financial flexibility than another, consider the practical impact on the ability to exercise rights to buy shares and whether flexibility should be given to pay for shares over time with a promissory note or otherwise provide for funding to buy shares. Otherwise, if one shareholder believes the other cannot exercise a right of first refusal, the shareholder may use that to his or her advantage.

If a shareholder is a lender to the corporation, will the lender have the right to put the shares to the corporation in certain circumstances, such as default, and will the corporation have the right to call the shares when the loan is repaid in full?

II. TRANSFER RESTRICTIONS

A. General Restriction on Transfer

Most shareholder agreements restrict the transfer of stock except as *expressly* permitted by the agreement. This helps ensure that the shareholders will not be co-owners in a privately-held business with someone they did not choose. In addition, transfer restrictions can preserve tax benefits, such as net operating losses or Subchapter S tax status.

Below is a sample definition of "Transfer" in a shareholders agreement:

"*'Transfer' means, as a noun, the direct or indirect, voluntary or involuntary sale, transfer, assignment, pledge, exchange, encumbrance, hypothecation or other disposition, and as a verb, to, directly or indirectly, sell, transfer, assign, pledge, encumber, hypothecate or similarly dispose of, either voluntarily or involuntarily, by operation of law or otherwise, or to enter into any contract, option or other arrangement or understanding with respect to the sale, transfer, assignment, pledge, encumbrance, hypothecation or similar disposition.*"

B. TBOC Provisions on Transfer Restrictions

Whenever a shareholders agreement relating to a Texas corporation purports to restrict the transfer of shares, the parties must consider applicable law that may prohibit the restrictions. Set forth below are provisions in the TBOC relating to transferability and the ability to restrict the transfer of shares of a Texas corporation.

General rule is shares are transferable. Section 21.209 of the TBOC provides that, except as otherwise provided in the TBOC, shares and other securities of a corporation are transferable in accordance with Chapter 8, Texas Business & Commerce Code.

Mechanics of imposing restrictions. Section 21.210 of the TBOC provides that a restriction on the transfer or registration of transfer of a security may be imposed by the corporation's certificate of formation or bylaws, a written agreement among two or more holders of the securities or a written agreement among one or more holders of the securities and the corporation if the corporation files a copy of the agreement at the principal place of business or registered office and the copy is subject to inspection by the shareholders, in person or by agent, as the books and records of the corporation.

Types of valid restrictions. Section 21.211 of the TBOC provides that a restriction on the transfer of a security is valid if the restriction reasonably:

1. obligates the holder to offer a person, including the corporation or other holders of securities of the corporation, an opportunity to acquire the restricted security within a reasonable time before the transfer;
2. obligates the corporation, to the extent provided by TBOC, or another person to purchase securities that are the subject of an agreement relating to the purchase and sale of the restricted security;
3. requires the corporation or the holders of a class of the corporation's securities to consent to a proposed transfer of the restricted security or to approve the proposed transferee of the restricted security for the purpose of preventing a violation of law;
4. prohibits the transfer of the restricted security to a designated person or group of persons and the designation is not manifestly unreasonable;
5. maintains the status of the corporation as an electing small business corporation under Subchapter S of the Internal Revenue Code;
6. maintains a tax advantage to the corporation;
7. maintains the status of the corporation as a close corporation under the TBOC;
8. obligates the holder of the restricted securities to sell or transfer an amount of restricted securities to a person or group of persons, including the corporation or other holders of securities of the coronation; or
9. causes or results in the automatic sale or transfer of an amount of restricted securities to a person or

group of persons, including the corporation or other holders of securities of the carnation.

Ability to make restrictions part of the public record. Under Section 21.212 of the TBOC, a corporation that has adopted a bylaw or is a party to an agreement that restricts the transfer of the shares may file with the Texas Secretary of State a copy of the bylaw or agreement with a notice regarding the existence of the transfer restrictions to establish the transfer restrictions in the public records.

Enforceability. Section 21.213 of the TBOC provides that a restriction placed on the transfer or registration of the transfer of a security is specifically enforceable against the holder, or a successor or transferee of the holder, if the restriction is reasonable and noted conspicuously on the certificate or other instrument representing the security or with respect to an uncertificated security, the restriction is reasonable and a notation of the restriction is contained in the notice sent with respect to the security under Section 3.205. Unless noted in the manner set forth above, an otherwise enforceable restriction is ineffective against a transferee for value without actual knowledge of the restriction at the time of the transfer or against a subsequent transferee, regardless of whether the transfer risk for value. A restriction is specifically enforceable against a person other than a transferee for value from the time the person acquires actual knowledge of the restriction's existence.

Based on the Texas law in the TBOC, the shareholders agreement should require that all shares bear a legend that conspicuously notes the existence of the shareholders agreement and the transfer restrictions contained therein in accordance with the corporate statutes. In addition, when drafting transfer restrictions, consider whether they fall within the TBOC guidelines.

C. Permitted Transfers.

It is common for a shareholders agreement to expressly permit certain transfers to specified persons for estate planning purposes and other reasons, but the precise scope of the exemption should be designated as narrowly as possible to preserve the general transfer restriction. From the shareholder's perspective, the provision should be broad enough to cover various types of entities the party may choose in the future as part of estate planning, such as a family trust or limited partnership.

Drafting considerations:

- If permitted transfers include the transfer of shares to a related entity, what type of relationship must the shareholder have with the entity—for example, with respect to a limited partnership, does the shareholder have to be the general partner or a holder of a majority of the limited partnership interests?
- When allowing transfers to a family-owned entity, it is also important to provide that the entity is a permitted transferee only as long as it remains controlled by the family member, and if there is a "change in control," then it is no longer considered a permitted transfer and may be subject to the buy-sell provisions below.

Example:

"'Permitted Transferee' means, with respect to a shareholder who is a natural person, (a) a trust under which the distribution of shares may be made only to such shareholder and/or any Family Group Member of the shareholder, (b) a charitable remainder trust, the income from which will be paid to the shareholder during his life, or (c) a corporation, partnership or limited liability company, the shareholders, partner or members of which at the time in question are only the shareholder and/or Family Group Members of the shareholders."

"'Family Group Member' means, with respect to any natural person, any spouse, ancestor, sibling or descendant (by consanguinity or adoption) and the spouses of each such natural persons at the time in question."

D. Pledges.

Often shareholders will ask whether the agreement will permit a pledge of shares. The senior lender to the corporation may request that the shareholders pledge their shares to secure the repayment of the corporation's indebtedness or a shareholder may ask for the ability to pledge shares to secure personal indebtedness. While the shareholders may need to pledge shares to the senior lender to obtain corporate financing, the parties should be cautious in allowing shareholders to pledge shares to secure personal indebtedness because this can raise issues of having potential future shareholders that were not approved by the parties.

Drafting considerations:

- Will the agreement permit pledges to secure corporate debt?
- Will the agreement permit pledges to secure shareholder debt?
- Will a person that buys the stock in foreclosure become a shareholder and a party to the shareholders agreement?

- Should the buyer in foreclosure have the same voting rights?
- Should the corporation or other owners have any consent rights with respect to pledges or acquisitions on foreclosure?

Example in which the shareholders were permitted to pledge their shares to the senior lender to secure the corporation's senior credit facility and permitted the senior lender to become a shareholder upon foreclosure (not an individual's debt):

"*Notwithstanding any other provision to the contrary herein, the holders are authorized to pledge their shares of Common Stock to [Senior Lender], and such pledge shall not require the prior consent any shareholder. [Senior Lender] shall be admitted as a shareholder upon the foreclosure of its pledge, and such Transfer shall not require the consent of any shareholder*."

E. Mechanics for Permitted Transfers.

The shareholders agreement should require that a party give the corporation prior written notice of any transfer of stock, even if permitted. The notice mechanism will permit a review of the transfer to ensure that it complies with the terms of the agreement and should also require that any permitted transferee execute a joinder agreement pursuant to which the party will become bound by all the terms of the shareholders agreement.

F. Consequences of Transfers in Violation of the Agreement.

The shareholders agreement will generally provide that any transfers that are not made in compliance with the terms of the agreement will be null and void.

An alternative is to provide that any shares transferred in violation of the agreement automatically convert to non-voting shares. In this case, the corporation's certificate of formation will need to provide for the additional class of stock and designate the rights, preferences and limitations of each class of capital stock.

Example: "Void Transfers. *Any Transfer or attempted Transfer in violation of any provision of this shareholders agreement shall be null and void."*

III. BUY-SELL PROVISIONS

A. General

The buy-sell provisions are often the central focus of negotiations. These provisions provide a mechanism to take out or provide liquidity for a shareholder upon the occurrence of specified events. Common trigger events include:

- Death;
- Disability;
- Bankruptcy;
- Termination of employment;
- Divorce;
- Foreclosure on a pledge of the shares.

Trigger events are often influenced by tax, personal and economic considerations and should be considered in light of the shareholders' circumstances.

The purchase and sale following the occurrence of a trigger event may be either mandatory or voluntary. For example, if an employee/shareholder is terminated, the agreement may include a call option pursuant to which the corporation may force the employee/shareholder to sell his stock back to the corporation. If a shareholder dies, the other shareholders may have a voluntary option to buy the deceased shareholder's shares pursuant to a right of first refusal.

Another consideration in drafting the buy sell provisions is who has the option or obligation to purchase the shares—the corporation or the other shareholders pursuant to the agreement. Factors to consider include the ability to fund any purchases.

In addition, if the corporation will buy back shares it has issued, the corporation must ensure that the redemption is permitted under the TBOC and under various contractual provisions, especially in financing agreements which have "restricted payment" provisions. Section 21.002(6) of the TBOC defines "distribution" to include the transfer of property, including cash by a corporation to its shareholders in the form of a purchase or redemption, directly or indirectly, of any of its own shares.

Under Section 21.303 of the TBOC, a corporation generally may not make a distribution (1) if the corporation would be insolvent after the distribution or (2) that exceeds the distribution limit, in each case, as specified in the statutes. The "distribution limit" as defined in Section 21.301 of the TBOC is generally the "surplus" of the corporation (the amount by which the net assets exceed the stated capital) for a repurchase of shares under a shareholders agreement but in some repurchase circumstances is the amount of the corporation's net assets.

The corporation may purchase life insurance on its shareholders to fund the purchase of stock in the event of death. Lenders often require life insurance and may have a priority right to any proceeds.

Disability is a common trigger event but raises complex issues, including the definition of disability. The corporation could also purchase disability insurance to fund the purchase, but it will be

important to ensure that the definition of disability in the policy is consistent with that used in the shareholders agreement. Consulting an employment lawyer in this area is generally recommended.

When a shareholder has received shares through "sweat equity" as compensation for services rendered as opposed to contributing dollars to the corporation, the shareholders agreement may provide that the shareholder's stock will be forfeited upon termination of employment or repurchased for a nominal value.

Drafting considerations:

- Who has the option?
- Is the purchase or sale voluntary or mandatory?
- What are the trigger events?
- If the purchase is optional, how much time should be allowed to make a decision to buy the stock or not?
- Should any consideration other than cash be permitted?
- Does the corporation have options, warrants or other convertible securities? Consider application to these securities.
- How will the value of the stock be determined?
- What happens if not all of the subject shares is purchased?
- If there is more than one class of equity, how do the different classes participate?
- How will the purchase be funded?

B. Deadlock Provisions

Although the shareholders may agree on everything when the business is formed, they may have irreconcilable disagreements in the future. Although deadlock is commonly considered with a 50/50 corporation, deadlock can also occur in other ownership situations where both or all shareholders have to agree on an item to take action. For example, under the TBOC, approval of a merger of a corporation requires the affirmative vote of the holders of two-thirds of the voting shares. If the majority shareholder owns 60% and the minority shareholder owns 40%, the minority shareholder is able to block the approval of a merger and cause deadlock. Deadlock in a closely held corporation can result in relationships that are very strained, especially if one party desires to exit the business but cannot without losing significant value.

Deadlocks can be resolved through various provisions, including the following which are referred to by various names, including "Russian Roulette", and "Texas Shoot Out":

- Each shareholder submits a sealed bid specifying the value per share and the shareholder with the higher bid buys out the others; or
- A shareholder provides notice to the other shareholder with a value per share. The other shareholders must either sell his shares at that price or allow the other shareholder to buy him out at the stated price; or
- Each shareholder submits a sealed bid with the lowest price per share at which the shareholder would sell. The shareholder with the highest price buys out the others at the lower price submitted; or
- The parties have a third party appraiser determine the value per share, and then the shareholder triggering the buy-sell will either buy the others' shares at a set premium to the determined value or sell shares at an equivalent discount.

The parties should consider setting a time limit on the process to provide some certainty.

Other methods to resolve deadlock include an agreement to arbitrate disputes or granting a "springing vote" to a third party which can be used in the event of a deadlock.

Drafting Considerations:

- Are the parties in different financial situations which would make it difficult for one party to purchase shares?
- What is the relative percentage ownership? It may be more difficult for a shareholder to purchase a large block.

An example of a deadlock provision is in Exhibit B attached hereto.

C. Right of First Refusal/Offer—Voluntary

The right of first refusal (or right of first offer) is one of the most common provisions in shareholders agreement and generally requires that a shareholder first offer his shares for sale to the corporation or its other shareholders before it can sell them to a third party. Technically, the right of first refusal applies when a third party presents an offer to the shareholders, and a right of first offer is considered to apply when a shareholder desires to transfer shares to a third party even if the shareholder does not have an offer yet. In practice, they operate in a very similar manner. In addition, a right of first refusal or offer

may be triggered by a "trigger event" instead of a bona fide written offer to sell shares to a third party or a desire by the shareholder to sell. If a third party sale is involved, the selling shareholder must offer the shares to the corporation or other shareholders on *terms no less favorable* than those with respect to the third party sale. This provision should also clearly specify the time periods for electing to exercise the right of first refusal and to complete the purchase of shares.

A right of first refusal/offer is an encumbrance that significantly restricts the marketability of the shares because most third parties are not willing to make a bona fide written offer and then wait for the time periods to lapse before being able to complete the sale. Practically, when a third party sale is contemplated, obtaining waivers from all parties who may benefit from the right of first refusal is generally the best strategy.

A right of first refusal/offer may also triggered by the occurrence of a "trigger event" as discussed above in "III. Buy-Sell Provisions; A. General." By providing that a right of first refusal is deemed granted upon the death of an owner, for example, the corporation or other shareholders will have a right to purchase the shares even if there is no bona fide third party offer. In this case, the agreement should set forth how the price will be determined.

Hypothetical: Joe and David have been shareholders in ABC Corporation for several years and they are parties to a shareholders agreement. David would like to exit the business and move on to a new venture. Sally has told David that she would like to buy his shares in ABC for $1,000 cash. Before David can sell to Sally, David must offer Joe the opportunity to buy the shares for $1,000 cash. Joe determines that he does not want Sally to be an owner in the business, and Joe exercises his right of first refusal and buys David's shares for $1,000.

Drafting considerations:

- Does the form of consideration have to be cash? If not, valuation is more difficult.
- Does a shareholder have to receive a bona fide written offer prior to sending the right of first refusal notice or is a desire to sell sufficient to start the process?
- Should the corporation or the other shareholders have the first right to buy? It may be that the corporation is more likely to have funds available to purchase the shares.
- If the corporation or other shareholder exercises the right, do they have to purchase all of the offered shares or can they purchase a portion?
- How much time will be given to consider the option?
- Should all shareholders be entitled to the right of first refusal? The agreement may provide that the founding shareholders have a right of first refusal but employee shareholders do not.
- What trigger events should apply?
- If there are multiple other shareholders who may buy, is their purchase *pro rata*, and do they have the right to purchase the *pro rata* portion of any non-participating other shareholder?
- How will the purchase price be funded?

Samples of a right of first refusal and a right of first offer are in <u>Exhibit A</u> attached hereto.

D. <u>Tag-along Right—Voluntary</u>

Tag-along rights benefit a minority shareholder by allowing the shareholder to sell its pro rata portion of shares that another shareholder is selling to a third party.

Drafting considerations:

- Will the tag-along be "one way"? In a one way tag-along, the minority shareholder may "tag along" on a sale by a larger shareholder, but the larger shareholder is not permitted to "tag along" on a sale by the minority shareholder.
- Tag-alongs generally do not include many conditions on the sale because it is an option to participate or not.
- Will the shareholders be required to provide indemnity?
- The minority shareholder should consider an express right to expenses if the majority shareholder breaches its obligations under the tag-along right.

An example of a tag-along right is set forth in <u>Example A</u> attached hereto.

E. <u>Drag-along Right—Mandatory</u>

The primary advantage of a drag-along provision is to facilitate a sale of the entire company by the majority shareholder and prevent one or more minority shareholders from blocking the sale.

Drafting considerations:

- What percentage of ownership justifies the drag-along—in other words, at what point

should the majority shareholder lose the drag-along right?

- What type of transaction should be covered? Merger, sale of all or substantially all of the assets, or less?
- Does the corporation have outstanding options, warrants or convertible securities? If so, these should be included in the drag-along.
- Is the drag-along applicable only if the consideration is cash or stock that is traded on a national securities exchange?
- If the transaction is the purchase of less than all of the stock, describe the formula to determine the number of shares each shareholder sells.
- What conditions can be imposed in the transaction? For example, will the minority shareholder be required to execute a non-compete agreement?
- In what time period must the transaction be completed?
- Will the drag-along occur before any right of first refusal or vice-versa?
- Do all shareholders share expenses or does the dragging shareholder or the corporation pay the expenses of the minority shareholders?

An example of a drag-along is set forth in Example B attached hereto.

F. Put Rights—Mandatory

A put right, or option to sell, is a provision that can benefit minority shareholders or any shareholder who wants liquidity in a closely held corporation. This right may be granted to particular shareholders or to all shareholders. For example, a shareholder may have the right to put the shares to the corporation following a change of control of the corporation or following some other trigger event. The put differs from the right of first refusal in that there is a mandatory obligation to purchase the shares as opposed to a voluntary option.

As with the other provisions, it is important to specify when the put right is exercisable, the mechanics of exercise, the price payable and any other conditions. In addition, the corporation or shareholder who has the obligation to purchase the shares must ensure that it has sufficient funds and can legally complete the purchase.

Drafting considerations:

- Should any party have the right to force the corporation or another entity to buy his or her shares?
- How will the party required to purchase the shares fund the purchase?
- What will the price be?
- What is the appropriate trigger event?
- Will there be a payout over time?

An example of a put option is set forth in Example B attached hereto.

G. Call Rights—Mandatory

In certain circumstances, the corporation (or a shareholder) may want the right to require another shareholder to sell his or her shares to the corporation (or the requesting shareholder). With a call right, or option to buy, the subject shareholder does not have an option to sell but is required to sell. A call right may be used in the situation where a shareholder employee's employment is terminated, whether by the corporation or the employee, with or without cause or good reason. The use of a call provision provides certainty that the subject shareholder will no longer be a shareholder.

Any call provision should set forth the purchase price for the shares or the method of determining the purchase price. Due to the mandatory nature of a call right, the subject shareholder may not be a willing participant in the sale and more likely to challenge any and all terms of the buyout. Finally, before the corporation or requesting shareholder may exercise the call right, it must ensure that it has sufficient funds and can legally complete the purchase.

Drafting considerations:

- Should any party have the right to force another party to sell shares to the party?
- What is the purchase price?
- What is the appropriate trigger event?
- Will there be a payout over time?

An example of a call option is set forth in Example B attached hereto.

IV. PURCHASE PRICE AND FUNDING

A. Valuation Overview

The shareholders agreement should include specific provisions regarding the determination of the purchase price in the event that shares are to be purchased by the corporation or the other shareholders pursuant to the agreement. The valuation provision is not only highly negotiated but also often litigated.

There are many alternatives to consider including: (i) a set price agreed to among the parties (which may or may not be updated over the years), (ii)

a price determined by appraisal which should approximate the "fair market value," and (iii) a price determined by a formula, which could include book value (assets minus liabilities), adjusted book value (e.g. including good will and the fair market value of significant assets instead of the book value), a multiple of earnings or other criteria. Each of these methods has its advantages and disadvantages.

B. Fixed Valuation

Some buy-sell agreements simply state a fixed price for shares in the event the buy-sell provisions are triggered. For example, the agreement could say that the purchase price will be $1,000 per share of common stock or set forth an aggregate valuation of all the common stock at $4 million. The disadvantage of fixed price valuations is that the intrinsic value of the business will fluctuate over time and the fixed price may be unfair to one or more parties if the agreement is triggered at a time when the value has changed significantly. If the parties want to set forth a fixed price, they should consider including a requirement to have the parties or an independent appraiser update the fixed price at specified intervals. In practice, parties may not want to incur the expense of multiple apprraisals.

C. Appraisal

The shareholders agreement may require that the value per share be determined by an independent third party, and, if the parties dispute the appraised value, the agreement may include a dispute resolution mechanism relating to the appraisal process. The provision should specify who pays the fees and expenses of the appraiser(s) and provide a timeframe for delivery of the appraisal and the dispute resolution mechanicsm. The provision may also specify whether a minority discount or a discount due to the lack of marketability of the shares should be applied.

Appraisal may produce a reasonable value but can be costly, especially if shareholders want to retain the right to appoint multiple appraisers.

D. Formula Price

The shareholders agreement may provide that the purchase price shall be determined based on a formula, including a formula based on the book value or a formula calculated as a multiple of earnings. While these types of formulae are often familiar to businesspersons and reasonable to negotiate, the formula that is appropriate at the time the agreement is executed may not be appropriate in the future when the business, the industry or factors relating to either have changed. For example, if the company expects losses for a few years before becoming profitable, a formula on book value may not yield fair results at every point. Similarly, if the parties desire to use a formula based on a multiple of earnings, they should be aware that multiples used may change over time for the industry, the business may change, rendering the prior formula inappropriate or there are certain factors existing at a time in the future that will yield unfair results. Discount rates that were used when the company began may not be appropriate years later. For example, if the value is based on EBITDA and the company incurs a large non-recurring charge in year 10 which is not taken into account in determining EBITDA, the EBITDA for that one year could be significantly different than the EBITDA in years nine and eleven.

E. Adjustments

Two adjustments which can significantly affect the value determination are the minority discount and the discount for lack of marketability. The parties should consider if either or both of these discounts should be included in some of the valuation determinations.

Although not applicable to a valuation pursuant to a shareholders agreement, TBOC includes a definition of "fair value" that applies when determining the price that shareholders are entitled to in connection with the exercise of dissenters' rights. This definition of "fair value" in Section 10.362 of the TBOC provides that the computation should not include any control premium, any minority ownership discount or any discount for lack of marketability.

F. Timing

In addition to the valuation method, the parties must consider the appropriate time for determining the valuation—whether it should be the date of the trigger event, the date of the exercise of right of first refusal, the date of the most recent year-end financial statements or another date. If the company is growing rapidly or undergoing significant changes, the timing can make a significant impact on the price. Note that Section 10.362 of the TBOC provides that in computing the fair value of an ownership interest in connection with the exercise of dissenters' rights, the computation should not include any control premium, any minority ownership discount or any discount for lack of marketability.

G. Texas Case Law on Valuation

Below are summaries of a few recent cases decided by Texas courts on valuation issues in the context of a shareholders agreement.

- In *Nacogdoches Heart Clinic, P.A. v. Pokala 12011000133-CV* (Tex. App.—Tyler 2-6-13), the court held that the corporation must pay a former employee for his shares which were forfeited on

termination of employment even though the employee did not comply with the terms of the buy sell agreement. The agreement included, as a condition precedent to any payment in a buy-out, that the shareholder execute a noncompete and resign medical privileges at certain hospitals following his termination of employment. The court held that the noncompete requirement was unreasonable and unenforceable and that payment under the buy-sell agreement was required despite the fact that the shareholder did not comply with the terms of the condition precedent to payment.

● In *Cardiac Perfusion Services, Inc. v. Hughes,* 380 S.W.3d 198 (Tex.App.—Dall— 2012, pet. filed), the court ordered that the corporation purchase the shares for "fair value" even though the parties had entered into a buy-sell agreement that required a purchase at "book value" following the Hughes' termination of employment. The court granted the equitable remedy and disregarded the contractual provision because the remaining shareholder Joubran had engaged in oppressive conduct. Hughes was a minority shareholder with a 10% interest. In this case, the jury found, among other things, that Joubran had denied Hughes certain profit distributions, misused corporate funds to pay himself excessive compensation and improperly pay family members and refused to allow Hughes to review the books and records of the corporation. As a result, the court concluded that requiring payment of fair value was the appropriate *equitable* remedy.

● In *Mandell v. Mandell*, (Tex. App. March 18, 2010), the court held that a shareholders agreement was enforceable against the spouse of a shareholder who did not sign it. The agreement provided that in the event of a divorce, the divorcing shareholder would have the right to purchase the spouse's interest in the shares for a nominal price. The wife claimed that the value of the shares was much higher but the court held that she was bound by the terms of the shareholders agreement.

H. Funding the Purchase

The funding of a purchase of stock by either the corporation or the owners can be challenging. Often, life insurance policies are used to fund the purchase price of shares upon the death of an owner. If the corporation will have the right to purchase shares, the corporation will pay for a life insurance policy on each of the owners. However, if the agreement is structured as a "cross purchase" agreement where the other owners have the right to purchase shares, the number of life insurance policies required can be significant.

If life insurance policies will not fund the purchase, the buyer generally will want some period of time to pay for the shares. The parties will have to negotiate the length of time—one year or three years, for example.

V. CORPORATE GOVERNANCE MATTERS

A. Board Size and Representation

In the typical privately-held Texas corporation without cumulative voting, a shareholder who owns a majority of the voting shares will be able to elect all of the directors. However, the shareholders agreement may give director designation rights to some or all shareholders, and the shareholders would agree to vote their shares as set forth in the agreement. Any requirement to vote for designated directors should be tied to maintaining a certain level of stock ownership.

In addition, the minority shareholder should make sure that the shareholders agreement contractually limits the size of the entire board so that the majority shareholder does not increase the size of the board and dilute the minority shareholder's representation. The shareholders should also consider whether the director designation rights should survive any transfer of the stock, even to a permitted family transferee.

As an alternative, a minority shareholder may have the right to a board "observer" who can go to director meetings but cannot vote as a director.

If the shareholders agreement provides for director designation rights, it should also include restrictions on the removal of directors and provisions regarding the filling of vacancies in directorships that parallel the voting requirement. The minority shareholder should also consider requiring that the minority shareholder's designee be a member of any board committee to prevent a board committee comprised of the majority shareholder's designees from taking actions without the knowledge of the minority shareholder designee.

Example: "*Each shareholder agrees to vote, or cause to be voted, all shares owned by the shareholder, or over which the shareholder has voting control, from time to time and at all times, as shall be necessary to ensure that the size of the board of directors shall be set and remain at __ directors. Each shareholder agrees to vote, or cause to be voted, all shares owned by the shareholder, or over which the shareholder has voting control, from time to time and at all times, as shall be necessary to ensure that at each annual or special meeting of shareholders at which an election of directors is held or pursuant to any written consent of the shareholders, the following persons shall be elected to the board of directors:*

(a) ________, designated by _____ for so long as _____ continues to own at least _____ shares of common stock, which number is subject to appropriate adjustment for all stock splits, dividends, combinations, recapitalizations and similar transactions.

In the event of a vacancy on the board of directors, the party who designated the director shall promptly designate a new director, and the shareholders shall promptly execute a written consent or vote their shares to elect such person to the board of directors."

Example (Observer): "[Name of Shareholder] shall be entitled to designate one non-voting observer, who is initially expected to be [Name]. The observer shall be entitled to be present at all meetings of the board of directors and each committee thereof. The corporation shall notify the observer of each such meeting, including the time and place of the meeting, in the same manner and at the same times as the directors or committee members are notified. The observer shall have the same access to information concerning the business and operations of the corporation, including, but not limited to, notes, minutes and consents of the board of directors, be entitled to participate in discussions of the affairs, finances and accounts of, and consult with, and make proposals and furnish advice to, the board of directors."

B. Special Voting Rights

Shareholders of a Texas corporation have certain voting rights as a matter of law. If the shareholders desire to have voting rights that differ from those granted by statute, the shareholders agreement may include voting provisions. For example, in a closely-held corporation, the shareholders, or certain shareholders, may want the right to approve the corporation's incurrence of indebtedness over a specified amount.

Items to consider adding include the approval of:

- Approval of a budget;
- Incurrence of indebtedness;
- Related party transactions;
- Acquisitions;
- Issuances of securities;
- Amendment of the charter or bylaws;
- Material changes to the nature of the business conducted or enter into a new business;
- Investments in other persons;
- A change in auditors or accounting methods; and
- A change in control.

C. Pre-emptive Rights

The issuance of an existing class of shares by a Texas corporation generally requires approval of the board of directors, but not shareholders unless the shareholders have statutory or contractual preemptive rights. Preemptive rights generally give shareholders the right to purchase their pro rata portion of new shares to maintain their percentage ownership in the corporation.

When the TBOC became effective in 2003, the default rule regarding statutory preemptive rights changed. Today, except as provided in Section 21.308 of the TBOC, Texas corporations do not have statutory preemptive rights unless the certificate of formation expressly permits or elects statutory preemptive rights. Section 21.308 of the TBOC provides that corporations incorporated prior to September 1, 2003 (prior to the effectiveness of the TBOC) have statutory preemptive rights unless otherwise provided in the articles of incorporation.

Even if the shareholders do not have statutory preemptive rights, the corporation may grant contractual preemptive rights. Section 21.203(c) of the TBOC does not impair a corporation's right to grant nonstatutory preemptive rights in a contract between the corporation and a shareholder or other person or in the governing documents of the corporation.

A shareholders agreement may include contractual preemptive rights which give shareholders the right to purchase shares to maintain their percentage ownership in the event of a new share issuance. Contractual preemptive rights may be limited to issuances at below market price or below a designated price or may apply in the event of all issuances.

Drafting considerations:

- Consider the need to carveout the following from triggering the preemptive right: issuances pursuant to existing option plans, issuances upon the conversion or exercise of existing convertible securities.

D. Access to Information

The shareholders agreement may give shareholders the right to receive certain information regarding the corporation. This can be important especially if the shareholders do not have a representative on the board of directors. Although the TBOC give shareholders certain inspection rights, a shareholders agreement may broaden the scope of

information shareholders are given access to and streamline the process for obtaining the information.

Drafting considerations:

- Do shareholders want the right to receive quarterly and annual financial statements or other financial information?
- Do shareholders want the right to inspect corporate records on reasonable notice?
- From the corporation's perspective, granting contractual information rights can be burdensome, especially as the number of shareholders grows.

E. Non-competition and Confidentiality

In a closely held corporation, the shareholders may want the protection of non-competition and confidentiality provisions to protect the corporation and its shareholders from having one shareholder operate or invest in a competing business.

Due to the amount of litigation on these provisions, it is prudent to check the status of the law before drafting a non-compete.

Drafting considerations:

- Describe the business to be protected.
- What time period should the restriction cover?
- Are any carve-outs needed for existing investments or minority investments in publicly-held companies?
- What is the geographic scope?
- Is the corporation presently contemplating entering into a new business or geographic area?

VI. UPDATING THE BUY-SELL AGREEMENT

Even if your clients negotiated a thoughtful buy-sell agreement, the agreement may become obsolete in the future for several reasons, including, among others, the number and characteristics of the owners may have changed, the value of the business may have changed dramatically, the type of business may have changed, or the method of valuation used in the agreement is outdated.

We recommend that parties to shareholders agreements review the provisions each year or two to consider whether an update would be appropriate.

VII. CONCLUSION

While drafting a good shareholders agreement is challenging, as a lawyer you can guide the business owners through difficult situations. On a practical level, the ability to effect business "separations" on a negotiated basis is usually the best approach because of the likelihood that there will be some provision that the shareholder reads years after signing the agreement and says, "Well, that is not the way I want it to work." However, there are a number of situations where a relationship has deteriorated to a point where a negotiated transaction is not possible. As a result, lawyers drafting shareholder agreements should do their best to ascertain the objectives of the shareholders and provide for all reasonably foreseeable events.

A few parting notes to consider in drafting your next shareholders agreement:

- Pay special attention to notice provisions in terms of mechanics and when items are deemed sent and received.
- Consider when the agreement should terminate automatically—e.g. upon the completion of an initial public offering meeting certain standards.
- If there are numerous shareholders, consider the amendment provision carefully. Generally the amendment will require approval of all parties, but consider if there can be a different approval standard and/or the corporation's ability to make certain amendments without a shareholders consent –similar to a corporation's ability to amend an indenture without the holder's consent to cure ambiguities, etc.

Exhibit A

Sample Voluntary Transfer Provisions

Right of First Refusal (Voluntary as to Right to Purchase)	Right of First Offer (Voluntary as to Right to Purchase)	Tag Along (Voluntary as to Participation in Sale)
General. *Subject to the terms of this agreement, each time a shareholder (the "Seller") receives a bona fide written offer to purchase shares (except with respect Permitted Transfers and Transfers subject to the Drag-along provision) from a Third-Party Purchaser that the Seller desires to accept, the Seller must comply with the provisions of this Section __ (the "Right of First Refusal").*	General. *Subject to the terms of this agreement, each time a shareholder (the "Seller") proposes to Transfer all or a portion of the shareholder's shares to a Third-Party Purchaser (except with respect to Permitted Transfers and Transfers subject to the Drag-along provision), the Seller must comply with the provisions of this Section __ (the "Right of First Offer").*	General. *Subject to the terms of this agreement, and [following compliance with the Rights of First Refusal/Right of First Offer provision], each time a shareholder or group of shareholders (the "Seller(s)") desires to Transfer all or a portion of the shareholders' shares in one or a series of related transactions (except with respect to Permitted Transfers and Transfers subject to the Drag-along provision), to a Third-Party Purchaser, [and the Shares to be sold represent over 25% of number of Shares then outstanding], the Seller must comply with the provisions of this Section __ (the "Tag Along Right").*
Notice of Offer. *The Seller shall inform the Company and the other shareholders by written notice within [5] days following receipt of the offer (the "Transfer Notice"). The Transfer Notice shall state the date it is being sent (the "Transfer Notice Date") as well as describe the shares that are subject to the proposed Transfer (the "Offered Shares"), the identity of the proposed transferee and the other material terms and conditions of the proposed Transfer, including the price per share and form of consideration (collectively, the "Transfer Amount") and the proposed time and place of closing of the Transfer which must be within 30 days of the date of the Transfer Notice.*	Notice of Offer. *The Seller shall inform the Company and the other shareholders by written notice (the "Transfer Notice"). The Transfer Notice shall state the date it is being sent (the "Transfer Notice Date") as well as describe the shares that are subject to the proposed Transfer (the "Offered Shares"), the identity of the proposed transferee and the other material terms and conditions of the proposed Transfer, including the proposed price per share and form of consideration (collectively, the "Transfer Amount") and the proposed time and place of closing of the Transfer which must be within 30 days of the date of the Transfer*	Notice of Offer. *The Seller shall inform the Company and the other shareholders by written notice (the "Tag Along Notice") which shall be delivered no more than 5 days after the execution of any definitive agreement for the Transfer and no less than 30 days prior to the proposed closing of the Transfer. The Transfer Notice shall state that the shareholders have certain tag along rights in connection with the proposed Transfer, the identity of the proposed transferee and the other material terms and conditions of the proposed Transfer, including the price per share and form of consideration (collectively, the "Transfer Amount" and the proposed time and place of closing of the Transfer which must be within 30 days of the date of the Transfer Notice).*

Right of First Refusal (Voluntary as to Right to Purchase)	Right of First Offer (Voluntary as to Right to Purchase)	Tag Along (Voluntary as to Participation in Sale)
<u>Offer Period; Representations</u>. By giving the Transfer Notice, the Seller shall be deemed to have granted first to the shareholders and second to the Company, an option to purchase the Offered Shares which offer shall be irrevocable for [20] [business] days. By delivering the Transfer Notice, the Seller represents and warrants to the other shareholders and the Company that the Seller has full right, title and interest in and to the Offered Shares and the Offered Shares are free and clear of any and all Liens other than those arising under the shareholders' agreement and the securities laws.	*<u>Offer Period; Representations</u>. By giving the Transfer Notice, the Seller shall be deemed to have granted first to the shareholders and second to the Company, an option to purchase the Offered Shares which offer shall be irrevocable for [20] [business] days. By delivering the Transfer Notice, the Seller represents and warrants to the other shareholders and the Company that the Seller has full right, title and interest in and to the Offered Shares and the Offered Shares are free and clear of any and all Liens other than those arising under the shareholders' agreement and the securities laws.*	
<u>Exercise</u>. Upon receipt of the Transfer Notice, a shareholder will have until the end of the period specified in the Transfer Notice to elect to purchase all (but not less than all) of the Offered Shares by delivering a written notice (the "Offer Notice") to the Seller and the Company stating that the shareholder offers to buy the Offered Shares on the terms specified in the Transfer Notice. The Offer Notice shall be binding and irrevocable with respect to the shareholder. If more than one shareholder delivers an Offer Notice, the number of Shares allocated shall be on a pro rata basis unless otherwise agreed by such shareholders. Each shareholder that does not deliver an Offer Notice in accordance with this Section __ shall be deemed to have waived its rights under this Section __.	*<u>Exercise</u>. Upon receipt of the Transfer Notice, a shareholder will have until the end of the period specified in the Transfer Notice to elect to purchase all (but not less than all) of the Offered Shares by delivering a written notice (the "Offer Notice") to the Seller and the Company stating that the shareholder offers to buy the Offered Shares on the terms specified in the Transfer Notice. The Offer Notice shall be binding and irrevocable with respect to the shareholder. If more than one shareholder delivers an Offer Notice, the number of Shares allocated shall be on a pro rata basis unless otherwise agreed by such shareholders. Each shareholder that does not deliver an Offer Notice in accordance with this Section __ shall be deemed to have waived its rights under this Section __.*	*<u>Exercise</u>. Each other shareholder may exercise its right to participate in the sale by the Seller by delivering to the Seller within 10 days after delivery of the Tag Along Notice, a written notice stating its irrevocable election to do so and setting forth the number of shares desired to be sold. By sending such written notice, the shareholder shall be obligated to sell pursuant to the proposed Transfer. The maximum number of shares a shareholder may sell pursuant to the Tag Along Right is equal to the product obtained by multiplying (1) the number of Shares held by the shareholder, by (2) a fraction, the numerator of which is equal to the number of Shares the Seller proposes to Transfer and the denominator of which is equal to the number of Shares then owned by the Seller.*

Right of First Refusal (Voluntary as to Right to Purchase)	Right of First Offer (Voluntary as to Right to Purchase)	Tag Along (Voluntary as to Participation in Sale)
Covenants. Each shareholder shall take all actions as may be reasonably necessary to consummate the sale contemplated in this Section __, including, without limitation, entering into agreements and delivering certificates and consents.	*Covenants. Each shareholder shall take all actions as may be reasonably necessary to consummate the sale contemplated in this Section __, including, without limitation, entering into agreements and delivering certificates and consents.*	*Covenants. The Seller shall use commercially reasonable efforts to include in the proposed Transfer all of the shares requested by the other shareholders; provided that the Third-Party purchaser shall not be required to purchase a number of Shares in excess of that specified in the Tag Along Notice. If the Third-Party Purchaser desires to purchase less Shares than requested by the shareholders under this Tag Along Right, the Shares to be sold by the Seller and the other shareholders exercising their Tag Along Right will be reduced on a pro rata basis (but not less than the number of Shares in the Tag Along Notice.*
Closing. At the closing of any sale under this provision, the Seller shall deliver to the purchaser(s) certificate(s) representing the Offered Shares to be sold (if any), accompanied by stock power and all necessary stock transfer taxes paid and stamp affixed, if necessary, against receipt of the purchase prices.	*Closing. At the closing of any sale under this provision, the Seller shall deliver to the purchaser(s) certificate(s) representing the Offered Shares to be sold (if any), accompanied by stock power and all necessary stock transfer taxes paid and stamp affixed, if necessary, against receipt of the purchase price.*	*Closing. At the closing of any sale under this provision, the Seller and/or any shareholder exercising its Tag Along Right shall deliver to the purchaser(s) certificate(s) representing the shares to be sold (if any), accompanied by stock power and all necessary stock transfer taxes paid and stamp affixed, if necessary, against receipt of the purchase price.*
Sale to Third Party. If no shareholder delivers an Offer Notice in accordance with this provision, or if a shareholder delivers an Offer Notice in accordance with this provision but does not complete the purchase of shares within [45] days of the end of the period specified in the Transfer Notice, the Seller may Transfer the shares during the [45] day period following the later of (i) the expiration of the Offer Period ***[subject to the Tag Along Right]*** *or (ii) the date on which the shareholder was required to complete the purchase; provided, that the Transfer shall be on terms and conditions no more favorable than those in the Transfer Notice.*	*Sale to Third Party. If no shareholder delivers an Offer Notice in accordance with this provision, or if a shareholder delivers an Offer Notice in accordance with this provision but does not complete the purchase of shares within [45] days of the end of the period specified in the Transfer Notice, the Seller may Transfer the shares during the [45] day period following the later of (i) the expiration of the Offer Period* ***[subject to the Tag Along Right]*** *or (ii) the date on which the shareholder was required to complete the purchase; provided, that the Transfer shall be on terms and conditions no more favorable than those in the Transfer Notice.*	*Sale to Third Party. If no shareholder exercises its Tag Along Right in accordance with this provision, the Seller(s) may Transfer the shares during the [45] day period following the date of the Tag Along Notice; provided, that the Transfer shall be on terms and conditions no more favorable than those in the Transfer Notice.*

Exhibit B

Sample Mandatory Transfer Provisions

Drag-along (Mandatory as to Participation in Sale)	Put (Mandatory as to requiring other party to purchase)	Call (Mandatory as to requiring other person to sell)
Drag-Along Right. *Drag-along. Subject to the terms of this agreement, if any shareholder acting individually, or any group of shareholders acting jointly, desires to Transfer all of their Shares, and such Shares constitute more than [fifty percent (50%)] of all the shares then held by the shareholders (any such transferring shareholder, a "Selling Shareholder") to a Third-Party Purchaser, then such Selling Shareholders shall have the right to require the other shareholders to sell all such other shareholders' Shares to such Third-Party Purchaser in connection with such sale on the same terms and conditions as such Selling Shareholder; [provided, that the consideration to be received by the other shareholders is cash, immediately available funds or securities registered on a national securities exchange]. If the sale is structured as a merger, consolidation or similar business combination, or would result in a Change of Control of the Company, each shareholder shall vote in favor of the transaction and take all actions necessary or appropriate to waive any dissenters, appraisal or other similar rights.* *Exercise. The Selling Shareholder shall exercise the right by giving written notice to each shareholder who shall state the aggregate proposed purchase price per Share and all other material terms and conditions of such sale (including the identity of the Third-Party Purchaser) and be accompanied by the written Transfer agreement between such Selling Shareholder and the Third-Party Purchaser.* *Priority. [The Drag-Along Right granted to shareholders herein shall take precedence over and be in lieu of the Right of First Refusal.]*	*Put Option.* *Put. Subject to the terms of this agreement, Shareholder A shall have the right to put his Shares of common stock to the Company for the purchase price of ________ at any time within [60] days following [Describe trigger event—date certain, death, Change in Control, termination of employment other than for cause, other].* *Notice. Shareholder A shall provide the Company a dated written notice of its desire to exercise the put option within the time period above (the "Put Option Notice").* *Closing. The closing of the purchase of the Shares by the Company shall occur not later than [30] days after the Put Notice Date and the purchase price shall be paid in cash or immediately available funds. Upon payment of the purchase price, Shareholder A shall Transfer the shares to the Company free and clear of any and all liens and encumbrances, and Shareholder A shall execute and deliver any documentation that the Company deems reasonable to effect the Transfer.* *Limitations. [Notwithstanding anything to the contrary herein, the Company may not purchase any Shares hereunder if the purchase would violate the provisions of the TBOC or the terms of the senior credit facility.]*	*Call Option.* *Call. Subject to the terms of this agreement, upon the occurrence of a Trigger Event with respect to any shareholder, that shareholder (and the shareholder's heirs, estate, legal representatives or assignee) (collectively, the "Seller") shall be deemed to have granted to the Company an option to purchase any or all of the Shares of the Seller for the price equal to ________________.* *Notice. The Seller shall issue a notice of a Trigger Event to the Company within 10 days of the Trigger Event (the "Trigger Notice").* *Exercise. The Company shall have until the [60th] day following the Trigger Notice to notify the Seller of the election to purchase all of the called Shares (the "Called Shares").* *Closing. The Seller shall at the closing represent and warrant to the Company that the Seller has full right, title and interest in and to the Called Shares and the Called Shares are free and clear of any and all Liens other than those arising under the shareholders agreement. The closing of the sale shall occur no later than ___ days following receipt of the Trigger Notice, and the Company shall give the Seller at least __ days' prior notice of the closing date. At the closing, the Seller shall deliver the certificates representing the Called Shares, together with any stock powers and necessary stock transfer taxes paid and stamps affixed, if necessary, against payment by the Company of the purchase price in cash or immediately available funds.*