

**DUE DILIGENCE IN ACQUISITION OF
PARTNERSHIP AND
LIMITED LIABILITY COMPANY
INTERESTS**

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DUE DILIGENCE IN ACQUISITION OF PARTNERSHIP AND LIMITED LIABILITY COMPANY INTERESTS

1. What are you purchasing?

Generally speaking, there are two methods by which a party will acquire an ownership interest in an existing partnership or limited liability company. One method is to contribute capital to the existing company in exchange for an ownership interest issued directly from the company. The second method is to acquire the ownership interest in the company from an existing owner.

The purpose of this paper is to highlight some of the more significant due diligence issues a party might consider in connection with the acquisition of an ownership interest in a partnership or limited liability company. We will also explore issues that may arise from the seller's perspective.

The list of issues in this paper are not intended to be an exhaustive list of due diligence considerations that might arise in connection with the purchase of an interest in a partnership or limited liability company, but rather is intended to highlight selected issues for discussion purposes, where due diligence may be at a premium.

2. Identify the Seller.

In a transaction in which the party is acquiring the ownership interest directly from the company, the payment of consideration will be to the company, and the primary party, with whom the purchaser will engage, on a legal and business basis, is usually the company, itself.

By contrast, in a transaction where the party is acquiring the ownership interest from an existing partner or member of the partnership or limited liability company, the payment of consideration will be to the selling partner or member, and the primary person the purchasing party will engage with, on a legal and business basis, is usually the selling partner or member.

3. Purchase of Ownership Interest from the Company.

a. *Subscription Agreement and Booklet.* A party seeking to acquire an interest in a limited partnership or limited liability company is often presented with an Offering Memorandum and Subscription Agreement. These documents are designed to protect the entity and the parties offering to sell the ownership interest to the purchaser. It is important to review these documents, as well as the terms of the partnership agreement or company agreement, and any proposed amendment to those agreements that are to be adopted in connection with the purchaser's

acquisition of its ownership interest. However, it is equally important to understand these documents are designed to assist the company in meeting its requirements related to securities laws, ERISA laws, and other exposures, as well as providing well-crafted disclosures to the purchaser for the purpose of establishing a level of protection for the company against potential claims from the purchaser/investor. They are not typically designed with the interest of the purchaser/investor in mind.

b. *Due Diligence Review of Company's Organizational Documents.* The following is a list of some of the items the purchaser will want to review and analyze in connection with the purchase of the ownership interest from the company.

i. Formation Documentation.

1. Obtain and review a copy of the partnership agreement or company agreement and Articles of Formation and qualification to do business in applicable jurisdictions.
2. Confirm the business purpose as well as any special limitation set out in the Articles of Formation.
3. Determine the location of operations.
4. Identify any special governmental requirements for the business operations and the status of the documentations supporting this requirement.

ii. Economics of the Deal. Review the company agreement or partnership agreement for a full understanding of the economics of the deal that you are to obtain from the potential investment. This should include a review of the following:

1. Status of existing Capital Accounts;
2. Duties to contribute Additional Contributions;
3. Remedies for a failure to contribute;
4. Rights to Distributions and priority returns;
 - a. Control;
 - b. Priority; and
 - c. Special tax distributions;
5. Allocations of Profits and Losses;
6. Analysis of shifting rights for distributions or allocations of profits; and
7. Fees or compensation paid to related parties.

iii. Term and Termination of the Company. Confirm when the term of the entity began, when it will end and the events requiring a winding up of the entity.

iv. Management Rights. Review the provisions relating to the management of the company, including:

1. Voting rights as owner;
2. Rights of managers or general partner or managing partner;
3. Standard of care as owners;

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