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# **Unincorporated Entity Owner Buyouts from the Inside Part 2: Drafting the Purchase Agreement**

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## Unincorporated Entity Owner Buyouts from the Inside Part 2: Drafting the Purchase Agreement

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### I. Introduction.

My intent in writing this article was to present a ‘drafting guide’ for buyouts of a member or partner from the buyer/company/partnership perspective that balances detail and readability for practitioners who may be approaching the drafting process for the 1<sup>st</sup> or 100<sup>th</sup> time. If you’re drafting a redemption/buyout for the 100<sup>th</sup> or more times, then I hope you’ll find some concepts in this article that you hadn’t previously considered or that perhaps refresh your memory. This article assumes that the issuing entity’s governing documents lacked terms for the buyout or that the parties otherwise chose to alter or avoid those terms.

The clauses and sample agreement I provide are based on one member in an LLC reacquiring the interest of another member that is a natural person. However, in the majority of circumstances (with notable exceptions, such as tax implications), the names/phrases can be changed, and the same core concepts applied to the issuing entity as buyer, a partnership reacquisition or a selling member that is itself an entity/organization/series. The sample agreement I provide and this article are all based on Texas law.

I’ll use the following terms throughout for the sake of simplicity: ‘buyer’ for the issuing entity or member acquiring or reacquiring interests/units of ownership from another member; ‘seller’ for the member whose interests are being acquired; ‘company’ for the issuer; ‘interest’ to refer simply to units or percentages of ownership interests; ‘purchase agreement’ to refer to the agreement to

acquire/reacquire the interests/units of ownership; ‘purchase’ to refer to the reacquisition/purchase; ‘TBOC’ for the Texas Business Organizations Code; ‘governing documents’ to refer to the company agreement/operating agreement for LLCs; and ‘Sample Agreement’ to refer to the Sample Agreement included with this article. Again, the above concepts can be largely applied to a partnership or partner that is buying out another partner’s interest.

While I have included my own template for your consideration, not every aspect of the Sample Agreement has been litigation tested (some portions have), and I don’t claim it to be error free. You may also compare the sample agreement with the ABA Model Agreement for LLC Redemptions, which can be found at <https://www.americanbar.org/products/ecd/e bk/217726/>.<sup>1</sup> Where referenced in this article, I simply call it the ‘ABA Model Agreement.’

My personal approach to the reacquisition of a seller’s interest or purchase by another member is to treat it almost the same as the buyout of a third party in an unfamiliar company, and that drives some of the detail in the Sample Agreement. Of course, you can simplify things to your preference and the Sample Agreement is provided ‘as-is.’

Several of the concepts discussed in this article are capable of entirely separate articles that explore those concepts in greater detail and, where possible, I have included references to outside resources for further reading.

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<sup>1</sup> The ABA requires a licensing fee for its educational publications, including the so-called ‘model agreement,’ and you may have to pay for access

unless you find the model agreement using an existing subscription, such as Westlaw.

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### A. To Redeem or Not to Redeem?

The TBOC does not define the concept of ‘redemption’ for LLC interests, whereas other state codes – such as Delaware’s – do.<sup>2</sup> While redemption is a defined concept for partnerships in Texas, it is conceptually limited to the matters set forth in the TBOC, which largely relate to a partner’s withdrawal.<sup>3</sup>

Speaking of a withdrawal, some practitioners make reference to the seller’s ‘withdrawal’ either in the body of the purchase agreement or by calling the purchase agreement a withdrawal agreement (the ABA Model Agreement includes such a clause). In my view, the concept of withdrawal DOES have a specific definition under the TBOC and it is intended to be a unilateral action by the seller that carries consequences for the company.<sup>4</sup> As such, in my opinion, the term withdrawal should *not* be used unless: the seller is, well, exercising the right to withdraw; and withdrawal is permitted under the governing documents or there are no governing documents.

For this reason, I style my reacquisition agreements simply as ‘purchase agreements’ or ‘repurchase agreements’ if the issuing entity is reacquiring the interests.

LLCs also do not generally have ‘treasury interests’ like ‘treasury stock’ in the corporate sense, though it is technically possible if the LLC operating agreement allows for it and courts may enforce that arrangement as a contractual matter.<sup>5</sup> Thus, if the LLC itself is the buyer reacquiring the

seller’s interests (as opposed to another member), it is best to include a statement, clause, exhibit, or similar presentation explaining what the holdings of each remaining member will be once the transaction is complete.

## II. Drafting the Core Elements

### A. Recitals

Recitals are often overlooked as ‘boilerplate’ in contract drafting but can be useful in helping a third-party reviewer – really, a court – understand why parties are engaging in a given transaction or, in a worst-case scenario, fill in the gaps created by an ambiguity or further demonstrate the intent of the parties entering into the contract.

A recital is a formal statement or setting forth of some matter of fact, in any deed or writing, in order to explain the reasons upon which the transaction is founded.<sup>6</sup> Recitals are generally not part of a contract unless the parties intended them to be, and will not control a contract’s operative clauses unless those clauses are ambiguous.<sup>7</sup> While the recitals may not be controlling, they do factor in to a court’s review or consideration of a given contract in its entirety.<sup>8</sup>

The purchase agreement recitals should be tailored depending on your specific facts, and it isn’t possible to succinctly summarize the range of possibilities. However, in the context of an interest purchase, consider drafting an explanation or recital summary

<sup>2</sup> See e.g. Del . Code Ann . tit . 6 § 18–702(e) (2010)

<sup>3</sup> See Tex. Bus. Org. Code § 152.601 – 152.612; See also § 152.406 and §152.501

<sup>4</sup> See Tex. Bus. Org. Code § 152.501 – 152.505

<sup>5</sup> See *Model Company Agreements for Closely Held LLCs*, by Cliff Ernst and Elizabeth S. Miller, presented

at 29<sup>th</sup> Annual LLCs, LPs and Partnerships, July 23–24, 2020

<sup>6</sup> *All Metals Fabricating v. Ramer Concrete*, 338 S.W.3d 557, 561 (Tex. App.–El Paso 2009, no pet.)

<sup>7</sup> *Id.*

<sup>8</sup> *Mikob Props., Inc. v. Joachim*, 468 S.W.3d 587, 596 n.4 (Tex. App.–Dallas 2015, pet. denied)

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