

M&A Nugget: Related Party Transactions

August 28, 2023

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It is important that the purchaser investigate related party transactions when conducting due diligence. A related party transaction is a transaction or a contract between the target and another company controlled by, or related to, the owners of the target. An example of a related party transaction that is often encountered is a real estate lease between the owner of the target and the target. Another example is a key supplier agreement between the target and a relative of the target's owner. Related party transactions must be examined to determine whether they are priced at fair market value. Often these arrangements are priced at higher than fair market value to benefit the related party. Another factor to consider is whether the related party will continue doing business with the purchaser post-closing, especially if the related party is a key supplier of goods or even a sole source provider. I have encountered situations where the key supplier was the target owner's relative, and while more than happy to do business with the target on generous terms, would not commit to continuing those terms with the purchaser. So, as part of the purchaser's due diligence, related party arrangements must be asked about and investigated.