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A Walk Through Purchase and Sale Agreements****Cliff Ernst****William H. Hornberger**

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Sale of Partnership and LLC Interests: A Walk Through Purchase and Sale Agreements

CONSIDERATIONS RELATING TO NEGOTIATING AND DRAFTING PURCHASE AND SALE AGREEMENTS

Table of Contents

	<u>Page</u>
I. Introduction	1
II. Why Sell Ownership Interests?	2
A. Tax Considerations	2
B. Liability Protection	2
C. Post Purchase Distributions	2
D. Avoidance of Assignments and Separate Conveyances	3
III. Due Diligence Considerations	3
IV. Mergers	4
V. The Form	4

**SELECTED FEDERAL INCOME TAX CONSIDERATIONS
RELATING TO SALES OF PARTNERSHIP INTERESTS**

[Table of Contents appears at
the beginning of this outline.]

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CONSIDERATIONS RELATING TO NEGOTIATING AND DRAFTING PURCHASE AND SALE AGREEMENTS

**Cliff Ernst
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I. Introduction.

The Business and Public Filings Division of the Office of the Texas Secretary of State reports that unincorporated entities, and in particular limited liability companies, have become the entities of choice in the State of Texas. More than half of all new entities formed in Texas in 2005 and 2006 were limited liability companies or limited partnerships.¹ It remains to be seen what impact, if any, the recently adopted changes in the Texas franchise tax laws (sometimes called the “margin tax”) will have on future choices of entity for business enterprises in the state of Texas, but if current trends continue, it is likely that more and more businesses in Texas and elsewhere will be conducted as unincorporated entities. As these businesses mature, it seems inevitable that lawyers, accountants, brokers and others who deal with the purchase and sale of business enterprises will be encountering transactions involving the sale of a limited liability company or limited partnership.

¹ The Master File Statistics Report generated on July 1, 2007 by the Office of the Texas Secretary of State shows the following total number of active (i.e., “in existence”) for-profit corporations, limited liability companies and limited partnerships :

Domestic For-Profit Corporations:	392,717
Domestic Limited Liability Companies:	251,714
Domestic Limited Partnerships:	142,900

The Filed Documents Report by the Office of the Texas Secretary of State shows the following number of certificates of formation were filed to create new for-profit corporations, limited liability companies and limited partnerships (consequently, these statistics do not include those entities created by conversion or merger):

Domestic For-Profit Corporations:	33,757
Domestic Limited Liability Companies:	58,288
Domestic Limited Partnerships:	16,355

The Filed Documents Report by the Office of the Texas Secretary of State for calendar year 2005 shows the following:

Domestic For-Profit Corporations:	34,856
Domestic Limited Liability Companies:	53,097
Domestic Limited Partnerships:	20,835

The primary purpose of this outline is to consider a form of purchase and sale agreement that might be appropriate for a transaction involving the purchase and sale of ownership interests in a limited liability company or limited partnership and certain issues related to such a transaction in the context of the form.

Before examining the form, a few preliminary observations are helpful.

II. Why Sell Ownership Interests?

One of the first questions always considered in connection with the purchase and sale of a business enterprise is the appropriate structure for the transaction. In particular, should the transaction be structured as a sale of assets by the target entity, or should it be structured as a sale of the ownership interests by the owners of the target entity (in a stock transaction, a sale of stock by the stockholders). Several factors affect this decision. We will begin by a brief examination of these factors in the context of the sale of an unincorporated entity.

A. Tax Considerations. Federal income tax considerations are an important, if not the most important, consideration in structuring any purchase and sale of a business. If the target entity is classified as a C Corporation for federal income tax purposes, then the sellers will likely have a strong incentive for structuring the transaction as a sale of stock or ownership interests to avoid the double taxation that would arise upon a sale of assets. If the entity is classified as a partnership or a disregarded entity, then the concern of double taxation will be eliminated, although other taxation considerations may apply. Refer to the outline prepared by William H. Hornberger, which follows the forms presented in this outline, for a discussion of selected federal income tax considerations relating to sales of partnership interests.

B. Liability Protection. Purchasers typically prefer to purchase the assets of a corporation rather than purchase the corporation through the purchase of its outstanding stock to avoid liabilities of the corporation, especially unknown or contingent liabilities. This is also a valid consideration in the context of the sale of the business enterprise conducted as a limited liability company or limited partnership. While a purchaser will attempt to protect itself from liability by conducting a thorough due diligence review of the business and by obtaining representations and warranties and indemnities from the sellers (all of which will be discussed further later in this outline), it would still seem to be the case that, all other factors being equal, a purchaser will have a strong preference for purchasing the assets of the business from the target entity, paying the purchase consideration to the target entity.

C. Post Purchase Distributions. If the sale of a business is structured as purchase and sale of assets by the target entity, then such transaction is typically followed by a distribution of the purchase proceeds to the owners of the entity, either in liquidation of the target entity, or otherwise. In the context of a sale by a limited liability company or limited partnership, the post-purchase distributions will be governed by the governing documents of the seller, either the Company Agreement or Regulations of the limited liability company² or the Agreement of

² The governing document of a limited liability company formed before the effectiveness of the Texas Business Organization Code on January 1, 2006 is called the Regulations; the governing document of a limited liability company formed under the Texas Business Organization Code is called the Company Agreement.

Limited Partnership of the limited partnership. These governing documents should be reviewed carefully in connection with the structuring of the purchase and sale transaction to be sure that the owners understand and are comfortable with way the sale proceeds will be distributed and will not surprised by the final distribution of the purchase consideration. For example, some governing documents provide for a different distribution scheme that applies to the distributions of the proceeds of a “capital transaction” versus the distribution of ordinary income. It seems unlikely the distribution provisions of the governing documents will be a strong determining factor in choosing a sale of ownership interests instead of a sale of assets, but they should be considered.

D. Avoidance of Assignments and Separate Conveyances. Besides tax considerations, the most frequent reason that the purchase and sale of a business is structured as a sale of the ownership interests (i.e. a stock sale) and not a sale of assets, is to avoid having to separately convey all of the assets of the business. If the target entity has entered into numerous contracts, then each of these contracts will need to be assigned by the target entity to the purchaser, typically with a separate assignment document for each contract. If the contracts require the consent of the other contracting party or parties, then additional labor and time will be required to obtain proper consents. In addition, the pending purchase and sale will have to be disclosed and described to customers, vendors, landlords and other contracting parties where consents are needed. It is general practice to document the sale of other tangible and intangible assets through the use of a General Conveyance that identifies in a schedule or otherwise the transferred assets. Depending upon the complexity of the business and the desires of the purchaser and seller for specificity, preparation of this schedule of assets can, in many cases, be a very cumbersome and expensive proposition. Additionally, if the assets being conveyed consist of real estate, motor vehicles or other “titled” assets, then a separate deed, title assignment, etc. will have to be prepared, executed and recorded or filed in the land office, motor vehicle registration office or other appropriate filing office. Filing fees and transfer taxes, if applicable, will be incurred in connection with the filings and transfers. Sometimes the daunting task of identifying and scheduling and conveying all assets together with the desire to minimize the need obtain consents and the desire to keep the transaction confidential prevails over the risk that the purchaser perceives in taking on the liabilities of the target entity. These considerations would apply regardless of whether the target entity is a corporation or an unincorporated entity.

III. Due Diligence Considerations.

A detailed discussion of due diligence procedures is beyond the scope of this outline. Many of the elements of a due diligence examination are “gender neutral” and will not be affected by the organizational form of the target entity. However, as will be discussed further later in this outline in the context of specific representations and warranties, certain aspects of the ownership and operation of an unincorporated entity, particularly accounting and tax matters, will be remarkably different for an unincorporated entity as compared to a corporation. Special attention should be focused during the due diligence process on such matters as capital account maintenance, records of distributions, any indication of wrongful distributions,³ transfers and

³ Wrongful distributions, which may create an obligation of limited partners to return the distribution, are dealt with in Section 153.112 and Section 153.210 of the Texas Business Organizations Code.

redemptions of ownership interest, and employee compensation arrangements that involve granting to employees or consultants ownership interests in the target entity.

IV. Mergers.

Another common structure for the acquisition of a business enterprise is a merger of the acquiring entity (or a subsidiary of the acquiring entity) with the target entity. A detailed examination of the many tax and business law issues involved in the mergers of unincorporated entities with other unincorporated entities or with corporations is beyond the scope of this outline. These issues have been examined in detail in the following excellent outlines: *Mergers, Conversions and Transmogrification* by Robert Keatinge, presented at The University of Texas School of Law Continuing Legal Education Program on Current Issues Affecting Partnerships, Limited Partnerships and Limited Liability Companies, July 17 and 18, 2003, and *Mergers, Acquisitions and Conversions with Partnerships and LLCs* by Michael K. Pierce and Kevin Thomson, presented at The University of Texas School of Law Continuing Legal Education Program on Current Issues Affecting Partnerships, Limited Partnerships and Limited Liability Companies on July 15 and 16, 2004.

If one were presented with the task of preparing a form of Merger Agreement involving an unincorporated entity, the form presented in this outline might be of some utility. Although the portions of the form dealing with the mechanics of the transaction (Article 2) would change, certain portion of the form such, as the sellers' representations and warranties (Article 3 and Article 4), covenants and conditions (Article 7, Article 8, and Article 9) and indemnities (Article 11) might be instructive.

V. The Form.

This brings us to our examination of our form of purchase and sale agreement. The following form is an amalgamation of provisions from a number of purchase and sale agreements and is not the product of a real, negotiated transaction. In particular the author wishes to acknowledge and are indebted to the members of the Committee on Negotiated Acquisitions of the American Bar Association's Business Law Section for their *Model Stock Purchase Agreement with Commentary* and the *Manual on Acquisition Review*, both published in 1995, and their *Model Asset Purchase Agreement with Commentary* published in 2001.

The form agreement commences on the next page. Commentary on the form for the balance of this outline will be presented in the form of footnotes to the form.

**FORM⁴ OF
[MEMBERSHIP / PARTNERSHIP] INTEREST⁵
PURCHASE AGREEMENT**

This [Membership / Partnership] Interest Purchase Agreement (“Agreement”) is made as of _____, 20__, by _____, a _____ [limited liability company / limited partnership / corporation] (the “Purchaser”), and each of the Persons listed on Exhibit “A” (collectively, the “Sellers” and each a “Seller”) ⁶.

W I T N E S S E T H

WHEREAS, the Sellers own, respectively, the [membership / partnership] interests (the “Interests”) of _____, a Texas [limited liability company / limited partnership] (the “Company” / the “Partnership”), indicated in Exhibit “A”, and

WHEREAS, _____, [a _____ corporation / limited liability company] and _____, [a _____ corporation / limited liability company] (the “Principal Seller[s]”) [is / are] the [managing member[s] / manager[s] / general partner[s]] of the [Company / Partnership] and [is / are] actively involved in managing the business of the [Company / Partnership], and accordingly, [is / are] in a position to make certain representations, warranties and covenants in respect of the [Company / Partnership] ⁷; and

WHEREAS, each of the Sellers wishes to sell, and the Purchaser wishes to purchase, the Interests, subject to the conditions contained in this Agreement;

⁴ This form agreement is not a form to be completed by filling in the blanks. Drafters should be certain that any agreement used by them is appropriate for the particular transaction. The presence or the absence of a particular provision in this form should not be taken as an indication that the provision is or is not “market standard.”

⁵ Consistent with the *Model Limited Liability Company Membership Interest Redemption Agreement* prepared by the Subcommittee on Limited Liability Companies of the Committee on Partnerships and Unincorporated Business Organizations, Section of Business Law, American Bar Association (published at 61 Bus. Law 1197, 2005–2006), we have chosen to call our form a “Membership Interest Purchase Agreement” or “Partnership Interest Purchase Agreement.” Some Company Agreements and Partnership Agreements designate membership or partnership interests as “Units.” If drafting an agreement in a transaction where interests are designated as “Units,” it may be appropriate to name the agreement “Unit Purchase Agreement.”

⁶ In stock purchase agreements, the sellers of stock are typically designated Stockholders or Shareholders. To simplify this form, the interest owners who are selling interests are called Sellers, rather than Unitholders, Interestholders, Limited and General Partners, Members or other similar designations.

⁷ In stock sale transactions where one or more “principal” stockholders own a controlling interest in the target entity and participate actively in the management of the target entity and minority shareholders play a passive role, the Sellers may prevail in limiting the representations and warranties made by the minority shareholders to matters, such as share ownership, within their knowledge and control. Because limited partnerships are managed and controlled by a general partner and because limited liability companies are frequently managed and controlled by one or more managers or one or more managing members, this form contemplates that the limited partners or members not involved in management would persuade the Purchaser to accept similar limited representations from the passive owners.

NOW, THEREFORE, in consideration of the mutual covenants and agreements set forth in this Agreement, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties do hereby agree as follows:

ARTICLE 1

Definitions

Section 1.1 **Definitions.** Certain terms used in this instrument are capitalized. Such terms shall have the meaning set forth in the text or in Section 12.18.

ARTICLE 2

Sale and Transfer of Interests; Closing

Section 2.1 **Agreement to Purchase and Sell.** Subject to the terms and conditions of this Agreement, at the Closing, the Sellers will sell, transfer and assign the Interests to the Purchaser, and the Purchaser will purchase the Interests from the Sellers.

Section 2.2 **Purchase Price.** The purchase price for the Interests (the "Purchase Price") is the aggregate sum of _____ Dollars (\$_____).⁸ The Purchase Price shall be payable by the Purchaser to the Sellers as set forth on Exhibit "A".⁹

Section 2.3 **Closing.** The closing of the transactions contemplated by this Agreement (the "Closing") will take place at the offices of the Purchaser's counsel at _____, at 10:00 a.m. (local time) on the later of (i) _____, 20__ or (ii) the date that is two business

⁸ *The Model Stock Purchase Agreement* promulgated by the Committee on Negotiated Acquisitions of the Section of Business Law of the American Bar Association provides for an adjustment to the agreed purchase price based upon changes in the target corporation's consolidated stockholder's equity between the date of the balance sheet relied upon by the Purchaser to determine the purchase price and the closing date. Mechanics are included for a post-closing preparation of financial statements as of the closing date and a "true-up" of the purchase price after the closing date financial statements are finalized. It has been the author's experience that there are no "standard" provisions for post closing adjustments to purchase price. In fact purchasers differ widely in their approach to post closing adjustments and the language they use regarding post closing adjustments. For this reason, this form does not include provisions for a post closing adjustment to the purchase price. However, it should be anticipated that the Purchaser may insist on such provisions and that such provisions will likely be among the most heavily negotiated provisions in the purchase agreement.

⁹ In a stock sale transaction, the purchase price is often expressed as \$X per share. This is a function of the fact that shares are more or less fungible; each share of a particular class of stock represents essentially the same rights as every other share of that class. The rights and obligations respecting ownership interests in partnerships and limited liability companies often vary widely from partner to partner or from member to member. For example, a "money partner" may be entitled preference distributions calculated based upon a percentage return of her invested capital or based upon a specified internal rate of return as well as return of her capital contribution before the "sweat equity" partner receives any distributions. These differences in rights of partners or members will of course affect the value of the interests. This form attempts to take into account the fact that it is likely the purchase price paid to each Seller will not be just a function of the Percentage Interest or number of Units owned by the Seller. Instead of describing the price as \$X per Unit, this form contemplates that an exhibit (Exhibit "A") would list the name of each Seller and the amount of the Purchase Price to be paid to each.

days following the termination of the applicable waiting period under the HSR Act¹⁰, or at such other time and place as the parties may agree. Subject to the provisions of Article 10, failure to consummate the purchase and sale provided for in this Agreement on the date and time and at the place determined pursuant to this Section 2.3 will not result in the termination of this Agreement and will not relieve any party of any obligation under this Agreement.

Section 2.4 Closing Obligations. At the Closing:

(a) Each of the Sellers will deliver to the Purchaser:

(i) an assignment of interest in substantially the form of Exhibit “B”¹¹ or other form of assignment or transfer document reasonably satisfactory to the Purchaser, with all blanks properly completed to indicate the Interest being sold by the Seller hereunder and executed by the Seller;

(ii) a certificate executed by the Seller representing and warranting to the Purchaser that each of the Seller’s representations and warranties contained in Article 3 was accurate in all respects as of the date of this Agreement and is accurate in all respects as of the Closing Date as if made on the Closing Date (giving full effect to any supplements to the Disclosure Letter that were delivered by the Sellers to the Purchaser prior to the Closing Date in accordance with Section 6.5); and

(b) The Principal Seller[s] will deliver or cause to be delivered to the Purchaser:

(i) an employment agreement in the form of Exhibit “C”, executed by each of the Key Employees (collectively, “Employment Agreements”);

(ii) a noncompetition agreement in the form of Exhibit “D”, executed by each of the Principal Seller[s] and Key Employees (collectively, the “Noncompetition Agreements”); and

(iii) a certificate executed by the Principal Seller[s] representing and warranting to the Purchaser that each of the representations and warranties of the Principal Seller[s] in Article 4 was accurate in all respects as of the date of this Agreement and is accurate in all respects as of the Closing Date as if made on the Closing Date (giving full effect to any supplements to the Disclosure Letter that were delivered by the Sellers to the Purchaser prior to the Closing Date in accordance with Section 6.5); and

¹⁰ For purposes of The Hart-Scott-Rodino Antitrust Improvements Act of 1976, the term “entity” means “any natural person, corporation, company, partnership, joint venture, association, joint-stock company, trust, estate of a deceased natural person, foundation, fund, institution, society, union, or club, whether incorporated or not . . .” C.F.R. § 801.1(a)(2). (Emphasis added.)

¹¹ Interests in partnerships and limited liability companies are typically not certificated interests. Such interests are usually transferred by means of an assignment instrument. A form of assignment is included as Exhibit “B” to this form.

(c) The Purchaser will:

(i) pay to the Sellers the respective amounts indicated as the “Closing Payments” on Exhibit “A” by direct wire transfers of immediately available funds to the accounts of Sellers as set forth in Exhibit “A” or to such other account of which a Seller may notify the Purchaser in writing prior to the Closing;

(ii) deliver promissory notes payable to each of the Sellers in the respective principal amounts indicated in Exhibit “A” (collectively, “Promissory Notes”);

(iii) pay the sum of \$ _____ (the “Escrowed Funds”) to the Escrow Agent by direct wire transfer of immediately available funds to the account specified by the Escrow Agent;

(iv) deliver a certificate executed by the Purchaser to the effect that, except as otherwise stated in such certificate, each of the Purchaser’s representations and warranties in this Agreement was accurate in all respects as of the date of this Agreement and is accurate in all respects as of the Closing Date as if made on the Closing Date; and

(v) deliver the Employment Agreements, executed by the Purchaser; and

(d) the Purchaser and the Sellers will enter into an escrow agreement in the form of Exhibit “E” (the “Escrow Agreement”) with _____ (the “Escrow Agent”); and¹²

(e) the Sellers will enter into a contribution agreement in the form of Exhibit “F”; and

(f) the Purchaser will be admitted as a [member / general partner / limited partner] of the [Company / Partnership] and will continue the business of the [Company / Partnership], and immediately following such admission, the Sellers will cease to be [members / partners] of the [Company / Partnership].¹³

¹² The Purchaser may require that a portion of the purchase price be paid into an escrow account either to satisfy “true-up” obligations or to provide readily available funds for any liability of the Sellers under the indemnification provisions of the Agreement.

¹³ Notice that the withdrawal of the Seller(s) occurs immediately following the admission of the Purchaser(s) so that there is no moment in time in which the target has no members or partners, resulting an inadvertent dissolution of the target.

ARTICLE 3

Representations and Warranties of Each of the Sellers

Each of the Sellers, separately and severally,¹⁴ represents and warrants to the Purchaser as follows:

Section 3.1 Execution, Validity and Authority. The Seller has the full legal right and capacity to enter into this Agreement and perform the Seller's obligations hereunder. This Agreement has been duly and validly executed and delivered by the Seller and, assuming due authorization, execution and delivery by the Purchaser, constitutes a legal, valid and binding obligation of the Seller, enforceable against the Seller in accordance with its terms, subject to laws of general application relating to bankruptcy, insolvency, and the relief of debtors and rules of law governing specific performance, injunctive relief or other equitable remedies (the "Bankruptcy Exception").

Section 3.2 Ownership. The Seller is the true and lawful owner of the Interest set forth opposite its name in Exhibit "A" to this Agreement, and such Interest is owned by the Seller free and clear of any and all Liens.

Section 3.3 No Options. Except as set forth in Section 3.3 of the Disclosure Letter, the Seller is not a party to any outstanding subscriptions, options, rights, warrants, calls, commitments or arrangements of any kind affecting the Interest owned by the Seller and there are no agreements or understandings with respect to the sale or transfer of such Interest other than as set forth in this Agreement.

Section 3.4 No Default of [Company / Partnership] Agreement. The Seller is not in default or breach of the [Company / Partnership] Agreement.

Section 3.5 Capital Contributions. The Seller has paid all capital contributions, assessments and other requests for funds for which it has received a capital call, invoice or other demand from the [Company / Partnership] and has no current or future obligation to contribute additional capital to the [Company / Partnership].¹⁵

¹⁴ Consistent with the theory that Sellers who are passive, minority interest holders in the target will only make representations and warranties as to matters within their knowledge and control, the limited representations and warranties of all Sellers are presented in this form as separate and several representations.

¹⁵ This representation as to satisfaction of capital contribution obligations and the representation in Section 3.4 regarding no breach of the Company or Partnership Agreement correspond to similar representations in *The Model Limited Liability Company Membership Interest Redemption Agreement* referenced in footnote 5. A stock purchase agreement will typically include a "capitalization" representation stating that the outstanding shares have been duly authorized and validly issued and are fully paid and nonassessable. In the context of an unincorporated entity without shares of stock, the purchaser should be able to satisfy itself regarding the capitalization of the target entity through a combination of this Section 3.5 representation, the representation in Section 3.4, the representation in Section 4.1(b) regarding the target entity's governing agreement and the financial statement representations in Section 4.4.

Section 3.6 **Certain Proceedings.** There is no pending Proceeding that has been commenced against the Seller and that challenges, or may have the effect of preventing, delaying, making illegal, or otherwise interfering with, any of the Contemplated Transactions. To the Seller's Knowledge, no such Proceeding has been Threatened.

Section 3.7 **Non-Contravention.** The execution and delivery by the Seller of this Agreement, the performance by the Seller of the Seller's obligations hereunder and the consummation of the transactions contemplated hereby, will not (a) result in the violation by the Seller of any Legal Requirement or Order of any Governmental or Regulatory Authority applicable to the Seller or any of Seller's assets or properties; or (b) if the consents and notices set forth in Section 3.8 of the Disclosure Letter are obtained or given, conflict with, result in a violation or breach of, constitute (with or without notice or lapse of time or both) a default under, require the Seller (except as set forth in the Disclosure Letter) to obtain any consent, approval or action of, make any filing with or give any notice to any Person pursuant to, result in or give to any Person any right of payment or reimbursement, termination, cancellation, modification or acceleration of, or result in the creation or imposition of any Liens upon any of the assets or properties of the Seller under, any of the terms, conditions or provisions of any Contract to which the Seller is a party or by which the Seller or any of the Seller's assets or properties is bound.

Section 3.8 **Approvals and Consents.** Except as set forth in Section 3.8 of the Disclosure Letter, no consent, approval, authorization or action of, registration or filing with, or notice to any Governmental or Regulatory Authority or other Person is necessary or required under any of the terms, conditions or provisions of any Legal Requirement or Order of any Governmental or Regulatory Authority or any Contract to which the Seller is a party or by which the Seller or any of the Seller's assets or properties is bound in connection with the execution and delivery by the Seller of this Agreement, the performance by the Seller of the Seller's obligations hereunder or the consummation of the transactions contemplated hereby.

Section 3.9 **Interests in Customers, Suppliers, Etc.** Except as set forth in Section 3.9 of the Disclosure Letter, neither the Seller, nor any Person controlled by the Seller, and to the Knowledge of the Seller no parent, brother, sister, child or spouse of the Seller, and no Person controlled by any parent, brother, sister, child or spouse of the Seller:

(a) owns, directly or indirectly, any interest in (except for ownership for investment purposes of less than 1% of the securities of any publicly held and traded company), or received or has any right to receive payments from, or is an officer, director, manager, employee, agent or consultant of, any Person which is, or is engaged in business as, a competitor, lessor, lessee, supplier, distributor, sales agent, customer or client of the [Company / Partnership];

(b) owns, directly or indirectly (other than through the Seller's ownership of the Interest of the Seller), in whole or in part, any tangible or intangible property (including, but not limited to, Intellectual Property) that the [Company / Partnership] uses in the conduct of its business; or

(c) is owed any amount by, has any cause of action or other claim whatsoever against, or owes any amount to, the [Company / Partnership], except for claims in the ordinary

course of business such as for accrued vacation pay, accrued benefits under employee benefit plans, and similar matters and agreements existing on the date hereof.

Section 3.10 Investment Intent. The Seller is acquiring its Promissory Note for its own account and not with a view to distribution within the meaning of Section 2(11) of the Securities Act. [The Seller is an “accredited investor” as such term is defined in Rule 501(a) under the Securities Act.]

Section 3.11 Disclosure by the Seller.

(a) No representation or warranty of the Seller in this Agreement omits to state a material fact necessary to make the statements herein or therein, in light of the circumstances in which they were made, not misleading.

(b) No notice given pursuant to Section 6.5 by the Seller will contain any untrue statement or omit to state a material fact necessary to make the statements therein or in this Agreement, in light of the circumstances in which they were made, not misleading.

ARTICLE 4

Representations and Warranties of the Principal Seller[s]

The Principal Seller[s], jointly and severally¹⁶, represent[s] and warrant[s] to the Purchaser as follows:

Section 4.1 Organization and Good Standing.

(a) The [Company / Partnership] is a [limited liability company / limited partnership] duly organized, validly existing, and in good standing under the laws of the State of Texas, with full power and authority to conduct its business as it is now being conducted, to own or use the properties and assets that it purports to own or use, and to perform all its obligations under Applicable Contracts. The [Company / Partnership] is duly qualified to do business as a foreign entity and is in good standing under the laws of each state or other jurisdiction in which either the ownership or use of the properties owned or used by it, or the nature of the activities conducted by it, requires such qualification.

(b) The Principal Seller[s] [has / have] delivered to the Purchaser copies of the [Certificate of Formation / Articles of Organization / Certificate of Limited Partnership] and [Company Agreement / Partnership Agreement] of the [Company / Partnership], as currently in effect.

Section 4.2 Non-Contravention. The execution and delivery by the Sellers of this Agreement, the performance by the Sellers of the Seller’s obligations hereunder and the

¹⁶ While the Purchaser may be convinced to accept separate and several representations and warranties with respect of a few limited matters such as individual power and authority and ownership, if there are multiple Sellers who have managed and controlled the target, it is likely that the Purchaser will insist that their representations regarding the business of the target entity be made jointly.

consummation of the transactions contemplated hereby, will not (a) contravene, conflict with, or result in a violation of any provision of the [Certificate of Formation / Articles of Organization or Company Agreement / Regulations of the Company / Certificate of Formation / Certificate of Limited Partnership or Partnership Agreement of the Partnership]; (b) result in the violation by the [Company / Partnership] of any Legal Requirement or Order of any Governmental or Regulatory Authority applicable to the [Company / Partnership] or any assets or properties of the [Company / Partnership]; or (c) if the consents and notices set forth in Section 4.3 of the Disclosure Letter are obtained or given, conflict with, result in a violation or breach of, constitute (with or without notice or lapse of time or both) a default under, require the [Company / Partnership] (except as set forth in the Disclosure Letter) to obtain any consent, approval or action of, make any filing with or give any notice to any Person pursuant to, result in or give to any Person any right of payment or reimbursement, termination, cancellation, modification or acceleration of, or result in the creation or imposition of any Liens upon any of the assets or properties of the [Company / Partnership] under, any of the terms, conditions or provisions of any Contract to which the [Company / Partnership] is a party or by which the [Company / Partnership] or any of the assets or properties of the [Company / Partnership] is bound.

Section 4.3 Approvals and Consents. Except as set forth in Section 4.3 of the Disclosure Letter, no consent, approval, authorization or action of, registration or filing with, or notice to any Governmental or Regulatory Authority or other Person is necessary or required under any of the terms, conditions or provisions of any Legal Requirement or Order of any Governmental or Regulatory Authority or any Contract to which the [Company / Partnership] is a party or by which the [Company / Partnership] or any of the assets or properties of the [Company / Partnership] is bound in connection with the execution and delivery by the Sellers of this Agreement, the performance by the Sellers of the Sellers' obligations hereunder or the consummation of the transactions contemplated hereby.

Section 4.4 Financial Statements.¹⁷

The Principal Seller[s] [has / have] delivered to the Purchaser:

(a) the [unaudited] balance sheets of the [Company / Partnership] as at _____ in each of the years ___ through ___, and the related [unaudited] statements of

¹⁷ In most cases, a target corporation will own subsidiary corporations and/or interests in unincorporated entities and financial statements and tax returns will be prepared for the group of entities on a consolidated basis. In recognition of this common situation, the *ABA Model Stock Purchase Agreement* uses the concept of "Acquired Companies" in connection with the Sellers' representations and warranties regarding the business enterprise. Another way this situation is commonly handled is to refer to the "Corporation and Its Subsidiaries" or the "Company and Its Owned Entities" or some other formulation that assures that the representations and warranties encompass the entire enterprise. For simplicity, this form does not include the concept of "Acquired Companies" and assumes that the target limited liability company or partnership does not own other entities. The form should be adjusted to include owned entities, if appropriate.

operations¹⁸, partners' equity,¹⁹ and cash flow for each of the fiscal years then ended, [together with the report thereon of _____, independent certified public accountants,]

(b) a balance sheet of the [Company / Partnership] as at _____ (including the notes thereto, the "Balance Sheet"), and the related statements of operations, partners' equity, and cash flow for the fiscal year then ended, together with the report thereon of _____, independent certified public accountants, and

(c) an unaudited consolidated balance sheet of the [Company / Partnership] as at _____ (the "Interim Balance Sheet") and the related unaudited statements of operations, partners' equity, and cash flow for the ___ months then ended, including in each case the notes thereto. Such financial statements and notes fairly present the financial condition and the results of operations, changes in partner capital accounts, and cash flow of the [Company / Partnership] as at the respective dates of and for the periods referred to in such financial statements, all in accordance with GAAP²⁰ [, subject, in the case of interim financial statements, to normal recurring year-end adjustments (the effect of which will not, individually or in the aggregate, be materially adverse) and the absence of notes (that, if presented, would not differ materially from those included in the Balance Sheet)]; the financial statements referred to in this Section 4.4 reflect the consistent application of such accounting principles throughout the periods involved [, except as disclosed in the notes to such financial statements].

Section 4.5 Books and Records. The books of account, [minute book,²¹ or other] records of meetings and written consents of [members of the Company / partners of the Partnership], records regarding the transfers of Interests, records showing the equity interests of the [Company / Partnership] and other records of the [Company / Partnership], all of which have been made available to the Purchaser, are complete and correct and have been maintained in accordance with sound business practices, including the maintenance of an adequate system of internal controls. [The minute book of the Company contains accurate and complete records of all meetings held of, and action taken by, the members, managers and committees of the managers of the Company, and no meeting of the member managers, or any such committee has been held for which minutes have not been prepared and are not contained in minute book]. Upon or immediately following the Closing Date the Principal Seller[s] will cause all of those

¹⁸ When a limited liability company or limited partnership is classified as a partnership for federal income tax purposes, and thus is a pass-through entity, the term "statement of operations" is typically used instead of the term "statement of income" in the financial statements for an unincorporated entity.

¹⁹ Financial statements for a corporation include statements of changes in shareholders' equity for the period or periods covered by the report. The term "statement of partners' equity" is used for the equivalent portion of the financial statements for an unincorporated entity classified as a partnership. The author has also encountered the term "partners' capital account reconciliation" used to identify this portion of the financial statements.

²⁰ Unincorporated entities classified as partnerships often maintain dual or multiple sets of financial records including financial records prepared according to GAAP and financial records prepared according to federal income tax accounting. The Purchaser may require that the Sellers make representations covering each set of financial records.

²¹ Many unincorporated entities do not maintain minute books.

books and records to be delivered to the Purchaser; provided that the Principal Seller[s] may retain any such books and records that in [its / their] opinion may be required to be maintained by the Principal Seller[s] and the other Seller[s] in connection with the taxation of the Seller[s] with respect to their ownership of the Interests prior to the Closing Date.²²

Section 4.6 Title to Properties; Liens. Section 4.6 of the Disclosure Letter contains a complete and accurate list of all real property, leaseholds, or other interests therein owned by the [Company / Partnership]. The Principal Seller[s] [has / have] delivered or made available to the Purchaser copies of the deeds and other instruments (as recorded) by which the [Company / Partnership] acquired such real property and interests, and copies of all title insurance policies, opinions, abstracts, and surveys in the possession of the Principal Seller[s] or the [Company / Partnership] and relating to such property or interests. The [Company / Partnership] owns (with good and marketable title in the case of real property, subject only to the matters permitted by the following sentence) all the properties and assets (whether real, personal, or mixed and whether tangible or intangible) it purports to own [located in the facilities owned or operated by the [Company / Partnership] or reflected as owned in the books and records of the [Company / Partnership], including all of the properties and assets reflected in the Balance Sheet and the Interim Balance Sheet (except for assets held under capitalized leases disclosed or not required to be disclosed in Section 4.6 of the Disclosure Letter and personal property sold since the date of the Balance Sheet and the Interim Balance Sheet, as the case may be, in the Ordinary Course of Business), and all of the properties and assets purchased or otherwise acquired by the [Company / Partnership] since the date of the Balance Sheet (except for personal property acquired and sold since the date of the Balance Sheet in the Ordinary Course of Business and consistent with past practice), which subsequently purchased or acquired properties and assets (other than inventory and short-term investments) are listed in Section 4.6 of the Disclosure Letter. All material properties and assets reflected in the Balance Sheet and the Interim Balance Sheet are free and clear of all Liens and are not, in the case of real property, subject to any rights of way, building use restrictions, exceptions, variances, reservations, or limitations of any nature except, with respect to all such properties and assets, (a) mortgages or security interests shown on the Balance Sheet or the Interim Balance Sheet as securing specified liabilities or obligations, with respect to which no default (or event that, with notice or lapse of time or both, would constitute a default) exists, (b) mortgages or security interests incurred in connection with the purchase of property or assets after the date of the Interim Balance Sheet (such mortgages and security interests being limited to the property or assets so acquired), with respect to which no default (or event that, with notice or lapse of time or both, would constitute a default) exists, (c) Liens for current taxes not yet due, and (d) with respect to real property, (i) minor imperfections of title, if any, none of which is substantial in amount, materially detracts from the value or impairs the use of the

²² Any tax audit or other question regarding taxation of a corporation after a stock sale will be the responsibility of the new Purchaser, as the new management of the corporation. For this reason, a typical stock purchase agreement provides that all books and records will remain in the possession of the corporation (and thus in the possession and control of the Purchaser). Because an unincorporated entity classified as a partnership is a pass-through entity, any tax audit or other question regarding taxation with respect to any period prior to the sale of Interests likely will be the responsibility of the members or partners. For this reason, this form provides that the general partner or manager or managing member will retain possession of the books and records that might be involved with any tax audit or other tax questions that arise after the Closing with respect to any period before the Closing Date. Note that mutual access is provided to all books and records in Section 12.4.

property subject thereto, or impairs the operations of the [Company / Partnership], and (ii) zoning laws and other land use restrictions that do not impair the present or anticipated use of the property subject thereto. All buildings, plants, and structures owned by the [Company / Partnership] lie wholly within the boundaries of the real property owned by the [Company / Partnership] and do not encroach upon the property of, or otherwise conflict with the property rights of, any other Person.

Section 4.7 Condition and Sufficiency of Assets. The buildings, plants, structures, and equipment of the [Company / Partnership] are structurally sound, are in good operating condition and repair, and are adequate for the uses to which they are being put, and none of such buildings, plants, structures, or equipment is in need of maintenance or repairs except for ordinary, routine maintenance and repairs that are not material in nature or cost. The building, plants, structures, and equipment of the [Company / Partnership] are sufficient for the continued conduct of the business of the [Company / Partnership] after the Closing in substantially the same manner as conducted prior to the Closing.

Section 4.8 Accounts Receivable. All accounts receivable of the [Company / Partnership] that are reflected on the Balance Sheet or the Interim Balance Sheet or on the accounting records of the [Company / Partnership] as of the Closing Date (collectively, the “Accounts Receivable”) represent or will represent valid obligations arising from sales actually made or services actually performed in the Ordinary Course of Business. Unless paid prior to the Closing Date, the Accounts Receivable are or will be as of the Closing Date current and collectible net of the respective reserves shown on the Balance Sheet or the Interim Balance Sheet or on the accounting records of the [Company / Partnership] as of the Closing Date (which reserves are adequate and calculated consistent with past practice and, in the case of the reserve as of the Closing Date, will not represent a greater percentage of the Accounts Receivable as of the Closing Date than the reserve reflected in the Interim Balance Sheet represented of the Accounts Receivable reflected therein and will not represent a material adverse change in the composition of such Accounts Receivable in terms of aging). Subject to such reserves, each of the Accounts Receivable either has been or will be collected in full, without any set-off, within ninety days after the day on which it first becomes due and payable. There is no contest, claim, or right of set-off, other than returns in the Ordinary Course of Business, under any Contract with any obligor of an Accounts Receivable relating to the amount or validity of such Accounts Receivable. Section 4.8 of the Disclosure Letter contains a complete and accurate list of all Accounts Receivable as of the date of the Interim Balance Sheet, which list sets forth the aging of such Accounts Receivable.

Section 4.9 Inventory. All inventory of the [Company / Partnership], whether or not reflected in the Balance Sheet or the Interim Balance Sheet, consists of a quality and quantity usable and salable in the Ordinary Course of Business, except for obsolete items and items of below-standard quality, all of which have been written off or written down to net realizable value in the Balance Sheet or the Interim Balance Sheet or on the accounting records of the [Company / Partnership] as of the Closing Date, as the case may be. All inventories not written off have been priced at the lower of cost or [market] [net realizable value] on a [last in, first out] [first in, first out] basis. The quantities of each item of inventory (whether raw materials, work-in-process, or finished goods) are not excessive, but are reasonable in the present circumstances of the [Company / Partnership].

Section 4.10 No Undisclosed Liabilities. Except as set forth in Section 4.10 of the Disclosure Letter, the [Company / Partnership] has no liabilities or obligations of any nature (whether known or unknown and whether absolute, accrued, contingent, or otherwise) except for liabilities or obligations reflected or reserved against in the Balance Sheet or the Interim Balance Sheet and current liabilities incurred in the Ordinary Course of Business since the respective dates thereof.

Section 4.11 Taxes

(a) The [Company / Partnership] has filed or caused to be filed all Tax Returns that are or were required to be filed by or with respect to it pursuant to applicable Legal Requirements. All such Tax Returns were correct and complete in all material respects. The Principal Seller[s] [has / have] delivered [or made available] to the Purchaser correct and complete copies of, and Section 4.11 of the Disclosure Letter contains a complete and accurate list of, all such Tax Returns relating to income or franchise taxes filed since _____. The [Company / Partnership] has paid, or made provision for the payment of, all Taxes that have or may have become due pursuant to those Tax Returns or otherwise, or pursuant to any assessment received by the [Company / Partnership], except such Taxes, if any, as are listed in Section 4.11 of the Disclosure Letter and are being contested in good faith and as to which adequate reserves (determined in accordance with GAAP) have been provided in the Balance Sheet and the Interim Balance Sheet.

(b) Section 4.11 of the Disclosure Letter contains a complete and accurate list of all Tax Returns filed since _____ that have been audited, including a reasonably detailed description of the nature and outcome of each audit, and indicates those Tax Returns that currently are the subject of audit. All deficiencies proposed as a result of such audits have been paid, reserved against, settled, or, as described in Section 4.11 of the Disclosure Letter, are being contested in good faith by appropriate proceedings. Except as described in Section 4.11 of the Disclosure Letter, the [Company / Partnership] has not been given or been requested to give waivers or extensions (or is or would be subject to a waiver or extension given by any other Person) of any statute of limitations relating to the payment of Taxes of the [Company / Partnership] or for which the [Company / Partnership] may be liable.

(c) Except as disclosed in the Balance Sheet or in Section 4.11 of the Disclosure Letter, there is no material dispute or claim concerning any Taxes of [the Company / Partnership] either (i) claimed or raised by any authority in writing or (ii) as to which any of the Sellers has Knowledge based upon personal contact with any agent of such authority.

(d) The unpaid Taxes of the [Company / Partnership] do not exceed by any material amount the charges, accruals, and reserves with respect to Taxes on the Interim Balance Sheet of the [Company / Partnership] and will not exceed by any material amount such charges, accruals and reserves as adjusted for operations and transactions through the Closing Date.

(e) All Taxes that the [Company / Partnership] is or was required by Legal Requirements to withhold or collect have been duly withheld or collected and, to the extent required, have been paid to the proper Governmental or Regulatory Authority or other Person.

(f) There is no tax sharing agreement that will require any payment by the [Company / Partnership] after the date of this Agreement.

(g) The [Company / Partnership] qualifies (and has since the date of its formation qualified) to be treated as a partnership for federal income tax purposes and none of the Partnership or any Partner or any taxing authority has taken a position inconsistent with such treatment.

(h) There are no Liens for Taxes upon any property of the [Company / Partnership] except for Liens for current Taxes not yet due and payable.

(i) None of the Sellers is a “foreign person” within the meaning of IRC Section 1445 and each of Sellers will furnish Purchaser with an affidavit satisfying the requirements of IRC Section 1445(b)(2) and the regulations thereunder of the United States Department of the Treasury.

Section 4.12 No Material Adverse Change. Since the date of the Balance Sheet, there has not been any material adverse change in the business, operations, properties, prospects, assets, or condition of the [Company / Partnership], and no event has occurred or circumstance exists that may result in such a material adverse change.

Section 4.13 Employee Benefits.

(a) Set forth in Section 4.13(a) of the Disclosure Letter is a complete and correct list of all “employee benefit plans” as defined by Section 3(3) of ERISA, all specified fringe benefit plans as defined in Section 6039D of the IRC, and all other bonus, incentive-compensation, deferred-compensation, profit-sharing, stock-option, stock-appreciation-right, stock-bonus, stock-purchase, employee-stock-ownership, savings, severance, change-in-control, supplemental-unemployment, layoff, salary-continuation, retirement, pension, health, life-insurance, disability, accident, group-insurance, vacation, holiday, sick-leave, fringe-benefit or welfare plan, and any other employee compensation or benefit plan, agreement, policy, practice, commitment, contract or understanding (whether qualified or nonqualified, currently effective or terminated, written or unwritten) and any trust, escrow or other agreement related thereto that:

(i) is maintained or contributed to by the [Company / Partnership] or any other entity or trade or business controlled by, controlling or under common control with the [Company / Partnership] (within the meaning of Section 414 of the IRC or Section 4001(a)(14) or 4001(b) of ERISA) (“ERISA Affiliate”) or has been maintained or contributed to in the last six (6) years by the [Company / Partnership] or any ERISA Affiliate, or with respect to which the [Company / Partnership] or any ERISA Affiliate has or may have any liability.

(ii) provides benefits, or describes policies or procedures applicable to any current or former director, officer, employee or service provider of the [Company / Partnership] or any ERISA Affiliate, or the dependents of any thereof, regardless of how (or whether) liabilities for the provision of benefits are accrued or assets are acquired or dedicated with respect to the funding thereof (collectively the “Employee Plans”).

Section 4.13(a) of the Disclosure Letter identifies as such any Employee Plan that is (A) a “Defined Benefit Plan” (as defined in Section 414(l) of the IRC); (B) a plan intended to meet the requirements of Section 401(a) of the IRC; (C) a “Multiemployer Plan” (as defined in Section 3(37) of ERISA); or (D) a plan subject to Title IV of ERISA, other than a Multiemployer Plan. Also set forth in Section 4.13(a) of the Disclosure Letter is a complete and correct list of all ERISA Affiliates of the [Company / Partnership] during the last six years.

(b) The Principal Seller[s] [has / have] delivered or caused to be delivered to the Purchaser true, accurate and complete copies of:

(i) the documents comprising each Employee Plan (or, with respect to any Employee Plan which is unwritten, a detailed written description of eligibility, participation, benefits, funding arrangements, assets and any other matters which relate to the obligations of The [Company / Partnership] or any ERISA Affiliate);

(ii) all trust agreements, insurance contracts or any other funding instruments related to the Employee Plans;

(iii) all rulings, determination letters, no-action letters or advisory opinions from the IRS, the U.S. Department of Labor, the Pension Benefit Guaranty Corporation (“PBGC”) or any other Governmental or Regulatory Authority that pertain to each Employee Plan and any open requests therefor;

(iv) the most recent actuarial and financial reports (audited and/or unaudited) and the annual reports filed with any Governmental or Regulatory Authority with respect to the Employee Plans during the current year and each of the three preceding years;

(v) all collective bargaining agreements pursuant to which contributions to any Employee Plan[s] have been made or obligations incurred (including both pension and welfare benefits) by the [Company / Partnership] or any ERISA Affiliate, and all collective bargaining agreements pursuant to which contributions are being made or obligations are owed by such entities;

(vi) all securities registration statements filed with respect to any Employee Plan;

(vii) all contracts with third-party administrators, actuaries, investment managers, consultants and other independent contractors that relate to any Employee Plan;

(viii) with respect to Employee Plans that are subject to Title IV of ERISA, the Form PBGC-1 filed for each of the three most recent plan years; and

(ix) all summary plan descriptions, summaries of material modifications and memoranda, employee handbooks and other written communications regarding the Employee Plans.

(c) Except as disclosed in Section 4.13(c) of the Disclosure Letter, full payment has been made of all amounts that are required under the terms of each Employee Plan to be paid as

