

Selling or Acquiring Your Practice – Do You Need a Letter of Intent?

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A letter of intent is an optional letter agreement which precedes preparation of the purchase and sale agreements. Sometimes a letter of intent is prepared by the attorney, advisor or broker who represents the seller and sometimes by the purchaser's attorney or advisor. There are two reasons for writing this article. First, a number of advisors believe that a letter of intent is unnecessary. Second, some of the letters of intent that I have reviewed recently have not adequately delineated the important provisions of the purchase and sale. As a result, the parties often get into disagreements on important terms at the "eleventh" hour. This article is limited to a letter of intent in a complete purchase and sale of a dental or dental specialty practice and does not consider the more detailed and very necessary "letter of understanding" for "partnerships" or "co-ownership."

Is a Letter of Intent Necessary?

I believe so, because a well-drafted letter of intent considers all key terms and contingencies of the purchase and sale in advance of paying lawyers to draft and review agreements. Here are some recent examples of disagreements over key terms that I have seen. A purchaser received multiple draft versions of agreements that have been prepared by the seller's legal counsel and the doctors have not yet agreed to the purchase price. The seller is relocating from the midwest to the south, yet there is disagreement over the radius of the restrictive covenant. The general dentist/seller would not agree to complete orthodontic cases, even though the purchaser, who does not perform orthodontic procedures, agreed to make arrangements for and pay the seller to do so. The accountant for a purchaser wanted to allocate one-half of the purchase price to dental equipment to obtain favorable amortization at the expense of the seller when the equipment was worth roughly 15% of the purchase price. The seller sold the practice and

insisted on continued employment for three years following the sale. Each of these disagreements could have been avoided had a well drafted letter of intent been prepared.

Letter of Intent Provisions

- 1. The Parties and Acquisition.** 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 within ten years, there will be two sellers, the C-corporation and dentist who sells his or her personal goodwill. On the purchaser's side, it is probably not the individual dentist, but the entity, through which the purchaser will practice, that it is the purchaser. If the selling dentist or dentist and spouse own the real estate, the real estate will, hopefully, be owned by a limited liability company. Possibly the members will be a family trust. The purchasing dentist would, hopefully, also form a limited liability company to purchase any real estate.
- 2. Purchase Price, Payment and Purchase Price Allocation.** The purchase price for any C-corporation's tangible assets and corporate goodwill should be separated from personal goodwill of the dentist/seller. Tip! Any personal goodwill should be separately appraised. The collective purchase price is usually fully payable by wire transfer, bank, or certified check at the closing. The purchase price would be reduced by any earnest money deposit, liens on the practice or brokerage fees paid to a broker. Finally, this provision provides for the purchase price allocation as designated in a schedule to the letter of intent. The purchase price allocation designates how the seller(s) is taxed on the sale and how the purchaser amortizes the purchase price, including goodwill, be it corporate, or personal to the selling dentist or specialist.
- 3. Excluded Assets.** Certain items will be excluded from the purchase and sale, such as seller's accounts receivable (although not always), cash, cash equivalents, and any personal items of the selling dentist, and any of the seller's debt, unless specifically assumed by the purchaser.
- 4. Accounts Receivable.** In the event the accounts receivable are not purchased by the purchaser, the purchaser typically collects the accounts receivable for a period of six months following closing, less an administrative fee.
- 5. Assets Free and Clear of Liens and Encumbrances.** This provision provides that all purchased assets will be free and clear of all liens and encumbrances at closing, unless specifically assumed by the purchaser.
- 6. Brokerage Fees.** This provision provides that all brokerage fees will be the sole responsibility of the seller.
- 7. Earnest Money Deposit.** Letters of intent often provide for an earnest money deposit. In exchange for an earnest money deposit, the purchaser expects the seller to remove the practice from the market until closing, which may be several months in the future. It is rare that a purchaser has the ability to obtain an earnest money deposit sufficiently large enough for the seller to take the practice off the market because the lender uses the practice, not the purchaser, as security. The earnest money deposits that I usually see are roughly \$5,000 and would be returned upon the occurrence of certain contingencies. While the \$5,000 does show good faith, my recommendation for the earnest money deposit is to eliminate it entirely and not take the practice off the market. Yes, there are exceptions.

8. Confidentiality. While this provision may be in a letter of intent, it should be in an earlier prepared and separate confidentiality letter signed by the purchaser because no purchaser should make an offer on a practice without review of the appraisal and financial information. A confidentiality provision provides that the purchaser will keep the information confidential and return it if negotiations cease for any reason.

9. Due Diligence. If this provision is included in the letter of intent, it provides that there will be a specified due diligence period for the purchaser to review the confidential information and if the purchaser or purchaser's advisors are not satisfied with the due diligence investigation, any earnest money deposit is returned to the purchaser.

10. Closing. This provision designates the date that closing will occur on or before a specified date, unless otherwise agreed to by the purchaser and seller in writing.

11. Representations and Warranties. Seller provides the purchaser with customary representations and warranties that will be contained in the purchase and sale agreements.

12. Non-Competition/Non-Solicitation. This provision spells out the restrictive covenant and non-solicitation provisions that will be

contained in the purchase and sale agreements for solicitation of patients and/or referral sources and former employees of the seller, irrespective of the geographic radius of the restrictive covenant.

13. Post-Closing Employment of the Seller. This provision should provide that, at the purchaser's discretion, the selling dentist will remain employed or engaged by purchaser's dental or dental specialty practice for a specified period, e.g., one year after closing and by mutual agreement thereafter.

14. Financing. This provision provides that the purchase and sale is contingent upon the purchaser obtaining "reasonable" financing for the purchase price on or before closing.

15. Lease Assignment, Lease and Real Estate. This provision provides that the purchaser will obtain a reasonable 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 right of first refusal for purchase of the real estate at fair market value. There may also be a mandatory purchase of any real estate at a certain point.

16. Death or Permanent Disability. This provision provides that the purchase and sale is contingent upon the

purchasing dentist not becoming disabled or deceased prior to closing. A specific definition of disability and selection of a physician is important.

17. Retreatment. This provision provides that the purchaser is not responsible for retreatment of the selling dentist's patients 12 months prior to closing.

18. Work-In-Process. This provision provides that the selling dentist will be permitted to complete cases started, but not finished, prior to closing. The seller customarily retains all fees for work-in-process and is responsible for payment of supplies, laboratory fees and use of any chairside assistant employed by the purchaser.

19. Mutual Indemnification. This provision provides that the seller and purchaser will hold each other harmless for the operation of the practice prior to and after closing.

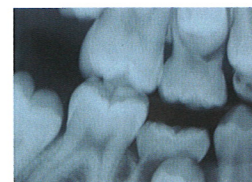
20. Definitive Legal Documents. This provision provides that the purchase and sale is expressly contingent upon and subject to the preparation of legal documents satisfactory to the purchasing dentist, the selling dentist and their respective legal counsel.

You tell me, after the examples of disagreements over key terms and the many important provisions that should be considered in the purchase and sale of a practice, isn't a letter of intent important? ●



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