

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10- K

☒ **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

☐ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the transition period from _____ to _____

Commission file number 1- 9761

ARTHUR J. GALLAGHER & CO.

(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

36- 2151613
(I.R.S. Employer
Identification Number)

Two Pierce Place
Itasca, Illinois
(Address of principal executive offices)

60143- 3141
(Zip Code)

Registrant's telephone number, including area code (630) 773- 3800

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common Stock, par value \$1.00 per share	New York Stock Exchange
Common Share Purchase Rights	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well- known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐.

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒.

Note: Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S- K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10- K or any amendment to this Form 10- K. ☒

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b- 2 of the Act). Yes ☒ No ☐.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b- 2 of the Exchange Act). Yes ☐ No ☒.

The aggregate market value of the voting common equity held by non- affiliates of the registrant, computed by reference to the last reported price at which the stock was sold on June 30, 2005 (the last day of the registrant's most recently completed second quarter) was \$2,462,581,000.

The number of outstanding shares of the registrant's Common Stock, \$1.00 par value, as of December 31, 2005 was 95,723,000.

Documents incorporated by reference:

Portions of Arthur J. Gallagher & Co.'s Annual Report to Stockholders for the year ended December 31, 2005 are incorporated by reference into this Form 10- K in response to Parts I and II to the extent described herein.

Portions of Arthur J. Gallagher & Co.'s definitive 2006 Proxy Statement are incorporated by reference into this Form 10- K in response to Parts II and III to the extent described herein.

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Arthur J. Gallagher & Co. and its subsidiaries (collectively referred to as "Gallagher" unless the context otherwise requires) are engaged in providing insurance brokerage, risk management and related services to clients in the U.S. and abroad. Gallagher's principal activity is the negotiation and placement of insurance for its clients. Gallagher also specializes in furnishing risk management services. Risk management involves assisting clients in analyzing risks and determining whether proper protection is best obtained through the purchase of insurance or through retention of all or a portion of those risks and the adoption of corporate risk management policies and cost-effective loss control and prevention programs. Risk management services also include claims management, loss control consulting and property appraisals. Gallagher believes that its ability to deliver comprehensively structured risk management and brokerage services is one of its major strengths. In addition, Gallagher has a financial services operation that manages its investment portfolio.

Gallagher operates through a network of more than 250 sales and service offices located throughout the U.S. and six countries abroad and through a network of correspondent brokers and consultants in 120 countries around the world. Some of these offices are fully staffed with sales, marketing, claims and other service personnel; others function as servicing offices for the brokerage and risk management service operations of Gallagher. Gallagher's international operations include a Lloyd's of London broker and affiliated companies in England and other facilities in Australia, Bermuda, Canada, Scotland and Singapore.

Gallagher was founded in 1927 and was reincorporated as a Delaware corporation in 1972. Gallagher's executive offices are located at Two Pierce Place, Itasca, Illinois 60143- 3141, and its telephone number is (630) 773- 3800.

Information Concerning Forward- Looking Statements

This annual report contains forward- looking statements within the meaning of that term in the Private Securities Litigation Reform Act of 1995 (the "Act") found at Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Additional written or oral forward- looking statements may be made by Gallagher from time- to- time in filings with the Securities and Exchange Commission (SEC), press releases, or otherwise. Statements contained in this report that are not historical facts are forward- looking statements made pursuant to the safe harbor provisions of the Act and the Exchange Act.

Forward- looking statements may include, but are not limited to, discussions concerning revenues, expenses, earnings, cash flow, capital structure and financial losses, as well as market and industry conditions, premium rates, financial markets, interest rates, foreign exchange rates, contingencies and matters relating to Gallagher's operations and income taxes. In addition, when used in this report, the words "anticipates," "believes," "should," "estimates," "expects," "intends," "plans" and variations thereof and similar expressions are intended to identify forward- looking statements. Such forward- looking statements are based on available current market and industry material, experts' reports and opinions and long- term trends, as well as management's expectations concerning future events impacting Gallagher.

Forward- looking statements made by or on behalf of Gallagher are subject to risks and uncertainties, including but not limited to the following: Gallagher's commission revenues are highly dependent on premiums charged by insurers, which are subject to fluctuation; lower interest rates reduce Gallagher's income earned on invested funds; alternative insurance markets continue to grow which could unfavorably impact commission and favorably impact fee revenue, though not necessarily to the same extent; Gallagher's revenues vary significantly from period to period as a result of the timing of policy inception dates and the net effect of new and lost business production; the insurance brokerage industry is subject to a great deal of uncertainty due to investigations into its business practices by various governmental authorities and related private litigation; the general level of economic activity can have a substantial impact on Gallagher's renewal business; Gallagher's operating results, returns on investments and financial position may be adversely impacted by exposure to various market risks such as interest rate, equity pricing, foreign exchange rates and the competitive environment; Gallagher's revenues and net earnings may continue to be subject to reduction due to the elimination of certain contingent commission arrangements on January 1, 2005 and related developments in the insurance industry; and Gallagher's effective income tax rate may be subject to increase as a result of changes in income tax laws, unfavorable interpretations of such laws or changes in crude oil prices or developments resulting in the loss or unavailability of Syn/Coal Credits. Gallagher's ability to grow has been enhanced through acquisitions, which may or may not be available on acceptable terms in the future and which, if consummated, may or may not be advantageous to Gallagher. Accordingly, actual results may differ materially from those set forth in the forward- looking statements. For a further discussion of certain of the matters described above see Item 1A, "Risk Factors."

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Readers are cautioned not to place undue reliance on any forward- looking statements contained in this report, which speak only as of the date set forth on the signature page hereto. Gallagher undertakes no obligation to publicly release the result of any revisions to these forward- looking statements that may be made to reflect events or circumstances after such date or to reflect the occurrence of anticipated or unanticipated events.

Operating Segments

Gallagher has identified three operating segments: Brokerage, Risk Management and Financial Services. The Brokerage Segment, for commission or fee compensation, primarily places commercial property/casualty (P/C) and employee benefit- related insurance on behalf of its customers. The Risk Management Segment provides P/C claim third- party administration, loss control and risk management consulting and insurance property appraisals. Third party administration is principally the management and processing of claims for self- insurance programs of Gallagher's clients or clients of other brokers. The Financial Services Segment is responsible for managing Gallagher's investment portfolio.

The two major sources of operating revenues for Gallagher are commissions from brokerage operations and service fees from brokerage and risk management operations. Information with respect to all sources of revenue, by operating segment, for each of the three years in the period ended December 31, 2005, is as follows (in millions):

	2005		2004		2003	
	Amount	% of Total	Amount	% of Total	Amount	% of Total
Commissions						
Brokerage	\$ 784.3	53%	\$ 726.8	51%	\$ 676.2	56%
Retail contingent commissions						
Brokerage	28.8	2%	33.8	2%	29.3	2%
Fees						
Brokerage	169.8	11%	146.2	10%	127.5	10%
Risk Management	367.7	25%	343.8	24%	291.2	24%
Investment income and other						
Brokerage	17.9	1%	13.4	1%	7.5	1%
Risk Management	2.9	0%	1.7	0%	0.8	0%
Financial Services	112.5	8%	171.3	12%	88.6	7%
Total revenues	\$ 1,483.9	100%	\$ 1,437.0	100%	\$ 1,221.1	100%

See Note 20 to the Consolidated Financial Statements of Gallagher's 2005 Financial Statements, which are incorporated herein by reference for additional financial information, including earnings from continuing operations before income taxes and identifiable assets, by operating segment, for 2005, 2004 and 2003.

During 2005, 2004 and 2003, Gallagher's total revenues and expenses each increased sequentially from quarter- to- quarter within the calendar years, except for first quarter 2005, which was negatively impacted by litigation and retail contingent commission related charges, and in fourth quarter 2005, due to the reduction in retail contingent commissions and charges related to retail contingent commission related matters and claims handling obligations. However, commission and fee revenues and the related expenses can vary from quarter- to- quarter as a result of the timing of policy inception dates that historically are heaviest in third and fourth quarters. Alternatively, salaries and employee benefits, rent, depreciation and amortization expenses generally tend to be more uniform throughout the year. In addition, the timing of acquisitions will also impact the trends in Gallagher's quarterly operating results. See Note 19 to the Consolidated Financial Statements of Gallagher's 2005 Financial Statements, which are incorporated herein by reference for unaudited quarterly operating results for 2005 and 2004.

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Brokerage

The Brokerage Segment comprises three operating divisions: the Brokerage Services- Retail Division (BSD), Specialty Marketing and International (SMI) and Gallagher Benefit Services (GBS).

BSD primarily places insurance for and services commercial, industrial, institutional, governmental, religious and personal accounts throughout the U.S. SMI places insurance for and services commercial, industrial, institutional, governmental, religious and personal accounts throughout the U.S. and abroad. BSD and SMI act as agents in soliciting, negotiating and effecting contracts of insurance through insurance companies worldwide, as brokers in procuring contracts of insurance on behalf of insureds, and as administrators in setting up and managing self- insured programs. In addition, SMI places insurance on behalf of other brokers. BSD and SMI both have the capability to handle insurable risks and related coverages for a wide variety of P/C products. SMI also places surplus lines coverages, which are coverages for various specialized risks not available from insurance companies licensed by the states in which the risks are located. In addition, SMI's reinsurance intermediary operations place reinsurance coverages for its insurance company clients.

GBS specializes in the management of employee benefit programs through fully insured and self- insured programs. GBS provides services in connection with the design, financing, implementation, administration and communication of compensation and employee benefit programs (including pension and profit- sharing plans, group life, health, accident and disability insurance programs and income tax deferral plans), and provides other professional services in connection therewith.

The primary source of Gallagher's compensation for its Brokerage Segment is commissions paid by insurance companies which are usually based upon a percentage of the premium paid by insureds. Commission rates are dependent on a number of factors including the type of insurance, the particular insurance company and the capacity in which Gallagher acts. In some cases, Gallagher is compensated for brokerage or advisory services directly by fees from clients. Historically, Gallagher also has received contingent commissions which are based on the estimated profit the underwriting insurance company earns and/or the overall volume of business placed by Gallagher in a given period of time. Occasionally, Gallagher shares commissions with other brokers who have participated with Gallagher in placing insurance or servicing insureds. GBS receives a fee for acting in the capacity of advisor and administrator with respect to employee benefit programs and receives commissions in connection with the placement of insurance under such programs. As previously reported, on May 18, 2005, Gallagher and its subsidiaries and affiliates, except for Gallagher Bassett Services, Inc., entered into an Assurance of Voluntary Compliance (the AVC) with the Attorney General of the State of Illinois and the Director of Insurance of the State of Illinois (collectively, the IL State Agencies) to resolve all of the issues related to certain investigations conducted by the IL State Agencies involving contingent commission arrangements. As stipulated in the AVC, on January 12, 2006, Gallagher paid \$26.9 million into a fund to be distributed to certain eligible policyholder clients. In addition, under the AVC Gallagher agreed to implement, to the extent not previously undertaken, certain business changes, including agreeing not to accept U.S.- domiciled retail contingent compensation as defined in the AVC. On October 26, 2004, Gallagher announced that it would not enter into any new volume- based or profit- based contingent commissions agreements as a retail broker effective January 1, 2005. However, as allowed under the AVC, Gallagher has continued to accept contingent compensation from non-retail business, including business generated by wholesalers, managing general agents and managing general underwriters. In addition, the AVC allows Gallagher to collect retail contingent compensation related to contracts in place at entities acquired up to one year from the acquisition date. See Note 17 to the Consolidated Financial Statements for a discussion of the material terms of the AVC. Accordingly, Gallagher has begun to experience reduced contingent commission revenue and it is expected that future contingent commission revenues will continue to be substantially reduced. The reduction in retail contingent commissions, as discussed above, could continue to have a substantial negative impact on Gallagher's pretax earnings beginning in 2006.

Risk Management

The Risk Management Segment consists of Gallagher's wholly- owned subsidiary, Gallagher Bassett Services (GB).

GB provides a full range of risk management services including claims management, risk control consulting services, information management, and property appraisals on a totally integrated or select, stand- alone basis. GB provides these services for Gallagher's clients through a network of service offices located throughout the U.S., Canada, England, Scotland and Australia.

GB primarily markets its risk management services directly to clients on an unbundled basis independent of Gallagher. GB also markets these services to BSD and SMI clients who use P/C risk management related services.

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In connection with its risk management services, GB provides "self- insurance" programs for large institutions, risk sharing pools and associations, and large commercial and industrial customers. Self- insurance, as administered by GB, is a program in which the client assumes a manageable portion of its insurance risks, usually (although not always) placing the less predictable and larger loss exposures with an insurance carrier that specializes in these less predictable exposures.

GB's revenues for risk management services are substantially in the form of fees. These fees are typically negotiated in advance on an annual basis based upon the type and estimated volume of the services to be performed.

On December 2, 2004, GB received a subpoena from the Attorney General of the State of New York requesting information in connection with an investigation it is conducting. Gallagher is fully cooperating with this investigation. The subpoena did not seek information concerning Gallagher's insurance brokerage operations.

Financial Services

The Financial Services Segment is primarily responsible for Gallagher's investment portfolio, which includes tax advantaged investments, real estate partnerships, an alternative investment fund manager, notes receivable from investees and an investment in an airplane leasing company that leases two cargo airplanes to the French Postal Service. Financial Services manages the invested assets of Gallagher in order to maximize the long- term after- tax return to Gallagher. See Note 3 to the Consolidated Financial Statements of Gallagher's 2005 Financial Statements, which are incorporated herein by reference, for a summary of Gallagher's investments.

Gallagher's overall non- fiduciary investment strategy going forward will be primarily focused on tax advantaged investments. Gallagher has used the limited partnership or limited liability company forms of legal ownership to fund many of its investments in order to obtain favorable tax treatment with respect to gains, losses and distributions, while limiting its liability. Based on the ownership structure of these investments, management believes that Gallagher's exposure to losses related to these investments is limited to the combination of its net carrying value, letters of credit, financial guarantees and funding commitments. In the event that certain of these limited partnerships or limited liability companies were to default on their debt obligations and Gallagher's net carrying value became impaired, the amount to be written- off could have a material effect on Gallagher's consolidated financial position or operating results. In some cases, Gallagher may be at risk for tax credits taken in previous years, which may also be material to its operations. See Note 3 and Note 17 to the Consolidated Financial Statements of Gallagher's 2005 Financial Statements, which are incorporated herein by reference for a summary of outstanding letters of credit, financial guarantees and funding commitments and Note 8 to the Consolidated Financial Statements for a summary of outstanding debt and contingent commitments. In addition, see Note 3 to the Consolidated Financial Statements of Gallagher's 2005 Financial Statements for a summary of Gallagher's tax credit exposure.

International Operations

Total revenues by geographic area for each of the three years in the period ended December 31, 2005 are as follows (in millions):

	2005		2004		2003	
	Amount	% of Total	Amount	% of Total	Amount	% of Total
United States	\$ 1,323.8	89%	\$ 1,289.7	90%	\$ 1,091.1	89%
Foreign, principally United Kingdom, Australia and Bermuda	160.1	11%	147.3	10%	130.0	11%
Total revenues	\$ 1,483.9	100%	\$ 1,437.0	100%	\$ 1,221.1	100%

The Brokerage Segment's international operations comprise the following: a Lloyd's of London broker and an insurance brokerage and risk management operation in the United Kingdom; an insurance and reinsurance brokerage operation, a captive management operation and two "rent- a- captive" insurance and segregated account company facilities in Bermuda; reinsurance intermediary operations in Australia and Singapore; and a network of correspondent brokers and consultants in 120 countries around the world.

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Arthur J. Gallagher (UK) Limited (AJG UK) is a wholly- owned London- based subsidiary of Gallagher. It provides brokerage and other services to clients primarily located outside the United Kingdom. The principal activity of AJG UK is to negotiate and place insurance and reinsurance with London underwriters and insurance companies worldwide. In addition, AJG UK is a Financial Services Authority (FSA) registered broker and an approved Lloyd's of London broker. AJG UK's brokerage services encompass most classes of business within the general categories of aviation, marine, reinsurance (treaty and facultative) and P/C. The thrust of AJG UK's business development has been with non- United Kingdom brokers, agents and insurers rather than domestic United Kingdom retail business. Its clients are primarily insurance and reinsurance companies, underwriters at Lloyd's of London, Gallagher's non- United Kingdom subsidiaries, other independent agents and brokers and major business corporations requiring direct insurance and reinsurance placements.

Risk Management Partners Ltd. (RMP) is a wholly- owned London- based subsidiary of Gallagher that markets customized insurance and risk management products and services to United Kingdom public entities through offices in England and Scotland. RMP was formed in 1994 and Gallagher believes that RMP is now the third largest provider of insurance brokerage related services to the public entity market in the United Kingdom.

Arthur J. Gallagher & Co. (Bermuda) Limited is a wholly- owned subsidiary of Gallagher that provides clients with direct access to the risk- taking capacity of foreign insurers for both direct and reinsurance placements. It also acts as a wholesaler to Gallagher's marketing efforts by accessing global insurance and reinsurance companies in the placement of U.S. and foreign risks. In addition, it provides services relating to the formation and management of offshore captive insurance companies.

Gallagher has ownership interests in two Bermuda- based insurance companies that operate segregated account "rent- a- captive" facilities: Artex Insurance Company, a partially owned joint- venture, and Protected Insurance Company, a wholly- owned subsidiary. Rent- a- captives enable clients to receive the benefits of owning a captive insurance company without certain disadvantages of ownership. Captive insurance companies are created for clients to insure their risks and capture underwriting profit and investment income, which is then available for use by the insured generally for reducing future costs of their insurance programs.

Arthur J. Gallagher Australasia Holdings Pty Ltd is a wholly- owned subsidiary of Gallagher that is headquartered in Sydney, Australia. This subsidiary provides insurance and reinsurance placements for international or local Australian companies, and specialty programs and coverages for Australian and other clients through underwriting facilities with Lloyd's of London and local underwriters.

Arthur J. Gallagher Asia Pte Ltd is a 51% owned joint- venture of AJG UK that is based in Singapore. It specializes in treaty and facultative reinsurance placements for insurance companies located throughout Asia. These placements are made directly with reinsurance companies or through Gallagher's subsidiaries and encompass several lines of business.

The Brokerage Segment also has strategic alliances with a variety of international brokers in countries where Gallagher does not have a physical presence. Through a network of correspondent brokers and consultants in 120 countries globally, Gallagher is able to fully serve its clients' coverage and service needs in virtually any geographic area where their operations are located.

The Risk Management Segment's international operations principally comprise risk management companies in the United Kingdom and Australia.

Gallagher Bassett International Ltd. (UK) (GB UK), a wholly- owned subsidiary of GB, provides risk management services for foreign operations, as well as U.S. operations that are foreign controlled. Headquartered in London with additional offices in England and Scotland, GB UK works with insurance companies, reinsurance companies, overseas brokers, and risk managers of overseas organizations. Services include consulting, claims management, information management, loss control and property valuations.

Gallagher Bassett Services Pty Ltd is a wholly- owned subsidiary of GB that is headquartered in Brisbane, Australia with additional facilities located throughout Australia. This subsidiary is principally engaged in providing claims adjusting and risk management services in Australia. Services include consulting, claims management, crisis management, information management, loss control and property valuations.

Gallagher also has risk management service facilities in Canada that are not material to Gallagher's Risk Management Segment.

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See Note 18 and Note 20 to the Consolidated Financial Statements of Gallagher's 2005 Financial Statements, which are incorporated herein by reference for additional financial information related to Gallagher's foreign operations, including earnings from continuing operations before income taxes and identifiable assets, by operating segment, for 2005, 2004 and 2003.

Markets and Marketing

A large portion of the commission and fee business of Gallagher is derived from all types of business institutions, not-for-profit organizations, associations and municipal and other governmental entities. Gallagher's clients include U.S. and multi-national corporations engaged in a broad range of commercial and industrial businesses. Gallagher also places insurance for individuals. Gallagher services its clients through its network of more than 250 sales and service offices in the U.S. and six countries abroad. No material part of Gallagher's business is dependent upon a single customer or on a few customers. The loss of any one customer would not have a materially adverse effect on Gallagher. In 2005, the largest single customer represented less than 1% of total revenues and the ten largest customers represented no more than 6% of total revenues.

Gallagher believes that its ability to deliver comprehensively structured risk management and brokerage services, including the placement of insurance and reinsurance, is one of its major strengths. Gallagher also believes that its risk management business enhances and attracts insurance brokerage business due to the nature and strength of business relationships that it forms with clients when providing a variety of risk management services on an ongoing basis.

Gallagher requires its employees serving in a sales or marketing capacity, including all executive officers of Gallagher, to enter into agreements with Gallagher restricting disclosure of confidential information and solicitation of clients and prospects of Gallagher upon their termination of employment. The confidentiality and non-solicitation provisions of such agreements terminate in the event of a hostile change in control of Gallagher, as defined therein.

Competition

According to *Business Insurance* magazine (July 18, 2005 edition), Gallagher is the fourth largest insurance broker worldwide (third largest in the U.S.) in terms of total revenues. The insurance brokerage and service business is highly competitive and there are many insurance brokerage and service organizations as well as individuals on a global basis who actively compete with Gallagher in every area of its business. Gallagher competes with three firms that are as large or significantly larger than Gallagher in global risk management and brokerage markets. In addition, there are various other competing firms that operate nationally or that are strong in a particular region or locality and may have, in that region or locality, an office that is as large or larger than the particular local office of Gallagher. Gallagher believes that the primary factors determining its competitive position with other organizations in its industry are the quality of the services rendered and the overall costs to its clients.

Gallagher is also in competition with certain insurance companies that write insurance directly for their customers. Government benefits relating to health, disability, and retirement are also alternatives to private insurance and hence indirectly compete with the business of Gallagher.

Regulation

In every state and foreign jurisdiction in which Gallagher does business, Gallagher and/or an employee is required to be licensed or receive regulatory approval in order for Gallagher to conduct business. In addition to licensing requirements applicable to Gallagher, most jurisdictions require that individuals who engage in brokerage and certain insurance service activities be personally licensed.

Gallagher's insurance brokerage and risk management operations depend on its continued good standing under the licenses and approvals pursuant to which it operates. Licensing laws and regulations vary from jurisdiction to jurisdiction. In all jurisdictions, the applicable licensing laws and regulations are subject to amendment or interpretation by regulatory authorities. Generally such authorities are vested with relatively broad and general discretion as to the granting, renewing and revoking of licenses and approvals.

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As previously discussed, on May 18, 2005, Gallagher and its subsidiaries and affiliates, except for Gallagher Bassett Services, Inc., entered into an Assurance of Voluntary Compliance (the AVC) with the Attorney General of the State of Illinois and the Director of Insurance of the State of Illinois (collectively, the IL State Agencies) to resolve all of the issues related to investigations conducted by the IL State Agencies. Under the AVC, Gallagher agreed to implement, to the extent not previously undertaken, certain business changes, including agreeing not to accept U.S.- domiciled retail contingent compensation as defined in the AVC. See Note 17 to the Consolidated Financial Statements of Gallagher's 2005 Financial Statements for a discussion of the material terms of the AVC.

Business Combinations

In 2005, Gallagher acquired the net assets of ten insurance brokerage firms (nine asset purchases and one stock purchase) in exchange for its common stock and/or cash and accounted for them as business combinations. See Note 4 to the Consolidated Financial Statements of Gallagher's 2005 Financial Statements, which are incorporated herein by reference for a summary of the 2005 acquisitions, the amount and nature of the consideration paid and the dates of acquisition.

Since December 31, 2005, Gallagher has completed one acquisition, which is as follows:

Effective on January 1, 2006, Gallagher acquired substantially all of the net assets of Benefit Management Group, Inc., a corporation engaged in the benefits insurance business, in exchange for 132,000 shares of Gallagher's common stock, cash of \$6.0 million and a contingent earnout obligation of \$8.5 million that, if any is earned, will be paid in cash or stock, at Gallagher's election.

Gallagher believes that the net effect of these acquisitions has been and will be to expand the volume of general services rendered by Gallagher and the geographical areas in which Gallagher renders such services and not to change substantially the nature of the services performed by Gallagher.

Gallagher is considering and intends to consider from time- to- time, additional acquisitions and divestitures on terms that it deems advantageous. Gallagher at this time is engaged in preliminary discussions with a number of candidates for possible future acquisitions. No assurances can be given that any additional acquisitions or divestitures will be consummated, or, if consummated, will be advantageous to Gallagher.

Employees

As of December 31, 2005, Gallagher employed approximately 8,100 employees, none of whom is represented by a labor union. Gallagher continuously reviews benefits and other matters of interest to its employees and considers its relations with its employees to be satisfactory.

Available Information

Gallagher makes available free of charge on its website at www.ajg.com its annual report on Form 10- K, quarterly reports on Form 10- Q, current reports on Form 8- K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after electronically filing or furnishing such material to the Securities and Exchange Commission.

Gallagher's Governance Guidelines, Audit Committee Charter, Compensation Committee Charter and Nominating/Governance Committee Charter are also available on our website or upon written or verbal request. Requests for copies of any of these documents should be directed in writing to Investor Relations, Arthur J. Gallagher & Co., Two Pierce Place, Itasca, Illinois 60143- 3141, or by telephone to (630) 773- 3800.

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Item 1A. Risk Factors.

Volatility or declines in premiums or other adverse trends in the insurance industry may seriously undermine Gallagher's profitability.

Gallagher derives much of its revenue from commissions and fees for brokerage and risk management services. Gallagher does not determine the insurance premiums on which its commissions are generally based. Moreover, insurance premiums are cyclical in nature and may vary widely based on market conditions. For example, for an extended period of years through late 2000, heavy competition for market share among insurance carriers, increased underwriting capacity and improved economies of scale following consolidations resulted in flat or reduced premium rates (a "soft" market), which in turn put downward pressure on Gallagher's commission revenue in many lines and in many geographic areas. After this period of time, the insurance industry transitioned to a "hard" market, in which premium rates were stable or increasing. This trend was accentuated by the events of September 11th, following which insurance coverage in many lines became less available and premium rates increased, in some cases dramatically. More recently, during 2004 and 2005, the market softened again in many lines and in many geographic areas. However, the abnormally high level of hurricane activity and other natural disasters in those years has hardened the market in certain geographic areas and business lines. Because of these market fluctuations for insurance products, which Gallagher cannot predict or control, its brokerage revenues and profitability may be volatile.

In addition, there have been and may continue to be various trends in the insurance industry toward alternative insurance markets including, among other things, greater levels of self- insurance, captives, rent- a- captives, risk retention groups and non- insurance capital markets- based solutions to traditional insurance. While Gallagher historically has been able to participate in certain of these activities on behalf of its customers, and obtain fee revenue for such services, there can be no assurance that Gallagher will realize revenues and profitability as favorable as what is realized from its traditional brokerage activities.

Gallagher's results may be adversely affected if it is unable to successfully implement a new business compensation model.

In October 2004, Gallagher announced that, effective January 1, 2005, it would not enter into any new volume- based or profit- based contingent commissions agreements as a retail broker. In connection with the elimination of contingent commissions, Gallagher established a new business compensation model and commission structure. This business compensation model and commission structure remains in its early stages, and there can be no assurance that it will generate incremental commission revenues equivalent to those previously received from contingent commissions. The inability to generate adequate revenues from Gallagher's new business compensation model and commission structure may significantly undermine Gallagher's operating results and profitability.

Gallagher is subject to a number of investigations and legal proceedings concerning contingent compensation, other industry practices and certain conduct, which, if determined unfavorably to Gallagher, could adversely affect its financial strength and results of operations.

Private parties have filed civil litigation against Gallagher under a variety of legal theories relating, among other things, to broker compensation practices. Gallagher is named as a defendant in a purported class action lawsuit pending in the Circuit Court of Cook County, Illinois, which challenges the propriety of alleged "undisclosed contingent commissions" paid pursuant to certain compensation arrangements between Gallagher and various insurance carriers. Additionally, Gallagher is one of a number of insurance brokerage and insurance company defendants in a Multi-District Litigation proceeding before the U.S. District Court for the District of New Jersey, and is party to various other litigation matters. Additionally, the insurance industry in general, and Gallagher individually, continue to be the subjects of a significant level of scrutiny by various regulatory bodies, including State Attorneys General and the departments of insurance for various states, with respect to contingent commission arrangements. On May 18, 2005, Gallagher and its subsidiaries and affiliates, except for Gallagher Bassett Services, Inc., entered into an Assurance of Voluntary Compliance (the AVC) with the Attorney General of the State of Illinois and the Director of Insurance of the State of Illinois (collectively, the IL State Agencies) to resolve all of the issues related to investigations conducted by the IL State Agencies, pursuant to which it paid \$26.9 million into a fund to be distributed to eligible retail customers by March 31, 2006, and agreed to undertake certain business changes. For a more detailed discussion of these matters refer to Note 17 to the Consolidated Financial Statements of Gallagher's 2005 Financial Statements.

The ultimate outcome of the matters referred to above and similar matters cannot be ascertained and liabilities in indeterminate amounts may be imposed on Gallagher. Gallagher's future results of operations or cash flows for any particular quarterly or annual period could be materially affected by an unfavorable resolution of these matters. In addition, even if Gallagher does not experience significant monetary costs, there has been and may continue to be adverse publicity associated with these matters that could result in reputational harm to Gallagher or to the insurance brokerage industry in general that may adversely affect Gallagher's business.

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Gallagher faces significant competitive pressures in each of its businesses.

The insurance brokerage and service business is highly competitive and there are many insurance brokerage and service organizations as well as individuals on a global basis who actively compete with Gallagher in one or more areas of its business. Gallagher competes with three firms that are as large or significantly larger than Gallagher in global risk management and brokerage markets. In addition, there are various other competing firms that operate nationally or that are strong in a particular region or locality and may have, in that region or locality, an office that is as large or larger than the particular local office of Gallagher. Gallagher believes that the primary factors determining its competitive position with other organizations in its industry are the quality of the services rendered and the overall costs to its clients. Losing business to competitors offering similar products at lower prices or having other competitive advantages would adversely affect Gallagher's business.

In addition, the increase in competition due to new legislative or industry developments could adversely affect Gallagher. These developments include:

- an increase in capital- raising by insurance underwriting companies, which could result in new capital in the industry which in turn may lead to a soft market and lower insurance premiums and commissions;

- the selling of insurance by insurance companies directly to insureds without the involvement of a broker or other intermediary;

- changes in Gallagher's business compensation model as a result of regulatory developments;

- the establishment of programs in which state- sponsored entities provide health insurance or, in certain cases, property insurance in catastrophe- prone areas or other alternative markets types of coverage;

- an increase in competition from newly- formed or existing insurance brokers who have not agreed to limit their use of contingent commission arrangements, thereby giving them a competitive advantage over those brokers, such as Gallagher, which have agreed to limit the use of such arrangements; and

- the creation of in- house servicing capabilities by insurance companies or by certain insurance consumers which compete with the third party administration and other administration, servicing and risk management products offered by Gallagher's Risk Management Segment.

New competition as a result of these or other competitive or industry developments could cause the demand for Gallagher's products and services to change, which could in turn could adversely affect Gallagher's results of operations and financial condition.

Gallagher faces a variety of risks from its Gallagher Bassett Services operations which are distinct from those it faces in its brokerage operations.

Gallagher's Risk Management Segment, which accounted for approximately 25% of Gallagher's total 2005 revenues, operates primarily through its subsidiary, Gallagher Bassett Services (GB). GB is a third party administrator and risk consultant that provides a range of risk management services, including claims management, risk control consulting services, information management and property appraisals. While GB's business has little exposure to the hard and soft market cycles described above to which Gallagher's brokerage business is exposed, GB faces a variety of other risks which are unique to its operations, including:

- the risk that the favorable trend among insureds toward outsourcing of various types of claims administration and risk management services will reverse or slow, causing GB to experience reduced revenues or a reduced rate of revenue growth;

- the risk that contracting terms will become less favorable or that the margins on GB's services will be decreased due to increased competition, regulatory constraints or other developments;

- the risk that GB cannot satisfy regulatory requirements on third party administrators or that regulatory developments will impose additional burdens, costs or business restrictions that make GB's business less attractive; and

- the risk that GB cannot control its labor and technology costs in such a manner as to remain competitive in the marketplace for claims administration and risk management services and to conclude its existing contracts (other than those that provide cost- plus or other margin protection) in a cost- efficient and profitable manner.

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Gallagher's business, results of operations, financial condition or liquidity may be materially adversely affected by errors and omissions and the outcome of certain actual and potential claims, lawsuits and proceedings.

Gallagher may be subject to various actual and potential claims, lawsuits and other proceedings relating principally to alleged errors and omissions in connection with the placement of insurance and reinsurance in the ordinary course of business. Because Gallagher often assists clients with matters involving substantial amounts of money, including the placement of insurance coverage and the handling of related claims, errors and omissions claims against Gallagher may arise which allege potential liability for all or part of the amounts in question. Claimants may seek large damage awards and these claims may involve potentially significant legal costs.

Gallagher purchases insurance to provide protection from errors and omissions claims that may arise in the ordinary course of business, subject to self-insured deductibles and limits. As of December 31, 2005, the amount of Gallagher's deductible and limit for claims were \$5.0 million and \$155.0 million, respectively. Gallagher's business, results of operations, financial condition and liquidity may be adversely affected if, in the future, its insurance coverage proves to be inadequate or unavailable or there is a general increase in the number or amounts of claims to which Gallagher is exposed. Gallagher's future ability to obtain professional indemnity insurance in the amounts and with the deductibles and limits it desires may be adversely impacted by general developments in the market for such insurance or Gallagher's own claims experience. In addition, claims, lawsuits and other proceedings may harm Gallagher's reputation or divert management resources away from operating its business.

Gallagher historically has engaged in a large number of acquisitions of insurance brokers and agencies. Gallagher may not be able to continue to implement such an acquisition strategy in the future and there are risks associated with such acquisitions.

In the past several years, Gallagher has completed numerous acquisitions of insurance brokers and agencies and may continue to make such acquisitions in the future. Gallagher's acquisition program has been an important part of its historical growth and Gallagher believes that similar acquisition activity will be critical to maintaining comparable growth in the future. Failure to successfully identify and complete acquisitions likely will result in Gallagher achieving slower growth. Various factors may affect Gallagher's ability to attract acquisition targets, including Gallagher's inability to continue certain contingent commission compensation structures, particularly in light of the fact that certain other companies in the insurance brokerage industry are not limited in this manner. Moreover, even if Gallagher is able to identify appropriate acquisition targets, it may not be able to execute acquisition transactions on favorable terms or integrate such targets following acquisition in a manner which allows Gallagher to realize the anticipated benefits of such acquisitions, thereby negatively affecting Gallagher's results of operations or leading to unanticipated contingent liabilities and losses.

Gallagher is subject to insurance industry regulation worldwide. If Gallagher fails to comply with regulatory requirements or if regulations change in a way that adversely affects Gallagher's operations, Gallagher may not be able to conduct its business or may be less profitable.

Many of Gallagher's activities are subject to regulatory supervision. Failure to comply with some of these regulations could lead to disciplinary action, that may include requiring clients to be compensated for loss, the imposition of penalties and the revocation of Gallagher's authorization to operate. In addition, changes in legislation or regulations and actions by regulators, including changes in administration and enforcement policies, could from time-to-time require operational changes which could result in lost revenues or higher costs or hinder Gallagher's ability to operate its business.

Gallagher's future success depends, in part, on its ability to attract and retain experienced and qualified personnel.

Gallagher believes that its future success depends, in part, on its ability to attract and retain experienced personnel, including its senior management, brokers and other key personnel. The insurance brokerage industry has experienced intense competition for the services of leading brokers, and Gallagher has lost key brokers to competitors in the past. The loss of any of its senior managers, brokers or other key personnel, or its inability to identify, recruit and retain such personnel, could materially and adversely affect Gallagher's business, operating results and financial condition.

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Gallagher has significant non- U.S. operations which expose it to certain additional risks, including the risk of exchange rate fluctuations and geopolitical risk.

A significant portion of Gallagher's operations is conducted outside the U.S. Accordingly, Gallagher is subject to legal, economic and market risks associated with operating in foreign countries. Operating in these countries may present risks that are different from, or greater than, risks to Gallagher of doing comparable business in the U.S.

Some of Gallagher's foreign subsidiaries receive revenues or incur obligations in currencies that differ from their functional currencies. Gallagher must also translate the financial results of its foreign subsidiaries into U.S. dollars. Although Gallagher implemented a foreign currency hedging strategy in 2005, such risks cannot be eliminated entirely, and significant changes in exchange rates may adversely affect Gallagher's results of operations.

Gallagher also operates in certain countries where the risk of political and economic uncertainty is relatively greater than that present in the U.S. and more established countries. Gallagher's operations in these countries may be temporarily or permanently disrupted by adverse geopolitical or economic conditions in these locations. For example, Gallagher uses a third- party service provider located in India for certain back office services. To date, the dispute between India and Pakistan involving the Kashmir region, incidents of terrorism in India and general geopolitical uncertainties have not adversely affected Gallagher's infrastructure in India. However, such factors could potentially affect Gallagher's infrastructure or ability to utilize third- party providers in the future. Should Gallagher's access to these services be disrupted, Gallagher's business, operating results and financial condition could be adversely affected.

Gallagher is exposed to various risks relating to losses on investments held by its Financial Services business.

Gallagher's Financial Services business holds a variety of investments, including (i) an interest in a holding company that holds interests in private investment management firms, (ii) early- stage loans, partnership interests relating to low income housing developments and an ownership interest in a low income housing developer and syndicator, (iii) investments in partnerships formed to develop energy that qualifies for tax credits under Internal Revenue Code (IRC) Section 29 and (iv) certain other real estate and other investments. These investments are subject to risk of impairment due to a variety of causes, including general overall economic conditions, the effects of changes in interest rates, various regulatory issues, credit risk, failure to monetize in an effective and/or cost- efficient manner and poor operating results. Any of these consequences may diminish the value of Gallagher's invested assets and adversely affect its net worth and profitability.

Gallagher has historically benefited from Section 29 tax credits. The disallowance or termination of Section 29 tax credits, or the loss of all or part of its Section 29 tax credits due to phase out of such credits, would decrease Gallagher's revenues, increase its costs, increase its effective tax rate and decrease its income.

Under current law, IRC Section 29 tax credits are not available for synthetic fuel sold after December 31, 2007, and, if the law is not extended, Gallagher's effective federal income tax rate in 2008 will likely adjust upward to fall within a range of approximately 35.0% to 42.0%. In addition, there have been initiatives from time- to- time to consider the early repeal or modification of IRC Section 29, and the IRS is continuing to audit taxpayers claiming Syn/Coal Credits with respect to a variety of issues. In addition, through December 31, 2007, IRC Section 29 has a phase- out provision that is triggered when domestic crude oil reaches certain "Phase- out Prices" as determined by the IRS. For calendar year 2006, Gallagher estimates that the commonly reported crude oil price (NYMEX price) would need to average approximately \$60.00 per barrel for calendar 2006 for any phase- out to begin and average approximately \$74.00 per barrel for calendar 2006 for a complete phase- out. The average daily NYMEX Price for 2006 through January 30 was \$65.41 per barrel.

There can be no assurance that future oil prices will be below future phase- out levels. Should Gallagher or its partners anticipate that oil prices may reach the range of Phase- out Prices in 2006 or in 2007, some or all of Gallagher's IRC Section 29 operations could be curtailed, resulting in Gallagher losing tax credits, realizing a higher effective tax rate for federal income tax purposes and triggering indemnification payment obligations under various agreements which Gallagher has with its investment partners. For further information about the negative effects these contingencies could have on Gallagher's results of operations, see the discussion on IRC Section 29 tax credits included in Management's Discussion and Analysis of Financial Condition and Results of Operations, which is included in Gallagher's 2005 Financial Statements under the caption entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and is incorporated herein by reference.

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Item 2. Properties.

Gallagher's executive offices and certain subsidiary and branch facilities are located at Two Pierce Place, Itasca, Illinois, where Gallagher leases approximately 308,000 square feet of space, or approximately 60% of the building. The lease commitment on this property expires February 28, 2011. Gallagher has a 60% ownership interest in the limited partnership that owns the Two Pierce Place property. This investment is consolidated into Gallagher's Consolidated Financial Statements. See Notes 3, 8 and 17 to the Consolidated Financial Statements of Gallagher's 2005 Financial Statements, which are incorporated herein by reference for additional information with respect to this ownership interest.

Gallagher generally operates in leased premises. Certain office space leases have options permitting renewals for additional periods. In addition to minimum fixed rentals, a number of leases contain annual escalation clauses generally related to increases in an inflation index. See Note 17 to the Consolidated Financial Statements of Gallagher's 2005 Financial Statements, which is incorporated herein by reference for information with respect to Gallagher's lease commitments at December 31, 2005.

Item 3. Legal Proceedings.

Information regarding legal proceedings of Gallagher is included in Note 17 (Litigation) to the Consolidated Financial Statements of Gallagher's 2005 Financial Statements and is incorporated herein by reference.

Item 4. Submission of Matters to a Vote of Security Holders.

No matters were submitted to a vote of security holders during Gallagher's fourth quarter ended December 31, 2005.

Item 4A. Executive Officers of the Registrant.

The executive officers of Gallagher are as follows:

<u>Name</u>	<u>Age</u>	<u>Position and Year First Elected</u>
Robert E. Gallagher	83	Chairman since 1990, Chief Executive Officer from 1963 until 1995
J. Patrick Gallagher, Jr.	54	President since 1990, Chief Executive Officer since 1995
Elizabeth J. Brinkerhoff	62	Vice President since 1993
Richard C. Cary	43	Controller since 1997, Chief Accounting Officer since 2001, Acting Chief Financial Officer September 2002 to April 2003
James W. Durkin, Jr.	56	Vice President since 1985, President of GBS since 1985
Nicholas M. Elsberg	63	Vice President since 1994
James S. Gault	54	Vice President since 1992, President and Chief Operating Officer of BSD since June 2002
Douglas K. Howell	44	Vice President since March 2003 and Chief Financial Officer since April 2003
David E. McGurn, Jr.	53	Vice President since 1993, President of SMI since 2001
Richard J. McKenna	59	Vice President since 1994, President of GB since 2000
John C. Rosengren	59	Vice President and General Counsel since 1995, Secretary since 2002

With the exception of Mr. Howell, each such person has been principally employed by Gallagher in management capacities for more than the past five years. All executive officers are elected annually and serve at the pleasure of the Board of Directors.

Prior to joining Gallagher on March 3, 2003, Mr. Howell was employed as Senior Vice President and Chief Financial Officer of 21st Century Insurance Group (NYSE:TW) from April 2001 to February 2003 and prior thereto as Senior Vice President and Chief Financial Officer of GuideOne Insurance Group since 1997.

Part II

Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Gallagher's common stock is listed on the New York Stock Exchange, trading under the symbol "AJG." The following table sets forth information as to the price range of Gallagher's common stock for the two- year period January 1, 2004 through December 31, 2005 and the dividends declared per common share for such period. The table reflects the range of high and low sales prices per share as reported on the New York Stock Exchange composite listing.

	High	Low	Dividends Declared per Common Share
Quarterly Periods			
2005			
First	\$ 32.85	\$ 28.55	\$.28
Second	29.15	26.48	.28
Third	29.78	26.54	.28
Fourth	31.94	28.16	.28
2004			
First	\$ 34.25	\$ 30.77	\$.25
Second	33.97	30.13	.25
Third	33.50	28.87	.25
Fourth	34.10	24.42	.25

As of December 31, 2005, there were approximately 900 holders of record of Gallagher's common stock.

Issuer Purchases of Equity Securities (in thousands, except per share data)

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs
October 1 to October 31, 2005	-	\$ -	-	5,000.0
November 1 to November 30, 2005	-	-	-	5,000.0
December 1 to December 31, 2005	-	-	-	5,000.0
Total	-	\$ -	-	

- (1) As set forth in its public filings, Gallagher has a common stock repurchase plan that was adopted by the Board of Directors on May 10, 1988 and has been periodically amended since that date to authorize additional shares for repurchase. On July 21, 2005, Gallagher announced the continuation of the repurchase plan, bringing the cumulative total repurchase authorization to 5.0 million shares. Under the provisions of the repurchase plan, as of December 31, 2005, Gallagher continues to have the capacity to repurchase approximately 5.0 million shares. There is no expiration date for the plan and Gallagher is under no commitment or obligation to repurchase any particular amount of common stock under the plan. At its discretion Gallagher may suspend the repurchase plan at any time.

Information relating to the compensation plans under which equity securities of Gallagher are authorized for issuance is included in the disclosure set forth under the caption "Equity Compensation Plan Information" in Gallagher's 2006 Proxy Statement and is incorporated herein by reference.

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Item 6. Selected Financial Data.

The following selected consolidated financial data for each of the five years in the period ended December 31, 2005 have been derived from Gallagher's Consolidated Financial Statements. Such data should be read in conjunction with Gallagher's Consolidated Financial Statements and related notes thereto, which have been incorporated by reference in Item 8 of this annual report.

	Year Ended December 31,				
	2005	2004	2003	2002	2001
(In millions, except per share and employee data)					
Consolidated Statement of Earnings Data:					
Commissions	\$ 813.1	\$ 760.6	\$ 705.5	\$ 621.8	\$ 502.9
Fees	537.5	490.0	418.7	352.2	293.1
Investment income and other	133.3	186.4	96.9	46.6	53.4
Total revenues	1,483.9	1,437.0	1,221.1	1,020.6	849.4
Total expenses before litigation and contingent commission matters and claims handling obligations	1,267.1	1,199.7	1,028.3	836.0	712.3
Litigation and contingent commission matters and claims handling obligations	219.6	-	-	-	-
Earnings before income taxes	(2.8)	237.3	192.8	184.6	137.1
Provision (benefit) for income taxes	(31.4)	47.8	46.9	55.2	14.6
Earnings from continuing operations	28.6	189.5	145.9	129.4	122.5
Earnings (loss) on discontinued operations, net of income taxes	2.2	(1.0)	0.3	0.5	2.8
Net earnings	\$ 30.8	\$ 188.5	\$ 146.2	\$ 129.9	\$ 125.3
Per Share Data:					
Diluted earnings from continuing operations per share (1)	\$.30	\$ 2.00	\$ 1.57	\$ 1.41	\$ 1.36
Diluted net earnings per share (1)	.32	1.99	1.57	1.41	1.39
Dividends declared per common share (2)	1.12	1.00	.72	.60	.52
Share Data:					
Shares outstanding at year end	95.7	92.1	90.0	88.5	85.1

Weighted average number of common shares outstanding	94.1	91.5	90.0	87.3	84.8
Weighted average number of common and common equivalent shares outstanding	96.1	94.5	93.3	91.9	90.1
Consolidated Balance Sheet Data:					
Total assets	\$ 3,389.5	\$ 3,233.3	\$ 2,900.4	\$ 2,463.5	\$ 2,145.3
Long- term debt less current portion	107.6	140.0	122.1	128.3	96.7
Total stockholders' equity	769.1	761.0	619.1	528.2	371.6
Return on beginning tangible net worth (3)	8%	48%	37%	42%	40%
Employee Data:					
Number of employees at year end	8,135	7,840	6,808	6,664	6,092
Total revenue per employee (4)	\$ 182,000	\$ 183,000	\$ 179,000	\$ 153,000	\$ 139,000
Earnings from continuing operations before litigation and contingent commission matters and claims handling obligations per employee (4) (5)	\$ 21,000	\$ 24,000	\$ 21,000	\$ 19,000	\$ 20,000

- (1) Based on the weighted average number of common and common equivalent shares outstanding during the year.
- (2) Based on the total dividends declared on a share of common stock outstanding during the entire year.
- (3) Represents net earnings divided by total stockholders' equity, less net balance of goodwill and amortizable intangible assets, as of the beginning of the year.
- (4) Based on the number of employees at year end.
- (5) Represents the earnings from continuing operations before the after tax impact of litigation and contingent commission matters and claims handling obligations related charges.

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Certain Non- GAAP Financial Measures. The line item in the preceding selected financial data table entitled "Earnings from continuing operations before litigation and contingent commission matters and claims handling obligations per employee" may be considered a "non- GAAP financial measure" within the meaning of SEC regulations because it is derived from Gallagher's consolidated financial information but is not required to be presented in financial statements that are prepared in conformity with U.S. generally accepted accounting principles (GAAP). Consistent with SEC regulations, a description of such information is provided in the table above and a reconciliation of certain of such items to GAAP is provided herein. Charges in 2005 related to litigation related matters, retail contingent commission related matters and claims handling obligations totaled \$131.0 million (or \$84.2 million after tax), \$73.6 million (or \$44.2 million after tax) and \$15.0 million (or \$9.8 million after tax), respectively. There were no such items in 2001 to 2004. These amounts, which Gallagher believes are non- recurring, were added back to earnings from continuing operations in 2005 in order to calculate earnings from continuing operations before litigation and contingent commission related matters and claims handling obligations per employee.

Gallagher believes the items included above provide meaningful additional information, which may be helpful to investors in assessing certain aspects of Gallagher's operating performance and financial condition that may not be otherwise apparent from GAAP. Industry peers provide similar supplemental information, although they may not use the same or comparable terminology and may not make identical adjustments. This non- GAAP information should be used in addition to, but not as a substitute for, the GAAP information.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Information regarding Management's Discussion and Analysis of Financial Condition and Results of Operations is included in Gallagher's 2005 Financial Statements under the caption entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and is incorporated herein by reference. All of such information should be read in conjunction with Gallagher's Consolidated Financial Statements and related notes thereto, which have been incorporated by reference in Item 8 of this annual report.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

Information regarding Quantitative and Qualitative Disclosures about Market Risk is included in Gallagher's 2005 Financial Statements under the caption entitled "Quantitative and Qualitative Disclosures about Market Risk" and is incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data.

Gallagher's Consolidated Financial Statements, the related notes thereto and Report of Independent Registered Public Accounting Firm are included in Gallagher's 2005 Financial Statements and are incorporated herein by reference.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

There were no changes in or disagreements with accountants on accounting and financial disclosure.

Item 9A. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures.

As of December 31, 2005, Gallagher's management, including Gallagher's Chief Executive Officer (CEO) and Chief Financial Officer (CFO), have conducted an evaluation of the effectiveness of its disclosure controls and procedures pursuant to Rule 13a- 15(b) of the Exchange Act. Based on that evaluation, the CEO and CFO concluded that Gallagher's disclosure controls and procedures are effective in ensuring that all material information required to be filed in this annual report has been made known to them in a timely manner.

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Design and Evaluation of Internal Control Over Financial Reporting.

Pursuant to Section 404 of the Sarbanes- Oxley Act of 2002, Gallagher included a report of management's assessment of the design and effectiveness of its internal controls as part of this Annual Report on Form 10- K for the fiscal year ended December 31, 2005. The independent registered public accounting firm of Gallagher also attested to, and reported on, management's assessment of the effectiveness of internal control over financial reporting. Management's report and the independent registered public accounting firm's attestation report are included in Gallagher's 2005 Financial Statements under the captions entitled "Management's Report on Internal Control Over Financial Reporting" and "Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting" and are incorporated herein by reference.

Changes in Internal Control Over Financial Reporting.

There has been no change in Gallagher's internal control over financial reporting during fourth fiscal quarter ended December 31, 2005 that has materially affected, or is reasonably likely to materially affect, Gallagher's internal control over financial reporting.

Item 9B. Other Information.

Not applicable.

Part III

Item 10. Directors and Executive Officers of the Registrant.

Information regarding directors and nominees for directors of Gallagher is included under the caption entitled "Election of Directors" in the 2006 Proxy Statement and is incorporated herein by reference. Information regarding executive officers of Gallagher is included under the caption entitled "Executive Officers of the Registrant" in Part I of this annual report. Information regarding Gallagher's Audit Committee is included under the caption entitled "Board of Directors and Committees - Audit Committee" in the 2006 Proxy Statement and is incorporated herein by reference.

The Board of Directors has determined that Gary P. Coughlan qualifies as an Audit Committee financial expert, as such term is defined in rules of the Securities and Exchange Commission implementing requirements of the Sarbanes- Oxley Act of 2002.

Gallagher has adopted a Code of Business Conduct and Ethics that applies to all of Gallagher's employees and directors, including its principal executive officer, principal financial officer and principal accounting officer. Gallagher's Code of Business Conduct and Ethics covers all areas of professional conduct including, but not limited to, conflicts of interest, disclosure obligations, insider trading, confidential information, as well as compliance with all laws, rules and regulations applicable to Gallagher's business.

A copy of Gallagher's Code of Business Conduct and Ethics is posted on its website at www.ajg.com. In the event that an amendment to, or a waiver from, a provision of Gallagher's Code of Business Conduct and Ethics that applies to any of Gallagher's officers or directors is necessary, Gallagher intends to post such information on its website.

Gallagher undertakes to provide without charge to any person, upon written or verbal request of such person, a copy of Gallagher's Code of Business Conduct and Ethics. Requests should be directed in writing to Investor Relations, Arthur J. Gallagher & Co., Two Pierce Place, Itasca, Illinois 60143-3141, or by telephone to (630) 773- 3800.

There have been no material changes to the procedures by which stockholders may recommend nominees to Gallagher's Board of Directors since Gallagher's disclosure of such procedures under the caption entitled "Corporate Governance- Nomination of Directors" in the 2005 Proxy Statement.

Item 11. Executive Compensation.

Information regarding executive compensation of Gallagher's directors and executive officers is included in the 2006 Proxy Statement under the caption entitled "Compensation of Executive Officers and Directors," and is incorporated herein by reference; except that the report of the Compensation Committee on executive compensation and the stock performance graph shall not be deemed to be incorporated herein by reference.

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Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Information regarding beneficial ownership of the Common Stock by certain beneficial owners and by management of Gallagher is included under the caption entitled "Principal Holders of Securities" in the 2006 Proxy Statement and is incorporated herein by reference.

Information regarding the number of shares of Common Stock available under Gallagher's equity compensation plans is included under the caption entitled "Equity Compensation Plan Information" in the 2006 Proxy Statement and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions.

Information relating to relationships and related transactions is included under the heading "Certain Relationships and Related Transactions" in Gallagher's 2006 Proxy Statement and is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services.

Information regarding principal accountant services is included in the 2006 Proxy Statement under the caption entitled "Principal Accountant Fees and Services," and is incorporated herein by reference.

Part IV

Item 15. Exhibits and Financial Statement Schedules.

The following documents are filed as a part of this report:

1. Consolidated Financial Statements from Gallagher's 2005 Financial Statements which are incorporated herein by reference:
 - (a) Consolidated Statement of Earnings for each of the three years in the period ended December 31, 2005.
 - (b) Consolidated Balance Sheet as of December 31, 2005 and 2004.
 - (c) Consolidated Statement of Cash Flows for each of the three years in the period ended December 31, 2005.
 - (d) Consolidated Statement of Stockholders' Equity for each of the three years in the period ended December 31, 2005.
 - (e) Notes to Consolidated Financial Statements.
 - (f) Report of Independent Registered Public Accounting Firm on Financial Statements.
 - (g) Management's Report on Internal Control Over Financial Reporting.
 - (h) Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting.
2. Consolidated Financial Statement Schedules required to be filed by Item 8 of this Form:
 - (a) Schedule II - Valuation and Qualifying Accounts.

All other schedules are omitted because they are not applicable, or not required, or because the required information is included in the Consolidated Financial Statements or the Notes thereto.

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3. Exhibits:

Included in this Form 10- K.

10.5.1	Amendments No. 1 to No. 15 to the Lease Agreement between Arthur J. Gallagher & Co. and HGC/Two Pierce Limited Partnership, an Illinois limited partnership, as successor to Itasca Center III Limited Partnership, a Texas limited partnership, dated May 20, 1991 to October 15, 2005.
*10.15.1	First Amendment to the Arthur J. Gallagher & Co. Supplemental Savings and Thrift Plan.
*10.15.2	Second Amendment to the Arthur J. Gallagher & Co. Supplemental Savings and Thrift Plan.
*10.16.1	First Amendment to the Arthur J. Gallagher & Co. Deferred Equity Participation Plan.
10.38	Operating Agreement of Chem- Mod LLC dated as of June 23, 2004, by and among NOx II, Ltd., an Ohio limited liability company, AJG Coal, Inc., a Delaware corporation, and IQ Clean Coal LLC, a Delaware limited liability company.
10.39	Option Agreement among Carolyn Kelly, NOx II, Ltd., an Ohio limited liability company, and AJG Financial Services, Inc., a wholly- owned subsidiary of Arthur J. Gallagher & Co. dated October 17, 2005.
10.40	Operating Agreement of Chem- Mod International LLC dated as of July 8, 2005, between NOx II International, Ltd., an Ohio limited liability company and AJG Coal, Inc., a Delaware corporation, together with Amendment No. 1 dated August 2, 2005.
13.0	Gallagher's 2005 Financial Statements.
21.0	Subsidiaries of Gallagher, including state or other jurisdiction of incorporation or organization and the names under which each does business.
23.1	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.
24.0	Powers of Attorney.
31.1	Rule 13a- 14(a) Certification of Chief Executive Officer.
31.2	Rule 13a- 14(a) Certification of Chief Financial Officer.
32.1	Section 1350 Certification of Chief Executive Officer.
32.2	Section 1350 Certification of Chief Financial Officer.

Not included in this Form 10- K.

3.1	Restated Certificate of Incorporation of Gallagher (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 1996, File No. 1- 9761).
3.1.1	Certificate of Amendment of Restated Certificate of Incorporation of Arthur J. Gallagher & Co., Amended as of May 18, 2000 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 2000, File No. 1- 9761).
3.1.2	Certificate of Amendment of Restated Certificate of Incorporation of Arthur J. Gallagher & Co., Amended as of May 23, 2001 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 2001, File No. 1- 9761).
3.2	By- Laws of Gallagher (incorporated by reference to the same exhibit number to Gallagher's Form S- 1 Registration Statement No. 33- 10447).
3.3	Rights Agreement between Gallagher and Bank of America Illinois (formerly Continental Illinois National Bank and Trust Company of Chicago) (incorporated by reference to Exhibits 1 and 2 to Gallagher's Form 8- A Registration Statement filed May 12, 1987, File No. 0- 13480).
3.4	Assignment and Assumption Agreement of Rights Agreement by and among Bank of America Illinois (formerly Continental Illinois National Bank and Trust Company of Chicago), Harris Trust and Savings Bank and Gallagher (incorporated by reference to the same exhibit number to Gallagher's Form S- 8 Registration Statement No. 33- 38031).

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3.5	Amendment No. 1 to Exhibit 3.3 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 1996, File No. 1- 9761).
3.6	Amendment No. 2 to Exhibit 3.3 (incorporated by reference to Exhibit 4.4 to Gallagher's Form 8- A/A Registration Statement filed on April 20, 2004, File No. 1- 9761).
3.7	Amendment to Exhibit 3.3 (incorporated by reference to Exhibit 4.5 to Gallagher's Form 8- A/A Registration Statement filed on April 20, 2004, File No. 1- 9761).
4.1	Instruments defining the rights of security holders (relevant portions contained in the Restated Certificate of Incorporation and By- Laws of Gallagher and the Rights Agreement in Exhibits 3.1, 3.2, and 3.3, respectively, hereby incorporated by reference).
10.1	Assurance of Voluntary Compliance between the Attorney General of the State of Illinois and the Director of Insurance of the State of Illinois and Arthur J. Gallagher & Co., dated May 18, 2005 (incorporated by reference to the same exhibit number to Gallagher's Form 8- K Current Report dated May 18, 2005, File No. 1- 9761).
10.5	Lease Agreement between Arthur J. Gallagher & Co. and Itasca Center III Limited Partnership, a Texas limited partnership, dated July 26, 1989 (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 1989, File No. 1- 9761).
10.7	Letter dated December 31, 1983 from Arthur J. Gallagher & Co. to Bank of America Illinois (formerly Continental Illinois National Bank and Trust Company of Chicago) regarding Common Stock Purchase Financing Program including exhibits thereto and related letters (incorporated by reference to the same exhibit number to Gallagher's Form S- 1 Registration Statement No. 2- 89195).
10.7.1	Amendment to Exhibit No. 10.7 dated September 11, 1985 (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 1985, File No. 0- 13480).
10.8	Multicurrency Credit Agreement dated as of October 5, 2005 among Arthur J. Gallagher & Co., the Guarantors Party thereto, the Lenders party thereto, Harris N.A., as Administrative Agent, Citibank, N.A., as Syndication Agent, and Barclays Bank PLC, as Documentation Agent (incorporated by reference to the Exhibit 10.1 to Gallagher's Form 8- K Current Report dated October 5, 2005, File No. 1- 9761).
*10.10	Board of Directors' Resolution from meeting on January 26, 1984 relating to consulting and retirement benefits for certain directors (incorporated by reference to the same exhibit number to Gallagher's Form S- 1 Registration Statement No. 2- 89195).
*10.11	Form of Indemnity Agreement between Gallagher and each of its directors and corporate officers (incorporated by reference to Attachment A to Gallagher's Proxy Statement dated April 10, 1987 for its Annual Meeting of Stockholders, File No. 0- 13480).
*10.14	Form of Change in Control Agreement between Gallagher and each of its Executive Officers (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 1998, File No. 1- 9761).
*10.15	Arthur J. Gallagher & Co. Supplemental Savings and Thrift Plan (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 1999, File No. 1- 9761).
*10.16	Arthur J. Gallagher & Co. Deferred Equity Participation Plan and Deferred Equity Trust Agreement dated March 22, 2001 (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2000, File No. 1- 9761).
*10.18	Promissory Note dated March 15, 2001 in the principal amount of \$2,382,900 from Michael J. Cloherty, payable to Gallagher (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2000, File No. 1- 9761).
*10.19	Employment Agreement dated January 1, 1999 between Gallagher and James J. Braniff III (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2000, File No. 1- 9761).
*10.20	Secured Promissory Note dated June 19, 1996 in the principal amount of \$1,155,000 from James J. Braniff III, payable to Gallagher (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2000, File No. 1- 9761).

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*10.21	Promissory Note dated February 1, 1999 in the principal amount of \$100,000 from James J. Braniff III, payable to Gallagher (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2000, File No. 1- 9761).
*10.22	Arthur J. Gallagher & Co. Brokerage Services Division Management Bonus Plan Amended and Restated as of March 21, 2002 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended March 31, 2002, File No. 1- 9761).
*10.22.1	Employment Agreement dated September 3, 2002 between Gallagher and Michael J. Cloherty (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended September 30, 2002, File No. 1- 9761).
*10.25	Arthur J. Gallagher & Co. United Kingdom Incentive Stock Option Plan, Amended and restated as of January 22, 1998 and approved by the Inland Revenue on June 12, 1998 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 1998, File No. 1- 9761).
*10.26	Arthur J. Gallagher & Co. 1988 Incentive Stock Option Plan, Amended and restated as of May 19, 1998 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 1998, File No. 1- 9761).
*10.26.1	Amendment No. 1 to the Arthur J. Gallagher & Co. Restated 1988 Incentive Stock Option Plan, Amended as of January 19, 2005 (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2004, File No. 1- 9761).
*10.27	Arthur J. Gallagher & Co. 1988 Nonqualified Stock Option Plan, Amended and restated as of January 22, 1998 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 1998, File No. 1- 9761).
*10.27.1	Amendment No. 1 to the Arthur J. Gallagher & Co. Restated 1988 Nonqualified Stock Option Plan, Amended as of January 20, 2000 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 2000, File No. 1- 9761).
*10.27.2	Amendment No. 2 to the Arthur J. Gallagher & Co. Restated 1988 Nonqualified Stock Option Plan, Amended as of January 18, 2001 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 2001, File No. 1- 9761).
*10.27.3	Amendment No. 3 to the Arthur J. Gallagher & Co. Restated 1988 Nonqualified Stock Option Plan, Amended as of January 17, 2002 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 2002, File No. 1- 9761).
*10.27.4	Amendment No. 4 to the Arthur J. Gallagher & Co. Restated 1988 Nonqualified Stock Option Plan, Amended as of January 23, 2003 (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2003, File No. 1- 9761).
*10.27.5	Amendment No. 5 to the Arthur J. Gallagher & Co. Restated 1988 Nonqualified Stock Option Plan, Amended as of January 22, 2004 (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2004, File No. 1- 9761).
*10.27.6	Amendment No. 6 to the Arthur J. Gallagher & Co. Restated 1988 Nonqualified Stock Option Plan, Amended as of January 19, 2005 (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2004, File No. 1- 9761).
*10.28	Arthur J. Gallagher & Co. 1989 Non- Employee Directors' Stock Option Plan, Amended and restated as of January 22, 1998 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 1998, File No. 1- 9761).
*10.28.1	Amendment No. 2 to the Arthur J. Gallagher & Co. Restated 1989 Non- Employee Directors' Stock Option Plan, Amended as of January 20, 2000 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 2000, File No. 1- 9761).

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*10.28.2	Amendment No. 3 to the Arthur J. Gallagher & Co. Restated 1989 Non- Employee Directors' Stock Option Plan, Amended as of January 18, 2001 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 2001, File No. 1- 9761).
*10.28.3	Amendment No. 4 to the Arthur J. Gallagher & Co. Restated 1989 Non- Employee Directors' Stock Option Plan, Amended as of January 17, 2002 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 2002, File No. 1- 9761).
*10.28.4	Amendment No. 5 to the Arthur J. Gallagher & Co. Restated 1989 Non- Employee Directors' Stock Option Plan, Amended as of January 23, 2003 (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2003, File No. 1- 9761).
*10.28.5	Amendment No. 6 to the Arthur J. Gallagher & Co. Restated 1989 Non- Employee Directors' Stock Option Plan, Amended as of May 17, 2005. (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 2005, File No. 1- 9761).
*10.29	Arthur J. Gallagher & Co. Restricted Stock Plan (incorporated by reference to Exhibit 4.6 to Gallagher's Form S- 8 Registration Statement, No. 333- 106539).
*10.30	Arthur J. Gallagher & Co. Employee Stock Purchase Plan (incorporated by reference to Exhibit A of Gallagher's Proxy Statement dated April 7, 2003 for its Annual Meeting of Stockholders, File No. 1- 9761).
*10.30.1	Amendment No. 1 to the Arthur J. Gallagher & Co. Employee Stock Purchase Plan, Amended as of January 19, 2005 (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2004, File No. 1- 9761).
*10.31	Form of Agreement for Stock Option Grants under the Arthur J. Gallagher & Co. Restated 1988 Incentive Stock Option Plan (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2004, File No. 1- 9761).
*10.32	Form of Agreement for Stock Option Grants under the Arthur J. Gallagher & Co. Restated 1988 Nonqualified Stock Option Plan (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2004, File No. 1- 9761).
*10.33	Form of Agreement for Stock Option Grants under the Arthur J. Gallagher & Co. Restated 1989 Non- Employee Directors' Stock Option Plan (Retainer Grant) Plan (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2004, File No. 1- 9761).
*10.34	Form of Agreement for Stock Option Grants under the Arthur J. Gallagher & Co. Restated 1989 Non- Employee Directors' Stock Option Plan (Discretionary Grant) Plan (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2004, File No. 1- 9761).
*10.35	Form of Agreement for Restricted Stock Awards under the Arthur J. Gallagher & Co. Restricted Stock Plan (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2004, File No. 1- 9761).
10.36	Purchase and Sale Agreement Dated as of March 22, 2005, entered into by and among AJG Financial Services, Inc., a wholly- owned subsidiary of Arthur J. Gallagher & Co., Three E Corporation and SOF- HARMONY, L.L.C. (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended March 31, 2005, File No. 1- 9761).

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- 10.37 Settlement Agreement and Mutual Release Dated as of May 1, 2005 by and between Headwaters Incorporated (formerly known as Covol Technologies, Inc.), Square D Company, Arthur J. Gallagher & Co. and AJG Financial Services, Inc. (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended March 31, 2005, File No. 1- 9761).

All other exhibits are omitted because they are not applicable, or not required, or because the required information is included in the Consolidated Financial Statements or Notes thereto.

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- * Such exhibit is a management contract or compensatory plan or arrangement required to be filed as an exhibit to this form pursuant to item 601 of Regulation S- K.

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Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on the 8th day of February, 2006.

ARTHUR J. GALLAGHER & CO.

By /s/ J. PATRICK GALLAGHER, JR.

J. Patrick Gallagher, Jr.
*President and Chief Executive
Officer*

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on the 8th day of February, 2006 by the following persons on behalf of the Registrant in the capacities indicated.

<u>Name</u>	<u>Title</u>
*ROBERT E. GALLAGHER	Chairman and Director
Robert E. Gallagher	
/s/ J. PATRICK GALLAGHER, JR.	President and Director (Principal Executive Officer)
J. Patrick Gallagher, Jr.	
/s/ DOUGLAS K. HOWELL	Vice President and Chief Financial Officer (Principal Financial Officer)
Douglas K. Howell	
/s/ RICHARD C. CARY	Controller (Principal Accounting Officer)
Richard C. Cary	
*T. KIMBALL BROOKER	Director
T. Kimball Brooker	
*GARY P. COUGHLAN	Director
Gary P. Coughlan	
*ILENE S. GORDON	Director
Ilene S. Gordon	
*ELBERT O. HAND	Director
Elbert O. Hand	
*DAVID S. JOHNSON	Director
David S. Johnson	
*KAY W. MC CURDY	Director
Kay W. Mc Curdy	
*JAMES R. WIMMER	Director
James R. Wimmer	

*By: /s/ JOHN C. ROSENGREN

Schedule II

	Balance at Beginning of Year		Additions Charged to Earnings		Adjustments		Balance at End of Year
(In millions)							
Year ended December 31, 2005							
Allowance for doubtful accounts	\$	3.0	\$	4.2	\$	(0.5) (1)	\$ 6.7
Allowance for estimated policy cancellations		4.5		0.4		-	4.9
Accumulated amortization of goodwill		7.1		-		(0.3) (2)	6.8
Accumulated amortization of expiration lists and noncompete agreements		33.4		20.7		(2.8) (3)	51.3
Year ended December 31, 2004							
Allowance for doubtful accounts	\$	2.7	\$	1.8	\$	(1.5) (1)	\$ 3.0
Allowance for estimated policy cancellations		3.0		1.5		-	4.5
Accumulated amortization of goodwill		6.8		-		0.3 (2)	7.1
Accumulated amortization of expiration lists and noncompete agreements		16.4		18.5		(1.5) (3)	33.4
Year ended December 31, 2003							
Allowance for doubtful accounts	\$	2.0	\$	1.9	\$	(1.2) (1)	\$ 2.7
Allowance for estimated policy cancellations		3.0		-		-	3.0
Accumulated amortization of goodwill		7.1		-		(0.3) (2)	6.8
Accumulated amortization of expiration lists and noncompete agreements		7.5		9.9		(1.0) (3)	16.4

Arthur J. Gallagher & Co.

Annual Report on Form 10- K

For the Fiscal Year Ended December 31, 2005

Exhibit Index

10.5.1	Amendments No. 1 to No. 15 to the Lease Agreement between Arthur J. Gallagher & Co. and HGC/Two Pierce Limited Partnership, an Illinois limited partnership, as successor to Itasca Center III Limited Partnership, a Texas limited partnership, dated May 20, 1991 to October 15, 2005.
10.15.1	First Amendment to the Arthur J. Gallagher & Co. Supplemental Savings and Thrift Plan.
10.15.2	Second Amendment to the Arthur J. Gallagher & Co. Supplemental Savings and Thrift Plan.
10.16.1	First Amendment to the Arthur J. Gallagher & Co. Deferred Equity Participation Plan.
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10.39	Option Agreement among Carolyn Kelly, NOx II, Ltd., an Ohio limited liability company, and AJG Financial Services, Inc., a wholly- owned subsidiary of Arthur J. Gallagher & Co., dated October 17, 2005.
10.40	Operating Agreement of Chem- Mod International LLC dated as of July 8, 2005, between NOx II International, Ltd., an Ohio limited liability company and AJG Coal, Inc., a Delaware corporation, together with Amendment No. 1 dated August 2, 2005.
13.0	Gallagher's 2005 Financial Statements.
21.0	Subsidiaries of Gallagher, including state or other jurisdiction of incorporation or organization and the names under which each does business.
23.1	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.
24.0	Powers of Attorney.
31.1	Rule 13a- 14(a) Certification of Chief Executive Officer.
31.2	Rule 13a- 14(a) Certification of Chief Financial Officer.
32.1	Section 1350 Certification of Chief Executive Officer.
32.2	Section 1350 Certification of Chief Financial Officer.

FIRST AMENDMENT TO LEASE AGREEMENT

THIS FIRST AMENDMENT TO LEASE AGREEMENT (the "First Amendment"), is made and entered into as of the 20TH day of May, 1991, by and between ITASCA CENTER III LIMITED PARTNERSHIP, a Texas limited partnership (the "Landlord") and ARTHUR J. GALLAGHER & CO., a Delaware corporation (the "Tenant").

WHEREAS, Landlord and Tenant entered into that certain Lease Agreement dated as of July 26, 1989 (the "Lease") for certain demised premises to be constructed in the Village of Itasca, Illinois, as more particularly described therein; and

WHEREAS, Landlord and Tenant wish to modify and amend certain terms and conditions contained in the Lease concerning Tenant's rights with respect to Pre- occupancy Expansion Space and Expansion Space (all capitalized terms used herein and not otherwise defined shall have the meanings ascribed to said terms in the Lease) and wish to confirm delivery to Landlord of a Pre- occupancy Expansion Notice with respect to certain Pre- occupancy Expansion Space; and

WHEREAS, Landlord and Tenant wish to acknowledge Tenant's waiver of certain option rights with respect to certain Available Space, all as more fully set forth herein; and

WHEREAS, Landlord and Tenant wish to confirm their agreement to modify certain provisions regarding assignment of the Lease and the Buildout Allowance, all as more fully set forth herein; and

WHEREAS, Landlord and Tenant wish to acknowledge Tenant's decision not to deliver an Exercise Notice pursuant to Paragraph 39 with respect to the lease of certain space located on the second floor of the Building to Cincinnati Bell Information Systems, Inc. ("CBIS") and to modify certain provisions regarding Building Identity and signage, all as more fully set forth herein; and

WHEREAS, Landlord wishes to demise and lease to Tenant and Tenant wishes to accept and lease from Landlord certain Storage Space (as hereinafter defined) on the terms and conditions set forth herein; and

WHEREAS, Landlord and Tenant wish to restate, confirm and recalculate Tenant's Proportionate Share, Base Rent, Additional Rent, the rentable square footage of the Leased Premises and the Commencement Date, all as contemplated by Paragraph 40 of the Lease.

NOW THEREFORE, in consideration of the covenants and agreements contained herein, Ten Dollars (\$10.00) in hand paid, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto do hereby mutually agree to amend the Lease as follows:

1. (a) This First Amendment shall confirm Tenant's timely delivery of a Pre- occupancy Expansion Notice with respect to the entire 20th floor of the Building, containing 20,439 rentable square feet, which additional space shall be deemed to be a part of the Leased Premises pursuant to the terms and conditions of Paragraph 36 of the Lease.

(b) Landlord and Tenant hereby confirm that all remaining Pre- Occupancy Expansion Options have expired without having been exercised, and Tenant hereby waives any and all rights it has to any additional Pre- occupancy Expansion Space.

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(c) Paragraph 1 of the Lease is hereby amended to include 20th floor in the definition of Leased Premises.

(d) Subparagraph 3B is hereby amended by (i) deleting the figure "184,127 square feet" and inserting the figure "205,020 square feet" in lieu thereof, and (ii) deleting Tenant's Proportionate Share of "37.87%" and inserting Tenant's Proportionate Share of "42.096%" in lieu thereof.

2. The introductory paragraph of subparagraph 37A is hereby deleted in its entirety and the following inserted in lieu thereof:

"A. Provided that there does not then exist an Event of Default hereunder with respect to (i) a breach of any material non- monetary obligation hereunder, (ii) a breach of any monetary obligation of Tenant hereunder in excess of Twenty- Five Thousand Dollars (\$25,000.00), or (iii) a breach of Tenant's obligations to pay any Base Rent due hereunder, then Tenant shall have the option to expand the Leased Premises by a total of up to an aggregate of five (5) floors in the Building, comprised of two (2) floors located in the low rise portion of the Building (including, in all cases, the 7th floor) and three (3) floors located in the high rise portion of the Building, in increments of up to an aggregate of two (2) floors per option (consisting of one (1) floor located in the high rise portion of the Building, and one (1) floor located in the low rise portion of the Building if Tenant has not theretofore exercised its options hereunder with respect to both of the two (2) floors of Expansion Space [as hereinafter defined] located in the low rise portion of the Building, either such floor being an "Eligible Floor"), exercisable by delivering written notice to Landlord (an "Intent to Expand Notice") specifying whether Tenant is exercising this option with respect to one or both Eligible Floors (if there are, at the time, two Eligible Floors remaining in the option) not less than sixteen (16) months prior to any one or more of: (a) the fourth (4th) anniversary (the "First Expansion Option"), (b) the sixth anniversary (the "Second Expansion Option"), and (c) the eleventh (11th) anniversary (the "Third Expansion Option") of the Commencement Date (any such anniversary, the "Effective Date") subject to the following terms, conditions and limitations:"

3. Subparagraph 35A is hereby amended by deleting the phrase "Forty- Five and 90/100 Dollars (\$45.90)" in the third line and inserting the phrase "Forty- Five and No/100 Dollars (\$45.00)" in lieu thereof.

4. Landlord and Tenant hereby acknowledge and confirm that Tenant has determined not to deliver an Exercise Notice with respect to the Available Space located on the second floor of the Building in connection with Landlord's lease thereof to CBIS.

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5. Pursuant to Paragraph 40 of the Lease, Landlord and Tenant hereby confirms that, as of the date hereof, the following terms are as follows:

- | | |
|---|-------------------------|
| A. Commencement Date: | March 1, 1991; |
| B. Tenant's Proportionate Share: | 42.096%; |
| C. Base Rent: | \$260,546.25 per month; |
| D. rentable square footage of Premises: | 205,020 square feet; |
| E. rentable square footage of Building: | 487,027 square feet. |

6. Paragraph 47 is hereby amended by adding the following provisions:

" A. The mahogany panels in the second level lobby of Building will remain in place and in the configuration and appearance existing as of the date of this First Amendment for the full term of this Lease, except for the two panels which will be removed in connection with leasing of second floor space to CBIS, as shown on Exhibit A attached hereto.

B. No signage identifying or referring to any tenants of the Building will appear in the second level lobby, except for the signage and identification in favor of Tenant that is contemplated by this Lease, and except for the identification of CBIS that will appear in the same location as Tenant's signage at the entry to the elevator banks, and except for the Building directory.

C. CBIS, in its design and use of its second level space, will be entitled to have its name or other identification etched in the glass entry doors to its second level space, but will not have other signage or identification in connection with that space.

D. Tenant and Landlord will mutually agree on the design and appearance of the security desk in the second level lobby, and the presentation and readability of the name "Gallagher Centre" that appears on that desk. Tenant and Landlord will each act reasonably and in good faith on reaching those agreements."

7. Subparagraph 42B is hereby amended by inserting the following sentence after the last line thereof:

"Notwithstanding anything to the contrary contained in this Subparagraph 42B, in the event that any such assignee has a net worth as determined by GAAP immediately after such assignment which is equal to or greater than the higher of (x) Tenant's net worth as determined by GAAP immediately prior to such assignment or (y) Tenant's net worth as determined by GAAP as of the date of this Lease, then provided that such assignee assumes in an instrument acceptable to Landlord, direct and primary responsibility and liability for the payment of all Rent due and the performance of all obligations of Tenant hereunder from and after the date of such assignment. Tenant shall be released from all such liability and obligations."

8. Paragraph 68 is hereby amended by adding the following subparagraphs:

"H. Landlord and Tenant hereby acknowledge that, in accordance with the provisions of Paragraph 46 hereof,

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Landlord has employed Concrete Structures of the Midwest, Inc. ("Concrete Structures"), the general contractor constructing the Building, to perform Tenant's Work with respect to the initial Leased Premises.

I. Notwithstanding anything to the contrary contained in the Workletter, the Costs of Tenant's Work with respect to the initial Leased Premises shall not include Landlord's Supervision Fee or construction interest on included dollars, but shall specifically include the following items:

(1) Any amount of the Two Hundred Fifty Thousand Dollar (\$250,000) bonus which may be payable to Concrete Structures pursuant to Landlord's contract with Concrete Structures dated August 28, 1990 (the "TI Contract") as a result of Concrete Structures' substantial completion of Tenant's Work in accordance with the terms and provisions of the TI Contract on or prior to March 1, 1991, as such date may be extended pursuant to the TI Contract; and

(2) Any fees in excess of Thirty Thousand Dollars (\$30,000), which may be due and owing Landlord's construction manager, Construction Business Associates, Ltd., ("CBA") for CBA's services in connection with Tenant's Work. The first Thirty Thousand Dollars (\$30,000) of CBA's fees shall be paid by Landlord and shall not be a portion of the Costs of Tenant's Work.

9. New Paragraph 71 is hereby inserted as follows:

71. Storage Space.

A. Landlord hereby demises and leases to Tenant and Tenant hereby accepts and leases from Landlord during the Term, certain storage space located on the 26th floor of the Building containing six hundred thirty- one (631) square feet, as outlined on Exhibit B attached hereto and made a part hereof (the "Storage Space"). Except as specifically set forth in this Paragraph 71, all terms and conditions of this Lease shall apply to the Storage Space as if the Storage Space were part of the Leased Premises, and all references to the Leased Premises contained herein, shall, where applicable, be deemed to be references to the Lease Premises and the Storage Space.

B. In addition to Base Rent, Tenant shall pay to Landlord as Additional Rent hereunder, rental for the Storage Space (the "Storage Space Rental") in an amount equal to five hundred seventy- eight dollars and 42/100 (\$578.42) per month (equivalent to an annual rate of \$11.00 per square foot of such Storage Space). The Storage Space Rental shall be increased by an amount equal to three percent (3%) of the then Storage Space Rental on each anniversary of the Commencement Date during the Term and such increased Storage Space Rental shall then be the Storage Space Rental for the next succeeding year of the Term. The Storage Space

Rental set forth in this Paragraph 71B includes all Taxes and Operating Expenses with respect to the Storage Space and Tenant's Proportionate Share of Taxes and Operating Expenses shall not be adjusted to include any such amounts which would otherwise be allocable to the Storage Space.

C. The Storage Space shall be used by Tenant solely for the storage of papers, files, records and other office materials used in connection with the conduct of Tenant's business from the Leased Premises and for no other purpose whatsoever. Tenant covenants and agrees to maintain the Storage Space in a clean and orderly condition and to maintain, at all times, clear aisles between the items stored by Tenant in the Storage Space with minimum widths of three feet (3'), sufficient to allow Landlord access to the Building equipment located in the Storage Space. In connection therewith, Landlord shall at all times retain pass keys to the Storage Space and shall make reasonable efforts, but shall have no obligation, to notify Tenant prior to Landlord's entry into the Storage Space.

D. Tenant agrees that it will repair promptly, at its own expense, any damage to the Storage Space caused by bringing into the Storage Space any property for Tenant's use or storage, or by the removal of such property, or by the negligence of Tenant or Tenant's employees, and that it will surrender the Storage Space at the expiration of the Term in as good condition as when received, reasonable wear and tear and damage by fire or other current casualty excepted broom clean and free of all debris.

E. Landlord shall construct the Storage Space pursuant to plans and specifications approved by Tenant. Tenant shall pay any and all costs incurred with respect to the preparation and approval of such plans and specifications as well as the construction of the Storage Space; provided, however, that Landlord shall credit against the Storage Space Rental next due and owing hereunder any such amounts so paid by Tenant, not to exceed, in the aggregate, one thousand seven hundred and sixty dollars (\$1,760.00).

F. Tenant shall have the right from time to time to terminate the lease for all or any of the three portions of Storage Space set forth in this Paragraph 71 at any time after the third (3rd) anniversary of the Commencement Date by giving Landlord written notice of its intent to so terminate no later than ninety (90) days prior to the effective date of such termination. In the event of such termination, Tenant shall pay to Landlord, together with the giving of such notice, an amount equal to the then unamortized portion of the sum of the commission paid by Landlord to L.J. Sheridan & Co. and Landlord's in-house commission in connection with the lease of this Storage Space. Landlord and Tenant hereby agree that for the purpose of calculating such payment, said commission shall be allocated pro-rata on a square footage basis to each portion of the Storage Space and amortized evenly over a fifteen (15) year period commencing on the Commencement Date.

10. Except as expressly set forth herein, the Lease shall remain unmodified and in full force and effect, enforceable in accordance with its terms.

IN WITNESS WHEREOF, the parties hereto have executed this First Amendment as of the day and year first set forth above.

LANDLORD:

ITASCA CENTER III LIMITED PARTNERSHIP,
a Texas limited partnership

By: GREAT LAKES- CHICAGO OFFICE III,
INC.,
a Texas corporation, its general partner

By: 
Its: VP

TENANT:

ARTHUR J. GALLAGHER & CO., a Delaware
corporation

By: 
Its: President

EXHIBIT A

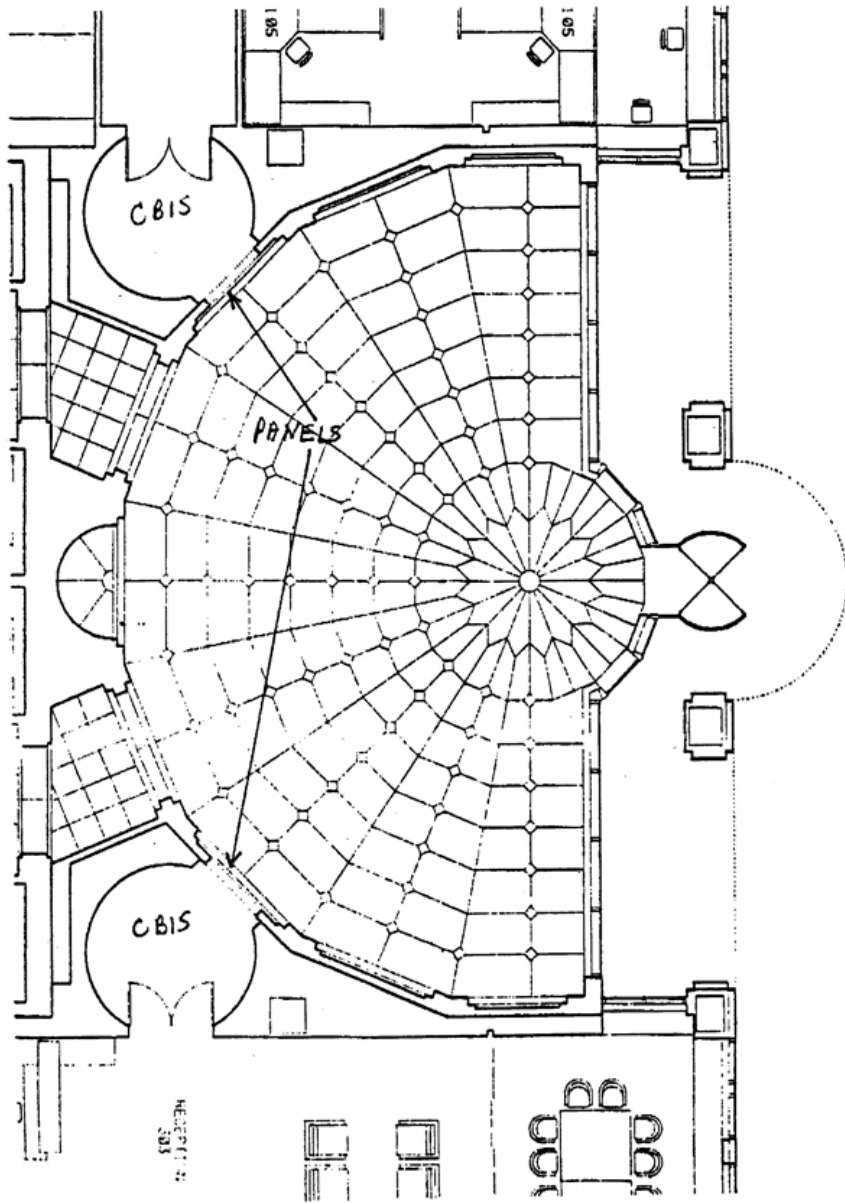
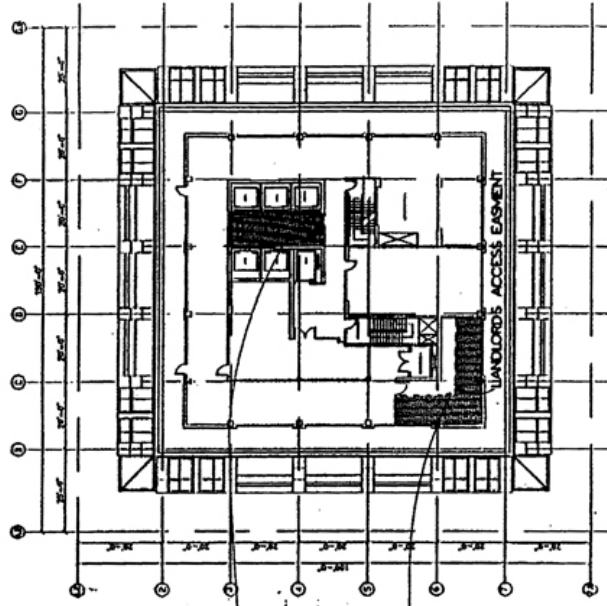


EXHIBIT B

TWO PIERCE PLACE RENTAL PLAN
URBAN DESIGN GROUP, INC.

Tammill Crow Company



STORAGE "A"
USF = 279

STORAGE "B"
USF = 352

Atlanta/Chicago/Denver/Tulsa

Architecture/Planning/Design

SECOND AMENDMENT TO LEASE AGREEMENT

THIS SECOND AMENDMENT TO LEASE AGREEMENT (this "Second Amendment") is made as of this 13th day of November, 1991, by and between ITASCA CENTER III LIMITED PARTNERSHIP, a Texas limited partnership ("Landlord") and ARTHUR J. GALLAGHER & CO., a Delaware corporation ("Tenant").

WITNESSETH:

WHEREAS, Landlord and Tenant entered into that certain Lease Agreement dated as of July 26, 1989, as amended by that certain First Amendment to Lease dated as of May 20, 1991 (as so amended, the "Lease"), whereby Landlord demised and leased to Tenant certain space (the "Leased Premises") in the building known as Two Pierce Place, Itasca, Illinois (the "Building"), which space is more particularly described in the Lease. All capitalized terms not otherwise defined in this Second Amendment shall have the same meaning ascribed to such terms in the Lease;

WHEREAS, Tenant desires to add to the Leased Premises certain additional space located on the ground floor of the Building for use as a smoking lounge for Tenant's employees;

WHEREAS, Landlord and Tenant desire to amend the Lease on the terms and conditions hereinafter set forth; and

NOW THEREFORE, in consideration of the mutual covenants and agreements herein contained and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Landlord and Tenant covenant and agree to amend the Lease as follows:

1. The foregoing recitals are incorporated in this Amendment as if fully set forth herein.
2. Effective on the earlier of December 1, 1991 or the date Tenant takes occupancy of the Smoking Lounge (as hereinafter defined), Subparagraph 3B is hereby amended by (i) deleting the figure "205,020 square feet" and inserting the figure "205,627 square feet" in lieu thereof, and (ii) deleting Tenant's Proportionate Share of "42.096%" and inserting Tenant's Proportionate Share of "42.208%" in lieu thereof.
3. New Paragraph 72 is hereby inserted as follows:

72. Smoking Lounge.

A. Landlord hereby demises and leases to Tenant, and Tenant hereby accepts and leases from Landlord, commencing on December 1, 1991 (the "Effective Date") and ending on the Termination Date, certain space consisting of 607 square feet located on the ground floor of the Building, as outlined on Exhibit A attached hereto and made a part hereof (the "Smoking Lounge"). Except as specifically set forth in this Paragraph 72, all terms and conditions of this Lease shall apply to the Smoking Lounge as if the Smoking Lounge were part of the Leased Premises, and all references to the Leased Premises contained herein, shall, where applicable, be deemed to be references to the Leased Premises and the Smoking Lounge.

B. In addition to Base Rent, Tenant shall pay to Landlord as Additional Rent hereunder, rental for the Smoking Lounge (the "Smoking Lounge Rental") in an amount equal to nine hundred sixty- one and 08/100 dollars (\$961.08) per month (equivalent to an annual rate of \$19.00 per square foot of such Smoking Lounge). The Smoking Lounge Rental shall be increased

by an amount equal to two percent (2%) of the then Smoking Lounge Rental on each anniversary of the Effective Date during the Term and such increased Smoking Lounge Rental shall then be the Smoking Lounge Rental for the next succeeding year of the Term. In addition to the Smoking Lounge Rental set forth in this Paragraph 72B, Tenant shall pay as additional rent Tenant's Proportionate Share of Taxes and Operating Costs with respect to the Smoking Lounge.

C. The Smoking Lounge shall be used by Tenant solely as a lounge in which smoking tobacco shall be permitted by Tenant's agents, employees, patrons, customers and invitees and for no other purpose whatsoever. Tenant covenants and agrees to maintain the Smoking Lounge in a clean and orderly condition and Landlord and Tenant shall work together to establish requirements and a schedule for routine, thorough cleanings of the Smoking Lounge. In connection therewith, Landlord shall at all times retain pass keys to the Smoking Lounge for the purposes of performing the aforesaid cleaning services and shall make reasonable efforts, but shall have no obligation, to notify Tenant prior to Landlord's entry into the Smoking Lounge.

D. Tenant agrees that it will repair promptly, at its own expense, any damage to the Smoking Lounge caused by bringing into the Smoking Lounge any property for Tenant's use, or by the removal of such property, or by the negligence of Tenant or Tenant's employees, and that it will surrender the Smoking Lounge at the expiration of the Term in as good condition as when received, reasonable wear and tear and damage by fire or other casualty excepted broom clean and free of all debris.

E. Landlord shall construct or cause to be constructed the Smoking Lounge on or prior to the Effective Date pursuant to plans and specifications and a final estimate of construction costs agreed to by both Landlord and Tenant. Tenant shall pay any and all costs incurred with respect to the preparation and approval of such plans and specifications as well as the construction of the Smoking Lounge, including but not limited to any contractor's profit and overhead (collectively, "Construction Costs"); provided, however, that Tenant shall not pay the cost of any developer markups associated with such construction; and provided further, that Landlord shall credit against the Smoking Lounge Rental next due and owing hereunder any Construction Costs paid by Tenant as hereinafter provided. Within two (2) weeks after completion of the Smoking Lounge, Landlord shall submit invoices for the construction Costs to Tenant. Tenant shall pay the Construction Costs within twenty (20) days of receipt of such invoices from Landlord. Landlord estimates that the Construction Costs shall not exceed thirteen thousand five hundred forty- three dollars (\$13,543.00) in the aggregate.

F. Notwithstanding anything contained herein to the contrary, Tenant expressly covenants and agrees that (i) the door to the Smoking Lounge shall be kept closed at all times, and (ii) Tenant shall use its best efforts to prohibit its agents, employees, patrons, customers and invitees from smoking and/or loitering in the halls outside the Smoking Lounge or

in other common areas of the Building, near or around any Building exits or outside of the Building. If Tenant defaults with respect to any of the covenants contained in this Paragraph 72, Landlord shall give Tenant written notice of such default. Thereafter, in the event of a continued or an additional default with respect to any of the foregoing covenants, Landlord shall have the right to terminate the lease of the Smoking Lounge by giving Tenant written notice of its intent to so terminate no later than thirty (30) days prior to the effective date of such termination. In such an event of termination, Tenant shall have no additional liability under the Lease except that Tenant shall reimburse Landlord for the value of the abatement granted at the commencement of the term.

G. Landlord acknowledges and agrees that if any future tenant desires a similar smoking lounge in the Building, Landlord will use its reasonable efforts to impose substantially similar standards on such tenant as have been imposed on Tenant to promote proper ventilation and to limit interference with the operations or quiet enjoyment of the other tenants in the Building.

4. Except as expressly set forth herein, the Lease shall remain unmodified and in full force and effect, enforceable in accordance with its terms.

IN WITNESS WHEREOF, the parties hereto have executed this Second Amendment as of the day and year first set forth above.

LANDLORD:

ITASCA CENTER III LIMITED PARTNERSHIP,
a Texas limited partnership

By: GREAT LAKES- CHICAGO OFFICE III,
INC.,
a Texas corporation, its general partner

By: 
Its: Agent

TENANT:

ARTHUR J. GALLAGHER & CO., a Delaware
corporation

By: 
Its: President

THIRD AMENDMENT TO LEASE AGREEMENT

THIS THIRD AMENDMENT TO LEASE AGREEMENT (this "Third Amendment") is made as of this _____ day of _____, 1992, by and between **ITASCA CENTER III LIMITED PARTNERSHIP**, a Texas limited partnership ("Landlord"), and **ARTHUR J. GALLAGHER & CO.**, a Delaware corporation ("Tenant").

WITNESSETH:

WHEREAS, Landlord and Tenant entered into that certain Lease Agreement dated as of July 26, 1989, as amended by that certain First Amendment to Lease dated as of May 20, 1991 and by that certain Second Amendment to Lease Agreement dated as of November 13, 1991 (as so amended, the "Lease"), whereby Landlord demised and leased to Tenant certain space (the "Leased Premises") in the building known as Two Pierce Place, Itasca, Illinois (the "Building"), which space is more particularly described in the Lease. All capitalized terms not otherwise defined in this Third Amendment shall have the same meaning ascribed to such terms in the Lease;

WHEREAS, Tenant desires to construct and add to the Leased Premises a patio;

WHEREAS, Landlord and Tenant desire to amend the Lease on the terms and conditions hereinafter set forth; and

NOW, THEREFORE, in consideration of the mutual covenants and agreements herein contained and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Landlord and Tenant covenant and agree to amend the Lease as follows:

1. The foregoing recitals are incorporated in this Third Amendment as fully set forth herein.
2. New Paragraph 73 is hereby inserted as follows:

73. Patio.

A. Landlord hereby demises and leases to Tenant, and Tenant hereby accepts and leases from Landlord, commencing on the date hereof and ending on the Termination Date, certain space contiguous to the ground floor of the Building, as outlined on Exhibit A attached hereto and made a part hereof (the "Patio Space"). Except as specifically set forth in this Paragraph 73, all terms and conditions of this Lease shall apply to the Patio Space as if the Patio Space were part of the Leased Premises, and all references to the Leased Premises contained herein, shall, where applicable, be deemed to be references to the Leased Premises and the Patio Space.

B. Tenant shall, at its sole cost and expense, cause to be constructed and/or installed (i) a patio within the Patio Space (the "Patio"), and (ii) all of the other improvements and landscaping depicted or identified in the plans (the "Plans") dated July 5, 1991 and attached hereto as Exhibit "A", with the exception of Tenant's logo which shall not be constructed (collectively, the "Improvements"). The Plans may not be further amended without the prior written consent of Landlord. Tenant shall cause the construction of the Improvements to commence promptly after the date hereof and to be prosecuted with due diligence until completion. All of the Improvements shall be sub-constructed by Concrete Structures, Inc. The landscaping required by the Plans shall be installed by a sub-contractor approved by Landlord in writing. The exterior lighting which is to be installed pursuant to the Plans shall be controlled

through the Building's automation system. Upon completion of the Improvements, any adjoining property or land, including but not limited to landscaping, which is disturbed, altered, damaged or destroyed in connection with the construction or installation of the Improvements shall be restored by Tenant, at its sole cost and expense, to the condition which existed immediately prior to the commencement of construction or installation of the Improvements, as reasonably determined by Landlord. The transplanting of any trees which is required in connection with the construction or installation of the Improvements shall be performed under the direct supervision of Landlord but at Tenant's sole cost and expense. Upon completion of the Improvements, the existing irrigation system shall be restored by Tenant, at its sole cost and expense, to proper operating condition, as reasonably determined by Landlord. Tenant shall, at its sole cost and expense, cause a minimum of two taps off of the irrigation system to be installed for the purpose of permitting hand watering. Tenant shall, at its sole cost and expense and at all times during the term of the Lease, maintain the card reader to be installed at the Patio door pursuant to the Plans in proper operating condition and in compliance with Itasca Fire Department requirements. The installation of the card reader must include Building standard locking hardware that will be keyed to the Building master system. Tenant shall assure Landlord, in Landlord's determination, that Landlord will have access to the Patio from the Patio door. The construction and installation of the Improvements and the other work required to be performed by Tenant pursuant to this Subparagraph B are collectively referred to herein as the "Work."

C. Tenant shall, at its sole cost and expense, obtain all permits, licenses, authorizations and approvals of all governmental authorities necessary to construct, occupy and use the Improvements or to otherwise perform the Work. All of the Improvements and the performance of the Work shall, at Tenant's sole cost and expense, comply with all applicable laws, statutes, ordinances, codes, rules and regulations and the local Board of Fire Underwriters (the "Laws"). Tenant shall cause the Work to be completed in a lien- free manner and shall immediately discharge of record (or bond over to the satisfaction of Landlord's title insurance company) any liens which arise out of the performance of any portion of the Work. Tenant shall cause the Work to be performed in such a manner so as to minimize interference with the use and occupancy of the Building by Landlord or other tenants.

D. At all times prior to the completion of the Work, Tenant shall, at its sole cost and expense, maintain or cause to be maintained a policy of Builder's Risk Insurance covering the Building. Such insurance policy shall (i) be in form and substance reasonably satisfactory to Landlord, (ii) name Landlord as an additional insured and (iii) provide that Landlord will receive 30 days' written notice prior to the cancellation or material modification of such policy.

E. Tenant hereby indemnifies and holds Landlord harmless from and against any and all claims, liabilities, damages, losses, costs and expenses, including but not limited to attorney's fees, asserted against or incurred by Landlord which arise out of or relate in any manner whatsoever to the Work except for any of the foregoing

which are directly attributable to Landlord's gross negligence or willful misconduct. Tenant shall pay all costs associated with or incurred in connection with the Work, including but not limited to all costs required to obtain the approval of Landlord, the holder of any mortgage encumbering the Building and Hamilton Lakes Property Owners' Association to the construction and installation of the Improvements.

F. At or prior to the completion of the Work, Tenant shall deliver to Landlord a warranty, in form and substance reasonably satisfactory to Landlord, from Vistawall (or such other person or entity which furnishes the patio door shown on the Plans if Vistawall fails to furnish the same) that the patio door will be air and water tight. The warranty shall expressly provide that it runs in favor of Landlord.

G. Tenant shall, at its sole cost and expense, decorate the interior of the Patio Space with furniture, furnishings and trash receptacles, the design and appearance of which shall be approved by Landlord, which approval shall not be unreasonably withheld.

H. Tenant shall not be required to permit Landlord and other Building Tenants and their respective employees to have access to and to use the Patio Space on an individual basis for the purpose of eating breakfast and lunch and taking "coffee breaks". However, to the extent Tenant elects not to permit such use, Tenant shall be solely responsible for enforcing such election and Landlord shall bear no responsibility for such enforcement, other than to encourage the compliance of its own employees with this restriction.

I. Tenant shall not permit any beer, wine or liquor to be served from or consumed upon the Patio Space unless (i) Tenant has obtained all licenses, permits and other governmental authorizations necessary to permit such service or consumption and has otherwise complied with all Laws relating to the service and consumption of beer, wine and liquor, and (ii) maintains dramshop insurance which (A) is in form and substance satisfactory to Landlord, (B) names Landlord as an additional insured, and (C) provides that Landlord shall receive 30 days' written notice prior to the cancellation or material modification of such policy. In the event alcoholic beverages are made available or consumed within the Patio Space during any party, reception or similar function, the party sponsoring such party, reception or similar function shall be required to indemnify, defend, protect and hold Landlord or Tenant, or Landlord and Tenant, as the case may be, harmless from and against any and all claims, liabilities, damages, losses, costs and expenses, including but not limited to attorneys' fees, asserted against or incurred by Landlord and Tenant or Landlord or Tenant, as the case may be, which arise out of or related in any manner whatsoever to the use of the Patio Space, including the consumption of alcoholic beverages thereon.

J. Notwithstanding anything to the contrary contained in the Lease, Landlord shall, at Tenant's sole cost and expense, maintain the Patio and Patio Space and keep the same in good condition and repair. Such maintenance shall include (i) janitorial maintenance, which shall consist of trash removal twice a day, Monday through Friday, and general cleaning each evening, Monday through Friday, (ii) light bulb replacement and (iii) landscape maintenance. Tenant shall reimburse Landlord for all

costs incurred by Landlord pursuant to this Paragraph J on a monthly basis in the same manner and at the same times as common area maintenance charges are paid by Tenant pursuant to the Lease.

4. Except as expressly set forth herein, the Lease shall remain unmodified and in full force and effect, enforceable in accordance with its terms.

IN WITNESS WHEREOF, the parties hereto have executed this Third Amendment as of the day and year first set forth above.

LANDLORD:

ITASCA CENTER III LIMITED PARTNERSHIP,
a Texas limited partnership

By: GREAT LAKES- CHICAGO OFFICE III, INC.,
a Texas corporation, its General Partner

By:



Its:

Agent

TENANT:

ARTHUR J. GALLAGHER & CO.,
a Delaware corporation

By:



Its:

V.P.

FOURTH AMENDMENT TO LEASE AGREEMENT

THIS FOURTH AMENDMENT TO LEASE AGREEMENT (this "Fourth Amendment") is made as of this ____ day of _____, 1992, by and between **ITASCA CENTER III LIMITED PARTNERSHIP**, a Texas limited partnership ("Landlord"), and **ARTHUR J. GALLAGHER & CO.**, a Delaware corporation ("Tenant").

WITNESSETH:

WHEREAS, Landlord and Tenant entered into that certain Lease Agreement dated as of July 26, 1989, as amended by that certain First Amendment to Lease dated as of May 20, 1991, that certain Second Amendment to Lease Agreement dated as of November 13, 1991, and that certain Third Amendment to Lease Agreement dated as of _____, 1992 (as so amended, the "Lease"), whereby Landlord demised and leased to Tenant certain space in the building known as Two Pierce Place, Itasca, Illinois (the "Building");

WHEREAS, Landlord desires to market the Building as "Two Pierce Place";

WHEREAS, Landlord and Tenant desire to amend the Lease on the terms and conditions hereinafter set forth; and

NOW, THEREFORE, in consideration of the mutual covenants and agreements herein contained and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Landlord and Tenant covenant and agree to amend the Lease as follows:

1. The foregoing recitals are incorporated in this Fourth Amendment as fully set forth herein.
2. Notwithstanding anything contained in the Lease, Landlord shall have the right to market the Building as "Two Pierce Place", including identification as such in all of Landlord's brochures, letterhead or other written materials issued by Landlord concerning the Building, and shall not be required to market the Building as "Gallagher Centre".

3. Except as expressly set forth herein, the Lease shall remain unmodified and in full force and effect, enforceable in accordance with its terms.

IN WITNESS WHEREOF, the parties hereto have executed this Fourth Amendment as of the day and year first set forth above.

LANDLORD:

a Texas limited partnership

By: GREAT LAKES- CHICAGO OFFICE III, INC.,
a Texas corporation, its General Partner

By:



Its:

TENANT:

ARTHUR J. GALLAGHER & CO.,
a Delaware corporation

By:



Its:

V.P.

FIFTH AMENDMENT TO LEASE AGREEMENT

THIS FIFTH AMENDMENT TO LEASE AGREEMENT (this "Fifth Amendment") made as of this 31st day of August, 1992, by and between ITASCA CENTER III LIMITED PARTNERSHIP, a Texas limited partnership ("Landlord"), and ARTHUR J. GALLAGHER & CO., a Delaware corporation ("Tenant");

WITNESSETH:

WHEREAS, Landlord and Tenant entered into a certain Lease Agreement dated as of July 26, 1989, as amended by that certain First Amendment to Lease dated as of May 20, 1991, that certain Second Amendment to Lease dated as of November 13, 1991, that certain Third Amendment to Lease dated as of _____, 1992, and that certain Fourth Amendment to Lease dated as of _____, 1992 (as so amended, the "Lease"), whereby Landlord demised and leased to Tenant certain space in the building known as Two Pierce Place, Itasca, Illinois (the "Building"); and

WHEREAS, Landlord and Tenant desire to amend the Lease as more particularly herein set forth;

NOW, THEREFORE, in consideration of the mutual covenants and agreements herein contained and other good and valuable consideration the receipt and sufficiency of which is hereby acknowledged by Landlord and Tenant, Landlord and Tenant do hereby covenant and agree to amend the Lease as follows:

1. The foregoing recitals are incorporated into this Fifth Amendment as hereinabove fully set forth.
2. Effective on the later of August 1, 1992, or the date Tenant takes occupancy of the Additional Premises (as this term is hereinafter defined), Subparagraph 3B is hereby amended by (i) deleting the figure "205,627 square feet" and inserting the figure "208,646 square feet" in lieu thereof, and (ii) deleting Tenant's Proportionate Share of "42.208%" and inserting Tenant's Proportionate Share of "42.841%" in lieu thereof.

A. Landlord hereby demises and leases to Tenant and Tenant hereby accepts and leases from Landlord, commencing upon the later of August 1, 1992, or the date Tenant takes occupancy of the Additional Premises (this date being hereinafter referred to as the "Additional Premises Commencement Date"), certain space consisting of 3019 square feet located on the seventh floor of the Building, as outlined in Exhibit A attached hereto and made a part hereof (the "Additional Premises"). Except as specifically set forth in this Paragraph 74, all terms and conditions of this Lease shall apply to the Additional Premises as if the Additional Premises were part of the Leased Premises and all references to the Leased Premises contained herein shall, where applicable, be deemed to be references to the Leased Premises and the Additional Premises.

B. Base Rent payable pursuant to this Lease with respect to the Additional Premises shall be as follows (subject to Paragraph C., below):
(a) \$3,836.65 per month from the Additional Premises Commencement Date (as hereinafter defined) through the expiration of the fifth year of the Term (equivalent to an annual rate of \$15.25 per annum per rentable square foot of the Additional

Premises), XXX,088.23 per month for the second (5) years of the Term (equivalent to an annual rate of \$16.25 per annum per rentable square foot of the Additional Premises), and (c) \$4,717.19 per month for the third (5) years of the Term (equivalent to an annual rate of \$18.75 per annum per rentable square foot of the Additional Premises). Base Rent for any partial calendar month during the Term shall be prorated.

C. Notwithstanding anything to the contrary contained in this Lease, Landlord will abate the Base Rent (and not that portion of the Additional Rent that is attributable to Operating Costs, Taxes, and CPI Adjustments), but only with respect to the portion thereof that is attributable to the Additional Premises, for a period of twelve (12) months from and after the Additional Premises Commencement Date. If, at any time during the three (3) year period beginning on the Additional Premises Commencement Date, Tenant suffers or permits an Event of Default to occur, which Event of Default results in Landlord exercising its right to terminate this Lease pursuant to Paragraph 19 hereof, then (i) the provisions of the immediately preceding sentence shall be deemed null and void as if they had never been set forth in this Lease and (ii) an amount equal to the total of the Rent Abatement theretofore allowed shall be added to, and constitute a part of, Landlord's damages pursuant to Paragraph 19C of this Lease.

D. Landlord shall improve or shall cause the Additional Premises to be improved according to plans and specifications (the "Plans and Specifications") and a final estimate of construction costs agreed to by both Landlord and Tenant. If the actual cost of improving the Additional Premises is less than \$75,475.00 (the Buildout Allowance), then the difference between the actual cost of improving the Additional Premises and the Buildout Allowance may be utilized by Tenant to reimburse Tenant for those expenses incurred by Tenant in moving into and furnishing the Additional Premises or this difference may be used by Tenant as a credit against any Rent payable by Tenant under this Lease. If the actual cost of improving the Additional Premises at any time equals the Buildout Allowance or if at any time Landlord reasonably determines that the remaining Buildout Allowance is insufficient to complete the improvements to the Additional Premises in accordance with the Plans and Specifications, (a) Landlord may immediately cease any further improvements to the Additional Premises, if Tenant no longer has sufficient financial ability to directly pay for all costs of improving the Additional Premises in excess of the Buildout Allowance, and (b) in all other events, Landlord shall invoice Tenant for all excess amounts from time to time, but not more often than once each calendar month (these invoices to be accompanied by copies of customary supporting vouchers, bills, and other materials) and Tenant shall pay each invoice in full within 10 days after receipt.

E. In no event shall the Additional Premises be considered to be a portion of an Eligible Floor or be considered to be Expansion Space (as these terms are defined in Paragraph 37.A of this Lease) and in no event shall the terms and conditions of Paragraph 37.A be applicable to the Additional Premises. Landlord has no obligation to provide Tenant with an additional 3,019 rentable square feet on any other floor in the Building at the time that Tenant exercises its option for the 17,452 rentable square feet in the Building on the seventh floor pursuant to Paragraph 37.A hereof.

4. Except as expressly set forth herein, the Lease shall remain unmodified and in full force and effect, enforceable in accordance with its terms.

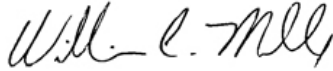
IN WITNESS WHEREOF, the parties hereto have executed this Fifth Amendment as of the day and year first above set forth.

LANDLORD:

Itasca Center III Limited Partnership, a Texas limited partnership

By: Great Lakes- Chicago Office III, Inc., a Texas corporation, General Partner

By:



Its:

TENANT:

Arthur J. Gallagher & Co., a Delaware corporation

By:



Its:

Vice President

EXHIBIT A

SIXTH AMENDMENT TO LEASE AGREEMENT

This SIXTH AMENDMENT TO LEASE AGREEMENT (the "Amendment") is made this _____ day of October, 1994 by and between Itasca Center III Limited Partnership, a Texas limited partnership (the "Landlord") and Arthur J. Gallagher & Co., a Delaware corporation (the "Tenant").

WITNESSETH:

WHEREAS, Landlord and Tenant entered into that certain Lease Agreement dated as of July 26, 1989, as amended by that certain First Amendment to Lease dated as of May 20, 1991, by that certain Second Amendment to Lease dated as of November 13, 1991, by that certain Third Amendment to Lease dated as of _____, 1992, by that certain Fourth Amendment to Lease dated as of _____, 1992, and by that certain Fifth Amendment to Lease Agreement dated as of August 31, 1992 (as so amended, the "Lease"), pursuant to which Landlord leased to Tenant and Tenant rented from Landlord certain space in the building commonly known as Two Pierce Place, Itasca, Illinois (the "Building"); and

WHEREAS, Landlord and Tenant desire to amend the Lease as more particularly set forth in this Amendment.

NOW, THEREFORE, in consideration of the mutual covenants and agreements herein contained and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, Landlord and Tenant hereby covenant and agree as follows:

1. All capitalized terms not otherwise defined herein shall have the meanings ascribed in the Lease.
2. Landlord and Tenant hereby agree that notwithstanding anything to the contrary in the Lease, including, without limitation, paragraph 37A of the Lease, Tenant hereby waives its Second Expansion Option solely as it relates to Tenant's right to expand the Leased Premises into the 19th floor of the Building (the "19th Floor Second Option"). In consideration of waiving the 19th Floor Second Option, Landlord and Tenant hereby agree that the Third Expansion Option for the 19th floor (the "19th Floor Third Option") is exercisable by delivering written notice to Landlord on or before December 1, 1998, in which event the Effective Date for the 19th Floor Third Option will be March 1, 2001. In no event shall Tenant's waiver of the 19th Floor Second Option have any affect on the remaining Expansion Options under the Lease or on the Second Expansion Option or Third Expansion Option as they relate to any floors other than the 19th floor.

3. Except to the extent expressly set forth herein, the Lease shall remain in full force and effect, enforceable in accordance with its terms.

IN WITNESS WHEREOF, the parties hereto have executed this Sixth Amendment to Lease Agreement as of the day and year first above written.

LANDLORD:

Itasca Center III Limited Partnership,
a Texas limited partnership.

By: Great Lakes- Chicago Office III, Inc.,
a Texas corporation, General Partner

By: _____

Its: _____

TENANT:

Arthur J. Gallagher & Co., a Delaware corporation.

By:



Its:

V.P.

SEVENTH AMENDMENT TO LEASE AGREEMENT

THIS, SEVENTH AMENDMENT TO LEASE AGREEMENT (this "Seventh Amendment") made as of this 10th day of February, 1999, by and between HGC/Two Pierce Limited Partnership, an Illinois limited partnership, as successor to Itasca Center III Limited Partnership, a Texas limited partnership ("Landlord") and Arthur J. Gallagher & Co., a Delaware Corporation ("Tenant");

WITNESSETH:

WHEREAS, Landlord and Tenant entered into a certain lease agreement dated as of July 26, 1989, as amended by that certain First Amendment to Lease dated as of May 20, 1991, by that certain Second Amendment to Lease dated as of November 13, 1991, by that certain Third Amendment to Lease dated as of July 14, 1992, by that certain Fourth Amendment to Lease dated as of August 10, 1992, by that certain Fifth Amendment to Lease dated August 31, 1992, and by that certain Sixth Amendment to Lease dated October 5, 1994 (as so amended, the "Lease"), pursuant to which Landlord leased to Tenant and Tenant rented from Landlord certain space in the building commonly known as Two Pierce Place, Itasca, Illinois (the "Building"); and

WHEREAS, Landlord and Tenant desire to amend the Lease as more particularly set forth in the Amendment.

NOW, THEREFORE, in consideration of the mutual covenants and agreements herein contained and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, Landlord and Tenant hereby covenant and agree as follows:

1. Effective on February 1, 1999, Subparagraph 3B is hereby amended by (i) deleting the figure "208,646 square feet" and inserting the figure "225,927 square feet" in lieu thereof, and (ii) deleting Tenant's Proportionate Share of "42.841%" and inserting Tenant's Proportionate Share of "46.389%" in lieu thereof.

2. New Paragraph 75 is hereby inserted as follows:

75. Additional Premises

- A. Landlord hereby demises and leases to Tenant and Tenant hereby accepts and leases from Landlord, commencing on February 1, 1999 (this date being hereafter referred to as the "Additional Premises Commencement Date"), certain space consisting of 17,281 square feet located on the seventh floor of the Building, as outlined in Exhibit A attached hereto and made a part hereof (the "Additional Premises"). Except as specifically set forth in this Paragraph 75, all terms and conditions of this Lease shall apply to the Additional Premises as if the Additional Premises were part of the Leased Premises and all references to the Leased Premises contained herein shall, where applicable, be deemed to be references to the Leased Premises and the Additional Premises.
- B. Net Base Rent payable pursuant to this lease with respect to the Additional Premises shall be as follows (subject to Paragraph C., below): \$27,721.60 per month from the Additional Premises Commencement Date (as hereinafter defined) through to the expiration date of February 28, 2006, except that the net base rent will escalate annually at the rate of 2 1/2%.
- C. Notwithstanding anything to the contrary contained in this Lease, in the event the Additional Premises are not ready for occupancy on February 1, 1999, then Tenant shall pay only taxes and operating expenses for said Additional Premises until March

1, 1999 or the date Tenant takes occupancy of the Additional Premises, whichever is earlier. Payment of base rent will commence no later than March 1, 1999.

- D. Landlord agrees to reimburse Tenant an allowance (the "Tenant Improvement Allowance") of \$259,215.00 towards the cost of all Tenant Improvements (including all architectural and design costs) for the Additional Premises. Tenant shall provide Landlord with paid invoices for actual Tenant Improvement costs, together with lien waivers from the general contractor and all subcontractors for the work which is the subject of those invoices. Landlord will reimburse Tenant within thirty (30) days of receipt of invoices.
3. Except as expressly set forth herein, the Lease shall remain unmodified and in full force and effect, enforceable in accordance with its terms.

IN WITNESS WHEREOF, the parties hereto have executed this Seventh Amendment as of the day and year first above set forth.

LANDLORD:

HGC/Two Pierce Limited Partnership
an Illinois limited partnership

By: HG/Two Pierce, L.L.C.,
an Illinois limited liability company,
its sole General Partner

By: H.P. Itasca Two Pierce, L.L.C.,
an Illinois limited liability company,
its Managing Member

By: _____
Ronald C. Lunt, Managing Member

TENANT:

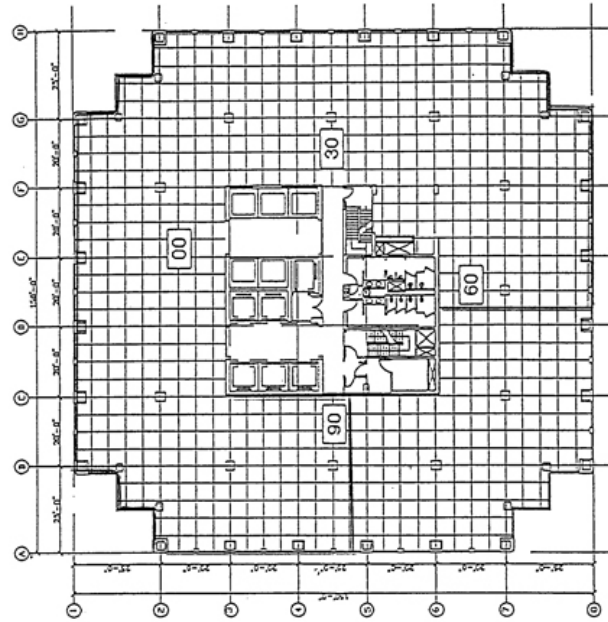
Arthur J. Gallagher & Co., a Delaware Corporation

By: 

Title: V.P.

EXHIBIT A

TWO PIERCE PLACE RENTAL PLAN
URBAN DESIGN GROUP, INC.



TWO PIERCE PLACE
SUITE 700
ITASCA, IL

Landlord: _____

Tenant: m

Architecture/Planning/Design

Atlanta/Chicago/Denver/Tulsa

EIGHTH AMENDMENT TO LEASE AGREEMENT

THIS, EIGHTH AMENDMENT TO LEASE AGREEMENT (this "Eighth Amendment") made as of the 26th day of July, 2001, by and between HGC/Two Pierce Limited Partnership, an Illinois limited partnership, as successor to Itasca Center III Limited Partnership, a Texas limited partnership ("Landlord") and Arthur J. Gallagher & Co., a Delaware Corporation ("Tenant");

WITNESSETH:

WHEREAS, Landlord and Tenant entered into a certain lease agreement dated as of July 26, 1989, as amended by that certain First Amendment to Lease dated as of May 20, 1991, by that certain Second Amendment to Lease dated as of November 13, 1991, by that certain Third Amendment to Lease dated as of July 14, 1992, by that certain Fourth Amendment to Lease dated as of August 10, 1992, by that certain Fifth Amendment to Lease dated August 31, 1992, by that certain Sixth Amendment to Lease dated October 5, 1994, and by that certain Seventh Amendment to Lease dated February 10, 1999 (as so amended, the "Lease"), pursuant to which Landlord leased to Tenant and Tenant rented from Landlord certain space in the building commonly known as Two Pierce Place, Itasca, Illinois (the "Building"); and

WHEREAS, Landlord and Tenant desire to amend the Lease as more particularly set forth in this Amendment.

NOW THEREFORE, in consideration of the mutual covenants and agreements herein contained and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, Landlord and Tenant hereby covenant and agree as follows:

1. Effective May 1, 2001, Subparagraph 3B is hereby amended by (i) deleting the figure "225,927 square feet" and inserting the figure "229,683 square feet" in lieu thereof, and (ii) deleting Tenant's Proportionate Share of "46.389%" and inserting Tenant's Proportionate Share of "47.100%" in lieu thereof.
2. New Paragraph 75 is hereby inserted as follows:
 75. Additional Premises
 - A. Landlord hereby demises and leases to Tenant and Tenant hereby accepts and leases from Landlord, commencing on May 1, 2001 (this date being hereafter referred to as the "Additional Premises Commencement Date"), certain space consisting of 3,756 rentable square feet on the nineteenth (19th) floor of the Building, as outlined in Exhibit A attached hereto and made a part hereof (the "Additional Premises"). Except as specifically set forth in this Paragraph 75, all terms and conditions of this Lease shall apply to the Additional Premises as if the Additional Premises were part of the Leased Premises and all references to the Leased Premises contained herein shall, where applicable, be deemed to be references to the Leased Premises and the Additional Premises.
 - B. Net Base Rent payable pursuant to this lease with respect to the Additional Premises shall be as follows: (subject to Paragraph C, below): \$8,261.83 per month from the Additional Premises Commencement Date (as hereinafter defined) through to the expiration date of February 28, 2006, except that the net base rent will escalate annually at the rate of 3%.
 - C. Notwithstanding anything to the contrary contained in this Lease, in the event the Additional Premises are not ready for occupancy on May 1, 2001, then Tenant shall pay only taxes and operating expenses for said Additional Premises until June 1, 2001 or the date Tenant takes occupancy of the Additional Premises, whichever is earlier. Payment of base rent will commence no later than June 1, 2001.

- D. Landlord agrees to reimburse Tenant an allowance (the "Tenant Improvement Allowance") of \$52,180.00 towards the cost of all Tenant Improvements (including all architectural and design costs) for the Additional Premises. Tenant shall provide Landlord with paid invoices for actual Tenant Improvement costs, together with lien waivers from the general contractor and all subcontractors for the work which is the subject of those invoices. Landlord will reimburse Tenant within thirty (30) days of receipt of invoices.

3. Except as expressly set forth herein, the Lease shall remain unmodified and in full force and effect, enforceable in accordance with its terms.

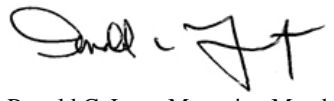
IN WITNESS WHEREOF, the parties hereto have executed this Eighth Amendment as of the day and year first set forth above.

LANDLORD:

HGC/Two Pierce Limited Partnership
an Illinois limited partnership

By: HG/Two Pierce, L.L.C.,
an Illinois limited liability company,
its sole General Partner

By: H.P. - Itasca Two Pierce, L.L.C.,
an Illinois limited liability company,
its Managing Member

By: 
Ronald C. Lunt, Managing Member

TENANT:

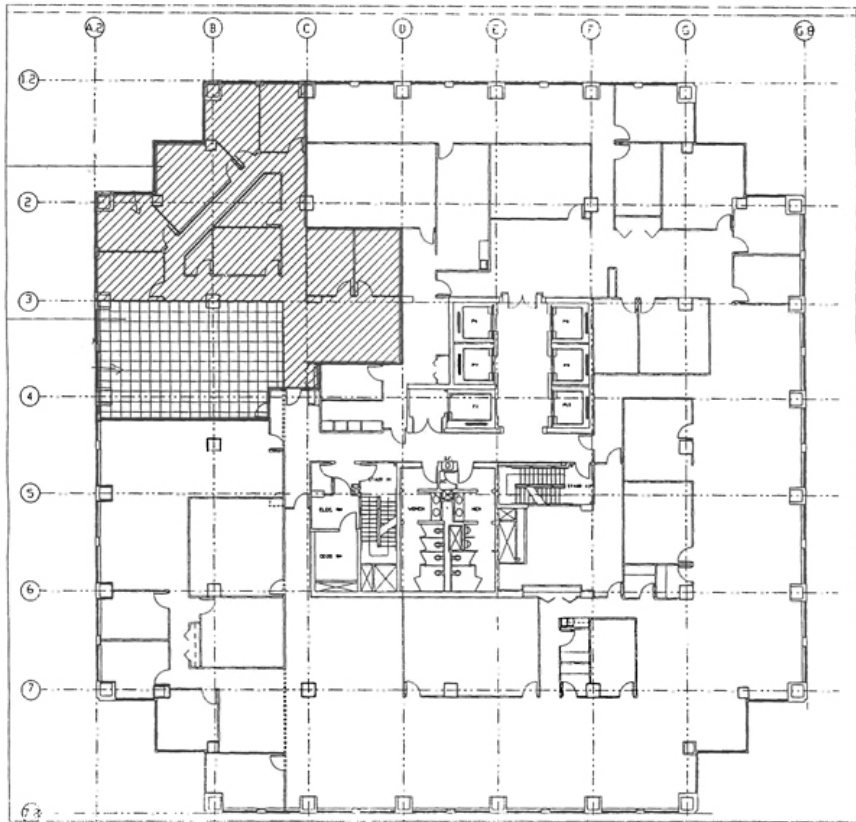
Arthur J. Gallagher & Co., a Delaware Corporation

By: 

Title: V.P.

EXHIBIT A

LEVEL 19
TWO PIERCE PLACE
Itasca, IL
HAMILTON
PARTNERS



Landlord: RL

Tenant: m

NINTH AMENDMENT TO LEASE AGREEMENT

THIS, NINTH AMENDMENT TO LEASE AGREEMENT (this "Ninth Amendment") made as of this 13th day of Nov. 2002, by and between HGC/Two Pierce Limited Partnership, an Illinois limited partnership, as successor to Itasca Center III Limited Partnership, a Texas limited partnership (Landlord) and Arthur J. Gallagher & Co., a Delaware Corporation ("Tenant")

WITNESSETH:

WHEREAS, Landlord and Tenant entered into a certain lease agreement ("Original Lease") dated July 26, 1989, as amended by that certain First Amendment to Lease dated as of May 20, 1991, by that certain Second Amendment to Lease dated as of November 13, 1991, by that certain Third Amendment to Lease dated as of July 14, 1992, by that certain Fourth Amendment to Lease dated as of August 10, 1992, by that certain Fifth Amendment to Lease dated August 31, 1992, by that certain Sixth Amendment to Lease dated October 5, 1994, by that certain Seventh Amendment to Lease dated February 10, 1999, and by that certain Eighth Amendment to Lease dated July 16, 2001 (as so amended, the "Lease"), pursuant to which Landlord leased to Tenant and Tenant rented from Landlord certain space in the building commonly known as Two Pierce Place, Itasca, Illinois (the "Building"); and

WHEREAS, Landlord and Tenant now desire to amend the Lease as more particularly set forth in this Amendment.

NOW, THEREFORE, in consideration of the mutual covenants and agreements herein contained and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, Landlord and Tenant hereby covenant and agree as follows

1. Effective November 1, 2002, Subparagraph 3B is hereby amended by (i) deleting the figure "229,683 square feet" and inserting the figure "237,945" in lieu thereof, and (ii) deleting Tenant's Proportionate Share of "47.100%" and inserting Tenant's Proportionate Share of "48.857%" in lieu thereof.
2. New Paragraph 75 is hereby inserted as follows:
 75. Additional Premises
 - A. Landlord hereby demises and leases to Tenant and Tenant hereby accepts and leases from Landlord, commencing on November 1, 2002 (this date being hereafter referred to as the "Additional Premises Commencement Date"), certain space consisting of 8,262 rentable square feet on the eighteenth (18th) floor of the Building, as shown in Exhibit A attached hereto and made a part hereof (the "Additional Premises"). Except as specifically set forth in this Paragraph 75, all terms and conditions of this Lease shall apply to the Additional Premises as if the Additional Premises were part of the Leased Premises and all references to the Leased Premises contained herein shall, where applicable, be deemed to be references to the Leased Premises and the Additional Premises.
 - B. Net Base Rent payable pursuant to this Lease with respect to the Additional Premises shall be as follows: \$12,393.00 per month from the Additional Premises Commencement Date (as hereinafter defined) through to the expiration date of February 28, 2006, except that the net base rent shall escalate annually at the rate of 3%.
 - C. Landlord agrees to reimburse Tenant an allowance (the "Tenant Improvement Allowance") of \$103,275.00 towards the cost of all Tenant Improvements (including all architectural and design costs) for the Additional Premises. Tenant shall provide Landlord with paid invoices for the actual Tenant Improvement costs, together with lien waivers from the general contractor and all subcontractors for the work relating to those invoices. Landlord shall reimburse Tenant within thirty (30) days of receipt of invoices.

-
3. Except as expressly set forth herein, the Lease shall remain unmodified and in full force and effect, enforceable in accordance with its terms.

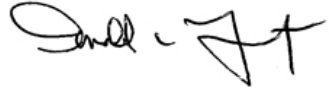
IN WITNESS WHEREOF, the parties have executed this Ninth Amendment to Lease Agreement as of the date and year first above written.

LANDLORD:

HGC/Two Pierce Limited Partnership
An Illinois limited partnership

By: HG/Two Pierce, L.L.C.
an Illinois limited liability company,
its sole General Partner

By: H.P. Itasca Two Pierce, L.L.C.,
an Illinois limited liability company,
its Managing Member

By: 
Ronald C. Lunt, Managing Member

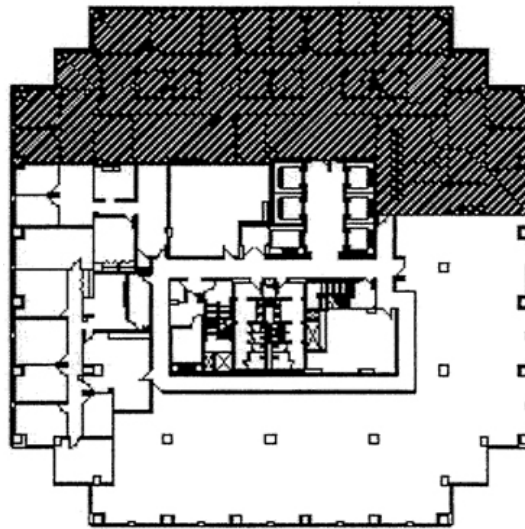
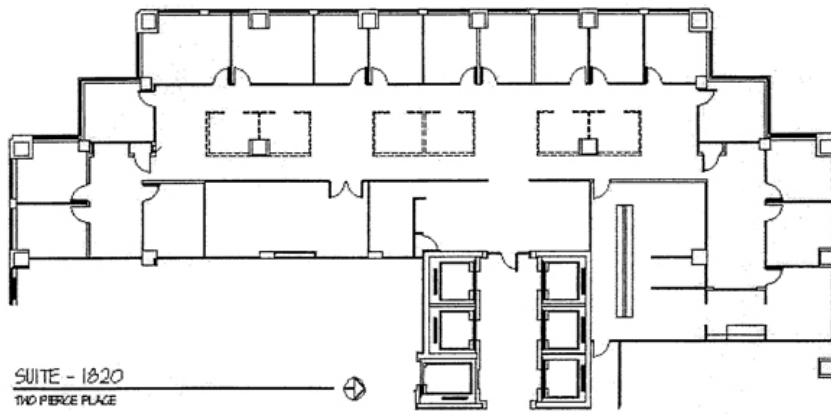
TENANT:

Arthur J. Gallagher & Co., a Delaware corporation

By: 

Title: Vice President

EXHIBIT A



TENTH AMENDMENT TO LEASE AGREEMENT

THIS, TENTH AMENDMENT TO LEASE AGREEMENT (this "Tenth Amendment") made as of this 5th day of April, 2004, by and between HGC/Two Pierce Limited Partnership, an Illinois limited partnership, as successor to Itasca Center III Limited Partnership, a Texas limited partnership (Landlord) and Arthur J. Gallagher & Co., a Delaware Corporation ("Tenant")

WITNESSETH:

WHEREAS, Landlord and Tenant entered into a certain lease agreement ("Original Lease") dated July 26, 1989, as amended by that certain First Amendment to Lease dated as of May 20, 1991, by that certain Second Amendment to Lease dated as of November 13, 1991, by that certain Third Amendment to Lease dated as of July 14, 1992, by that certain Fourth Amendment to Lease dated as of August 10, 1992, by that certain Fifth Amendment to Lease dated August 31, 1992, by that certain Sixth Amendment to Lease dated October 5, 1994, by that certain Seventh Amendment to Lease dated February 10, 1999, by that certain Eighth Amendment to Lease dated July 16, 2001, and by that certain Ninth Amendment to Lease dated November 13, 2002 (as so amended, the "Lease"), pursuant to which Landlord leased to Tenant and Tenant rented from Landlord certain space in the building commonly known as Two Pierce Place, Itasca, Illinois (the "Building"); and

WHEREAS, Landlord and Tenant now desire to amend the Lease as more particularly set forth in this Amendment.

NOW, THEREFORE, in consideration of the mutual covenants and agreements herein contained and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, Landlord and Tenant hereby covenant and agree as follows

1. Effective August 1, 2004, Subparagraph 3B is hereby amended by (i) deleting the figure "237,945" square feet and inserting the figure "240,725" in lieu thereof, and (ii) deleting Tenant's Proportionate Share of "48.857%" and inserting Tenant's Proportionate Share of "49.500%" in lieu thereof.
2. New Paragraph 75 is hereby inserted as follows:
 75. Additional Premises
 - A. Landlord hereby leases to Tenant and Tenant hereby accepts and leases from Landlord, commencing on August 1, 2004 (this date being hereafter referred to as the "Additional Premises Commencement Date"), certain space consisting of 2,780 rentable square feet on the eighteenth (18th) floor of the Building, as shown in Exhibit A attached hereto and made a part hereof (the "Additional Premises"). Except as specifically set forth in this Paragraph 75, all terms and conditions of this Lease shall apply to the Additional Premises as if the Additional Premises were part of the Leased Premises and all references to the Leased Premises contained herein shall, where applicable, be deemed to be references to the Leased Premises and the Additional Premises.

- B. Net Base Rent payable pursuant to this Lease with respect to the Additional Premises shall be as follows: \$3,706.67 per month from the Additional Premises Commencement Date (as hereinafter defined) through to the expiration date of February 28, 2006, except that the net base rent shall escalate annually at the rate of 3%.
- C. Tenant shall lease the Additional Premises "as is".
3. Except as expressly set forth herein, the Lease shall remain unmodified and in full force and effect, enforceable in accordance with its terms.

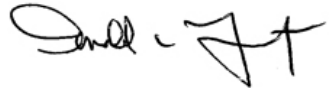
IN WITNESS WHEREOF, the parties have executed this Tenth Amendment to Lease Agreement as of the date and year first above written.

LANDLORD:

HGC/Two Pierce Limited Partnership
An Illinois limited partnership

By: HG/Two Pierce, L.L.C.
an Illinois limited liability company,
its sole General Partner

By: H.P. Itasca Two Pierce, L.L.C.,
an Illinois limited liability company,
its Managing Member

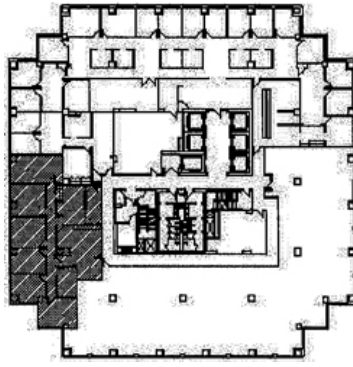
By: 
Ronald C. Lunt, Managing Member

TENANT:

Arthur J. Gallagher & Co., a Delaware corporation

By: 
Title: Chief Financial Officer

EXHIBIT A



ELEVENTH AMENDMENT TO LEASE

THIS ELEVENTH AMENDMENT TO LEASE is made as of this 10th day of February, 2005, by and between HGC/Two Pierce Limited Partnership, an Illinois limited partnership ("Landlord") and Arthur J. Gallagher & Co., a Delaware corporation ("Tenant").

WITNESSETH:

WHEREAS, Landlord's predecessor in interest and Tenant entered into a written lease dated July 26, 1989 (the "Original Lease"), as amended by that certain First Amendment to Lease dated as of May 20, 1991, that certain Second Amendment to Lease dated as of November 13, 1991, that certain Third Amendment to Lease dated as of July 14, 1992, that certain Fourth Amendment to Lease dated as of August 10, 1992, that certain Fifth Amendment to Lease dated as of August 31, 1992, that certain Sixth Amendment to Lease dated as of October 5, 1994, that certain Seventh Amendment to Lease dated as of February 10, 1999, that certain Eighth Amendment to Lease dated as of July 16, 2001, that certain Ninth Amendment to Lease dated as of November 13, 2002, and that certain Tenth Amendment to Lease dated as of April 5, 2004 (collectively, the "Amended Lease") for approximately 240,725 rentable square feet (the "Premises") and 631 square feet of storage space (the "Storage Space"), at Two Pierce Place, Itasca, Illinois; and

WHEREAS, Tenant has exercised its option to extend the Term of the Amended Lease pursuant to Paragraph 41 of the Original Lease.

NOW, THEREFORE, in consideration of the mutual covenants and conditions hereinafter contained, Landlord and Tenant hereby agree as follows:

1. Term. The Term of the Amended Lease shall be extended from the current Termination Date of February 28, 2006, until February 28, 2011 (the "Extension Term").
2. Base Rent. Tenant shall pay as Monthly Base Rent for the Premises for the Extension Term the following amounts:

<u>Period</u>	<u>Monthly Base Rent</u>
3/1/06 1/31/07	\$ 240,725.00
2/1/07 2/28/07	\$ 0.00
3/1/07 1/31/08	\$ 245,539.50
2/1/08 2/29/08	\$ 0.00
3/1/08 1/31/09	\$ 250,450.29
2/1/09 2/28/09	\$ 0.00
3/1/09 1/31/10	\$ 255,459.30
2/1/10 2/28/10	\$ 0.00
3/1/10 1/31/11	\$ 260,568.48
2/1/11 2/28/11	\$ 0.00

3. Storage Space Rental. Tenant shall pay as Monthly Storage Space Rental for the Storage Space for the Extension Term the following amounts:

Period	Monthly Base Rent
3/1/06 2/28/07	\$ 525.83
3/1/07 2/29/08	\$ 541.61
3/1/08 2/28/09	\$ 557.86
3/1/09 2/28/10	\$ 574.59
3/1/10 2/28/11	\$ 591.83

4. Improvements. Landlord shall have no obligation to alter or improve the Premises or the Storage Space and Tenant agrees to accept the Premises and the Storage Space in their then "AS IS" condition. Tenant hereby waives any right to require Landlord to paint the Premises during the Extension Term pursuant to Paragraph 49 of the Original Lease (Refurbishment of Leased Premises).

5. Superceded Provision.

A. Paragraph 4 of the Original Lease (CPI Adjustment) shall not apply to the Extension Term. Therefore, with respect to periods during the Term after March 1, 2007, Tenant shall not pay increases in Base Rent based upon increases in the Consumer Price Index.

B. Paragraph 37 of the Original Lease (Expansion Options) is hereby deleted and shall have no further force or effect.

6. Broker's Commission. Tenant represents that Tenant has not directly dealt with any broker in connection with this Eleventh Amendment and agrees to indemnify and hold Landlord and the managing agent and leasing agent harmless from all losses, damages, claims, liens, liabilities, costs and expense (including without limitation reasonable attorney's fees) arising from any claims or demands of any broker or brokers or finders for any commission or other compensation alleged to be due such broker or brokers or finders in connection with its participating on behalf of Tenant in the negotiation of this Eleventh Amendment or in exhibiting the Premises.

7. Terms of Amended Lease. Capitalized terms used but not defined herein shall have the meanings ascribed thereto in the Amended Lease.

8. Incorporation of Amended Lease. Except as otherwise amended hereby, the terms and covenants of the Amended Lease remain in full force and effect.

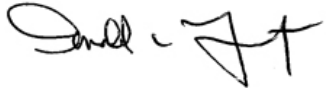
IN WITNESS WHEREOF, Landlord and Tenant have executed this Eleventh Amendment as of the day and year first above written.

LANDLORD:

HGC/Two Pierce Limited Partnership, an Illinois limited partnership

By: HG/Two Pierce, L.L.C., an Illinois limited liability company, its sole general partner

By: H.P. Itasca Two Pierce, L.L.C., an Illinois limited liability company, its Managing Member

By: 

Its: Managing Member

TENANT:

Arthur J. Gallagher & Co., a Delaware corporation

By: 

Its: CFO

TWELFTH AMENDMENT TO LEASE

THIS TWELFTH AMENDMENT TO LEASE is made as of this 10th day of February, 2005, by and between HGC/Two Pierce Limited Partnership, an Illinois limited partnership ("Landlord") and Arthur J. Gallagher & Co., a Delaware corporation ("Tenant").

WITNESSETH:

WHEREAS, Landlord's predecessor in interest and Tenant entered into a written lease dated July 26, 1989 (the "Original Lease"), as amended by that certain First Amendment to Lease dated as of May 20, 1991, that certain Second Amendment to Lease dated as of November 13, 1991, that certain Third Amendment to Lease dated as of July 14, 1992, that certain Fourth Amendment to Lease dated as of August 10, 1992, that certain Fifth Amendment to Lease dated as of August 31, 1992, that certain Sixth Amendment to Lease dated as of October 5, 1994, that certain Seventh Amendment to Lease dated as of February 10, 1999, that certain Eighth Amendment to Lease dated as of July 16, 2001, that certain Ninth Amendment to Lease dated as of November 13, 2002, that certain Tenth Amendment to Lease dated as of April 5, 2004, and that certain Eleventh Amendment to Lease dated as of (collectively, the "Amended Lease") for approximately 240,725 rentable square feet (the "Current Premises") and 631 square feet of storage space, at Two Pierce Place, Itasca, Illinois; and

WHEREAS, Landlord and Tenant have agreed to expand the Current Premises, all on the terms and conditions set forth herein.

NOW, THEREFORE, in consideration of the mutual covenants and conditions hereinafter contained, Landlord and Tenant hereby agree as follows:

1. Additional Premises. Landlord and Tenant have agreed that in addition to the Current Premises, beginning as of July 15, 2005 (the "2nd Floor Additional Premises Commencement Date"), Tenant will lease Suite 200 containing approximately 3,809 rentable square feet on the 2nd floor (the "2nd Floor Additional Premises") as shown on Exhibit B attached hereto and incorporated herein. Further, Landlord and Tenant have agreed that in addition to the Current Premises and the 2nd Floor Additional Premises, beginning as of September 1, 2005 (the "14th Floor Additional Premises Commencement Date"), Tenant will lease Suite 1400 containing approximately 19,998 rentable square feet on the 14th floor (the "14th Floor Additional Premises") as shown on Exhibit A attached hereto and incorporated herein. Therefore, as of each Additional Premises Commencement Date, and with respect to periods thereafter during the Term, the term "Leased Premises" shall mean such Additional Premises as well as the Current Premises, unless the context requires otherwise.

2. **Base Rent.** Tenant shall pay as Monthly Base Rent for the 14th Floor Additional Premises and for the 2nd Floor Additional Premises for the Term the following amounts:

Period	Monthly Base Rent
7/15/05 7/31/05	\$ 2,088.81
8/1/05 8/31/05	\$ 3,809.00
9/1/05 1/31/07	\$ 23,807.00
2/1/07 2/28/07	\$ 0.00
3/1/07 1/31/08	\$ 24,283.14
2/1/08 2/29/08	\$ 0.00
3/1/08 1/31/09	\$ 24,768.80
2/1/09 2/28/09	\$ 0.00
3/1/09 1/31/10	\$ 25,264.18
2/1/10 2/28/10	\$ 0.00
3/1/10 1/31/11	\$ 25,769.46
2/1/11 2/28/11	\$ 0.00

3. **Tenant's Proportionate Share.** Effective as of July 15, 2005, Subparagraph 3B of the Original Lease is hereby amended by (i) deleting the figure "240,725" and inserting the figure "244,534" in lieu thereof, and (ii) deleting Tenant's Proportionate Share of "49.500%" and inserting Tenant's Proportionate Share of "50.297%" in lieu thereof. Effective as of September 1, 2005, Subparagraph 3B of the Original Lease is hereby amended by (i) deleting the figure "244,534" and inserting the figure "264,532" in lieu thereof, and (ii) deleting Tenant's Proportionate Share of "53.612%" and inserting Tenant's Proportionate Share of "54.410%" in lieu thereof.

4. **Improvements.** Landlord shall have no obligation to alter or improve either the 14th Floor Additional Premises or the 2nd Floor Additional Premises and Tenant agrees to accept such Additional Premises in their then "AS IS" condition.

5. **Expansion of Premises.** Tenant shall lease the first available full floor in the Building containing approximately 19,998 rentable square feet of space (the "Expansion Space") effective as the Expansion Commencement Date. The Expansion Space shall automatically be included in the Premises effective as of the Expansion Commencement Date and all of the covenants, conditions and provisions of the Amended Lease (as further amended hereby) shall thereupon be applicable to the Expansion Space, except that (x) the Annual and Monthly Base Rent for each period during the Term shall be increased proportionately based upon the Annual and Monthly Base Rent for each period for the Current Premises (except that in the months that no Base Rent is due and payable with respect to the Current Premises, Base Rent shall be due and payable with respect to the Expansion Space at the rate per square foot for the previous month), (y) Tenant's proportionate share shall increase accordingly, and (z) the renewal option set forth in Paragraph 41 of the Original Lease shall apply to the Expansion Space except that the Base Rent for the Expansion Space during such renewal term shall be determined in accordance with Paragraph 38 of the Original Lease as modified by Paragraph 6 hereof. The Expansion Space shall be leased on an "AS IS" basis, except that Landlord will provide Tenant a construction allowance determined by multiplying \$25 per rentable square foot in the Expansion Space by a fraction which has as its numerator the number of days then (i.e., as of the Expansion Commencement Date) remaining in the Term after March 1, 2006 and until February 28, 2011, and which has as its denominator the total number of days from March 1, 2006 until February

28, 2011. The construction allowance shall be paid one half upon completion of the improvements (and receipt of final lien waivers and other applicable evidence of completion of the work in accordance with applicable laws and approved plans, if applicable), one quarter on March 1, 2009, and the balance on March 1, 2010. As used herein, the term "Expansion Commencement Date" shall mean the date set forth in a notice to Tenant as the date that a full floor in the Building will be available for lease (which date may not be less than sixty (60) days after the date of Landlord's notice). If Landlord fails to give possession of the Expansion Space on the Expansion Commencement Date for any reason outside of the reasonable control of Landlord, including the holdover of an existing tenant, Landlord shall not be subject to any liability whatsoever for such failure. Under such circumstances, neither the term with respect to the Expansion Space nor Tenant's obligation to pay rent with respect to such space shall commence until the date Landlord is able to deliver possession of such space. Tenant acknowledges that it has no further options to expand the Current Premises except as set forth in this paragraph. (However, nothing contained in this paragraph shall affect any rights Tenant may have pursuant to Paragraph 39 of the Original Lease.)

6. Expansion Space Renewal Rent Rate. For purposes of the Expansion Space taken by Tenant as contained herein and any future expansion space taken by Tenant under the Original Lease and its amendments, the following shall apply:

(a) The Expansion Space (and any additional expansion space) renewal rent rate shall be 100% of the Prevailing Market Rate as determined in accordance with Paragraph 38A of the Original Lease as modified by this Paragraph 6.

(b) Once Tenant has delivered a Renewal Notice with respect to the Expansion Space (or any additional expansion space), it is obligated to lease the Expansion Space (and any additional expansion space) at the Prevailing Market Rate as determined in accordance with Paragraph 38 of the Original Lease as modified by this Paragraph 6 (i.e., Tenant may not deliver a Withdrawal Notice with respect to the Expansion Space or any additional expansion space).

(c) Paragraph 38B shall not apply to the Expansion Space (and any additional expansion space) and in lieu thereof "Prevailing Market Rate" shall mean: the annual rental rate per square foot of rentable area which a tenant would agree to pay, and a landlord would agree to accept, as of the date in question, for the term in question, for the space in question in its then existing condition, assuming reasonably prudent persons, each being fully knowledgeable in all the facts, and each being willing to deal but neither being under the compulsion to deal, and assuming an amendment containing all of the terms, covenants and conditions of a subsequent amendment by the parties memorializing such agreement. Such Prevailing Market Rate shall be based on prevailing rental rates being charged to tenants in comparable buildings in the Development, including the Building, and, if and only if there are no comparable leases in the Development, then in the western and northwestern suburbs of Chicago. The Prevailing Market Rate shall be determined giving due consideration to whether or not tenant concessions, i.e., improvement allowances or costs, moving allowances, free or abated rent, leasing commissions or other lease concessions (collectively, the "Tenant Concessions") are then customarily being offered in connection with renewal leases in connection with the

renewal of existing leases, it being the intention that Landlord shall provide Tenant Concessions which are consistent with and determined contemporaneously with the determination of the Prevailing Market Rate.

7. Broker's Commission. Tenant represents that Tenant has not directly dealt with any broker in connection with this Twelfth Amendment and agrees to indemnify and hold Landlord and the managing agent and leasing agent harmless from all losses, damages, claims, liens, liabilities, costs and expense (including without limitation reasonable attorney's fees) arising from any claims or demands of any broker or brokers or finders for any commission or other compensation alleged to be due such broker or brokers or finders in connection with its participating on behalf of Tenant in the negotiation of this Twelfth Amendment or in exhibiting the 14th Floor Additional Premises, the 2nd Floor Additional Premises or the Expansion Space.

8. Terms of Amended Lease. Capitalized terms used but not defined herein shall have the meanings ascribed thereto in the Amended Lease.

9. Incorporation of Amended Lease. Except as otherwise amended hereby, the terms and covenants of the Amended Lease remain in full force and effect.

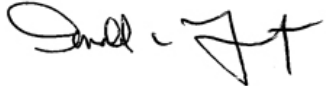
IN WITNESS WHEREOF, Landlord and Tenant have executed this Twelfth Amendment as of the day and year first above written.

LANDLORD:

HGC/Two Pierce Limited Partnership, an Illinois limited partnership

By: HG/Two Pierce, L.L.C., an Illinois limited liability company, its sole general partner

By: H.P. Itasca Two Pierce, L.L.C., an Illinois limited liability company, its Managing Member

By: 

Its: Managing Member

TENANT:

Arthur J. Gallagher & Co., a Delaware corporation

By: 

Its: CFO

THIRTEENTH AMENDMENT TO LEASE

THIS THIRTEENTH AMENDMENT TO LEASE is made as of this 28th day of March, 2005, by and between HGC/Two Pierce Limited Partnership, an Illinois limited partnership ("Landlord") and Arthur J. Gallagher & Co., a Delaware corporation ("Tenant").

WITNESSETH:

WHEREAS, Landlord's predecessor in interest and Tenant entered into a written lease dated July 26, 1989 (the "Original Lease"), as amended by that certain First Amendment to Lease dated as of May 20, 1991, that certain Second Amendment to Lease dated as of November 13, 1991, that certain Third Amendment to Lease dated as of July 14, 1992, that certain Fourth Amendment to Lease dated as of August 10, 1992, that certain Fifth Amendment to Lease dated as of August 31, 1992, that certain Sixth Amendment to Lease dated as of October 5, 1994, that certain Seventh Amendment to Lease dated as of February 10, 1999, that certain Eighth Amendment to Lease dated as of July 16, 2001, that certain Ninth Amendment to Lease dated as of November 13, 2002, that certain Tenth Amendment to Lease dated as of April 5, 2004, that certain Eleventh Amendment to Lease dated as of February 10, 2005, and that certain Twelfth Amendment dated as of February 10, 2005 (collectively, the "Amended Lease") for approximately 264,531 rentable square feet (the "Current Premises") and 631 square feet of storage space, at Two Pierce Place, Itasca, Illinois; and

WHEREAS, Landlord and Tenant have agreed to expand the Current Premises, all on the terms and conditions set forth herein.

NOW, THEREFORE, in consideration of the mutual covenants and conditions hereinafter contained, Landlord and Tenant hereby agree as follows:

1. Additional Premises. Landlord and Tenant have agreed that in addition to the Current Premises, beginning as of April 1, 2005 (the "18th Floor Additional Premises Commencement Date"), Tenant will lease Suite 1800 containing approximately 1,290 rentable square feet on the 18th floor (the "18th Floor Additional Premises") as shown on Exhibit A attached hereto and incorporated herein. Therefore, as of the 18th Floor Additional Premises Commencement Date, and with respect to periods thereafter during the Term, the term "Leased Premises" shall mean the 18th Floor Additional Premises as well as the Current Premises, unless the context requires otherwise.

2. **Base Rent.** Tenant shall pay as Monthly Base Rent for the 18th Floor Additional Premises for the Term the following amounts:

Period	Monthly Base Rent
4/1/05 2/28/06	\$ 1,505.00
3/1/06 2/28/07	\$ 1,535.10
3/1/07 2/29/08	\$ 1,565.80
3/1/08 2/28/09	\$ 1,597.12
3/1/09 2/28/10	\$ 1,629.06
3/1/10 2/28/11	\$ 1,661.64

3. **Tenant's Proportionate Share.** Effective as of April 1, 2005, Subparagraph 3B of the Original Lease is hereby amended by (i) deleting the figure "240,725" and inserting the figure "242,015" in lieu thereof, and (ii) deleting Tenant's Proportionate Share of "49.500%" and inserting Tenant's Proportionate Share of "49.779%" in lieu thereof. Effective as of July 15, 2005, Subparagraph 3B of the Original Lease is hereby amended by (i) deleting the figure "242,015" and inserting the figure "245,824" in lieu thereof, and (ii) deleting Tenant's Proportionate Share of "49.779%" and inserting Tenant's Proportionate Share of "50.562%" in lieu thereof. Effective as of September 1, 2005, Subparagraph 3B of the Original Lease is hereby amended by (i) deleting the figure "245,824" and inserting the figure "265,822" in lieu thereof, and (ii) deleting Tenant's Proportionate Share of "50.562%" and inserting Tenant's Proportionate Share of "54.675%" in lieu thereof.

4. **Improvements.** Landlord shall have no obligation to alter or improve the 18th Floor Additional Premises and Tenant agrees to accept the 18th Additional Premises in their then "AS IS" condition.

5. **Expansion Space Renewal Rent Rate.** The 18th Floor Additional Premises shall be deemed "additional expansion space" and the provisions of Paragraph 6 of the Twelfth Amendment shall apply to the 18th Floor Additional Premises.

6. **Broker's Commission.** Tenant represents that Tenant has not directly dealt with any broker in connection with this Twelfth Amendment other than H.P. Itasca Two Pierce, L.L.C. and agrees to indemnify and hold Landlord and the managing agent and leasing agent harmless from all losses, damages, claims, liens, liabilities, costs and expense (including without limitation reasonable attorney's fees) arising from any claims or demands of any other broker or brokers or finders for any commission or other compensation alleged to be due such broker or brokers or finders in connection with its participating on behalf of Tenant in the negotiation of this Thirteenth Amendment or in exhibiting the 18th Floor Additional Premises. Landlord shall pay the commission due H.P. Itasca Two Pierce, L.L.C.

7. **Terms of Amended Lease.** Capitalized terms used but not defined herein shall have the meanings ascribed thereto in the Amended Lease.

8. **Incorporation of Amended Lease.** Except as otherwise amended hereby, the terms and covenants of the Amended Lease remain in full force and effect.

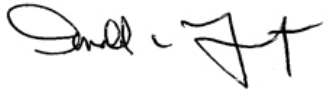
IN WITNESS WHEREOF, Landlord and Tenant have executed this Thirteenth Amendment as of the day and year first above written.

LANDLORD:

HGC/Two Pierce Limited Partnership, an Illinois limited partnership

By: HGC/Two Pierce, L.L.C., an Illinois limited liability company, its sole general partner

By: H.P. Itasca Two Pierce, L.L.C., an Illinois limited liability company, its Managing Member

By: 

Its: Managing Member

TENANT:

Arthur J. Gallagher & Co., a Delaware corporation

By: 

Its: CFO

EXHIBIT A

18TH FLOOR ADDITIONAL PREMISES

4

FOURTEENTH AMENDMENT TO LEASE

THIS FOURTEENTH AMENDMENT TO LEASE is made as of this 31st day of October 2005, by and between HGC/Two Pierce Limited Partnership, an Illinois limited partnership ("Landlord") and Arthur J. Gallagher & Co., a Delaware corporation ("Tenant").

WITNESSETH:

WHEREAS, Landlord's predecessor in interest and Tenant entered into a written lease dated July 26, 1989 (the "Original Lease"), as amended by that certain First Amendment to Lease dated as of May 20, 1991, that certain Second Amendment to Lease dated as of November 13, 1991, that certain Third Amendment to Lease dated as of July 14, 1992, that certain Fourth Amendment to Lease dated as of August 10, 1992, that certain Fifth Amendment to Lease dated as of August 31, 1992, that certain Sixth Amendment to Lease dated as of October 5, 1994, that certain Seventh Amendment to Lease dated as of February 10, 1999, that certain Eighth Amendment to Lease dated as of July 16, 2001, that certain Ninth Amendment to Lease dated as of November 13, 2002, that certain Tenth Amendment to Lease dated as of April 5, 2004, that certain Eleventh Amendment to Lease dated as of February 10, 2005, that certain Twelfth Amendment dated as of February 10, 2005, and that certain Thirteenth Amendment dated as of February 10, 2005 (collectively, the "Amended Lease") for approximately 265,822 rentable square feet (the "Current Premises") and 631 square feet of storage space, at Two Pierce Place, Itasca, Illinois; and

WHEREAS, Landlord and Tenant have agreed to expand the Current Premises, all on the terms and conditions set forth herein.

NOW, THEREFORE, in consideration of the mutual covenants and conditions hereinafter contained, Landlord and Tenant hereby agree as follows:

1. Additional Premises. Pursuant to Paragraph 5 of the Twelfth Amendment, Tenant is required to lease the first full floor becoming available in the Building. In accordance with Paragraph 5 of the Twelfth Amendment, Landlord and Tenant have agreed that in addition to the Current Premises, beginning as of November 1, 2005 (the "16th Floor Additional Premises Commencement Date"), Tenant will lease Suite 1600 containing approximately 20,439 rentable square feet on the 16th floor (the "16th Floor Additional Premises") as shown on Exhibit A attached hereto and incorporated herein. Therefore, as of the 16th Floor Additional Premises Commencement Date, and with respect to periods thereafter during the Term, the term "Leased Premises" shall mean the 16th Floor Additional Premises as well as the Current Premises, unless the context requires otherwise.

2. **Base Rent.** Tenant shall pay as Monthly Base Rent for the 16th Floor Additional Premises for the Term the following amounts:

Period	Monthly Base Rent
11/1/05 2/28/07	\$ 20,439.00
3/1/07 2/29/08	\$ 20,847.78
3/1/08 2/28/09	\$ 21,264.74
3/1/09 2/28/10	\$ 21,690.04
3/1/10 2/28/11	\$ 22,123.86

3. **Tenant's Proportionate Share.** Effective as of November 1, 2005, Subparagraph 3B of the Original Lease is hereby amended by (i) deleting the figure "242,015" and inserting the figure "286,261" in lieu thereof, and (ii) deleting Tenant's Proportionate Share of "49.779%" and inserting Tenant's Proportionate Share of "58.879%" in lieu thereof.

4. **Improvements.** Landlord shall have no obligation to alter or improve the 16th Floor Additional Premises and Tenant agrees to accept the 16th Floor Additional Premises in their then "AS IS" condition, except that Landlord will provide Tenant a construction allowance of \$25.00 per rentable square foot in the 16th Floor Additional Premises. The construction allowance shall be paid one half upon completion of the improvements (and receipt of final lien waivers and other applicable evidence of completion of the work in accordance with applicable laws and approved plans, if applicable), one quarter on March 1, 2009, and the balance on March 1, 2010.

5. **Expansion Space Renewal Rent Rate.** The 16th Floor Additional Premises shall be deemed "additional expansion space" and the provisions of Paragraph 6 of the Twelfth Amendment shall apply to the 16th Floor Additional Premises.

6. **Broker's Commission.** Tenant represents that Tenant has not directly dealt with any broker in connection with this Fourteenth Amendment other than H.P. Itasca Two Pierce, L.L.C. and agrees to indemnify and hold Landlord and the managing agent and leasing agent harmless from all losses, damages, claims, liens, liabilities, costs and expense (including without limitation reasonable attorney's fees) arising from any claims or demands of any other broker or brokers or finders for any commission or other compensation alleged to be due such broker or brokers or finders in connection with its participating on behalf of Tenant in the negotiation of this Fourteenth Amendment or in exhibiting the 16th Floor Additional Premises. No commission shall be due to H.P. Itasca Two Pierce, L.L.C.

7. **Terms of Amended Lease.** Capitalized terms used but not defined herein shall have the meanings ascribed thereto in the Amended Lease.

8. **Incorporation of Amended Lease.** Except as otherwise amended hereby, the terms and covenants of the Amended Lease remain in full force and effect.

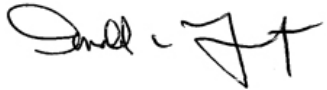
IN WITNESS WHEREOF, Landlord and Tenant have executed this Fourteenth Amendment as of the day and year first above written.

LANDLORD:

HGC/Two Pierce Limited Partnership, an Illinois limited partnership

By: HGC/Two Pierce, L.L.C., an Illinois limited liability company, its sole general partner

By: H.P. Itasca Two Pierce, L.L.C., an Illinois limited liability company, its Managing Member

By: 

Its: Managing Member

TENANT:

Arthur J. Gallagher & Co., a Delaware corporation

By: 

Its: CFO
Douglas K. Howell

EXHIBIT A

16TH FLOOR ADDITIONAL PREMISES

4

FIFTEENTH AMENDMENT TO LEASE

THIS FIFTEENTH AMENDMENT TO LEASE is made as of this 31st day of October, 2005, by and between HGC/Two Pierce Limited Partnership, an Illinois limited partnership ("Landlord") and Arthur J. Gallagher & Co., a Delaware corporation ("Tenant").

WITNESSETH:

WHEREAS, Landlord's predecessor in interest and Tenant entered into a written lease dated July 26, 1989 (the "Original Lease"), as amended by that certain First Amendment to Lease dated as of May 20, 1991, that certain Second Amendment to Lease dated as of November 13, 1991, that certain Third Amendment to Lease dated as of July 14, 1992, that certain Fourth Amendment to Lease dated as of August 10, 1992, that certain Fifth Amendment to Lease dated as of August 31, 1992, that certain Sixth Amendment to Lease dated as of October 5, 1994, that certain Seventh Amendment to Lease dated as of February 10, 1999, that certain Eighth Amendment to Lease dated as of July 16, 2001, that certain Ninth Amendment to Lease dated as of November 13, 2002, that certain Tenth Amendment to Lease dated as of April 5, 2004, that certain Eleventh Amendment to Lease dated as of February 10, 2005, that certain Twelfth Amendment dated as of February 10, 2005, that certain Thirteenth Amendment dated as of February 10, 2005, and that certain Fourteenth Amendment dated as of October 31, 2005 (collectively, the "Amended Lease") for approximately 286,261 rentable square feet (the "Current Premises") and 631 square feet of storage space, at Two Pierce Place, Itasca, Illinois; and

WHEREAS, Landlord and Tenant have agreed to expand the Current Premises, all on the terms and conditions set forth herein.

NOW, THEREFORE, in consideration of the mutual covenants and conditions hereinafter contained, Landlord and Tenant hereby agree as follows:

1. Additional Premises. Landlord and Tenant have agreed that in addition to the Current Premises, beginning as of January 1, 2007 (the "8th Floor Additional Premises Commencement Date"), Tenant will lease Suite 800 containing approximately 19,998 rentable square feet on the 8th floor (the "8th Floor Additional Premises") as shown on Exhibit A attached hereto and incorporated herein. Therefore, as of the 8th Floor Additional Premises Commencement Date, and with respect to periods thereafter during the Term, the term "Leased Premises" shall mean the 8th Floor Additional Premises as well as the Current Premises, unless the context requires otherwise.

2. **Base Rent.** Tenant shall pay as Monthly Base Rent for the 8th Floor Additional Premises for the Term the following amounts:

Period	Monthly Base Rent
1/1/07 2/29/08	\$ 23,331
3/1/08 2/28/09	\$ 24,031
3/1/09 2/28/10	\$ 24,752
3/1/10 2/28/11	\$ 25,494

3. **Tenant's Proportionate Share.** Effective as of January 1, 2007, Subparagraph 3B of the Original Lease is hereby amended by (i) deleting the figure "286,261" and inserting the figure "306,259" in lieu thereof, and (ii) deleting Tenant's Proportionate Share of "58.879%" and inserting Tenant's Proportionate Share of "62.833%" in lieu thereof.

4. **Improvements.** Landlord shall have no obligation to alter or improve the 8th Floor Additional Premises and Tenant agrees to accept the 8th Floor Additional Premises in their then "AS IS" condition.

5. **Expansion Space Renewal Rent Rate.** The 8th Floor Additional Premises shall be deemed "additional expansion space" and the provisions of Paragraph 6 of the Twelfth Amendment shall apply to the 8th Floor Additional Premises.

6. **Broker's Commission.** Tenant represents that Tenant has not directly dealt with any broker in connection with this Fifteenth Amendment other than H.P. Itasca Two Pierce, L.L.C. and agrees to indemnify and hold Landlord and the managing agent and leasing agent harmless from all losses, damages, claims, liens, liabilities, costs and expense (including without limitation reasonable attorney's fees) arising from any claims or demands of any other broker or brokers or finders for any commission or other compensation alleged to be due such broker or brokers or finders in connection with its participating on behalf of Tenant in the negotiation of this Fifteenth Amendment or in exhibiting the 8th Floor Additional Premises. Landlord shall pay the commission due H.P. Itasca Two Pierce, L.L.C.

7. **Terms of Amended Lease.** Capitalized terms used but not defined herein shall have the meanings ascribed thereto in the Amended Lease.

8. **Incorporation of Amended Lease.** Except as otherwise amended hereby, the terms and covenants of the Amended Lease remain in full force and effect.

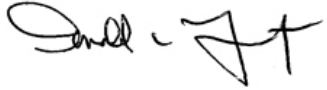
IN WITNESS WHEREOF, Landlord and Tenant have executed this Fifteenth Amendment as of the day and year first above written.

LANDLORD:

HGC/Two Pierce Limited Partnership, an Illinois limited partnership

By: HG/Two Pierce, L.L.C., an Illinois limited liability company, its sole general partner

By: H.P. Itasca Two Pierce, L.L.C., an Illinois limited liability company, its Managing Member

By: 

Its: Managing Member

TENANT:

Arthur J. Gallagher & Co., a Delaware corporation

By: 

Its: CFO
Douglas K. Howell

**FIRST AMENDMENT
TO
ARTHUR J. GALLAGHER & CO.
SUPPLEMENTAL SAVINGS AND THRIFT PLAN**

WHEREAS, Arthur J. Gallagher & Co. (the "Company") maintains the Arthur J. Gallagher & Co. Supplemental Savings and Thrift Plan (the "Deferred Compensation Plan"), for the benefit of its eligible employees; and

WHEREAS, Section 9.1 of the Deferred Compensation Plan reserves to the Company the right to amend the Deferred Compensation Plan from time to time; and

WHEREAS, the Company desires to amend the Deferred Compensation Plan;

NOW, THEREFORE, the Deferred Compensation Plan is hereby amended, effective [date], in the following respects:

1. Section 2.5 of the Plan is amended to read as follows:

"2.5 Compensation means in the case of a Participant who is an Eligible Employee, (i) the total cash compensation of such Participant paid by the Employer during any year, including salary and annual bonuses (paid with respect to performance in 1999 and later years), and also including overtime pay and commissioned earnings (whether paid as a draw against commissions or as a settlement of earned commissions), before reductions for contributions made to this Plan, the Qualified Plan, or a cafeteria plan under Code Section 125; and (ii) a cash or stock distribution from another deferred compensation arrangement of the Company or an affiliate that is attributable to an annual bonus, but not including any bonus actually paid during 2002 under the AJG Financial Services, Inc. Bonus Plan. Notwithstanding the foregoing, or any other provision of the Plan, Compensation shall not include (A) relocation pay or related payments; (B) severance pay; (C) Matching Deferrals and Performance Deferrals under this Plan; or (D) amounts related to stock options."

2. Section 2.9 of the Plan is amended to read as follows:

"2.9 Eligible Employee means, on the Effective Date or on any Entry Date thereafter, each employee of the Employer (i) whose total annual Compensation is not less than the dollar amount then in effect under Section 401(a)(17) of the Code based upon such employee's current salary or Compensation for the prior year; and (ii) who has completed sixty (60) days of employment with the Employer. If an Eligible Employee's actual Compensation is (i) less than the applicable dollar amount during two consecutive Plan Years, such Eligible Employee will be suspended from making any additional Elective Deferrals under the Plan for each subsequent Plan Year, until the Plan Year following the Plan Year such Eligible Employee's Compensation is not less than the applicable dollar amount; or (ii) less than \$150,000 for two consecutive Plan Years, such Eligible Employee's Account shall be distributed in accordance with the terms of

Section 7.7 unless, prior to such distribution, such Eligible Employee's Compensation is not less than the applicable dollar amount in a Plan Year."

3. A new Section 4.1(c) is added to the Plan (and subsequent subsections are redesignated accordingly) and shall read as follows:

"(c) An Eligible Employee who has received (or is to receive) a Restricted Share of common stock of Gallagher or an affiliate who is specifically designated by the Plan Administrator for such purpose may elect to defer such Restricted Share to the Plan (a "Share Deferral"). An Eligible Employee who desires to elect a Share Deferral shall complete and file an Enrollment Form with the Plan Administrator. Cash dividends paid on deferred Shares shall be credited to the Participant's Account, subject to Section 5.2. The Funding Trustee shall not be required to hold on behalf of a Participant any Share deferred in accordance with this paragraph. Instead, the Funding Trustee shall credit to the Participant's Account an amount equal to the fair market value thereof on the date that the Share would otherwise be vested. The Participant may request, in accordance with Section 5.2, that amounts credited to his or her Account following a Share Deferral be invested in Shares, provided that the Funding Trustee shall have no obligation to comply with such request."

4. Redesignated Section 4.1(e) of the Plan is amended to read as follows:

"(d) Except as provided in the penultimate sentence of this paragraph, elections pursuant to Section 4.1(a) to defer Compensation paid in a Plan Year must be made prior to the first day of such Plan Year. Notwithstanding the foregoing: (i) the election to defer the salary portion of Compensation pursuant to Section 4.1(a)(i) for the 1999 Plan Year must be made prior to January 7, 1999; (ii) except as provided in (iii), an election to defer the bonus portion of Compensation pursuant to Section 4.1(a)(i) must be made on or prior to September 30 of the Plan Year prior to the Plan Year in which the bonus is paid; and (iii) an election to defer a distribution from a deferred compensation arrangement attributable to a bonus must be made no less than six months before the date the distribution would otherwise occur, or by October 31, 2002 if later. Except as provided in the penultimate sentence of this paragraph, Share Deferral elections must be made on or prior to the date determined by the Plan Administrator that is in the prior

calendar year and at least six months before the Restricted Share is scheduled to vest. Notwithstanding the foregoing, in the case of an individual who first becomes an Eligible Employee following the commencement of a Plan Year, the election to defer must be made within 30 days after the date the individual becomes an Eligible Employee, and will be effective with respect to Compensation earned or Restricted Shares that vest after the Enrollment Form is filed. Any election pursuant to this paragraph shall be irrevocable from and after the deadline for such election provided that it may be changed after such deadline in the event of (and consistent with) an Unforeseeable Emergency, as determined by the Plan Administrator."

5. Section 4.2(b)(A) is amended to read as follows:

"(A) 50% of his Elective Deferrals of Compensation described in Section 2.5(i) of this Plan and the Qualified Plan"

IN WITNESS WHEREOF, the Company hereby adopts this First Amendment this 1st day of October, 2002.

ARTHUR J. GALLAGHER & CO.

By:	<u>/s/ Elizabeth J. Brinkerhoff</u>
Title:	VP Human Resources

ATTEST:

/s/ Janet A. Hoggay

**SECOND AMENDMENT TO THE
ARTHUR J. GALLAGHER & CO.
SUPPLEMENTAL SAVINGS AND THRIFT PLAN**

WHEREAS, Arthur J. Gallagher & Co., a Delaware corporation (the "Company"), maintains the Arthur J. Gallagher & Co. Supplemental Savings and Thrift Plan, effective January 1, 1999 (the "Plan");

WHEREAS, pursuant to Section 9.1 of the Plan, the Company has reserved the power to amend the Plan by an instrument in writing which has been executed on its behalf by a duly authorized officer;

WHEREAS, the Company desires to amend the Plan to permit employees who receive awards under the Arthur J. Gallagher & Co. Restricted Stock Plan during the 2005 calendar year to elect to defer the receipt of shares issued upon the vesting of such awards; and

WHEREAS, the Company desires to amend the Plan to permit employees who elected to defer their 2005 bonuses to revoke such election.

NOW, THEREFORE, pursuant to the power of amendment contained in Section 9.1 of the Plan, Section 4.1 of the Plan is hereby amended, effective January 1, 2005, by adding the following new subsections thereto:

(f) Each Eligible Employee who is granted an award under the Arthur J. Gallagher & Co. Restricted Stock Plan during the 2005 calendar year may elect, not later than March 10, 2005, to defer the receipt of the shares subject to such award, pursuant to the terms of this Plan and such other terms and conditions prescribed by the Company. An Eligible Employee may revoke the deferral of some or all of the shares deferred pursuant to such election, by submitting a notice of revocation not later than December 31, 2005, in accordance with such terms and conditions as are prescribed by the Company.

(g) Each Eligible Employee who elects to defer his or her annual bonus earned in 2005 may revoke such election by submitting a notice of revocation not later than December 31, 2005, in accordance with such terms and conditions as are prescribed by the Company.

- 1 -

IN WITNESS WHEREOF, the Company has caused this Amendment to be executed by its duly authorized officer this 17th day of November, 2005.

ARTHUR J. GALLAGHER & CO.

By: /s/ J. Patrick
Gallagher, Jr.
& Chief Executive
Officer

- 2 -

**FIRST AMENDMENT TO THE
ARTHUR J. GALLAGHER & CO.
DEFERRED EQUITY PARTICIPATION PLAN**

WHEREAS, Arthur J. Gallagher & Co., a Delaware corporation (the "Company"), maintains the Arthur J. Gallagher & Co. Deferred Equity Participation Plan (the "Plan");

WHEREAS, the Company has reserved the power to amend the Plan; and

WHEREAS, the Company desires to amend the Plan to permit certain participants to revoke their participation in the Plan on or before December 31, 2005.

NOW, THEREFORE, the Plan is hereby amended, effective January 1, 2005, by adding the following new section at the end thereof:

Participants who attain age 62 on or before December 31, 2005 shall be permitted to revoke the deferral of some or all of their vested amounts deferred under the Plan and to receive a full distribution of such amounts prior to December 31, 2005.

IN WITNESS WHEREOF, the Company has caused this Amendment to be executed by its duly authorized officer this 17th day of November, 2005.

ARTHUR J. GALLAGHER & CO.

By: /s/ J. Patrick
Gallagher, Jr.
& Chief Executive
Officer

**OPERATING AGREEMENT
OF
CHEM- MOD LLC**

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Exhibit B	-	Development Budget
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**OPERATING AGREEMENT OF
CHEM- MOD LLC**

This Operating Agreement (this "Agreement") of **CHEM- MOD LLC**, a Delaware limited liability company (the "Company"), is made and entered into as of June 23, 2004, by and among NCXII, Ltd., an Ohio Limited Liability Company ("NOX"), AJG Coal, Inc., a Delaware corporation ("AJG"), and IQ Clean Coal LLC, a Delaware limited liability company ("IQCC").

R E C I T A L S :

The parties to this Agreement desire to form a Delaware limited liability company for the purpose of developing, using and commercializing certain coal remediation technology described in Exhibit A attached to this Agreement (the "Technology").

By this Agreement, the parties desire to create the Company on the terms and conditions set forth herein.

NOW THEREFORE, in consideration of the foregoing, of the mutual promises contained herein, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereby agree as follows:

ARTICLE 1

DEFINITIONS AND INTERPRETATION

1.1 **Definitions.** As used in this Agreement, the following terms shall have the meanings set forth below.

Adjusted Capital Account Deficit. With respect to any Member, the deficit balance, if any, in such Member's Capital Account, as of the end of the relevant fiscal year, after giving effect to the following adjustments: (i) crediting thereto (A) the amount of such Member's share of Minimum Gain, including any "partner nonrecourse debt minimum gain" (as defined in Treasury Regulations Section 1.704- 2(i)), and (B) the amount of Company liabilities allocated to such Member under Section 752 of the Code with respect to which such Member bears the economic risk of loss (as defined in Treasury Regulations Section 1.752- 2(a)), to the extent such liabilities do not constitute "partner nonrecourse debt" under Treasury Regulations Section 1.752- 2 and (ii) reduced by all reasonably expected adjustments, allocations and distributions described in Treasury Regulations Sections 1.704- 1(b)(2)(ii)(d)(4), (5) and (6).

Affiliate. (a) Any Person directly or indirectly owning, controlling or holding the power to vote 10% or more of the outstanding voting securities of an identified other Person; (b) any Person 10% or more of whose voting securities are directly or indirectly owned, controlled or held with power to vote, by such other Person; (c) any Person directly or indirectly controlling, controlled by, or under common control with such other Person; (d) any officer, director,

member, manager or partner of such other Person; (e) if such other Person is an officer, director, member, manager or partner, any entity for which such Person acts in any such capacity; and (f) any spouse, lineal ancestor or descendant of such other Person.

Annual Budget. As defined in Section 10.3.

Approved Budget. The Development Budget and any Annual Budget, in each case for the period to which such Budget applies.

Annual Tax Liability. For any Member for any fiscal year, the product of (a) forty percent (40%) multiplied by (b) the excess, if any, of (i) the amount of all items of taxable income and gain of the Company for federal income tax purposes allocated to such Member for such fiscal year over (ii) the amount of all items of deductible expense and loss of the Company allocated to such Member for such fiscal year.

Capital Account. The capital account maintained for each Member pursuant to Section 6.6.

Capital Contributions. With respect to any Member, the amount of money and the fair market value (as agreed by the Members) of any property or services contributed to the Company by such Member.

Certificate. The Certificate of Formation of the Company, as amended from time to time.

Code. The Internal Revenue Code of 1986, as amended from time to time, or any replacement or successor law.

Cumulative Tax Liability. For each Member, as of any date during the term of this Agreement, the product of (a) forty percent (40%) multiplied by (b) the excess, if any, (i) the amount of all items of taxable income and gain of the Company for federal income tax purposes allocated to such Member for all periods beginning on the date of this Agreement through the end of the end of the fiscal year immediately preceding such date of calculation, over (ii) the amount of all items of deductible expense and loss of the Company allocated to such Member for all periods beginning on the date of this Agreement through the end of the end of the fiscal year immediately preceding such date of calculation (with any excess of amounts in clause (ii) over amounts in clause (i) in prior fiscal periods being carried forward as an item of loss in clause (ii) until absorbed in the subsequent fiscal period).

Development Budget. The budget for the development of the Intellectual Property in accordance with the Test Protocol, a copy of which is attached to this Agreement as Exhibit B.

Gross Cash Receipts. With respect to any period, the amount of all cash funds received by the Company from all sources.

Intellectual Property. Any and all intellectual property and proprietary rights recognized in any country or jurisdiction in the United States and Canada and their respective

possessions and territories now or in the future including, without limitation: (i) rights under patent, trademark, copyright and trade secret laws; (ii) moral rights and similar rights; and (iii) documentation, research, databases, manuals, data, design information, materials, technical expertise, trade secrets, plans, specifications, and general know-how relating to the Technology and/or Inventions, regardless of whether patentable or copyrightable, whether in tangible or intangible form and whether or not stored, compiled or memorialized physically, electronically, graphically, photographically or in writing.

Inventions. As defined in Section 11.8(e).

Investors. AJG and IQCC, and their respective successors and assigns.

License. The Technology License Agreement attached to this Agreement as Exhibit C, pursuant to which NOX has granted the Company an exclusive, royalty-free right to use the Intellectual Property in perpetuity.

Major Decisions. As defined in Section 10.2.

Members. NOX, AJG and IQCC, and each Person who may become a substituted or additional Member pursuant to the provisions hereof and applicable law.

Minimum Gain. As such term is defined in Treasury Regulation Section 1.704-2(d), which shall generally mean the amount by which the nonrecourse liabilities secured by any assets of the Company exceed the adjusted tax basis of such assets as of the date of determination. A Member's share of Minimum Gain (and any net decrease thereof) at any time shall be determined in accordance with Treasury Regulation Section 1.704-2(g).

Net Cash Receipts. With respect to any period, the amount by which the Gross Cash Receipts in such period exceed the sum of the following: (a) all principal and interest payments on any indebtedness of the Company, and all other sums paid to such lenders in such period, but excluding any payments specifically described in Article 8; (b) all cash expenditures (including expenditures for capital improvements) made in such period incident to the operation of the Company business, including but not limited to those expenses of the Members paid, either directly or indirectly, by the Company; and (c) working capital and other reserves in such amounts and for such purposes as the Members deem necessary for proper current and future operation of the Company business.

Participating Percentage. For each Member, the percentage set forth opposite such Member's name below, as adjusted from time to time as provided in Section 6.2:

<u>Member</u>	<u>Participating Percentage</u>
NOX	95.0%
AJG	2.5%
IQCC	2.5%

Permitted Transferee. As defined in Section 12.2.

Person. A natural person, corporation, limited liability company, trust, partnership, estate, unincorporated association or other entity.

Prime Rate. The rate of interest announced from time to time as its "prime rate" or "corporate base rate" (or equivalent rate) by The Bank of America at Chicago, Illinois (or its successor- in- interest).

Priority Return. For each Investor, and NOX to the extent of any cash capital contributions as of any date, the sum of (a) the Capital Contributions in the form of cash or other immediately available funds of such Investor, plus (b) the Cumulative Tax Liability of such Investor as of such date.

Profits or Losses. The net income or loss of the Company for federal income tax purposes as finally determined by the Company's accountants for each fiscal year of the Company, as well as, where the context requires, related federal tax items such as tax preferences and credits, in each case appropriately adjusted with respect to final determination of any of the foregoing for federal income tax purposes.

Test Protocol. The program for testing the Technology set forth in Exhibit D to this Agreement.

1.2 **Interpretation.** The definitions in Section 1.1 shall apply equally to both the singular and plural forms of the terms defined. Wherever the context may require, any pronoun used in this Agreement shall include the corresponding masculine, feminine and neuter forms. For all purposes of this Agreement, the term "control" and variations thereof shall mean the direct or indirect possession of the power to direct or cause the direction of the management and policies of the specified entity, through the ownership of equity interests therein, by contract or otherwise. As used in this Agreement, the words "include," "includes" and "including" shall be deemed to be followed by the phrase "without limitation". As used in this Agreement, the terms "herein," "hereof and "hereunder" shall refer to this Agreement in its entirety. Any references in this Agreement to "Sections," "Articles" of "Exhibits" shall, unless otherwise specified, refer to Sections, Articles, or Exhibits, respectively, in or attached to this Agreement.

ARTICLE 2

FORMATION OF THE COMPANY

2.1 **Formation.** The parties hereto agree to and do hereby form a limited liability company under and pursuant to the provisions of the Act; and the rights and obligations of the Members shall be as provided therein except as otherwise expressly provided in this Agreement. The Members agree to execute such certificates or documents and to do such filings and recordings and all other acts, including the filing or recording of the Certificate, and any assumed name filings in the appropriate offices in the State of Delaware and any other applicable jurisdictions as may be required to comply with applicable law.

2.2 **Entire Agreement.** Each and every other agreement or understanding, oral or written, relating in any way to the formation or operation of the Company is hereby superseded in its entirety. From and after the execution of this Agreement, the same shall constitute the only Operating Agreement of the Company except as the same may hereafter be amended pursuant to the provisions hereof. This Agreement represents the entire agreement and understanding of the parties hereto concerning the Company and their relationship as Members, and all prior or concurrent agreements, understandings, representations and warranties in regard to the subject matter hereof are and have been merged herein.

ARTICLE 3

NAME AND PRINCIPAL OFFICE

3.1 **Name.** The business of the Company shall be conducted under the name of "Chem- Mod LLC," or such other name as the Members may designate.

3.2 **Principal Office, Registered Office and Registered Agent.** The principal office of the Company shall be located at c/o NOX Inc., 4281 Meadowlark Trail, Stow, Ohio 44224. The registered agent and the registered office of the Company in Delaware shall be Corporation Service Company, 2711 Centerville Road, Suite 400, Wilmington, Delaware 19808. The Members may from time to time designate another registered agent or another location for the principal office or registered office of the Company upon notice to all Members.

ARTICLE 4

PURPOSE

The purpose of the Company is to engage in developing, commercializing, using, licensing and otherwise exploiting Intellectual Property pursuant to the License; financing any of the foregoing; and making prudent interim investments of Company funds, including, without limitation, investments in obligations of federal, state and local governments or their agencies, mutual funds, money market funds and bank certificates of deposit; and engaging in any and all activities related or incidental thereto. Except as specifically limited or prohibited by this Agreement, the Company is empowered to perform such actions and engage in such activities consistent with, useful or necessary to carry out the purpose of the Company.

ARTICLE 5

TERM AND FISCAL YEAR

5.1 **Term.** The term of the Company shall commence as of the date hereof and shall continue in perpetuity, unless sooner terminated pursuant to the provisions of this Agreement or as otherwise provided by law.

5.2 **Fiscal Year.** The fiscal year of the Company shall be the calendar year.

ARTICLE 6

CAPITAL CONTRIBUTIONS, LOANS AND CAPITAL ACCOUNTS

6.1 **Contribution of License.** Concurrently with the execution of this Agreement, NOX shall enter into the License as a contribution to the capital of the Company. For purposes of this Agreement, the Members agree that the fair market value of the License on the date of this Agreement is zero. Immediately after a patent application with respect to all or any portion of the Technology has been filed, NOX shall provide each Investor with a copy of such patent application.

(i) Concurrently with the execution of this Agreement, each Investor has advanced immediately available funds to the Company in the amount of One Hundred Thousand Dollars (\$100,000) as a Capital Contribution. Within thirty (30) days after the execution of this Agreement, each Investor shall advance additional immediately available funds to the Company in the amount of One Hundred Thousand Dollars (\$100,000) as a Capital Contribution. The Company shall use such funds for the performance of the testing referred to as Phases 1 through 3 in the Test Protocol (the "Phase 1- 3 Testing").

(ii) If the actual cost of the Phase 1- 3 Testing exceeds the Capital Contributions pursuant to Section 6.2(a)(i), NOX shall provide all additional funds needed to complete the Phase 1- 3 Testing in accordance with the Test Protocol, at such time or times as such funds are needed therefor. Any such funds so provided by NOX shall constitute Capital Contributions by NOX. If NOX shall at any time fail to provide the additional funds, if any, necessary to complete the Phase 1- 3 Testing, then the Investors (in proportion to their Participating Percentages or in such other proportion as they may agree upon) shall have the right, but shall not be required, to provide all or any portion of such additional required funds. If an Investor provides funds pursuant this Section 6.2(a)(ii) then (A) such funds shall constitute Capital Contributions by such Investor, (B) the Participating Percentage of such Investor shall immediately and automatically be increased by the number of percentage points equal to the product of (x) one (1) percentage point multiplied by (y) the ratio of the amount of funds provided by such Investor pursuant to this Section 6.2(a)(ii) to Eighty Thousand Dollars (\$80,000), and (C) the Participating Percentage of NOX shall immediately and automatically be reduced by the increase to the Participating Percentage of such Investor pursuant to clause (B) above.

(iii) If the Capital Contributions pursuant to Section 6.2(a)(i) exceed the actual costs of the Phase 1- 3 Testing, then (A) if any Capital Contributions are required of the Investors pursuant to Section 6.2(b)(i), then fifty percent (50%) of

such excess shall be applied toward each Investor's obligation to contribute capital pursuant to Section 6.2(b)(i), or (B) if Capital Contributions are not required of the Investors pursuant to Section 6.2(b)(i), then such excess shall be distributed pursuant to Section 8.1.

(b) **Phase 4 Testing.**

(i) If the Members unanimously agree that the Phase 1- 3 Testing is successful, then each Investor shall advance immediately available funds to the Company in the amount of Two Hundred Thousand Dollars (\$200,000) (subject to reduction as provided in Section 6.2(a)(iii) above) as a Capital Contribution. The Capital Contributions pursuant to this Section 6.2(b)(i) shall be made on such date or dates as all of the Members may agree upon, and based upon the availability of the University of North Dakota laboratory, contemplated as July 19, 2004. If an Investor fails to make the full Capital Contribution required pursuant to this Section 6.2(b)(i), then the other Investor shall have the right, but shall not be required, to advance immediately available funds to the Company in amount of such deficiency, as a Capital Contribution by such other Investor. Immediately upon the receipt by the Company of Capital Contributions from an Investor pursuant to this Section 6.2(b)(i), (A) the Participating Percentage of such Investor shall automatically be increased by the number of percentage points equal to the product of (x) one (1) percentage point multiplied by (y) the ratio of the amount of such Investor's Capital Contribution pursuant to this Section 6.2(b)(i) (including any amount applied toward such Capital Contribution pursuant to Section 6.2(a)(iii)) to Eighty Thousand Dollars (\$80,000), and (B) the Participating Percentage of NOX shall automatically be reduced by the increase to such Investor's Participating Percentage pursuant to clause (A) above. The Capital Contributions pursuant to this Section 6.2(b)(i) shall be used to fund the testing referred to as "Phase 4 Testing" in the Test Protocol (the "Phase 4 Testing").

(ii) If the actual cost of the Phase 4 Testing exceeds the Capital Contributions pursuant to Section 6.2(b)(i), NOX shall provide all additional funds needed to complete the Phase 4 Testing in accordance with the Test Protocol, at such time or times as such funds are needed therefor. Any such funds so provided by NOX shall constitute Capital Contributions by NOX. If NOX shall at any time fail to provide the additional funds, if any, necessary to complete the Phase 4 Testing, then the Investors (in proportion to their Participating Percentages or in such other proportion as they may agree upon) shall have the right, but shall not be required, to provide all or any portion of such additional required funds. If an Investor provides funds pursuant to this Section 6.2(b)(ii) then (A) such funds shall constitute Capital Contributions by such Investor, (B) the Participating Percentage of such Investor shall immediately and automatically be increased by the number of percentage points equal to the product of (x) one (1) percentage point multiplied by (y) the ratio of the amount of funds provided by such Investor pursuant to this Section 6.2(b)(ii) to Eighty Thousand Dollars

(\$80,000), and (C) the Participating Percentage of NOX shall immediately and automatically be reduced by the increase to the Participating Percentage of such Investor pursuant to clause (B) above.

(iii) If the Capital Contributions pursuant to Section 6.2(b)(i) exceed the actual costs of the Phase 4 Testing, then (A) if any Capital Contributions are required of the Investors pursuant to Section 6.2(c)(i), then fifty percent (50%) of such excess shall be applied toward each Investor's obligation to contribute capital pursuant to Section 6.2(c)(i), or (B) if Capital Contributions are not required of the Investors pursuant to Section 6.2(c)(i), then such excess shall be distributed pursuant to Section 8.1.

(c) **Phase 5 Testing and Commercial Development.**

(i) If the Members unanimously agree that the Phase 4 Testing is successful, then the Investors shall provide facilities, coal, chemicals and other goods and services to the Company and make facilities available to the Company to the extent necessary to allow the Company to perform the testing referred to as "Phase 5 testing" in the Test Protocol (the "Phase 5 Testing") in accordance with the Test Protocol. Immediately upon the completion of the Phase 5 Testing as a result of the goods, services and facilities provided the Investors in accordance with this Section 6.2(c)(i), (A) the Participating Percentage of each Investor shall automatically be increased by five (5) percentage points, and (B) the Participating Percentage of NOX shall automatically be reduced by ten (10) percentage points.

(ii) If the Members unanimously agree that the Phase 4 Testing is successful, then, in addition to the obligations described in Section 6.2(c)(i), each Investor shall advance immediately available funds to the Company in the amount of fifty percent (50%) of Two Hundred Thousand Dollars (\$200,000) (subject to reduction as provided in Section 6.2(b)(iii) above) or such lesser amount as the Company may require for the Phase 5 Testing and the commercial development of the Intellectual Property. The Capital Contributions to be made pursuant to this Section 6.2(c)(ii) shall be made on such date or dates as all of the Members may agree upon. If an Investor fails to make the full Capital Contribution required of such Investor pursuant to this Section 6.2(c)(ii), then the other Investor shall have the right, but shall not be required, to advance immediately available funds to the Company as a Capital Contribution by such other Investor up to the amount of such deficiency (a "Default Contribution"). If an Investor makes a Default Contribution, then immediately upon the receipt by the Company of such Default Contribution, (A) the Participating Percentage of such contributing Investor shall automatically be increased by the number of percentage points equal to the product of (x) one (1) percentage point multiplied by (y) the ratio of the amount of the Default Contribution to One Hundred Forty Thousand Dollars (\$140,000), and (B) the Participating Percentage of the defaulting Investor shall automatically be reduced by the increase to the Participating Percentage of the contributing Investor pursuant to clause (A) above.

(iii) The Capital Contributions advanced pursuant to Section 6.2(c)(ii) shall be applied to fund the Phase 5 Testing and the commercial development of the Intellectual Property. If the Capital Contributions pursuant to Section 6.2(c)(ii) exceed the actual costs of the Phase 5 Testing, then such excess shall be distributed pursuant to Section 8.1.

(d) **Amendments.** Each Member acting alone is hereby authorized to amend this Agreement to evidence any adjustment to the Participating Percentages in accordance with Section 6.2.

(e) **Sole Remedy.** The adjustments to the Participating Percentages described in Sections 6.2(a), (b) and (c) above shall be the sole remedies for any failure to contribute capital required under this Section 6.2.

6.3 **Additional Contributions.** Except as specifically set forth in Section 6.1 and Section 6.2 of this Agreement, no Member shall be required to make any additional contributions to the capital of the Company.

6.4 **Loans.**

(a) If at any time in the opinion of the Members, the Company's revenues and funds are not sufficient to satisfy the obligations and liabilities of the Company or to preserve, protect and develop the property of the Company, the Members may arrange for the Company to borrow such required funds from a third party on such terms and conditions as the Members deem advisable, provided that:

(i) No Member shall have any personal liability for repayment of any loan without such Member's prior written consent; and

(ii) No Member shall be required to make a loan to the Company.

(b) If at any time the Members determine that the Company's revenues and funds are not sufficient to satisfy the obligations and liabilities of the Company or to develop, preserve and protect the property of the Company, and the Company cannot borrow the required funds from commercial lenders on terms that are reasonable under the circumstances (including but not limited to the terms described in Section 6.4(a) above), then one or more of the Members or their Affiliates, in such person's sole discretion, may loan the required funds to the Company. Any such loans shall be made by the lending Members or their Affiliates in proportion to the applicable lending Members' respective Participating Percentages or in such other proportion as the lending Members or their Affiliates may agree upon. All such loans (i) shall be payable only from the assets of the Company without any recourse against or right of contribution from any Member; (ii) shall bear interest at an annual rate equal to the Prime Rate plus three percent (3%), adjusting when and as the Prime Rate shall adjust, compounded annually; and (iii) shall mature and be due and payable, to the extent not paid pursuant to other provisions of this Agreement, upon termination of the Company.

6.5 **Return of Capital Contributions.** Except as specifically provided in this Agreement a Member shall not be entitled to the return of his capital contribution to the Company.

6.6 **Capital Account.** A separate Capital Account shall be established and maintained for each Member in accordance with the Code and the regulations promulgated thereunder, including but not limited to the rules regarding the maintenance of partners' capital accounts set forth in Treasury Regulation Section 1.704- 1. Subject to the immediately preceding sentence, there shall be credited to each Member's Capital Account (i) the amount of money and the fair market value (as determined by the Members) of any property (net of related liabilities) contributed by the Member to the Company, and (ii) the Member's share of income or gain (or items thereof) of the Company, including income and gain exempt from tax. There shall be charged against each Member's Capital Account (iii) the amount of money and the fair market value (as determined by the Members) of any property (net of related liabilities) distributed to the Member by the Company and (iv) the Member's share of loss and deduction (or items thereof) of the Company. If property is contributed to the capital of the Company or if there is a revaluation of any Company property such that the book value of such property differs from its adjusted tax basis, the Members' Capital Accounts shall be appropriately adjusted for income, gain, loss and deduction as required by Treasury Regulation Section 1.704- 1(b)(2)(iv)(g). To the extent a Member's Capital Account is greater than zero, such excess is hereinafter referred to as a "positive balance." To the extent that a Member's Capital Account is less than zero, said amount is hereinafter referred to as a "deficit balance."

6.7 **Interest on Capital Contributions.** Except as specifically provided in this Agreement, the Company shall not pay interest on Capital Contributions or undistributed Profits.

ARTICLE 7

ALLOCATION OF PROFITS AND LOSSES

7.1 **General Allocation of Profits and Losses.** After giving effect to the allocations set forth in Sections 7.5 and 7.6, all Profits and Losses (including all items of income and expense entering into the determination of such Profits and Losses), as finally determined for federal income tax purposes for each fiscal year of the Company, shall be allocated among the Members as follows:

(a) **Profits.** Profits shall be allocated among the Members in the following order of priority:

(i) First, to the Members in proportion to and to the extent of the excess, in the case of each Member, of (A) all Losses allocated to such Member pursuant to Section 7.1(b)(iii), over (B) all Profits previously allocated to such Member pursuant to this Section 7.1(a)(i).

(ii) Second, to the Members in proportion to and to the extent of the excess, in the case of each Member, of (A) all Losses allocated such Member pursuant to Section 7.1(b)(ii), over (B) all Profits previously allocated to such Member pursuant to this Section 7.1(a)(ii).

-
- (iii) Third, to the Investors in proportion to and to the extent of the excess, in the case of each Investor, of (A) the amount of all distributions of Net Cash Receipts to such Investor pursuant to Section 8.1(b) over (B) all prior allocations of Profits to such Member pursuant to this Section 7.1(a)(iii).
 - (iv) Fourth, to NOX, in the amount of the excess, if any of (A) the amount of all distributions of Net Cash Receipts to NOX pursuant to Section 8.1(c) over (B) all prior allocations of Profits to such Member pursuant to this Section 7.1(a)(iv).
 - (v) Fifth, to the Members in proportion to and to the extent of the excess, in the case of each Member, of (A) the amount of all distributions of Net Cash Receipts to such Member pursuant to Section 8.1(d) over (B) all prior allocations of Profits to such Member pursuant to this Section 7.1(a)(v).
 - (vi) Sixth, any remaining Profits shall be allocated to the Members in accordance with their Participating Percentages

(b) **Losses.** Losses shall be allocated among the Members in the following order of priority:

- (i) First, to the Members in proportion to and to the extent of the excess, in the case of each Member, of (A) all Profits allocated to such Member pursuant to Section 7.1(a)(vi), over (B) all Losses previously allocated to such Member pursuant to this Section 7.1(b)(i).
- (ii) Second, to the Members having positive balances in their Capital Accounts in proportion to and to the extent of such positive balances.
- (iii) Third, to the Members in accordance with their Participating Percentages.

7.2 **Depreciation Recapture.** Subject to Section 7.6, if any portion of Profit recognized from the disposition of property by the Company represents the "recapture" of previously allocated deductions by virtue of the application of Code Section 1(h)(1)(D), 1245 or 1250 ("Recapture Gain"), such Recapture Gain shall be allocated as follows:

- (a) First, to the Members in proportion to the lesser of each Member's (i) allocable share of the total Profit recognized from the disposition of such property and (iii) share of depreciation or amortization with respect to such property (as determined in the manner provided in Treasury Regulations Sections 1.1245-1(e)(2) and (3)), until each such Member has been allocated Recapture Gain equal to such lesser amount.

(b) Second, the balance of Recapture Gain shall be allocated among the Members whose allocable shares of total Profit from the disposition of such property exceed their shares of depreciation or amortization with respect to such property (as determined in the manner provided in Treasury Regulations Sections 1.1245-1(e)(2) and (3)), in proportion to their shares of total Profit (including Recapture Gain) from the disposition of such property; provided, however, that no Member shall be allocated Recapture Gain under this Section 7.2 in excess of the total Profit otherwise allocated to such Member from such disposition.

7.3 **Allocations with Respect to Transferred Interests.** Except as otherwise provided below or unless otherwise required by the provisions of the Code or agreed by the Members, any Profit or Loss allocable to an interest in the Company which has been transferred during any year shall be allocated among the Persons who were holders of such interest during such year in proportion to the number of days during such year that each holder was recognized as the holder of the interest, without regard to the results of Company operations during the period the holder was recognized as the owner thereof.

7.4 **Tax Credits.** Unless otherwise required by the Code, any tax credits of the Company shall be allocated among the Members in accordance with their Participating Percentages. Any recapture of tax credits shall be allocated among the Members in the same ratio as the applicable tax credits were allocated to the Members.

7.5 **Regulatory Allocations.**

(a) **Minimum Gain Chargeback.** Notwithstanding any other provision of this Agreement, if there is a net decrease in Minimum Gain for a Company taxable year, each Member shall be allocated, before any other allocation of Company items for such taxable year, items of gross income and gain for such year (and, if necessary, for subsequent years) in proportion to, and to the extent of, the amount of such Member's share of the net decrease in Minimum Gain during such year. The income allocated pursuant to this Section 7.5(a) in any taxable year shall consist first of gains recognized from the disposition of property subject to one or more nonrecourse liabilities of the Company, and any remainder shall consist of a pro rata portion of other items of income or gain of the Company. The allocation otherwise required by this Section 7.5(a) shall not apply to a Member to the extent provided in Treasury Regulation 1.704-2(f)(2) through (5).

(b) **Qualified Income Offset.** Notwithstanding any other provision of this Agreement, if a Member unexpectedly receives an adjustment, allocation or distribution described in Treasury Regulation Section 1.704-1(b)(2)(ii)(d)(4), (5) or (6) that causes or increases an Adjusted Capital Account Deficit with respect to such Member, items of Company gross income and gain shall be specially allocated to such Member in an amount and manner sufficient to eliminate such Adjusted Capital Account Deficit as quickly as possible.

(c) **Gross Income Allocation.** If at the end of any Company taxable year, a Member has an Adjusted Capital Account Deficit, such Member shall be specially allocated items of Company income or gain in an amount and manner sufficient to eliminate such deficit Adjusted Capital Account Deficit as quickly as possible.

(d) **Nonrecourse Deductions.** Any deductions attributable to partnership nor recourse liabilities (as determined pursuant to Treasury Regulation Section 1.704- 2(c)) of the Company for any taxable year shall be allocated among the Members in the same proportion as Profits or Losses (as may apply) for such year are allocated.

(e) **Member Nonrecourse Debt.** Notwithstanding any other provision of this Agreement, any item of Company Loss, deduction or expenditures described in Code Section 705(a)(2)(B) that is attributable to a partner nonrecourse debt (as defined in Treasury Regulation Section 1.704- 2(b)(4)) of a Member shall be allocated to those Members that bear the economic risk of loss for such partner nonrecourse debt, and among such Members in accordance with the ratios in which they share such economic risk, determined in accordance with Treasury Regulation Section 1.704- 2(i). If there is a net decrease for a Company taxable year in any partner nonrecourse debt minimum gain of the Company, each Member with a share of such partner nonrecourse debt minimum gain as of the beginning of such year shall be allocated items of gross income and gain in the manner and to the extent provided in Treasury Regulation Section 1.704- 2(i)(4).

(f) **Interpretation.** The foregoing provisions of this Section 7.5 are intended to comply with Treasury Regulation Sections 1.704- 1(b) and 1.704- 2 and shall be interpreted consistently with this intention. Any terms used in such provisions that are not specifically defined in this Agreement shall have the meaning, if any, given such terms in the Regulations cited above.

7.6 **Section 704(c) Allocation.** Notwithstanding the foregoing allocations of Profits and Losses, if any property contributed to the Company has a fair market value (as agreed by the Members) that differs from its adjusted basis for federal income tax purposes at the time of such contribution, or if there is a revaluation of any Company property such that the book value of such property differs from its adjusted basis for federal income tax purposes, items of income, gain, loss, and deduction with respect to any such property shall be allocated among the Members so as to take account of such difference, in the manner intended by Section 704(c) of the Code and the Treasury Regulations from time to time promulgated thereunder, using such method permitted by such Treasury Regulations as the Members may determine.

7.7 **Allocation of Excess Nonrecourse Liabilities.** Solely for the purpose of allocating excess nonrecourse liabilities of the Company among the Members in connection with the determination of the Members' adjusted tax bases for their interests in the Company, in accordance with Section 752 of the Code and the Treasury Regulations from time to time promulgated thereunder, the Members agree that each Member's interest in Company Profits equals such Member's Participating Percentage.

ARTICLE 8

DISTRIBUTIONS

8.1 **Distribution of Net Cash Receipts.** Net Cash Receipts, if any, shall be applied and distributed in the following order of priority:

- (a) First, to pay principal and unpaid accrued interest on any loans made to the Company by any Member or any Affiliate thereof pursuant to Section 6.4(b), in proportion to the respective amounts of the outstanding principal and accrued interest of such loans.
- (b) Second, until each Investor has received distributions of Net Cash Receipts pursuant to this Section 8.1 (b) in the amount of its Priority Return, to the Investors in proportion to and to the extent of the excess, in the case of each Investor, of (i) such Investor's Priority Return over (ii) all prior distributions of Net Cash Receipts to such Investor pursuant to this Section 8.1(b).
- (c) Third, to NOX until NOX has received distributions of Net Cash Receipts pursuant to this Section 8.1(b) in the amount of its Priority Return, if any.
- (d) Fourth, from and after such time as each of the Investors and NOX has received aggregate distributions pursuant to Sections 8.1(b) and 8.1(c) in the amount of such Member's Priority Return, Net Cash Receipts shall be distributed to the Members in accordance with their Participating Percentages. To the extent that Net Cash Receipts are available for distribution pursuant to this Section 8.1(d), the Company shall distribute Net Cash Receipts pursuant to this Section 8.1(d) on a quarterly basis in an amount sufficient to distribute to each Member pursuant to this Section 8.1(d) not less than twenty- five percent (25%) of such Member's Annual Tax Liability for the immediately preceding fiscal year.

8.2 **Timing of Distribution; No Third- Party Beneficiaries.** Subject to Section 8. (d), Net Cash Receipts shall be distributed to the Members in such amounts and at such intervals as the Members, in their sole discretion, may determine, but no less frequently than annually. The foregoing priorities of application of Net Cash Receipts are for the benefit of the Members only and not for the benefit of any third party or creditor of the Company or of any Member, and neither the Company nor any Member shall be liable or responsible to any third party or creditor of the Company or of any Member for any deviation from such priorities.

ARTICLE 9

BOOKS OF ACCOUNT, RECORDS AND REPORTS

9.1 **Books of Account and Records.**

- (a) The Members shall maintain at the principal place of business of the Company all of the following:

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- (i) a list of the full name and last known business address of each Member setting forth the amount of cash each Member has contributed, a description and statement of the agreed value of any other property or services each Member has contributed or has agreed to contribute in the future, and the date on which each became a Member;
 - (ii) a copy of the Certificate and all amendments thereto, together with executed copies of any powers of attorney pursuant to which any such instrument was executed;
 - (iii) copies of the Company's federal, state and local income tax returns and reports, if any, for the three most recent years;
 - (iv) copies of this Agreement and any amendments hereto;
 - (v) copies of the financial statements, if any, of the Company for the three most recent years; and
 - (vi) proper and complete records and books of account for the Company.

Any of the foregoing may be inspected and copied by any Member or its duly authorized representatives, at the expense of such Member, during ordinary business hours.

- (b) If a Member reasonably requests the Company to assemble or compile information, the Members shall have the authority to pass on all costs of labor, duplicating or other related charges so incurred to the Member making the request.

9.2 **Reports to Members.** The Members, at Company expense, shall cause to be furnished to each of the Members as soon as practicable after the end of each calendar year the following:

- (a) A copy of the federal income tax return filed by the Company for the calendar year, except for Schedules K-1 applicable to other Members;
- (b) All information relative to the Company necessary for the preparation of the Members' federal and state income tax returns; and
- (c) A balance sheet as of the close of such calendar year and statements of Profits or Losses, and Net Cash Receipts, if any, all of which shall be prepared in accordance with generally accepted accounting principles or tax accounting principles, with or without audit or review by an independent certified public accountant, in each case in the discretion of the Members.

In addition, the Company shall provide each Member with copies of any additional reports in existence regarding the Company or the Intellectual Property as such Member may reasonably request, provided the information requested does not jeopardize the ability of NOX to obtain foreign patents,

ARTICLE 10

MANAGEMENT OF THE COMPANY

10.1 **Management of Company Affairs.** Except as otherwise specifically provided in this Agreement, the management of the Company shall be vested in the Members. Except as provided in Section 10.2 or as otherwise specifically provided in this Agreement, all rights and authority granted to the Members under this Agreement or the Act, and all decisions and determinations to be made by the Members may be exercised or made only upon the approval of Members having more than fifty percent (50%) of the aggregate Participating Percentages of all Members at such time. Any action (authorized in accordance with this Agreement) taken by a Member (in its capacity as such) shall constitute the act of and serve to bind the Company. Each Member may designate one or more of its employees, agents or Affiliates to carry out its duties and responsibilities to the Company. Persons dealing with the Company shall be entitled to rely conclusively on the power and authority of each Member as set forth in this Agreement. The Members shall not employ, or permit another Person to employ any funds or assets of the Company in any manner other than for the exclusive benefit of the Company. Except as all Members may agree from time to time, the Members shall not be entitled to any fees or other compensation for the performance of their duties as such; provided, however, the Company shall reimburse each Member for all direct costs incurred by such Member, its Affiliates, employees or agents on behalf of the Company or otherwise in connection with performance of the duties of a Member

10.2 **Major Decisions.** Notwithstanding the provisions of Section 10.1 or any other provision of this Agreement, the following actions and decisions ("Major Decisions") by or on behalf of the Company shall require the prior written approval of all Members at such time:

- (a) The adoption of Annual Budgets pursuant to Section 10.3.
- (b) Any modification or amendment to any Approved Budget.
- (c) Any expenditure in excess of one hundred ten percent (110%) of the amount set forth in an Approved Budget for such expenditure.
- (e) Any modification or amendment to the Test Protocol.
- (f) Any sale, sublicense or other grant or disposition of the ownership of or right to use all or any portion of the property of the Company, including the Intellectual Property, the Technology and the Inventions.

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- (g) Any decisions relating to applying for, prosecuting, obtaining, maintaining, enforcing or defending any Intellectual Property with respect to the Technology and/or Inventions.
 - (h) The amount and timing of any distributions of Net Cash Receipts other than in accordance with Article 8.
 - (i) Subject to Section 10.4, any decisions relating to any transaction between the Company and any Member or any Affiliate of any Member.
 - (j) The borrowing of any funds or other incurrence of any indebtedness which is either (i) secured by any assets of the Company, or (ii) in excess of Five Thousand Dollars (\$5,000); and any refinancing of or material modification of the terms of any such indebtedness.
 - (k) Any expenditures or commitments to make expenditures in excess of Five Thousand Dollars (\$5,000).
 - (l) The acquisition or lease of any real property.
 - (m) The issuance of any membership interest in the Company, any options or other rights to acquire any membership interest in the Company, or any other securities convertible into any membership interest in the Company, and any purchase or redemption by the Company of any membership interest in the Company (provided that if any additional membership interests in the Company are issued with the consent of the Members, in no event shall the Participating Percentage of either Investor be reduced).
 - (n) The employment and the dismissal of any employee of the Company, and any changes in salaries or benefits of any employee of the Company.
 - (o) Any commitments with respect to pensions, phantom equity or deferred compensation to the Company's employees, any bonuses for the Company's employees in excess of their base salaries, and any arrangements concerning the private use of vehicles belonging to the Company.
 - (p) The organization of any subsidiaries of the Company, the investment in any other entity or the acquisition of any equity securities of any other entity.
 - (q) The merger or consolidation of the Company or any subsidiary of the Company with any other entity.
 - (r) Any conversion or reorganization of the Company or any other entity into any other form of legal entity.
 - (s) The engagement or termination of any independent contractor, the terms of any such engagement and any material modification to any of the foregoing.

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- (t) The engagement of any accountant or attorneys on behalf of the Company.
 - (u) The establishment of or addition to any cash reserve, except to the extent required by any agreement to which the Company is a party.
 - (v) Any material tax elections or decisions required in the preparation and filing of Company tax returns and any decisions or agreements in connection with any examination or controversy relating to the tax returns or positions of the Company.
 - (w) The commencement, compromise or settlement of any lawsuit, legal proceeding, bankruptcy proceeding or arbitration proceeding involving the Company or affecting the Intellectual Property.
 - (x) The decision to dissolve the Company.
 - (y) Any transaction outside the ordinary course of the day- to- day business Company.

10.3 **Budgets.**

- (a) **Development Budget.** The Members hereby approve and adopt the Development Budget. The Development Budget shall constitute an Approved Budget through December 31, 2004.
- (b) **Annual Budgets.** On or before November 1 of each year, NOX shall prepare a preliminary annual budget for the Company for the next calendar year, and shall submit such preliminary annual budget to each Member. Each preliminary annual budget shall set forth reasonably itemized estimates of all revenues, expenses, reserves, capital expenditures and receipts from capital transactions of the Company, as well as any relevant business plans for the Company for the next calendar year. On or before December 1 of each year, the Members, by the written approval of all Members, shall approve and adopt an annual budget for the Company for the next calendar year. Each annual budget described above and approved by all Members is referred to herein as an "Annual Budget" and shall constitute an Approved Budget for the period covered by such Annual Budget. If all of the Members do not approve an Annual Budget for any calendar year prior to the commencement of such calendar year then, until the Members shall agree upon an Annual Budget for such year, the Annual Budget in effect for the immediately preceding calendar year shall constitute the Annual Budget for such calendar year, except that any items or portion of the preliminary annual budget for such calendar year upon which all Members agree shall be substituted for the corresponding items in the preceding year's Annual Budget.
- (c) **Separate Approval Not Required.** Any expenditures or other matters set forth in an Approved Budget shall be deemed approved by all Members for purposes of Section 10.2 for the period covered by such Approved Budget, and the separate approval of the Members of any such matters shall not be required.

10.4 Employment of Affiliates. Subject to Section 10.2, the Members may, on behalf and at the expense of the Company, engage any Member or an Affiliate of any Member to render services or provide goods to the Company. Notwithstanding Section 10.2 or any other provision of this Agreement, all decisions relating to any contract or other arrangements between the Company and any Member or any Affiliate of any Member, including the License, shall be made solely by the Members that are not parties to such arrangement and whose Affiliates are not parties to such arrangement (the "Other Members"). Any such decision shall require the approval of all of the Other Members if such matter is a Major Decision or the approval of Members having a majority of the Participating Percentages of the Other Members if such matter is not a Major Decision. Such matters shall include any decision to exercise or waive any rights or remedies of the Company under, or to amend or modify, the License or any other contract or arrangement from time to time in effect between the Company and any Member or any Affiliate of any Member.

10.5 Liability of the Members. The Members and their respective Affiliates, agents and employees shall not be liable, responsible or accountable in damages or otherwise to the Company or any of the Members or their successors or assigns for any acts performed or omitted within the scope of his authority as a Member, or otherwise conferred on the Member and such Affiliates, agents and employees by this Agreement, including the execution and delivery of deeds in lieu of foreclosure, provided that such Member or such Affiliates, agents or employees shall act in good faith and shall not be guilty of willful misconduct or gross negligence.

10.6 Devotion of Time by Members. Each Member and its agents, Affiliates, employees and agents of Affiliates shall devote such time to the Company business as is reasonably necessary to manage and supervise the Company business and affairs in an efficient manner and to accomplish the purposes of the Company. Each Member and each employee, agent or Affiliate thereof shall be free to engage in other business ventures whether or not directly competing with the Company, or to exploit business opportunities whether or not arising from the conduct of Company business.

10.7 Other Business of Members. Subject to Section 11.8, each Member and its Affiliates may engage in or possess any interests in other business ventures of any kind, independently or with others. Subject to Section 11.8, neither the Company, any Member, nor the holder of any interest in the Company shall have any right by virtue of this Agreement or the relationship created hereby in or to such ventures or activities or to the income or profits derived therefrom, and the pursuit of such ventures, even if competitive with the business of the Company, shall not be deemed wrongful or improper.

10.8 Tax Matters Partner. AJG, for so long as it shall be a Member, shall be the "tax matters partner" (within the meaning of Section 6231 of the Code) of the Company, and as such, subject to Section 10.2, shall have all powers and authorities granted tax matters partners under the applicable provisions of the Code and any regulations promulgated thereunder. All costs and expenses incurred by the tax matters partner in connection with an audit by the Internal Revenue Service or other government tax agency of a Company income tax return shall be borne by the Company.

10.9 **Election to Adjust Basis.** In the event of a distribution of property made in the manner provided in Section 734 of the Code (or any comparable provision of any succeeding law), or in the event of a transfer of any membership interest in the Company permitted by this Agreement made in the manner provided in Section 743 of the Code, the Members, in their sole discretion, may make or revoke on behalf of the Company the election referred to in Section 754 of the Code permitting adjustments to basis as provided in Sections 734 and 743 of the Code. Any additional costs or expenses incurred by the Company as a result of such an election shall be borne pro rata by the Member or Members benefiting from such an election.

10.10 **Company Indemnification of Members.** The Company shall indemnify, defend, and hold the Members and their respective Affiliates, employees and agents, or their respective successors, executors, administrators or personal representatives harmless from and against any loss, liability, damage, cost or expense (including reasonable attorneys' fees) sustained or incurred as a result of any act or omission concerning the business or activities of the Company; provided that the Member or any Affiliate, employee, or agent is not guilty of gross negligence, willful misconduct or violation of fiduciary duty and was acting in good faith within what it reasonably believed to be the scope of its authority for a purpose which it reasonably believed to be not opposed to the best interests of the Company. The foregoing indemnity shall not be enforceable against any Member personally but solely from such Member's interest in the Company.

ARTICLE 11

RIGHTS AND DUTIES OF MEMBERS

11.1 **Admission of Members.** Each of NOX, AJG and IQCC is hereby recognized and admitted as a Member of the Company. No other person shall be recognized or admitted as a Member of the Company unless such person has satisfied the requirements of Article 12.

11.2 **Limited Liability.** Except to the extent provided in Section 11.5, the debts, obligations and liabilities of the Company, whether arising in contract, tort, or otherwise, shall be solely the debts, obligations, and liabilities of the Company, and the Members shall not be obligated personally for any such debt, obligation or liability of the Company solely by reason of being a Member of the Company. Except as provided in Section 11.5, no Member, in its capacity as a Member of the Company, shall be responsible or liable for any indebtedness or obligation of any other Member, nor, except to the extent provided in Section 11.6, shall the Company be responsible or liable for any indebtedness or obligation of any Member.

11.3 **No Individual Authority.** Except as otherwise expressly provided in this Agreement or in the Act, no Member, acting alone, shall have any authority to act for, or to create, undertake or assume any liabilities, obligations or responsibilities on behalf of the Company or any other Member.

11.4 **Representations by Members.** Each Member represents and warrants to the other Members and to the Company that (i) all transactions contemplated by this Agreement to be performed by such Member have been duly authorized by all necessary action and do not

require the consent or approval of any third party, (ii) such Member has all necessary power with respect thereto, (iii) the consummation of such transactions will not (and with the giving of notice or lapse of time or both would not) result in a breach or violation of, or a default or loss of contractual benefits under, any trust agreement or other agreement by which such Member or any of such Member's properties is bound, or any statute, regulation, order or other law to which such Member or any of such Member's properties is subject, or give rise to a lien or other encumbrance upon any of such Member's properties or assets, and (iv) this Agreement is a valid and binding agreement on the part of such Member, enforceable in accordance with its terms.

11.5 Indemnification by the Members. Each Member hereby agrees to indemnify the Company and each of its other Members and hold them each harmless from and against all liability, loss, cost, damage and expense (including attorneys' fees and costs incurred in the investigation, defense and settlement of the matter) which the Company or any of such other Members shall ever sustain, suffer or incur which relate or arise out of or in connection with a breach by the indemnifying Member of any representation, warranty or covenant made by the indemnifying Member in this Agreement or in any agreement or instrument delivered pursuant hereto. If the Company is made a party to any litigation or otherwise incurs any loss or expense as a result of or in connection with any Member's personal obligations or liabilities unrelated to Company business, such Member shall indemnify and reimburse the Company for all such loss and expense incurred, including reasonable attorneys' fees. The liability of any Member pursuant to this Section 11.5 may be assessed against such Member's interest in the Company, including the right to receive any distributions of Net Cash Receipts; provided, however, the liability of a Member under this Section 11.5 shall not be limited to such Member's interest in the Company but shall also be enforceable against such Member personally.

11.6 Indemnification by the Company. The Company shall indemnify each of its Members and former Members for all costs, losses, liabilities and damages paid or incurred by any of them in connection with the business of the Company, including any judgments, settlements, penalties, fines and expenses incurred in a proceeding to which any such person is a party because the person is or was a Member of the Company, to the fullest extent provided or allowed by the Act or any other applicable laws; provided, however, that such liability does not arise by reason of the willful misconduct or gross negligence of such Member or any matter described in Section 11.5 with respect to which the Member is obligated to indemnify the Company.

11.7 Rights of a Former Member. No Member shall have the right or power to resign or withdraw by voluntary act from the Company. If a Member shall cease to be a Member, and if the Company is not then dissolved, then (i) such former Member shall be in breach of this Agreement, and (ii) notwithstanding the terms of Section 18- 604 of the Act, such former Member shall not thereby be entitled to receive the fair value of such former Member's membership interest in the Company or any other payment or any other distribution except as specifically provided in this Agreement.

11.8 Covenants. Notwithstanding anything contrary herein, each Member covenants as follows:

(a) **Confidential Information.** Each Member acknowledges the economic value of the Confidential Information (as defined below) of the Company. Accordingly, during the Confidential Restricted Period (as defined below), each such Member shall not, in whole or in part, directly or indirectly:

(i) divulge, furnish, make available or disclose any Confidential Information in any manner to any person, firm, corporation, partnership, limited liability company, association or other entity, or

(ii) use any Confidential Information for itself or for any other Person except as may be necessary in connection with the performance of its duties hereunder, or

(iii) bring to the Company's offices nor use, disclose to the Company, or induce the Company to use, any confidential information or documents belonging to a third party.

As used herein, the term "Confidential Information" shall mean all information used in or relating to the Intellectual Property or the business of the Company which is not generally known to the competitors of the Company, whether or not a trade secret as defined under applicable law, and which gives an advantage to the Company, including, without limitation, its patents, know-how and other intellectual property, its development plans, designs, specifications, flow charts, processes, formulas, data, all such information relating to the identity of the potential and actual customers of the Company, their respective methods of operation, financial data and pricing policies. Notwithstanding the foregoing, the term "Confidential Information" shall not include any information which is or becomes publicly known through no wrongful act of a Member, or which is rightfully received by a Member from any third party who is not bound by any similar restriction.

As used herein, the term "Confidential Restricted Period" with respect to each Member shall mean with respect to each particular item of Confidential Information: (a) the period commencing with the date such Member first becomes a Member of the Company and ending three (3) years after such Member ceases to be a Member of the Company if the item of Confidential Information at issue does not constitute a trade secret; or (b) the period commencing with the date such Member first becomes a Member of the Company and continuing indefinitely, if the item of Confidential Information at issue constitutes a trade secret, until such item of Confidential Information at issue ceases to be a trade secret, but in no event ending earlier than three (3) years after such Member ceases to be a Member of the Company.

The terms, conditions and covenants contained in the Confidentiality and Nondisclosure Agreement, attached hereto, made a part hereof, and attached as Exhibit E, are incorporated herein by this reference.

(b) **Diversification of Customers.** For so long as a Member is a Member and for a period of three (3) years thereafter (the "Restricted Period"), a Member shall not, either directly or indirectly, on its own account or as a partner, joint venturer, consultant, employee, agent, member or shareholder of any other Person or in any other capacity, in any way, solicit, divert or take away, or attempt to solicit, divert or take away, any potential transaction with the Company's customers or potential customers, wherever located.

(c) **Solicitation for Employment.** Throughout the Restricted Period, a Member shall not, either directly or indirectly, on its own account or as a partner, joint venturer, consultant, employee, agent, member or shareholder of any other Person or in any other capacity, in any way, solicit for employment or for engagement as an independent contractor in a competitive business any person who is then, or within a period of twelve (12) months prior to any such relevant solicitation was, an employee of or independent contractor engaged by the Company.

(d) **Business Opportunities.** Throughout the period it is a Member of the Company, a Member shall not directly or indirectly have any financial interest in or derive any financial benefits from contacts made by the Company with any third party (except in its capacity as a Member of the Company) without first disclosing such interest or benefit to the other Members and obtaining the approval of all such other Members thereto.

(e) **Inventions.** All Inventions (as defined below) shall be the sole and exclusive property of the Company. Such ownership of Inventions shall inure to the benefit of the Company from the date of the conception, creation or fixation of the Invention in a tangible medium of expression, as applicable. All newly- created copyright aspects of the Inventions, whether created solely or jointly, shall be considered a "work- made- for- hire" within the meaning of the Copyright Act of 1976, as amended. If and to the extent the Inventions, or any part thereof, are found by a court of competent jurisdiction not to be a "work- made- for- hire" within the meaning of the Copyright Act of 1976, as amended, each Member agrees that all exclusive, right, title and interest in and to those newly- created copyrightable aspects of the Inventions, and all copies thereof, are hereby expressly assigned automatically to the Company without further consideration. Any agreement entered into by a Member and a third party in connection with the development of an Invention shall require the prior consent of the Company and shall further include substantially the same terms as those appearing in this Section 11.8(e) to ensure that the Company obtains the same rights in the Inventions generated under such third party agreement as those set forth in this Section 11.8(e). Each Member agrees to: (a) assist the Company in obtaining and enforcing all rights and other legal protections for the Inventions; (b) perform all acts deemed necessary or desirable by the Company to permit and assist it, at the Company's expense, in registering, recording, obtaining, maintaining, defending, enforcing and assigning Inventions or works made for hire in the United States and Canada; and (c) execute any and all documents that the Company may reasonably request from time to time in connection therewith, including any copyright assignment document(s), without further consideration. Each Member hereby

irrevocably designates and appoints the Company and its duly authorized officers and agents as such Member's agents and attorneys- in- fact to act for and in such Member's behalf and instead of such Member, to execute and file any documents and to do all other lawfully permitted acts to further the above purposes with the same legal force and effect as if executed by such Member. This designation and appointment constitutes an irrevocable power of attorney and is coupled with an interest. Each Member agrees to promptly disclose to the Company all Inventions, all original works of authorship and all work product relating thereto. This disclosure will include complete and accurate copies of all source code, object code or machine- readable copies, documentation, work notes, flowcharts, diagrams, test data, reports, samples and other tangible evidence or results (collectively, "Tangible Embodiments") of such Inventions, works of authorship and work product. All Tangible Embodiments of any Invention, work of authorship or work product related thereto will be deemed to have been assigned to the Company as a result of the act of expressing any invention or work of authorship therein.

As used herein, the term "Inventions" shall mean any and all inventions, developments, discoveries, improvements, works of authorship, concepts or ideas or expressions thereof, whether or not subject to patent, copyright, trademark, trade secret protection or other intellectual property right protection (in the United States or Canada), and whether or not reduced to practice, which both (i) relate to or result from any Intellectual Property or the actual or anticipated business, work, research or investigation of the Company, and (ii) are conceived or developed by a Member or any Affiliate or employee of a Member while such Member has an interest in the Company or within one (1) year following termination of such Member's interest in the Company.

The Members agree that the Inventions contemplated by this Section do not include inventions and patents involving cold ceramics, concrete products or the cement industry.

(f) **Remedies.** The covenants of Section 11.8 above, singly and collectively are sometimes referred to herein as "Covenants." Each Member agrees that the Covenants are the minimum such restrictions necessary to protect the goodwill, Confidential Information and legitimate business interests of the Company and its successors and assigns, that the time periods and the territorial areas described above (in view of the scope of the business to be conducted by the Company), are reasonable and necessary for said protection, and that damages cannot adequately compensate the Company in a event of a Member's violation of any Covenant. Accordingly, each Member agrees that if it shall violate or breach any Covenant, then the Company shall be entitled to obtain injunctive relief against such Member, without bond but upon due notice, in addition to such further relief as may be available at law or in equity. In the event of the entry of any such injunction, such Member's sole remedy shall be the dissolution of such injunction, if such is warranted following a full hearing, and all claims for damages by reason of the wrongful issuance of any such injunction are hereby waived by such Member. The Company's obtaining of any such injunction shall not be considered an election of remedies or a waiver of any right by the Company to assert any other remedy or remedies the Company may have against a Member at law or in equity.

Each Covenant shall be construed as an agreement which is independent of the other provisions of this Agreement and severable and separate, and the existence of any claim or cause of action against the Company, of whatever nature, shall not constitute a defense to the Company's enforcement of any Covenant. Any of the foregoing applicable restricted periods will be extended with respect to a Member for any equivalent period of time during which such Member violates the provisions of this Section 11.8. To the extent any Covenant may be deemed unenforceable by virtue of its scope in terms of geographical area, length of time or otherwise, but may be made enforceable by limitations thereon, each Member agrees that such Covenant shall be modified and enforced to the fullest extent permissible under the laws and public policies of the jurisdiction in which such enforcement is sought. The parties hereto hereby authorize any court of competent jurisdiction to modify or reduce the scope of any such Covenant to the extent necessary to make such Covenant enforceable.

ARTICLE 12

TRANSFER OF MEMBER INTERESTS

12.1 **General Prohibition.** A Member may not sell, transfer, encumber, pledge or assign all or any part of its interest in the Company except (a) to a Permitted Transferee in accordance with Section 12.2, (b) in accordance with the procedure set forth in Section 12.3, (c) in accordance with the procedure set forth in Article 13, (d) pursuant to the procedures of Article 14 or (e) with the prior written consent of all of the other Members, which consent may be granted or withheld in each Member's sole and absolute discretion. In order for an assignee to constitute a substituted or additional Member, the conditions set forth in Section 12.8 must be satisfied. In no event shall a Member consent to an assignment of any interest of a Member in the Company unless in the opinion of counsel satisfactory to the Company such assignment (i) will not result in a termination of the Company for federal income tax purposes (or the transferring Member and its transferee jointly and severally indemnify the Company and each other Member against any and all loss or cost arising from such termination), (ii) will not result in the Company failing to qualify for an exemption from the registration requirements of the federal or any applicable state securities laws, (iii) will not be to a person that is a "foreign person" as that term is defined in the Foreign Investment in Real Property Tax Act of 1980, as amended ("FIRPTA"), (iv) will not result in the imposition of fiduciary responsibility on the Company any Member, or any Affiliate of any of the foregoing under the Employee Retirement Income and Security Act of 1974, as amended from time to time ("ERISA"), and (v) will not result in the violation of any term or provision of any agreement to which the Company is a party or the acceleration of any indebtedness of the Company.

12.2 **Permitted Transfers.** A Member may assign all or any part of its interest in the Company without the consent of any other Member to a "Permitted Transferee." For purposes of this Agreement, the term "Permitted Transferee" shall mean, with respect to any Member (i) a partnership in which such Member, Persons controlled by such Member or Persons controlling such Member on the date hereof are the sole or controlling general partner(s) and other partners are Persons controlled by such Member, Persons controlling such Member on the date hereof, or members of the immediate family of such Member or Persons controlling such Member on the

date hereof, (ii) a corporation controlled by such Member or persons controlling such Member on the date hereof, and all of the issued and outstanding capital stock of all classes of such corporation is owned and controlled by such Member, Persons controlled by such Member, Persons controlling such Member on the date hereof, or by members of the immediate family of such Member or of Persons controlling such Member on the date hereof, (iii) a trust controlled by such Member or Persons controlling such Member on the date hereof and for the benefit of such Member, Persons controlling such Member on the date hereof, or members of the immediate family of such Member or of Persons controlling such Member on the date hereof, (iv) a limited liability company controlled by such Member or Persons controlling such Member on the date hereof and all of the membership interests of which are owned by such Member, Persons controlled by such Member, Persons controlling such Member on the date hereof, or members of the immediate family of such Member or Persons controlling such Member on the date hereof, or (v) another Member. For purposes of this Agreement, the immediate family of any Person shall mean the spouse and lineal descendants (either natural or by adoption) of such Person.

No withstanding anything in this Section 12.2 to the contrary, a Member may not assign all or part of its interest in the Company if such assignment would, in the opinion of counsel to the Company, (v) result in a termination of the Company for federal income tax purposes (or the transferring Member and its transferee jointly and severally indemnify the Company and each other Member against any and all loss or cost arising from such termination), (w) result in the Company not qualifying for an exemption from the registration requirements of the federal or any applicable state securities laws, (x) be to a person that is a "foreign person" as that term is defined in FIRPTA, (y) result in the imposition of fiduciary responsibility on the Company, any Member, or any Affiliate of any of the foregoing under ERISA, or (z) result in the violation of any term or provision of any agreement to which the Company is a party or the acceleration of any indebtedness of the Company.

Notwithstanding the right of a Member to transfer all or any portion of its interest to a Permitted Transferee, a Permitted Transferee shall not be admitted as an additional or substituted Member of the Company unless and until the provisions of Section 12.8 are satisfied. Until the provisions of Section 12.8 are satisfied with respect to a Permitted Transferee, such Permitted Transferee shall not be a Member but shall be an assignee having the rights described in Section 12.7.

12.3 Right of First Offer Refusal.

(a) If a Member (the "Transferring Member") shall desire to transfer all or any portion of its interest as a Member of the Company (the "Offered Membership Interest") to any Person other than a Permitted Transferee or pursuant to a transaction that has been approved by all of the other Members pursuant to clause (e) of Section 12.1, pursuant to a bona fide written offer (a "Third- Party Offer") for the purchase of such interest in exchange for a cash price payable entirely at closing, the Transferring Member shall deliver written notice (the "Offer Notice") to each other Member (the "Offeree Members") setting forth the Participating Percentage that the Transferring Member desires to transfer and a copy of the Third- Party Offer. The Offer Notice shall constitute

an offer (the "Offer") by the Transferring Member to the Offeree Members to purchase the Offered Membership Interest in exchange for the price and on the terms set forth in the Third- Party Offer. The Offeree Members shall have the right, for a period of thirty (30) days after the Offer Notice is delivered, to accept the Offer in proportion to their Participating Percentages or in such other proportion as they may agree upon. The Offeree Members shall accept the Offer, if at all, by delivering of written notice setting forth such acceptance to the Transferring Member within the 30- day period described above.

(b) If the Offeree Members, in the aggregate, accept the Offer with respect to the entire Offered Membership Interest, the purchase and sale of the Offered Membership Interest shall close not later than sixty (60) days following the expiration of the 30- day period described in Section 12.3(a). At the closing, the Transferring Member shall deliver to those Offeree Members accepting the Offer an assignment of the Offered Membership Interest, free and clear of all liens and encumbrances. At the closing, the Offeree Members purchasing the Offered Membership Interest shall pay to the Transferring Member immediately available funds in the aggregate amount of the price set forth in the Third- Party Offer.

(c) If the Offeree Members, in the aggregate, fail to accept the Offer with respect to the entire Offered Membership Interest within the 30- day period described in Section 12.3(a), then the Transferring Member may transfer the Offered Membership Interest to the Person submitting the Third- Party Offer, at the price and on the terms set forth therein, without the consent of any other Member provided that (i) such transfer is completed within one hundred twenty (120) days following the expiration of the 30- day period described in Section 12.3(a); (ii) such transfer complies with the limitations set forth in clauses (v) through (z) of Section 12.2; and (iii) such transfer shall be subject to Article 13, if applicable. Any Person acquiring an interest in the Company pursuant to this Section 12.3(c) shall not be a Member but shall an assignee having the rights described in Section 12.7, until the provisions of Section 12.8 are satisfied with respect to such Person.

12.4 Involuntary Transfers. In the event (i) of the death or adjudication of insanity or incompetency of an individual Member, or (ii) any Member shall be adjudged bankrupt, enter into proceedings for reorganization or into an assignment for the benefit of creditors, have a receiver appointed to administer the Member's interest in the Company, be the subject of a voluntary or involuntary petition for bankruptcy, apply to any court for protection from its creditors, or have its interest in the Company seized by a judgment creditor (such Member being referred 10 herein as a "Bankrupt Member"), the personal representative or trustee (or successor- in- interest) of the deceased, insane or incompetent Member or Bankrupt Member shall be an assignee of such Member's interest in the Company having the rights set forth in Section 12.7 and shall not become an additional or substituted Member unless and until the conditions set forth in Section 12.8 are satisfied; and any such Member's estate (or successor- in- interest) shall be liable for all of its obligations as a Member.

12.5 Dissolution or Termination of Members. In the event of the dissolution of a Member that is a partnership, limited liability company or a corporation or the termination of a Member that is a trust, the successors- in- interest of the dissolved or terminated Member shall, for the purposes of winding up the affairs of the dissolved or terminated Member, have the rights of an assignee of such Member's interest in the Company, as described in Section 12.7, and shall not become additional or substituted Members unless and until the conditions set forth in Section 12.8 are satisfied.

12.6 Transfers of Ownership Interests in Members. For purposes of this Article 12, any transfer or assignment of any direct or indirect ownership or other interest in a Member that (taking into account any prior such transfers or assignments, and any prior pledges, encumbrances or collateral assignments described below) results in such Member being controlled by a Person or Persons other than the Person or Persons that control such Member on the date hereof shall be deemed an assignment of the interest in the Company of such Member and therefore subject to all of the restrictions and provisions of this Article 12. In addition, any encumbrance, pledge or other collateral assignment of a direct or indirect ownership or other interest in a Member that, if the pledgee or other assignee were to exercise its right to acquire such interest, would (taking into account any prior transfers or assignments described above and any prior such pledges, encumbrances or collateral assignments) result in such Member being controlled by a Person or Persons other than the Person or Persons that control such Member on the date hereof shall be deemed an assignment of the interest in the Company of such Member and therefore subject to all of the restrictions and provisions of this Article 12.

12.7 Status of Assignee. Any person who acquires all or any portion of the interest of a Member in the Company in any manner (including a Permitted Transferee), shall not be a Member of the Company unless and until the conditions of Section 12.8 are satisfied. Unless and until such conditions are satisfied, such person shall, to the extent of the interest acquired, be entitled only to the transferor Member's rights, if any, in the Profits, Losses, Net Cash Receipts and other distributions to the Members pursuant to this Agreement, subject to the liabilities and obligations of transferor Member hereunder; but such person shall have no right to act on behalf of the Company or otherwise participate in the management of the business and affairs of the Company, and such person and his Participating Percentage shall be disregarded in determining whether the approval, consent or any other action has been given or taken by the Members. Any such assignee shall have the same right, subject to the same limitations, as the transferor Member had under the provisions of this Article 12 to assign its interest as a Member (including the right to assign such interest to any Permitted Transferee of such Member pursuant to Section 12.2), but any such further assignee shall have only the rights set forth in this Section 12.7 and shall not become an additional or substituted Member of the Company unless and until the conditions of Section 12.8 have been satisfied.

12.8 Admission Requirements. No assignee of all or any portion of a Member's interest in the Company (including a Permitted Transferee) or any other person shall be admitted as an additional or substituted Member of the Company unless and until:

(a) such admission has been approved in writing by all of the other Members, which approval may be given or withheld in the sole discretion of each Member;

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- (b) such assignment is made in writing, signed by the assigning Member (or its successor) and accepted in writing by the assignee, and a duplicate original of such assignment has been delivered to each Member;
 - (c) the Company has received an opinion of counsel as contemplated by Section 12.1 or each Member has waived this requirement; and
 - (d) the assignee executes and delivers to the Company and each other Member a written agreement in form reasonably satisfactory to all of the other Members, pursuant to which such assignee agrees to be bound by and confirms the obligations, representations and warranties contained in this Agreement.

12.9 **Effective Date of Assignment.** If an assignment is made in accordance with this Agreement, unless otherwise required by the Code:

- (a) the effective date of such assignment shall be the first date that both the written instrument of assignment is received by the other Members and, if required, approved by the other Members; provided that such assignee shall not be admitted as a Member unless and until the approvals and other requirements of Section 12.8 are satisfied;
- (b) the Company and the other Members shall be entitled to treat the assignor of the assigned interest as the absolute owner thereof in all respects and shall incur no liability for allocations of Profits or Losses and distributions of Net Cash Receipts or other amounts made in good faith to such assignor until such time as the written instrument of assignment has been actually received by each Member, and recorded in the books of the Company, and, if required, approved by the Members described in Section 12.1; and
- (c) any Profits and Losses shall be allocated between the assignor and the assignee of the assigned interest in the manner described in Section 7.3.

12.10 **Status of Assignor.** If there is a transfer or assignment of a Member's interest in the Company, then, without regard to whether or when such assignee or transferee is admitted as a Member of the Company, from and after the effective date of such assignment or transfer, the assigning or transferring Member shall cease to be a Member with respect to the transferred or assigned interest; and if such Member has transferred or assigned his entire membership interest in the Company, upon the effective date of such transfer or assignment, such Member shall cease to be a Member of the Company.

12.11 **Cost of Admission.** The cost of processing and perfecting an admission contemplated by this Article 12 (including reasonable attorneys' fees incurred by the Company) shall be borne by the party seeking admission as a Member to the Company.

ARTICLE 13

TAG- ALONG RIGHT

If at any time Members owning seventy- five percent (75%) or more of the Participating Percentages ("Controlling Members") shall desire to sell all of their membership interests in the Company to any third party (other than a Permitted Transferee), and the other Members do not elect to purchase such interests pursuant to Section 12.3, such Controlling Members shall give written notice thereof (a "Tag- Along Notice") to each of the other Members ("Minority Members") specifying the Participating Percentage to be sold and the price and terms of such sale. Each Minority Member may elect to participate in any such transaction as an additional selling Member on identical terms and conditions (with the aggregate price to be paid to the Controlling Members and the Minority Members electing to participate in the transaction allocated among them in proportion to the amounts each such Member would receive upon a hypothetical distribution of the aggregate purchase price pursuant to Section 15.4(c) in complete liquidation of the Company), by delivering a written notice thereof (a "Tag- Along Election Notice") to the Controlling Members within fifteen (15) days after such Minority Member's receipt of such Tag- Along Notice, thereby electing to sell in such transaction any portion of its interest in the Company specified in the Tag- Along Election Notice which is less than or equal to the product of (i) the aggregate Participating Percentage which the Controlling Members propose to transfer in such transaction, multiplied by (ii) a fraction, the numerator of which is the Participating Percentage owned by such Minority Member, and the denominator of which is the aggregate Participating Percentage owned by the Controlling Members and all Minority Members electing to participate in such transaction. If Minority Members elect to sell interests pursuant to this Article 13, the aggregate Participating Percentage to be sold or transferred to such third party by the Controlling Members and the Minority Members shall remain constant.

ARTICLE 14

BUY/SELL

14.1 **Right to Initiate.** Each Investor and NOX shall have the right, exercisable at any time after eighteen months from the date of the execution of this Agreement, in its sole discretion, to initiate the buy/sell procedures of this Article 14 in the manner described in Section 14.2.

14.2 **Initiation and Elections.** A Member (the "Initiating Party") shall initiate the buy/sell procedures of this Article 14, if at all, by delivering to either NOX (if the Initiating Party is an Investor) or to either Investor (if the Initiating Party is NOX) (the "Other Party") a written notice stating that the Initiating Party intends to proceed with this buy/sell procedure (a "Buy/Sell Notice"). The Buy/Sell Notice shall in addition set forth a gross value (without reduction for liabilities) for all of the assets owned by the Company other than cash and cash equivalents (such cash and cash equivalents being referred to herein as "Cash Assets" and such other assets being referred to herein as "Non- Cash Assets"), which assets shall include the Intellectual Property (the "Asset Value"), such value to be determined in the sole discretion of the Initiating Party. The Other Party shall have a period of ninety (90) days after the receipt of

the Buy/Sell Notice (the "Exercise Period") within which to notify the Initiating Party in writing (the "Reply Notice") whether the Other Party shall either (x) sell to the Initiating Party its entire interest in the Company at a price computed in the manner set forth in Section 14.2(a) (the "Reply Price"), or (y) buy the entire interest in the Company of the Initiating Party at a price computed in the manner set forth in Section 14.2(b) (the "Buy/Sell Price"). If the Other Party timely gives the Reply Notice electing (x) above, the Initiating Party shall be conclusively deemed to have agreed to purchase, and the Other Party shall be conclusively deemed to have agreed to sell, the entire interest in the Company of the Other Party at the Reply Price. If the Other Party timely gives the Reply Notice electing (y) above, the Initiating Party shall be conclusively deemed to have agreed to sell, and the Other Party shall be conclusively deemed to have agreed to purchase, the entire interest in the Company of the Initiating Party at the Buy/Sell Price. If the Other Party fails to give a Reply Notice prior to the expiration of the Exercise Period, it shall be conclusively presumed that the Other Party has properly elected (x) above.

(a) **Reply Price.** The Reply Price for the purchase of the interest in the Company of the Other Party shall be the amount that would be distributed to the Other Party pursuant to Section 15.4(c) if the Company sold all of its Non- Cash Assets for cash in the amount of the Asset Value, sold all of its Cash Assets for cash in the amounts shown for them on the books of the Company, applied such cash in full payment of all liabilities on the books of the Company, and the amount of such cash not so applied was available for distribution to the Members pursuant to Section 15.4(c) upon liquidation of the Company as of the date of the closing of this buy/sell.

(b) **Buy/Sell Price.** The Buy/Sell Price for the purchase of the interest in the Company of the Initiating Party shall be the amount that would be distributed to the Initiating Party pursuant to Section 15.4(c) if the Company sold all of its Non- Cash Assets for cash in the amount of the Asset Value, sold all of its Cash Assets for cash in the amounts shown for them on the books of the Company, applied such cash in full payment of all liabilities on the books of the Company, and the amount of such cash not so applied was available for distribution to the Members pursuant to Section 15.4(c) upon liquidation of the Company as of the date of the closing of this buy/sell.

(c) **Price Determinations.** The determination of the amount of the Buy/Sell Price, the Reply Price and any other amounts payable pursuant to this Article 14 shall be made by the independent accountants then employed by the Company on the basis of the Asset Value set forth in the Buy/Sell Notice and the Cash Assets and liabilities of the Company reflected on the books of the Company as of the date of closing of the buy/sell, which determination shall be final and nonappealable, absent manifest error.

(d) **Exclusivity of Buy/Sell Notice.** Only one Buy/Sell Notice shall be entertained at any one time. The order of consideration of Buy/Sell Notices shall be determined by the date upon which the Other Party receives the Buy/Sell Notice in accordance with Article 17.

14.3 **Closing.** The transactions contemplated by the applicable buy/sell shall be consummated (herein, the "Closing") at the principal office of the Company on the business day

specified by the purchasing Member, provided that such date shall be not less than thirty (30) days and not more than sixty (60) days after the expiration of the Exercise Period. At the Closing, the purchase price shall be paid by the purchasing Member to the selling Member in cash, by wire transfer of immediately available funds to the account or accounts designated by the selling Member, or by certified bank check. The selling Member shall execute and deliver at the Closing an assignment, instrument of conveyance or other instrument appropriate to convey the entire interest in the Company of the selling Member to the purchasing Member, and shall deliver to the purchasing Member such evidence as the purchasing Member may reasonably request showing that the interest in the Company being sold is owned free and clear of any and all claims, liens and encumbrances of any kind or nature.

14.4 **Payment of Loans.** If there shall be any outstanding loans due from the Company to the selling Member or any Affiliates thereof (other than loans payable pursuant to Section 8.1(a), which shall be taken into account in determining the Reply Price or the Buy/Sell Price, as may apply), such loans, including accrued and unpaid interest, shall be purchased at par by the purchasing Member as a condition precedent to the Closing. The purchase price for such loans shall be paid in full at the Closing in the same manner as the Reply Price or the Buy/Sell Price (as may apply) is paid. At the Closing, the selling Member (or any Affiliates thereof) shall deliver and endorse without recourse to the purchasing Member each note or other instrument evidencing such loans and all documents securing such loans (including any loans referred to in Section 8.1(a)).

14.5 **Other Remedies for Noncompliance.** It is the intent of the Members that the requirements or obligations, if any, of any Member to sell or purchase an interest in the Company in accordance with the provisions of this Article 14 shall be enforceable by an action for specific performance, with the same force and effect and at least to the same extent as is permitted at law or in equity for the specific performance of a contract relating to the purchase of real property or an interest therein.

14.6 **Assignees.** For purposes of this Article 14, the interest in the Company of each Member shall include all membership interests owned by such Member and any portion of such interest that is owned by any Affiliate of such Member or that such Member has assigned or transferred to an Affiliate of such Member or any other Person (other than to a Person that is a Member or Affiliate of any other Member at the time of such transfer). Any elections made by a Member under this Article 14 shall bind each Affiliate of such Member and any such assignee of such Member. All references in this Article 14 to a Member shall include all Affiliates of such Member and, except as provided above, all Persons to which such Member has transferred or assigned any portion of his membership interest in the Company.

14.7 **Additional Effects of a Buy/Sell.** If the selling Member or any Affiliate thereof is a guarantor or an indemnitor of or with respect to any obligations of the Company, a condition precedent to the Closing shall be that the purchasing Member shall obtain a release of such guaranty or liability; or, if such a release is not so obtainable and the selling Member agrees, the purchasing Member shall fully indemnify the selling Member and his Affiliates with respect to any such obligations. Any such indemnity by the purchasing Member shall be secured by its right to all distributions by the Company (including both distributions with respect to such

purchased interest in the Company and with respect to all other interests in the Company of the purchasing Member or his Affiliates) arising from and after the date there has been a default on an indemnified debt or obligation of the Company.

14.8 **Right to Assign.** The purchasing Member may assign his purchase rights under this Article 14 in whole or in part to a third party who, upon Closing, shall become a Member of the Company, without the consent of the selling Member but subject to the consent of all other Members, provided that (a) the purchasing Member delivers written notice to the selling Member of such assignment and of the identity of the assignee prior to the Closing; (b) such assignment, in the opinion of counsel to the Company, would not require registration of any interests in the Company under the Securities Act of 1933 or any applicable state securities or "Blue Sky" law, or result in any violation of any such laws; and (c) no such assignment shall relieve the purchasing Member of his obligations and liabilities under this Article 14.

ARTICLE 15

DISSOLUTION AND LIQUIDATION OF COMPANY

15.1 **Dissolution of the Company.** The Company shall be dissolved upon the happening of any of the following:

- (a) the agreement of the Members pursuant to Section 10.2 to dissolve and wind up the affairs of the Company;
- (b) any event that makes it unlawful for the Company business to be continued; or
- (c) the sale, disposition, or abandonment of all or substantially all of the non- cash assets of the Company.

The death, retirement, resignation, bankruptcy, court declaration of incompetence, or dissolution of any one or more Members or the occurrence of any other event that terminates the continued membership of any one or more Members (except as provided in the immediately preceding sentence) shall not cause the dissolution of the Company.

15.2 **Winding Up of Affairs.** In the event of the dissolution and liquidation of the Company for any reason, the Members shall commence to wind up the affairs of the Company and shall convert all of the Company's assets to cash or cash equivalents within such reasonable period of time as may be required to receive fair value therefor. All items of income, gain, loss, deduction and credit during the period of liquidation shall be allocated among the Members in the same manner as before the dissolution.

15.3 **Accounting.** In the case of the dissolution and termination of the Company, prior to any distributions to Members pursuant to Section 15.4(c), a proper accounting shall be made of the Capital Accounts of the Members and of each item of income, gain, loss, deduction and credit of the Company from the date of the last previous accounting to the date of dissolution. A copy of such accounting shall be provided to all Members.

15.4 **Final Distribution of Company Property.** Upon termination of the Company, the Members shall apply and distribute the remaining property of Company, together with the proceeds of any sales of same, as follows:

- (a) first, all Company debts and liabilities shall be paid and discharged, except any debts (i) described in Section 8.1, or (ii) that are nonrecourse to the extent that the Members elect not to pay such debts;
- (b) second, to establish any reserve which the Members may deem reasonably necessary for any contingent or unforeseen liabilities or obligations of the Company. Such funds may be placed in escrow by the Members for the purposes of disbursing such funds in payment of any of the contingencies, liabilities, or obligations, and, at the expiration of such period as the Members shall deem advisable, the balance then remaining shall be distributed pursuant to Section 15.4(c); and
- (c) third, to apply and distribute the balance in the manner and priority set forth in Section 8.1.

15.5 **Certificate of Cancellation.** Upon completion of the liquidation of the Company and the distribution of all Company property, the Company shall terminate and the Members shall have the authority to execute and record one or more Certificates of Cancellation of the Company as well as any and all other documents required or considered advisable by the Members to effectuate and evidence the dissolution and termination of the Company.

15.6 **No Restoration of Deficit Capital Accounts.** Except as otherwise expressly provided herein, at no time shall a Member with a deficit balance in its Capital Account have any obligation to the Company or to another Member or to any other person to restore such deficit balance.

ARTICLE 16

AMENDMENTS

16.1 **Amendment of Agreement.** Except as provided in Section 6.2(d), this Agreement may be amended only with the written concurrence of all of the Members.

16.2 **Amendment of Certificate.** If this Agreement shall be amended pursuant to this Article 16, the Members shall cause the Certificate to be amended, to the extent required by applicable law, to reflect such change. Each Member shall promptly be notified of any amendments made under this Section 16.2.

ARTICLE 17

NOTICES

Any and all notices to be served hereunder shall be in writing and shall be personally delivered, sent by private courier, sent by certified mail, postage prepaid, or sent by facsimile

transmission and (a) if intended for the Company, to the Company at the address of the principal place of business of the Company set forth herein, with a copy to each Member or (b) if intended for a Member, to such Member at the address set forth below; or to such other address or facsimile telecopier number as the Members, on behalf of the Company, or a Member, on his own behalf, may designate from time to time in a written notice served upon the Company and each other Member in accordance herewith. Any notice personally delivered shall be deemed delivered on the date actually delivered. Any notice sent by private courier shall be deemed delivered on the date of delivery or rejection of delivery, as shown on the receipt for delivery. Any notice sent by mail as provided above shall be deemed delivered on the third (3rd) business day next following the postmark date which it bears. Any notice sent by facsimile transmission shall be deemed delivered on the date shown on the evidence of completed transmission. The addresses of the Members are as follows:

NOX:	NOX II, Ltd. 4281 Meadowlark Trail Stow, Ohio 44224 Fax No.: (330) 686- 8916
AJG:	AJG Coal, Inc. Two Pierce Place Itasca, Illinois 60143- 3141 Fax No.: (630) 284- 4272
IQCC:	IQ Clean Coal LLC 21 Martin Dale North Greenwich, Connecticut 06830 Fax No.: (203) 622- 6338

ARTICLE 18

MISCELLANEOUS PROVISIONS

18.1 **Severability.** If any provision of this Agreement or the application of such provision to any Person or circumstance shall be held invalid, the remainder of this Agreement, or the application of such provision to Persons or circumstances other than those as to which it is held invalid, shall not be affected.

18.2 **Parties Bound.** Any Person acquiring or claiming an interest in the Company, in any manner whatsoever, shall be subject to and bound by all terms, conditions and obligations of this Agreement to which his or its predecessor in interest was subject or bound, without regard to whether such Person has executed a counterpart hereof or any other document contemplated hereby. No Person, including the legal representative, heir or legatee of a deceased Member, shall have any rights or obligations greater than those set forth in this Agreement and no Person

shall acquire an interest in the Company or become a Member thereof except as permitted by the terms of this Agreement. This Agreement shall be binding upon the parties hereto, their successors, heirs, devisees, assigns, legal representatives, executors and administrators.

18.3 **Applicable Law.** The Company and this Agreement shall be governed by the laws of the State of Delaware.

18.4 **Additional Documents and Acts.** In connection with this Agreement as well as all transactions contemplated by this Agreement, each party hereto shall execute and deliver such additional documents and instruments, and perform such additional acts, as any other party hereto may reasonably deem necessary or desirable from time to time to effectuate, perform and evidence all of the terms, provisions and conditions of this Agreement and all such transactions.

18.5 **Benefit.** Nothing contained herein, express or implied, is intended to confer upon any person other than the parties hereto and their respective successors and permitted assigns any rights or remedies under or by reason of this Agreement.

18.6 **Waiver.** The failure to insist upon strict enforcement of any of the provisions of this Agreement or of any agreement or instrument delivered pursuant hereto shall not be deemed or construed to be a waiver of any such provision, nor to in any way affect the validity of this Agreement or any agreement or instrument delivered pursuant hereto or any provision hereof or the right of any party hereto to thereafter enforce each and every provision of this Agreement and each agreement and instrument delivered pursuant hereto. No waiver of any breach of any of the provisions of this Agreement or any agreement or instrument delivered pursuant hereto shall be effective unless set forth in a written instrument executed by the party against which enforcement of such waiver is sought, and no waiver of any such breach shall be construed or deemed to be a waiver of any other or subsequent breach.

18.7 **Survival.** The representations, warranties and covenants of the Members contained herein or in any agreement or instrument delivered pursuant hereto shall survive the consummation of the transactions contemplated hereby, and shall not be affected by any investigation which may have been made by any of the parties hereto.

18.8 **Headings.** The headings in this Agreement are inserted for convenience and identification only and are in no way intended to describe, interpret, define or limit the scope, extent or intent of this Agreement or any provision.

18.9 **Counterparts.** This Agreement may be executed in multiple counterparts with separate signature pages, each such counterpart shall be considered an original, but all of which together shall constitute one and the same instrument.

IN WITNESS WHEREOF, each of the parties has executed this Agreement as of the date first set forth above, confirms its agreement to become a Member of the Company, agrees to be bound by this Agreement, and swears that the statements set forth herein are true and correct.

NOX II, LTD., an Ohio limited liability company

By:

Name:

Title:

AJG COAL, INC., a Delaware corporation

By:

/s/ Sally Wasikowski

Name: Sally Wasikowski

Title: Vice President

liability company

By:

Name:

Title:

IN WITNESS WHEREOF, each of the parties has executed this Agreement as of the date first set forth above, confirms its agreement to become a Member of the Company, agrees to be bound by this Agreement, and swears that the statements set forth herein are true and correct.

NOX, Ltd., an Ohio limited liability company

By: /s/ Carolyn A. Kelly

Name: Carolyn A. Kelly

Title: Managing Member

AJG COAL, INC., a Delaware corporation

By: _____

Name: _____

Title: _____

liability company

By: _____

Name: _____

Title: _____

OPTION AGREEMENT

This Option Agreement (the "Agreement") is entered into as of this 17TH day of October, 2005 by and among Carolyn Kelly ("Seller"), NOx II, Ltd., an Ohio limited liability company (the "Company") and AJG Financial Services, Inc., a Delaware corporation ("Purchaser").

WHEREAS, Seller is the record and beneficial owner (subject to the Milford Agreement, as hereinafter defined) of sixty- three and seven- tenths percent (63.7%) of the issued and outstanding equity interests (the "Equity Interests") of the Company; and

WHEREAS, Seller desires to grant to Purchaser and Purchaser desires to obtain from Seller an option to purchase up to thirty- two and ninety- four one hundredths percent (32.94%) of the issued and outstanding equity interests in the Company which is equivalent to fifty- one and seventy- one one hundredths percent (51.71%) of the Equity Interests on the date hereof (the "Interests"); and

WHEREAS, Vincent A. Vellella ("Vellella"), the Company and Purchaser are entering into an Option Agreement ("Vellella Option Agreement"), of even date herewith pursuant to which Vellella is granting to Purchaser an option to purchase up to seven and six one hundredths percent (7.06%) of the issued and outstanding equity interests of the Company which is equivalent to fifty- one and seventy- two one hundredths percent (51.72%) of the equity interests owned by Vellella on the date hereof.

NOW, THEREFORE, in consideration of the mutual covenants and agreements of the parties and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties hereby agree as follows:

1. Grant of Option and Option Term. Subject to the terms and conditions hereof, and in reliance upon the representations, warranties, covenants and agreements made herein by Seller and Purchaser, Seller does hereby irrevocably grant to Purchaser the right, privilege and option to purchase from Seller equity interests in the Company owned by Seller up to the amount of the Interests in one or more transactions (the "Option") for an aggregate purchase price for all of the Interests of Nine Million Fifty Eight Thousand Five Hundred Dollars (\$9,058,500) (the "Purchase Price"). The term of the Option granted hereunder shall commence on the date hereof and shall expire (to the extent not exercised) at midnight on December 31, 2007 (the "Option Term").

2. Consideration for Option. Subject to Purchaser's right of recovery set forth below in this Section 2, in consideration for Seller's grant of the Option to Purchaser hereunder, Purchaser shall pay to Seller the sum of Seven Hundred Seventy- Three Thousand Five Hundred Dollars (\$773,500) (the "Option Consideration") which sum shall be paid to Seller by Purchaser within three (3) business days after the date upon which Seller shall execute this Agreement by delivery of cash, certified check, bank cashier's check, or via wire transfer of immediately available funds to a bank account designated by Seller in writing. The obligation of Purchaser to deliver the consideration for the Option provided for in this Section 2 shall be conditioned upon the prior receipt by Purchaser of each of the following:

- (a) A Restrictive Covenant Agreement in the form of Exhibit 2(a) attached hereto, duly executed by Seller and Douglas Comrie;
- (b) A Consent in the form of Exhibit 2(b) attached hereto, duly executed by each member of the Company and the Company (the "Consent").

Interests, then Purchaser shall be entitled to the return of that portion of the Option Consideration equal to the Option Consideration multiplied by a fraction, the numerator of which is the Interests in the Company which have not on the applicable date been acquired by Purchaser and the denominator of which is all of the Interests in the Company that Purchaser may acquire hereunder. Any amount due hereunder shall be paid to Purchaser by Seller contemporaneously with the closing of such sale.

3. Exercise of Option.

(a) Subject to the provisions of Paragraph 3(d) below, Purchaser may exercise the Option at any time and from time to time during the Option Term, in whole or in part by delivering a written notice (the "Notice") to Seller (with a copy to the Company) indicating the percentage of the Interests (the "Percentage") Purchaser has elected to purchase at such time; provided that any partial exercise of the Option may not be for an amount less than three and five- tenths percent (3.5%) of the Equity Interests.

(b) Within 5 business days of delivery of the Notice to Seller by Purchaser, Seller and Purchaser shall each execute and deliver a Purchase Agreement substantially in the form of Exhibit B hereto for the sale of that portion of the Interests which is then being sold pursuant to the exercise of the Option; provided, however, that anything in this Agreement or such Purchase Agreement to the contrary notwithstanding, Purchaser shall not be obligated to consummate the purchase of the Interests with respect to which the Option has been exercised unless Purchaser shall have accepted and approved all disclosures made by Seller on the schedules attached to the Purchase Agreement.

(c) In connection with Purchaser's decision whether to exercise any portion of the Option, and in connection with Purchaser's due diligence investigation of the Company with respect to matters disclosed by Seller on the disclosure schedules, if any, to the Purchase Agreement and other matters, Purchaser, either directly or through one or more authorized agents, shall have the unrestricted right during normal business hours to review and inspect the facilities, books, records, data, information and other assets of the Company and to make copies, extracts or compilations thereof, and Purchaser shall have the further right to interview officers, managers, employees, agents and contractors of the Company in connection therewith. All such information shall be held in confidence by Purchaser as described in Section 1.9 of the Amended and Restated Limited Liability Company Agreement of the Company attached to and made a part of the Consent as Exhibit A (the "Company Operating Agreement"), on the same basis as if Purchaser were a "Member" of the Company on the date such information was received.

(d) The exercise of an Option under this Agreement is subject and conditioned upon Purchaser's simultaneous pro rata exercise of the option granted to Purchaser by Carolyn under the Carolyn Option Agreement for the purchase of equity interests in the Company owned by Carolyn. For example, if Purchaser exercises its option hereunder for one half (1/2) of the Interests, then Purchaser must exercise its option under the Carolyn Option Agreement to acquire one half (1/2) of the Interests that are subject to the Carolyn Option Agreement.

4. Adjustment of Option. In the event of a change in the equity interests of the Company resulting from a reorganization, reclassification, merger, consolidation or other similar transaction, then, and in each such event, Purchaser shall have the right thereafter, upon exercise of the Option pursuant to Section 3, to convert the Interests into the kind and amount of interests, units, shares of stock and/or other securities and/or other property receivable by the holders of the equity interests of the Company upon such reorganization, reclassification, merger, consolidation or other similar transaction, which Purchaser would have been entitled to receive if Purchaser had exercised the Option immediately prior to such transaction.

5. Consent. As an inducement to Purchaser to enter into the Agreement and to consummate some or all of the transactions contemplated hereby, the Company agrees and acknowledges with and to Purchaser that (i) the Company has been provided with a true, correct and complete copy of the Agreement and will maintain the Agreement in its files during the Option Term without disclosing such Agreement or any of its terms to any party without the prior written consent of Purchaser; (ii) the Company has made a notation of the existence of this Agreement and the Option granted to Purchaser hereunder on the Company's books and records with respect to the ownership of equity interests in the Company; (iii) the Company will make appropriate modifications to its books and records with respect to the ownership of equity interests in the Company to reflect Purchaser's exercise of all or any portion of the Option; (iv) the Company will not effectuate or permit the transfer of any portion of the Interests during the Option Term in contravention of the Option or after the expiration of the Option Term with respect to any portion of the Option exercised by Purchaser during the Option Term, without the prior written Consent of Purchaser; (v) any attempted transfer in violation of the above provisions or in violation of any provision of the Agreement shall be deemed null and void and of no force or effect; and (vi) the Company shall cooperate with Purchaser and make available such information and personnel as Purchaser shall request in connection with its due diligence investigation pursuant to Section 3(c) above.

6. Representations and Warranties of Seller. To induce Purchaser to enter into this Agreement Seller represents and warrants to Purchaser as follows, which representations and warranties, shall survive the consummation of the transactions contemplated by this Agreement:

(a) Due Organization and Status. The Company is a limited liability company duly organized, validly existing and in good standing under the laws of the state of its organization. The Company is duly authorized to conduct business and is in good standing under the laws of each jurisdiction where such qualification is required, except where the lack of such qualification would not have a material adverse effect on the financial condition of the Company taken as a whole. The Company has full corporate power and authority to carry on the businesses in which it is engaged and to own and use the properties owned and used by it.

(b) Authority: Enforceability. Seller has the full power and authority to execute and deliver this Agreement and to perform its obligations hereunder. This Agreement has been duly executed and delivered by Seller and constitutes a legal, valid and binding agreement of Seller, enforceable against Seller in accordance with its terms.

(c) Title to Equity. Seller owns the Equity Interests free and clear of any and all options, proxies, voting trusts, voting agreements, judgments, pledges, charges, escrows, rights of first refusal or first offer, mortgages, indentures, claims, transfer restrictions, liens, equities, security interests and other encumbrances of every kind and nature whatsoever, whether arising by agreement, operation of law or otherwise ("Claims").

(d) Consents. No consent, authorization, order or approval of, or filing or registration with, any person, entity (including, but not limited to, the Company) or governmental authority is required for or in connection with the execution and delivery of this Agreement by Seller or the consummation by Seller of any of the transactions contemplated hereby.

(e) Conflicts Under Laws. Neither the execution and delivery of this Agreement by Seller, nor the consummation by Seller of any of the transactions contemplated hereby will conflict with or constitute a breach of any of the terms, conditions or provisions of any statute or

administrative regulation, or of any order, writ, injunction, judgment or decree of any court or governmental authority or of any arbitration award, to which Seller is a party or by which Seller is bound.

(f) Conflicts Under Contracts. Seller is not a party to, or bound by, any unexpired, undischarged or unsatisfied written or oral contract, agreement, indenture, mortgage, debenture, note or other instruments under the terms of which the execution, delivery and performance by Seller of this Agreement and the consummation of any of the transactions contemplated hereby by Seller will require a consent, or approval which has not been obtained on or prior to the date hereof, or notice which has not been given on or prior to the date hereof, or result in a lien on the Equity Interests or any portion thereof owned by Seller.

(g) Ownership of Interests. To the knowledge of Seller (solely as to the interests of persons other than Seller) Schedule 5(h) sets forth a complete and correct description of the beneficial and record owners of all equity interests of the Company and the percentage of ownership that each such equity interest bears to all equity interests in the Company. Seller owns beneficially and of record the Equity Interests of the Company and such Equity Interests are owned free and clear of Claims. The Equity Interests have been duly authorized and validly issued, and were offered, issued, sold and delivered by the Company to Seller in compliance with all applicable state and federal laws concerning the issuance of securities. Further, none of such Equity Interests were issued in violation of any preemptive or similar rights of any past or present member or other person or entity.

7. Additional Covenants of Seller. From the date hereof until the expiration of the Option Term:

(a) Seller shall not sell, convey, assign or otherwise transfer or grant any right or interest in the Interests or any portion thereof, except as provided herein.

(b) Seller shall not create any security interest in, mortgage, pledge, or otherwise encumber the Interests or any part thereof, or permit the same to be or become subject to any lien, attachment, execution, sequestration, other legal or equitable process, or any encumbrance of any kind or character.

8. Restrictive Legend. In the event any portion of the Interests shall be certificated or otherwise evidenced by any document or instrument that is subject to transfer or assignment, then such certificate shall immediately be delivered to Purchaser for safekeeping and as security for the Option during the Option Term. Each such certificate or other such document or instrument shall bear a restrictive legend on its face, in bold type, stating as follows:

"THE EQUITY INTEREST IN NOX II, LTD. EVIDENCED HEREBY IS SUBJECT TO THE TERMS AND CONDITIONS OF THAT CERTAIN OPTION AGREEMENT DATED AS OF SEPTEMBER 7, 2005 BY AND BETWEEN VINCENT A. VELLELLA AND AJG FINANCIAL SERVICES, INC."

Such restrictive legend shall be removed upon the expiration of the Option Term to the extent the Option has not been duly exercised by Purchaser.

9. Succession and Assignment. This Agreement shall be binding upon and inure to the benefit of the parties named herein and their respective successors and permitted assigns and, with respect to Seller, his heirs, executors, administrators, personal representatives and legal representatives. No party

may assign either this Agreement or any of its rights, interests, or obligations hereunder without the prior written approval of the other party; provided that Purchaser may assign the Agreement or any of its rights, interests or obligations hereunder to an Affiliate (as defined in the Company Operating Agreement) without the consent of Seller.

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

11. Headings. The section headings contained in this Agreement are inserted for convenience only and shall not affect in any way the meaning or interpretation of this Agreement.

12. Notices. All notices, requests, demands, claims, and other communications hereunder shall be in writing. Any notice, request, demand, claim, or other communication hereunder shall be deemed duly given two business days after it is sent by registered or certified mail, return receipt requested, postage prepaid, and addressed to the intended recipient as set forth below:

One Thorn Run Center
Suite 425
Telecopier: (412) 264- 2327

if to Purchaser:

c/o Arthur J. Gallagher & Co.
Two Pierce Place
Attention: Sally Wasikowski
Telecopier: (630) 285- 4272

if to the Company:

NOx II, Ltd.
Stow, Ohio

Any party may send any notice, request, demand, claim, or other communication hereunder to the intended recipient at the address set forth above using any other means (including personal delivery, expedited courier, messenger service, telecopy, telex, ordinary mail, or electronic mail), but no such notice, request, demand, claim, or other communication shall be deemed to have been duly given unless and until it actually is received by the intended recipient. Any party may change the address to which notices, requests, demands, claims, and other communications hereunder are to be delivered by giving the other party notice in the manner herein set forth.

13. Entire Agreement. This Agreement and the instruments to be delivered by the parties pursuant to the provisions hereof constitute the entire agreement between the parties with respect to the subject matter hereof, and all prior or contemporaneous negotiations, discussions, agreements or understandings are merged herein and are superceded hereby. Each schedule shall be considered incorporated into this Agreement.

14. Governing Law. This Agreement shall be governed by and shall be construed and enforced in accordance with the laws of the State of Delaware, without regard to its conflict of law principles.

15. Amendments and Waivers. No amendment of any provision of this Agreement shall be valid unless the same shall be in writing and signed by Purchaser and Seller. The failure in any one or more instances of a party to insist upon performance of any of the terms, covenants or conditions of this Agreement, to exercise any right or privilege in this Agreement conferred, or the waiver by said party of any breach of any of the terms, covenants or conditions of this Agreement, shall not be construed as a subsequent waiver of any such terms, covenants, conditions, rights or privileges, but the same shall continue and remain in full force and effect as if no such forbearance or waiver had occurred. No waiver shall be effective unless it is in writing and signed by an authorized representative of the waiving party and no waiver by any party of any default, misrepresentation, or breach of warranty or covenant hereunder, shall be deemed to extend to any prior or subsequent default, misrepresentation, or breach of warranty or covenant hereunder.

16. Severability. Any term or provision of this Agreement that is invalid or unenforceable in any situation in any jurisdiction shall not affect the validity or enforceability of the remaining terms and provisions hereof or the validity or enforceability of the offending term or provision in any other situation or in any other jurisdiction.

[signature page follows]

IN WITNESS WHEREOF, the parties hereto have executed this Option Agreement as of the day and year first above written.

AJG Financial Services, Inc.

By: /s/ Sally Wasikowski

Its: Vice President

NOx II, Ltd.

By: _____

Its: _____

Carolyn Kelly, in her individual capacity

JOINDER

To induce Purchaser to enter into the foregoing Option Agreement the undersigned, DOUGLAS COMRIE, hereby agrees to execute and deliver to Purchaser a counterpart of the Restrictive Covenant Agreement referred to in Section 2(a) above immediately after the execution of such Option Agreement.

Dated as of the 17th day of October, 2005.

Douglas Comrie

IN WITNESS WHEREOF, the parties hereto have executed this Option Agreement as of the day and year first above written.

AJG Financial Services, Inc.

By: _____

Its: _____

NOx II, Ltd.

By: /s/ Carolyn A. Kelly

Its: President

Carolyn Kelly

Carolyn Kelly, in her individual capacity

JOINDER

To induce Purchaser to enter into the foregoing Option Agreement the undersigned, DOUGLAS COMRIE, hereby agrees to execute and deliver to Purchaser a counterpart of the Restrictive Covenant Agreement referred to in Section 2(a) above immediately after the execution of such Option Agreement.

Dated as of the 17th day of October, 2005.

/s/ Douglas Comrie
Douglas Comrie

EXHIBIT A
TO
OPTION AGREEMENT DATED AS OF OCTOBER 17, 2005
BETWEEN
CAROLYN KELLY
AND
AJG FINANCIAL SERVICES, INC.

PURCHASE AGREEMENT

This Purchase Agreement (this "Agreement") is made and entered into as of _____, 200_ by and between **CAROLYN KELLY** ("Seller") and **AJG FINANCIAL SERVICES, INC.**, a Delaware corporation ("Purchaser").

RECITALS

WHEREAS, as of September 7, 2005 Seller owned (subject to the Milford Agreement, as hereinafter defined) sixty- three and seven- tenths percent (63.7%) of the issued and outstanding equity interests (the "Equity Interests") of NOx II, Ltd., an Ohio limited liability company (the "Company");

WHEREAS, the Company, through its affiliate Chem- Mod, LLC., a Delaware limited liability company, is engaged in the business of utilizing certain sorbent chemical technology for sulfur, NOX, chlorine, mercury and other heavy metal remediation of combusted carbonaceous materials in the United States and Canada (the "Business");

WHEREAS, on September 7, 2005 Seller and Purchaser entered into that certain Option Agreement (the "Option Agreement") pursuant to which Seller granted to Purchaser the option to purchase up to thirty two and ninety four one hundredths percent (32.94%) of the issued and outstanding equity interests of the Company, which is equivalent to fifty one and seventy one hundredths percent (51.71%) of the Equity Interests (the "Option Equity Interests");

WHEREAS, in accordance with the Option Agreement, which allows Purchaser to purchase Equity Interests in one or more transactions, Purchaser has given a written notice to Seller pursuant to which Purchaser has elected to purchase _____% of the Option Equity Interests (the "Interests"); and

WHEREAS, Purchaser desires to purchase, and Seller desires to sell the Interests.

NOW, THEREFORE, to induce Purchaser to purchase the Interests, and to induce Seller to sell the Interests, and for other good and valuable consideration, the parties hereto agree as follows:

ARTICLE I. PURCHASE OF INTERESTS; PURCHASE PRICE

Section 1.1 Sale and Purchase of Interests. Subject to the terms and conditions hereof, and in reliance upon the representations, warranties, covenants and agreements made herein by Seller and Purchaser, Purchaser shall purchase and accept the Interests from Seller, and Seller shall sell, transfer, convey, assign and deliver the Interests to Purchaser at the Closing, on the Closing Date (defined in Section 7.1 below).

Section 1.2 Consideration. The aggregate purchase price for all of the Option Equity Interests is Nine Million Fifty Eight Thousand Five Hundred Dollars (\$9,058,500). The purchase price (the "Purchase Price") payable by Purchaser for the Interests shall be an amount equal to (i) the percentage of the Option Equity Interests being purchased pursuant to this Agreement, (ii) multiplied by Nine Million Fifty Eight Thousand Five Hundred Dollars (\$9,058,500). By way of example, if 20% of the Option Equity Interests is purchased, the purchase price shall be equal to One Million Eight Hundred Eleven Thousand Seven Hundred Dollars (\$1,811,700), the product of .20 x \$9,058,500.

ARTICLE II. REPRESENTATIONS AND WARRANTIES OF PURCHASER

Section 2.1 As an inducement to Seller to enter into and perform its obligations under this Agreement, and in consideration of the covenants of Seller contained herein, Purchaser represents and warrants to Seller on the date hereof and on the Closing Date as follows:

- (a) Organization. Purchaser is a corporation duly organized, validly existing and in good standing under the laws of the state of its organization.
- (b) Authorization; Enforceability. Purchaser has the full power and authority to execute and deliver this Agreement and to perform its obligations hereunder. This Agreement constitutes the valid and legally binding obligation of Purchaser, enforceable in accordance with its terms.
- (c) Consents. No consent, authorization, order or approval of, or filing or registration with, any governmental authority is required for or in connection with the consummation by Purchaser of the transactions contemplated hereby.
- (d) Conflicts Under Constituent Documents or Laws. Neither the execution and delivery of this Agreement by Purchaser, nor the consummation by Purchaser of the transactions contemplated hereby will conflict with or result in a breach of any of the terms, conditions or provisions of its certificate of incorporation or by-laws, or of any statute or administrative regulation, or of any order, writ, injunction, judgment or decree of any court or governmental authority or of any arbitration award which has been served upon Purchaser.
- (e) Conflicts Under Contracts. Purchaser is not a party to any unexpired, undischarged or unsatisfied written or oral contract, agreement, indenture, mortgage, debenture, note or other instrument under the terms of which performance by Purchaser of the terms of this Agreement may be prohibited, prevented or delayed.

ARTICLE III. REPRESENTATIONS AND WARRANTIES OF SELLER

Section 3.1 As an inducement to Purchaser to enter into and perform its obligations under this Agreement and in consideration of the covenants of Purchaser contained herein, Seller represents and warrants to Purchaser, except as set forth on the Disclosure Schedule (if any) attached hereto, on the date hereof and on the Closing Date as follows:

- (a) Due Organization and Corporate Status. The Company is a limited liability company duly organized, validly existing and in good standing under the laws of the state of its organization. The Company is duly authorized to conduct business and is in good standing under the laws of each jurisdiction where such qualification is required, except where the lack of such qualification would not have a Material Adverse Effect on the Company taken as a whole. The Company has full corporate power and authority to carry on the businesses in which it is engaged and to own and use the properties owned and used by it. As used in this Agreement, "Material Adverse Effect" means a material adverse effect on the business, operations (including results of operations), assets, liabilities, condition (financial or otherwise) or prospects of the Company or the consummation of the transaction contemplated hereby.
- (b) Authority; Enforceability. Seller has the full power and authority to execute and deliver this Agreement and to perform its obligations hereunder. This Agreement has been duly executed and delivered by Seller and constitutes a legal, valid and binding agreement of Seller, enforceable against Seller in accordance with its terms.

-
- (c) Title to Interests. Except with respect to (i) the option granted to Purchaser pursuant to the Option Agreement, and (ii) the right of Milford Associates, LLC, a Michigan limited liability company ("Milford") to the financial benefits (but not the right to vote) associated with a two percent (2%) membership interest in the Company as granted to Milford by Seller pursuant to the Agreement, dated April 27, 2005, between Milford and Seller ("Milford Agreement"), Seller owns the Interests free and clear of any and all options, proxies, voting trusts, voting agreements, judgments, pledges, charges, escrows, rights of first refusal or first offer, mortgages, indentures, claims, transfer restrictions, liens, equities, security interests and other encumbrances of every kind and nature whatsoever, whether arising by agreement, operation of law or otherwise ("Claims").
- (d) Consents. No consent, authorization, order or approval of, or filing or registration with or notice to, any person, entity (including, but not limited to, the Company) or governmental authority is required for or in connection with the consummation by Seller of the transaction contemplated hereby, other than the Consent executed and delivered pursuant to the Option Agreement (the "Consent").
- (e) Conflicts Under Laws. Neither the execution and delivery of this Agreement by Seller, nor the consummation by Seller of the transaction contemplated hereby will conflict with or constitute a breach of any of the terms, conditions or provisions of any statute or administrative regulation, or of any order, writ, injunction, judgment or decree of any court or governmental authority or of any arbitration award, to which Seller is a party or by which Seller is bound.
- (f) Conflicts Under Contracts. Seller is not a party to, or bound by, any unexpired, undischarged or unsatisfied written or oral contract, agreement, indenture, mortgage, debenture, note or other instruments under the terms of which the execution, delivery and performance by Seller of this Agreement and the consummation of the transaction contemplated hereby by Seller will result in a lien on the Option Equity Interests or any portion thereof owned by Seller or would prohibit, prevent or delay timely performance by Seller according to the terms of this Agreement.
- (g) Ownership of Interests. One hundred percent (100%) of the equity interests of the Company are issued and outstanding. The Equity Interests have been duly authorized and validly issued and were offered, issued, sold and delivered by the Company to Seller in compliance with all applicable state and federal laws concerning the issuance of securities. Further, none of such Equity Interests were issued in violation of any preemptive or similar rights of any past or present member or other person or entity.
- (h) Subsidiaries. The Company has no subsidiaries.
- (i) Constituent Documents. True and complete copies of the articles of organization and all amendments thereto, the operating agreement, as amended and currently in force, all equity interest records, and all minute books and records of the Company have been furnished for inspection by Purchaser. Such equity interest records accurately reflect all equity interest transactions and the equity interest ownership of the Company. The minute books and records of the Company contain true and complete copies of all resolutions adopted by the members or the board of managers of the Company, and any other action formally taken by the Company.
- (j) Undisclosed Liabilities. The Company does not have any Liability that relate to or that have arisen out of a breach of contract, breach of warranty, tort, or infringement by or against the Company or any claim or lawsuit involving the Company. The Company does not have any obligation or liability of any nature whatsoever (direct or indirect, matured or

unmatured, absolute, accrued, contingent or otherwise), which would be required by GAAP to be provided or reserved against on a balance sheet (a "Liability"), which has not been properly and adequately reserved on the most recent balance sheet of the Company, a true, correct and complete copy of which has been delivered to Purchaser by Seller prior to the date hereof:

(k) Title to Assets. The Company has good title to its assets, free and clear of any Claims, except for statutory liens for federal or state taxes not yet due. No unreleased mortgage, trust deed, chattel mortgage, security agreement, financing statement or other instrument encumbering any of the Company's assets has been recorded, filed, executed or delivered.

(l) Conduct of Business. Except as is set forth in Schedule 3.1(s) hereto, since the date of the most recent financial statements (balance sheet and profit and loss statement) of the Company delivered to Purchaser by Seller, the business of the Company has only been conducted in the usual and ordinary course, consistent with past practices, and there has not occurred any Material Adverse Effect.

(m) Employees Relations. The Company does not currently have and since its inception has not had any employees (except to the extent, if any, that Seller or Douglas C. Comrie are considered employees of the Company) and, since the formation of the Company, no wages or other compensation have been paid to any person which resulted in the issuance of Internal Revenue Service Form W- 2, no employment agreement has been entered into between the Company and any individual, and the Company has not treated or dealt with any individual as if such individual is or was an employee of the Company.

(n) Real Estate. The Company has not in the past owned or leased and does not currently own or lease any real property.

(o) Litigation and Claims. There is no litigation or proceeding, in law or in equity, and there are no proceedings or governmental investigations before any commission or other administrative authority, pending or, to Seller's knowledge, overtly threatened against the Company or any of the Company's officers, managers, members or affiliates, with respect to or affecting the Company's operations, Business or assets, or with respect to the Interests, the Option Equity Interests or the consummation of the transactions contemplated hereby. To Seller's knowledge there are no facts which, if known by a potential claimant or governmental authority, would give rise to a claim or proceeding which, (i) if asserted or conducted with results unfavorable to the Company, may have a Material Adverse Effect; or (ii) if asserted or conducted with results unfavorable to the Seller, may have a material adverse effect upon (1) Seller; (2) the value of the Interests or the Option Equity Interests; or (3) Seller's ability to consummate the sale of the Interests contemplated hereby.

(p) Compliance with Laws. To Seller's knowledge after due inquiry and investigation, the Company is not in violation of, or delinquent in respect to, any decree, order or arbitration award or law, statute, or regulation of or agreement with, or any permit from, any federal, state or local governmental authority to which the property, assets, personnel or Business activities of the Company are subject, including federal, state or local laws, statutes and regulations relating to equal employment opportunities, fair employment practices, occupational health and safety, wages and hours, and discrimination. Since the inception of the Company, the Company has not received from any governmental authority any written notification with respect to possible noncompliance of any decree, order, writ, judgment or arbitration award or law, statute, or regulation.

(q) Complete Disclosure. The representations and warranties of Seller herein do not omit to state a material fact necessary in order to make the representations, warranties or statements contained in this Agreement not misleading. The copies of all documents furnished by Seller to Purchaser pursuant to the terms of this Agreement are complete and accurate in all material respects.

ARTICLE IV. COVENANTS OF SELLER

Section 4.1 Expenses and Transfer Taxes. Seller will bear the legal, accounting and other expenses incurred by Seller in connection with the negotiation, preparation and execution of this Agreement and the other documents, instruments and agreements contemplated hereby and the transactions contemplated hereby and thereby, and will pay all sales, transfer, recordation and documentary taxes and fees that may be payable in connection with the transactions contemplated by this Agreement.

Section 4.2 Further Assurances. Seller shall use commercially reasonable efforts to implement the provisions of this Agreement, and for such purpose Seller, at the request of Purchaser, at or after the Closing shall without further consideration promptly execute and deliver, or cause to be executed and delivered, to Purchaser such further instruments or documents, and take all such other actions, as Purchaser may reasonably deem necessary or desirable to implement any provision of this Agreement.

ARTICLE V. COVENANTS OF PURCHASER

Section 5.1 Expenses. Purchaser will bear the legal, accounting and other expenses incurred by it in connection with the negotiation, preparation and execution of this Agreement and the other documents, instruments and agreements contemplated hereby and the transactions contemplated hereby and thereby.

Section 5.2 Further Assurances. Purchaser shall use commercially reasonable efforts to implement the provisions of this Agreement, and for such purpose Purchaser, at the request of Seller, at or after the Closing shall without further consideration promptly execute and deliver, or cause to be executed and delivered, to Seller such further instruments or documents, and take all such other actions, as Seller may reasonably deem necessary or desirable to implement any provision of this Agreement.

ARTICLE VI. CONDITIONS PRECEDENT TO PURCHASER'S OBLIGATIONS

Section 6.1 Conditions Precedent. The obligation of Purchaser to consummate the transaction contemplated by this Agreement shall be conditioned upon the fulfillment (or written waiver by Purchaser) of each of the following conditions:

- (a) The representations and warranties of Seller shall be true, correct and not breached.
- (b) Seller shall have fully performed each and every covenant and agreement applicable to Seller at or prior to the Closing on the Closing Date.
- (c) Purchaser shall have approved and accepted each of the schedules (as to both form and content) to Seller's representations and warranties set forth herein.
- (d) The members of the Company shall have executed and delivered to Purchaser an Amended and Restated Operating Agreement in the form of Exhibit 6.1(e) attached hereto.

ARTICLE VII. CLOSING; CLOSING DELIVERIES

Section 7.1 Closing. As used in this Agreement, the "Closing" shall mean the time at which Seller consummates the sale, transfer, conveyance, assignment and delivery of the Interests to Purchaser as provided herein by the execution and delivery by Seller of this Agreement against the execution and delivery by Purchaser of this Agreement and the payment by Purchaser to Seller of the Purchase Price in accordance with Article I. The date of the Closing shall be referred to herein as the "Closing Date." Unless the parties otherwise agree, the Closing shall occur at 9:00 a.m. on the date hereof at the offices of DLA Piper Rudnick Gray Cary US LLP at 203 North LaSalle Street, Chicago, Illinois, or at such other time or location as the parties shall agree upon.

Section 7.2 Deliveries by Seller at Closing. At the Closing, Seller will deliver or cause to be delivered to Purchaser the following:

- (a) a certificate or certificates, if any, representing all of the Interests, endorsed by Seller in blank, or with equity interest transfer powers executed by Seller in blank attached;
- (b) if the Interests are not certificated, an Assignment in a form approved in writing by Purchaser pursuant to which the Interests are transferred, sold and assigned to Purchaser by Seller free and clear of any and all Claims;
- (c) articles of organization certified by the Secretary of the State of Ohio and dated within 30 days of Closing;
- (d) certificate of good standing certified by the Secretary of the State of Ohio dated within 10 days of Closing;
- (e) certificates of good standing certified by the secretary of state of each state in which the Company is qualified to do business as a foreign limited liability company dated within 10 days of Closing; and
- (f) without limitation by specific enumeration of the foregoing, all other documents reasonably required from Seller to consummate the transactions contemplated hereby.

Section 7.3 Deliveries by Purchaser at Closing. At the Closing, in consideration of the receipt by Purchaser of the Seller deliveries referred to in Section 7.2 above and the satisfaction of the other conditions set forth in Section 6.1 above, Purchaser will deliver or cause to be delivered to Seller the following:

- (a) the Purchase Price by wire transfer to a bank account designated by Seller in writing at least two (2) business days before the Closing Date.

ARTICLE VIII. INDEMNIFICATION

Section 8.1 Certain Definitions. As used in this Agreement, the following terms have the meanings set forth below:

- (a) "Damages" means all actions, lawsuits, proceedings, hearings, investigations, charges, complaints, demands, injunctions, judgments, orders, decrees, rulings, dues, liabilities, obligations, taxes, liens, assessments, levies, losses, fines, penalties, damages, claims, costs, fees and expenses, including reasonable attorneys', accountants', investigators', and experts' fees and expenses incurred in investigating or defending any of the foregoing.

(b) "Purchaser Indemnitees" means Purchaser and its directors, managers, officers, members, shareholders, partners, agents, representatives, successors and assigns, and the term "Purchaser Indemnitee" means any one of the foregoing Purchaser Indemnitees.

(c) "Survival Date" means for claims made based on an alleged breach of the Representations and Warranties located in Article III, the second anniversary of the Closing Date; provided however that with respect to the breach of any representation or warranty which was known by Seller to be untrue when made, the Survival Date shall be deemed to be the date six months after the applicable statute of limitations would bar such claim.

Section 8.2 Seller's Indemnification Obligations. Subject to the provisions of Section 8.3, Seller shall indemnify, save and keep each Purchaser Indemnitee harmless against and from all Damages sustained or incurred by any Purchaser Indemnitee, as a result of, or arising out of, or by virtue of:

(a) any inaccuracy in or breach of any representation and warranty made by Seller to Purchaser herein or in any closing document delivered to Purchaser in connection herewith; or

(b) the breach by Seller of, or failure of Seller to comply with any of the covenants or obligations under this Agreement to be performed by Seller (including Seller's obligations under this Article VIII).

Section 8.3 Limitation on Seller's Indemnification Obligations. Seller's obligations pursuant to the provisions of Section 8.2 are subject to each of the following limitations:

(a) Purchaser Indemnitees shall not be entitled to recover under Section 8.2 unless a claim has been asserted by written notice, delivered to Seller on or prior to the Survival Date.

(b) Purchaser Indemnitees shall not be entitled to recover under Section 8.2 for the amount of Damages in excess of the Purchase Price.

Section 8.4 Payment of Amount Due. Any amount to which Purchaser is entitled pursuant to this Article 8 shall be paid within ten (10) business days after demand therefore and any amount not paid when due shall bear interest from the due date thereof until it is paid in full at the rate of ten percent (10%) per annum.

ARTICLE IX. GENERAL

Section 9.1 Succession and Assignment. This Agreement shall be binding upon and inure to the benefit of the parties named herein and their respective heirs, legatees, devisees, executors, administrators, legal representatives, successors and permitted assigns. No party may assign either this Agreement or any of its rights, interests, or obligations hereunder without the prior written approval of the other party; provided, however, that nothing herein shall prohibit an assignment by Purchaser to any affiliate of Purchaser.

Section 9.2 Counterparts. This Agreement may be executed in two or more counterparts and by facsimile, each of which shall be deemed an original but all of which together will constitute one and the same instrument.

Section 9.3 Headings. The section headings contained in this Agreement are inserted for convenience only and shall not affect in any way the meaning or interpretation of this Agreement.

Section 9.4 Notices. All notices, requests, demands, claims, and other communications hereunder shall be in writing. Any notice, request, demand, claim, or other communication hereunder shall be deemed duly given two business days after it is sent by registered or certified mail, return receipt requested, postage prepaid, and addressed to the intended recipient as set forth below:

if to Seller:

Carolyn Kelly
4281 Meadowlark Trail
Telecopier: (330) 686- 4968

With a copy to:

Dennis K. Loy, P.C.
Attn: Dennis k. Loy
Eastpointe, Michigan 48021
Telecopier: (586) 775- 1752

if to Purchaser:

c/o Arthur J. Gallagher & Co.
Itasca, Illinois 60143
Attention: Sally Wasikowski

Suite 1900
203 N. LaSalle Street
Attention: Stephen A. Landsman, Esq.
Telecopier: (312) 630- 6330

Any party may send any notice, request, demand, claim, or other communication hereunder to the intended recipient at the address set forth above using any other means (including personal delivery, expedited courier, messenger service, telecopy, telex, ordinary mail, or electronic mail), but no such notice, request, demand, claim, or other communication shall be deemed to have been duly given unless and until it actually is received by the intended recipient. Any party may change the address to which notices, requests, demands, claims, and other communications hereunder are to be delivered by giving the other party notice in the manner herein set forth.

Section 9.5 Entire Agreement. The Option Agreement, this Agreement (including any Disclosure Schedule to this Agreement) and the instruments to be delivered by the parties pursuant to the provisions hereof constitute the entire agreement between the parties with respect to the subject matter hereof, and all prior or contemporaneous negotiations, discussions, understandings, representations, warranties or agreements are merged herein and superceded hereby (it being understood and agreed that the Option Agreement shall survive the Closing and shall remain in full force and effect).

Section 9.6 Governing Law. This Agreement shall be governed by and shall be construed and enforced in accordance with the laws of the State of Delaware, without regard to its conflict of law principles

Section 9.7 Amendments and Waivers. No amendment of any provision of this Agreement shall be valid unless the same shall be in writing and signed by Purchaser and Seller. The failure in any one or more instances of a party to insist upon performance of any of the terms, covenants or conditions of this Agreement, to exercise any right or privilege in this Agreement conferred, or the waiver by said party of any breach of any of the terms, covenants or conditions of this Agreement, shall not be construed as a subsequent waiver of any such terms, covenants, conditions, rights or privileges, but the same shall continue and remain in full force and effect as if no such forbearance or waiver had occurred. No waiver shall be effective unless it is in writing and signed by an authorized representative of the waiving party and no waiver by any party of any default, misrepresentation, or breach of warranty or covenant hereunder, shall be deemed to extend to any prior or subsequent default, misrepresentation, or breach of warranty or covenant hereunder.

Section 9.8 Severability. Any term or provision of this Agreement that is invalid or unenforceable in any situation in any jurisdiction shall not affect the validity or enforceability of the remaining terms and provisions hereof or the validity or enforceability of the offending term or provision in any other situation or in any other jurisdiction.

[signature page follows]

IN WITNESS WHEREOF, the parties hereto have executed this Purchase Agreement as of the day and year first above written.

CAROLYN KELLY

AJG FINANCIAL SERVICES, INC., a Delaware
corporation

By: _____

Its: _____

**OPERATING AGREEMENT
OF
CHEM- MOD INTERNATIONAL LLC**

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Exhibit A	-	Copies of patent applications filed comprising the Technology
Exhibit B	-	License
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**OPERATING AGREEMENT OF
CHEM- MOD INTERNATIONAL LLC**

This Operating Agreement (this "Agreement") of **CHEM- MOD INTERNATIONAL LLC**, an Delaware limited liability company (the "Company"), is made and entered into as of July 8, 2005, by and between NOX II International, Ltd., an Ohio limited liability company ("NOX") and AJG Coal, Inc., a Delaware corporation ("AJG").

RECITALS:

The parties to this Agreement desire to form a Delaware limited liability company for the purpose of developing, using and commercializing certain coal technology in the International Market related to the remediation of combusted carbonaceous materials and described in the patent applications filed in the United States Patent and Trademark Office ("USPTO"), as the same may be supplemented, modified, or expanded upon, including related filings under the Patent Cooperation Treaty ("PCT Filings"), copies of which are attached as Exhibit A to this Agreement (collectively, the "Technology"),

By this Agreement, the parties desire to create the Company on the terms and conditions set forth herein.

NOW THEREFORE, in consideration of the foregoing, of the mutual promises contained herein, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereby agree as follows:

ARTICLE 1

DEFINITIONS AND INTERPRETATION

1.1 **Definitions.** In addition to capitalized terms defined elsewhere in this Agreement, the following capitalized terms shall have the meanings set forth below.

Act. The Delaware Limited Liability Company Act, as amended from time to time and any successor to the Act.

Adjusted Capital Account Deficit. With respect to any Member, the deficit balance, if any, in such Member's Capital Account, as of the end of the relevant fiscal year, after giving effect to the following adjustments: (i) crediting thereto (A) the amount of such Member's share of Minimum Gain, including any "partner nonrecourse debt minimum gain" (as defined in Treasury Regulations Section 1.704- 2(i)), and (B) the amount of Company liabilities allocated to such Member under Section 752 of the Code with respect to which such Member bears the economic risk of loss (as defined in Treasury Regulations Section 1.752- 2(a)), to the extent such liabilities do not constitute "partner nonrecourse debt" under Treasury Regulations Section 1.752- 2 and (ii) reduced by all reasonably expected adjustments, allocations and distributions described in Treasury Regulations Sections 1.704- 1(b)(2)(ii)(d)(4), (5) and (6).

Affiliate. (a) Any Person directly or indirectly owning, controlling or holding the power to vote 10% or more of the outstanding voting securities of an identified other Person; (b) any Person 10% or more of whose voting securities are directly or indirectly owned, controlled or held with power to vote, by such other Person; (c) any Person directly or indirectly controlling, controlled by, or under common control with such other Person; (d) any officer, director, member, manager or partner of such other Person; (e) if such other Person is an officer, director, member, manager or partner, any entity for which such Person acts in any such capacity; and (f) any spouse, lineal ancestor or descendant of such other Person.

Annual Budget. As defined in Section 10.3(b).

Approved Budget. The Development Budget and any Annual Budget, in each case for the period to which such Budget applies.

Annual Tax Liability. For any Member for any fiscal year, the product of (a) forty percent (40%) multiplied by (b) the excess, if any, of (i) the amount of all items of taxable income and gain of the Company for federal income tax purposes allocated to such Member for such fiscal year over (ii) the amount of all items of deductible expense and loss of the Company allocated to such Member for such fiscal year.

Capital Account. The capital account maintained for each Member pursuant to Section 6.6.

Capital Contributions. With respect to any Member, the amount of money and the fair market value (as agreed by the Members) of any property or services contributed to the Company by such Member.

Certificate. The Certificate of Formation of the Company, as amended from time to time.

Code. The United States Internal Revenue Code of 1986, as amended from time to time, or any replacement or successor law.

Cumulative Tax Liability. For each Member, as of any date during the term of this Agreement, the product of (a) forty percent (40%) multiplied by (b) the excess, if any, of: (i) the amount of all items of taxable income and gain of the Company for federal income tax purposes allocated to such Member for all periods beginning on the date of this Agreement through the end of the fiscal year immediately preceding such date of calculation, over (ii) the amount of all items of deductible expense and loss of the Company allocated to such Member for all periods beginning on the date of this Agreement through the end of the fiscal year immediately preceding such date of calculation (with any excess of amounts in clause (ii) over amounts in clause (i) in prior fiscal periods being carried forward as an item of loss in clause (ii) until absorbed in the subsequent fiscal period).

Cross Cash Receipts. With respect to any period, the amount of all cash funds received by the Company from all sources.

Intellectual Property. Any and all patents, patent applications, and rights to obtain PCT Filings relating to the Technology, including any patents derivative of any such patents, any enhancements to any of the foregoing and all related property, including all related know- how, development plans, designs, specifications, flow charts, processes and formulas (limited, however, to the International Market).

International Market. The international market, excluding The United States of America and Canada only.

Investor. AJG, and its respective successors and assigns.

License. The Technology License Agreement attached to this Agreement as Exhibit B, pursuant to which NOX grants the Company an exclusive, royalty- free right to use the Intellectual Property in perpetuity in the International Market.

Major Decisions. As defined in Section 10.2.

Members. NOX and AJG, and each Person who may become a substituted or additional Member pursuant to the provisions hereof and applicable law.

Minimum Gain. As such term is defined in Treasury Regulation Section 1.704- 2(d), which shall generally mean the amount by which the nonrecourse liabilities secured by any assets of the Company exceed the adjusted tax basis of such assets as of the date of determination. A Member's share of Minimum Gain (and any net decrease thereof) at any time shall be determined in accordance with Treasury Regulation Section 1.704- 2(g).

Net Cash Receipts. With respect to any period, the amount by which the Gross Cash Receipts in such period exceed the sum of the following: (a) all principal and interest payments on any indebtedness of the Company, and all other sums paid to such lenders in such period, but excluding any payments made pursuant to Article 8; (b) all cash expenditures (including expenditures for capital improvements) made in such period incident to the operation of the Company business, including but not limited to those expenses of the Members paid, either directly or indirectly, by the Company; and (c) working capital and other reserves in such amounts and for such purposes as the Members deem necessary for proper current and future operation of the Company business.

Participating Percentage. For each Member, the percentage set forth opposite such Member's name below, as adjusted from time to time as provided in Section 6.2:

<u>Member</u>	<u>Participating Percentage</u>
<u>NOX II INTERNATIONAL, LTD.</u>	<u>90%</u>
<u>AJG</u>	<u>10%</u>

Permitted Transferee. As defined in Section 12.2.

Person. A natural person, corporation, limited liability company, trust, partnership, estate, unincorporated association, governmental entity or other entity.

Prime Rate. The rate of interest announced from time to time as its "prime rate" or "corporate base rate" (or equivalent rate) by The Bank of America at Chicago, Illinois (or its successor- in- interest).

Priority Return. For the Investor, and other Members to the extent of any cash capital contributions, as of any date, the sum of (a) the Capital Contributions in the form of cash or other immediately available funds of such Investor, plus (b) the Cumulative Tax Liability of such Investor as of such date.

Profits or Losses. The net income or loss of the Company for federal income tax purposes as finally determined by the Company's accountants for each fiscal year of the Company, as well as, where the context requires, related federal tax items such as tax preferences and credits, in each case appropriately adjusted with respect to final determination of any of the foregoing for federal income tax purposes.

1.2 **Interpretation.** The definitions in Section 1.1 shall apply equally to both the singular and plural forms of the terms defined. Wherever the context may require, any pronoun used in this Agreement shall include the corresponding masculine, feminine and neuter forms. For all purposes of this Agreement, the term "control" and variations thereof shall mean the direct or indirect possession of the power to direct or cause the direction of the management and policies of the specified entity, through the ownership of equity interests therein, by contract or otherwise. As used in this Agreement, the words "include," "includes" and "including" shall be deemed to be followed by the phrase "without limitation". As used in this Agreement, the terms "herein," "hereof" and "hereunder" shall refer to this Agreement in its entirety. Any references in this Agreement to "Sections," "Articles" of "Exhibits" shall, unless otherwise specified, refer to Sections, Articles, or Exhibits, respectively, in or attached to this Agreement.

ARTICLE 2

FORMATION OF THE COMPANY

2.1 **Formation.** The parties hereto agree to and do hereby form a limited liability company under and pursuant to the provisions of the Act; and the rights and obligations of the Members shall be as provided therein except as otherwise expressly provided in this Agreement. The Members agree to execute such certificates or documents and to do such filings and recordings and all other acts, including the filing or recording of the Certificate, and any assumed name filings in the appropriate offices in the State of Delaware and any other applicable jurisdictions as may be required to comply with applicable law.

2.2 **Entire Agreement.** Each and every other agreement or understanding, oral or written, relating in any way to the formation or operation of the Company is hereby superseded in its entirety. From and after the execution of this Agreement, the same shall constitute the only Operating Agreement of the Company except as the same may hereafter be amended pursuant to the provisions hereof. This Agreement represents the entire agreement and understanding of the parties hereto concerning the Company and their relationship as Members, and all prior or concurrent agreements, understandings, representations and warranties in regard to the subject matter hereof are and have been merged herein.

ARTICLE 3

NAME AND PRINCIPAL OFFICE

3.1 **Name.** The business of the Company shall be conducted under the name of "Chem- Mod International LLC," or such other name as the Members may designate.

3.2 **Principal Office, Registered Office and Registered Agent.** The principal office of the Company shall be located at 4281 Meadowlark Trail, Stow, Ohio 44224. The registered agent and the registered office of the Company shall be Carolyn A. Kelly, 4281 Meadowlark Trail, Stow, Ohio 44224. The Members may from time to time designate another registered agent or another location for the principal office or registered office of the Company upon notice to all Members.

ARTICLE 4

PURPOSE

The purpose of the Company is to engage in developing, commercializing, using, licensing and otherwise exploiting Intellectual Property pursuant to the License; financing any of the foregoing; and making prudent interim investments of Company funds, including, without limitation, investments in obligations of federal, state and local governments or their agencies, mutual funds, money market funds and bank certificates of deposit; and engaging in any and all activities related or incidental thereto. Except as specifically limited or prohibited by this Agreement, the Company is empowered to perform such actions and engage in such activities consistent with, useful or necessary to carry out the purpose of the Company.

ARTICLE 5

TERM AND FISCAL YEAR

5.1 **Term.** The term of the Company shall commence as of the date hereof and shall continue in perpetuity, unless sooner terminated pursuant to the provisions of this Agreement or as otherwise provided by law.

5.2 **Fiscal Year.** The fiscal year of the Company shall be the calendar year.

ARTICLE 6

CAPITAL CONTRIBUTIONS, LOANS AND CAPITAL ACCOUNTS

6.1 **Contribution of License.** Concurrently with the execution of this Agreement, NOX shall enter into the License. Immediately after a PTC Filing and/or patent application with respect to all or any portion of the Technology has been filed, NOX and AJG shall be provided with a copy of such patent application or filing.

6.2 **Contributions of Cash.** AJG shall contribute Seven Hundred Fifty Thousand Dollars (\$750,000.00) to the company, in cash, in return for its membership interests. Three Hundred Seventy- Five Thousand Dollars (\$375,000.00) shall be paid to NOX or its assigns in exchange for the License and Technology rights obtained herein, and Three Hundred Seventy- Five Thousand Dollars (\$375,000.00) shall remain in the Company for use as working capital.

6.3 **Additional Contributions.** Except as specifically set forth in Section 6.1 and Section 6.2 of this Agreement, no Member shall be required to make any additional contributions to the capital of the Company.

(a) If at any time in the opinion of the Members, the Company's revenues and funds are not sufficient to satisfy the obligations and liabilities of the Company or to preserve, protect and develop the property of the Company, the Members may arrange for the Company to borrow such required funds from a third party on such terms and conditions as the Members deem advisable, provided that:

(i) No Member shall have any personal liability for repayment of any loan without such Member's prior written consent; and

(ii) No Member shall be required to make a loan to the Company.

(b) If at any time the Members determine that the Company's revenues and funds are not sufficient to satisfy the obligations and liabilities of the Company or to develop, preserve and protect the property of the Company, and the Company cannot borrow the required funds from commercial lenders on terms that are reasonable under the circumstances (including but not limited to the terms described in Section 6.4(a) above), then one or more of the Members or their Affiliates, in such person's sole discretion, may loan the required funds to the Company. Loans made available to the Company by Members shall not be considered Capital Contributions. Any such loans shall be made by the lending Members or their Affiliates in proportion to the applicable lending Members' respective Participating Percentages or in such other proportion as the lending Members or their Affiliates may agree upon. All such loans (i) shall be payable only from the assets of the Company without any recourse against or right of contribution from any Member, (ii) shall bear interest at an annual rate equal to the Prime Rate plus

three percent (3%), adjusting when and as the Prime Rate shall adjust, compounded annually; and (iii) shall mature and be due and payable, to the extent not paid pursuant to other provisions of this Agreement, upon termination of the Company.

6.5 **Return of Capital Contributions.** Except as specifically provided in this Agreement, a Member shall not be entitled to the return of its capital contribution to the Company.

6.6 **Capital Account.** A separate Capital Account shall be established and maintained for each Member in accordance with the Code and the regulations promulgated thereunder, including but not limited to the rules regarding the maintenance of partners' capital accounts set forth in Treasury Regulation Section 1.704- 1. Subject to the immediately preceding sentence, there shall be credited to each Member's Capital Account (i) the amount of money and the fair market value (as determined by the Members) of any property (net of related liabilities) contributed by the Member to the Company, and (ii) the Member's share of income or gain (or items thereof) of the Company, including income and gain exempt from tax. There shall be charged against each Member's Capital Account (i) the amount of money and the fair market value (as determined by the Members) of any property (net of related liabilities) distributed to the Member by the Company and (ii) the Member's share of loss and deduction (or items thereof) of the Company. If property is contributed to the capital of the Company or if there is a revaluation of any Company property such that the book value of such property differs from its adjusted tax basis, the Members' Capital Accounts shall be appropriately adjusted for income, gain, loss and deduction as required by Treasury Regulation Section 1.704- 1(b)(2)(iv)(g). To the extent a Member's Capital Account is greater than zero, such excess is hereinafter referred to as a "positive balance." To the extent that a Member's Capital Account is less than zero, said amount is hereinafter referred to as a "deficit balance." The initial Capital Accounts of the Members are set forth on Exhibit D attached hereto.

6.7 **Interest on Capital Contributions.** Except as specifically provided in this Agreement, the Company shall not pay interest on Capital Contributions or undistributed Profits.

ARTICLE 7

ALLOCATION OF PROFITS AND LOSSES

7.1 **General Allocation of Profits and Losses.** After giving effect to the allocations set forth in Sections 7.5 and 7.6, all Profits and Losses (including all items of income and expense entering into the determination of such Profits and Losses), as finally determined for federal income tax purposes for each fiscal year of the Company, shall be allocated among the Members as follows:

(a) **Profits.** Profits shall be allocated among the Members in the following order of priority:

(i) First, to the Members in proportion to and to the extent of the excess, in the case of each Member, of (A) all Losses allocated to such Member

pursuant to Section 7.1(b)(iii), over (B) all Profits previously allocated to such Member pursuant to this Section 7.1(a)(i).

(ii) Second, to the Members in proportion to and to the extent of the excess, in the case of each Member, of (A) all Losses allocated such Member pursuant to Section 7.1(b)(ii), over (B) all Profits previously allocated to such Member pursuant to this Section 7.1(a)(ii).

(iii) Third, to the Investor, and if applicable, the other Members, in proportion to and to the extent of the excess of (A) the amount of all distributions of Net Cash Receipts to such Investor pursuant to Section 8.1(b) over (B) all prior allocations of Profits to such Member pursuant to this Section 7.1(a)(iii).

(iv) Fourth, to the Members in proportion to and to the extent of the excess, in the case of each Member, of (A) the amount of all distributions of Net Cash Receipts to such Member pursuant to Section 8.1(c) over (B) all prior allocations of Profits to such Member pursuant to this Section 7.1(a)(iv).

(v) Fifth, any remaining Profits shall be allocated to the Members in accordance with their Participating Percentages.

(b) **Losses.** Losses shall be allocated among the Members in the following order of priority:

(i) First, to the Members in proportion to and to the extent of the excess, in the case of each Member, of (A) all Profits allocated to such Member pursuant to Section 7.1(a)(v), over (B) all Losses previously allocated to such Member pursuant to this Section 7.1(b)(i).

(ii) Second, to the Members having positive balances in their Capital Accounts in proportion to and to the extent of such positive balances.

(iii) Third, to the Members in accordance with their Participating Percentages.

7.2 **Depreciation Recapture.** Subject to Section 7.6, if any portion of Profit recognized from the disposition of property by the Company represents the "recapture" of previously allocated deductions by virtue of the application of Code Section 1(h)(1)(D), 1245 or 1250 ("Recapture Gain"), such Recapture Gain shall be allocated as follows:

(a) First, to the Members in proportion to the lesser of each Member's (i) allocable share of the total Profit recognized from the disposition of such property and (ii) share of depreciation or amortization with respect to such property (as determined in the manner provided in Treasury Regulations Sections 1.1245-1(e)(2) and (3)), until each such Member has been allocated Recapture Gain equal to such lesser amount.

(b) Second, the balance of Recapture Gain shall be allocated among the Members whose allocable shares of total Profit from the disposition of such property exceed their shares of depreciation or amortization with respect to such property (as determined in the manner provided in Treasury Regulations Sections 1.1245- 1(e)(2) and (3)), in proportion to their shares of total Profit (including Recapture Gain) from the disposition of such property; provided, however, that no Member shall be allocated Recapture Gain under this Section 7.2 in excess of the total Profit otherwise allocated to such Member from such disposition.

7.3 **Allocations with Respect to Transferred Interests.** Except as otherwise provided below or unless otherwise required by the provisions of the Code or agreed by the Members, any Profit or Loss allocable to an interest in the Company which has been transferred during any year shall be allocated among the Persons who were holders of such interest during such year in proportion to the number of days during such year that each holder was recognized as the holder of the interest, without regard to the results of Company operations during the period the holder was recognized as the owner thereof.

7.4 **Tax Credits.** Unless otherwise required by the Code, any tax credits of the Company shall be allocated among the Members in accordance with their Participating Percentages. Any recapture of tax credits shall be allocated among the Members in the same ratio as the applicable tax credits were allocated to the Members.

7.5 **Regulatory Allocations.**

(a) **Minimum Gain Chargeback.** Notwithstanding any other provision of this Agreement, if there is a net decrease in Minimum Gain for a Company taxable year, each Member shall be allocated, before any other allocation of Company items for such taxable year, items of gross income and gain for such year (and, if necessary, for subsequent years) in proportion to, and to the extent of, the amount of such Member's share of the net decrease in Minimum Gain during such year. The income allocated pursuant to this Section 7.5(a) in any taxable year shall consist first of gains recognized from the disposition of property subject to one or more nonrecourse liabilities of the Company, and any remainder shall consist of a pro rata portion of other items of income or gain of the Company. The allocation otherwise required by this Section 7.5(a) shall not apply to a Member to the extent provided in Treasury Regulation Section 1.704- 2(f)(2) through (5).

(b) **Qualified Income Offset.** Notwithstanding any other provision of this Agreement, if a Member unexpectedly receives an adjustment, allocation or distribution described in Treasury Regulation Section 1.704- 1(b)(2)(ii)(d)(4), (5) or (6) that causes or increases an Adjusted Capital Account Deficit with respect to such Member, items of Company gross income and gain shall be specially allocated to such Member in an amount and manner sufficient to eliminate such Adjusted Capital Account Deficit as quickly as possible.

(c) **Gross Income Allocation.** If at the end of any Company taxable year, a Member has an Adjusted Capital Account Deficit, such Member shall be specially allocated items of Company income or gain in an amount and manner sufficient to eliminate such deficit Adjusted Capital Account Deficit as quickly as possible.

(d) **Nonrecourse Deductions.** Any deductions attributable to partnership nonrecourse liabilities (as determined pursuant to Treasury Regulation Section 1.704- 2(c)) of the Company for any taxable year shall be allocated among the Members in the same proportion as Profits or Losses (as may apply) for such year are allocated.

(e) **Member Nonrecourse Debt.** Notwithstanding any other provision of this Agreement, any item of Company Loss, deduction or expenditures described in Code Section 705(a)(2)(B) that is attributable to a partner nonrecourse debt (as defined in Treasury Regulation Section 1.704- 2(b)(4)) of a Member shall be allocated to those Members that bear the economic risk of loss for such partner nonrecourse debt, and among such Members in accordance with the ratios in which they share such economic risk, determined in accordance with Treasury Regulation Section 1.704- 2(i). If there is a net decrease for a Company taxable year in any partner nonrecourse debt minimum gain of the Company, each Member with a share of such partner nonrecourse debt minimum gain as of the beginning of such year shall be allocated items of gross income and gain in the manner and to the extent provided in Treasury Regulation Section 1.704- 2(i)(4).

(f) **Interpretation.** The foregoing provisions of this Section 7.5 are intended to comply with Treasury Regulation Sections 1.704- 1(b) and 1.704- 2 and shall be interpreted consistently with this intention. Any terms used in such provisions that are not specifically defined in this Agreement shall have the meaning, if any, given such terms in the Regulations cited above.

7.6 **Section 704(c) Allocation.** Notwithstanding the foregoing allocations of Profits and Losses, if any property contributed to the Company has a fair market value (as agreed by the Members) that differs from its adjusted basis for federal income tax purposes at the time of such contribution, or if there is a revaluation of any Company property such that the book value of such property differs from its adjusted basis for federal income tax purposes, items of income, gain, loss, and deduction with respect to any such property shall be allocated among the Members so as to take account of such difference, in the manner intended by Section 704(c) of the Code and the Treasury Regulations from time to time promulgated thereunder, using such method permitted by such Treasury Regulations as the Members may determine.

7.7 **Allocation of Excess Nonrecourse Liabilities.** Solely for the purpose of allocating excess nonrecourse liabilities of the Company among the Members in connection with the determination of the Members' adjusted tax bases for their interests in the Company, in accordance with Section 752 of the Code and the Treasury Regulations from time to time promulgated thereunder, the Members agree that each Member's interest in Company Profits equals such Member's Participating Percentage.

ARTICLE 8

DISTRIBUTIONS

8.1 **Distribution of Net Cash Receipts.** Net Cash Receipts, if any, shall be applied and distributed in the following order of priority:

- (a) First, to pay principal and unpaid accrued interest on any loans made to the Company by any Member or any Affiliate thereof pursuant to Section 6.4(b), in proportion to the respective amounts of the outstanding principal and accrued interest of such loans.
- (b) Second, until each Investor, and if applicable, the other Members to the extent that the other Members make cash capital contributions pursuant to this Agreement, has received distributions of Net Cash Receipts pursuant to this Section 8.1(b) in the amount of its Priority Return, to the Investor (other Members) in proportion to and to the extent of the excess, in the case of each Investor (other Members), of (i) such Investor's (other Members) Priority Return over (ii) all prior distributions of Net Cash Receipts to such Investor (other Members) pursuant to this Section 8.1(b).
- (c) Third, from and after such time as each Investor has received aggregate distributions pursuant to Section 8.1(b) in the amount of such Investor's Priority Return, Net Cash Receipts shall be distributed to the Members in accordance with their Participating Percentages. To the extent that Net Cash Receipts are available for distribution pursuant to this Section 8.1(c), the Company shall distribute Net Cash Receipts pursuant to this Section 8.1(c) on a quarterly basis in an amount sufficient to distribute to each Member pursuant to this Section 8.1(c) not less than twenty- five percent (25%) of such Member's Annual Tax Liability for the immediately preceding fiscal year.

8.2 **Timing of Distribution; No Third- Party Beneficiaries.** Subject to Section 8.1(c), Net Cash Receipts shall be distributed to the Members in such amounts and at such intervals as the Members, in their sole discretion, may determine, but no less frequently than annually. The foregoing priorities of application of Net Cash Receipts are for the benefit of the Members only and not for the benefit of any third party or creditor of the Company or of any Member and neither the Company nor any Member shall be liable or responsible to any third party or creditor of the Company or of any Member for any deviation from such priorities.

ARTICLE 9

BOOKS OF ACCOUNT, RECORDS AND REPORTS

- (a) The Members shall maintain at the principal place of business of the Company all of the following:
 - (i) a list of the full name and last known business address of each Member setting forth the amount of cash each Member has contributed, a description and statement of the agreed value of any other property or services each Member has contributed or has agreed to contribute in the future, and the date on which each became a Member;
 - (ii) a copy of the Certificate and all amendments thereto, together with executed copies of any powers of attorney pursuant to which any such instrument was executed;
 - (iii) copies of the Company's federal, state and local income tax returns and reports, if any, for the three most recent years;
 - (v) copies of the financial statements, if any, of the Company for the three most recent years; and
 - (vi) Proper and complete records and books of account for the Company.

Any of the foregoing may be inspected and copied by any Member or its duly authorized representatives, at the expense of such Member, during ordinary business hours.

- (b) If a Member reasonably requests the Company to assemble or compile information, the Members shall have the authority to pass on all costs of labor, duplicating or other related charges so incurred to the Member making the request.

9.2 **Reports to Members.** The Members, at Company expense, shall cause to be furnished to each of the Members as soon as practicable after the end of each calendar year the following:

- (a) A copy of the federal income tax return filed by the Company for the calendar year, except for Schedules K- 1 applicable to other Members;
- (b) All information relative to the Company necessary for the preparation of the Members' federal and state income tax returns; and

(c) A balance sheet as of the close of such calendar year and statements of Profits or Losses, and Net Cash Receipts, if any, all of which shall be prepared in accordance with generally accepted accounting principles or tax accounting principles, with or without audit or review by an independent certified public accountant, in each case in the discretion of the Members.

In addition, the Company shall provide each Member with copies of any additional reports in existence regarding the Company or the Intellectual Property as such Member may reasonably request; provided the information requested does not jeopardize the ability of the Company to obtain foreign patents.

ARTICLE 10

MANAGEMENT OF THE COMPANY

10.1 **Management of Company Affairs.** Except as otherwise specifically provided in this Agreement, the management of the Company shall be vested in the Members. Except as provided in Section 10.2 or as otherwise specifically provided in this Agreement, all rights and authority granted to the Members under this Agreement or the Act, and all decisions and determinations to be made by the Members may be exercised or made only upon the approval of Members having more than fifty percent (50.0%) of the aggregate Participating Percentages of all Members at such time. Any action (authorized in accordance with this Agreement) taken by a Member (in its capacity as such) shall constitute the act of and serve to bind the Company. Each Member may designate one or more of its employees, agents or Affiliates to carry out its duties and responsibilities to the Company. Persons dealing with the Company shall be entitled to rely conclusively on the power and authority of each Member as set forth in this Agreement. The Members shall not employ, or permit another Person to employ any funds or assets of the Company in any manner other than for the exclusive benefit of the Company. Except as all Members may agree from time to time, the Members shall not be entitled to any fees or other compensation for the performance of their duties as such; provided, however, the Company shall reimburse each Member for all direct costs incurred by such Member, its Affiliates, employees or agents on behalf of the Company or otherwise in connection with performance of the duties of a Member.

10.2 **Major Decisions.** Notwithstanding the provisions of Section 10.1 or any other provision of this Agreement, the following actions and decisions ("Major Decisions") by or on behalf of the Company shall require the prior written approval of all Members:

- (b) Any modification or amendment to any Approved Budget.
- (c) Any expenditure in excess of one hundred ten percent (110%) of the amount set forth in an Approved Budget for such expenditure.

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- (e) Any sale, sublicense or other grant or disposition of the ownership of or right to use all or any portion of the property of the Company, including the Intellectual Property.
 - (f) Any decisions relating to applying for or obtaining any patents with respect to any of the Intellectual Property.
 - (g) The amount and timing of any distributions of Net Cash Receipts other than in accordance with Article 8.
 - (h) Subject to Section 10.4, any decisions relating to any transaction between the Company and any Member or any Affiliate of any Member.
 - (i) The borrowing of any funds or other incurrence of any indebtedness which is either (i) secured by any assets of the Company, or (ii) in excess of Twenty Thousand Dollars (\$20,000); and any refinancing of or material modification of the terms of any such indebtedness.
 - (j) Any expenditures or commitments to make expenditures in excess of Thirty Thousand Dollars (\$30,000).
 - (l) The issuance of any membership interest in the Company, any options or other rights to acquire any membership interest in the Company, or any other securities convertible into any membership interest in the Company, and any purchase or redemption by the Company of any membership interest in the Company (provided that if any additional membership interests in the Company are issued with the consent of the Members, in no event shall the Participating Percentage of either Investor be reduced).
 - (m) The employment and the dismissal of any employee of the Company, and any changes in salaries or benefits of any employee of the Company.
 - (n) Any commitments with respect to pensions, phantom equity or deferred compensation to the Company's employees, any bonuses for the Company's employees in excess of their base salaries, and any arrangements concerning the private use of vehicles belonging to the Company.
 - (o) The organization of any subsidiaries of the Company, the investment in any other entity or the acquisition of any equity securities of any other entity.
 - (p) The merger or consolidation of the Company or any subsidiary of the Company with any other entity.

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- (q) Any conversion or reorganization of the Company into any other form of legal entity.
 - (r) The engagement or termination of any independent contractor, the terms of any such engagement and any material modification to any of the foregoing.
 - (s) The engagement of any accountant or attorneys on behalf of the Company.
 - (t) The establishment of or addition to any cash reserve, except to the extent required by any agreement to which the Company is a party.
 - (u) Any material tax elections or decisions required in the preparation and filing of Company tax returns and any decisions or agreements in connection with any examination or controversy relating to the tax returns or positions of the Company.
 - (v) The commencement, compromise or settlement of any lawsuit, legal proceeding, bankruptcy proceeding or arbitration proceeding involving the Company or affecting the Intellectual Property.
 - (w) The decision to dissolve the Company.
 - (x) Any transaction outside the ordinary course of the day- to- day business of the Company.

10.3 **Budgets.**

- (a) **Development Budget.** The Members hereby approve and adopt the Corporate Development and Marketing Budget ("Development Budget") attached hereto as Exhibit C. The Development Budget shall constitute an Approved Budget through December 31, 2006.
- (b) **Annual Budgets.** On or before November 1 of each year starting in 2006, NOX shall prepare a preliminary annual budget for the Company for the next calendar year, and shall submit such preliminary annual budget to each Member. Each preliminary annual budget shall set forth reasonably itemized estimates of all revenues, expenses, reserves, capital expenditures and receipts from capital transactions of the Company, as well as any relevant business plans for the Company for the next calendar year. On or before December 1 of each year, the Members, by the written approval of all Members, shall approve and adopt an annual budget for the Company for the next calendar year. Each annual budget described above and approved by all Members is referred to herein as an "Annual Budget" and shall constitute an Approved Budget for the period covered by such Annual Budget. If the Members do not approve an Annual Budget for any calendar year prior to the commencement of such calendar year then, until the Members shall agree upon an Annual Budget for such year, the Annual Budget in effect for the immediately preceding calendar year shall constitute the Annual Budget for such calendar year, except that any items or portion of the preliminary annual budget for

such calendar year upon which all Members agree shall be substituted for the corresponding items in the preceding year's Annual Budget.

(c) **Separate Approval Not Required.** Any expenditures or other matters set forth in an Approved Budget shall be deemed approved by all Members for purposes of Section 10.2 for the period covered by such Approved Budget, and the separate approval of the Members of any such matters shall not be required.

10.4 **Employment of Affiliates.** Subject to Section 10.2, the Members may, on behalf and at the expense of the Company, engage any Member or an Affiliate of any Member to render services or provide goods to the Company. Notwithstanding Section 10.2 or any other provision of this Agreement, all decisions relating to any contract or other arrangements between the Company and any Member or any Affiliate of any Member, including the License, shall be made solely by the Members that are not parties to such arrangement and whose Affiliates are not parties to such arrangement (the "Other Members"). Any such decision shall require the approval of all of the Other Members if such matter is a Major Decision or the approval of Members having a majority of the Participating Percentages of the Other Members if such matter is not a Major Decision. Such matters shall include any decision to exercise or waive any rights or remedies of the Company under, or to amend or modify, the License or any other contract or arrangement from time to time in effect between the Company and any Member or any Affiliate of any Member.

10.5 **Liability of the Members.** A Member and its respective Affiliates, agents and employees shall not be liable, responsible or accountable in damages or otherwise to the Company or any of the Members or their successors or assigns for any acts performed or omitted within the scope of his authority as a Member, or otherwise conferred on the Member and such Affiliates, agents and employees by this Agreement, including the execution and delivery of deeds in lieu of foreclosure, provided that such Member or such Affiliates, agents or employees shall act in good faith and shall not be guilty of willful misconduct or gross negligence.

10.6 **Devotion of Time by Members.** Each Member and its agents, Affiliates, employees and agents of Affiliates shall devote such time to the Company business as is reasonably necessary to manage and supervise the Company business and affairs in an efficient manner and to accomplish the purposes of the Company. Each Member and each employee, agent or Affiliate thereof shall be free to engage in other business ventures whether or not directly competing with the Company, or to exploit business opportunities whether or not arising from the conduct of Company business.

10.7 **Other Business of Members.** Subject to Section 11.8, each Member and its Affiliates may engage in or possess any interests in other business ventures of any kind, independently or with others. Subject to Section 11.8, neither the Company, any Member, nor the holder of any interest in the Company shall have any right by virtue of this Agreement or the relationship created hereby in or to such ventures or activities or to the income or profits derived therefrom, and the pursuit of such ventures, even if competitive with the business of the Company, shall not be deemed wrongful or improper.

10.8 **Tax Matters Partner.** AJG, for so long as it shall be a Member, shall be the "tax matters partner" (within the meaning of Section 6231 of the Code) of the Company, and as such, subject to Section 10.2, shall have all powers and authorities granted tax matters partners under the applicable provisions of the Code and any regulations promulgated thereunder. All costs and expenses incurred by the tax matters partner in connection with an audit by the Internal Revenue Service or other government tax agency of a Company income tax return shall be borne by the Company.

10.9 **Election to Adjust Basis.** In the event of a distribution of property made in the manner provided in Section 734 of the Code (or any comparable provision of any succeeding law), or in the event of a transfer of any membership interest in the Company permitted by this Agreement made in the manner provided in Section 743 of the Code, the Members, in their sole discretion, may make or revoke on behalf of the Company the election referred to in Section 754 of the Code permitting adjustments to basis as provided in Sections 734 and 743 of the Code. Any additional costs or expenses incurred by the Company as a result of such an election shall be borne pro rata by the Member or Members benefiting from such an election.

10.10 **Company Indemnification of Members.** The Company shall indemnify, defend, and hold the Members and their respective Affiliates, officers, directors, employees and agents, on their respective successors, executors, administrators or personal representatives harmless from and against any loss, liability, damage, cost or expense (including reasonable attorneys' fees) sustained or incurred as a result of any act or omission concerning the business or activities of the Company; provided that the Member or any Affiliate, employee, or agent is not guilty of gross negligence, willful misconduct or violation of fiduciary duty and was acting in good faith within what it reasonably believed to be the scope of its authority for a purpose which it reasonably believed to be not opposed to the best interests of the Company. The foregoing indemnity shall not be enforceable against any Member personally but solely from such Member's interest in the Company.

ARTICLE 11

RIGHTS AND DUTIES OF MEMBERS

11.1 **Admission of Members.** Each of NOX and AJG is hereby recognized and admitted as a Member of the Company. No other person shall be recognized or admitted as a Member of the Company unless such person has satisfied the requirements of Article 12.

11.2 **Limited Liability.** Except to the extent provided in Section 11.5, the debts, obligations and liabilities of the Company, whether arising in contract, tort, or otherwise, shall be solely the debts, obligations, and liabilities of the Company, and the Members shall not be obligated personally for any such debt, obligation or liability of the Company solely by reason of being a Member of the Company. Except as provided in Section 11.5, no Member, in its capacity as a Member of the Company, shall be responsible or liable for any indebtedness or obligation of any other Member, nor, except to the extent provided in Section 11.6, shall the Company be responsible or liable for any indebtedness or obligation of any Member.

11.3 **No Individual Authority.** Except as otherwise expressly provided in this Agreement or in the Act, no Member, acting alone, shall have any authority to act for, or to create, undertake or assume any liabilities, obligations or responsibilities on behalf of the Company or any other Member.

11.4 **Representations by Members.** Each Member represents and warrants to the other Members and to the Company that (i) all transactions contemplated by this Agreement to be performed by such Member have been duly authorized by all necessary action and do not require the consent or approval of any third party, (ii) such Member has all necessary power with respect thereto, (iii) the consummation of such transactions will not (and with the giving of notice or lapse of time or both would not) result in a breach or violation of, or a default or loss of contractual benefits under, any trust agreement or other agreement by which such Member or any of such Member's properties is bound, or any statute, regulation, order or other law to which such Member or any of such Member's properties is subject, or give rise to a lien or other encumbrance upon any of such Member's properties or assets, and (iv) this Agreement is a valid and binding agreement on the part of such Member, enforceable in accordance with its terms.

11.5 **Indemnification by the Members.** Each Member hereby agrees to indemnify the Company and each of its other Members and hold them each harmless from and against all liability, loss, cost, damage and expense (including attorneys' fees and costs incurred in the investigation, defense and settlement of the matter) which the Company or any of such other Members shall ever sustain, suffer or incur which relate or arise out of or in connection with a breach by the indemnifying Member of any representation, warranty or covenant made by the indemnifying Member in this Agreement, in any agreement or instrument delivered pursuant hereto, on any other agreement with the Company. If the Company is made a party to any litigation or otherwise incurs any loss or expense as a result of or in connection with any Member's personal obligations or liabilities unrelated to Company business, such Member shall indemnify and reimburse the Company for all such loss and expense incurred, including reasonable attorneys' fees. The liability of any Member pursuant to this Section 11.5 may be assessed against such Member's interest in the Company, including the right to receive any distributions of Net Cash Receipts; provided, however, the liability of a Member under this Section 11.5 shall not be limited to such Member's interest in the Company but shall also be enforceable against such Member personally.

11.6 **Indemnification by the Company.** The Company shall indemnify each of its Members and former Members for all costs, losses, liabilities and damages paid or incurred by any of them in connection with the business of the Company, including any judgments, settlements, penalties, fines and expenses incurred in a proceeding to which any such person is a party because the person is or was a Member of the Company, to the fullest extent provided or allowed by the Act or any other applicable laws; provided, however, that such liability does not arise by reason of the willful misconduct or gross negligence of such Member or any matter described in Section 11.5 with respect to which the Member is obligated to indemnify the Company.

11.7 **Rights of a Former Member.** Except as otherwise provided herein, no Member shall have the right or power to resign or withdraw by voluntary act from the Company. If a

Member shall cease to be a Member, and if the Company is not then dissolved, then (i) such former Member shall be in breach of this Agreement, and (ii) notwithstanding the terms of Section 18- 604 of the Act, such former Member shall not thereby be entitled to receive the fair value of such former Member's membership interest in the Company or any other payment or any other distribution except as specifically provided in this Agreement.

11.8 **Covenants.** Notwithstanding anything contrary herein, each Member covenants as follows:

- (a) **Confidential Information.** Each Member acknowledges the economic value of the Confidential Information (as defined below) of the Company. Accordingly, during the Confidential Restricted Period (as defined below), each such Member shall not, in whole or in part, directly or indirectly:
- (i) divulge, furnish, make available or disclose any Confidential Information in any manner to any person, firm, corporation, partnership, limited liability company, association or other entity, except with respect to business of the Company where a Confidentiality Agreement in substantially the form of Exhibit E attached hereto has been obtained for the benefit of the Company;
 - (ii) use any Confidential Information for itself or for any other Person except as may be necessary in connection with the performance of its duties hereunder; or
 - (iii) bring to the Company's offices nor use, disclose to the Company, or induce the Company to use, any confidential information or documents belonging to a third party.

As used herein, the term "Confidential Information" shall mean all information used in or relating to the Intellectual Property or the business of the Company which is not generally known to the competitors of the Company, whether or not a trade secret as defined under applicable law, and which gives an advantage to the Company, including, without limitation, its patents, know- how and other intellectual property, its development plans, designs, specifications, flow charts, processes, formulas, data, all such information relating to the identity of the potential and actual customers of the Company, their respective methods of operation, financial data and pricing policies. Notwithstanding the foregoing, the term "Confidential Information" shall not include (i) any information which is or becomes publicly known through no wrongful act of a Member; (ii) any information which is rightfully received by a Member from any third party who is not known by the Member to be bound by any similar restriction; and (iii) any information required to be disclosed by order of a court of competent jurisdiction, administrative body or governmental body, or by subpoena, summons or legal process, or by law, rule or regulation, but only to the extent required by law and after the Member required to make such disclosure has provided to the Company prompt notice of such disclosure, if such notice is permitted by law.

As used herein, the term "Confidential Restricted Period" with respect to each Member shall mean with respect to each particular item of Confidential Information: (a) the period commencing with the date such Member first becomes a Member of the Company and ending three (3) years after such Member ceases to be a Member of the Company if the item of Confidential Information at issue does not constitute a trade secret; or (b) the period commencing with the date such Member first becomes a Member of the Company and continuing indefinitely, if the item of Confidential Information at issue constitutes a trade secret, until such item of Confidential Information at issue ceases to be a trade secret, but in no event ending earlier than three (3) years after such Member ceases to be a Member of the Company.

Each Member shall provide at least the same care to avoid disclosure or unauthorized use of the Confidential Information as it generally provides to protect its own proprietary information, which shall, in all events, equal or exceed a standard and level of care generally recognized as being reasonable for the protection of highly confidential information.

Notwithstanding anything herein to the contrary, each Member (and each employee, representative, or other agent of such Member) may (i) consult any tax advisor regarding the U.S. federal income tax treatment or tax structure of the transaction, and (ii) disclose to any and all persons, without limitation of any kind, the U.S. federal income tax treatment and tax structure of the transaction and all materials of any kind (including opinions or other tax analyses) that are provided to the Member relating to such tax treatment and tax structure. For this purpose, "tax structure" is limited to any facts relevant to the U.S. federal income tax treatment of the transaction and does not include information relating to the identity of the Members.

(b) **Diversification of Customers.** For so long as a Member is a Member and for a period of three (3) years thereafter (the "Restricted Period"), a Member shall not, either directly or indirectly, on its own account or as a partner, joint venturer, consultant, employee, agent, member or shareholder of any other Person or in any other capacity, in any way, solicit, divert or take away, or attempt to solicit, divert or take away, any potential transaction with the Company's customers or potential customers, wherever located.

(c) **Solicitation for Employment.** Throughout the Restricted Period, a Member shall not, either directly or indirectly, on its own account or as a partner, joint venturer, consultant, employee, agent, member or shareholder of any other Person or in any other capacity, in any way, solicit or hire for employment or for engagement as an independent contractor in a business that is competitive with the business of the Company any person who is then, or within a period of twelve (12) months prior to any such relevant solicitation was, an employee of or independent contractor engaged by the Company.

(d) **Business Opportunities.** Throughout the period it is a Member of the Company, a Member shall not directly or indirectly have any financial interest in or derive any financial benefits from contacts made by the Company with any third party (except in its capacity as a Member of the Company) without first disclosing such interest or benefit to the other Members and obtaining the approval of all such other Members thereto.

(e) **Inventions.** All Inventions (as defined below) shall be the sole and exclusive property of the Company. Such ownership of Inventions shall inure to the benefit of the Company from the date of the conception, creation or fixation of the Invention in a tangible medium of expression, as applicable. All newly- created copyright aspects of the Inventions, whether created solely or jointly, shall be considered a "work- made- for- hire" within the meaning of the Copyright Act of 1976, as amended. If and to the extent the Inventions, or any part thereof, are found by a court of competent jurisdiction not to be a "work- made- for- hire" within the meaning of the Copyright Act of 1976, as amended, each Member agrees that all exclusive, right, title and interest in and to those newly- created copyrightable aspects of the Inventions, and all copies thereof, are hereby expressly assigned automatically to the Company without further consideration. Any agreement entered into by a Member and a third party in connection with the development of an Invention shall require the prior consent of the Company and shall further include substantially the same terms as those appearing in this Section 11.8(e) to ensure that the Company obtains the same rights in the Inventions generated under such third party agreement as those set forth in this Section 11.8(e). Each Member agrees to: (a) assist the Company in obtaining and enforcing all rights and other legal protections for the Inventions; (b) perform all acts deemed necessary or desirable by the Company to permit and assist it, at the Company's expense, in registering, recording, obtaining, maintaining, defending, enforcing and assigning Inventions or works made for hire in the International Market; and (c) execute any and all documents that the Company may reasonably request from time to time in connection therewith, including any copyright assignment document(s), without further consideration. Each Member hereby irrevocably designates and appoints the Company and its duly authorized officers and agents as such Member's agents and attorneys- in- fact to act for and in such Member's behalf and instead of such Member, to execute and file any documents and to do all other lawfully permitted acts to further the above purposes with the same legal force and effect as if executed by such Member. This designation and appointment constitutes an irrevocable power of attorney and is coupled with an interest. Each Member agrees to promptly disclose to the Company all Inventions, all original works of authorship and all work product relating thereto. This disclosure will include complete and accurate copies of all source code, object code or machine- readable copies, documentation, work notes, flowcharts, diagrams, test data, reports, samples and other tangible evidence or results (collectively, "Tangible Embodiments") of such Inventions, works of authorship and work product. All Tangible Embodiments of any Invention, work of authorship or work product related thereto will be deemed to have been assigned to the Company as a result of the act of expressing any invention or work of authorship therein.

As used herein, the term "Inventions" shall mean any and all inventions, developments, discoveries, improvements, works of authorship, concepts or ideas or expressions thereof, whether or not subject to patent, copyright, trademark, trade secret protection or other intellectual property right protection, and whether or not reduced to practice, which both (i) relate to or result from any Intellectual Property or the actual or anticipated business, work, research or investigation of the Company, and (ii) are conceived or developed by a Member while such Member has an interest in the Company or within one (1) year following termination of such Member's interest in the Company.

The Members agree that the Inventions contemplated by this Section are only those inventions related to the remediation of combusted carbonaceous materials.

(f) **Remedies.** The covenants of Section 11.8 above, singly and collectively are sometimes referred to herein as "Covenants." Each Member agrees that the Covenants are the minimum such restrictions necessary to protect the goodwill, Confidential Information and legitimate business interests of the Company and its successors and assigns, that the time periods and the territorial areas described above (in view of the scope of the business to be conducted by the Company), are reasonable and necessary for said protection, and that damages cannot adequately compensate the Company in a event of a Member's violation of any Covenant. Accordingly, each Member agrees that if it shall violate or breach any Covenant, then the Company shall be entitled to obtain injunctive relief against such Member, without bond but upon due notice, in addition to such further relief as may be available at law or in equity. In the event of the entry of any such injunction, such Member's sole remedy shall be the dissolution of such injunction, if such is warranted following a full hearing, and all claims for damages by reason of the wrongful issuance of any such injunction are hereby waived by such Member. The Company's obtaining of any such injunction shall not be considered an election of remedies or a waiver of any right by the Company to assert any other remedy or remedies the Company may have against a Member at law or in equity. Each Covenant shall be construed as an agreement which is independent of the other provisions of this Agreement and severable and separate, and the existence of any claim or cause of action against the Company, of whatever nature, shall not constitute a defense to the Company's enforcement of any Covenant. Any of the foregoing applicable restricted periods will be extended with respect to a Member for any equivalent period of time during which such Member violates the provisions of this Section 11.8. To the extent any Covenant may be deemed unenforceable by virtue of its scope in terms of geographical area, length of time or otherwise, but may be made enforceable by limitations thereon, each Member agrees that such Covenant shall be modified and enforced to the fullest extent permissible under the laws and public policies of the jurisdiction in which such enforcement is sought. The parties hereto hereby authorize any court of competent jurisdiction to modify or reduce the scope of any such Covenant to the extent necessary to make such Covenant enforceable.

ARTICLE 12

TRANSFER OF MEMBER INTERESTS

12.1 **General Prohibition.** A Member may not sell, transfer, encumber, pledge or assign all or any part of its interest in the Company except (a) to a Permitted Transferee in accordance with Section 12.2, (b) in accordance with the procedure set forth in Section 12.3, (c) in accordance with the procedure set forth in Article 13, (d) pursuant to the procedures of Article 14, or (e) with the prior written consent of all of the other Members, which consent may be granted or withheld in each Member's sole and absolute discretion. In order for an assignee to constitute a substituted or additional Member, the conditions set forth in Section 12.8 must be satisfied. In no event shall a Member consent to an assignment of any interest of a Member in the Company unless in the opinion of counsel satisfactory to the Company such assignment (i) will not result in a termination of the Company for federal income tax purposes (or the transferring Member and its transferee jointly and severally indemnify the Company and each other Member against any and all loss or cost arising from such termination), (ii) will not result in the Company failing to qualify for an exemption from the registration requirements of the federal or any applicable state securities laws, (iii) will not result in the imposition of fiduciary responsibility on the Company, any Member, or any Affiliate of any of the foregoing under the Employee Retirement Income and Security Act of 1974, as amended from time to time ("ERISA"), and (iv) will not result in the violation of any term or provision of any agreement to which the Company is a party or the acceleration of any indebtedness of the Company.

12.2 **Permitted Transfers.** A Member may assign all or any part of its interest in the Company without the consent of any other Member to a "Permitted Transferee." For purposes of this Agreement, the term "Permitted Transferee" shall mean, with respect to any Member (i) a partnership in which such Member, Persons controlled by such Member or Persons controlling such Member on the date hereof are the sole or controlling general partner(s) and other partners are Persons controlled by such Member, Persons controlling such Member on the date hereof, or members of the immediate family of such Member or Persons controlling such Member on the date hereof, (ii) a corporation controlled by such Member or persons controlling such Member on the date hereof, and all of the issued and outstanding capital stock of all classes of such corporation is owned and controlled by such Member, Persons controlled by such Member, Persons controlling such Member on the date hereof, or by members of the immediate family of such Member or of Persons controlling such Member on the date hereof, (iii) a trust controlled by such Member or Persons controlling such Member on the date hereof and for the benefit of such Member, Persons controlling such Member on the date hereof, or members of the immediate family of such Member or of Persons controlling such Member on the date hereof, (iv) a limited liability company controlled by such Member or Persons controlling such Member on the date hereof and all of the membership interests of which are owned by such Member, Persons controlled by such Member, Persons controlling such Member on the date hereof, or members of the immediate family of such Member or Persons controlling such Member on the date hereof, or (v) another Member. For purposes of this Agreement, the immediate family of any Person shall mean the spouse and lineal descendants (either natural or by adoption) of such Person.

Notwithstanding anything in this Section 12.2 to the contrary, a Member may not assign all or part of its interest in the Company if such assignment would, in the opinion of counsel to the Company, (v) result in a termination of the Company for federal income tax purposes (or the transferring Member and its transferee jointly and severally indemnify the Company and each other Member against any and all loss or cost arising from such termination), (w) result in the Company not qualifying for an exemption from the registration requirements of the federal or any applicable state securities laws, (x) result in the imposition of fiduciary responsibility on the Company, any Member, or any Affiliate of any of the foregoing under ERISA, or (y) result in the violation of any term or provision of any agreement to which the Company is a party or the acceleration of any indebtedness of the Company.

Notwithstanding the right of a Member to transfer all or any portion of its interest to a Permitted Transferee, a Permitted Transferee shall not be admitted as an additional or substituted Member of the Company unless and until the provisions of Section 12.8 are satisfied. Until the provisions of Section 12.8 are satisfied with respect to a Permitted Transferee, such Permitted Transferee shall not be a Member but shall be an assignee having the rights described in Section 12.7.

12.3 **Right of First Refusal.**

(a) If a Member (the "Transferring Member") shall desire to transfer all or any portion of its interest as a Member of the Company (the "Offered Membership Interest") to any Person other than a Permitted Transferee or pursuant to a transaction that has been approved by all of the other Members pursuant to clause (e) of Section 12.1, pursuant to a bona fide written offer (a "Third- Party Offer") for the purchase of such interest in exchange for a cash price payable entirely at closing, the Transferring Member shall deliver written notice (the "Offer Notice") to each other Member (the "Offeree Members") setting forth the Participating Percentage that the Transferring Member desires to transfer and a copy of the Third- Party Offer. The Offer Notice shall constitute an offer (the "Offer") by the Transferring Member to the Offeree Members to purchase the Offered Membership Interest in exchange for the price and on the terms set forth in the Third- Party Offer. The Offeree Members shall have the right, for a period of thirty (30) days after the Offer Notice is delivered, to accept the Offer in proportion to their Participating Percentages or in such other proportion as they may agree upon. The Offeree Members shall accept the Offer, if at all, by delivering of written notice setting forth such acceptance to the Transferring Member within the 30- day period described above.

(b) If the Offeree Members, in the aggregate, accept the Offer with respect to the entire Offered Membership Interest, the purchase and sale of the Offered Membership Interest shall close not later than sixty (60) days following the expiration of the 30- day period described in Section 12.3(a). At the closing, the Transferring Member shall deliver to those Offeree Members accepting the Offer an assignment of the Offered Membership Interest, free and clear of all liens and encumbrances. At the closing, the Offeree Members purchasing the Offered Membership Interest shall pay to the

Transferring Member immediately available funds in the aggregate amount of the price set forth in the Third- Party Offer.

(c) If the Offeree Members, in the aggregate, fail to accept the Offer with respect to the entire Offered Membership Interest within the 30- day period described in Section 12.3(a), then the Transferring Member may transfer the Offered Membership Interest to the Person submitting the Third- Party Offer, at the price and on the terms set forth therein, without the consent of any other Member provided that (i) such transfer is completed within one hundred twenty (120) days following the expiration of the 30- day period described in Section 12.3(a); (ii) such transfer complies with the limitations set forth in clauses (v) through (y) of Section 12.2; and (iii) such transfer shall be subject to Article 13, if applicable. Any Person acquiring an interest in the Company pursuant to this Section 12.3(c) shall not be a Member but shall be an assignee having the rights described in Section 12.7, until the provisions of Section 12.8 are satisfied with respect to such Person.

12.4 Involuntary Transfers. In the event (i) of the death or adjudication of insanity or incompetency of an individual Member, or (ii) any Member shall be adjudged bankrupt, enter into proceedings for reorganization or into an assignment for the benefit of creditors, have a receiver appointed to administer the Member's interest in the Company, be the subject of a voluntary or involuntary petition for bankruptcy, apply to any court for protection from its creditors, or have its interest in the Company seized by a judgment creditor (such Member being referred to herein as a "Bankrupt Member"), the personal representative or trustee (or successor- in- interest) of the deceased, insane or incompetent Member or Bankrupt Member shall be an assignee of such Member's interest in the Company having the rights set forth in Section 12.7 and shall not become an additional or substituted Member unless and until the conditions set forth in Section 12.8 are satisfied; and any such Member's estate (or successor- in- interest) shall be liable for all of its obligations as a Member.

12.5 Dissolution or Termination of Members. In the event of the dissolution of a Member that is a partnership, limited liability company or a corporation or the termination of a Member that is a trust, the successors- in- interest of the dissolved or terminated Member shall, for the purposes of winding up the affairs of the dissolved or terminated Member, have the rights of an assignee of such Member's interest in the Company, as described in Section 12.7, and shall not become additional or substituted Members unless and until the conditions set forth in Section 12.8 are satisfied.

12.6 Transfers of Ownership Interests in Members. For purposes of this Article 12, any transfer or assignment of any direct or indirect ownership or other interest in a Member that (taking into account any prior such transfers or assignments, and any prior pledges, encumbrances or collateral assignments described below) results in such Member being controlled by a Person or Persons other than the Person or Persons that control such Member on the date hereof shall be deemed an assignment of the interest in the Company of such Member and therefore subject to all of the restrictions and provisions of this Article 12. In addition, any encumbrance, pledge or other collateral assignment of a direct or indirect ownership or other interest in a Member that, if the pledgee or other assignee were to exercise its right to acquire

such interest, would (taking into account any prior transfers or assignments described above and any prior such pledges, encumbrances or collateral assignments) result in such Member being controlled by a Person or Persons other than the Person or Persons that control such Member on the date hereof shall be deemed an assignment of the interest in the Company of such Member and therefore subject to all of the restrictions and provisions of this Article 12.

12.7 Status of Assignee. Any person who acquires all or any portion of the interest of a Member in the Company in any manner (including a Permitted Transferee), shall not be a Member of the Company unless and until the conditions of Section 12.8 are satisfied. Unless and until such conditions are satisfied, such person shall, to the extent of the interest acquired, be entitled only to the transferor Member's rights, if any, in the Profits, Losses, Net Cash Receipts and other distributions to the Members pursuant to this Agreement, subject to the liabilities and obligations of transferor Member hereunder; but such person shall have no right to act on behalf of the Company or otherwise participate in the management of the business and affairs of the Company, and such person and his Participating Percentage shall be disregarded in determining whether the approval, consent or any other action has been given or taken by the Members. Any such assignee shall have the same right, subject to the same limitations, as the transferor Member had under the provisions of this Article 12 to assign its interest as a Member (including the right to assign such interest to any Permitted Transferee of such Member pursuant to Section 12.2), but any such further assignee shall have only the rights set forth in this Section 12.7 and shall not become an additional or substituted Member of the Company unless and until the conditions of Section 12.8 have been satisfied.

12.8 Admission Requirements. No assignee of all or any portion of a Member's interest in the Company (including a Permitted Transferee) or any other person shall be admitted as an additional or substituted Member of the Company unless and until:

(a) such admission has been approved in writing by all of the other Members, which approval may be given or withheld in the sole discretion of each Member;

(b) such assignment is made in writing, signed by the assigning Member (or its successor) and accepted in writing by the assignee, and a duplicate original of such assignment has been delivered to each Member;

(c) the Company has received an opinion of counsel as contemplated by Section 12.1 or each Member has waived this requirement; and

(d) the assignee executes and delivers to the Company and each other Member a written agreement in form reasonably satisfactory to all of the other Members, pursuant to which such assignee agrees to be bound by and confirms the obligations, representations and warranties contained in this Agreement.

12.9 Effective Date of Assignment. If an assignment is made in accordance with this Agreement, unless otherwise required by the Code:

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- (a) the effective date of such assignment shall be the first date that both the written instrument of assignment is received by the other Members and, if required, approved by the other Members; provided that such assignee shall not be admitted as a Member unless and until the approvals and other requirements of Section 12.8 are satisfied;
- (b) the Company and the other Members shall be entitled to treat the assignor of the assigned interest as the absolute owner thereof in all respects and shall incur no liability for allocations of Profits or Losses and distributions of Net Cash Receipts or other amounts made in good faith to such assignor until such time as the written instrument of assignment has been actually received by each Member, and recorded in the books of the Company, and, if required, approved by the Members described in Section 12.1; and
- (c) any Profits and Losses shall be allocated between the assignor and the assignee of the assigned interest in the manner described in Section 7.3.

12.10 Status of Assignor. If there is a transfer or assignment of a Member's interest in the Company, then, without regard to whether or when such assignee or transferee is admitted as a Member of the Company, from and after the effective date of such assignment or transfer, the assigning or transferring Member shall cease to be a Member with respect to the transferred or assigned interest; and if such Member has transferred or assigned his entire membership interest in the Company, upon the effective date of such transfer or assignment, such Member shall cease to be a Member of the Company.

12.11 Cost of Admission. The cost of processing and perfecting an admission contemplated by this Article 12 (including reasonable attorneys' fees incurred by the Company) shall be borne by the party seeking admission as a Member to the Company.

ARTICLE 13

TAG- ALONG RIGHT

If at any time Members owning seventy- five percent (75%) or more of the Participating Percentages ("Controlling Members") shall desire to sell 50% or more of their aggregate membership interests in the Company to any third party (other than a Permitted Transferee), and the other Members do not elect to purchase such interests pursuant to Section 12.3, such Controlling Members shall give written notice thereof (a "Tag- Along Notice") to each of the other Members ("Minority Members") specifying the Participating Percentage to be sold and the price and terms of such sale. Each Minority Member may elect to participate in any such transaction as an additional selling Member on identical terms and conditions (with the aggregate price to be paid to the Controlling Members and the Minority Members electing to participate in the transaction allocated among them in proportion to the amounts each such Member would receive upon a hypothetical distribution of the aggregate purchase price pursuant to Section 15.4(c) in complete liquidation of the Company), by delivering a written notice thereof (a "Tag- Along Election Notice") to the Controlling Members within fifteen (15) days after such

Minority Member's receipt of such Tag- Along Notice, thereby electing to sell in such transaction any portion of its interest in the Company specified in the Tag- Along Election Notice which is less than or equal to the product of (i) the aggregate Participating Percentage which the Controlling Members propose to transfer in such transaction, multiplied by (ii) a fraction, the numerator of which is the Participating Percentage owned by such Minority Member, and the denominator of which is the aggregate Participating Percentage owned by the Controlling Members and all Minority Members electing to participate in such transaction. If Minority Members elect to sell interests pursuant to this Article 13, the aggregate Participating Percentage to be sold or transferred to such third party by the Controlling Members and the Minority Members shall remain constant.

ARTICLE 14

BUY/SELL

14.1 **Right to Initiate.** Each Member shall have the right, exercisable at any time after two (2) years from the execution of this Agreement, in its sole discretion, to initiate the buy/sell procedures of this Article 14 in the manner described in Section 14.2.

14.2 **Initiation and Elections.** A Member (the "Initiating Party") shall initiate the buy/sell procedures of this Article 14, if at all, by delivering to one or more Members (the "Other Party") a written notice stating that the Initiating Party intends to proceed with this buy/sell procedure (a "Buy/Sell Notice"). The Buy/Sell Notice shall in addition set forth a gross value (without reduction for liabilities) for all of the assets owned by the Company other than cash and cash equivalents (such cash and cash equivalents being referred to herein as "Cash Assets" and such other assets being referred to herein as "Non- Cash Assets"), which assets shall include the Intellectual Property (the "Asset Value"), such value to be determined in the sole discretion of the Initiating Party. The Other Party shall have a period of ninety (90) days after the receipt of the Buy/Sell Notice (the "Exercise Period") within which to notify the Initiating Party in writing (the "Reply Notice") whether the Other Party shall either (x) sell to the Initiating Party its entire interest in the Company at a price computed in the manner set forth in Section 14.2(a) (the "Reply Price"), or (y) buy the entire interest in the Company of the Initiating Party at a price computed in the manner set forth in Section 14.2(b) (the "Buy/Sell Price"). If the Other Party timely gives the Reply Notice electing (x) above, the Initiating Party shall be conclusively deemed to have agreed to purchase, and the Other Party shall be conclusively deemed to have agreed to sell, the entire interest in the Company of the Other Party at the Reply Price. If the Other Party timely gives the Reply Notice electing (y) above, the Initiating Party shall be conclusively deemed to have agreed to sell, and the Other Party shall be conclusively deemed to have agreed to purchase, the entire interest in the Company of the Initiating Party at the Buy/Sell Price. If the Other Party fails to give a Reply Notice prior to the expiration of the Exercise Period, it shall be conclusively presumed that the Other Party has properly elected (x) above.

(a) **Reply Price.** The Reply Price for the purchase of the interest in the Company of the Other Party shall be the amount that would be distributed to the Other Party pursuant to Section 15.4(c) if the Company sold all of its Non- Cash Assets for cash in the amount of the Asset Value, sold all of its Cash Assets for cash in the amounts

shown for them on the books of the Company, applied such cash in full payment of all liabilities on the books of the Company, and the amount of such cash not so applied was available for distribution to the Members pursuant to Section 15.4(c) upon liquidation of the Company as of the date of the closing of this buy/sell.

(b) **Buy/Sell Price.** The Buy/Sell Price for the purchase of the interest in the Company of the Initiating Party shall be the amount that would be distributed to the Initiating Party pursuant to Section 15.4(c) if the Company sold all of its Non- Cash Assets for cash in the amount of the Asset Value, sold all of its Cash Assets for cash in the amounts shown for them on the books of the Company, applied such cash in full payment of all liabilities on the books of the Company, and the amount of such cash not so applied was available for distribution to the Members pursuant to Section 15.4(c) upon liquidation of the Company as of the date of the closing of this buy/sell.

(c) **Price Determinations.** The determination of the amount of the Buy/Sell Price, the Reply Price and any other amounts payable pursuant to this Article 14 shall be made by the independent accountants then employed by the Company on the basis of the Asset Value set forth in the Buy/Sell Notice and the Cash Assets and liabilities of the Company reflected on the books of the Company as of the date of closing of the buy/sell, and shall not include any adjustments for lack of liquidity or minority or majority ownership interests. Their determination shall be final and nonappealable, absent manifest error.

(d) **Exclusivity of Buy/Sell Notice.** Only one Buy/Sell Notice shall be entertained at any one time. The order of consideration of Buy/Sell Notices shall be determined by the date upon which the Other Party receives the Buy/Sell Notice in accordance with Article 17.

14.3 **Closing.** The transactions contemplated by the applicable buy/sell shall be consummated (herein, the "Closing") at the principal office of the Company on the business day specified by the purchasing Member, provided that such date shall be not less than thirty (30) days and not more than sixty (60) days after the expiration of the Exercise Period. At the Closing, the purchase price shall be paid by the purchasing Member to the selling Member in cash, by wire transfer of immediately available funds to the account or accounts designated by the selling Member, or by certified bank check. The selling Member shall execute and deliver at the Closing an assignment, instrument of conveyance or other instrument appropriate to convey the entire interest in the Company of the selling Member to the purchasing Member, and shall deliver to the purchasing Member such evidence as the purchasing Member may reasonably request showing that the interest in the Company being sold is owned free and clear of any and all claims, liens and encumbrances of any kind or nature.

14.4 **Payment of Loans.** If there shall be any outstanding loans due from the Company to the selling Member or any Affiliates thereof (other than loans payable pursuant to Section 8.1(a), which shall be taken into account in determining the Reply Price or the Buy/Sell Price, as may apply), such loans, including accrued and unpaid interest, shall be purchased at par by the purchasing Member as a condition precedent to the Closing. The purchase price for such

loans shall be paid in full at the Closing in the same manner as the Reply Price or the Buy/Sell Price (as may apply) is paid. At the Closing, the selling Member (or any Affiliates thereof) shall deliver and endorse without recourse to the purchasing Member each note or other instrument evidencing such loans and all documents securing such loans (including any loans referred to in Section 8.1(a)).

14.5 Other Remedies for Noncompliance. It is the intent of the Members that the requirements or obligations, if any, of any Member to sell or purchase an interest in the Company in accordance with the provisions of this Article 14 shall be enforceable by an action for specific performance, with the same force and effect and at least to the same extent as is permitted at law or in equity for the specific performance of a contract relating to the purchase of real property or an interest therein.

14.6 Assignees. For purposes of this Article 14, the interest in the Company of each Member shall include all membership interests owned by such Member and any portion of such interest that is owned by any Affiliate of such Member or that such Member has assigned or transferred to an Affiliate of such Member or any other Person (other than to a Person that is a Member or Affiliate of any other Member at the time of such transfer). Any elections made by a Member under this Article 14 shall bind each Affiliate of such Member and any such assignee of such Member. All references in this Article 14 to a Member shall include all Affiliates of such Member and, except as provided above, all Persons to which such Member has transferred or assigned any portion of his membership interest in the Company.

14.7 Additional Effects of a Buy/Sell. If the selling Member or any Affiliate thereof is a guarantor or an indemnitor of or with respect to any obligations of the Company, a condition precedent to the Closing shall be that the purchasing Member shall obtain a release of such guaranty or liability; or, if such a release is not so obtainable and the selling Member agrees, the purchasing Member shall fully indemnify the selling Member and his Affiliates with respect to any such obligations. Any such indemnity by the purchasing Member shall be secured by its right to all distributions by the Company (including both distributions with respect to such purchased interest in the Company and with respect to all other interests in the Company of the purchasing Member or his Affiliates) arising from and after the date there has been a default on an indemnified debt or obligation of the Company.

14.8 Right to Assign. The purchasing Member may assign its rights obtained with respect to any participating interest under this Article 14 in whole or in part to a third party who, upon Closing, shall become a Member of the Company, without the consent of the selling Member but subject to the consent of all other Members, provided that (a) the purchasing Member delivers written notice to the selling Member of such assignment and of the identity of the assignee prior to the Closing; (b) such assignment, in the opinion of counsel to the Company, would not require registration of any interests in the Company under the Securities Act of 1933 or any applicable state securities or "Blue Sky" law, or result in any violation of any such laws; and (c) no such assignment shall relieve the purchasing Member of his obligations and liabilities under this Article 14.

ARTICLE 15

DISSOLUTION AND LIQUIDATION OF COMPANY

15.1 **Dissolution of the Company.** The Company shall be dissolved upon the happening of any of the following:

- (a) the agreement of the Members pursuant to Section 10.2 to dissolve and wind up the affairs of the Company;
- (b) any event that makes it unlawful for the Company business to be continued; or
- (c) the sale, disposition, or abandonment of all or substantially all of the non- cash assets of the Company.

The death, retirement, resignation, bankruptcy, court declaration of incompetence, or dissolution of any one or more Members or the occurrence of any other event that terminates the continued membership of any one or more Members (except as provided in the immediately preceding sentence) shall not cause the dissolution of the Company.

15.2 **Winding Up of Affairs.** In the event of the dissolution and liquidation of the Company for any reason, the Members shall commence to wind up the affairs of the Company and shall convert all of the Company's assets to cash or cash equivalents within such reasonable period of time as may be required to receive fair value therefor. All items of income, gain, loss, deduction and credit during the period of liquidation shall be allocated among the Members in the same manner as before the dissolution.

15.3 **Accounting.** In the case of the dissolution and termination of the Company, prior to any distributions to Members pursuant to Section 15.4(c), a proper accounting shall be made of the Capital Accounts of the Members and of each item of income, gain, loss, deduction and credit of the Company from the date of the last previous accounting to the date of dissolution. A copy of such accounting shall be provided to all Members.

15.4 **Final Distribution of Company Property.** Upon termination of the Company, the Members shall apply and distribute the remaining property of the Company, together with the proceeds of any sales of same, as follows:

- (a) first, all of the Company's debts and liabilities shall be paid and discharged, except any debts (i) described in Section 8.1, or (ii) that are nonrecourse to the extent that the Members elect not to pay such debts;
- (b) second, to establish any reserve which the Members may deem reasonably necessary for any contingent or unforeseen liabilities or obligations of the Company. Such funds may be placed in escrow by the Members for the purposes of disbursing such funds in payment of any of the contingencies, liabilities, or obligations, and, at the

expiration of such period as the Members shall deem advisable, the balance then remaining shall be distributed pursuant to Section 15.4(c); and

(c) third, to apply and distribute the balance in the manner and priority set forth in Section 8.1.

15.5 **Certificate of Cancellation.** Upon completion of the liquidation of the Company and the distribution of all Company property, the Company shall terminate and the Members shall have the authority to execute and record one or more Certificates of Cancellation of the Company as well as any and all other documents required or considered advisable by the Members to effectuate and evidence the dissolution and termination of the Company.

15.6 **No Restoration of Deficit Capital Accounts.** Except as otherwise expressly provided herein, at no time shall a Member with a deficit balance in its Capital Account have any obligation to the Company or to another Member or to any other person to restore such deficit balance.

ARTICLE 16

AMENDMENTS

16.1 **Amendment of Agreement.** This Agreement may be amended only with the written concurrence of all of the Members.

16.2 **Amendment of Certificate.** If this Agreement shall be amended pursuant to this Article 16, the Members shall cause the Certificate to be amended, to the extent required by applicable law, to reflect such change. Each Member shall promptly be notified of any amendments made under this Section 16.2.

ARTICLE 17

NOTICES

Any and all notices to be served hereunder shall be in writing and shall be personally delivered, sent by private courier, sent by certified mail, postage prepaid, or sent by facsimile transmission and (a) if intended for the Company, to the Company at the address of the principal place of business of the Company set forth herein, with a copy to each Member or (b) if intended for a Member, to such Member at the address set forth below; or to such other address or facsimile telecopier number as the Members, on behalf of the Company, or a Member, on his own behalf, may designate from time to time in a written notice served upon the Company and each other Member in accordance herewith. Any notice personally delivered shall be deemed delivered on the date actually delivered. Any notice sent by private courier shall be deemed delivered on the date of delivery or rejection of delivery, as shown on the receipt for delivery. Any notice sent by certified mail as provided above shall be deemed delivered on the third (3rd) business day next following the postmark date which it bears. Any notice sent by facsimile

transmission shall be deemed delivered on the date shown on the evidence of completed transmission. The addresses of the Members are as follows:

NOX:	4281 Meadowlark Trail Fax No.: 330- 686- 8916
AJG:	AJG Coal, Inc. Itasca, Illinois 60143- 3141 Fax No.: (630)284- 4272

ARTICLE 18

MISCELLANEOUS PROVISIONS

18.1 **Severability.** If any provision of this Agreement or the application of such provision to any Person or circumstance shall be held invalid, the remainder of this Agreement, or the application of such provision to Persons or circumstances other than those as to which it is held invalid, shall not be affected.

18.2 **Parties Bound.** Any Person acquiring or claiming an interest in the Company, in any manner whatsoever, shall be subject to and bound by all terms, conditions and obligations of this Agreement to which his or its predecessor in interest was subject or bound, without regard to whether such Person has executed a counterpart hereof or any other document contemplated hereby. No Person, including the legal representative, heir or legatee of a deceased Member, shall have any rights or obligations greater than those set forth in this Agreement and no Person shall acquire an interest in the Company or become a Member thereof except as permitted by the terms of this Agreement. This Agreement shall be binding upon the parties hereto, their successors, heirs, devisees, assigns, legal representatives, executors and administrators.

18.3 **Applicable Law.** The Company and this Agreement shall be governed by the laws of the State of Delaware.

18.4 **Additional Documents and Acts.** In connection with this Agreement as well as all transactions contemplated by this Agreement, each party hereto shall execute and deliver such additional documents and instruments, and perform such additional acts, as any other party hereto may reasonably deem necessary or desirable from time to time to effectuate, perform and evidence all of the terms, provisions and conditions of this Agreement and all such transactions.

18.5 **Benefit.** Nothing contained herein, express or implied, is intended to confer upon any person other than the parties hereto and their respective successors and permitted assigns any rights or remedies under or by reason of this Agreement.

18.6 **Waiver.** The failure to insist upon strict enforcement of any of the provisions of this Agreement or of any agreement or instrument delivered pursuant hereto shall not be deemed or construed to be a waiver of any such provision, nor to in any way affect the validity of this Agreement or any agreement or instrument delivered pursuant hereto or any provision hereof or the right of any party hereto to thereafter enforce each and every provision of this Agreement and each agreement and instrument delivered pursuant hereto. No waiver of any breach of any of the provisions of this Agreement or any agreement or instrument delivered pursuant hereto shall be effective unless set forth in a written instrument executed by the party against which enforcement of such waiver is sought, and no waiver of any such breach shall be construed or deemed to be a waiver of any other or subsequent breach.

18.7 **Survival.** The representations, warranties and covenants of the Members contained herein or in any agreement or instrument delivered pursuant hereto shall survive the consummation of the transactions contemplated hereby, and shall not be affected by any investigation which may have been made by any of the parties hereto.

18.8 **Headings.** The headings in this Agreement are inserted for convenience and identification only and are in no way intended to describe, interpret, define or limit the scope, extent or intent of this Agreement or any provision.

18.9 **Counterparts.** This Agreement may be executed in multiple counterparts with separate signature pages, each such counterpart shall be considered an original, but all of which together shall constitute one and the same instrument.

[signature page follows]

IN WITNESS WHEREOF, each of the parties has executed this Agreement as of the date first set forth above, confirms its agreement to become a Member of the Company, agrees to be bound by this Agreement, and swears that the statements set forth herein are true and correct.

NOX II INTERNATIONAL LTD., an
Ohio limited liability company

By:	<u>/s/ Carolyn A. Kelly</u>
Name:	Carolyn A. Kelly
Title:	President

AJG COAL, INC., a Delaware corporation

By:	<u>/s/ Sally Wasikowski</u>
Name:	Sally Wasikowski
Title:	Vice President

IN WITNESS WHEREOF, each of the parties has executed this Agreement as of the date first set forth above, confirms its agreement to become a Member of the Company, agrees to be bound by this Agreement, and swears that the statements set forth herein are true and correct.

NOX II INTERNATIONAL LTD., an
Ohio limited liability company

By: /s/ Carolyn A. Kelly

Name: Carolyn A. Kelly
Title: Managing Member

AJG COAL, INC., a Delaware corporation

By: _____
Name: _____
Title: _____

IN WITNESS WHEREOF, each of the parties has executed this Agreement as of the date first set forth above, confirms its agreement to become a Member of the Company, agrees to be bound by this Agreement, and swears that the statements set forth herein are true and correct.

NOX II INTERNATIONAL LTD., an
Ohio limited liability company

By: _____

Name: _____

Title: _____

AJG COAL, INC., a Delaware corporation

By: /s/ Sally Wasikowski

Name: Sally Wasikowski

Title: Vice President

IN WITNESS WHEREOF, each of the parties has executed this Agreement as of the date first set forth above, confirms its agreement to become a Member of the Company, agrees to be bound by this Agreement, and swears that the statements set forth herein are true and correct.

NOX II INTERNATIONAL LTD., an
Ohio limited liability company

By: _____ /s/ Carolyn A. Kelly
Name: Carolyn A. Kelly
Title: Managing Member

AJG COAL, INC., a Delaware corporation

By: _____
Name: _____
Title: _____

IN WITNESS WHEREOF, each of the parties has executed this Agreement as of the date first set forth above, confirms its agreement to become a Member of the Company, agrees to be bound by this Agreement, and swears that the statements set forth herein are true and correct.

NOX II INTERNATIONAL LTD., an
Ohio limited liability company

By: /s/ Carolyn A. Kelly
Name: Carolyn A. Kelly
Title: President

AJG COAL, INC., a Delaware corporation

By: /s/ Sally Wasikowski
Name: Sally Wasikowski
Title: Vice President

**AMENDMENT NO. 1 TO
OPERATING AGREEMENT OF
CHEM- MOD INTERNATIONAL LLC**

This Amendment No. 1 (this "Amendment") to the Operating Agreement of Chem- Mod International LLC, a Delaware limited liability company (the "Company"), is entered into as of August 2, 2005 by and between the undersigned members (the "Members") of the Company.

PRELIMINARY STATEMENTS

The Members have entered into the Operating Agreement of the Company dated as of July 8, 2005 (the "Agreement").

The Members desire to amend the Agreement as set forth herein.

AGREEMENTS

NOW, THEREFORE, in consideration of the mutual execution hereof and other good and valuable consideration, the parties hereto agree to amend the Agreement as follows:

1. Defined Terms. Capitalized terms used herein and not otherwise defined herein shall have the meanings attributed to such terms in the Agreement, as amended hereby.

2. Amendment to Agreement. The Agreement is hereby amended as follows:

2.1 The definition of "Participating Percentage" located in Section 1.1 of the Agreement is hereby deleted in its entirety and replaced as follows:

Participating Percentage. For each Member, the percentage set forth opposite such Member's name below, as adjusted from time to time:

<u>Member</u>	<u>Participating Percentage</u>
<u>NOX II INTERNATIONAL, LTD.</u>	<u>80%</u>
<u>AJG</u>	<u>20%</u>

2.2 Section 6.2 of the Agreement is hereby deleted in its entirety and replaced as follows:

6.2 Contributions of Cash AJG shall contribute One Million Five Hundred Thousand Dollars (\$1,500,000.00) to the company, in cash, in return for its membership interests. Three Hundred Seventy- Five Thousand Dollars (\$375,000.00) shall be paid to NOX or its assigns in

exchange for the License and Technology rights obtained herein, and Three Hundred Seventy- Five Thousand Dollars (\$375,000.00) shall remain in the Company for use as working capital.

3. Reaffirmation of Agreement. Except as expressly amended hereby, the Agreement shall remain in full force and effect. All references in the Agreement to the "Agreement" shall refer to the Agreement as amended pursuant to this Amendment
4. Severability. If any provision of this Amendment or its application to any Person or circumstance is held invalid or unenforceable to any extent, the remainder of this Amendment and the application of that provision to other Persons or circumstances is not affected and that provision will be enforced to the greatest extent permitted by applicable law.
5. Governing Law. This Amendment shall be governed by and construed in accordance with the laws of the State of Delaware for all purposes and in all respects, without regard to the conflict of laws provisions of such state.
6. Headings. Section headings in this Amendment are included herein for convenience of reference only and shall not constitute a part of this Amendment for any other purposes.
7. Counterparts. This Amendment may be executed in any number of counterparts, each of which when so executed shall be deemed an original but all such counterparts shall constitute one and the same instrument. This Amendment, to the extent signed and delivered by means of a facsimile machine, shall be treated in all manner and respects as an original agreement or instrument and shall be considered to have the same binding legal effect as if it were the original signed version thereof delivered in person.

[signature page follows]

IN WITNESS WHEREOF, this Amendment has been duly executed as of the day and year first above written.

NOX II INTERNATIONAL LTD., an Ohio
limited liability company

By: /s/ Carolyn A. Kelly

Name: Carolyn A. Kelly
Title: President

AJG COAL, INC., a Delaware corporation

By: /s/ Sally Wasikowski

Name: Sally Wasikowski
Title: Vice President

Arthur J. Gallagher & Co.

2005 Financial Statements

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Management's Discussion and Analysis of Financial Condition and Results of Operations

Introduction

The following discussion and analysis should be read in conjunction with Gallagher's consolidated financial statements and the related notes thereto that are included elsewhere herein.

Gallagher provides insurance brokerage and risk management services to a wide variety of commercial, industrial, institutional, governmental and personal accounts throughout the U.S. and abroad. Commission revenue is primarily generated through the negotiation and placement of insurance for its clients. Fee revenue is primarily generated by providing other risk management services including claims management, information

management, risk control services and appraisals in either the property/casualty (P/C) market or human resource/employee benefits market. In addition, Gallagher receives fee revenue related to negotiated fee in lieu of commission arrangements for placement of insurance for its clients in either the P/C market or human resource/employee benefits market. Investment income and other revenue is generated from Gallagher's investment portfolio, which includes fiduciary funds, tax advantaged and other investments. Gallagher is headquartered in Itasca, Illinois, has operations in seven countries and does business in 120 countries globally through a network of correspondent brokers and consultants.

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains certain statements relating to future results which are forward- looking statements as that term is defined in the Private Securities Litigation Reform Act of 1995. See "Cautionary Language Regarding Forward- Looking Statements" on the last page of the 2005 Annual Report.

Insurance Market Overview

Fluctuations in premiums charged by P/C insurance carriers (Carriers) have a direct and potentially material impact on the insurance brokerage industry. Commission revenues are generally based on a percentage of the premiums paid by insureds and normally follow premium levels. Insurance premiums are cyclical in nature and may vary widely based on market conditions. Various factors, including competition for market share among insurance carriers, increased underwriting capacity and improved economies of scale following consolidations, can result in flat or reduced P/C premium rates (a "soft" market). A soft market tends to put downward pressure on commission revenues. Various countervailing factors, such as heavier than anticipated loss experience and capital shortages, can result in increasing P/C premium rates (a "hard" market). A hard market tends to favorably impact commission revenues. Hard and soft markets may be broad- based or more narrowly focused across individual product lines or geographic areas.

For an extended period of years through late 2000 the P/C industry was in a soft market. This pricing pressure, together with a period of natural catastrophes and other losses, resulted in billions of dollars of underwriting losses in the P/C insurance market in the late 1990s and early in 2000. These losses, coupled with subsequent downward pressure on insurance companies' investment returns due to declining equity markets and interest rates, resulted in a general market hardening in the three year period from late 2000 through 2003. This market hardening was accentuated in 2001 by the events of September 11th, following which insurance coverage in many lines became less available and premium rates increased, in some cases dramatically. These developments had a positive impact on Gallagher's 2002 and 2003 operating results.

In 2004 and 2005, the market softened again in many lines and in many geographic areas. However, an abnormally high level of hurricane activity and other natural disasters in those years has hardened the market in certain geographic areas and business lines. For example, the fourth quarter 2005 survey by the Council of Insurance Agents & Brokers (CIAB) indicates that, while over half of the commercial brokers responding to the survey reported that they had not seen pricing changes due to Hurricanes Katrina and Rita, insureds in coastal areas subject to flooding and wind storms were experiencing decreases in capacity and increases in premiums, deductibles and exclusions. The CIAB represents the leading domestic and international insurance brokers who write 80% of the commercial P/C premiums in the U.S.

In a period of rising insurance costs, there is resistance among certain insureds, who are the buyers of insurance (Gallagher's brokerage clients), to pay increased premiums and the higher commissions generated by these premiums. Such resistance often causes some buyers to raise their deductibles and/or reduce the overall amount of insurance coverage they purchase. As the market softens, or costs decrease, these trends have historically reversed. During the most recent hard market period, some buyers switched to negotiated fee in lieu of commission arrangements to compensate Gallagher for placing their risks. Other buyers moved toward the alternative insurance market, which includes self- insurance, captives, rent- a- captives, risk retention groups and capital market solutions to transfer risk. According to industry estimates, these mechanisms now account for nearly 50% of the total commercial P/C market in the U.S. Gallagher's brokerage units are very active in these markets as well, which could have a favorable effect on Gallagher's Risk Management Services Segment. While the gradual movement toward these alternative markets has reduced commission revenue to Gallagher, Gallagher anticipates that new sales and renewal increases in the areas of risk management, claims management, captive insurance and self- insurance services may continue to be major factors in Gallagher's fee revenue growth in 2006.

Inflation tends to increase the levels of insured values and risk exposures, thereby resulting in higher overall premiums and higher commissions. However, the impact of hard and soft market fluctuations historically has had a greater impact on changes in premium rates, and therefore on Gallagher's revenues, than inflationary pressures.

Historically, Gallagher has utilized acquisitions to grow its Brokerage Segment's commission and fee revenues. Acquisitions allow Gallagher to expand into desirable geographic locations and further extend its presence in the retail and wholesale insurance brokerage services industry. Gallagher expects that its Brokerage Segment's commission and fee revenues will continue to grow from acquisitions. Gallagher is considering, and intends to continue to consider from time- to- time, additional acquisitions on terms that it deems advantageous. At any particular time, Gallagher generally will be engaged in discussions with multiple acquisition candidates. However, no assurances can be given that any additional acquisitions will be consummated, or, if consummated, that they will be advantageous to Gallagher.

Contingent Commissions and Other Industry Developments

The insurance industry has come under a significant level of scrutiny by various regulatory bodies, including State Attorneys General and the departments of insurance for various states, with respect to contingent compensation arrangements and other matters. The Attorney General of the State of New York (the New York AG) issued subpoenas to various insurance brokerage firms and Carriers beginning in April 2004. The investigation by the New York AG, among other things, led to its filing a complaint on October 14, 2004 against Marsh & McLennan Companies, Inc. and its subsidiary, Marsh Inc. (collectively, Marsh), stating claims for, among other things, fraud and violations of New York State antitrust and securities laws. In light of these allegations, Marsh announced on October 15, 2004 that it was suspending its use of contingent commission agreements. On October 26, 2004, Marsh announced that it would permanently eliminate the practice of receiving any form of contingent compensation from Carriers. Within the week following Marsh's initial announcement, two other large insurance brokerage firms, Willis Group and Aon Corporation, each announced that it would discontinue contingent commission agreements and unwind such arrangements by the end of 2004.

Although the New York AG's October 14, 2004 complaint against Marsh focused primarily upon arrangements with P/C Carriers, subpoenas were served on a number of group life and disability and traditional health Carriers, as well as the insurance brokerage firms who assist in the placement of such types of insurance. At the press conference announcing its complaint against Marsh, the New York AG indicated that its investigation would look across various lines of insurance. In connection with its investigation of the insurance industry, the New York AG brought criminal charges against company executives and employees at various brokers and Carriers, some of which have resulted in guilty pleas being entered.

As previously reported, on May 18, 2005, Gallagher and its subsidiaries and affiliates, except for Gallagher Bassett Services, Inc., entered into an Assurance of Voluntary Compliance (the AVC) with the Attorney General of the State of Illinois and the Director of Insurance of the State of Illinois (collectively, the IL State Agencies) to resolve all of the issues related to certain investigations conducted by the IL State Agencies involving contingent commission arrangements. As stipulated in the AVC, on January 12, 2006, Gallagher paid \$26.9 million into a fund to be distributed to certain eligible policyholder clients. In addition, under the AVC Gallagher agreed to implement, to the extent not previously undertaken, certain business changes, including agreeing not to accept U.S.- domiciled retail contingent compensation as defined in the AVC. On October 26, 2004, Gallagher announced that it would not enter into any new volume- based or profit- based contingent commissions agreements as a retail broker effective January 1, 2005. However, as allowed under the AVC, Gallagher has continued to accept contingent compensation from non- retail business, including business generated by wholesalers, managing general agents and managing general underwriters. In addition, the AVC allows Gallagher to collect retail contingent compensation related to contracts in place at entities acquired up to one year from the acquisition date. See Note 17 to the Consolidated Financial Statements for a discussion of the material terms of the AVC. Accordingly, in 2005 Gallagher began to experience reduced contingent commission revenue and it is expected that future contingent commission revenues will continue to be substantially reduced. The reduction in retail contingent commissions, as discussed above, could continue to have a substantial negative impact on Gallagher's pretax earnings beginning in 2006.

In 2004, the New York State Insurance Department commenced an investigation and issued requests to various brokers and Carriers for information, including one of Gallagher's New York brokerage subsidiaries, concerning contingent commission arrangements. In addition to the IL State Agencies, various other State Attorneys General and other state departments of insurance have also issued subpoenas to Gallagher or initiated investigations relating to Gallagher concerning contingent commissions and other business practices. Gallagher is fully cooperating with each of these investigations.

In addition, the departments of insurance for various states have proposed new regulations, and other state insurance departments have indicated that they will propose new regulations, that address contingent commission arrangements, including prohibitions involving the payment of money by Carriers in return for business and enhanced disclosure of contingent commission arrangements to insureds. On December 29, 2004, the National Association of Insurance Commissioners announced that it had adopted model legislation to implement new disclosure requirements related to broker compensation arrangements.

In response to these industry developments, in October 2004 Gallagher retained independent counsel to perform an internal review of certain of its business practices. Such independent counsel completed its internal review and found no evidence that Gallagher had engaged in any price fixing or bid rigging of the type alleged in the New York AG's October 14, 2004 complaint against Marsh, nor had it engaged in any improper tying arrangements.

Gallagher, along with other major insurance brokerage firms, is also a defendant in various lawsuits brought by private litigants which relate to these practices. Certain of these lawsuits have been included in a Multi- District Litigation proceeding before the U.S. District Court for the District of New Jersey. Gallagher cannot predict the outcome of these investigations, regulatory proceedings, and lawsuits, nor their effect upon Gallagher's business, financial condition or results of operations. See Note 17 to the Consolidated Financial Statements for an additional discussion on these matters.

On December 2, 2004, Gallagher Bassett Services, Inc., a third party administrator and a wholly- owned subsidiary of Gallagher, received a subpoena from the New York AG requesting information in connection with an investigation it is conducting. Gallagher is fully cooperating with this investigation. The subpoena did not seek information concerning Gallagher's insurance brokerage operations.

In 2005, Gallagher recorded pretax charges totaling \$73.6 million (\$44.2 million after tax) in connection with the regulatory and legal actions by the State Attorneys General and private litigants related to contingent commissions and various other historical business practices, as described above. In first quarter 2005, Gallagher incurred \$35.0 million of the charge, which was primarily related to costs associated with the AVC and other investigations and inquiries from other governmental authorities related to contingent commissions and various other historical business practices. In fourth quarter 2005, Gallagher incurred the remainder of the charge, or \$38.6 million, which was primarily related to costs associated with investigations and inquiries from governmental authorities related to contingent commissions and various other historical business practices, and the pending civil litigation. The amount accrued as of December 31, 2005 represents Gallagher's best estimate of the amount required to resolve the state insurance investigations, which includes all of the costs related to the funding and administration of the AVC, plus an accrual to resolve the pending litigation and an accrual for legal costs incurred or to be incurred to resolve these matters. Legal costs include amounts incurred or estimated to be incurred associated with the subpoenas received from State Attorneys General and investigations by governmental authorities and the internal review that was conducted by Gallagher's independent counsel. Gallagher continues to be the subject of a substantial number of regulatory and legal actions by State Attorneys General and private litigants investigating various historical business practices.

Gallagher's contingent commissions for 2005, 2004 and 2003 were \$35.2 million, \$39.5 million and \$32.6 million, respectively. The contingent commissions recognized in 2005 by Gallagher generally relate to contingent commission agreements in force during 2004, but received in 2005. As allowed under the AVC, Gallagher has continued to accept contingent compensation from non- retail business, including business generated by wholesalers, managing general agents and managing general underwriters. In addition, the AVC allows Gallagher to collect retail contingent compensation related to contracts in place at entities acquired for up to one year from the acquisition date. The amount of contingent commission revenue in 2005, 2004 and 2003 in which Gallagher participated as a retail broker and which involved volume- based or profit- based contingent commission agreements aggregated to \$28.8 million, \$33.8 million and \$29.3 million, respectively. A summary of revenues recognized in 2005 and 2004 related to retail contingent commission contracts in effect prior to January 1, 2005 is as follows (in millions):

	<u>1st Q</u>	<u>2nd Q</u>	<u>3rd Q</u>	<u>4th Q</u>	<u>Total</u>
2004	\$ 15.9	\$ 7.8	\$ 1.9	\$ 8.2	\$ 33.8
2005	16.7	9.4	2.0	0.7	28.8

The decrease in contingent commissions in fourth quarter 2005 compared to fourth quarter 2004 is indicative of the declining levels of such revenue for Gallagher, which decline is expected to continue in 2006 and future periods and is expected to continue to have a substantial negative impact on Gallagher's pretax earnings.

Critical Accounting Policies

Gallagher's consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles (GAAP), which require management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Gallagher believes the following significant accounting policies may involve a higher degree of judgment and complexity. See Note 1 to the Consolidated Financial Statements for other significant accounting policies.

Revenue Recognition

Commission revenues are recognized at the latter of the billing or the effective date of the related insurance policies, net of an allowance for estimated policy cancellations. Commission revenues related to installment premiums are recognized periodically as billed. Contingent commissions and commissions on premiums directly billed by insurance carriers are recognized as revenue when the data necessary to reasonably determine such amounts has been obtained by Gallagher. Typically, these types of commission revenues cannot be reasonably determined until the cash or the related policy detail is received by Gallagher from the insurance carrier. A contingent commission is a commission paid by an insurance carrier that is based on the overall profit and/or volume of the business placed with that insurance carrier. Commissions on premiums billed directly by insurance carriers to the insureds generally relate to a large number of small premium P/C transactions and a substantial portion of the revenues generated by Gallagher's employee benefit operations. Under these direct bill arrangements the billing and policy issuance process is controlled entirely by the insurance carrier. The income effects of subsequent premium adjustments are recorded when the adjustments become known.

Fee revenues generated from the Brokerage Segment primarily relate to fees negotiated in lieu of commissions, which are recognized in the same manner as commission revenues. Fee revenues generated from the Risk Management Segment relate to third party claims administration, loss control and other risk management consulting services, which are provided over a period of time, typically one year. These fee revenues are recognized ratably as the services are rendered. The income effects of subsequent fee adjustments are recorded when the adjustments become known.

Premiums and fees receivable in the consolidated balance sheet are net of allowances for estimated policy cancellations and doubtful accounts. The allowance for estimated policy cancellations is established through a charge to revenues, while the allowance for doubtful accounts is established through a charge to other operating expenses. Both of these allowances are based on estimates and assumptions using historical data to project future experience. Gallagher periodically reviews the adequacy of these allowances and makes adjustments as necessary. The use of different estimates or assumptions could produce different results.

Fair Value of Investments

For investments that do not have quoted market prices, Gallagher utilizes various valuation techniques to estimate fair value and proactively looks for indicators of impairment. Factors, among others, that may indicate that an impairment could exist include defaults on interest and/or principal payments, reductions or changes to dividend payments, sustained operating losses or a trend of poor operating performance, recent refinancings or recapitalizations, unfavorable press reports, untimely filing of financial information, significant customer or revenue loss, litigation, tax audits, losses by other companies in a similar industry, overall economic conditions, management and expert advisor changes and significant changes in strategy. In addition, in cases where the ultimate value of an investment is directly dependent on Gallagher for future financial support, Gallagher assesses its willingness and intent to provide future funding.

If an indicator of impairment exists, Gallagher compares the investment's carrying value to an estimate of its fair value. To estimate the fair value of loans, Gallagher discounts the expected future cash flows from principal and interest payments. This requires Gallagher to exercise significant judgment when estimating both the amount and the timing of the expected cash flows. To estimate the fair value of its equity investments, Gallagher compares values established in recent recapitalizations or appraisals conducted by third parties. In some cases, no such recapitalizations or appraisals exist and Gallagher must perform its own valuations. This also requires Gallagher to exercise significant judgment. Even if impairment indicators exist, no impairment may be required if the estimated fair value is not less than the current carrying value or the decline in value is determined to be temporary and Gallagher has the ability and intent to hold the investment for a period of time sufficient for the value to recover. When Gallagher determines an impairment is other- than- temporary, and therefore that an impairment is required, it is recorded as a realized loss against current period earnings.

Both the process to review for indicators of impairment and, if such indicators exist, the method to compute the amount of impairment incorporate quantitative data and qualitative criteria including the receipt of new information that can dramatically change the decision about the valuation of an investment in a short period of time. The determination of whether a decline in fair value is other- than- temporary is necessarily a matter of subjective judgment. The timing and amount of realized losses reported in earnings could vary if management's conclusions were different.

Due to the inherent risk of investments, Gallagher cannot give assurance that there will not be impairments in the future should economic and other conditions change.

Intangible Assets

Intangible assets represent the excess of cost over the value of net tangible assets of acquired businesses. Gallagher classifies its intangible assets as either goodwill, expiration lists or non- compete agreements. Expiration lists and non- compete agreements are amortized using the straight- line method over their estimated useful lives (five to fifteen years for expiration lists and five to six years for non- compete agreements), while goodwill is not subject to amortization. Allocation of intangible assets between goodwill, expiration lists and non- compete agreements and the determination of estimated useful lives are based on valuations Gallagher receives from qualified independent appraisers. The calculations of these amounts are based on estimates and assumptions using historical and pro forma data and recognized valuation methods. The use of different estimates or assumptions could produce different results. Intangible assets are carried at cost, less accumulated amortization in the consolidated balance sheet.

While goodwill is not amortized, it is subject to periodic reviews for impairment. Gallagher reviews intangible assets for impairment periodically (at least annually) and whenever events or changes in business circumstances indicate that the carrying value of the assets may not be recoverable. Such impairment reviews are performed at the division level with respect to goodwill and at the business unit level for amortizable intangible assets. In reviewing intangible assets, if the fair value were less than the carrying amount of the respective (or underlying) asset, an indicator of impairment would exist and further analysis would be required to determine whether or not a loss would need to be charged against current period earnings. No such indicators were noted in 2005 or 2003. In 2004, Gallagher determined that an indicator of impairment existed related to the amortizable assets of one of its 2001 acquisitions. Based on the results of this impairment review, Gallagher wrote- off \$1.8 million of amortizable assets in 2004. The determinations of impairment indicators and fair value are based on estimates and assumptions related to the amount and timing of future cash flows and future interest rates. The use of different estimates or assumptions could produce different results.

Business Combinations and Dispositions

See Notes 4 and 5 to the Consolidated Financial Statements for a discussion of the 2005 business combinations and dispositions, respectively. In addition, see Note 3 to the Consolidated Financial Statements for a discussion of disposition activities with respect to certain of Gallagher's consolidated investments.

Results of Operations

In the discussion that follows regarding Gallagher's results of operations, Gallagher provides organic growth percentages with respect to its commission and fee revenues. This information may be considered a "non- GAAP financial measure" because it is derived from Gallagher's consolidated financial information but is not required to be presented in financial statements that are prepared in conformity with GAAP. Rules and regulations of the Securities and Exchange Commission (SEC) require supplemental explanations and reconciliations of all "non- GAAP financial measures." When Gallagher refers to organic growth percentages with respect to its commission and fee revenues in its discussion of results of operations, Gallagher excludes the first twelve months of net commission and fee revenues generated from the acquisitions and the net commission and fee revenues related to operations disposed of in each year presented. These commissions and fees are excluded from organic revenues in order to determine the revenue growth that is associated with the operations that were part of Gallagher in both the current and prior year. In addition, organic growth excludes contingent commission revenues. These commissions are excluded from organic revenues in order to determine the revenue growth that is associated with the revenue sources that will be continuing in 2006 and beyond. Management has historically utilized organic revenue growth as an important indicator when assessing and evaluating the performance of its Brokerage and Risk Management Segments. Management also believes that the use of this measure allows financial statement users to measure, analyze and compare the growth from its Brokerage and Risk Management Segments in a meaningful and consistent manner. A reconciliation of organic revenue growth percentages to the reported revenue growth percentages for the Brokerage and Risk Management Segments is presented in the paragraphs immediately following each table in which such percentages are presented.

In the discussion that follows regarding Gallagher's results of operations, Gallagher provides the following ratios with respect to its operation results: pretax profit margin before the impact of pretax retail contingent commission related matters and claims handling obligations, compensation expense ratio and operating expense ratio. Pretax profit margin before the impact of pretax retail contingent commission related matters and claims handling obligations represents pretax earnings (loss) from continuing operations before the impact of pretax retail contingent commission related matters and claims handling obligations divided by total revenues, excluding retail contingent commissions. The compensation expense ratio is derived by dividing compensation expense by total revenues, excluding retail contingent commissions. The operating expense ratio is derived by dividing operating expense by total revenues, excluding retail contingent commissions.

Brokerage

The Brokerage Segment comprises three operating divisions: the Brokerage Services- Retail Division (BSD), Specialty Marketing and International (SMI) and Gallagher Benefit Services (GBS). The Brokerage Segment, for commission or fee compensation, places commercial P/C and employee benefit- related insurance on behalf of its customers. Financial information relating to Gallagher's Brokerage Segment is as follows (in millions):

	2005	Percent Change	2004	Percent Change	2003
Commissions	\$ 784.3	8%	\$ 726.8	7%	\$ 676.2
Retail contingent commissions	28.8	(15%)	33.8	15%	29.3
Fees	169.8	16%	146.2	15%	127.5
Investment income - fiduciary	17.9	34%	13.4	79%	7.5
Total revenues	1,000.8	9%	920.2	9%	840.5
Compensation	584.0	11%	527.5	11%	476.4
Operating	219.1	24%	176.1	4%	170.1
Depreciation	13.6	5%	12.9	7%	12.1
Amortization	20.3	17%	17.3	92%	9.0
Retail contingent commission related matters	73.6	NMF	-	NMF	-
Claims handling obligations	15.0	NMF	-	NMF	-
Total expenses	925.6	26%	733.8	10%	667.6
Earnings from continuing operations before income taxes	75.2	(60%)	186.4	8%	172.9
Provision for income taxes	3.1	(92%)	37.4	(11%)	42.2
Earnings from continuing operations	\$ 72.1	(52%)	\$ 149.0	14%	\$ 130.7
Growth - revenues	9%		9%		14%
Organic growth in commissions and fees	2%		2%		9%
Growth - pretax earnings	(60%)		8%		16%
Compensation expense ratio	60%		60%		60%
Operating expense ratio	23%		20%		20%
Pretax profit margin before retail contingent commission related matters and claims handling obligations	17%		21%		21%
Effective tax rate	4%		20%		24%
Identifiable assets at December 31	\$ 2,498.5		\$ 2,354.5		\$ 2,042.9

The increase in commissions for 2005 was principally due to revenues associated with acquisitions that were made in the last twelve months (\$64.0 million). This increase was partially offset by a net decrease in commissions from existing operations of \$6.0 million (new business production of \$117.0 million, which was offset by renewal rate decreases and lost business of \$123.0 million). The increase in fees for 2005 compared to 2004 resulted from new business production and renewal rate increases of approximately \$36.0 million, which were offset by lost business of \$12.0 million. The increase in commissions and fees for 2004 was principally due to revenues associated with acquisitions that were made in the last 12 months (\$54.0 million). This increase was partially offset by a net decrease in commissions from existing operations of \$3.0 million (new business production of \$122.0 million, which was offset by renewal rate decreases and lost business of \$125.0 million). The increase in fees for 2004

compared to 2003 resulted from new business production and renewal rate increases of approximately \$35.0 million, which were offset by lost business of \$16.0 million. The organic growth in commission and fee revenues was 2% in 2005, 2% in 2004 and 9% in 2003. The following commission and fee revenues related to contingent commissions and acquisitions (that were made in the last twelve months of each respective year) were excluded in deriving the organic growth percentages: \$99.2 million in 2005, \$93.5 million in 2004 and \$66.9 million in 2003.

Investment income - fiduciary, which primarily represents interest income earned on cash and restricted funds, increased in 2005 and 2004 primarily due to increases in short- term interest rates and increases in the amount of cash available to invest due to growth in operations and to a reduction in common stock repurchased in 2005. The decrease in shares repurchased in 2005 as compared to 2004 was primarily due to anticipated cash needs in the latter part of 2005 and into 2006.

The increase in compensation expense in 2005 compared to 2004 was primarily due to an increase in the average number of employees, salary increases (\$34.5 million in the aggregate), compensation related to new hires in the retail operations (\$7.6 million), new hires and charges related to staffing changes made in Gallagher's U.S and U.K. reinsurance operations (\$18.7 million), severance costs (\$1.4 million) and an increase in expense related to stock- based compensation (\$2.6 million). These increases were partially offset by the defined benefit pension plan curtailment gain that was recognized in second quarter 2005 (\$6.9 million) and the favorable impact of foreign currency translation (\$1.4 million). The increase in employee headcount in 2005 primarily relates to the addition of employees associated with the acquisitions that were made in the last twelve months. The increase in compensation expense in 2004 compared to 2003 was primarily due to an increase in the average number of employees, salary increases, increases in incentive compensation linked to Gallagher's overall operating results (\$31.2 million in the aggregate), an increase in employee benefit expenses (\$5.6 million), the adverse impact of foreign currency translation (\$5.5 million), one- time compensation related restructuring charges related to Gallagher's London operations (\$3.4 million), the expensing of stock- based compensation in 2004 (\$3.2 million) which began prospectively in 2003 and an increase in the amortization of deferred compensation and restricted stock (\$2.2 million). The increase in employee headcount in 2004 primarily relates to the addition of employees associated with the acquisitions that were made in the last twelve months.

The increase in operating expenses in 2005 over 2004 was due primarily to increases in professional services fees (\$5.2 million), an increase in rent and utility costs associated with leased office space and office expansion (\$2.4 million), an increase in business insurance costs (\$5.2 million), operating costs related to the staffing changes made in Gallagher's London and reinsurance operations (\$3.5 million), uncollectible international receivables (\$2.4 million), lease cancellation costs (\$2.1 million) and the adverse impact of foreign currency translation (\$4.1 million). The increase in professional fees is primarily related to legal fees and consulting fees for sourcing and other cost containment initiatives. Also contributing to the increase in operating expenses in 2005 were expenses associated with the acquisitions completed in the last twelve months. The increases in operating expenses in 2004 compared to 2003 were due primarily to an increase in fees for professional services (\$8.0 million), costs associated with leased office space and office expansion (\$5.1 million), increases in travel and entertainment costs primarily related to new business development from new producers (\$2.8 million) and expenses associated with the acquisitions that were made in the last twelve months. These increases were offset by a reduction in business insurance costs (\$4.2 million), a net year- over- year foreign currency translation gain (\$2.3 million) and a decrease in minority interest expense (\$1.8 million). The decrease in minority interest expense was due to the acquisition of the remaining 50% ownership interest in Risk Management Partners Ltd. in first quarter 2004. Included in fees for professional services in 2004 were \$4.1 million for external costs to implement Sarbanes- Oxley 404 requirements and \$1.7 million related to the subpoenas received from State Attorneys General and investigations by governmental authorities as well as the internal review that was conducted by independent counsel and consulting fees related to sourcing and other cost containment initiatives.

The increase in depreciation expense in 2005 compared to 2004 and 2004 compared to 2003 were due primarily to the purchases of furniture, equipment and leasehold improvements related to office expansions and moves made during 2005 and 2004, respectively. Also contributing to the increase in 2005 and 2004 was the depreciation expense associated with the acquisitions completed in 2005, 2004 and 2003.

The increase in amortization in 2005 compared to 2004 and 2004 compared to 2003 were due primarily to amortization expense of intangible assets associated with acquisitions completed in 2005, 2004 and 2003. Expiration lists and non- compete agreements are amortized using the straight- line method over their estimated useful lives (five to fifteen years for expiration lists and five to six years for non- compete agreements). Also contributing to the increase in amortization expense in 2004 was the \$1.8 million impairment of amortizable assets in 2004 related to one of Gallagher's 2001 acquisitions.

Retail contingent commission related matters in 2005 represent pretax charges totaling \$73.6 million (\$44.2 million after tax) recorded by Gallagher in 2005 in connection with the regulatory and legal actions by the State Attorneys General and private litigants related to contingent commissions and various other historical business practices, as described more fully in Note 17 to the Consolidated Financial Statements and "Management's Discussion and Analysis Contingent Commissions and Other Industry Developments". In first quarter 2005, Gallagher incurred \$35.0 million of the charge, which was primarily related to costs associated with the AVC and other investigations and inquiries from other governmental authorities related to contingent commissions and various other historical business practices. In fourth quarter 2005, Gallagher incurred the remainder of the charge, or \$38.6 million, which was primarily related to costs associated with investigations and inquiries from governmental authorities related to contingent commissions and various other historical business practices, and the pending civil litigation. The amount accrued as of December 31, 2005 represents Gallagher's best estimate of the amount required to resolve the state insurance investigations, which includes all of the costs related to the funding and administration of the AVC, plus an accrual to resolve the pending litigation and an accrual for legal costs incurred or to be incurred to resolve these matters. Legal costs include amounts incurred or estimated to be incurred associated with the subpoenas received from State Attorneys General and investigations by governmental authorities and the internal review that was conducted by Gallagher's independent counsel. Gallagher continues to be the subject of a substantial number of regulatory and legal actions by State Attorneys General and private litigants investigating various historical business practices.

Claims handling obligations in 2005 represent a pretax charge of \$15.0 million (\$9.8 million after tax) recorded by Gallagher in fourth quarter 2005 related to obligations to provide future claims handling and certain administrative services for reinsurance brokerage clients. During 2005 and the latter part of 2004, in connection with recent legal interpretations and accounting guidance issued by the Institute of Chartered Accountants in the U.K., many global insurance brokerage firms reassessed their obligations to provide future claims handling and certain administrative services for reinsurance brokerage clients. This guidance, which is referred to as FRS 5, was issued in 2004 and is specifically directed to insurance brokers engaged in the industry practice of providing clients future claims handling and administrative services. Based on a detailed review of its reinsurance brokerage operations in both the U.S. and U.K. that was completed in fourth quarter 2005, its current accounting practices for these operations and recent legal interpretations, Gallagher determined that under certain circumstances it is obligated to provide future claims handling and certain administrative services based on its current business practices. Thus, Gallagher recorded a non- cash pretax charge of \$15.0 million to reflect the change in the estimated costs to provide these future services to former clients.

See the Results of Operations for the Financial Services Segment for a discussion on changes in the overall effective income tax rate in 2005 compared to 2004 and 2004 compared to 2003. Also contributing to the decrease in the overall effective income tax rate in the Brokerage Segment in 2005 compared to 2004 was the income tax effect (benefit) associated with the retail contingent commission related charge of \$73.6 million (\$44.2 million after tax) and the claims handling obligations charge of \$15.0 million (\$9.8 million after tax).

Risk Management

The Risk Management Segment provides P/C claim third- party administration, loss control and risk management consulting and insurance property appraisals. Third- party administration is principally the management and processing of claims for self- insurance programs of Gallagher's clients or clients of other brokers. Financial information relating to Gallagher's Risk Management Segment is as follows (in millions):

	2005	Percent Change	2004	Percent Change	2003
Fees	\$ 367.7	7%	\$ 343.8	18%	\$ 291.2
Investment income - fiduciary	2.9	71%	1.7	113%	0.8
Total revenues	370.6	7%	345.5	18%	292.0
Compensation	205.9	10%	187.3	16%	161.7
Operating	88.2	(4%)	91.8	12%	81.7
Depreciation	7.7	(1%)	7.8	1%	7.7
Amortization	0.4	0%	0.4	NMF	0.1
Total expenses	302.2	5%	287.3	14%	251.2
Earnings from continuing operations before income taxes	68.4	18%	58.2	43%	40.8
Provision for income taxes	15.8	40%	11.3	18%	9.6
Earnings from continuing operations	\$ 52.6	12%	\$ 46.9	50%	\$ 31.2
Growth - revenues	7%		18%		17%
Organic growth in fees	7%		18%		17%
Growth - pretax earnings	18%		43%		38%
Compensation expense ratio	56%		54%		55%
Operating expense ratio	24%		27%		28%
Pretax profit margin	18%		17%		14%
Effective tax rate	23%		19%		23%
Identifiable assets at December 31	\$ 284.4		\$ 231.2		\$ 200.6

The increase in fees for 2005 compared to 2004 and 2004 compared to 2003 was due primarily to new business production, renewal rate increases and high retention rates on existing business, all of which aggregated to \$41.0 million in 2005 and \$71.0 million in 2004 and were offset by lost business of \$17.0 million in 2005 and \$21.0 million in 2004. Also included in 2004 fees are \$2.7 million of one- time revenues related to two client projects that were completed in fourth quarter 2004. The organic growth in fee revenues was 7% in 2005, 18% in 2004 and 17% in 2003. Historically, the Risk Management Segment has made few acquisitions, and these acquisitions have not been material to this Segment's operations. Thus, there typically is no material difference between GAAP revenues and organic revenues for this Segment.

Investment income - fiduciary, which primarily represents interest income earned on Gallagher's cash and cash equivalents, increased in 2005 and 2004 primarily due to increases in short- term interest rates and increases in the amount of cash available to invest due to growth in operations and to a reduction in common stock repurchased in 2005. The decrease in shares repurchased in 2005 as compared to 2004 was primarily due to anticipated cash needs in the latter part of 2005 and into 2006.

The increase in compensation expense in 2005 compared to 2004 was due to an increase in the average number of employees and salary increases (\$23.4 million in the aggregate), the adverse impact of foreign currency translation (\$0.5 million) and an increase in stock- based compensation expense in 2005 (\$0.4 million). These increases were partially offset by the defined benefit pension plan curtailment gain of \$3.1 million that was recognized in second quarter 2005 and a decrease in employee benefit expenses (\$2.6 million). The increase in employee headcount relates to the hiring of additional staff to support claims activity related to new business generated. The increase in compensation expense in 2004 compared to 2003 was due to an increase in the average number of employees and increases in incentive compensation linked to Gallagher's overall operating results (\$21.3 million in the aggregate), an increase in employee benefit expenses (\$2.1 million), the adverse impact of foreign currency translation (\$1.7 million) and an increase in stock- based compensation expense in 2004 (\$0.5 million). The increase in employee headcount relates to the hiring of additional claims staff to support new business generated.

The decrease in operating expenses in 2005 from 2004 was due primarily to the overall impact of sourcing and other cost containment initiatives implemented in the latter part of 2004 (\$2.3 million) and to a decrease in professional services fees (\$5.4 million) in 2005, which were partially offset by increases in other operating expenses and an asset write- off in the international operations of \$0.5 million. The increase in operating expenses in 2004 compared to 2003 was due primarily to increases in business insurance costs (\$3.5 million), rent and utility costs associated with leased office space and office expansion (\$2.2 million), fees for professional services (\$1.1 million), and increases in travel and entertainment costs primarily related to new business development (\$1.2 million).

Depreciation expense was relatively unchanged in 2005 compared to 2004 and 2004 compared to 2003. Changes in depreciation expense from year-to- year are due primarily to the timing of purchases of furniture, equipment and leasehold improvements related to office expansions and moves.

Amortization expense was unchanged in 2005 compared to 2004. The increase in amortization in 2004 compared to 2003 was due to amortization expense of intangible assets associated with an acquisition that was completed in fourth quarter 2003. Expiration lists and non- compete agreements are amortized using the straight- line method over their estimated useful lives (five to fifteen years for expiration lists and five to six years for non- compete agreements).

See the Results of Operations for the Financial Services Segment for a discussion on changes in the overall effective income tax rate in 2005 compared to 2004 and 2004 compared to 2003.

Financial Services

The Financial Services Segment is responsible for managing Gallagher's investment portfolio. See Note 3 to the Consolidated Financial Statements for a summary of Gallagher's investments as of December 31, 2005 and 2004 and a detailed discussion on the nature of the investments held.

Financial information relating to Gallagher's Financial Services Segment is as follows (in millions):

	2005	Percent Change	2004	Percent Change	2003
Investment income:					
Trading securities	\$ -	(100%)	\$ 0.3	(96%)	\$ 7.0
Asset Alliance Corporation (AAC) related investments	(2.7)	(175%)	3.6	(29%)	5.1
Low income housing investments	0.2	(91%)	2.3	130%	1.0
Alternative energy investments	56.3	24%	45.4	10%	41.3
Real estate, venture capital and other investments	1.7	143%	0.7	240%	(0.5)
Consolidated investments	53.3	27%	42.0	296%	10.6
Impact of FIN 46 from consolidated investments	-	(100%)	69.9	51%	46.4
Other	0.1	110%	(1.0)	(145%)	2.2
Total investment income	108.9	(33%)	163.2	44%	113.1
Investment gains (losses)	3.6	(56%)	8.1	133%	(24.5)
Total revenues	112.5	(34%)	171.3	93%	88.6
Investment expenses	104.9	17%	89.9	88%	47.9
Impact of FIN 46 on investment expenses	-	(100%)	67.2	52%	44.1
Interest	11.6	22%	9.5	19%	8.0
Depreciation	11.4	23%	9.3	29%	7.2
Impact of FIN 46 on depreciation	-	(100%)	2.7	17%	2.3
Litigation related matters	131.0	NMF	-	NMF	-
Total expenses	258.9	45%	178.6	63%	109.5
Loss from continuing operations before income taxes	(146.4)	NMF	(7.3)	NMF	(20.9)
Provision (benefit) for income taxes	(50.3)	NMF	(0.9)	NMF	(4.9)
Loss from continuing operations	\$ (96.1)	NMF	\$ (6.4)	NMF	\$ (16.0)
Identifiable assets at December 31	\$ 606.6		\$ 647.6		\$ 656.9

Investment income from trading securities decreased in 2005 and 2004 compared to 2003 due to the liquidation of the trading securities portfolio during the latter part of 2003 and first quarter 2004. Amounts included in investment income from trading securities represent interest and dividend income and normal recurring realized and unrealized gains and losses on trading securities.

Investment income from AAC related investments primarily represents income associated with Gallagher's debt, preferred and common stock investments in AAC. Gallagher accounts for the common stock portion of its investment using equity method accounting and accounts for the interest and dividend income on its debt and preferred stock investments as it is earned. The decrease in AAC related income in 2005 compared to 2004 was due to a decline in AAC's operating results in 2005, which included a charge that AAC recognized in fourth quarter 2005 related to the sales and impairment of its investments in three of its private investment management firms. Gallagher's portion of the charge using equity method accounting was \$3.1 million. The decrease in AAC related income in 2004 compared to 2003 was due to a moderate decline in AAC's operational results in 2004 and to a reduction in the amount invested by Gallagher in AAC debt and preferred stock.

Investment income from low income housing (LIH) developments primarily represents income associated with Gallagher's equity investment in a LIH Developer that is accounted for using equity method accounting and interest income from bridge loans made by Gallagher related to LIH developments. The change in LIH income in 2005 compared to 2004 and 2004 compared to 2003 was primarily due to the timing of project sale transactions of the LIH Developer that generated equity income to Gallagher in 2004. Also impacting income in 2004 compared to 2003 was a decrease in bridge loans and the related interest income in 2004.

Investment income from alternative energy investments primarily relates to installment gains from the sales of Gallagher's interests in limited partnerships that operate synthetic coal (Syn/Coal) facilities. The increase in income from these investments in 2005 was due to higher Syn/Coal production at the facilities and to installment gains related to 2004 limited partnership sales. The increase in installment gains in 2004 compared to 2003 was a direct result of higher Syn/Coal production at the facilities.

Income (losses) from real estate, venture capital and other investments principally relates to Gallagher's portion of the earnings (losses) of these entities accounted for using equity method accounting. The increase in income from these investments in 2005 compared to 2004 is primarily due to the appreciation in value on two venture capital investments that were recovered in 2005 after being impaired in prior years. The recoveries of the amounts previously impaired have been included in investment gains (losses) in the table above. The increase in income from these investments in 2004 compared to 2003 is primarily a result of impairment charges in 2004 and 2003 related to investments that were generating losses.

Investment income from consolidated investments includes income related to Gallagher's home office building, the airplane leasing company and two Syn/Coal facilities. Rental income of the home office building was \$6.4 million, \$6.6 million and \$6.8 million in 2005, 2004 and 2003, respectively. Total expenses associated with the home office building rental income, including interest and depreciation expenses, were \$6.3 million, \$6.6 million and \$6.6 million in 2005, 2004 and 2003, respectively. In 2005, 2004 and 2003, rental income of the airplane leasing company was \$4.1 million, \$3.4 million and \$3.2 million, respectively, and total expenses associated with this income, including interest and depreciation expenses, was \$5.5 million, \$4.9 million and \$5.0 million, respectively. On December 21, 2005, the lease agreement for the two airplanes leased to the French Postal Service, which was originally going to expire in 2006, was extended for an additional five years to 2011. The extended agreement is cash flow neutral to Gallagher. In 2005, 2004 and 2003, income from the Syn/Coal facilities was \$42.8 million, \$31.9 million and \$1.0 million, respectively. Total expenses, including interest and depreciation expenses, relating to this income were \$78.7 million, \$61.2 million and \$15.9 million in 2005, 2004 and 2003, respectively. Gallagher acquired its interest in these two facilities in fourth quarter 2003 and second quarter 2004, which resulted in the 2004 increases in Syn/Coal related income and expenses. The increase in revenues and expenses in 2005 was a direct result of higher Syn/Coal production at the facilities.

Investment income from consolidated investments for 2004 and 2003 was also impacted by the adoption of FASB Interpretation No. 46 (FIN 46), "Consolidation of Variable Interest Entities.". Effective July 1, 2003, Gallagher early adopted FIN 46, which required Gallagher to consolidate a Syn/Coal partnership in which it had a 5% ownership interest at the time of consolidation. Prior to July 1, 2003, this partnership was not consolidated because it was not controlled by Gallagher through a majority voting interest. Gallagher recognized both investment income and expenses of \$69.9 million and \$46.4 million in 2004 and 2003, related to the consolidation of the Syn/Coal partnership. During third quarter 2004, Gallagher sold a 4% ownership interest in this investment, which eliminated the requirement to consolidate the investment under the FIN 46 rules. This investment is now accounted for using equity method accounting.

Investment gains (losses) primarily include realized gains and losses that occurred in the respective years related to impairments, dispositions and recoveries of venture capital investments, which included loans and equity holdings in start-up companies. During 2005, Gallagher recognized a net \$3.6 million investment gain related to assets impaired in prior years, the main components of which were as follows: \$0.6 million gain on the sale of a shopping center investment, a \$0.5 million loss from an investment related to the Biogas Project described in Note 3 to the Consolidated Financial Statements (the Biogas Project), a \$2.5 million loss as a result of a write-down of a substantial portion of its investment in a multi-pollutant reduction venture, a \$2.1 million dividend from its investment in Allied World Assurance Holdings, Ltd, a \$1.3 million gain on the sale of the Biogas Project and a \$1.2 million gain from the Biogas Project that had previously been impaired. The remaining \$1.4 million net gain is from other transactions, none of which is greater than \$0.4 million, related to the sale or recoveries of venture capital investments. During 2004, Gallagher recognized a net \$8.1 million investment gain related to assets impaired in 2003, the main components of which were as follows: a \$2.0 million reversal of a loss contingency reserve, a \$1.0 million recovery of previously accrued interest income, a \$3.0 million recovery of unsecured notes receivable, a \$0.5 million gain from a distribution on an investment previously impaired and a \$0.7 million gain related to distributions received from a venture capital fund. The reversal of the loss contingency reserve was made as a result of the successfully completed funding transaction related to a Gallagher partially owned Biogas Project. During 2003, Gallagher incurred \$29.1 million of investment losses and generated \$4.6 million of investment gains, for a net investment loss of \$24.5 million. Substantially all of these losses (\$25.7 million) related to impairments and dispositions when Gallagher decided to withdraw virtually all continued support for its venture capital investments in first quarter 2003, except to the limited extent needed to realize value from the remaining assets. Without Gallagher's support at that time, it was doubtful that these operations would be able to execute their business plans. Therefore, Gallagher's investments were determined to be other-than-temporarily impaired.

Investment expenses include operating expenses of the alternative energy investments, including expenses related to the Headwaters Incorporated (Headwaters) royalty, expenses of the real estate partnerships and airplane leasing company and expenses related to compensation, professional fees and overhead expenses such as rent and utilities. The increase in investment expenses for 2005 compared to 2004 was primarily due to increases in direct operating expenses of the alternative energy investments (\$13.6 million) because of increased volume and to the royalty payments due to Headwaters (\$14.6 million) offset by reductions in incentive compensation (\$6.0 million) and professional fees (\$3.8 million). See discussion on litigation related matters below. The increase in investment expenses for 2004 compared to 2003 was primarily due to increases in direct operating expenses of the alternative energy investments (\$41.0 million) due to increased volume.

Investment and depreciation expenses related to the impact of FIN 46 decreased to zero in 2005 due to the sale of the 4% ownership interest in the previously consolidated Syn/Coal partnership, which eliminated the requirement to consolidate this investment under the FIN 46 rules.

The increase in interest expense in 2005 compared to 2004 was due to \$2.0 million of interest accrued on payments due to Headwaters and an increase in interest rates on the variable rate loan of the airplane leasing company. The increase in interest expense in 2004 compared to 2003 is due to the additional investment related debt in 2004 of a biogas project and one Syn/Coal facility.

The increase in depreciation expense in 2005 compared to 2004 was due to Gallagher acquiring its interest in one of the two Syn/Coal facilities in second quarter 2004. The increase in depreciation expense in 2004 compared to 2003 was due to Gallagher acquiring its interest in two Syn/Coal facilities in fourth quarter 2003 and second quarter 2004.

Litigation related matters in 2005 represent a pretax charge of \$131.0 million (\$84.2 million after tax) recorded by Gallagher in first quarter 2005. On February 11, 2005, a jury in the Fourth District Court for the State of Utah awarded damages against Gallagher's subsidiary, AJG Financial Services, Inc. (AJGFS), and in favor of Headwaters in the amount of \$175.0 million. AJGFS and Headwaters entered into a definitive agreement effective as of May 1, 2005 to settle this and all other litigation between the companies for \$50.0 million, which was paid to Headwaters in May 2005. Additionally, AJGFS and Headwaters have modified their existing licensing agreement allowing AJGFS to utilize Headwaters' technology on two of AJGFS' synthetic fuel facilities in exchange for (i) \$70.0 million, which was paid to Headwaters on January 4, 2006 and (ii) an annual royalty to Headwaters in 2005, 2006 and 2007. The first quarter 2005 litigation charge provides for amounts related to this settlement, including the \$120.0 million of settlement costs, together with litigation, bonding and other costs of approximately \$11.0 million. In connection with the Headwaters licensing agreement, Gallagher recorded \$14.6 million of royalty expense in 2005, based on the Syn/Coal production volume, which was included in investment expenses. At full production, the maximum annual royalty in 2006 and 2007 would be equal to \$20.0 million of AJGFS' estimated annual pre- royalty, pretax earnings of \$40.0 million from these two facilities.

The overall effective income tax rate reflects the tax credits generated by investments in limited partnerships that operate alternative energy projects (IRC Section 29) and low income housing, which are partially offset by state and foreign taxes. In addition to tax credits generated by production from the Syn/Coal facilities, the effective income tax rate of 23.0% reported in 2005, which is below the statutory rate, has been impacted by the marginal income tax (benefit) effect on the two previously discussed litigation related charges that Gallagher recorded in 2005. Due to the size and nature of the litigation charges, Gallagher has recorded an income tax benefit using an effective marginal income tax rate of 40.0% for the Brokerage Segment related litigation charge and 35.7% for the Financial Services Segment related litigation charge. The level of production from the Syn/Coal facilities in 2004 and 2003 resulted in effective tax rates in 2004 of 20.0% and 2003 of 24.0%, which are below the statutory rates.

IRC Section 29 tax credits expire on December 31, 2007 and, if the law is not extended, Gallagher's effective tax rate in 2008 will likely adjust upward to approximately 35.0% to 42.0%. In addition, through December 31, 2007, IRC Section 29 has a phase- out provision that is triggered when the "Market Wellhead Price" of domestic crude oil reaches certain "Phase- out Prices" as determined by the Internal Revenue Service (IRS). The Market Wellhead Prices of domestic crude and the Phase- out Prices as determined by the IRS for the last six years are as follows:

Calendar Year	Market Wellhead Price (1)	Phase- out Price (2)	
		Starts At	Fully Phased Out At
2000	\$ 26.73	\$ 48.07	\$ 60.34
2001	21.86	49.15	61.70
2002	22.51	49.75	62.45
2003	27.56	50.14	62.94
2004	36.75	51.35	64.47
2005 (estimated based on first 10 months 2005)	49.90 (3)	52.50	66.00

(1) Market Wellhead Price is the IRS' estimate of the calendar year average wellhead price per barrel for all domestic crude oil, the price of which is not subject to regulation by the U.S. The IRS historically estimates this price based on the monthly average wellhead price of domestic crude oil as published by the Department of Energy as Domestic First Purchase Prices.

(2) Phase- out Prices for 2000 to 2004 as established by the IRS. These Phase- out Prices are based on an inflation adjustment factor. This factor represents the change since calendar year 1979 of the first revision of the implicit price deflator for the gross national product of the U.S. as computed and published by the U.S. Department of Commerce. The IRS will not publish the Phase- out Prices for calendar year 2005 until April 2006. The 2005 Phase- out Prices represent management's best estimate using the latest public information available. There can be no assurance that management's estimated Phase- out Prices will approximate what the IRS ultimately publishes.

(3) This amount represents an estimated, ten- month average of Market Wellhead Prices. The table below shows the published Market Wellhead Prices through October 2005 (latest month available). November and December prices have been estimated by management. There can be no assurance that management's estimate will approximate what is ultimately published by the Department of Energy or the IRS. The 2005 monthly average prices are as follows:

January	\$ 40.20	April	\$ 46.93	July	\$ 53.30	October	\$ 56.96
February	41.93	May	44.03	August	58.77	November	53.36
March	47.39	June	49.89	September	59.60	December	54.35

As indicated in the table above, oil prices were considerably higher in 2005 than 2004, but still below the estimated 2005 Phase- out Prices. Because oil prices were substantially below the 2004 estimated Phase- out Price, there was no phase- out for 2004 and management anticipates there will be no phase- out for 2005. Management estimates that the Market Wellhead Price in 2006 would need to average approximately \$53.75 to start a phase- out and average approximately \$67.50 for a complete phase- out. The commonly reported crude oil price of futures contracts traded on the New York Mercantile Exchange (NYMEX Price) for 2006 averaged \$65.41 through January 30. The NYMEX Price averaged \$6.11 above the Market Wellhead Price for the ten- month period ended October 31, 2005. There can be no assurance that future oil prices will average under future phase- out levels. Should Gallagher or its partners anticipate that oil prices may reach the range of Phase- out Prices in 2006, some or all of Gallagher's IRC Section 29 operations may be curtailed.

Using the information in the preceding paragraph, for calendar year 2006, Gallagher estimates that the commonly reported crude oil price NYMEX Price) would need to average approximately \$60.00 per barrel for calendar year 2006 for any phase- out to begin and average approximately \$74.00 per barrel for calendar year 2006 for a complete phase- out.

During 2006, Gallagher will monitor the NYMEX Price and decide if it should continue to produce Syn/Coal. Gallagher's evaluation, in part, will be based on the following:

(a) If Gallagher believes the 2006 price of oil will average below the phase- out price and decides to continue its current Syn/Coal production schedule, Gallagher estimates the Financial Services Segment would expect to report a pretax loss of approximately \$20.0 million to \$25.0 million for 2006. Gallagher's overall tax rate would be approximately 23.0% to 25.0% for 2006.

- (b) If Gallagher believes the 2006 price of oil will average above the phase-out price and decides to idle its Syn/Coal facilities, Gallagher estimates the Financial Services Segment could report a maximum one-time non-cash pretax charge of approximately \$18.0 million related to an impairment charge on these facilities and other related assets. In addition, if the Syn/Coal facilities remain idle for all of 2006, Gallagher estimates the Financial Services Segment would expect to report a pretax loss of approximately \$5.0 million to \$10.0 million for 2006. Gallagher's overall tax rate would be approximately 39.0% to 41.0% for full year 2006.
- (c) Gallagher is currently exploring certain financial transactions and/or operating strategies that, if pursued, are designed to produce results for the Financial Services Segment and Gallagher's overall tax rate between scenarios (a) and (b) above.

The following table illustrates the impact on earnings from continuing operations and earnings from continuing operations per share for the years ended December 31, 2005, 2004 and 2003, if Gallagher had curtailed all IRC Section 29-related operations as of January 1, 2003. This illustration is prepared for comparative purposes only and does not purport to be indicative of past or future operating results. A summary of the pro forma impact is as follows (in millions, except per share data):

Year Ended December 31,				
	2005		2004	2003
Pretax earnings (loss) from continuing operations, as reported	\$ (2.8)	\$	237.3	\$ 192.8
Pro forma pretax adjustment for IRC Section 29 operations	5.7		(6.5)	(11.9)
Pro forma pretax earnings (loss) from continuing operations	2.9		230.8	180.9
Pro forma income tax provision assuming a 40.0% effective rate	1.2		92.3	72.4
Pro forma earnings from continuing operations	\$ 1.7	\$	138.5	\$ 108.5
Diluted earnings from continuing operations per share - pro forma	\$ 0.02	\$	1.46	\$ 1.16

Gallagher is an investor in a privately-owned, multi-pollutant reduction venture, Chem-Mod LLC (Chem-Mod) which possesses rights, information and technology for the reduction of unwanted emissions created during the combustion of coal. As reported by Chem-Mod in a press release dated February 8, 2006, Chem-Mod has developed and is the exclusive licensee of a new proprietary emissions technology it refers to as The Chem-Mod Solution, which uses a dual injection sorbent system to reduce mercury, sulfur dioxide and other toxic emissions at coal-fired power plants. Substantial testing of The Chem-Mod Solution has been completed both in a laboratory environment and at three full-scale commercial power plants, all yielding positive test results. Although Chem-Mod is in the early stages of commercializing the technology, the principal potential market for The Chem-Mod Solution is coal-fired power plants owned by utility companies. Chem-Mod has indicated publicly that it believes The Chem-Mod Solution is a more cost-effective technology for reducing emissions in a manner consistent with the Environmental Protection Agency's Clean Air Mercury Rules than other technologies currently in the marketplace. Gallagher, through two wholly-owned subsidiaries, currently owns a 10% equity interest in Chem-Mod, an option to acquire an additional 32% indirect equity interest in Chem-Mod and owns a 20% equity interest in Chem-Mod International LLC, an entity formed to commercialize The Chem-Mod Solution outside the U.S. and Canada (the Chem-Mod Interests). Gallagher first began providing funding to Chem-Mod in June 2004. Currently, Gallagher's carrying value with respect to its Chem-Mod Interests is approximately \$0.6 million. Gallagher also has additional funding commitments of approximately \$0.7 million. Gallagher's option to acquire the additional 32% indirect equity interest in Chem-Mod is exercisable at any time on or prior to December 31, 2007 at an exercise price of \$11.0 million. Chem-Mod and its equityholders have retained an investment banking firm to help evaluate a variety of strategies to maximize value for Chem-Mod's equityholders, including a potential sale. However, there are a number of variables surrounding such strategies, particularly in light of the early stage of Chem-Mod's commercialization efforts. While Gallagher currently believes that its Chem-Mod Interests may prove to have substantial value, there can be no assurance given as to timing or amount, if any, with respect to any realization on this investment.

Financial Condition and Liquidity

Cash Provided by Operations - Liquidity describes the ability of a company to generate sufficient cash flows to meet the cash requirements of its business operations. The insurance brokerage industry is not capital intensive. Historically, Gallagher's capital requirements have primarily included dividend payments on its common stock, repurchases of its common stock, funding of its investments, acquisitions of brokerage and risk management operations and capital expenditures. The capital used to fund Gallagher's investment portfolio was primarily generated from the excess cash provided by its operations and tax savings generated from tax advantaged investments. During 2003, Gallagher decided to withdraw virtually all continued support for its venture capital investments and to liquidate its trading securities portfolio. As a result, since 2003 the capital requirements for funding

It was anticipated that the litigation and retail contingent commission related matters would have a substantial negative impact on Gallagher's net cash provided by operating activities in 2005. Such matters are likely to continue to have a substantial unfavorable impact in 2006. As previously discussed, AJGFS has been in the process of reducing its ownership interests in its non- tax advantaged investments, and in 2005, that process was accelerated in anticipation of payments that were needed to be made as a result of the Headwaters litigation matter. The liquidation of AJGFS' investments along with positive net cash flows from AJGFS' operating activities provided enough liquidity to fund the payments related to Headwaters litigation matters. Gallagher anticipates that any contingent commission matters in 2006 will be funded by net cash flows from operating activities. If net cash flows from operating activities do not provide the necessary cash flow to cover the contingent commission matters, then Gallagher can use borrowings under its Credit Agreement to meet its short- term cash flow needs.

Gallagher's ability to meet its future cash requirements related to the payments of dividends on its common stock and the repurchases of its common stock substantially depends upon its ability to generate positive cash flows from its operating activities. Cash provided by operating activities was \$188.8 million, \$277.2 million and \$228.9 million for 2005, 2004 and 2003, respectively. The decrease in cash provided by operating activities in 2005 compared to 2004 was primarily due to the \$50.0 million payment to Headwaters made in May 2005 related to first quarter 2005 litigation charge of \$131.0 million and to Gallagher's \$24.5 million funding of the pension plan during 2005. On January 4, 2006, in accordance with the modified licensing agreement, AJGFS paid \$75.5 million to Headwaters related to first quarter 2005 litigation charge. The retail contingent commission related matters charge of \$73.6 million and the claims handling obligations charge of \$15.0 million did not have a significant impact on cash provided by operating activities in 2005, as the vast majority of these charges were non- cash in 2005. On January 12, 2006, Gallagher paid \$26.9 million into a fund to be distributed to certain eligible policyholder clients under the AVC. The increase in cash provided by operating activities in 2004 compared to 2003 was primarily due to the increase in net earnings. In addition, the liquidation of the majority of the trading securities portfolio during 2003 contributed to the increase in cash provided by operating activities in 2003. Gallagher's cash flows from operating activities are primarily derived from its earnings from continuing operations, as adjusted for realized gains and losses and its noncash expenses, which include depreciation, amortization, deferred compensation, restricted stock and stock- based compensation expenses. When assessing the overall liquidity of Gallagher, the focus should be on earnings from continuing operations, adjusted for noncash items, in the statement of earnings and cash provided by operating activities in the statement of cash flows as indicators of trends in liquidity. From a balance sheet perspective, the focus should not be on premium and fees receivable, premiums payable or restricted cash for trends in liquidity. Because of the variability related to the timing of premiums and fees receivable and premiums payable, net cash flows provided by operations will vary substantially from quarter- to- quarter and year- to- year related to these items. In addition, funds restricted as to Gallagher's use, premiums and clients' claim funds held as fiduciary funds, are presented in Gallagher's consolidated balance sheet as "Restricted cash" and have not been included in determining Gallagher's overall liquidity. In order to consider these items in assessing trends in liquidity for Gallagher, they should be looked at in a combined manner, because changes in these balances are interrelated and are based on the timing of premium movement. In assessing the overall liquidity of Gallagher from a balance sheet perspective, it should be noted that at December 31, 2005, Gallagher had no Corporate related borrowings outstanding, a cash and cash equivalent balance of \$317.8 million and tangible net worth of \$350.9 million. Gallagher has a \$450.0 million unsecured multicurrency credit agreement (Credit Agreement) it can use from time- to- time to borrow funds to supplement operating cash flows. Due to outstanding letters of credit, \$417.8 million remained available for potential borrowings at December 31, 2005. The Credit Agreement contains various covenants that require Gallagher to maintain specified levels of net worth and financial leverage ratios. Gallagher was in compliance with these covenants at December 31, 2005.

Except for 2005, Gallagher's earnings from continuing operations have increased every year since 1991. In 2005, earnings from continuing operations were adversely impacted by charges incurred for the litigation and retail contingent commission related matters and the claims handling obligations. Gallagher expects the historically favorable trend in earnings from continuing operations to continue in the foreseeable future because it intends to continue to expand its business through organic growth from existing operations and growth through acquisitions. Acquisitions allow Gallagher to expand into desirable businesses and geographic locations, further extend its presence in the retail and wholesale insurance brokerage services industry and increase the volume of general services currently provided. However, management has no plans to substantially change the nature of the services performed by Gallagher. Gallagher believes that it has the ability to adequately fund future acquisitions through the use of cash and/or its common stock.

Another source of liquidity to Gallagher is the issuance of its common stock related to its stock option and employee stock purchase plans. Gallagher has four stock option plans for directors, officers and key employees of Gallagher and its subsidiaries. The options are primarily granted at the fair value of the underlying shares at the date of grant and generally become exercisable at the rate of 10% per year beginning the calendar year after the date of grant. In addition, Gallagher has an employee stock purchase plan which allows Gallagher's employees to purchase its common stock at 85% of its fair market value. Proceeds from the issuance of its common stock related to these plans have contributed favorably to net cash provided by financing activities and Gallagher believes this favorable trend will continue in the foreseeable future.

Currently, Gallagher believes it has sufficient capital to meet its cash flow needs. However, in the event that Gallagher needs capital to fund its operations and investing requirements, it would use borrowings under its Credit Agreement to meet its short- term needs and would consider other alternatives for its long- term needs. Such alternatives would include raising capital through public or private markets or restructuring its operations in the event that cash flows from operations are reduced dramatically due to lost business. However, Gallagher has historically been profitable and cash flows from operations and short- term borrowings under its Credit Agreement have been sufficient to fund Gallagher's operating, investment and capital expenditure needs. Gallagher expects this favorable cash flow trend to continue in the foreseeable future.

Dividends - In 2005 Gallagher declared \$106.1 million in cash dividends on its common stock, or \$1.12 per common share. Gallagher's dividend policy is determined by the Board of Directors. Quarterly dividends are declared after considering Gallagher's available cash from earnings and its anticipated cash needs. On January 13, 2006, Gallagher paid a fourth quarter dividend of \$.28 per common share to shareholders of record at December 31, 2005, a 12% increase over the fourth quarter dividend per share in 2004. On January 26, 2006, Gallagher announced an increase in its quarterly dividend for the first quarter of 2006 from \$.28 to \$.30 per common share, a 7.1% increase over 2005. If each quarterly dividend in 2006 is \$.30 per common share, this increase in the dividend will result in an annualized increase in the net cash used by financing activities in 2006 of approximately \$8.0 million.

Capital Expenditures - Net capital expenditures were \$22.8 million, \$29.0 million and \$25.3 million for 2005, 2004 and 2003, respectively. Capital expenditures by Gallagher are related primarily to office relocations and expansions and updating computer systems and equipment. In 2006, Gallagher expects total expenditures for capital improvements to be approximately \$30.0 million.

Common Stock Repurchases - Gallagher has a common stock repurchase plan that has been approved by the Board of Directors. Gallagher did not repurchase any shares under the plan in 2005. Under the plan, Gallagher repurchased 1.8 million shares at a cost of \$56.2 million and 2.9 million shares at a cost of \$80.8 million in 2004 and 2003, respectively. The reduction in shares repurchased in 2005 as compared to 2004 was primarily due to anticipated cash needs to fund the Headwaters and AVC related payments in 2005 and 2006. The reduction in shares repurchased in 2004 as compared to 2003 was due to increased cash used for acquisitions in 2004. Repurchased shares are held for reissuance in connection with its equity compensation and stock option plans. Under the provisions of the repurchase plan, as of December 31, 2005, Gallagher was authorized to repurchase approximately 5.0 million additional shares. Gallagher is under no commitment or obligation to repurchase any particular amount of common stock and at its discretion may suspend the repurchase plan at any time. The common stock repurchases reported in the consolidated statement of cash flows for 2005 represent 76,000 shares (at a cost of \$2.2 million) that were repurchased by Gallagher to cover employee income tax withholding obligations in connection with 2005 restricted stock distributions.

Acquisitions - Cash paid for acquisitions, net of cash acquired, was \$32.9 million, \$112.8 million and \$28.7 million in 2005, 2004 and 2003, respectively. While stock is Gallagher's preferred "currency" for acquisitions, cash in lieu of stock was used in order to complete a significant portion of the acquisitions in 2005 and 2004. The increased use of cash for acquisitions in 2004 correlates with the reduction in common stock repurchases in 2005 and 2004. Gallagher completed ten, nineteen and fourteen acquisitions in 2005, 2004 and 2003, respectively.

During 2005, Gallagher issued 0.4 million shares of its common stock and paid \$1.8 million in cash and accrued \$2.7 million in current liabilities related to earnout obligations of eight acquisitions made prior to 2005 and recorded additional goodwill of \$15.3 million. During 2004, Gallagher paid \$2.3 million in cash related to earnout obligations of three acquisitions made prior to 2004 and recorded additional goodwill and expiration lists of \$1.8 million and \$0.5 million, respectively. During 2003, Gallagher issued 0.3 million shares to settle a contingent earnout obligation related to one acquisition made prior to 2003 and recorded additional goodwill of \$7.9 million.

Dispositions - In first quarter 2005, Gallagher entered into an agreement to sell the net assets of Northshore International Insurance Services (NiiS), a medical claims management and auditing services provider, for cash of \$4.8 million. Gallagher recognized a pretax loss of \$12.7 million (\$12.3 million after tax loss) in first quarter 2005 in connection with the sale. Also, in first quarter 2005, Gallagher entered into an agreement to sell all of the stock of Gallagher Benefit Administrators, Inc. (GBA), a third party employee benefit claim payment administrator, for cash of \$9.2 million and a promissory note in the amount of \$4.4 million. Gallagher recognized a pretax gain of \$9.6 million (\$6.8 million after tax gain) in first quarter 2005 in connection with the sale. The promissory note has a 10% fixed rate of interest, with interest only payments payable monthly through August 22, 2007, when the note matures. In second quarter 2005, Gallagher sold its ownership interests in the limited partnership that owns the Florida Community Development investment. Pursuant to the transaction, Gallagher received cash of \$25.7 million and recorded a pretax gain of \$12.6 million (\$7.6 million after tax gain) in second quarter 2005 in connection with the sale. See Note 5 to the Consolidated Financial Statements for an additional discussion on the 2005 business dispositions.

In fourth quarter 2005, Gallagher began to explore opportunities to sell its home office land and building. If a sale occurs, Gallagher expects to sell the building for an amount approximately equal to its net book value. However, under GAAP, if Gallagher incurs a loss on the sale, the loss will be reflected in the consolidated statement of earnings, while any gain would be deferred and amortized as a reduction of future rent expense over the remaining term of the lease.

Contractual Obligations and Commitments

In connection with its investing and operating activities, Gallagher has entered into certain contractual obligations as well as funding commitments and financial guarantees. See Notes 3, 8 and 17 to the Consolidated Financial Statements for additional discussion of these obligations and commitments. Gallagher's future minimum cash payments, excluding interest, associated with its contractual obligations pursuant to its Credit Agreement, investment related borrowings, operating leases and purchase commitments at December 31, 2005 are as follows (in millions):

Contractual Obligations	Payments Due by Period						Total
	2006	2007	2008	2009	2010	Thereafter	
Credit Agreement	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Investment related borrowings:							
Home office mortgage loan	0.9	1.1	74.1	-	-	-	76.1
Airplane leasing company debt	1.9	2.1	2.2	2.3	2.5	18.9	29.9
Syn/Coal facility purchase note	2.5	3.5	0.9	-	-	-	6.9
Total debt Obligations	5.3	6.7	77.2	2.3	2.5	18.9	112.9
Operating lease obligations	57.0	49.4	42.2	34.9	29.5	40.7	253.7
Net Syn/Coal purchase commitments	4.6	3.0	-	-	-	-	7.6
Outstanding purchase obligations	4.9	-	-	-	-	-	4.9
Total contractual obligations	\$ 71.8	\$ 59.1	\$ 119.4	\$ 37.2	\$ 32.0	\$ 59.6	\$ 379.1

The amounts presented in the table above may not necessarily reflect the actual future cash funding requirements of Gallagher, because the actual timing of the future payments made may vary from the stated contractual obligation.

Credit Agreement - Gallagher has a \$450.0 million Credit Agreement it uses to standby or commercial letters of credit (LOCs) and that it can use from time- to- time to borrow funds to supplement operating cash flows. At December 31, 2005, \$32.2 million of LOCs (of which Gallagher has \$9.0 million of liabilities recorded as of December 31, 2005) were outstanding under the Credit Agreement, which primarily related to Gallagher's investments as discussed in Note 3 to the Consolidated Financial Statements. There were no borrowings outstanding under the Credit Agreement at December 31, 2005. Accordingly, as of December 31, 2005, \$417.8 million remained available for potential borrowings, of which \$92.8 million may be in the form of additional LOCs. Gallagher is under no obligation to utilize the Credit Agreement in performing its normal business operations. See Note 8 to the Consolidated Financial Statements for a discussion of the terms of the Credit Agreement.

Investment Related Borrowings - As more fully described in Notes 3 and 8 to the Consolidated Financial Statements, at December 31, 2005, the accompanying balance sheet includes \$112.9 million of borrowings related to Gallagher's investment related enterprises of which \$3.0 million is recourse to Gallagher. These borrowings are partially secured by the underlying assets of the investment enterprises and support their operations.

Operating Lease Obligations - Gallagher generally operates in leased premises. Certain office space leases have options permitting renewals for additional periods. In addition to minimum fixed rentals, a number of leases contain annual escalation clauses generally related to increases in an inflation index.

Net Syn/Coal Purchase Commitments - Gallagher has interests in two Syn/Coal facilities that it consolidates. See Note 3 to the Consolidated Financial Statements for additional disclosures regarding these partnerships. The facilities have entered into raw coal purchase and Syn/Coal sales agreements. These agreements terminate immediately in the event the Syn/Coal produced ceases to qualify for credits under IRC Section 29 or upon termination of either the purchase or sales agreements. The net annual Syn/Coal purchase commitments represent the minimum raw coal purchases at estimated costs less sales of Syn/Coal at estimated prices.

Outstanding Purchase Obligations - Gallagher is a service company and thus typically does not have a material amount of outstanding purchase obligations at any point in time. The amount disclosed in the table above represents the aggregate amount of unrecorded purchase obligations that Gallagher has outstanding as of December 31, 2005. These obligations represent agreements to purchase goods or services that were executed in the normal course of business.

Off- Balance Sheet Arrangements

Off- Balance Sheet Commitments - Gallagher's total unrecorded commitments associated with outstanding LOCs, financial guarantees and funding commitments as of December 31, 2005 are as follows (in millions):

Off- Balance Sheet Commitments	Amount of Commitment Expiration by Period						Total Amounts Committed
	2006	2007	2008	2009	2010	Thereafter	
Investment related:							
Letters of credit							
\$	-	\$ -	\$ -	\$ -	\$ -	\$ 23.7	\$ 23.7
Funding commitments	0.7	0.6	-	-	-	-	1.3
Total commitments	\$ 0.7	\$ 0.6	\$ -	\$ -	\$ -	\$ 23.7	\$ 25.0

At December 31, 2005, Gallagher had no off- balance sheet commitments related to its Brokerage or Risk Management operations. Since commitments may expire unused, the amounts presented in the table above do not necessarily reflect the actual future cash funding requirements of Gallagher. See Notes 3 and 17 to the Consolidated Financial Statements for a discussion of Gallagher's outstanding LOCs, financial guarantees and funding commitments. All of the LOCs represent multiple year commitments and have annual, automatic renewing provisions and are classified by the latest commitment date.

During the period from January 1, 2002 to December 31, 2005, Gallagher acquired fifty- three companies, which were accounted for as business combinations. Substantially all of the purchase agreements related to these acquisitions contain earnout obligations. The earnout obligations related to the 2005 acquisitions are disclosed in Note 4 to the Consolidated Financial Statements. These earnout obligations represent the maximum amount of additional consideration that could be paid pursuant to the purchase agreements related to these acquisitions. These potential earnout obligations are primarily based upon future earnings of the acquired entities and were not included in the purchase price that was recorded for these acquisitions at their respective acquisition dates. Future payments made under these arrangements will generally be recorded as upward adjustments to goodwill when the earnouts are settled. The aggregate amount of unrecorded earnout obligations outstanding as of December 31, 2005 related to acquisitions made by Gallagher in the period from 2002 to 2005 was \$84.4 million.

Off- Balance Sheet Debt - Gallagher's unconsolidated investment portfolio includes investments in enterprises where Gallagher's ownership interest is between 1% and 50%, whereby management has determined that Gallagher's level of economic interest is not sufficient to require consolidation. As a result, these investments are accounted for using either the lower of amortized cost/cost or fair value, or the equity method, whichever is appropriate depending on the legal form of Gallagher's ownership interest and the applicable percentage of the entity owned. As such, the balance sheets of these investees are not consolidated in Gallagher's consolidated balance sheet at December 31, 2005 and 2004. The December 31, 2005 and 2004 balance sheets of several of these unconsolidated investments contain outstanding debt, which are also not required to be included in Gallagher's consolidated balance sheet.

In certain cases, Gallagher guarantees a portion of the enterprises' debt. Based on the ownership structure of these investments, management believes that Gallagher's exposure to losses related to these investments is limited to the combination of its net carrying value, funding commitments, LOCs and financial guarantees. In the event that certain of these enterprises were to default on their debt obligations and Gallagher's net carrying value became impaired, the amount to be impaired could have a material effect on Gallagher's consolidated operating results and/or financial position. See Notes 3 and 17 to the Consolidated Financial Statements.

In addition to obligations and commitments related to Gallagher's investing activities discussed above, at December 31, 2005, Gallagher has posted an LOC of \$5.5 million for the benefit of an insurance company related to Gallagher's self- insurance deductibles, for which it has a recorded liability of \$6.0 million.

Quantitative and Qualitative Disclosure about Market Risk

Gallagher is exposed to various market risks in its day- to- day operations. Market risk is the potential loss arising from adverse changes in market rates and prices, such as interest and foreign currency exchange rates and equity prices. The following analyses present the hypothetical loss in fair value of the financial instruments held by Gallagher at December 31, 2005 that are sensitive to changes in interest rates and equity prices. The range of changes in interest rates used in the analyses reflects Gallagher's view of changes that are reasonably possible over a one- year period. This discussion of market risks related to Gallagher's consolidated balance sheet includes estimates of future economic environments caused by changes in market risks. The effect of actual changes in these risk factors may differ materially from Gallagher's estimates. In the ordinary course of business, Gallagher also faces risks that are either nonfinancial or unquantifiable, including credit risk and legal risk. These risks are not included in the following analyses.

Gallagher's invested assets are primarily held as cash and cash equivalents, which are subject to various market risk exposures such as interest rate risk. The fair value of Gallagher's cash and cash equivalents investment portfolio at December 31, 2005 approximated its carrying value due to its short- term duration. Market risk was estimated as the potential decrease in fair value resulting from a hypothetical one percentage point increase in interest rates for the instruments contained in the cash and cash equivalents investment portfolio. The resulting fair values were not materially different from the carrying values at December 31, 2005.

Gallagher has other investments that have valuations that are indirectly influenced by equity market and general economic conditions that can change rapidly. In addition, some investments require direct and active financial and operational support from Gallagher. A future material adverse effect may result from changes in market conditions or if Gallagher elects to withdraw financial or operational support.

At December 31, 2005, Gallagher had no borrowings outstanding under its Credit Agreement. However, in the event that Gallagher does have borrowings outstanding, the fair value of these borrowings would likely approximate their carrying value due to their short- term duration and variable interest rates. The market risk would be estimated as the potential increase in the fair value resulting from a hypothetical one- percentage point decrease in Gallagher's weighted average short- term borrowing rate at December 31, 2005 and the resulting fair values would not be materially different from its carrying value.

Gallagher is subject to foreign currency exchange rate risk primarily from its U.K. based subsidiaries that incur expenses denominated primarily in British pounds while receiving a substantial portion of their revenues in U.S. dollars. Foreign currency gains (losses) related to this market risk are recorded in earnings from continuing operations before income taxes as they are incurred. Assuming a hypothetical adverse change of 10% in the average foreign currency exchange rate for 2005 (a weakening of the U.S. dollar), earnings from continuing operations before income taxes would decrease by approximately \$9.9 million. Gallagher is also subject to foreign currency exchange rate risk associated with the translation of its foreign subsidiaries into U.S. dollars. Gallagher attempts to manage the balance sheet of its foreign subsidiaries in such a manner that foreign liabilities are matched with equal foreign assets thereby maintaining a "balanced book" which minimizes the effects of currency fluctuations. Historically, Gallagher has not entered into derivatives or other similar financial instruments for hedging, trading or speculative purposes. However, with respect to managing foreign currency exchange rate risk, Gallagher engaged a consultant in the latter part of 2004 to explore foreign currency hedging strategies. Based on the recommendations of the consultant, Gallagher implemented a foreign currency hedging strategy in 2005, the impact of which was not material to Gallagher's Consolidated Financial Statements for 2005.

Arthur J. Gallagher & Co.

Consolidated Statement of Earnings
(In millions, except per share data)

Year Ended December 31,

	2005	2004	2003
Commissions	\$ 784.3	\$ 726.8	\$ 676.2
Retail contingent commissions	28.8	33.8	29.3
Fees	537.5	490.0	418.7
Investment income - fiduciary funds	20.8	15.1	8.3
Investment income - all other	108.9	163.2	113.1
Investment gains (losses)	3.6	8.1	(24.5)
Total revenues	1,483.9	1,437.0	1,221.1
Compensation	789.9	714.8	638.1
Operating	322.3	267.9	251.8
Investment expenses	104.9	157.1	92.0
Interest	11.6	9.5	8.0
Depreciation	32.7	32.7	29.3
Amortization	20.7	17.7	9.1
Litigation related matters	131.0	-	-
Retail contingent commission related matters	73.6	-	-
Total expenses	1,486.7	1,199.7	1,028.3
Earnings (loss) from continuing operations before income taxes	(2.8)	237.3	192.8
Provision (benefit) for income taxes	(31.4)	47.8	46.9
Earnings from continuing operations	28.6	189.5	145.9
Discontinued operations:			
Earnings (loss) from discontinued operations before income taxes	0.2	(1.8)	0.5
Gain on disposal of operations	9.5	-	-
Provision (benefit) for income taxes	7.5	(0.8)	0.2
Earnings (loss) from discontinued operations	2.2	(1.0)	0.3
Net earnings	\$ 30.8	\$ 188.5	\$ 146.2
Basic net earnings (loss) per share:			
Earnings from continuing operations	\$.30	\$ 2.07	\$ 1.63
	.03	(.01)	-

Earnings (loss) from discontinued operations						
Net earnings	\$	.33	\$	2.06	\$	1.63
Diluted net earnings (loss) per share:						
Earnings from continuing operations	\$	.30	\$	2.00	\$	1.57
Earnings (loss) from discontinued operations		.02		(.01)		-
Net earnings	\$	.32	\$	1.99	\$	1.57
Dividends declared per common share						
	\$	1.12	\$	1.00	\$	.72

See notes to consolidated financial statements.

Arthur J. Gallagher & Co.

Consolidated Balance Sheet
(In millions)

December 31,

	2005	2004
Cash and cash equivalents	\$ 317.8	\$ 224.6
Restricted cash	518.3	488.9
Unconsolidated investments - current	43.2	26.0
Premiums and fees receivable	1,396.8	1,350.9
Other current assets	125.7	132.8
Total current assets	2,401.8	2,223.2
Unconsolidated investments - noncurrent	68.6	132.4
Fixed assets related to consolidated investments - net	126.0	195.6
Other fixed assets - net	59.1	63.4
Deferred income taxes	236.1	184.8
Other noncurrent assets	79.7	59.7
Goodwill - net	245.7	219.0
Amortizable intangible assets - net	172.5	155.2
Total assets	\$ 3,389.5	\$ 3,233.3
Premiums payable to insurance and reinsurance companies	\$ 1,917.4	\$ 1,838.9
Accrued compensation and other accrued liabilities	378.3	258.4
Unearned fees	35.7	25.4
Income taxes payable	24.6	24.8
Other current liabilities	25.0	18.6
Corporate related borrowings	-	-
Investment related borrowings - current	5.3	41.4
Total current liabilities	2,386.3	2,207.5
Investment related borrowings - noncurrent	107.6	140.0
Other noncurrent liabilities	126.5	124.8
Total liabilities	2,620.4	2,472.3
Stockholders' equity:		
Common stock - issued and outstanding 95.7 shares in 2005 and 92.1 shares in 2004	95.7	92.1
Capital in excess of par value	236.1	146.4
Retained earnings	463.7	539.0
Unearned deferred compensation	(14.5)	(12.2)
Unearned restricted stock	(5.3)	(4.3)
Accumulated other comprehensive loss	(6.6)	-
Total stockholders' equity	769.1	761.0
Total liabilities and stockholders' equity	\$ 3,389.5	\$ 3,233.3

See notes to consolidated financial statements.

Arthur J. Gallagher & Co.

Consolidated Statement of Cash Flows
(In millions)

Year Ended December 31,

	2005	2004	2003
Cash flows from operating activities:			
Earnings from continuing operations	\$ 28.6	\$ 189.5	\$ 145.9
Adjustments to reconcile earnings from continuing operations to net cash provided by operating activities:			
Net (gain) loss on investments and other	(3.6)	(8.1)	25.0
Gain on sales of operations	-	-	(2.5)
Depreciation and amortization	53.4	53.3	41.1
Amortization of deferred compensation and restricted stock	7.1	10.0	7.6
Stock- based compensation expense	8.9	5.6	1.8
Increase in restricted cash	(29.4)	(51.3)	(181.3)
Increase in premiums receivable	(51.0)	(32.8)	(68.3)
Increase in premiums payable	67.2	61.8	212.7
Decrease in trading securities - net	-	5.9	55.5
Decrease (increase) in other current assets	6.9	22.6	(37.4)
Increase in accrued compensation and other accrued liabilities	105.6	45.4	33.1
Net change in fees receivable/unearned fees	14.9	(9.7)	1.8
Net change in income taxes payable	(0.2)	0.5	12.2
Tax benefit from issuance of common stock	10.6	17.6	14.1
Net change in deferred income taxes	(84.0)	(45.9)	(32.1)
Other	61.1	13.8	(0.5)
Net cash provided by operating activities of continuing operations	196.1	278.2	228.7
Earnings (loss) from discontinued operations	2.2	(1.0)	0.3
Net gain on sales of discontinued operations	(9.5)	-	-
Net cash provided by operating activities	188.8	277.2	229.0
Cash flows from investing activities:			
Net additions to fixed assets	(22.8)	(29.0)	(25.3)
Cash paid for acquisitions, net of cash acquired	(32.9)	(112.8)	(28.7)
Proceeds from sales of discontinued operations	37.6	-	-
Proceeds from sales of operations	-	-	4.2
Other	3.5	2.8	4.0
	(14.6)	(139.0)	(45.8)

Net cash used by investing activities			
Cash flows from financing activities:			
Proceeds from issuance of common stock	28.1	30.6	23.7
Repurchases of common stock	(2.2)	(56.2)	(80.8)
Dividends paid	(102.3)	(84.9)	(61.9)
Borrowings on line of credit facilities	1.9	12.9	36.3
Repayments on line of credit facilities	(0.1)	-	(56.5)
Borrowings of long- term debt	0.1	-	-
Repayments of long- term debt	(6.5)	(9.6)	(3.0)
Net cash used by financing activities	(81.0)	(107.2)	(142.2)
Net increase in cash and cash equivalents	93.2	31.0	41.0
Cash and cash equivalents at beginning of year	224.6	193.6	152.6
Cash and cash equivalents at end of year	\$ 317.8	\$ 224.6	\$ 193.6
Supplemental disclosures of cash flow information:			
Interest paid	\$ 12.7	\$ 11.5	\$ 9.2
Income taxes paid	47.0	71.3	50.0

See notes to consolidated financial statements.

pension plan, net of taxes								
Unrealized loss on foreign currency hedge, net of taxes	-	-	-	-	-	-	(0.4)	(0.4)
Comprehensive earnings								24.2
Compensation expense related to stock option plan grants	-	-	8.9	-	-	-	-	8.9
Tax benefit from issuance of common stock	-	-	10.6	-	-	-	-	10.6
Common stock issued in:								
Eleven purchase transactions	1.3	1.3	36.1	-	-	-	-	37.4
Stock option plans	1.6	1.6	17.8	-	-	-	-	19.4
Employee stock purchase plan	0.4	0.4	8.3	-	-	-	-	8.7
Deferred compensation	0.2	0.2	4.4	-	(2.3)	-	-	2.3
Restricted stock	0.2	0.2	5.7	-		(1.0)	-	4.9
Common stock repurchases	(0.1)	(0.1)	(2.1)	-	-	-	-	(2.2)
Cash dividends declared on common stock	-	-	-	(106.1)	-	-	-	(106.1)
Balance at December 31, 2005	95.7	\$ 95.7	\$ 236.1	\$ 463.7	\$ (14.5)	\$ (5.3)	\$ (6.6)	\$ 769.1

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

December 31, 2005

1. Summary of Significant Accounting Policies

Nature of Operations - Arthur J. Gallagher & Co. (Gallagher) provides insurance brokerage and risk management services to a wide variety of commercial, industrial, institutional and governmental organizations. Commission revenue is principally generated through the negotiation and placement of insurance for its clients. Fee revenue is primarily generated by providing other risk management services including claims management, information management, risk control services and appraisals in either the property/casualty (P/C) market or human resource/employee benefit market. Investment income and other revenue is generated from Gallagher's investment portfolio, which includes fiduciary funds, tax advantaged investments, real estate partnerships and other investments. Gallagher is headquartered in Itasca, Illinois, has operations in seven countries and does business in 120 countries globally through a network of correspondent brokers and consultants.

Basis of Presentation - The accompanying consolidated financial statements include the accounts of Gallagher and all of its majority owned subsidiaries (50% or greater ownership). Substantially all of Gallagher's investments in partially owned entities in which Gallagher's ownership is less than 50% are accounted for using either the lower of amortized cost/cost or fair value, or the equity method, whichever is appropriate depending on the legal form of Gallagher's ownership interest and the applicable ownership percentage of the entity. See Note 3 for a discussion on a partially owned entity in which Gallagher's ownership percentage was 5% that had been consolidated in 2003 and unconsolidated in 2004 under FIN 46 rules. For partially owned entities accounted for using the equity method, Gallagher's share of the net earnings of these entities is included in consolidated net earnings. All material intercompany accounts and transactions have been eliminated in consolidation. Certain reclassifications have been made to the prior years' financial statements in order to conform to the current year presentation.

Use of Estimates - The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known which could impact the amounts reported and disclosed herein.

Revenue Recognition - Gallagher's revenues are derived from commissions, fees and investment income.

Commission revenues are recognized at the latter of the billing or the effective date of the related insurance policies, net of an allowance for estimated policy cancellations. Commission revenues related to installment premiums are recognized periodically as billed. Contingent commissions and commissions on premiums directly billed by insurance carriers are recognized as revenue when the data necessary to reasonably determine such amounts has been obtained by Gallagher. Typically, these types of commission revenues cannot be reasonably determined until the cash or the related policy detail is received by Gallagher from the insurance carriers. A contingent commission is a commission paid by an insurance carrier that is based on the overall profit and/or volume of the business placed with that insurance carrier. Commissions on premiums billed directly by insurance carriers to the insureds generally relate to a large number of small premium P/C transactions and a substantial portion of the revenues generated by Gallagher's employee benefit operations. Under these direct bill arrangements the billing and policy issuance process is controlled entirely by the insurance carrier. The income effects of subsequent premium adjustments are recorded when the adjustments become known.

Fee revenues generated from the Brokerage Segment primarily relate to fees negotiated in lieu of commissions, which are recognized in the same manner as commission revenues. Fee revenues generated from the Risk Management Segment relate to third party claims administration, loss control and other risk management consulting services, which are provided over a period of time, typically one year. These fee revenues are recognized ratably as the services are rendered. The income effects of subsequent fee adjustments are recorded when the adjustments become known.

Brokerage expense is deducted from gross revenues in the determination of Gallagher's total revenues. Brokerage expense represents commissions paid to sub-brokers related to the placement of certain business by Gallagher's Brokerage Services- Retail Division. This expense is recognized in the same manner as commission revenues.

Premiums and fees receivable in the accompanying consolidated balance sheet are net of allowances for estimated policy cancellations and doubtful accounts. The allowance for estimated policy cancellations was \$4.9 million and \$4.5 million at December 31, 2005 and 2004, respectively, which represents a reserve for future reversals in commission and fee revenues related to the potential cancellation of client insurance policies that were in force as of year-end. The allowance for doubtful accounts was \$6.7 million and \$3.0 million at December 31, 2005 and 2004, respectively. The allowance for estimated policy cancellations is established through a charge to revenues, while the allowance for doubtful accounts is established through a charge to other operating expenses. Both of these allowances are based on estimates and assumptions using historical data to project future experience. Gallagher periodically reviews the adequacy of these allowances and makes adjustments as necessary. The use of different estimates or assumptions could produce different results.

Investment income primarily includes interest income, dividend income, net realized and unrealized gains (losses), income (loss) from equity investments, installment gains, income from consolidated investments and gains on sales of operations. Interest income is recorded as earned. Income (loss) from equity investments represents Gallagher's proportionate share of income or losses from investments accounted for using the equity method.

Claims Handling Obligations - Based on recent legal interpretations and accounting guidance issued by the Institute of Chartered Accountants in the U.K., Gallagher reassessed its obligations to provide future claims handling and certain administrative services for reinsurance brokerage clients. This guidance, which is referred to as FRS 5, was first applicable in 2004 and is specifically directed to insurance brokers engaged in the industry practice of providing clients future claims handling and administrative services. Based on a detailed review of its reinsurance brokerage operations in both the U.S. and U.K. that was completed in fourth quarter 2005, its current accounting practices for these operations and recent legal interpretations, Gallagher determined that under certain circumstances, it is obligated to provide future claims handling and certain administrative services based on its current business practices. Accordingly, a liability of \$15.0 million has been accrued in the accompanying December 31, 2005 consolidated balance sheet based on the estimated costs to provide these future services to former clients. This liability is based on estimates and assumptions using historical data to project future experience. Gallagher periodically reviews the adequacy of this liability and will make adjustments as necessary. The use of different estimates or assumptions could produce different results.

Earnings per Share - Basic net earnings per share is computed by dividing net earnings by the weighted average number of common shares outstanding during the reporting period. Diluted net earnings per share is computed by dividing net earnings by the weighted average number of common and common equivalent shares outstanding during the reporting period. Common equivalent shares include incremental shares from dilutive stock options, which are calculated from the date of grant under the treasury stock method using the average market price for the period.

Cash and Cash Equivalents - Short- term investments, consisting principally of commercial paper and certificates of deposit that have a maturity of 90 days or less at date of purchase, are considered cash equivalents.

Restricted Cash - In its capacity as an insurance broker, Gallagher collects premiums from insureds and, after deducting its commissions and/or fees, remits these premiums to insurance carriers. Unremitted insurance premiums are held in a fiduciary capacity until disbursed by Gallagher and are restricted as to use by laws in certain states and foreign jurisdictions in which Gallagher's subsidiaries operate. Various state and foreign agencies regulate insurance brokers and provide specific requirements that limit the type of investments that may be made with such funds. Accordingly, Gallagher invests these funds in cash, money market accounts, commercial paper and certificates of deposit. Gallagher earns interest income on these unremitted funds, which is reported as interest income from fiduciary funds in the accompanying consolidated statement of earnings. These unremitted amounts are reported as restricted cash in the accompanying consolidated balance sheet, with the related liability reported as premiums payable to insurance carriers. Additionally, several of Gallagher's foreign subsidiaries are required by various foreign agencies to meet certain liquidity and solvency requirements. Gallagher was in compliance with these requirements at December 31, 2005.

Related to its third party administration business, Gallagher is responsible for client claim funds that it holds in a fiduciary capacity. Gallagher does not earn any interest income on these funds held. These client funds have been included in restricted cash, along with a corresponding liability, in the accompanying consolidated balance sheet.

Investments - For investments that do not have quoted market prices, Gallagher utilizes various valuation techniques to estimate fair value and proactively looks for indicators of impairment. Factors, among others, that may indicate that an impairment could exist include defaults on interest and/or principal payments, reductions or changes to dividend payments, sustained operating losses or a trend of poor operating performance, recent refinancings or recapitalizations, unfavorable press reports, untimely filing of financial information, significant customer or revenue loss, litigation, tax audits, losses by other companies in a similar industry, overall economic conditions, management and expert advisor changes and significant changes in strategy. In addition, in cases where the ultimate value of an investment is directly dependent on Gallagher for future financial support, Gallagher assesses its willingness and intent to provide future funding.

If an indicator of impairment exists, Gallagher compares the investment's carrying value to an estimate of its fair value. To estimate the fair value of loans, Gallagher discounts the expected future cash flows from principal and interest payments. This requires Gallagher to exercise significant judgment when estimating both the amount and the timing of the expected cash flows. To estimate the fair value of its equity investments, Gallagher compares values established in recent recapitalizations or appraisals conducted by third parties. In some cases, no such recapitalizations or appraisals exist and Gallagher must perform its own valuations. This also requires Gallagher to exercise significant judgment. Even if impairment indicators exist, no impairment may be required if the estimated fair value is not less than the current carrying value or the decline in value is determined to be temporary and Gallagher has the ability and intent to hold the investment for a period of time sufficient for the value to recover. When Gallagher determines an impairment is other- than- temporary, and therefore that an impairment is required, it is recorded as a realized loss against current period earnings.

Both the process to review for indicators of impairment and, if such indicators exist, the method to compute the amount of impairment incorporate quantitative data and qualitative criteria including the receipt of new information that can dramatically

change the decision about the valuation of an investment in a short period of time. The determination of whether a decline in fair value is other- than- temporary is necessarily a matter of subjective judgment. The timing and amount of realized losses reported in earnings could vary if management's conclusions were different.

Due to the inherent risk of investments, Gallagher cannot give assurance that there will not be impairments in the future should economic and other conditions change.

Fixed Assets - Fixed assets are carried at cost, less accumulated depreciation, in the accompanying consolidated balance sheet. Gallagher periodically reviews long- lived assets for impairment whenever events or changes in business circumstances indicate that the carrying value of the assets may not be recoverable. Under those circumstances, if the fair value were less than the carrying amount of the asset, a loss would be recognized for the difference. Depreciation for fixed assets is computed using the straight- line method over the following estimated useful lives:

	Useful Life
Furniture and equipment	Three to ten years
Buildings and improvements	Three to forty years
Airplanes of a consolidated leasing company	Fifteen years
Syn/Coal equipment	Monthly pro rata basis through December 2007
Leasehold improvements	Lesser of remaining life of the asset or life of lease

Intangible Assets - Intangible assets represent the excess of cost over the value of net tangible assets of acquired businesses. Gallagher classifies its intangible assets as either goodwill, expiration lists or non- compete agreements. Expiration lists and non- compete agreements are amortized using the straight- line method over their estimated useful lives (five to fifteen years for expiration lists and five to six years for non- compete agreements), while goodwill is not subject to amortization. Allocation of intangible assets between goodwill, expiration lists and non- compete agreements and the determination of estimated useful lives are based on valuations Gallagher receives from qualified independent appraisers. The calculations of these amounts are based on estimates and assumptions using historical and pro forma data and recognized valuation methods. The use of different estimates or assumptions could produce different results. Intangible assets are carried at cost, less accumulated amortization in the accompanying consolidated balance sheet.

While goodwill is not amortized, it is subject to periodic reviews for impairment. Gallagher reviews intangible assets for impairment periodically (at least annually) and whenever events or changes in business circumstances indicate that the carrying value of the assets may not be recoverable. Such impairment reviews are performed at the division level with respect to goodwill and at the business unit level for amortizable intangible assets. In reviewing intangible assets, if the fair value were less than the carrying amount of the respective (or underlying) asset, an indicator of impairment would exist and further analysis would be required to determine whether or not a loss would need to be charged against current period earnings. No such indicators were noted in 2005 and 2003. Based on the results of an impairment review in 2004, Gallagher wrote- off \$1.8 million of amortizable assets in second quarter 2004. The determinations of impairment indicators and fair value are based on estimates and assumptions related to the amount and timing of future cash flows and future interest rates. The use of different estimates or assumptions could produce different results.

Income Taxes - Deferred income tax has been provided for the effect of temporary differences between financial reporting and tax bases of assets and liabilities and has been measured using the enacted marginal tax rates and laws that are currently in effect. Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized.

Stock- Based Compensation - In 2003, Gallagher adopted the fair value method of accounting for employee stock options pursuant to Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock- Based Compensation," and SFAS No. 148, "Accounting for Stock- Based Compensation - Transition and Disclosure, An Amendment of SFAS No. 123." Prior to January 1, 2003, Gallagher applied the intrinsic value method as permitted under SFAS 123 and defined in Accounting Principles Board Opinion No. 25 (APB 25), "Accounting for Stock Issued to Employees," which excluded employee options granted at fair market value from compensation expense. Substantially all of the stock options currently outstanding have an exercise price equal to the fair market price at the date of grant and, therefore, under APB 25, virtually no compensation expense was recorded in 2002 and prior years. The change to the fair value method of accounting is being applied prospectively to all stock option awards granted, modified, or settled after January 1, 2003 and to all employee stock purchases made during 2005, 2004 and 2003 through participation in Gallagher's employee stock purchase plan. During 2005, 2004 and 2003, Gallagher recognized \$8.9 million, \$5.6 million and \$1.8 million, respectively, of compensation expense related to its stock option plans and its employee stock purchase plan.

At December 31, 2005, Gallagher had four stock option plans, which are described more fully in Note 11. Gallagher primarily grants stock options for a fixed number of shares to employees, with an exercise price equal to the fair value of the underlying shares at the date of grant. For all options granted prior to January 1, 2003, Gallagher continues to account for stock option grants under the recognition and measurement principles of APB 25 and related Interpretations and, accordingly, recognizes no compensation expense for these stock options granted to employees. The following table illustrates the effect on earnings from continuing operations and earnings from continuing operations per share if Gallagher had consistently applied the fair value recognition provisions of SFAS 123 to stock- based employee compensation (in millions):

Year Ended December 31,				
	2005		2004	2003
Earnings from continuing operations - as reported	\$ 28.6	\$	189.5	\$ 145.9
Add: Stock- based employee compensation expense included in reported net earnings, net of related tax effects	6.9		4.5	1.4
Deduct: Total stock- based employee compensation expense determined under fair value based method for all awards (see Note 11), net of related tax effects	(10.0)		(8.0)	(5.5)
Pro forma net earnings	\$ 25.5	\$	186.0	\$ 141.8
Basic earnings from continuing operations per share - as reported	\$.30	\$	2.07	\$ 1.63
Basic earnings from continuing operations per share - pro forma	.27		2.03	1.58
Diluted earnings from continuing operations per share - as reported	.30		2.00	1.57
Diluted earnings from continuing operations per share - pro forma	.27		1.97	1.54

As presented in the table above, had Gallagher applied the fair value recognition provisions of SFAS 123 to the 2002 and prior stock options grants, diluted net earnings per share as reported would have been reduced by \$.03 in 2005, 2004 and 2003. The pro forma disclosures above only include the effect of options granted in the period from January 1, 1995 to December 31, 2005. Accordingly, the effects of applying the SFAS 123 pro forma disclosures to future periods may not be indicative of future results.

Fair Value of Financial Instruments - The carrying amounts of financial assets and liabilities reported in the accompanying consolidated balance sheet for cash and cash equivalents, restricted cash, premiums and fees receivable, premiums payable to insurance carriers, accrued salaries and bonuses, accounts payable and other accrued liabilities, unearned fees and income taxes payable, at December 31, 2005 and 2004, approximate fair value because of the short maturity of these instruments. Fair values for other investments and notes receivable are disclosed in Note 3. The carrying amounts of borrowings outstanding under Gallagher's \$450.0 million unsecured multicurrency credit agreement (Credit Agreement) and other debt agreements listed in Note 8 approximate their fair values at December 31, 2005 because the borrowings are at floating interest rates or the rates are not significantly different from the prevailing market rates.

2. Effect of New Accounting Pronouncements

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No.123 (revised 2004) (SFAS 123(R)), "Share- Based Payment," which is a revision of SFAS 123, "Accounting for Stock- Based Compensation." SFAS 123(R) supersedes Accounting Principles Board Opinion No. 25 (APB 25), "Accounting for Stock Issued to Employees," and amends SFAS 95, "Statement of Cash Flows." Generally, the approach to accounting for share- based payments in SFAS 123(R) is similar to the approach described in SFAS 123, which, as discussed in Notes 1 and 11, Gallagher adopted on a prospective basis in 2003. However, SFAS 123(R) requires all share- based payments to employees, including grants of employee stock options (for all grant years), to be recognized in the financial statements over the vesting period based on their grant date fair values. Pro forma disclosure is no longer an alternative to financial statement recognition for years prior to January 1, 2003. SFAS 123(R) is effective for public companies at the beginning of the next fiscal year beginning after June 15, 2005. Thus, Gallagher must adopt SFAS 123(R) no later than January 1, 2006.

SFAS 123(R) permits public companies to account for share- based payments using one of two methods: modified- prospective method or modified- retrospective method. The modified- prospective method is similar to the modified- prospective method described in SFAS 148, "Accounting for

Stock- Based Compensation - Transition and Disclosure, An Amendment of SFAS 123." Under this method, compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS 123(R) for all share- based payments granted after the effective date and (b) based on the requirements of SFAS 123 for all awards granted to employees prior to the effective date of SFAS 123(R) that remain unvested on the effective date.

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Under the modified- retrospective method, which includes the requirements of the modified prospective method described above, companies are permitted to restate, based on the amounts previously recognized under SFAS 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

Gallagher plans to adopt SFAS 123(R) effective on January 1, 2006, but has not yet determined what method it will use to account for share- based payments made to employees. In 2005, 2004 and 2003, Gallagher used the fair- value- based method to account for all employee stock options granted subsequent to January 1, 2003. In addition, Gallagher used the Black- Scholes formula to estimate the value of stock options granted to employees and expects to continue to use this acceptable option valuation model upon the required adoption of SFAS 123(R). Because SFAS 123(R) must be applied not only to new awards but to previously granted awards that are not fully vested on the effective date, and because Gallagher adopted SFAS 123 using the prospective method, which applied only to awards granted, modified or settled after the adoption date, compensation cost for some previously granted awards that were not recognized under SFAS 123 will be recognized under SFAS 123(R). Thus, Gallagher will have to apply the provisions of SFAS 123(R) to all unvested awards granted prior to the adoption of SFAS 123 (prior to January 1, 2003) for recognition of share- based payments to employees. However, had Gallagher adopted SFAS 123(R) in prior periods, the impact of that standard would have approximated the impact of SFAS 123 as described in the disclosure of pro forma net earnings and earnings per share in Note 1. In 2006, Gallagher expects to incur \$5.4 million of additional stock based compensation expense due to the adoption of SFAS 123(R) related to the vesting in 2006 of options granted prior to January 1, 2003.

SFAS 123(R) requires that compensation cost be recognized for unvested awards over the period through the date that the employee is no longer required to provide future services to earn the award, rather than over the explicit service period. Accordingly, Gallagher will adjust its existing policy for recognizing compensation cost to coincide with the date that the employee is eligible to retire, rather than the actual retirement date, for all options granted subsequent to January 1, 2006.

SFAS 123(R) also requires the benefits of tax deductions in excess of compensation amounts recognized for book purposes, to be reported as a financing cash flow rather than as an operating cash flow as required under current rules. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. Gallagher cannot estimate what those amounts will be in the future because they depend on, among other things, when employees exercise stock options. The amount of operating cash flows recognized in prior periods for such excess tax deductions was \$10.6 million, \$17.6 million and \$14.1 million in 2005, 2004 and 2003, respectively.

3. Investments

The following is a summary of Gallagher's other investments and the related outstanding letters of credit (LOCs), financial guarantees and funding commitments (in millions):

Unconsolidated Investments:	December 31, 2005		December 31, 2004		December 31, 2005	
	Current	Noncurrent	Current	Noncurrent	LOCs & Financial Guarantees	Funding Commitments
Direct and indirect investments in Asset Alliance Corporation (AAC)	\$ 13.3	\$ 30.2	\$ 0.8	\$ 46.7	\$ -	\$ -
Low income housing (LIH) developments:						
Bridge loans	5.4	-	5.2	-	-	-
Partnership interests	-	1.1	-	1.5	-	-
LIH Developer	-	8.9	-	9.2	-	-
Alternative energy investments:						
Owned partnership interests	0.6	14.8	0.9	19.1	4.4	0.7
Biogas project	-	-	-	14.7	-	-
Partnership interest	21.3	6.5	18.6	12.9	-	-

installment sales						
Bermuda insurance investments	-	0.4	-	20.4	6.7	-
Real estate, venture capital and other investments	2.6	6.7	0.5	7.9	-	0.6
Total unconsolidated investments	43.2	68.6	26.0	132.4	11.1	1.3
Non- recourse borrowings - Biogas project	-	-	(0.2)	(13.8)	-	-
Net unconsolidated investments	\$ 43.2	\$ 68.6	\$ 25.8	\$ 118.6	\$ 11.1	\$ 1.3

Asset Alliance Corporation - Through various debt, preferred stock and common stock investments, Gallagher effectively owns 25% of AAC, an investment management company that owns up to a two-thirds interest in ten private investment management firms (the Firms). AAC and the Firms collectively manage domestic and international investment hedge fund portfolios for various institutions and individuals, which totaled approximately \$3.4 billion at December 31, 2005. AAC has a proportional interest in the Firms' revenues or net earnings that result principally from fees and participation in investment returns from the managed investment portfolios. Gallagher accounts for its holdings in AAC's common stock using equity method accounting.

In 2002, Beacon Hill Asset Management LLC (Beacon Hill) withdrew from managing hedge fund portfolios for AAC due to various legal, contractual and business issues. In 2003, investors in a Beacon Hill investment partnership filed a lawsuit to recover investment losses naming AAC as a co-defendant. AAC's motion to dismiss the lawsuit against AAC and other unrelated parties stemming from AAC's 50% ownership of Beacon Hill was granted in part and denied in part. Gallagher is unable to estimate the impact, if any, this lawsuit may have on AAC and the resulting impact, if any, on Gallagher's carrying value of its AAC investment.

Low Income Housing (LIH) Developments - Gallagher's investments in LIH consist of three components:

Bridge Loans represent early-stage loans on properties that are mainly being developed to qualify for LIH tax credits. The loans are collateralized by the land and buildings under development and carry interest rates ranging from 4.00% to the prime rate, which was 7.25% at December 31, 2005. The loans are generally outstanding for twelve to thirty-six months and accrue interest until the projects are refinanced by a purchaser or syndicator. No loan has ever defaulted since Gallagher began making these types of loans in 1996.

Partnership Interests represent Gallagher's ownership in completed and certified LIH developments. At December 31, 2005, Gallagher owned limited partnership interests in 26 LIH developments. These are generating tax benefits to Gallagher on an ongoing basis in the form of both tax deductions for operating losses and tax credits. These investments are generally accounted for using the effective yield method and are carried at amortized cost. Under the effective yield method, Gallagher recognizes the tax credits as they are allocated by the partnerships, which are included, net of amortization of the investment, as a component of the provision for income taxes. Gallagher has never incurred a loss on a LIH project.

Eleven of the LIH developments have been determined to be variable interest entities (VIE), as defined by FASB Interpretation No. 46 (FIN 46), "Consolidation of Variable Interest Entities," but are not required to be consolidated. Gallagher invested in these developments between 1990 and 2000 as a limited partner. At December 31, 2005, total assets and total debt of these developments were approximately \$67.0 million and \$52.0 million, respectively. Gallagher's maximum exposure to a potential loss from these VIEs was \$1.1 million at December 31, 2005, which equaled the net aggregate carrying value of its investments.

LIH Developer represents Gallagher's 27% ownership interest in the company that is the developer and/or syndicator of most of Gallagher's LIH development investments. The LIH Developer has been determined to be a VIE but is not required to be consolidated. Gallagher's original investment in the LIH Developer was made in 1996. The LIH Developer generates revenues from syndication and development fees and 83% of its equity is in cash, cash producing real estate project receivables and bridge loans. Gallagher accounts for this investment using equity method accounting. At December 31, 2005, the LIH Developer had total assets of approximately \$24.0 million and no debt. Gallagher's maximum exposure to a potential loss from this VIE was \$8.9 million at December 31, 2005, which equaled the net carrying value of its investment.

Alternative Energy Investments - Gallagher has made investments in partnerships formed to develop energy that qualifies for tax credits under Internal Revenue Code (IRC) Section 29. There are two types of such investments:

Owned Partnership Interests consist of (i) waste-to-energy (Biomass) partnerships which own the rights to gas emissions (Biogas) from landfills and the wells and infrastructure necessary to capture the Biogas and (ii) synthetic coal (Syn/Coal) partnerships which own and lease equipment that processes qualified fuel under IRC Section 29. Gallagher has an interest in six Biomass limited partnerships and five Syn/Coal limited partnerships or limited liability companies that generate tax benefits to Gallagher on an ongoing basis in the form of both tax deductions for operating losses and tax credits. At December 31, 2005, two of the Syn/Coal limited partnerships are consolidated into Gallagher's financial statements due to ownership percentage. The remainder of these investments are carried at amortized cost. Gallagher recognizes the tax credits as they are allocated by the partnerships, which are included as a component of the provision for income taxes.

During fourth quarter 2005, Gallagher sold a portion of its equity ownership interest in the "parent" company that operates two of the Biomass limited partnerships. As part of that same transaction, Gallagher converted \$6.0 million of debt into equity of the "parent."

In addition to the owned partnership interests discussed above, Gallagher had an LOC and a funding commitment outstanding at December 31, 2005 totaling \$5.0 million related to the reclamation of a Syn/Coal property and the multi-pollutant reduction venture discussed below.

Gallagher is an investor in a privately- owned, multi- pollutant reduction venture, Chem- Mod LLC (Chem- Mod) which possesses rights, information and technology for the reduction of unwanted emissions created during the combustion of coal. As reported by Chem- Mod in a press release dated February 8, 2006, Chem- Mod has developed and is the exclusive licensee of a new proprietary emissions technology it refers to as The Chem- Mod Solution, which uses a dual injection sorbent system to reduce mercury, sulfur dioxide and other toxic emissions at coal- fired power plants. Substantial testing of The Chem- Mod Solution has been completed both in a laboratory environment and at three full- scale commercial power plants, all yielding positive test results. Although Chem- Mod is in the early stages of commercializing the technology, the principal potential market for The Chem- Mod Solution is coal- fired power plants owned by utility companies. Chem- Mod has indicated publicly that it believes The Chem- Mod Solution is a more cost- effective technology for reducing emissions in a manner consistent with the EPA's Clean Air Mercury Rules than other technologies currently in the marketplace. Gallagher, through two wholly- owned subsidiaries, currently owns a 10% equity interest in Chem- Mod, an option to acquire an additional 32% indirect equity interest in Chem- Mod and owns a 20% equity interest in Chem- Mod International LLC, an entity formed to commercialize The Chem- Mod Solution outside the U.S. and Canada (the Chem- Mod Interests). Gallagher first began providing funding to Chem- Mod in June 2004. Currently, Gallagher's carrying value with respect to its Chem- Mod Interests is approximately \$0.6 million. Gallagher also has additional funding commitments of approximately \$0.7 million. Gallagher's option to acquire the additional 32% indirect equity interest in Chem- Mod is exercisable at any time on or prior to December 31, 2007 at an exercise price of \$11.0 million. Chem- Mod and its equityholders have retained an investment banking firm to help evaluate a variety of strategies to maximize value for Chem- Mod's equityholders, including a potential sale. However, there are a number of variables surrounding such strategies, particularly in light of the early stage of Chem- Mod's commercialization efforts. While Gallagher currently believes that its Chem- Mod Interests may prove to have substantial value, there can be no assurance given as to timing or amount, if any, with respect to any realization on this investment.

Biogas Projects During 2003, Gallagher exited from the majority of its investment positions in various venture capital, developmental- stage enterprises and turn- arounds and recorded impairments related to these investments. Since then, Gallagher has pursued recoveries where appropriate. As part of these recovery efforts, during first and second quarters 2004, one of Gallagher's partially owned Biogas projects (Biogas Project), which was being managed by a turn- around enterprise, was a party in a series of transactions to establish a publicly traded Canadian income trust, which partially funded the Biogas Project. In connection therewith, Gallagher (i) recognized a \$2.0 million non- cash gain in first quarter 2004 due to the reversal of a non- cash loss contingency reserve established in 2003, (ii) received \$5.0 million in cash in second quarter 2004 in full repayment of a note receivable from the turn- around enterprise, (iii) recognized a \$1.0 million gain in second quarter 2004 when it received cash as payment for accrued interest income related to the note discussed in (ii) above that was impaired in 2003, and (iv) recognized \$0.4 million of interest income in second quarter 2004 when it received cash for the remaining interest due on the note discussed in (ii) above. To finalize the above transactions, during second quarter 2004, Gallagher made an equity investment of \$14.0 million in the Biogas Project to fund its operations and make capital improvements to increase Biogas production, which was funded by a \$14.0 million non- recourse loan to Gallagher from the turn- around enterprise. Principal and interest payments were only required if, and when, cash distributions were made from the Biogas Project. There was a tri- party right to offset the distributions from the Biogas Project against the obligations under the loan between the Biogas Project, Gallagher and the turn- around enterprise, which made the loan non- recourse to Gallagher. GAAP thereby required the investment and related debt be presented gross in Gallagher's consolidated balance sheet. The \$14.0 million investment was accounted for using equity method accounting.

During second quarter 2005, Gallagher sold its partnership interest in the Biogas Project discussed above. As a result of this transaction, Gallagher recorded a loss of \$0.5 million in first quarter 2005 and recorded a gain on the sale of \$1.3 million in second quarter 2005. As a result of the sale, Gallagher's investment in the Biogas Project as well as the related debt obligation to the turn- around enterprise have been removed from Gallagher's December 31, 2005 consolidated balance sheet.

Four of the six Biomass projects have been determined to be VIEs but are not required to be consolidated. Gallagher is a limited partner in each investment. The investments were entered into by Gallagher between 1991 and 1998. At December 31, 2005, total assets and total debt of these investments were approximately \$5.0 million and \$3.0 million, respectively. Gallagher's maximum exposure to a potential loss from these VIEs was zero at December 31, 2005, which equaled the net aggregate carrying value of its investments.

Effective July 1, 2003, Gallagher adopted FIN 46, which required Gallagher to consolidate one 5% owned Syn/Coal entity due to Gallagher's economic interest in the entity. The other 95% had been previously sold on the installment sale basis and had substantial residual value to Gallagher. Under FIN 46 criteria, this investment had been determined to be a VIE and required Gallagher to consolidate this facility into its consolidated financial statements. FIN 46 requires Gallagher to reevaluate each investment at any "triggering event." On August 6, 2004, Gallagher sold an additional 4% of its remaining 5% ownership to the party that previously owned 95% of the entity, resulting in Gallagher owning a 1% interest in this entity. After considering this sale transaction, it was determined that Gallagher is no longer the primary beneficiary of this VIE and therefore does not have to consolidate this partially owned entity. The net impact of this investment on Gallagher's net earnings and stockholders' equity is the same whether it is accounted for on the consolidated basis or using equity method accounting.

The following is a summary of the amounts included in the consolidated statement of earnings for the consolidation of this partially owned entity (in millions):

Year Ended December 31,				
	2005		2004	
	2003			
Investment income - all other	\$	-	\$	69.9
Investment expenses		-		67.2
Depreciation		-		2.7
Total expenses		-		69.9
Earnings before income taxes	\$	-	\$	-

Partnership Interest Installment Sales represent the remaining book value and receivables from the Biomass and Syn/Coal operations that have been either partially or completely sold to third parties. Gallagher accounts for these investments on the installment sale basis, which requires that the net gains, including the amortization of the bases of the assets sold, be recognized over time as a component of investment income.

Biomass - As part of selling its interests in Biomass partnerships, Gallagher provided indemnifications to the buyers for taxes that may arise as a result of incorrect representations. Gallagher obtained legal, tax, and other expert services and advice when making these representations. At December 31, 2005, the maximum potential amount of future payments that Gallagher could be required to make under these indemnifications totaled approximately \$14.6 million, net of the applicable income tax benefit. Gallagher did not record any liability in its December 31, 2005 consolidated balance sheet for these potential indemnifications.

Syn/Coal - As part of selling its interests in Syn/Coal partnerships, Gallagher provided indemnifications to the buyers for taxes that may arise as a result of incorrect representations. Gallagher obtained legal, tax, and other expert services and advice when making these representations, and subsequently obtained private letter rulings (PLRs) from the Internal Revenue Service (IRS). Gallagher has not recorded any liability in its December 31, 2005 consolidated balance sheet for these potential indemnifications.

On October 29, 2003, the IRS issued Announcement 2003- 70 stating that it had completed a review of chemical change issues associated with tax credits claimed under IRC Section 29 relating to the production and sale of synthetic coal (Syn/Coal Credits). It further stated that it would resume the issuance of PLRs concerning Syn/Coal Credits consistent with the guidelines regarding chemical change previously set forth in Revenue Procedures 2001- 30 and 2001- 34 and certain additional requirements related to sampling, testing and recordkeeping procedures, even though the IRS does not believe the level of chemical change required under that guidance is sufficient for IRC Section 29 purposes. The IRS also stated in the announcement that it would continue to issue PLRs because it recognized that many taxpayers and their investors have relied on the IRS's long standing PLR practice to make investments. Previously, in Announcement 2003- 46 issued on June 27, 2003, the IRS had questioned the validity of certain test procedures and results that had been presented to it by taxpayers with interests in synthetic fuel operations as evidence that the required significant chemical change had occurred, and had initiated a review of these test procedures and results which was completed as noted in Announcement 2003- 70.

Separately, the Permanent Subcommittee on Investigations of the Government Affairs Committee of the U.S. Senate (Subcommittee) is conducting an ongoing investigation of potential abuses of tax credits by producers of synthetic fuel under IRC Section 29. The Subcommittee Chairman, in a memorandum updated in March 2005, has stated that the investigation is examining the utilization of Syn/Coal Credits, the nature of the technologies and the fuels created, the use of these fuels, and other aspects of IRC Section 29. The memorandum also states that the investigation will address the IRS's administration of Syn/Coal Credits.

The effect of these two developments on the synthetic coal industry is not clear. Gallagher is aware that a number of PLRs have been issued since October 29, 2003, and management has participated in an interview with Subcommittee staff. Gallagher continues to believe it is claiming Syn/Coal Credits in accordance with IRC Section 29 and four PLRs previously obtained by Syn/Coal partnerships in which it has an interest. Gallagher understands these PLRs are consistent with those issued to other taxpayers and has received no indication from the IRS that it will seek to revoke or modify them. In that regard, one of the Syn/Coal partnerships in which Gallagher has an interest was under examination by the IRS for the tax year 2000 and in March 2004, Gallagher was notified that the examination was closed without any changes being proposed.

Notwithstanding the foregoing, the IRS is continuing to audit taxpayers claiming Syn/Coal Credits with respect to a variety of issues. The partnerships in which Gallagher has an interest may be audited in the future, and any such audit could adversely affect Gallagher's ability to claim Syn/Coal Credits or cause it to be subject to liability under indemnification obligations related to the prior sale of interests in partnerships claiming Syn/Coal Credits. Furthermore, Syn/Coal Credits have been controversial both politically and administratively, and no assurance can be given that the IRS will not in the future discontinue issuing PLRs, issue administrative guidance adverse to Gallagher's interests, or support the enactment of legislation to curtail or repeal IRC

Section 29. A bill to repeal IRC Section 29 was introduced in the U.S. House of Representatives in 2005 that was not enacted, but a similar bill could be reintroduced in a future session and any such action could potentially result in the curtailment or repeal of Syn/Coal Credits prior to the end of 2007, when the Syn/Coal Credits expire under current law. Similarly, future administrative or judicial decisions could adversely affect Gallagher's ability to claim Syn/Coal Credits or cause it to be subject to liability under indemnification obligations related to prior sales of partnership interests.

Gallagher has insurance policies in place, the scope of which Gallagher believes would provide substantial coverage in the event the Syn/Coal Credits are disallowed. While there can be no assurance that such coverage would ultimately be available, if the full amount of the policies were collected, Gallagher's maximum after tax exposure at December 31, 2005 relating to the disallowance of the Syn/Coal Credits is as follows (in millions):

	Maximum	Net of Insurance
Gross tax credits recorded by Gallagher	\$ 209.7	\$ 115.7
Installment sale proceeds subject to indemnification	247.3	58.0
Net carrying value of assets held at December 31, 2005	6.9	6.9
Total exposure	\$ 463.9	\$ 180.6

IRC Section 29 tax credits expire on December 31, 2007 if the law is not extended. In addition, through December 31, 2007, IRC Section 29 has a phase- out provision that is triggered when the "Market Wellhead Price" of domestic crude oil reaches certain "Phase- out Prices," as determined by the IRS. Management estimates that the Market Wellhead Price in 2006 would need to average approximately \$53.75 to start a phase- out and average approximately \$67.50 for a complete phase- out. The commonly reported crude oil price of futures contracts traded on the New York Mercantile Exchange (NYMEX Price) for 2006 averaged \$65.41 through January 30. The NYMEX Price averaged \$6.11 above the Market Wellhead Price for the ten- month period ended October 31, 2005. There can be no assurance that future oil prices will average under future phase- out levels. Should Gallagher or its partners anticipate that oil prices may reach the range of Phase- out Prices in 2006, some or all of Gallagher's IRC Section 29 operations may be curtailed. If Gallagher believes the 2006 price of oil will average above the phase- out price and decides to idle its Syn/Coal facilities, Gallagher estimates the Financial Services Segment could report a maximum one- time non- cash pretax charge of approximately \$18.0 million related to an impairment charge on these facilities and other related assets.

Litigation related matters in 2005 represent a pretax charge of \$131.0 million (\$84.2 million after tax) recorded by Gallagher in first quarter 2005. On February 11, 2005, a jury in the Fourth District Court for the State of Utah awarded damages against Gallagher's subsidiary, AJG Financial Services, Inc. (AJGFS), and in favor of Headwaters in the amount of \$175.0 million. AJGFS and Headwaters entered into a definitive agreement effective as of May 1, 2005 to settle this and all other litigation between the companies for \$50.0 million, which was paid to Headwaters in May 2005. Additionally, AJGFS and Headwaters have modified their existing licensing agreement allowing AJGFS to utilize Headwaters' technology on two of AJGFS' synthetic fuel facilities in exchange for (i) \$70.0 million, which was paid to Headwaters on January 4, 2006 and (ii) an annual royalty to Headwaters in 2005, 2006 and 2007. The first quarter 2005 litigation charge provides for amounts related to this settlement, including the \$120.0 million of settlement costs, together with litigation, bonding and other costs of approximately \$11.0 million. In connection with the Headwaters licensing agreement, Gallagher recorded \$14.6 million of royalty expense in 2005, based on the Syn/Coal production volume, which was included in investment expenses. At full production, the maximum annual royalty in 2006 and 2007 would be equal to \$20.0 million of AJGFS' estimated annual pre- royalty, pretax earnings of \$40.0 million from these two facilities.

Bermuda Insurance Investments - Prior to July 19, 2005, Gallagher had an equity investment (less than 2% ownership) in Allied World Assurance Holdings, Ltd (AWAH), which is a Bermuda based insurance and reinsurance company founded in 2001 by American International Group, Inc., The Chubb Corporation and affiliates of Goldman, Sachs & Co. This investment was carried at cost. On March 31, 2005, AWAH announced a distribution payable to shareholders of record as of April 1, 2005. Gallagher received \$5.8 million in second quarter 2005, of which \$2.1 million was deemed a dividend and \$3.7 million was deemed a return of capital. Gallagher's percent ownership in AWAH did not change as a result of the return of capital. Accordingly, Gallagher's carrying value of this investment was reduced to \$16.3 million. On July 19, 2005, Gallagher sold its remaining interest in this investment for cash. No gain or loss resulted from this sale.

The investment balance as of December 31, 2005 of \$0.4 million represented Gallagher's equity investment in a segregated account rent- a- captive facility, formed in 1997, that Gallagher uses as a placement facility for certain of its insurance brokerage operations. Gallagher has posted \$6.7 million of LOCs to allow the rent- a- captive to meet minimum statutory surplus requirements and for additional collateral related to premium and claim funds held in a fiduciary capacity. These LOCs have never been drawn upon.

Real Estate, Venture Capital and Other Investments - At December 31, 2005, Gallagher had investments in three real estate ventures with a net carrying value of \$1.1 million in the aggregate, the largest of which was \$0.9 million. Gallagher also had investments in five venture capital investments and funds that consisted of various debt and equity investments in development- stage companies and turn- arounds with an aggregate net carrying value of \$8.2 million, the largest of which was \$5.0 million. Three of the eight investments discussed above have been determined to be VIEs but are not required to be consolidated. These were originally invested in between 1997 and 2001. At December 31, 2005, total assets and total debt of these three investments were approximately \$10.0 million and \$26.0 million, respectively. Gallagher's maximum exposure to a potential loss related to these investments was \$0.3 million at December 31, 2005, which equaled the net aggregate carrying value of these investments.

Consolidated Investments - Gallagher has an ownership interest in excess of 50% in four investment enterprises, which are consolidated into Gallagher's consolidated financial statements: a real estate partnership, an airplane leasing limited liability company and two Syn/Coal facilities.

The real estate partnership represents a 60% investment in a limited partnership that owns the building that Gallagher leases for its home office and several of its subsidiary operations. Gallagher also owns 90% of an airplane leasing company that leases two cargo airplanes to the French Postal Service. On May 19, 2004, Gallagher purchased a 98% equity interest in a Syn/Coal production facility that had previously been operated by Gallagher through a facility rental agreement. The purchase price was made with an \$11.1 million seller financed note payable that is non- recourse to Gallagher. Principal and interest payments are only required when the facility is operating and generating Syn/Coal Credits. The other Syn/Coal investment represents Gallagher's 99% equity interest in a Syn/Coal facility. Both of these investments are held by Gallagher to generate Syn/Coal Credits.

In fourth quarter 2005, Gallagher began to explore opportunities to sell its home office land and building. If a sale occurs, Gallagher expects to sell the building for an amount approximately equal to its net book value. However, under GAAP, if Gallagher incurs a loss on the sale, the loss will be reflected in the consolidated statement of earnings, while any gain would be deferred and amortized as a reduction of future rent expense over the remaining term of the lease.

Prior to second quarter 2005, Gallagher had an 80% investment in a limited partnership that is developing an 11,000- acre community near Orlando, Florida (Florida Community Development). In second quarter 2005, Gallagher sold its ownership interests in the limited partnership that owns the Florida Community Development investment. Pursuant to the transaction, Gallagher received cash of \$25.7 million and recorded a pretax gain on the sale of \$12.6 million in second quarter 2005. Terms of the transaction require Gallagher to continue to post a \$12.6 million letter of credit to guarantee \$12.4 million of bonds issued by the Florida Community Development. Gallagher is fully indemnified by an affiliate of the purchaser and in consideration for posting the LOC will receive cash compensation sufficient to cover its costs plus 1% of certain future cash flow residuals from the Florida Community Development. In Gallagher's previously reported financial information, the Florida Community Development's operating results were included in the Financial Services Segment, which have been reclassified to discontinued operations in the accompanying consolidated statement of earnings for all periods presented. See Note 5 for a discussion on discontinued operations.

On December 21, 2005, the lease agreement for the two airplanes leased to the French Postal Service, which was originally going to expire in 2006, was extended for an additional five years to 2011. The extended agreement is cash flow neutral to Gallagher. In addition, on December 21, 2005, the loan agreement related to the two airplanes, which was originally going to expire in 2006, was extended for an additional five years to 2011. At December 31, 2003, Gallagher owned 5% of a Syn/Coal facility. Under the FIN 46 rules, this investment had been determined to be a VIE and required Gallagher to consolidate this facility into its consolidated financial statements. During third quarter 2004, Gallagher sold a 4% ownership interest in this investment, which eliminated the requirement to consolidate this investment under the FIN 46 rules. This investment is now accounted for using equity method accounting.

The following is a summary of these consolidated investments and the related outstanding LOCs, financial guarantees and funding commitments (in millions):

		December 31, 2005			
	December 31, 2005	December 31, 2004	LOCs & Financial Guarantees	Funding Commitments	
Home office land and building:					
Fixed assets	\$ 101.9	\$ 101.3	\$ -	\$ -	
Accumulated depreciation	(18.3)	(15.8)	-	-	
Non- recourse borrowings - current	(0.9)	(0.9)	-	-	
Recourse borrowings - current	-	-	-	-	
Non- recourse borrowings - noncurrent	(72.2)	(73.1)	-	-	
Recourse borrowings - noncurrent	(3.0)	(3.0)	-	-	
Net other consolidated assets and liabilities	4.0	2.8	3.0	-	
Net investment	11.5	11.3	3.0	-	
Florida Community Development:					
Fixed assets	-	60.3	-	-	
Accumulated depreciation	-	(0.7)	-	-	
Non- recourse borrowings - current	-	(17.9)	-	-	
Recourse borrowings - current	-	(17.0)	-	-	
Non- recourse borrowings - noncurrent	-	(0.1)	-	-	
Recourse borrowings - noncurrent	-	(12.4)	-	-	
Net other consolidated assets and liabilities	-	(2.4)	12.6	-	
Net investment	-	9.8	12.6	-	
Airplane leasing company:					
Fixed assets	51.8	51.8	-	-	
Accumulated depreciation	(17.7)	(14.1)	-	-	
Non- recourse borrowings - current	(1.9)	(2.6)	-	-	
Recourse borrowings - current	-	-	-	-	
Non- recourse borrowings - noncurrent	(28.0)	(29.9)	-	-	
Recourse borrowings - noncurrent	-	-	-	-	
Net other consolidated assets and liabilities	(0.4)	-	-	-	

Net investment	3.8	5.2	-	-
Syn/Coal partnerships:				
Fixed assets	15.6	15.6	-	-
Accumulated depreciation	(7.3)	(2.8)	-	-
Non- recourse borrowings - current	(2.5)	(2.8)	-	-
Recourse borrowings - current	-	-	-	-
Non- recourse borrowings - noncurrent	(4.4)	(7.7)	-	-
Recourse borrowings - noncurrent	-	-	-	-
Net other consolidated assets and liabilities	(1.3)	1.6	-	-
Net investment	0.1	3.9	-	-
Total consolidated investments:				
Fixed assets	169.3	229.0	-	-
Accumulated depreciation	(43.3)	(33.4)	-	-
Non- recourse borrowings - current	(5.3)	(24.2)	-	-
Recourse borrowings - current	-	(17.0)	-	-
Non- recourse borrowings - noncurrent	(104.6)	(110.8)	-	-
Recourse borrowings - noncurrent	(3.0)	(15.4)	-	-
Net other consolidated assets and liabilities	2.3	2.0	15.6	-
Net investment	\$ 15.4	\$ 30.2	\$ 15.6	\$ -

As presented in the above table, three of the four consolidated investments had borrowings related to their assets as of December 31, 2005. See Note 17 for a summary of future cash payments, excluding interest, related to the borrowings of Gallagher's consolidated investments.

At December 31, 2005, Gallagher's maximum exposure to a potential loss related to these investments is as follows (in millions):

Net carrying value	\$	15.4
Recourse portion of debt		3.0
LOCs, financial guarantees and funding commitments		12.6
<hr/>		
Maximum exposure	\$	31.0

Impairment Reviews - Gallagher has a management investment committee that meets ten to twelve times per year to review its investments. For investments that do not have quoted market prices, Gallagher utilizes various valuation techniques to estimate fair value and proactively looks for indicators of impairment. Factors, among others, that may indicate that an impairment could exist include defaults on interest and/or principal payments, reductions or changes to dividend payments, sustained operating losses or a trend of poor operating performance, recent refinancings or recapitalizations, unfavorable press reports, untimely filing of financial information, significant customer or revenue loss, litigation, tax audits, losses by other companies in a similar industry, overall economic conditions, management and expert advisor changes, and significant changes in strategy. In addition, in cases where the ultimate value of an investment is directly dependent on Gallagher for future financial support, Gallagher assesses its willingness and intent to provide future funding.

If an indicator of impairment exists, Gallagher compares the investment's carrying value to an estimate of its fair value. To estimate the fair value of loans, Gallagher discounts the expected future cash flows from principal and interest payments. This requires Gallagher to exercise significant judgment when estimating both the amount and the timing of the expected cash flows. To estimate the fair value of its equity investments, Gallagher compares values established in recent recapitalizations or appraisals conducted by third parties. In some cases, no such recapitalizations or appraisals exist and Gallagher must perform its own valuations. This also requires Gallagher to exercise significant judgment. Even if impairment indicators exist, no impairment may be required if the estimated fair value is not less than the current carrying value or the decline in value is determined to be temporary and Gallagher has the ability and intent to hold the investment for a period of time sufficient for the value to recover. When Gallagher determines an impairment is other- than- temporary, and therefore that an impairment is required, it is recorded as a realized loss against current period earnings.

Both the process to review for indicators of impairment and, if such indicators exist, the method to compute the amount of impairment incorporate quantitative data and qualitative criteria including the receipt of new information that can dramatically change the decision about the valuation of an investment in a short period of time. The determination of whether a decline in fair value is other- than- temporary is necessarily a matter of subjective judgment. The timing and amount of realized losses reported in earnings could vary if management's conclusions were different.

Due to the inherent risk of investments, Gallagher cannot give assurance that there will not be investment impairments in the future should economic and other conditions change.

Year Ended December 31,

	2005	2004	2003
Interest - fiduciary	\$ 20.8	\$ 15.1	\$ 8.3
Trading securities:			
Interest	-	0.4	3.3
Dividends	-	0.1	1.7
Net change in unrealized gain (loss)	-	(0.5)	0.6
Net realized gain	-	0.3	1.4
Other net realized gains	-	0.5	-
AAC related investments:			
Interest	0.8	0.9	1.1
Dividends	0.6	0.6	1.1
Income (loss) from equity ownership	(1.0)	2.1	2.9
Loss from AAC's sales and impairment of investments in fund managers	(3.1)	-	-
Gain on sale of portion of minority interest	-	0.3	-
LIH developments:			
Interest	0.1	0.3	0.9
Income from equity ownership	0.1	2.0	0.1
Other realized gains	-	0.1	2.1
Alternative energy investments:			
Interest	0.4	1.3	1.4
Installment gains	57.4	44.1	39.0
Other income (loss)	(1.5)	-	0.9
Other realized losses	(1.6)	-	-
Real estate, venture capital and other investments:			
Gain (loss) from equity ownership	1.7	0.7	(0.5)
Other income	2.1	-	-
Realized gains (losses) on dispositions, recoveries and impairments	3.1	(1.3)	(29.1)
Other realized gains	-	8.5	-
Income from consolidated investments	53.3	42.0	10.6
Impact of FIN 46 from consolidated investments	-	69.9	46.4
Gain on sale of operation	-	-	2.5
Other income	0.1	(1.0)	2.2
Total investment income	\$ 133.3	\$ 186.4	\$ 96.9

Interest - fiduciary primarily represents interest income earned on Gallagher's cash and cash equivalents.

Amounts included in investment income from trading securities represent interest and dividend income and normal recurring realized and unrealized gains and losses on trading securities. Trading securities, which were liquidated during the latter part of 2003 and first quarter 2004, consisted primarily of common and preferred stocks, corporate bonds and investments structured through limited partnerships.

Investment income from AAC related investments primarily represents income associated with Gallagher's debt, preferred and common stock investments in AAC. Gallagher accounts for the common stock portion of its investment using equity method accounting and accounts for the interest and dividend income on its debt and preferred stock investments as it is earned. During fourth quarter 2005, AAC recognized a charge related to the sales and impairment of its investments in three of its private investment management firms. Gallagher's portion of the charge using equity method accounting was \$3.1 million.

Investment income from LIH developments primarily represents income associated with Gallagher's equity investment in a LIH Developer that is accounted for using equity method accounting and interest income from bridge loans made by Gallagher related to LIH developments.

Investment income from alternative energy investments primarily relates to installment gains from several sales of Gallagher's interests in limited partnerships that operate Syn/Coal facilities that occurred in 2001, 2002 and 2004.

Income (losses) from real estate, venture capital and other investments principally relates to Gallagher's portion of the earnings (losses) of these entities accounted for using equity method accounting. Gains (losses) from real estate, venture

capital and other investments primarily include realized gains and losses related to impairments, dispositions and recoveries of venture capital investments, which included loans and equity holdings in start-up companies. During 2005, Gallagher recognized a \$2.1 million dividend from its investment in Allied World Assurance Holdings, Ltd. and a net \$3.1 million investment gain related to assets impaired in prior years, the main components of which were as follows: a \$1.2 million gain on a recovery from the Biogas Project and a \$0.6 million gain on the sale of a shopping center investment. The remaining \$1.4 million net gain is from other transactions, none of which is greater than \$0.4 million, related to the sale or recoveries of venture capital investments. During 2004, Gallagher recognized a net \$8.5 million investment gain related to assets impaired in first quarter 2003, the main components of which were as follows: a \$2.0 million reversal of a loss contingency reserve, a \$1.0 million recovery of previously accrued interest income, a \$3.0 million recovery of unsecured notes receivable, a \$0.5 million gain from a distribution on an investment previously impaired and a \$0.7 million gain related to distributions received from a venture capital fund. The reversal of the loss contingency reserve was made as a result of the successfully completed funding transaction related to a Gallagher partially owned Biogas Project. During 2003, Gallagher recognized \$29.1 million of losses related to impairments and dispositions when it decided to withdraw virtually all continued support for its venture capital investments, except to the limited extent needed to realize value from the remaining assets. Without Gallagher's support at that time, it was doubtful that these operations would be able to execute their business plans. Therefore, Gallagher's investments were then determined to be other-than-temporarily impaired.

Investment income from consolidated investments includes income related to Gallagher's home office building, the airplane leasing company and two Syn/Coal facilities. Rental income of the home office building was \$6.4 million, \$6.6 million and \$6.8 million in 2005, 2004 and 2003, respectively. Total expenses associated with the home office building rental income, including interest and depreciation expenses, were \$6.3 million, \$6.6 million and \$6.6 million in 2005, 2004 and 2003, respectively. In 2005, 2004 and 2003, rental income of the airplane leasing company was \$4.1 million, \$3.4 million and \$3.2 million, respectively, and total expenses associated with this income, including interest and depreciation expenses, was \$5.5 million, \$4.9 million and \$5.0 million, respectively. On December 21, 2005, the lease agreement for the two airplanes leased to the French Postal Service, which was originally going to expire in 2006, was extended for an additional five years to 2011. In 2005, 2004 and 2003, income from the Syn/Coal facilities was \$42.8 million, \$31.9 million and \$1.0 million, respectively. Total expenses, including interest and depreciation expenses, relating to this income were \$78.7 million, \$61.2 million and \$15.9 million in 2005, 2004 and 2003, respectively. Gallagher acquired its interest in these two facilities in fourth quarter 2003 and second quarter 2004.

Investment income from consolidated investments for 2004 and 2003 was also impacted by the adoption of FIN 46. Effective July 1, 2003, Gallagher early adopted FIN 46, which required Gallagher to consolidate a Syn/Coal partnership in which it had a 5% ownership interest at the time of consolidation. Prior to July 1, 2003, this partnership was not consolidated because it was not controlled by Gallagher through a majority voting interest. Gallagher recognized both investment income and expenses of \$69.9 million and \$46.4 million in 2004 and 2003, respectively, related to the consolidation of the Syn/Coal partnership. During 2004, Gallagher sold a 4% ownership interest in this investment, which eliminated the requirement to consolidate the investment under the FIN 46 rules. This investment is now accounted for using equity method accounting.

Gain on sale of operation represents a gain from the disposition of a branch operation in 2003. The net assets sold and the operating results included in the 2003 consolidated statement of earnings related to this operation were not material to the consolidated financial statements.

4. Business Combinations

During 2005, Gallagher acquired substantially all the net assets of the following insurance brokerage firms (nine asset purchases and one stock purchase) in exchange for its common stock and/or cash. These acquisitions have been accounted for as business combinations (in millions except share data):

Name and Effective Date of Acquisitions	Common Shares Issued	Common Share Value	Cash Paid	Accrued Liability	Escrow Deposited	Recorded Purchase Price	Earnout Payables
(000s)							
Horton Insurance Agency, Inc. (HIA)							
January 1, 2005	-	\$ -	\$ 3.6	\$ 0.4	\$ -	\$ 4.0	2.8
Marine Insurance Service, LLC							
January 1, 2005	-	-	1.3	0.2	-	1.5	0.8
Chris Schroeder Insurance, Inc.							
April 1, 2005	25	0.5	0.9	-	0.2	1.6	0.8
Alternative Market Specialists (AMS)							
May 1, 2005	36	0.5	4.0	-	0.5	5.0	2.6
WorkCare Northwest, Inc. (WCN)							
May 1, 2005	50	0.7	5.7	-	0.7	7.1	-
Belmont Associates Consultants, Inc. (BAC)							
June 1, 2005	149	3.6	0.8	-	0.5	4.9	1.6
Classic Insurance Services, Ltd. (CIS)							
June 1, 2005	189	4.8	-	-	0.5	5.3	2.7
Corporate Life Consultants, Inc. (CLC)							
August 1, 2005	352	8.6	2.9	-	1.0	12.5	4.3
Interpacific Underwriting Agencies Pty Ltd							
November 1, 2005	-	-	2.5	-		2.5	-
Brokerage Professionals, Inc. (BPI)							
December 31, 2005	97	1.8	8.3	-	1.2	11.3	4.6
	898	\$ 20.5	\$ 30.0	\$ 0.6	\$ 4.6	\$ 55.7	\$ 20.2

Common shares exchanged in connection with acquisitions are valued at closing market prices as of the effective date of the respective acquisition. Escrow deposits that are returned to Gallagher as a result of adjustments to net assets acquired are recorded as downward adjustments to goodwill when the escrows are settled. The earnout payables that are disclosed in the foregoing table represent the maximum amount of additional consideration that could be paid pursuant to the purchase agreements related to these acquisitions. These potential earnout obligations are primarily based upon future earnings of the acquired entities and were not included in the purchase price that was recorded for these acquisitions at their respective acquisition dates because they are not fixed and determinable. Future payments made under these arrangements, if any are earned, will be paid in either cash or stock, typically at Gallagher's election, and will generally be recorded as upward adjustments to goodwill when the earnouts are settled. The aggregate amount of unrecorded earnout payables outstanding as of December 31, 2005 related to acquisitions made by Gallagher in the period from 2002 to 2005 was \$84.4 million.

During 2005, Gallagher issued 0.4 million shares of its common stock and paid \$1.8 million in cash and accrued \$2.7 million in current liabilities related to earnout obligations of eight acquisitions made prior to 2005 and recorded additional goodwill of \$15.3 million. During 2004, Gallagher

paid \$2.3 million in cash related to earnout obligations of three acquisitions made

prior to 2004 and recorded additional goodwill and expiration lists of \$1.8 million and \$0.5 million, respectively. During 2003, Gallagher issued 0.3 million shares to settle a contingent earnout obligation related to one acquisition made prior to 2003 and recorded additional goodwill of \$7.9 million.

The following is a summary of the estimated fair values of the assets acquired at the date of each acquisition based on preliminary purchase price allocations (in millions):

	HIA	AMS	WCN	BAC	CIS	CLC	BPI	Three Other Acquisitions	Total
Current assets	\$ 2.4	\$ 1.8	\$ 0.5	\$ -	\$ 0.2	\$ 0.2	\$ 0.9	\$ 6.9	\$ 12.9
Fixed assets	0.3	-	-	-	0.2	0.1	0.2	0.1	0.9
Goodwill	0.6	0.9	3.3	2.1	1.5	5.1	4.1	3.0	20.6
Expiration lists	2.7	3.6	3.5	2.6	3.2	6.4	6.6	2.8	31.4
Non-compete agreements	0.5	0.1	0.1	0.3	0.2	0.7	0.3	0.2	2.4
Total assets acquired	6.5	6.4	7.4	5.0	5.3	12.5	12.1	13.0	68.2
Current liabilities	2.5	1.4	0.3	0.1	-	-	0.8	7.4	12.5
Total liabilities assumed	2.5	1.4	0.3	0.1	-	-	0.8	7.4	12.5
Total net assets acquired	\$ 4.0	\$ 5.0	\$ 7.1	\$ 4.9	\$ 5.3	\$ 12.5	\$ 11.3	\$ 5.6	\$ 55.7

These acquisitions allow Gallagher to expand into desirable geographic locations, further extend its presence in the retail and wholesale insurance brokerage services industry and increase the volume of general services currently provided. The excess of the purchase price over the estimated fair value of the tangible net assets acquired at the acquisition date was allocated within the Brokerage Segment to goodwill, expiration lists and non-compete agreements in the amounts of \$20.6 million, \$31.4 million and \$2.4 million, respectively. Purchase price allocations are preliminarily established at the time of the acquisition and are subsequently reviewed within the first year of operations to determine the necessity for allocation adjustments.

Expiration lists and non-compete agreements related to these acquisitions are currently being amortized on a straight-line basis over a weighted average useful life of ten to fifteen years and five years, respectively. Goodwill is not amortized, but is subject to periodic reviews for impairment. Gallagher reviews intangible assets for impairment periodically (at least annually) and whenever events or changes in business circumstances indicate that the carrying value of the assets may not be recoverable. In reviewing intangible assets, if the fair value were less than the carrying amount of the respective (or underlying) asset, an indicator of impairment would exist and further analysis would be required to determine whether or not a loss would need to be charged against current period earnings. No such indicators were noted in 2005 or 2003. In 2004, Gallagher determined that an indicator of impairment existed related to the amortizable assets of one of its 2001 Brokerage Segment acquisitions. Based on the results of this impairment review, Gallagher wrote-off \$1.8 million of amortizable assets in 2004. Of the \$31.4 million of expiration lists and \$2.4 million of non-compete agreements related to the 2005 acquisitions, \$4.0 million and \$0.3 million, respectively, are not expected to be deductible for income tax purposes. Accordingly, Gallagher recorded a deferred tax liability of \$1.6 million, and a corresponding amount of goodwill, in 2005 related to the nondeductible amortizable assets. This amount has not been included in the above table.

Gallagher's consolidated financial statements for the year ended December 31, 2005 include the operations of these companies from the date of their respective acquisition. The following is a summary of the unaudited pro forma historical results, as if these purchased entities had been acquired at January 1, 2004 (in millions, except per share data):

	Year Ended December 31,	
	2005	2004
Total revenues	\$ 1,498.9	\$ 1,467.4

Earnings from continuing operations	29.3	192.2
Basic Earnings from continuing operations per share	0.31	2.08
Diluted Earnings from continuing operations per share	0.30	2.01

The unaudited pro forma results above have been prepared for comparative purposes only and do not purport to be indicative of the results of operations which actually would have resulted had the acquisitions occurred at January 1, 2004, nor is it necessarily indicative of future operating results. Annualized revenues of entities acquired in 2005 totaled approximately \$32.5 million.

5. Discontinued Operations

In first quarter 2005, Gallagher entered into an agreement to sell the net assets of Northshore International Insurance Services (NiiS), a medical claims management and auditing services provider, for cash of \$4.8 million. Gallagher recognized a pretax loss of \$12.7 million (\$12.3 million after tax loss) in first quarter 2005 in connection with the sale. In Gallagher's previously reported financial information, NiiS's operating results were included in the Brokerage Segment, which have been reclassified to discontinued operations in the accompanying consolidated statement of earnings for all periods presented.

In first quarter 2005, Gallagher entered into an agreement to sell all of the stock of Gallagher Benefit Administrators, Inc. (GBA), a third party employee benefit claim payment administrator, for cash of \$9.2 million and a promissory note in the amount of \$4.4 million. Gallagher recognized a pretax gain of \$9.6 million (\$6.8 million after tax gain) in first quarter 2005 in connection with the sale. The promissory note has a 10% fixed rate of interest, with interest only payments payable monthly through August 22, 2007, when the note matures. In Gallagher's previously reported financial information, GBA's operating results were included in the Risk Management Segment, which have been reclassified to discontinued operations in the accompanying consolidated statement of earnings for all periods presented.

In second quarter 2005, Gallagher sold its ownership interests in the limited partnership that owns the Florida Community Development investment. Pursuant to the transaction, Gallagher received cash of \$25.7 million and recorded a pretax gain of \$12.6 million (\$7.6 million after tax gain) in second quarter 2005 in connection with the sale. In Gallagher's previously reported financial information, the Florida Community Development's operating results were included in the Financial Services Segment, which have been reclassified to discontinued operations in the accompanying consolidated statement of earnings for all periods presented.

The assets and liabilities included in the accompanying December 31, 2004 consolidated balance sheet related to the three discontinued operations were as follows (in millions):

Current assets	\$	5.8
Fixed assets - net		62.8
Goodwill - net		13.1
Amortizable intangible assets - net		3.7
Total assets	\$	85.4
Current liabilities	\$	3.8
Investment related borrowings		47.4
Noncurrent liabilities		0.5
Total liabilities	\$	51.7

Total revenues reclassified to discontinued operations for 2005, 2004 and 2003 were \$11.0 million, \$43.3 million and \$42.7 million, respectively.

6. Fixed Assets

Major classes of fixed assets consist of the following (in millions):

December 31,			
	2005		2004
Furniture and equipment	\$ 162.7	\$	161.1
Buildings and improvements	98.1		103.0
Land and improvements	3.8		54.6
Airplanes of consolidated leasing company	51.8		51.8
Leasehold improvements	31.8		30.5
Syn/Coal equipment	15.6		15.6
	363.8		416.6
Accumulated depreciation	(178.7)		(157.6)
Net fixed assets	\$ 185.1	\$	259.0

7. Intangible Assets

Major classes of amortizable intangible assets consist of the following (in millions):

	December 31,	
	2005	2004
Expiration lists	\$ 203.8	\$ 162.5
Accumulated amortization - expiration lists	(41.2)	(25.1)
	162.6	137.4
Non- compete agreements	20.0	26.1
Accumulated amortization - non- compete agreements	(10.1)	(8.3)
	9.9	17.8
Net amortizable assets	\$ 172.5	\$ 155.2

Estimated aggregate amortization expense for each of the next five years is as follows:

2006	21.8
2007	20.9
2008	18.9
2009	17.3
2010	16.5
Total	\$ 95.4

The changes in the carrying amount of goodwill for 2005 are as follows (in millions):

	Brokerage	Risk Management	Financial Services	Total
Balance as of January 1, 2005	\$ 209.5	\$ 9.5	\$ -	\$ 219.0
Goodwill acquired during the year	37.5	-	-	37.5
Adjustments related to independent appraisals and other purchase accounting adjustments	3.0	-	-	3.0
Goodwill written- off related to sales of business units and impairment reviews during the year	(13.8)	-	-	(13.8)
Balance as of December 31, 2005	\$ 236.2	\$ 9.5	\$ -	\$ 245.7

8. Credit and Other Debt Agreements

On October 5, 2005, Gallagher entered into an unsecured multicurrency credit agreement (Credit Agreement), which expires on October 4, 2010, with a group of ten financial institutions. The Credit Agreement provides for a revolving credit commitment of up to \$450.0 million, of which up to \$125.0 million may be used for issuances of standby or commercial letters of credit (LOCs) and up to \$30.0 million may be used for the making of

swing loans, as defined in the Credit Agreement. Gallagher may from time- to- time request, subject to certain conditions, an increase in the revolving credit commitment up to a maximum aggregate revolving credit commitment of \$550.0 million.

The Credit Agreement provides that Gallagher may elect that each borrowing in U.S. dollars be either base rate loans or Eurocurrency loans, as defined in the Credit Agreement. All loans denominated in currencies other than U.S. dollars shall be Eurocurrency loans. Interest rates on base rate loans and outstanding drawings on LOCs in U.S. dollars under the Credit Agreement are based on the base rate, as defined in the Credit Agreement. Interest rates on Eurocurrency loans or outstanding drawings on LOCs in currencies other than U.S. dollars under the Credit Agreement are based on adjusted LIBOR, as defined in the Credit Agreement, plus a margin of .400%, .500%, .600% or .800%, depending on the financial leverage ratio maintained by Gallagher. Interest rates on swing loans are based, at the election of Gallagher, on either the base rate, as defined in the Credit Agreement, or such alternate rate as may be quoted by the lead lender. The annual facility fee related to the Credit Agreement is either .100%, .125%, .150% or .200% of the used and unused portions of the revolving credit commitment, depending on the financial leverage ratio maintained by Gallagher. In connection with entering into the Credit Agreement, Gallagher incurred approximately \$1.4 million of debt acquisition costs that was capitalized and will be amortized on a pro rata basis over the term of the Credit Agreement.

The terms of the Credit Agreement include various covenants, including covenants that require Gallagher to maintain specified levels of net worth and financial leverage ratios. Gallagher was in compliance with these covenants at December 31, 2005. The Credit Agreement also includes customary events of default, with corresponding grace periods, including, without limitation, payment defaults, cross- defaults to other agreements evidencing indebtedness and bankruptcy-

related defaults. Gallagher's obligations under the Credit Agreement are unconditionally guaranteed by several of its wholly- owned subsidiaries.

At December 31, 2005, \$32.2 million of LOCs (of which Gallagher has \$9.0 million of liabilities recorded as of December 31, 2005) were outstanding under the Credit Agreement, which primarily related to Gallagher's investments as discussed in Notes 3 and 17. There were no borrowings outstanding under the revolving credit commitment at December 31, 2005. Accordingly, as of December 31, 2005, \$417.8 million remained available for potential borrowings, of which \$92.8 million may be in the form of additional LOCs.

The Credit Agreement replaced a \$250.0 million unsecured revolving credit facility (that was to expire on July 20, 2006), which was terminated upon the execution of the new credit agreement. All indebtedness, liabilities and obligations outstanding under the previous credit agreement were fully paid and satisfied, except for those certain letters of credit which became letters of credit under the Credit Agreement. There were no early termination penalties or fees incurred, but Gallagher wrote- off approximately \$0.5 million of unamortized debt acquisition costs in fourth quarter 2005 related to the termination of the previous credit agreement.

On December 21, 2005, the loan agreement related to the two airplanes leased to the French Postal Service, which was originally going to expire in 2006, was extended for an additional five years to 2011. Terms of the previous agreement required monthly principal and interest payments with a balloon payment due in 2006 and had a variable interest rate based on LIBOR plus 1.62%. The terms of the new loan agreement are included in the summary below.

The following is a summary of Gallagher's Credit Agreement and investment related debt (in millions):

	December 31,	
	2005	2004
Corporate related borrowings:		
Gallagher's Credit Agreement (entered into on October 5, 2005):		
Periodic payments of interest and principal, prime or LIBOR plus up to 0.80%, expires October 2010	\$ -	\$ -
Investment related borrowings:		
Mortgage loan on Gallagher's home office:		
Monthly installments of principal and interest, fixed rate of 8.35%, 30 year amortization, balloon payment 2008, subject to prepayment provisions	76.1	77.0
Line of credit facility on Florida Community Development:		
Permits borrowings up to \$17.0 million, quarterly interest- only payments, variable rate of LIBOR plus 2.00%, expired 2005	-	17.0
Line of credit facility on Florida Community Development:		
Permits borrowings up to \$20.0 million, monthly interest- only payments, rate of prime plus 0.50%, expired 2005	-	17.7
Bonds payable on Florida Community Development:		
Monthly interest- only payments through 2010, variable rate based on commercial paper rate, balloon payment 2010	-	12.4
Equipment loans on Florida Community Development:		
Fixed monthly payments, fixed rates of 6.25% and 7.00%, expire 2005 and 2008	-	0.3
Loan on airplanes leased to French Postal Service (extended on December 21, 2005):		
Monthly principal and interest payments, fixed rate of 5.38%, balloon payment 2011 (see paragraph	29.9	32.5

above for terms prior to December 21, 2005)

Loan on investment in Biogas project:			
Monthly principal and interest payments, fixed rate of 15.00%, subject to prepayment provisions		-	14.0
Syn/Coal facility purchase note:			
Quarterly variable principal and interest payments, fixed rate of 7.00%		6.9	10.5
	\$	112.9	\$ 181.4

See Note 17 for additional discussion on commitments and contingencies.

9. Capital Stock and Stockholders' Rights Plan

Capital Stock - The table below summarizes certain information about Gallagher's capital stock at December 31, 2005 and 2004 (in millions, except par value data):

Class	Par Value	Authorized Shares
Preferred stock	No par	1
Common stock	\$ 1.00	400

Stockholders' Rights Plan - Non-voting Rights, authorized by the Board of Directors and approved by stockholders in 1987, are outstanding on each share of Gallagher's outstanding common stock. The Rights Plan was amended in 1996 to extend the expiration of the Rights to May 12, 2007, and was amended again on March 19, 2004 to increase the exercise price from \$25.00 to \$55.00. Under certain conditions, each Right may be exercised to purchase one share of common stock at the exercise price. The Rights become exercisable and transferable upon the earlier of (a) the tenth business day after a person or group (as defined) has acquired 20% or more of the common stock or (b) the tenth business day (or such later date as may be determined by the Board) after a person or group has commenced or publicly announced an intention to commence a tender offer or exchange offer which would result in such person or group acquiring 20% or more of the common stock. If Gallagher is acquired in a merger or business combination, each Right exercised gives the holder the right to purchase \$110.00 of market value of common stock of the surviving company for the \$55.00 exercise price. The Rights may be redeemed by Gallagher at \$.0125 per Right at any time prior to the earlier of (a) or (b) above.

10. Earnings per Share

The following table sets forth the computation of basic and diluted net earnings per share (in millions, except per share data):

Year Ended December 31,				
	2005	2004	2003	
Earnings from continuing operations	\$ 28.6	\$ 189.5	\$ 145.9	
Earnings (loss) from discontinued operations	2.2	(1.0)	0.3	
Net earnings	\$ 30.8	\$ 188.5	\$ 146.2	
Weighted average number of common shares outstanding	94.1	91.5	90.0	
Dilutive effect of stock options using the treasury stock method	2.0	3.0	3.3	
Weighted average number of common and common equivalent shares outstanding	96.1	94.5	93.3	
Basic net earnings (loss) per share:				
Earnings from continuing operations	\$.30	\$ 2.07	\$ 1.63	
Earnings (loss) from discontinued operations	.03	(.01)	-	
Net earnings	\$.33	\$ 2.06	\$ 1.63	
Diluted net earnings (loss) per share:				
Earnings from continuing operations	\$.30	\$ 2.00	\$ 1.57	

Earnings (loss) from discontinued operations		.02		(.01)		-
Net earnings	\$	.32	\$	1.99	\$	1.57

Options to purchase 7.3 million, 1.9 million and 2.0 million shares of common stock were outstanding at December 31, 2005, 2004 and 2003, respectively, but were not included in the computation of the dilutive effect of stock options for the year then ended. These options were excluded from the computation because the options' exercise prices were greater than the average market price of the common shares during the respective period and, therefore, would be antidilutive to earnings per share under the treasury stock method.

11. Stock Option Plans

Gallagher has incentive and nonqualified stock option plans for officers and key employees of Gallagher and its subsidiaries. The options are primarily granted at the fair value of the underlying shares at the date of grant. Options granted under the nonqualified plan primarily become exercisable at the rate of 10% per year beginning the calendar year after the date of grant or earlier in the event of death, disability or retirement. Options expire ten years from the date of grant, or earlier in the event of termination of the employee.

In addition, Gallagher has a non-employee directors' stock option plan, which currently authorizes 1,925,000 shares for grant, with Discretionary Options granted at the direction of the Compensation Committee of the Board of Directors (the Compensation Committee) and Retainer Options granted in lieu of the directors' annual retainer. Discretionary Options shall be exercisable at such rates as shall be determined by the Compensation Committee on the date of grant. Retainer Options shall be cumulatively exercisable at the rate of 25% of the total Retainer Option at the end of each full fiscal quarter succeeding the date of grant. The excess of fair value at the date of grant over the option price for these nonqualified stock options is considered compensation and is charged against earnings ratably over the vesting period.

Gallagher also has an incentive stock option plan for its officers and key employees resident in the U.K. The U.K. plan is essentially the same as Gallagher's domestic employee stock option plans, with certain modifications to comply with U.K. law and to provide potentially favorable tax treatment for grantees resident in the U.K.

All of the aforementioned stock option plans provide for the immediate vesting of all outstanding stock option grants in the event of a change in control of Gallagher as defined in the plan documents.

For purposes of the pro forma disclosures in Note 1 and for the expense recognition in 2005, 2004 and 2003, the estimated fair values of the stock option grants are amortized to expense over the options' expected lives. The fair value of stock options at the date of grant was estimated using the Black- Scholes option pricing model with the following weighted average assumptions:

Year Ended December 31,			
	2005	2004	2003
Expected dividend yield	3.0%	3.0%	2.8%
Expected risk- free interest rate	4.2%	4.2%	4.1%
Volatility	26.2%	26.7%	26.9%
Expected life (in years)	6.9	6.8	6.9

The Black- Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because Gallagher's employee and director stock options have characteristics significantly different from those of traded options, and because changes in the selective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee and director stock options. The weighted average fair value per option for all options granted during 2005, 2004 and 2003, as determined on the grant date using the Black- Scholes option valuation model, was \$6.69, \$7.35 and \$6.38, respectively.

The following is a summary of Gallagher's stock option activity and related information (in millions, except exercise price data):

	Year Ended December 31,					
	2005		2004		2003	
	Shares Under Option	Weighted Average Exercise Price	Shares Under Option	Weighted Average Exercise Price	Shares Under Option	Weighted Average Exercise Price
Beginning balance	15.7	\$ 22.00	15.0	\$ 18.59	14.4	\$ 16.05
Granted	3.1	27.37	3.2	29.89	2.9	24.99
Exercised	(1.6)	11.96	(2.2)	10.36	(2.1)	9.44
Canceled	(0.6)	26.81	(0.3)	21.22	(0.2)	21.00
Ending balance	16.6	\$ 23.82	15.7	\$ 22.00	15.0	\$ 18.59
Exercisable at end of year	5.6		5.1		5.2	

Options with respect to 5.3 million shares were available for grant at December 31, 2005.

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Other information regarding stock options outstanding and exercisable at December 31, 2005 is summarized as follows (in millions, except exercise price data):

Range of Exercise Prices	Options Outstanding			Options Exercisable		
	Number Outstanding	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price	
\$ 1.11 - \$ 22.70	5.3	4.07	\$ 15.81	2.8	\$ 14.02	
22.87 - 26.50	4.5	6.53	25.44	1.8	25.47	
26.87 - 29.42	5.6	8.92	28.20	0.5	28.48	
29.56 - 36.94	1.2	7.50	32.29	0.5	32.60	
\$ 1.11 - \$ 36.94	16.6	6.63	\$ 23.82	5.6	\$ 20.67	

12. Deferred Compensation

Gallagher has a Deferred Equity Participation Plan, which is a non-qualified plan that provides for distributions to certain key executives of Gallagher upon their normal retirement. Under the provisions of the plan, Gallagher contributes shares of its common stock, in an amount approved by the Compensation Committee, to a rabbi trust on behalf of the executives participating in the plan. Distributions under the plan may not normally be made until the participant reaches age 62 and are subject to forfeiture in the event of voluntary termination of employment prior to age 62. All distributions from the plan, except for accumulated non-invested dividends, are made in the form of Gallagher's common stock.

In first quarter 2005, 2004 and 2003, Gallagher contributed \$4.7 million, \$4.6 million and \$4.4 million, respectively, to the plan through the issuance of 157,000, 142,000 and 169,000 shares, respectively, of Gallagher's common stock. The Gallagher common stock that is issued under the plan to the rabbi trust is valued at historical cost (fair market value at the date of grant) and the unearned deferred compensation obligation is classified as a contra equity amount. The unearned deferred compensation balance is shown as a reduction of stockholders' equity in the accompanying consolidated balance sheet and is being amortized to compensation expense ratably over the vesting period of the participants. Future changes in the fair value of the Gallagher common stock that is owed to the participants do not have any impact on Gallagher's consolidated financial statements. During 2005, 2004 and 2003, \$2.3 million, \$1.7 million and \$1.4 million, respectively, was charged to compensation expense related to this plan.

13. Restricted Stock Awards

Gallagher has adopted a restricted stock plan for its directors, officers and other employees. Under the provisions of the plan, Gallagher is authorized to issue 4.0 million shares of Gallagher common stock. The Compensation Committee is responsible for the administration of the plan. Each award granted under the plan represents a right of the holder of the award to receive shares of Gallagher common stock, cash or a combination of shares and cash, subject to the holder's continued employment with Gallagher for a period of time after the date the award is granted. The Compensation Committee shall determine each recipient of an award under the plan, the number of shares of common stock subject to such award and the period of continued employment required for the vesting of such award. These terms will be included in an award agreement between Gallagher and the recipient of the award. As discussed in the paragraph below, 200,000 shares of restricted stock awards were granted under this plan during 2005 (120,000 shares were issued in 2004 under the plan). Accordingly, as of December 31, 2005, 3.7 million shares are available for grant under this plan.

In first quarter 2005, 2004 and 2003, Gallagher granted 124,000, 65,000 and 302,000 shares, respectively, of its common stock to employees related to incentive compensation plans, with an aggregate fair value of \$3.7 million, \$2.1 million and \$7.9 million, respectively, at the date of grant. The majority of the 2005, 2004 and 2003 restricted stock awards vest over a two-year period (21,000 and 19,000 shares of the 2005 and 2004 grants, respectively, vest over a one-year period and 50,000 of the 2005 grants vest over a three-year period at the rate of 33 1/3% per year beginning on March 31, 2006), primarily at the rate of 50% per year beginning on March 31, 2006, 2005 and 2004, respectively. In second quarter 2005, Gallagher granted 40,000 shares of its common stock to employees related to incentive compensation plans, with an aggregate fair value of \$1.1 million at the date of grant, all of which vest over a three-year period at the rate of 33 1/3% per year beginning on June 21, 2006. In fourth quarter 2005, Gallagher granted 36,000 shares of its common stock to employees related to incentive compensation plans, with an aggregate fair value of \$1.1 million at the date of grant, all of which vest over a five-year period at the rate of 20% per year beginning on November 1, 2006. In second quarter 2004, Gallagher granted 6,000 shares of its common stock to employees related to incentive compensation plans, with an aggregate fair value of \$0.2 million at the

date of grant, all of which vest over a three- year period at the rate of 20% per year beginning on March 31, 2005. In fourth quarter 2004, Gallagher granted 49,000 shares of its common stock to employees related to incentive compensation plans, with an

aggregate fair value of \$1.3 million at the date of grant, all of which vest over a three- year period at the rate of 33 1/3% per year beginning on October 31, 2005.

Gallagher accounts for restricted stock at historical cost which equals its fair market value at the date of grant. When restricted shares are issued, an unearned restricted stock obligation is recorded as a reduction of stockholders' equity, which will be ratably charged to compensation expense over the vesting period of the participants. Future changes in the fair value of the Gallagher common stock that is owed to the participants do not have any impact on Gallagher's consolidated financial statements. During 2005, 2004 and 2003, \$4.9 million, \$8.3 million and \$6.2 million, respectively, was charged to compensation expense related to restricted stock awards granted between 2002 and 2005.

14. Employee Stock Purchase Plan

Gallagher has an employee stock purchase plan (ESPP) under which the sale of 4.0 million shares of Gallagher's common stock has been authorized. Eligible employees may contribute up to 15% of their compensation toward the quarterly purchase of Gallagher's common stock. The employees' purchase price is 85% of the lesser of the fair market value of the stock on the first business day or the last business day of the quarterly offering period. Employees may annually purchase shares having a fair market value of up to \$25,000 (measured as of the first day of the quarterly offering period of each calendar year). Effective as of the end of each quarter in 2005, Gallagher issued 0.1 million shares of common stock in each quarter to employees who participated in the ESPP during those quarters at an aggregate purchase price of \$3.0 million, or \$24.48 per share, \$2.2 million, or \$23.06 per share, \$1.9 million, or \$23.13 per share, and \$1.7 million, or \$24.62 per share, respectively. Effective as of the end of each quarter in 2004, Gallagher issued 0.1 million shares of common stock in each quarter to employees who participated in the ESPP during those quarters at an aggregate purchase price of \$2.7 million, or \$27.16 per share, \$2.1 million, or \$25.88 per share, \$1.8 million, or \$25.85 per share, and \$1.6 million, or \$27.63 per share, respectively. Effective as of the end of third and fourth quarters of 2003, Gallagher issued 0.1 million shares of common stock each quarter to employees who participated in the ESPP during those quarters at an aggregate purchase price of \$1.8 million, or \$22.89 per share, and \$1.9 million, or \$24.71 per share, respectively. Currently, there are 3.2 million shares reserved for future issuance. During 2005, 2004 and 2003, \$1.8 million, \$1.4 million and \$0.7 million was charged to compensation expense related to the common stock issued under the ESPP.

15. Retirement Plans

Gallagher has a noncontributory defined benefit pension plan that covers substantially all domestic employees who have attained a specified age and one year of employment. Benefits under the plan are based on years of service and salary history. Prior to July 1, 2005, Gallagher accounted for the defined benefit pension plan in accordance with Statement of Financial Accounting Standards No. 87 (SFAS 87), "Employers' Accounting for Pensions." In second quarter 2005, Gallagher amended its defined benefit pension plan to freeze the accrual of future benefits for all domestic employees, effective on July 1, 2005, which resulted in Gallagher recognizing a curtailment gain of \$10.0 million.

A reconciliation of the beginning and ending balances of the pension benefit obligation and fair value of plan assets and the funded status of the plan is as follows (in millions):

	Year Ended December 31,			
	2005		2004	
Change in pension benefit obligation:				
Benefit obligation at beginning of year	\$	195.7	\$	153.7
Service cost		10.7		17.2
Interest cost		10.8		10.0
Net actuarial loss		15.9		17.5
Benefits paid		(3.2)		(2.7)
Curtailment		(48.2)		-
Benefit obligation at end of year	\$	181.7	\$	195.7
Change in plan assets:				
Fair value of plan assets at beginning of year	\$	137.0	\$	115.8
Actual return on plan assets		11.0		11.4
Contributions by Gallagher		24.5		12.5
Benefits paid		(3.2)		(2.7)
Fair value of plan assets at end of year	\$	169.3	\$	137.0
Funded status of the plan (underfunded)	\$	(12.4)	\$	(58.7)
Unrecognized net actuarial loss		10.2		29.5
Unrecognized prior service cost		-		2.7
Unrecognized transition obligation		-		0.1
Net amount recognized	\$	(2.2)	\$	(26.4)
Amounts recognized in the consolidated balance sheet consist of:				
Accrued benefit liability	\$	(12.4)	\$	(26.4)
Accumulated other comprehensive loss		10.2		-
Net amount recognized	\$	(2.2)	\$	(26.4)

The components of the net periodic pension benefit cost for the plan consists of the following (in millions):

	Year Ended December 31,			
	2005	2004	2003	
Service cost- benefits earned during the year	\$	10.7	\$	17.2
			\$	14.5

Interest cost on benefit obligation	10.8	10.0	8.5
Expected return on plan assets	(12.1)	(10.2)	(7.5)
Amortization of prior service cost	0.2	0.3	0.3
Amortization of net actuarial loss	0.6	-	0.4
Amortization of transition obligation	-	0.1	0.1
Net periodic benefit cost	10.2	17.4	16.3
Curtailment gain	(10.0)	-	-
Total benefit cost	\$ 0.2	\$ 17.4	\$ 16.3

The following is information required to be separately disclosed for pension plans with an accumulated benefit obligation in excess of plan assets (in millions):

December 31,			
		2005	2004
Projected benefit obligation	\$	181.7	\$ 195.7
Accumulated benefit obligation		181.7	151.4
Fair value of plan assets		169.3	137.0

The following weighted average assumptions were used at December 31 in determining the plan's pension benefit obligation:

December 31,			
		2005	2004
Discount rate		5.75%	6.00%
Weighted average rate of increase in future compensation levels		-	6.10%
Weighted average expected long-term rate of return on plan assets		8.25%	8.25%

The following weighted average assumptions were used at January 1 in determining the plan's net periodic pension benefit cost:

Year Ended December 31,			
		2005	2004
Discount rate		6.00%	6.50%
Weighted average rate of increase in future compensation levels		6.10%	6.10%
Weighted average expected long-term rate of return on plan assets		8.25%	8.50%

The following is a summary of the plan's weighted average asset allocations at December 31 by asset category:

December 31,			
Asset Category		2005	2004
Equity securities		56.0%	56.0%
Debt securities		35.0%	37.0%
Real estate		9.0%	7.0%
Total		100.0%	100.0%

The following benefit payments are expected to be paid by the plan (in millions):

2006	\$	3.5
2007		4.1
2008		5.0
2009		5.9
2010		6.9
Years 2011 to 2015		60.3

Plan assets are invested in various pooled separate accounts under a group annuity contract managed by a life insurance carrier. The plan's investment policy provides that investments shall be allocated in a manner designed to provide a long-term investment return greater than the actuarial assumptions, maximize investment return commensurate with risk, and to comply with the Employee Retirement Security Act of 1974 (ERISA) by investing the funds in a manner consistent with ERISA's fiduciary standards. The weighted average expected long-term rate of return on plan assets assumption of 8.25% was determined based on a review of the asset allocation strategy of the plan using expected ten-year return assumptions for all of the asset classes in which the plan was invested at December 31, 2005. The ten-year return assumptions used in the valuation were based on data provided by the plan's external investment advisors.

In 2006, Gallagher does not anticipate making any contributions to the pension plan. This expected level of funding is based on the plan being frozen and substantially funded at December 31, 2005. In addition, Gallagher expects there will be no minimum contribution required under the IRC.

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Gallagher has a qualified contributory savings and thrift (401(k)) plan covering the majority of its domestic employees. Gallagher's matching contributions (up to a maximum of 2.5% of eligible compensation in 2005 and 2004; in 2003 the maximum was 2.0% of eligible compensation; effective January 1, 2006 the maximum was increased to 5.0%) are at the discretion of Gallagher's Board of Directors and may not exceed the maximum amount deductible for federal income tax purposes. Gallagher contributed \$9.5 million, \$8.7 million and \$6.5 million in 2005, 2004 and 2003, respectively. Gallagher also has a nonqualified deferred compensation plan for certain employees who, due to IRS rules, cannot take full advantage of the Gallagher matching contributions under the savings and thrift plan. The plan permits these employees to annually elect to defer a portion of their compensation until their retirement. Gallagher's matching contributions to this plan are also at the discretion of Gallagher's Board of Directors. Gallagher contributed \$0.9 million, \$0.6 million and \$0.6 million to the plan in 2005, 2004 and 2003, respectively. The fair value of the plan's assets at December 31, 2005 and 2004, respectively, including employee contributions and investment earnings thereon, was \$50.7 million and \$39.7 million, respectively, and has been included in other noncurrent assets and the corresponding liability has been included in other noncurrent liabilities in the accompanying consolidated balance sheet.

Gallagher also has several foreign benefit plans, the largest of which is a defined contribution plan that provides for basic contributions by Gallagher and voluntary contributions by employees resident in the U.K., which are matched 100% by Gallagher, up to a maximum of 5% of eligible compensation. Net expense for foreign retirement plans amounted to \$6.3 million, \$5.3 million and \$4.1 million in 2005, 2004 and 2003, respectively.

16. Postretirement Benefits Other than Pensions

In 1992, Gallagher amended its health benefits plan to eliminate retiree coverage, except for retirees and those employees who had already attained a specified age and length of service at the time of the amendment. The retiree health plan is contributory, with contributions adjusted annually, and is funded on a pay- as- you- go basis.

A reconciliation of the beginning and ending balances of the postretirement benefit obligation and the funded status of the plan is as follows (in millions):

		Year Ended December 31,	
		2005	2004
Change in postretirement benefit obligation:			
Benefit obligation at beginning of year	\$	7.6	\$ 7.3
Service cost		-	-
Interest cost		0.4	0.5
Net actuarial loss		0.4	-
Benefits paid		(0.4)	(0.2)
Benefit obligation at end of year	\$	8.0	\$ 7.6
Change in plan assets:			
Fair value of plan assets at beginning and end of year	\$	-	\$ -
Funded status of the plan (underfunded)	\$	(8.0)	\$ (7.6)
Unrecognized net actuarial gain		(3.3)	(4.0)
Unrecognized transition obligation		3.6	4.1
Net amount recognized	\$	(7.7)	\$ (7.5)

The components of the net periodic postretirement benefit cost include the following (in millions):

		Year Ended December 31,		
		2005	2004	2003
Service cost- benefits earned during the year	\$	-	\$ -	\$ -

Interest cost on benefit obligation		0.4		0.5		0.4
Amortization of transition obligation		0.5		0.5		0.5
Amortization of net actuarial gain		(0.3)		(0.3)		(0.4)
Net periodic benefit cost	\$	0.6	\$	0.7	\$	0.5

The discount rate used to measure the postretirement benefit obligation was 5.25% at December 31, 2005 and 6.00% at December 31, 2004. The discount rate used to measure the net periodic postretirement benefit cost at January 1 was 6.00% for 2005 and 6.50% for 2004. The transition obligation is being amortized over a 20- year period.

The following assumed healthcare cost trend rates were used at December 31 in determining the plan's postretirement benefit obligation:

	December 31,	
	2005	2004
Healthcare cost trend rate assumed for next year	10.00%	8.00%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.00%	4.50%
Year the rate reaches the ultimate trend rate	2011	2009

The assumed healthcare cost trend rate has a significant effect on the amounts reported and disclosed herein. A one percentage point change in the assumed healthcare cost trend rate would have the following effects (in millions):

One Percentage Point			
		Increase	Decrease
Effect on the net periodic postretirement benefit cost in 2005	\$	0.1	\$ (0.1)
Effect on the postretirement benefit obligation at December 31, 2005		0.9	(0.7)

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid by the plan (in millions):

	Prior to Reflecting Medicare Part D	After Reflecting Medicare Part D
2006	\$ 0.5	\$ 0.5
2007	0.6	0.5
2008	0.6	0.5
2009	0.6	0.5
2010	0.6	0.6
Years 2011 to 2015	3.3	3.0

In December 2003, the President of the U.S. signed into law the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act). The Act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. In May 2004, the FASB issued FASB Staff Position (FSP) 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003". FSP 106-2 provided guidance on accounting for the effects of the Act for employers that sponsor postretirement health care plans that provide drug benefits. This FSP also required employers to provide certain disclosures regarding the effect of the federal subsidy provided by the Act. In accordance with FSP 106-1, Gallagher elected to defer accounting for the effects of the Act until 2005. As such, any measures of the postretirement benefit obligation or net periodic postretirement benefit cost for 2004 and 2003 in the consolidated financial statements do not reflect the effects of the Act.

The transition method outlined in FSP 106-2 required public companies to conclude whether the enactment of the Act was a "significant event" pursuant to SFAS 106, "Employers Accounting for Postretirement Benefits Other than Pensions." In 2005, Gallagher determined that the enactment of the Act was not a "significant event" pursuant to SFAS 106 and that the prescription drug benefit provided under the Gallagher plan to its participants is the actuarial equivalent to Medicare Part D. Accordingly, Gallagher adopted the provisions of FSP 106-2 in the Plan's 2005 SFAS 106 actuarial valuation, the effect of which was a \$0.1 million decrease in the 2005 net periodic benefit cost.

17. Commitments, Contingencies, Financial Guarantees and Off- Balance Sheet Arrangements

In connection with its investing and operating activities, Gallagher has entered into certain contractual obligations as well as commitments. See Notes 3 and 8 for additional discussion of these obligations and commitments. Gallagher's future minimum cash payments, excluding interest, associated with its contractual obligations pursuant to the Credit Agreement, investment related borrowings, operating leases and purchase commitments at December 31, 2005 are as follows (in millions):

Contractual Obligations	Payments Due by Period						
	2006	2007	2008	2009	2010	Thereafter	Total
Credit Agreement	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Investment related borrowings:							
Home office mortgage loan	0.9	1.1	74.1	-	-	-	76.1
Airplane leasing company debt	1.9	2.1	2.2	2.3	2.5	18.9	29.9
Syn/Coal facility purchase note	2.5	3.5	0.9	-	-	-	6.9
Total debt obligations	5.3	6.7	77.2	2.3	2.5	18.9	112.9
Operating lease obligations	57.0	49.4	42.2	34.9	29.5	40.7	253.7
Net Syn/Coal purchase commitments	4.6	3.0	-	-	-	-	7.6
Outstanding purchase obligations	4.9	-	-	-	-	-	4.9
Total contractual obligations	\$ 71.8	\$ 59.1	\$ 119.4	\$ 37.2	\$ 32.0	\$ 59.6	\$ 379.1

The amounts presented in the table above may not necessarily reflect the actual future cash funding requirements of Gallagher, because the actual timing of the future payments made may vary from the stated contractual obligation.

Credit Agreement - Gallagher has a \$450.0 million Credit Agreement it uses to post LOCs and that it can use from time- to- time to borrow funds to supplement operating cash flows. At December 31, 2005, \$32.2 million of LOCs (of which Gallagher has \$9.0 million of liabilities recorded as of December 31, 2005) were outstanding under the Credit Agreement, which primarily related to Gallagher's investments as discussed in Note 3. There were no borrowings outstanding under the Credit Agreement at December 31, 2005. Accordingly, as December 31, 2005, \$417.8 million remained available for potential borrowings, of which \$92.8 million may be in the form of additional LOCs. Gallagher is under no obligation to utilize the Credit Agreement in performing its normal business operations. See Note 8 for a discussion of the terms of the Credit Agreement.

Investment Related Borrowings - As more fully described in Note 3, at December 31, 2005, the accompanying balance sheet includes \$112.9 million of borrowings related to Gallagher's investment related enterprises of which \$3.0 million is recourse to Gallagher. These borrowings are partially secured by the underlying assets of the investment enterprises and support their operations.

Operating Lease Obligations - Gallagher's executive offices and certain subsidiary and branch facilities are located at Two Pierce Place, Itasca, Illinois, where Gallagher leases approximately 308,000 square feet of space, or approximately 60% of the building. The lease commitment on this property expires February 28, 2011. Gallagher has a 60% ownership interest in the limited partnership that owns the Two Pierce Place property. This investment is consolidated into Gallagher's consolidated financial statements.

Gallagher generally operates in leased premises at its other locations. Certain office space leases have options permitting renewals for additional periods. In addition to minimum fixed rentals, a number of leases contain annual escalation clauses generally related to increases in an inflation index.

Total rent expense, including rent relating to cancelable leases and leases with initial terms of less than one year, amounted to \$62.4 million in 2005, \$57.9 million in 2004 and \$53.7 million in 2003.

With respect to the home office building, the property is leased to Gallagher and non- Gallagher tenants under operating leases that expire at various dates over the next three years. In the normal course of business, Gallagher expects that the leases will be renewed or replaced. The following is a summary of the minimum future rentals to be received from non- Gallagher tenants on noncancelable operating leases related to the home office building and to sublease arrangements of other office space as of December 31, 2005 (in millions):

Year	Amount
2006	\$ 4.8
2007	1.6
2008	1.5
2009	1.5
2010	1.2
Thereafter	2.2
Total	\$ 12.8

Charges for real estate taxes and common area maintenance are adjusted annually based on actual expenses, and the related revenues are recognized in the year in which the expenses are incurred. These amounts are not included in the minimum future rentals to be received in the table above.

Net Syn/Coal Purchase Commitments - Gallagher has interests in two Syn/Coal facilities that it consolidates. See Note 3 for additional disclosures regarding these partnerships. The facilities have entered into raw coal purchase and Syn/Coal sales agreements. These agreements terminate immediately in the event the Syn/Coal produced ceases to qualify for credits under IRC Section 29 or upon termination of either the purchase or sales agreements. The net annual Syn/Coal purchase commitments represent the minimum raw coal purchases at estimated costs less sales of Syn/Coal at estimated prices.

Outstanding Purchase Obligations - Gallagher is a service company and thus typically does not have a material amount of outstanding purchase obligations at any point in time. The amount disclosed in the table above represents the aggregate amount of unrecorded purchase obligations that Gallagher has outstanding as of December 31, 2005. These obligations represent agreements to purchase goods or services that were executed in the normal course of business.

Off- Balance Sheet Commitments - Gallagher's total unrecorded commitments associated with outstanding letters of credit, financial guarantees and funding commitments as of December 31, 2005 are as follows (in millions):

Amount of Commitment Expiration by Period

Off- Balance Sheet Commitments	2006	2007	2008	2009	2010	Thereafter	Total Amounts Committed
Investment related:							
Letters of credit							
\$	-	\$ -	\$ -	\$ -	\$ -	\$ 23.7	\$ 23.7
Funding commitments	0.7	0.6	-	-	-	-	1.3
Total commitments	\$ 0.7	\$ 0.6	-	-	-	\$ 23.7	\$ 25.0

At December 31, 2005, Gallagher had no off- balance sheet commitments related to its Brokerage or Risk Management operations. Since commitments may expire unused, the amounts presented in the table above do not necessarily reflect the actual future cash funding requirements of Gallagher. See Note 3 for a discussion of Gallagher's outstanding LOCs, financial guarantees and funding commitments. All of the LOCs represent multiple year commitments and have annual, automatic renewing provisions and are classified by the latest commitment date.

During the period from January 1, 2002 to December 31, 2005, Gallagher acquired fifty- three companies, which were accounted for as business combinations. Substantially all of the purchase agreements related to these acquisitions contain earnout obligations. The earnout obligations related to the 2005 acquisitions are disclosed in Note 4. These earnout payables represent the maximum amount of additional consideration that could be paid pursuant to the purchase agreements related to these acquisitions. These potential earnout obligations are primarily based upon future earnings of the acquired entities and were not included in the purchase price that was recorded for these acquisitions at their respective acquisition dates. Future payments made under these arrangements will generally be recorded as upward adjustments to goodwill when the earnouts are settled. The aggregate amount of unrecorded earnout obligations outstanding as of December 31, 2005 related to acquisitions made by Gallagher in the period from 2002 to 2005 was \$84.4 million.

Off- Balance Sheet Debt - Gallagher's unconsolidated investment portfolio includes investments in enterprises where Gallagher's ownership interest is between 1% and 50%, whereby management has determined that Gallagher's level of economic interest is not sufficient to require consolidation. As a result, these investments are accounted for using either the lower of amortized cost/cost or fair value, or the equity method, whichever is appropriate depending on the legal form of Gallagher's ownership interest and the applicable percentage of the entity owned. As such, the balance sheets of these investees are not consolidated in Gallagher's consolidated balance sheet at December 31, 2005 and 2004. The December 31, 2005 and 2004 balance sheets of several of these unconsolidated investments contain outstanding debt, which are also not required to be included in Gallagher's consolidated balance sheet.

In certain cases, Gallagher guarantees a portion of the enterprises' debt. Based on the ownership structure of these investments, management believes that Gallagher's exposure to losses related to these investments is limited to the combination of its net carrying value, funding commitments, LOCs and financial guarantees. In the event that certain of these enterprises were to default on their debt obligations and Gallagher's net carrying value became impaired, the amount to be impaired could have a material effect on Gallagher's consolidated operating results and/or financial position. See Note 3 for additional disclosures regarding these investments.

In addition to obligations and commitments related to Gallagher's investing activities discussed above, at December 31, 2005, Gallagher has posted an LOC of \$5.5 million for the benefit of an insurance company related to Gallagher's self- insurance deductibles, for which it has a recorded liability of \$6.0 million.

Gallagher's commitments associated with outstanding letters of credit (LOCS), financial guarantees and funding commitments at December 31, 2005 were as follows (all dollar amounts in table are in millions):

Description, Purpose and Trigger	Collateral	Compensation to Gallagher	Maximum Exposure	Liability Recorded
Tax advantaged investments				
"Reclamation" collateral (LOC) for land owned by Gallagher - expires after 2010 Trigger - Activities cease and Gallagher does not proceed with the reclamation process	(1)	None	\$ 4.4	\$ -
Funding commitment to a multi- pollutant reduction venture - expires 2006 Trigger - Agreed conditions met	None	None	0.7	-
Real estate, venture capital and other				
Funding commitments to two funds - expires 2007 Trigger - Agreed conditions met	None	None	0.6	-
Investments accounted for on a consolidated basis				
Credit support (LOC) for Gallagher's corporate headquarters building mortgage - expires 2008 Trigger - Manager (partial owner) defaults on mortgage payment	None	None	3.0	3.0
Credit support (LOC) for Florida Community Development bonds - expires 2032 Trigger - Florida Community Development defaults on payments	(2)	Reimbursement of LOC fees, plus "residual" cash payments	12.6	-
Other				
Credit support (LOC) for deductibles due by Gallagher on its own insurance coverages - expires after 2010 Trigger - Gallagher does not reimburse the insurance company for deductibles the insurance company advances on behalf of Gallagher - Total recorded liability for these self insurance deductibles was \$6.0 million at December 31, 2005	None	None	5.5	5.5
Credit enhancement (LOC) for Gallagher's Bermuda captive insurance operation to meet minimum statutory capital requirements - expires after 2010 Trigger - Dissolution or catastrophic financial results of the operation	(3)	Reimbursement of LOC fees	3.7	-
	None		3.0	-

Credit support (2 LOCs) for clients' claim funds held by Gallagher's Bermuda captive insurance operation in a fiduciary capacity - expires after 2010	Reimbursement of LOC fees	
Trigger - Investments fall below prescribed levels		
	\$ 33.5	\$ 8.5

-
- (1) Specific parcels of land.
(2) Indemnification by an affiliate of the purchaser of the project.
(3) The majority owners of the operation pledge their percentage ownership portion of any draw.

See the Management's Discussion and Analysis of Financial Condition and Results of Operations for an analysis of the Off- Balance Sheet Commitments. Since commitments may expire unused, the amounts presented in the table above do not necessarily reflect the actual future cash funding requirements of Gallagher.

As more fully described in Notes 3 and 8, at December 31, 2005, Gallagher had LOCs, financial guarantees and funding commitments related to its investments.

Litigation - Gallagher is engaged in various legal actions incident to the nature of its business.

Private parties have filed civil litigation against Gallagher under a variety of legal theories relating to, among other things, broker compensation practices. As previously reported, Gallagher is a defendant in a purported class action (Village of Orland Hills v. Arthur J. Gallagher & Co., Case No. 00 CH 13855, pending in the Circuit Court of Cook County, Illinois), which challenges the propriety of alleged "undisclosed contingent commissions" paid pursuant to certain compensation arrangements between Gallagher and various insurance carriers. This action was terminated when Gallagher's motion for summary judgment was granted in 2002 but was reinstated in 2003 when such ruling was overturned by an intermediate appeals court.

In addition, on October 19, 2004, Gallagher was joined as a defendant in a purported class action, originally filed in August 2004, in the U.S. District Court for the Southern District of New York by OptiCare Health Systems Inc. against various large insurance brokerage firms and commercial insurers (OptiCare Health Systems Inc. v. Marsh & McLennan Companies, Inc., et al., Case No. 04 CV 06954 (DC)). The amended complaint alleges that the defendants used the contingent commission structure of placement service agreements in a conspiracy to deprive policyholders of "independent and unbiased brokerage services, as well as free and open competition in the market for insurance." On February 1, 2006, the plaintiffs filed a second amended complaint that added additional defendants, including two of Gallagher's subsidiaries, but which otherwise did not contain any new claims or allegations. Since fourth quarter 2004, nine other similar purported class actions have been filed alleging claims similar to those alleged by the plaintiff in the OptiCare litigation. These cases have been, or likely will be, included in a Multi-District Litigation proceeding before the U.S. District Court for the District of New Jersey. Additionally, there are three state cases alleging similar claims.

On December 15, 2004, a shareholder derivative action was filed against Gallagher's directors and certain officers in the U.S. District Court for the Northern District Court of Illinois (Fener v. Robert E. Gallagher, et al., Case No. 040 8093). This derivative action alleged that such directors and officers violated various state laws, including breaches of fiduciary duties, abuse of control, gross mismanagement, waste of corporate assets and unjust enrichment, by purportedly causing Gallagher to engage in fraudulent insurance placement practices and to violate federal securities laws by disseminating false and misleading statements concerning Gallagher's financial results and operations. This case was dismissed by the trial court on September 8, 2005 and the plaintiff filed a notice of voluntary dismissal on October 11, 2005.

Gallagher believes it has meritorious defenses in all of these cases and intends to defend itself vigorously. However, neither the outcomes of these cases nor their effect upon Gallagher's business, financial condition or results of operations can be predicted at this time.

See Note 3 for a discussion on a litigation related pretax charge of \$131.0 million recorded by Gallagher in first quarter 2005.

Contingent Commissions and Other Industry Developments - The insurance industry in general, and Gallagher individually, continue to be the subjects of a significant level of scrutiny by various regulatory bodies, including State Attorneys General and the departments of insurance for various states, with respect to certain contingent commission arrangements (generally known as contingent commission or placement service agreements) between insurance brokers and insurance carriers.

On May 18, 2005, Gallagher and its subsidiaries and affiliates, except for Gallagher Bassett Services, Inc., entered into an Assurance of Voluntary Compliance (the AVC) with the Attorney General of the State of Illinois and the Director of Insurance of the State of Illinois (collectively, the IL State Agencies) to resolve all of the issues related to investigations conducted by the IL State Agencies. A copy of the AVC was previously disclosed as an exhibit to Gallagher's Current Report on Form 8-K dated May 18, 2005.

The material terms of the AVC and actions which have been taken under it are as follows:

On January 12, 2006, Gallagher paid \$26.9 million into a fund (the Fund) to be distributed to certain eligible policyholder clients. These payments are in full satisfaction of Gallagher's obligations under the AVC and the IL State Agencies have agreed not to impose any other financial obligation or liability on Gallagher in connection with their investigations. No portion of the payments by Gallagher is considered a fine or penalty.

The Fund, plus any interest, will be used to compensate Gallagher's eligible policyholder clients according to procedures set out in the AVC.

In third quarter 2005, Gallagher calculated, in accordance with a formula approved by the IL State Agencies, the amount that each policyholder client is eligible to receive from the Fund. Clients eligible to participate in the Fund are those retail policyholders who retained Gallagher's U.S. offices to place, renew, consult on or service insurance with inception or renewal dates between January 1, 2002 and December 31, 2004 (the Relevant Period) where such placement, renewal, consultation or servicing resulted in contingent commissions or overrides recorded by Gallagher during the Relevant Period (the Eligible Policyholders).

On September 30, 2005, Gallagher sent a notice to each Eligible Policyholder setting forth, among other things, the amount it will be paid from the Fund if it elects to participate (a Participating Policyholder). Participating Policyholders must tender a release of claims against Gallagher arising from acts, omissions, transactions or conduct that are the subject of the investigations by the IL State Agencies.

As of December 31, 2005, \$18.0 million had been claimed from the Fund by eligible policyholders.

On or before March 31, 2006, Gallagher will distribute from the Fund to each Participating Policyholder, that Participating Policyholder's aggregate share of the Fund with the monies then available in the Fund.

In the event that an Eligible Policyholder elects not to participate or otherwise had not responded by December 31, 2005 (a Non-Participating Policyholder), that client's allocated share may be used by Gallagher to satisfy any pending or other claims asserted by clients relating to the matters covered by the AVC. In no event shall a distribution be made from the Fund to any other client until all Participating Policyholders have been paid, nor shall total payments to any Non- Participating Policyholder exceed 80% of that policyholder's original allocated share. If any funds remain in the Fund as of December 31, 2007, such funds shall be distributed pro rata to the Participating Policyholders with the approval of the IL State Agencies. In no event shall any of the amounts paid into the Fund be used to pay attorneys' fees.

On or before December 31, 2005, Gallagher undertook certain changes to business practices, including the following:

With respect to U.S.- domiciled retail brokerage agency, producing, consulting or other services, to accept only a specific fee to be paid by the client, a specific fee or a specific percentage commission to be paid by an insurer set at the time of purchase, renewal, placement or servicing of an insurance policy, or a combination of both.

To fully disclose, in plain unambiguous written language, commissions and fees in either dollars or percentage amounts.

Not to accept any other material (\$500 or more) compensation or consideration from an insurer other than as stated above, including contingent compensation in connection with any retail insurance policy covering U.S. clients or risks.

To disclose to each retail client based in the U.S. or with risks in the U.S., at least annually, all compensation received during the preceding year from any insurer or third party in connection with the client's policy.

To implement company- wide written standards of conduct regarding compensation from insurers consistent with the terms of the AVC and institute appropriate training of employees, including business ethics, professional obligations, conflicts of interest, antitrust and trade practices compliance and recordkeeping.

To establish a Compliance Committee of Gallagher's Board of Directors.

To maintain a record of all complaints regarding compensation from any insurer, and provide such record to the Compliance Committee.

To file annual reports with the IL State Agencies for three years, beginning for the year ended December 31, 2006.

Although the investigation uncovered no evidence of Gallagher having engaged in the practices listed below, Gallagher also agreed:

Not to accept or request of any insurer any compensation in connection with Gallagher's selection of insurance companies from which to solicit bids for its clients.

Not to request or accept from any insurer any false, fictitious or inflated quote, or quote that does not represent the insurers' best evaluation at the time, of the minimum premium the insurer would require to bind the insurance coverage sought by the client.

Not to request or accept from any insurer any promise or commitment for the use of Gallagher' services, including reinsurance brokerage, agency or producing services, conditioned upon any arrangement to provide preferential treatment for any insurer.

Not to place, renew or service a client's business through a wholesale broker unless Gallagher discloses to the client all of the compensation to be received, any interest or contractual agreements Gallagher may have in the wholesale broker, and any alternative to using the wholesale broker.

Gallagher shall not, directly or indirectly, seek or accept indemnification pursuant to any insurance policy with respect to any amounts payable under the AVC.

As allowed under the AVC, Gallagher may accept contingent compensation from non- retail business, including business generated by wholesalers, managing general agents and managing general underwriters. In addition, the AVC allows Gallagher to collect retail contingent compensation related to contracts in place at entities acquired up to one year from the acquisition date.

In 2005, Gallagher recorded a pretax charge of \$73.6 million (\$44.2 million after tax) in connection with the regulatory and legal actions by the State Attorneys General and private litigants related to contingent commissions and various other historical business practices discussed above. In first quarter 2005, Gallagher incurred \$35.0 million of the charge, which was primarily related to costs associated with the AVC and other investigations and inquiries from other governmental authorities related to contingent commissions and various other historical business practices. In fourth quarter 2005, Gallagher incurred the remainder of the charge, or \$38.6 million, which was primarily related to costs associated with investigations and inquiries from governmental authorities related to contingent commissions and various other historical business practices, and the pending civil litigation. The amount accrued as of December 31, 2005 represents Gallagher's best estimate of the amount required to resolve the state insurance investigations, which includes all of the costs related to the funding and administration of the AVC, plus an accrual to resolve the pending litigation and an accrual for legal costs incurred or to be incurred to resolve these matters. Legal costs include amounts incurred or estimated to be incurred associated with the subpoenas received from State Attorneys General, investigations by governmental authorities and the internal review that was conducted by Gallagher's independent counsel. Gallagher continues to be the subject of a substantial number of regulatory and legal actions by State Attorneys General and private litigants investigating various historical business practices.

Contingent Liabilities - Gallagher purchases insurance to provide protection from errors and omissions (E&O) claims that may arise during the ordinary course of business. However, insuring 100% of potential claims is not cost effective. Effective June 1, 2005, Gallagher began to retain the first \$5.0 million of each and every E&O claim. Prior to June 1, 2005, Gallagher retained the first \$2.5 million of each and every E&O claim. Gallagher's E&O insurance provides aggregate coverage for E&O losses up to \$155.0 million in excess of Gallagher's retained amounts. Gallagher has historically maintained self- insurance reserves for the portion of its E&O exposure that is not insured. Gallagher periodically determines a range of possible reserve levels using actuarial techniques that rely heavily on projecting historical claim data into the future. Gallagher's E&O reserve in the December 31, 2005 consolidated balance sheet is above the lower end of the most recently determined actuarial range by \$6.0 million and below the upper end of the actuarial range by \$4.0 million. There can be no assurances that the historical claim data used to project the current reserve levels will be indicative of future claim activity. Thus, the actuarial ranges and E&O reserve level could change in the future as more information becomes known, which could materially impact the amounts reported and disclosed herein.

18. Income Taxes

Gallagher and its principal domestic subsidiaries are included in a consolidated federal income tax return. Gallagher's international subsidiaries file various income tax returns in their jurisdictions. Significant components of earnings from continuing operations before income taxes and the provision (benefit) for income taxes are as follows (in millions):

Year Ended December 31,				
	2005	2004	2003	
Earnings (loss) from continuing operations before income taxes:				
Domestic	\$ 5.0	\$ 221.3	\$ 174.6	
Foreign, principally United Kingdom, Australia and Bermuda	(7.8)	16.0	18.2	
	\$ (2.8)	\$ 237.3	\$ 192.8	
Provision (benefit) for income taxes - continuing operations:				
Federal:				
Current	\$ 41.9	\$ 64.8	\$ 57.0	
Deferred	(74.7)	(40.5)	(30.3)	
	(32.8)	24.3	26.7	
State and local:				
Current	11.3	23.7	16.5	
Deferred	(9.9)	(5.4)	(1.7)	
	1.4	18.3	14.8	
Foreign:				
Current	4.7	4.5	4.9	
Deferred	(4.7)	0.7	0.5	

	-	5.2	5.4
Total provision (benefit) for income taxes - continuing operations	\$ (31.4)	\$ 47.8	\$ 46.9

A reconciliation of the provision (benefit) for income taxes from continuing operations with the U.S. federal income tax rate is as follows (in millions):

Year Ended December 31,						
	2005		2004		2003	
	Amount	% of Pretax Earnings	Amount	% of Pretax Earnings	Amount	% of Pretax Earnings
Federal statutory rate	\$ (1.0)	35.0	\$ 83.0	35.0	\$ 67.5	35.0
State income taxes - net of federal benefit	0.9	NMF	12.1	5.1	9.7	5.0
Foreign taxes	2.9	NMF	(0.4)	(0.2)	(2.6)	(1.3)
Low income housing and alternative energy tax credits	(40.0)	NMF	(54.8)	(23.1)	(31.8)	(16.5)
Amortization expense of low income housing and alternative energy investment, net of tax benefit	0.3	NMF	1.1	0.5	1.6	0.8
Foreign dividends and other permanent differences	3.8	NMF	6.3	2.7	2.3	1.2
Stock compensation	0.6	NMF	0.5	0.2	0.2	0.1
Increase due to uncertain tax positions	1.9	NMF	-	-	-	-
Foreign tax credit	(1.9)	NMF	-	-	-	-
IRC Section 965 dividend	1.1	NMF	-	-	-	-
Provision (benefit) for income taxes - continuing operations	\$ (31.4)	35.0	\$ 47.8	20.2	\$ 46.9	24.3

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of Gallagher's deferred tax assets and liabilities are as follows (in millions):

December 31,			
	2005		2004
Deferred tax assets:			
Alternative minimum tax (AMT) and other credit carryforwards	\$	119.1	\$ 83.9
Accrued and unfunded compensation and employee benefits		62.9	68.2
Litigation related matters		60.9	-
Investment- related partnerships		46.7	72.7
Accrued liabilities		23.6	22.3
Minimum liability of pension plan		4.0	-
Other		4.1	5.1
Total deferred tax assets		321.3	252.2
Valuation allowance for deferred tax assets		-	-
Deferred tax assets		321.3	252.2
Deferred tax liabilities:			
Nondeductible amortizable intangible assets		23.5	23.1
Accrued and unfunded compensation and employee benefits		-	0.9
Accrued liabilities		0.3	7.9
Investment- related partnerships		13.3	22.1

Total deferred tax liabilities	37.1	54.0
Net deferred tax assets	\$ 284.2	\$ 198.2

At December 31, 2005 and 2004, \$85.2 million and \$67.4 million, respectively, of deferred tax assets have been included in other current assets in the accompanying consolidated balance sheet. At December 31, 2005 and 2004, \$37.1 million and \$54.0 million, respectively, of deferred tax liabilities have been included in other current and noncurrent liabilities in the accompanying consolidated balance sheet. AMT credits and other credits have an indefinite and twenty year life, respectively. Gallagher expects to fully utilize the amounts carried forward. Gallagher does not provide for U.S. federal

income taxes on the undistributed earnings (\$21.0 million at December 31, 2005) of foreign subsidiaries which are considered permanently invested outside of the U.S. The amount of unrecognized deferred tax liability on these undistributed earnings is \$5.4 million at December 31, 2005.

On October 22, 2004, the American Jobs Creation Act of 2004 (the Act) was signed into law. The Act provided for a special one- time opportunity for Gallagher to repatriate foreign earnings at a maximum rate of 5.25%. In 2005, Gallagher repatriated \$29.5 million from its foreign subsidiaries. Accordingly, Gallagher has recorded income tax expense of \$1.1 million related to the repatriation under the Act.

19. Quarterly Operating Results (unaudited)

Quarterly operating results for 2005 and 2004 were as follows (in millions, except per share data):

	1st	2nd	3rd	4th
2005				
Total revenues	\$ 346.8	\$ 371.1	\$ 389.9	\$ 376.1
Litigation related matters	131.0	-	-	-
Retail contingent commission related matters	35.0	-	-	38.6
Other expenses	305.5	313.7	324.3	338.6
Total expenses	471.5	313.7	324.3	377.2
Earnings (loss) from continuing operations before income taxes	(124.7)	57.4	65.6	(1.1)
Earnings (loss) from continuing operations	(73.6)	44.2	50.5	7.5
Earnings (loss) from discontinued operations	(5.4)	7.6	-	-
Net earnings (loss)	(79.0)	51.8	50.5	7.5
Basic net earnings (loss) per share:				
Earnings (loss) from continuing operations	\$ (.80)	\$.47	\$.53	\$.08
Earnings (loss) from discontinued operations	(.05)	.08	-	-
Net earnings (loss)	\$ (.85)	\$.55	\$.53	\$.08
Diluted net earnings (loss) per share:				
Earnings (loss) from continuing operations	\$ (.80)	\$.46	\$.52	\$.08
Earnings (loss) from discontinued operations	(.05)	.08	-	-
Net earnings (loss)	\$ (.85)	\$.54	\$.52	\$.08
2004				
Total revenues	\$ 331.4	\$ 368.7	\$ 363.5	\$ 373.4
Total expenses	282.1	310.8	295.0	311.8
Earnings from continuing operations before income taxes	49.3	57.9	68.5	61.6
Earnings from continuing operations	39.3	46.3	54.7	49.2
Loss from discontinued operations	(0.4)	(0.2)	(0.3)	(0.1)
Net earnings	38.9	46.1	54.4	49.1
Basic net earnings per share:				
Earnings from continuing operations	\$.43	\$.51	\$.59	\$.53
Loss from discontinued operations	-	-	-	-
Net earnings	\$.43	\$.51	\$.59	\$.53

Diluted net earnings per share:						
Earnings from continuing operations	\$	.41	\$	.49	\$.57	\$.52
Loss from discontinued operations		-		-	-	-
Net earnings	\$	.41	\$	.49	\$.57	\$.52

In fourth quarter 2005, Gallagher adjusted the previously reported amount for its first quarter 2005 discontinued operating results for a \$5.0 million, or \$0.05 per diluted share, income tax charge related to the income tax provision on the sale of one of its medical claim management operations that occurred in first quarter 2005.

20. Segment Information

Gallagher has identified three operating segments: Brokerage, Risk Management and Financial Services. The Brokerage Segment comprises three operating divisions: the Brokerage Services- Retail Division, Specialty Marketing and International and Gallagher Benefit Services. The Brokerage Segment, for commission or fee compensation, places commercial property/casualty (P/C) and employee benefit- related insurance on behalf of its customers. The Risk Management Segment provides P/C third- party administration, loss control and risk management consulting and insurance property appraisals. Third party administration is principally the management and processing of claims for self- insurance programs of Gallagher's clients or clients of other brokers. The Financial Services Segment is responsible for managing Gallagher's investment portfolio. Allocations of investment income and certain expenses are based on reasonable assumptions and estimates. Reported operating results by segment would change if different methods were applied. Financial information relating to Gallagher's segments for 2005, 2004 and 2003 is as follows (in millions):

	Brokerage		Risk Management		Financial Services		Total	
Year Ended December 31, 2005								
Revenues:								
Commissions	\$	784.3	\$	-	\$	-	\$	784.3
Retail contingent commissions		28.8		-		-		28.8
Fees		169.8		367.7		-		537.5
Investment income - fiduciary		17.9		2.9		-		20.8
Investment income all other		-		-		108.9		108.9
Investment income gains		-		-		3.6		3.6
Total revenues		1,000.8		370.6		112.5		1,483.9
Compensation		584.0		205.9		-		789.9
Operating		234.1		88.2		-		322.3
Investment expenses		-		-		104.9		104.9
Interest		-		-		11.6		11.6
Depreciation		13.6		7.7		11.4		32.7
Amortization		20.3		0.4		-		20.7
Litigation related matters		-		-		131.0		131.0
Retail contingent commissions related matters		73.6		-		-		73.6
Total expenses		925.6		302.2		258.9		1,486.7
Earnings (loss) from continuing operations before income taxes		75.2		68.4		(146.4)		(2.8)
Provision (benefit) for income taxes		3.1		15.8		(50.3)		(31.4)
Earnings (loss) from continuing operations	\$	72.1	\$	52.6	\$	(96.1)	\$	28.6
Net foreign exchange gain (loss)	\$	(2.6)	\$	(0.1)	\$	-	\$	(2.7)
Revenues:								
United States	\$	878.9	\$	335.1	\$	109.8	\$	1,323.8
Foreign, principally United Kingdom, Australia and Bermuda		121.9		35.5		2.7		160.1
Total revenues	\$	1,000.8	\$	370.6	\$	112.5	\$	1,483.9

At December 31, 2005

Identifiable assets:

United States	\$	1,927.7	\$	239.8	\$	569.7	\$	2,737.2
Foreign, principally United Kingdom, Australia and Bermuda		570.8		44.6		36.9		652.3
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Total identifiable assets	\$	2,498.5	\$	284.4	\$	606.6	\$	3,389.5
		<hr/>		<hr/>		<hr/>		<hr/>
Goodwill - net	\$	236.2	\$	9.5	\$	-	\$	245.7
Amortizable intangible assets - net		168.3		4.2		-		172.5

	Brokerage	Risk Management	Financial Services	Total
Year Ended December 31, 2004				
Revenues:				
Commissions	\$ 726.8	\$ -	\$ -	\$ 726.8
Retail contingent commissions	33.8	-		33.8
Fees	146.2	343.8	-	490.0
Investment income - fiduciary	13.4	1.7	-	15.1
Investment income all other	-	-	93.3	93.3
Impact of FIN 46 on investment income all other	-	-	69.9	69.9
Investment income gains	-	-	8.1	8.1
Total revenues	920.2	345.5	171.3	1,437.0
Compensation	527.5	187.3	-	714.8
Operating	176.1	91.8	-	267.9
Investment expenses	-	-	89.9	89.9
Impact of FIN 46 on investment expenses	-	-	67.2	67.2
Interest	-	-	9.5	9.5
Depreciation	12.9	7.8	9.3	30.0
Impact of FIN 46 on depreciation	-	-	2.7	2.7
Amortization	17.3	0.4	-	17.7
Total expenses	733.8	287.3	178.6	1,199.7
Earnings (loss) from continuing operations before income taxes	186.4	58.2	(7.3)	237.3
Provision (benefit) for income taxes	37.4	11.3	(0.9)	47.8
Earnings (loss) from continuing operations	\$ 149.0	\$ 46.9	\$ (6.4)	\$ 189.5
Net foreign exchange gain (loss)	\$ 2.3	\$ -	\$ -	\$ 2.3
Revenues:				
United States	\$ 814.9	\$ 306.9	\$ 167.9	\$ 1,289.7
Foreign, principally United Kingdom, Australia and Bermuda	105.3	38.6	3.4	147.3
Total revenues	\$ 920.2	\$ 345.5	\$ 171.3	\$ 1,437.0
At December 31, 2004				
Identifiable assets:				
United States	\$ 1,752.6	\$ 189.0	\$ 609.8	\$ 2,551.4
Foreign, principally United Kingdom, Australia and Bermuda	601.9	42.2	37.8	681.9
Total identifiable assets	\$ 2,354.5	\$ 231.2	\$ 647.6	\$ 3,233.3
Goodwill - net	\$ 209.5	\$ 9.5	\$ -	\$ 219.0

Amortizable intangible assets - net	150.6	4.6	-	155.2
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	Brokerage		Risk Management		Financial Services		Total	
Year Ended December 31, 2003								
Revenues:								
Commissions	\$	676.2	\$	-	\$	-	\$	676.2
Retail contingent commissions		29.3		-		-		29.3
Fees		127.5		291.2		-		418.7
Investment income - fiduciary		7.5		0.8		-		8.3
Investment income all other		-		-		66.7		66.7
Impact of FIN 46 on investment income all other		-		-		46.4		46.4
Investment income losses		-		-		(24.5)		(24.5)
Total revenues		840.5		292.0		88.6		1,221.1
Compensation		476.4		161.7		-		638.1
Operating		170.1		81.7		-		251.8
Investment expenses		-		-		47.9		47.9
Impact of FIN 46 on investment expenses		-		-		44.1		44.1
Interest		-		-		8.0		8.0
Depreciation		12.1		7.7		7.2		27.0
Impact of FIN 46 on depreciation		-		-		2.3		2.3
Amortization		9.0		0.1		-		9.1
Total expenses		667.6		251.2		109.5		1,028.3
Earnings (loss) from continuing operations before income taxes		172.9		40.8		(20.9)		192.8
Provision (benefit) for income taxes		42.2		9.6		(4.9)		46.9
Earnings (loss) from continuing operations	\$	130.7	\$	31.2	\$	(16.0)	\$	145.9
Net foreign exchange gain (loss)	\$	0.5	\$	(0.3)	\$	-	\$	0.2
Revenues:								
United States	\$	745.2	\$	260.6	\$	85.3	\$	1,091.1
Foreign, principally United Kingdom, Australia and Bermuda		95.3		31.4		3.3		130.0
Total revenues	\$	840.5	\$	292.0	\$	88.6	\$	1,221.1
At December 31, 2003								
Identifiable assets:								
United States	\$	1,433.2	\$	174.2	\$	611.7	\$	2,219.1
Foreign, principally United Kingdom, Australia and Bermuda		609.7		26.4		45.2		681.3

Total identifiable assets	\$	2,042.9	\$	200.6	\$	656.9	\$	2,900.4
Goodwill - net	\$	129.8	\$	8.5	\$	-	\$	138.3
Amortizable intangible assets - net		79.4		5.2		-		84.6

Report of Independent Registered Public Accounting Firm on Financial Statements

Arthur J. Gallagher & Co.

We have audited the accompanying consolidated balance sheet of Arthur J. Gallagher & Co. (Gallagher) as of December 31, 2005 and 2004, and the related consolidated statements of earnings, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of Gallagher's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Arthur J. Gallagher & Co. at December 31, 2005 and 2004, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Gallagher's internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control- Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 8, 2006, expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP
Ernst & Young LLP

Chicago, Illinois

Management's Report on Internal Control Over Financial Reporting

Gallagher's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a- 15(f). Under the supervision and with the participation of management, including Gallagher's principal executive officer and principal financial officer, Gallagher conducted an evaluation of the effectiveness of internal control over financial reporting based on the framework in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

In conducting Gallagher's evaluation of the effectiveness of its internal control over financial reporting, Gallagher has excluded the following acquisitions completed by Gallagher in 2005 of Horton Insurance Agency, Inc., Marine Insurance Service, LLC, Chris Schroeder Insurance, Inc., Alternative Market Specialists, WorkCare Northwest, Inc., Belmont Associates Consultants, Inc., Classic Insurance Services, Ltd., Corporate Life Consultants, Inc., Interpacific Underwriting Agencies Pty Ltd and Brokerage Professionals, Inc. Collectively, these acquisitions constituted approximately 1% of total assets as of December 31, 2005 and approximately 1% of total revenues and net earnings of \$3.1 million for the year then ended. Refer to Note 4 to the consolidated financial statements for further discussion of these acquisitions and their impact on Gallagher's consolidated financial statements.

Based on Gallagher's evaluation under the framework in Internal Control Integrated Framework, management concluded that internal control over financial reporting was effective as of December 31, 2005. Management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2005 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report which is included herein.

Arthur J. Gallagher & Co.
Itasca, Illinois

/s/ J. Patrick Gallagher, Jr.
J. Patrick Gallagher, Jr.
President and Chief Executive Officer

/s/ Douglas K. Howell
Douglas K. Howell
Chief Financial Officer

Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting

Board of Directors and Stockholders

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Arthur J. Gallagher & Co. (Gallagher) maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control- Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Gallagher's management is responsible for maintaining effective internal control over financial reporting and for its assessment about the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of Gallagher's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As indicated in the accompanying Management's Report on Internal Control Over Financial Reporting, management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of Horton Insurance Agency, Inc., Marine Insurance Service, LLC, Chris Schroeder Insurance, Inc., Alternative Market Specialists, WorkCare Northwest, Inc., Belmont Associates Consultants, Inc., Classic Insurance Services, Ltd., Corporate Life Consultants, Inc., Interpacific Underwriting Agencies Pty Ltd and Brokerage Professionals, Inc., which are included in the 2005 consolidated financial statements of Gallagher and constituted approximately 1% of total assets as of December 31, 2005 and approximately 1% of total revenues and net earnings of \$3.1 million for the year then ended. Management did not assess the effectiveness of internal control over financial reporting at these entities because Gallagher acquired these entities during 2005. Refer to Note 4 to the consolidated financial statements for further discussion of these acquisitions and their impact on Gallagher's consolidated financial statements. Our audit of internal control over financial reporting of Gallagher also did not include an evaluation of the internal control over financial reporting of the entities referred to above.

In our opinion, management's assessment that Gallagher maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Gallagher maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Arthur J. Gallagher & Co. as of December 31, 2005 and 2004 and the related consolidated statements of earnings, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2005 and our report dated February 8, 2006 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP
Ernst & Young LLP

Chicago, Illinois

Subsidiaries of Gallagher

In the following list of subsidiaries of Gallagher, those companies that are indented represent subsidiaries of the corporation under which they are indented. Except for directors' qualifying shares, 100% of the voting stock of each of the subsidiaries listed below, other than those indicated by footnote, is owned of record or beneficially by its indicated parent.

Name	State or Other Jurisdiction of Incorporation
Arthur J. Gallagher & Co. (Registrant)	Delaware
Arthur J. Gallagher & Co. (Illinois)	Illinois
Arthur J. Gallagher Service Company	Delaware
Arthur J. Gallagher Brokerage & Risk Management Services, LLC	Illinois
Arthur J. Gallagher Risk Management Services, Inc.	Illinois
Arthur J. Gallagher & Co. (Florida)	Florida
Arthur J. Gallagher & Co. of New York, Inc.	New York
Arthur J. Gallagher & Co.- Greenville	South Carolina
Arthur J. Gallagher & Co.- Little Rock	Arkansas
Arthur J. Gallagher & Co. Insurance Brokers of California, Inc.	California
Charity First Insurance Services, Inc.	California
Arthur J. Gallagher & Co. of Mississippi, Inc.	Mississippi
Arthur J. Gallagher & Co. of Tennessee, Inc.	Tennessee
Arthur J. Gallagher & Co. of Kentucky, Inc.	Kentucky
C. W. Excess Incorporated	New York
Gallagher Loss Control Services, Inc.	Tennessee
Gallagher Healthcare Insurance Services, Inc.	Texas
Gallagher Healthcare Insurance Services of Kansas City, LLC ⁽¹⁾	Missouri
Lamberson Koster & Company	California
Manning & Smith Insurance, Inc.	Kansas
Risk Placement Services, Inc.	Illinois
Risk Placement Services of Texas, Inc.	Texas
Risk Placement Services of Arkansas, Inc.	Arkansas
Risk Placement Insurance Services of Massachusetts, Inc.	Massachusetts
Risk Placement Services of Louisiana, Inc.	Louisiana
Risk Placement Services of Pennsylvania, Inc.	Pennsylvania
Risk Placement Services of New York, Inc.	New York
Edwin Rollins M. Company.	North Carolina
Risk Placement Services of Nevada, Inc.	Nevada
Risk Placement Services of Arizona, Inc.	Arizona
Arthur J. Gallagher & Co. (Bermuda) Limited	Bermuda
Arthur J. Gallagher Intermediaries (Bermuda) Limited	Bermuda
Arthur J. Gallagher Management (Bermuda) Limited	Bermuda
Gallagher Captive Services (Cayman) Limited	Cayman Islands
Scholastic Risk Services Limited	Bermuda
Artex Insurance Company Ltd ⁽²⁾ .	Bermuda
Artex Underwriting Managers Ltd.	Bermuda
Protected Insurance Company	Bermuda
Arthur J. Gallagher (UK) Limited	England
Risk Management Partners Ltd.	England
John Plumer & Company Limited	England
MRS Holdings Limited	England
Morgan Read & Sharman Limited	England
Arthur J. Gallagher Asia Pte Ltd ⁽³⁾ .	Singapore
Arthur J. Gallagher Asia Limited	Hong Kong
Arthur J. Gallagher (L) BHD	Malaysia
Connor Hale Kerslake Limited	England

Name	State or Other Jurisdiction of Incorporation
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Arthur J. Gallagher Australasia Pty Ltd.	Australia
Australis Group (Underwriting) Pty Ltd.	Australia
Interpacific Underwriting Agencies Pty Ltd.	Australia
Arthur J. Gallagher Reinsurance Australasia Pty Ltd.	Australia
Arthur J. Gallagher (Aus) Pty Ltd.	Australia
Gallagher Re, Inc.	Delaware
Gallagher Bassett Services, Inc.	Delaware
Gallagher Bassett of New York, Inc.	New York
Gallagher Bassett International Ltd.	Delaware
Gallagher Bassett International Ltd. (UK)	England
Gallagher Bassett Canada Inc.	Canada
Gallagher Bassett Services Pty Ltd.	Australia
Wyatt Gallagher Bassett Workers Compensation Victoria Pty Ltd.	Australia
Gallagher Bassett International S.A.	France
AJG Financial Services, Inc.	Delaware
AJG Capital, Inc. ⁽⁴⁾	Illinois
Aviacargo Leasing Limited	Ireland
AJG Investments, Inc.	Delaware
AJG Coal, Inc.	Delaware
AJG Chem Mod Holdings LLC	Delaware
Gallagher Holdings Bermuda Company Limited	Bermuda
AJG Coal Indiana LLC	Delaware
AJG Two Pierce, Inc.	Delaware
Gallagher Benefit Services, Inc.	Delaware
GBS Retirement Services, Inc.	New York
GBS Insurance and Financial Services, Inc.	Delaware
GBS Administrators, Inc.	Washington

- (1) 49% of the Common Stock of this subsidiary is owned by a third party.
- (2) 76% of the Common Stock of this subsidiary is owned by two third parties.
- (3) 49% of the Common Stock of this subsidiary is owned by two third parties.
- (4) 10% of the Common Stock of this subsidiary is owned by an unrelated party.

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in this Annual Report (Form 10- K) of Arthur J. Gallagher & Co. (Gallagher) of our reports dated February 8, 2006, on the consolidated financial statements and on internal control over financial reporting, included in Gallagher's 2005 Annual Report to Stockholders.

Our audits also included the consolidated financial statement schedule of Gallagher listed in Item 15(2)(a). This schedule is the responsibility of Gallagher's management. Our responsibility is to express an opinion based on our audits. In our opinion, the consolidated financial statement schedule referred to above, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We consent to the incorporation by reference in the Registration Statements (Form S- 8, No. 33- 604 and Form S- 8, No. 33- 14625) pertaining to the Arthur J. Gallagher & Co. Incentive and United Kingdom Incentive Plans, in the Registration Statements (Form S- 8, No. 33- 24251, Form S- 8, No. 33- 38031 and Form S- 8, No. 333- 57155) pertaining to the Arthur J. Gallagher & Co. 1988 Incentive and 1988 Nonqualified Stock Option Plans, in the Registration Statement (Form S- 8, No. 33- 30816) pertaining to the Arthur J. Gallagher & Co. Non- Employee Directors' Stock Option Plan, in the Registration Statements (Form S- 8, No. 33- 64614 and Form S- 8, No. 33- 80648) pertaining to the Arthur J. Gallagher & Co. 1988 Incentive, 1988 Nonqualified, and Non- Employee Directors' Stock Option Plans, in the Registration Statements (Form S- 8, No. 333- 06359, Form S- 8, No. 333- 40000, Form S- 8, No. 333- 87320 and Form S- 8, No. 333- 106535) pertaining to the Arthur J. Gallagher & Co. 1988 Nonqualified and Non- Employee Directors' Stock Option Plans, in the Registration Statement (Form S- 8, No. 333- 62930) pertaining to the Arthur J. Gallagher & Co. 1988 Nonqualified and Non- Employee Directors' Stock Option Plans and the Gallagher Healthcare Insurance Services, Inc. 2001 Nonqualified Stock Option Plan, in the Registration Statement (Form S- 8, No. 333- 106534) pertaining to the Arthur J. Gallagher & Co. Employee Stock Purchase Plan, in the Registration Statement (Form S- 8, No. 333- 106539) pertaining to the Arthur J. Gallagher & Co. Restricted Stock Plan, in the Registration Statements (Form S- 3, No. 333- 84139, Form S- 4, No. 333- 55254, Form S- 4, No. 333- 75197 and Form S- 4, No. 333- 84896), and in the related Prospectuses, of our reports dated February 8, 2006 with respect to internal control over financial reporting and the consolidated financial statements of Gallagher incorporated by reference herein, and our report included in the preceding paragraph with respect to the consolidated financial statement schedule included in this Annual Report (Form 10- K) for the year ended December 31, 2005.

/s/ Ernst & Young LLP

Ernst & Young LLP

Chicago, Illinois
February 8, 2006

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned hereby constitutes and appoints John C. Rosengren his true and lawful attorney-in- fact and agent, for him, and in his name, place and stead, in any and all capacities (i) to sign the Arthur J. Gallagher & Co. Annual Report on Form 10- K for the fiscal year ending December 31, 2005 and any and all amendments thereto and (ii) to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney- in- fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in such connection, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorney- in- fact and agent, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed this instrument as of this 26th day of January, 2006.

/s/ ROBERT E. GALLAGHER
Robert E. Gallagher

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned hereby constitutes and appoints John C. Rosengren his true and lawful attorney-in- fact and agent, for him, and in his name, place and stead, in any and all capacities (i) to sign the Arthur J. Gallagher & Co. Annual Report on Form 10- K for the fiscal year ending December 31, 2005 and any and all amendments thereto and (ii) to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney- in- fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in such connection, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorney- in- fact and agent, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed this instrument as of this 26th day of January, 2006.

/s/ T. KIMBALL BROOKER
T. Kimball Brooker

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned hereby constitutes and appoints John C. Rosengren his true and lawful attorney-in- fact and agent, for him, and in his name, place and stead, in any and all capacities (i) to sign the Arthur J. Gallagher & Co. Annual Report on Form 10- K for the fiscal year ending December 31, 2005 and any and all amendments thereto and (ii) to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney- in- fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in such connection, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorney- in- fact and agent, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed this instrument as of this 26th day of January, 2006.

/s/ GARY P. COUGHLAN

Gary P. Coughlan

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned hereby constitutes and appoints John C. Rosengren her true and lawful attorney-in- fact and agent, for her, and in her name, place and stead, in any and all capacities (i) to sign the Arthur J. Gallagher & Co. Annual Report on Form 10- K for the fiscal year ending December 31, 2005 and any and all amendments thereto and (ii) to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney- in- fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in such connection, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorney- in- fact and agent, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed this instrument as of this 26th day of January, 2006.

/s/ ILENE S. GORDON
Ilene S. Gordon

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned hereby constitutes and appoints John C. Rosengren his true and lawful attorney-in- fact and agent, for him, and in his name, place and stead, in any and all capacities (i) to sign the Arthur J. Gallagher & Co. Annual Report on Form 10- K for the fiscal year ending December 31, 2005 and any and all amendments thereto and (ii) to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney- in- fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in such connection, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorney- in- fact and agent, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed this instrument as of this 26th day of January, 2006.

/s/ ELBERT O. HAND
Elbert O. Hand

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned hereby constitutes and appoints John C. Rosengren his true and lawful attorney-in- fact and agent, for him, and in his name, place and stead, in any and all capacities (i) to sign the Arthur J. Gallagher & Co. Annual Report on Form 10- K for the fiscal year ending December 31, 2005 and any and all amendments thereto and (ii) to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney- in- fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in such connection, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorney- in- fact and agent, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed this instrument as of this 26th day of January, 2006.

/s/ DAVID S. JOHNSON

David S. Johnson

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned hereby constitutes and appoints John C. Rosengren her true and lawful attorney-in- fact and agent, for her, and in her name, place and stead, in any and all capacities (i) to sign the Arthur J. Gallagher & Co. Annual Report on Form 10- K for the fiscal year ending December 31, 2005 and any and all amendments thereto and (ii) to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney- in- fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in such connection, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorney- in- fact and agent, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed this instrument as of this 26th day of January, 2006.

/s/ **KAY W. McCURDY**

Kay W. McCurdy

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned hereby constitutes and appoints John C. Rosengren his true and lawful attorney-in- fact and agent, for him, and in his name, place and stead, in any and all capacities (i) to sign the Arthur J. Gallagher & Co. Annual Report on Form 10- K for the fiscal year ending December 31, 2005 and any and all amendments thereto and (ii) to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney- in- fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in such connection, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorney- in- fact and agent, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed this instrument as of this 26th day of January, 2006.

/s/ JAMES R. WIMMER

James R. Wimmer

Rule 13a- 14(a) Certification of Chief Executive Officer**Certification**

1. I have reviewed this annual report on Form 10- K of Arthur J. Gallagher & Co.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a- 15(e) and 15d- 15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a- 15(f) and 15d- 15(f)) for the registrant and have:
 - (a.) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b.) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles;
 - (c.) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d.) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a.) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b.) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 8, 2006

/s/ J. Patrick Gallagher, Jr.
J. Patrick Gallagher, Jr.
President and Chief Executive Officer
(principal executive officer)

Rule 13a- 14(a) Certification of Chief Financial Officer**Certification**

1. I have reviewed this annual report on Form 10- K of Arthur J. Gallagher & Co.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a- 15(e) and 15d- 15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a- 15(f) and 15d- 15(f)) for the registrant and have:
 - (a.) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b.) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles;
 - (c.) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d.) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a.) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b.) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 8, 2006

/s/ Douglas K. Howell
Douglas K. Howell
Vice President
Chief Financial Officer
(principal financial officer)

Section 1350 Certification of Chief Executive Officer

I, J. Patrick Gallagher, Jr., the chief executive officer of Arthur J. Gallagher & Co., certify that (i) the Annual Report on Form 10- K of Arthur J. Gallagher & Co. for the twelve month period ended December 31, 2005 (the "Form 10- K") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and (ii) the information contained in the Form 10- K fairly presents, in all material respects, the financial condition and results of operations of Arthur J. Gallagher & Co. and its subsidiaries.

Date: February 8, 2006

/s/ J. Patrick Gallagher, Jr.
J. Patrick Gallagher, Jr.
President and Chief Executive Officer
(principal executive officer)

Section 1350 Certification of Chief Financial Officer

I, Douglas K. Howell, the chief financial officer of Arthur J. Gallagher & Co., certify that (i) the Annual Report on Form 10- K of Arthur J. Gallagher & Co. for the twelve month period ended December 31, 2005 (the "Form 10- K") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and (ii) the information contained in the Form 10- K fairly presents, in all material respects, the financial condition and results of operations of Arthur J. Gallagher & Co. and its subsidiaries.

Date: February 8, 2006

/s/ Douglas K. Howell
Douglas K. Howell
Vice President
Chief Financial Officer
(principal financial officer)