

Letters of intent

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A LETTER OF INTENT IN A COMPLETE SALE AND PURCHASE TRANSACTION

is a written agreement that precedes preparation of the sale and purchase agreements. Its purpose is to delineate all significant sale and purchase terms in advance of agreement preparation. Unfortunately, most letters of intent that I review either incorrectly state or omit important terms completely. As a result, the parties can get into disagreements on important terms prior to closing at the 11th hour.

THE NECESSITY OF A LETTER OF INTENT

Before the selling dentist or specialist pays a lawyer to draft the agreements and the purchaser pays a lawyer to review the properly drafted agreements, make sure that both parties agree on all significant terms. Here are some examples of disagreements over key terms that I've recently seen:

- A purchaser received multiple draft versions of agreements that had been prepared by the seller's legal counsel, and yet the doctors had not yet agreed to the purchase price. Disagreement over the purchase price is more common than you think.
- A selling dentist was relocating from the Midwest to the South, and there was disagreement over a 15-mile radius of the restrictive covenant.
- A selling dentist who performed significant orthodontic treatment would not agree to complete the unfinished cases on the practice premises. The purchaser, who did not perform orthodontic treatment, would have made arrangements for and would have paid the selling dentist to complete the work.
- An accountant for a buyer wanted to allocate half of the purchase price to dental equipment to obtain favorable amortization at the expense of the seller when the equipment was worth, at most, 25% of the purchase price.
- A seller insisted on continued full-time employment for three years following the sale, although production was insufficient for two doctors.

▲ **Each one of these disagreements** could have been avoided had a well-drafted letter of intent been prepared.

IMPORTANT LETTER OF INTENT PROVISIONS

The parties to the sale and purchase—The parties to the transaction(s) need to be identified. When the practice is organized as a C-corporation, or an S-corporation that was previously a C-corporation for fewer than 10 years, there will be two sellers—the C-corporation, and the dentist who sells his or her personal goodwill. On the purchaser side, the entity through which the purchasing doctor will practice will be the

purchaser, not the individual dentist. If the selling dentist or dentist and spouse own the real estate, the real estate will usually be owned by a limited liability company or family trust. The purchasing dentist should also form a limited liability company to purchase any real estate.

Purchase price, payment, and purchase price allocations—The purchase price must be included in the letter of intent. The purchase price is reduced by any earnest

money deposit, liens on the practice, and any fees paid to a broker. All payment terms should be designated. The purchase price allocation determines how the seller(s) is/are taxed on the sale and how the purchaser deducts the purchase price, and it should be included as a schedule to the letter.

Earnest money deposits—In exchange for an earnest money deposit, the purchaser expects the seller to remove the practice from the market until closing. However, a purchaser rarely has the ability to obtain a sum that is sufficient for the seller to do so. The deposits are usually \$5,000, and the sum is returned upon the occurrence of certain contingencies. While the \$5,000 does show good faith, my recommendation to the selling dentist is to eliminate it entirely and not take the practice off of the market. An alternative is to prepare promissory notes in a meaningful amount, (e.g., \$50,000), which become fully due and payable should either party default.

Excluded assets—Certain items will be excluded from the purchase and sale, such as the seller's accounts receivable (although not always), cash, cash equivalents, retirement plan contributions, any personal items of the selling dentist, and any of the seller's debt, unless specifically assumed by the purchaser.

Accounts receivable—In the event that the accounts receivable are not purchased by the purchaser, the purchaser typically collects them for a period of six months following closing, less a 5% administrative fee. From the purchaser's perspective, dollars are traded for dollars borrowed versus paid, and they need to be at least equal.

Assets free and clear of liens and encumbrances—All assets should be free and clear of all liens and encumbrances at closing, unless specifically assumed.

Brokerage fees—All brokerage fees should be the sole responsibility of the seller.

Confidentiality—While a confidentiality provision may be included in a letter of intent, it should also be included in an earlier prepared and separate confidentiality letter signed by the purchaser/candidate. A confidentiality letter stipulates that the purchaser/candidate will keep all information confidential but will be permitted to share it with advisors, and will return all of it if negotiations cease for any reason.

Due diligence—A due diligence provision should be included for a specific time period (e.g., 30 days), for the purchaser and advisor(s) to review the confidential information. If they are not satisfied with the findings, any earnest money deposit or promissory note is returned to the purchaser without future obligation of either party.

Closing—The date that closing will occur should be designated on a specified date or within a specific time period.

Representations and warranties—The seller's practice entity and the selling dentist or specialist will provide the purchaser with usual and customary representations and warranties that will be contained in the purchase and sale agreements.

Noncompetition/nonsolicitation—A detailed noncompetition/nonsolicitation provision spells out the time limit and geographic radius of the restrictive covenant and nonsolicitation provisions for patients and/or referral sources and former employees of the seller.

Post-closing employment of the seller—At the purchaser's discretion, the selling dentist or specialist will remain employed or engaged as an independent contractor by the purchaser's dental or dental specialty practice for a specified period, (e.g., one year after closing) and by mutual agreement thereafter. Be careful of inappropriate independent contractor relationships because the IRS, states, and Department of Labor believe that the retired dentist or specialist is an employee.

Financing—The purchase and sale will be contingent upon the purchaser obtaining lender financing for the purchase price on or before closing.

Lease assignment, lease, and real estate—The purchaser will obtain a lease assignment or lease for the practice premises on or before closing. If the real estate is owned by the selling dentist and/or spouse or in a separate limited liability company, there may be an option and/or modified right of first refusal that does not require an offer from a third party. There may also be a mandatory purchase of any real estate at a certain point (e.g., after three years).

Death or permanent disability—The purchase and sale is contingent upon the purchasing dentist not becoming disabled or deceased prior to closing. A specific definition of disability is important.

Retreatment—The seller is responsible for retreatment of the selling dentist's patients 12 months prior to closing. In the event that the seller and purchaser disagree on the necessity of retreatment for any patient, an arbitrator should be designated, such as a dental society peer review committee. If present, these provisions usually omit the important "tie-breaker" language should the parties disagree.

Work-in-process—The selling dentist or specialist will be permitted to complete cases started, but not finished, prior to closing. Completion of specialty procedures such as orthodontics is also delineated. This can be complex and may cause a reduction to the sale and purchase price if the cases must be referred to an orthodontist. The seller customarily retains all fees for work-in-process and is responsible for payment of laboratory fees and any chairside assistants. A work-in-process provision and schedule of cases, patient names, and procedures are included in the purchase and sale agreements.

Mutual indemnification—The seller and purchaser will hold each other harmless for the operation of the practice prior to and after closing.

Definitive legal documents—The purchase and sale are expressly contingent upon and subject to the preparation of legal documents satisfactory to the seller, purchaser, and their respective legal counsel.

You tell me. After reading these examples of disagreements over key terms that should be considered in the sale and purchase of a practice, is a letter of intent important? The lawyer who drafts the sale and purchase agreements prepares them based upon the letter of intent. **DE**



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