

[Buyer]

Proposed Acquisition of

[Target]

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**Due Diligence Review Report**

[Date], 202\_

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[Law Firm]  
[Address]

[Law Firm] has prepared this Due Diligence Review Report (the "**Report**") to assist [Buyer] ("**You**" or "[Buyer]") in considering a possible acquisition (the "**Acquisition**") of all of the membership interests of [Target] (the "**Company**") from the members of the Company (the "**Sellers**").

**A. EXECUTIVE SUMMARY**

This Executive Summary is designed to highlight the major issues uncovered during the legal acquisition review conducted by [Law Firm]. You are encouraged to read and review this section in conjunction with the entire Report, including all exhibits.

1. **RISKS**

- 1.1 The Company failed to disclose fully the extent of its intellectual property. Therefore, we are unable to determine what, if any, risks exist as to potential infringement actions or ownership issues.
- 1.2 The Company failed to disclose fully its customer and supplier agreements. Therefore, we are unable to determine whether any third-party consents are necessary, and the terms of such agreements.
- 1.3 The financial information was prepared by a member of the Company.

### **THIRD-PARTY CONSENTS**

- 1.4 The [Company 1] contract may require a consent, which the Company has already obtained.
- 1.5 As stated above, we did not receive full disclosures on the customer and supplier contracts and therefore cannot evaluate the need for any consents.

### **ISSUES REQUIRING FOLLOW-UP**

- 1.6 [Individual 1] stated that he would only disclose or discuss matters relating to the Company's intellectual property and other information and documents the Company has not provided to you directly.
- 1.7 The original note for \$[Amount] should be cancelled before closing.
- 1.8 [Bank 1] should consent to the [Nth] lien in favor of [Individual 1], [Individual 2], [Target Member 2], and [Individual 4].

## **A. REPORT**

### **CORPORATE MATTERS**

The Company is organized and in good standing in the state of [State 1]. One of the Company's members, [Target Member 1], did not sign the existing Members Agreement. The minute book that the Company provided appears to be relatively current. According to the information provided by Company, all prior securities sales have purportedly been completed by private placement.

### **GOVERNMENTAL MATTERS**

The Company reported that it is not subject to any specific regulatory schemes outside of OSHA and EEOC. The Company reported that it has not had any complaints, violations, or correspondence regarding governmental matters.

### **TAX MATTERS**

The Company's prior three years of tax returns have been provided. The Company reported that the returns are prepared by [Target Member 2], a member. The Company reported that it has never had an audit. The Company has not provided any further information regarding material tax issues or correspondence.

### **PERSONAL PROPERTY**

The Company has disclosed limited equipment and personal property. According to the documents and information provided by the Company, all of the Company's property and accounts receivable are pledged as collateral for [Number] bank loans (described below). The only personal property lease reported by the Company is a lease for one [Specific Type] machine from [Company 2], a company owned by [Individual 1]. The rental for this machine is for \$[Amount] per month and terminates in [Month] 202\_\_. The Company has an option to purchase the machine for fair market value at the termination of the lease. [Individual 1] reports that they did it through this company because the Company was unable to obtain credit to lease or purchase the machine directly. According to the Company, this machine is no longer the primary [Specific Type] machine.

### **INTELLECTUAL PROPERTY**

The Company, specifically [Individual 1], refused to provide a majority of the information and documents requested due to [Buyer] being a competitor and the sensitive nature of the information. We are unable to review fully the intellectual property of the Company. The Company reported that it has no trademarks or copyrights. We searched the United States Patent and Trademark Office database and did not find any patents or trademarks owned by the Company. The Company did report [Number] patents or applications, including a patent application that was assigned to [Company 3 / Customer], under which the Company operates as a licensee. The Company reports that the remaining patent applications have lapsed, as the Company wants to keep the technology as a trade secret, due to its inability to detect patent infringement. The Company refused to disclose its research and development agreements.

The Company provided a license agreement with [Company 3 / Customer] under which it is licensed to use the patent application for fabricating [Specific Product] used in [Specific Type]

processes. This agreement is for a term of [Number Spelled Out] ([Number]) years, ending on [Date], 202\_\_. This agreement requires a payment to [Company 3 / Customer] of \$[Amount] on [Date], 202\_\_, and royalty payments of [Number]% to [Number]% of net sales price based on the product sold and whether the patent has been issued. Additionally, there is a minimum annual royalty of \$[Amount] per year until 202\_\_, and \$[Amount] per year beginning in 202\_\_ until the end of the term.

The Company did provide its form non-disclosure and non-competition agreements, which we are in the process of reviewing, along with its invention assignment agreements, as well as signed copies of such agreements by all full-time employees. The Company reported that all past and present full-time employees and all present part-time employees have signed such agreements.

The Company reported that, although [Target Member 1] is a member of the Company, [Target Member 1] does not own or have an interest in any intellectual property used by the Company. [Target Member 1] became a member by means of a merger of a different entity which used [Target Member 1] licensed technology, but the members determined that this technology was not commercially viable.

### **BUSINESS OPERATIONS**

The Company refused to disclose information and documents about its suppliers and provided limited information about its customers. The Company did not provide any customer or supplier contracts. The Company reported that it does not have a formal document control system, or specific return or credit policies, as this is left to the discretion of the Company's president, [Individual 3].

As discussed, two of the Company's three biggest customers, [Company 4 / Customer] and [Company 5 / Customer] ([Company 5 / Customer] being the largest, followed by [Company 3 / Customer] and then [Company 4 / Customer]), are also members of the Company. Although [Individual 1] refused to disclose the terms of sale to those customers, it is possible that the sales terms are different.

### **CONTRACTUAL MATTERS**

The Company reported that it has few formal contracts. In addition to the [Company 3 / Customer] license agreement, and the lease with [Company 2] for the [Specific Type] machine, the Company also reported that it has a distributor agreement with [Company 1], which required consent in the event of a change in control. The Company obtained a consent to the transaction. The Company also reported that it has a Consulting Agreement with [Company 6], whereby [Company 6] provides technical and marketing advice and strategies to develop and exploit markets for the Company's products. The Company provided a copy of this agreement. The agreement is for a term of [Number] years, ending [Date], 202\_\_. This agreement provides that the Company will pay \$[Amount] per month in [Month] 202\_\_, and a \$[Amount] per month retainer, plus [Amount]% commission on the increase in monthly gross profit compared to the same month from the previous year. This agreement also contains a non-disclosure agreement and an invention assignment agreement.

### **BANK AND CREDIT ARRANGEMENTS**

The Company reported that it has [Number Spelled Out] ([Number]) loans with [Bank 1] of [City]. The Company provided a letter from the bank reporting that the total outstanding

principal amount on those loans as of [Date], 202\_\_ was \$[Amount]. This includes a real estate loan, for \$[Amount]. This real estate loan is secured by a deed of trust on the [City] facility.

The Company also reports a revolving line of credit for \$[Amount], a non-revolving line of credit for \$[Amount], a term loan maturing [Date], 202\_\_, with monthly payments of \$[Amount], for a balance of \$[Amount], and a term loan maturing [Date], 202\_\_, with monthly payments of \$[Amount], for a balance of \$[Amount]. These loans are secured by a combination of all of the Company's accounts receivable, inventory, and equipment. It appears that the bank has filed the necessary financing statements to perfect their liens.

The Company also reported that it has [Number Spelled Out] ([Number]) promissory notes payable to [Individual 1], [Individual 2], [Target Member 2], and [Individual 4]. According to the documents provided, the principal amount of the notes payable to [Individual 2], [Target Member 2] and [Individual 4] is \$[Amount] each, while the principal amount of the note payable to [Individual 1] is \$[Amount]. According to the documents provided, the notes are [Number] month term notes beginning [Date], 202\_\_, and bearing interest at rate of [Number]%. The provided documents require monthly payments of \$[Amount] for [Individual 1] and \$[Amount] for each of the others. These promissory notes are reportedly secured by a deed of trust on the real property. There is a subordination agreement signed by each of the members of the Company that subordinates any loan from any member to the Company to the loans of [Bank 1] of [City]. However, the bank did not sign this subordination agreement. We are attempting to contact the Company's counsel to determine if the bank ever consented to the second deed of trust on the real property. In order to comply with the terms of the bank's deed of trust, the Company must obtain consent to the second deed of trust. Additionally, the Company provided a similar note, which [Individual 1] reported was the original note evidencing the \$[Amount] owed to [Individual 1], [Individual 2], [Target Member 2], and [Individual 4]. [Individual 1] reported that this original note should have been cancelled, but this was never done. The note should be cancelled before closing.

[Individual 1] and [Individual 2] have also signed personal guarantees for all of the Company's loans with the bank. The other members, aside from [Target Member 1], have agreed to reimburse [Individual 1] and [Individual 2] for their proportional share of any amounts paid under those guarantees.

## **EMPLOYEES AND COMPENSATION**

The Company reported that it has [Number] full-time employees and [Number] part-time employees. Their compensation as reported by the Company is set out in a schedule provided separately. The Company does have one employment agreement with [Individual 3], but this agreement was signed in 202\_\_, and the terms of the agreement do not reflect her current compensation or duties. This agreement should be expressly terminated before closing.

## **INSURANCE**

The Company provided insurance policies that purportedly show that it has insurance on its building and general liability insurance. According to the policy documents provided by the Company, the general liability premium is \$[Amount] with a \$[Amount] aggregate limit and the property insurance premium is \$[Amount] with a \$[Amount] deductible and a limit of \$[Amount] on the building and \$[Amount] on the contents. The Company reports that it did have insurance on the building it rented before it moved to the current location in [Month] 202\_\_. The Company reports that it did file a claim for some [Specific Type] damage done by a storm, but already has