

# Letter of intent provisions in a complete sale and purchase of a dental practice

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A letter of intent in a complete sale and purchase of a dental or dental specialty practice is a written agreement that precedes the preparation of the sale and purchase agreements. Its purpose is to delineate all significant sale and purchase terms in advance of agreement preparation.

Unfortunately, many letters of intent either incorrectly state or omit important terms. As a result, the selling and purchasing dentists could easily get into disagreements on important terms prior to closing for the sale and purchase. The failure to prepare a thorough letter of intent can result in unnecessary and expensive negotiations for both the selling and purchasing dentists that could have been avoided had the letter of intent been prepared.

The letter of intent should include provisions related to the parties involved, financial matters, assets purchased or excluded, patient concerns, obligations, and conditions of purchase.

## **PARTIES INVOLVED**

### **The parties to the practice sale and purchase**

The parties to the sale and purchase transaction need to be identified. The seller's practice entity, the selling dentist, the purchasing dentist's practice entity, and the purchasing dentist should be identified in the letter of intent. If the purchasing dentist's practice entity is

not formed as of the date of the letter of intent, "entity to be formed" language should be included in the provision. For corporate sales, there is a purchasing entity and the entity owned in the applicable state by the dentist who becomes the custodian of the seller's records.

## **FINANCIAL MATTERS**

### **Purchase price, payment, and purchase price allocation**

The purchase price should 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 provides how the seller is taxed on the sale and how the purchaser deducts the purchase price. If the selling dentist is or was a C-corporation in the last 10 years, there will likely be a significant component of the purchase price allocated to the selling dentist's personal goodwill, in addition to the goodwill component of the practice and its tangible assets. An allocation to the selling

dentist's personal goodwill does not affect the purchaser at all.

## **Earnest money deposits**

In exchange for an earnest money deposit, the purchasing dentist expects the selling dentist to remove the practice from the market until closing. However, a purchasing dentist rarely has the ability to obtain a sum sufficient for the selling dentist to do so. The deposits are usually between \$5,000 and \$10,000, and the sum is returned upon the occurrence of specified contingencies. Such contingencies include state licensure, not incurring a disability, passing away, inability to obtain satisfactory financing or a facility lease, or discovering a problem in the due diligence or purchaser investigation by the purchasing dentist or his or her advisors. While \$5,000 does show good faith, a recommendation to the selling dentist is to eliminate the earnest money entirely and not take the practice off the market. An alternative is to prepare mutual promissory notes in a meaningful sum—e.g., \$50,000 or \$100,000—which becomes fully due and payable should the purchasing dentist not purchase the practice, except for specified contingencies, or the selling dentist no longer agrees to sell it under the terms of the letter of intent.

## **Accounts receivable**

Should the accounts receivable not be purchased by the purchaser, the purchaser typically collects them for a period of six months following closing, less, typically, a 5% administrative fee. The seller should not want the collection process or protocol changed until after the collection period.

A well-prepared letter of intent **minimizes the risk of disagreements** over the terms of a sale and purchase for both the selling and purchasing dentists.

## LETTER OF INTENT PROVISIONS

### Brokerage fees

All brokerage fees should be the sole responsibility of the seller. If not, the selling and purchasing dentists need to be aware of and agree to any conflict of interest in joint broker representation.

### ASSETS PURCHASED OR EXCLUDED

#### Included assets

Assets to be included in the sale and purchase are typically all dental equipment, office equipment, furniture and technology, dental supplies and instruments, and, most important, goodwill, whether from the practice or personal to the selling dentist.

#### Excluded assets

Certain items should be excluded from the sale and purchase, such as the seller's accounts receivable, cash, cash equivalents, retirement plan assets, personal items, and debt unless specifically assumed by the purchaser. While the purchase of the seller's accounts receivable can sometimes help reduce the purchasing dentist's loan, from the purchasing dentist's perspective, dollars are traded for dollars borrowed versus paid and they need to be at least equal. For example, if the historical collection rate of the practice is 97%, the selling and purchasing dentists may agree that the accounts receivable would be purchased for 90% of face value.

#### 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 by the purchaser.

### PATIENT CONCERNS

#### Work in process

The selling dentist should be permitted to complete and retain the fees for those cases started but not completed prior to closing. The seller customarily retains all fees for work in process and is responsible for payment of laboratory fees and sometimes for the cost of any chairside assistant and/or specified supplies; e.g., implants. A work in process provision and schedule of cases, patient

names, procedures, and use of the facility are included as a schedule to the sale and purchase agreements.

However, completion of specialty cases, such as orthodontics, can be complex. Should the selling dentist leave the purchasing dentist's practice before the completion of the specialty procedures, it may be necessary for the purchasing dentist to refer those procedures to a specialist. In such cases, there may be an offset against the purchase price to cover the cost of referrals to any specialist. The letter of intent should define the process for completion of specialty cases should the selling dentist's employment terminate for any reason.

#### Re-treatment

The selling dentist should be responsible for re-treatment of his or her former patients, typically 12 months prior to closing. Should the selling and purchasing dentists disagree on the necessity of the re-treatment of any patient, an arbitrator should be designated, such as a state or local dental society peer review committee. Re-treatment provisions should not omit the important "tie-breaker" language if the doctors disagree on the necessity.

### OBLIGATIONS OF SELLER AND/OR PURCHASER

#### Noncompetition/nonsolicitation

A detailed noncompetition/nonsolicitation provision should define the time limitations and geographic radius or map of the restrictive covenant and nonsolicitation provisions, irrespective of the geographical radius or map, for patients and/or referral sources and former employees of the seller. It should be noted that restrictive covenants are very state-specific and are evolving on both state and federal levels.

#### Confidentiality

While a confidentiality provision may be included in a letter of intent, it should be in an earlier prepared and separate confidentiality letter signed by the purchasing dentist. The reason for the earlier preparation is the purchasing dentist and their advisors may want

to review certain tax and financial information of the practice in question before the letter of intent is prepared. A confidentiality letter provides that the purchasing dentist should keep all information confidential, but is permitted to share it with advisors, and should return all financial and other materials should negotiations cease for any reason.

#### Due diligence

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

#### Postclosing employment of the selling dentist

At the purchaser's discretion, the selling dentist may remain employed by the purchaser's dental practice for a specified period following closing and by mutual consent thereafter. The selling and purchasing dentists should be careful of inappropriate independent contractor relationships as the Internal Revenue Service states, and the Department of Labor believes, that the retired dentist or specialist is an employee.

#### Representations and warranties

The seller's practice entity and the selling dentist should provide the purchaser and purchasing dentist with the usual and customary representations and warranties that will be contained in the sale and purchase agreements, such as liabilities of any nature that will affect the purchaser or the purchasing dentist.

#### Mutual indemnification

The seller, selling dentist, purchaser, and purchasing dentist should hold one another harmless for the operation of the practice prior to and after closing.

### CONDITIONS OF PURCHASE

#### Death or permanent disability

The purchase and sale should be contingent upon the purchasing dentist not

becoming disabled or deceased prior to closing. A specific definition of disability is important, and the closing date should be moved up should the selling dentist become disabled or deceased.

### **Financing**

The sale and purchase should be contingent on the purchaser obtaining lender financing satisfactory to the purchasing dentist for the full purchase price on or before closing.

### **Lease assignment, lease, and real estate**

The purchaser should obtain a lease assignment or lease, satisfactory to the purchasing dentist, 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 the purchasing dentist or an entity owned by

them to purchase the real estate. There may also be a mandatory purchase of any real estate at a certain point.

### **Closing**

The closing date should be designated as a specified date or within a defined time period, subject to the contingencies contained in the letter of intent. Any earnest money deposit should be either applied to the purchase price, retained by the seller, or returned to the purchaser dependent upon the contingencies in the letter of intent.

### **SUMMARY AND THOUGHTS**

The sale and purchase should be expressly contingent on and subject to the preparation of legal documents satisfactory to the seller, purchaser, and their respective legal counsel.

A well-prepared letter of intent minimizes the risk of disagreements over the terms of a sale and purchase

for both the selling and purchasing dentists. The lawyer who drafts the sale and purchase agreements should prepare them in accordance with the terms of the letter of intent to which the selling and purchasing dentists have agreed. **DE**



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