Letters of Intent – Negotiating the Framework of Your Transaction

Benjamin P. Malerba | Douglas E. Menikheim | Sean N. Simensky

In our last installment, we discussed some of the initial steps involved in the process of selling a dental practice, including preparing your practice for sale and finding a potential suitor. Specifically, we described ways in which sellers can find potential buyers and work with advisors and brokers to evaluate the best fit. In this installment, we will be focusing on letters of intent which typically come after you have found a potential suitor.

Letters of Intent – Generally

Once you've found a potential buyer that seems to be aligned with your values and the culture of your dental practice it is often beneficial to outline the parties' basic understanding of the transaction in a simple document prior to drafting the purchase agreement and other definitive contracts. This short document is often referred to as a letter of intent (LOI) but can also be referred to as a memorandum of understanding (MOU) or term sheet. An LOI is beneficial in almost every transaction, particularly if selling to a DSO.

The LOI documents the overall framework of the transaction, including the major business and legal terms, at an early stage, prior to the parties incurring major expenditures (e.g., legal and accounting fees). There is sometimes a disconnect between what a potential buyer may say in preliminary conversations and what they are ultimately willing to give. The LOI is a way of preventing that disconnect. In addition, it will allow the parties to identify any potential deal-breakers early in the process. An LOI reduces the likelihood that an agreement will fall through by laying out the high-level deal points early on. As an added benefit, the LOI can also help streamline negotiations and create at least a soft timeline for the transaction.

An LOI can be very basic and contain just the high-level terms of the proposed transaction or it can be very thorough and cover many of the business and legal terms of the proposed transaction. The level of detail will depend entirely on the parties and/or the timing and complexity of the transaction.

Typically, the buyer will prepare the LOI. Most DSOs have a form LOI that they use because they are often involved in numerous acquisitions and have a preferred set of deal terms which they offer to potential targets. Oftentimes the buyer will push you to sign the LOI as soon as possible in order to move to the next phase of the transaction. In some cases, the LOI may even specify a date by which you must sign before the buyer's offer will expire. You should never sign an LOI without first consulting legal counsel for at least the two reasons discussed below.

First, you want to make sure you fully understand the terms how they impact the whole transaction before agreeing to them and your legal counsel will be able to help identify any potential concerns. Although, the parties are not legally bound by the provisions in the LOI (except for certain specific provisions which are described below), it serves as a framework for the transaction upon which the definitive agreements will be drafted. If there is a disagreement during negotiations concerning a particular matter that was covered in the LOI, the buyer will be able to argue that the definitive agreements need to reflect what was in the LOI, thus leaving you to either concede the point or continue to push the matter, which could create tension in the negotiations.

Second, an LOI is and should always be subject to negotiation. You are selling your practice, requiring you to expend a substantial amount of time, money and energy in the process, so you should be sure you are selling on terms that you are comfortable with. You will also want to gauge how receptive the buyer is to negotiating a deal that is fair to both sides. Your legal counsel can help guide you through these negotiations.

Though an LOI should be tailored to the specifics of the deal, there are certain provisions that appear in most LOIs. Set forth below are some of such standard provisions, each of which should be expressly designated as either "binding" (meaning you would have liability to the buyer if you breach it) or "non-binding".

Business Terms and Description of Transaction

The LOI should cover the most important aspects of the transaction. That is, it should identify the parties to the transaction; describe the type of transaction contemplated, whether an acquisition of assets or stock, merger, or otherwise; describe how the buyer has valued your practice (e.g., a multiple of the practice's EBITDA); the resulting purchase price/consideration that you will receive in connection with the transaction, including the payment terms; and any other associated terms (e.g., any potential earnout payments and/or rollover equity).

In addition, the LOI may include other high-level business and legal terms that will help outline the proposed transaction, such as:

- any restrictive covenants (e.g., non-competition and non-solicitation covenants), including the restricted period of time, the geographic scope of the restriction and the prohibited activities;
- real estate (e.g., will an existing lease be assigned to the buyer or will the buyer want a new lease for your office location);
- basic terms of your post-closing employment, if any (e.g., term of employment and compensation);
- specific closing conditions or contingencies (e.g., financing contingencies);
- and post-closing transition services.

Although the abovementioned matters all represent material terms of the transaction, these terms would typically be "non-binding" and, technically, subject to further negotiation. For example, many DSOs will indicate that their valuation of your practice and the resulting purchase price/consideration that you will receive is subject to adjustment based on further financial diligence and a quality of earnings process.

Exclusivity

Generally, one of the few binding provisions of an LOI is the so called "exclusivity" or "no-shop" provision. The purpose of the "exclusivity/no-shop" provision is to protect a buyer who is expending time and resources performing due diligence and drafting the definitive agreements from the threat that you will engage in discussions with, solicit offers from or enter into agreements for the sale of your practice with other buyers, including using the existing buyer's offer to solicit offers from other buyers. The length of the exclusivity period will depend greatly on the size of the deal and the extent of due diligence required. The buyer will want a time frame long enough to allow the buyer to conduct thorough due diligence and to negotiate and sign a definitive agreement, which is understandable, but you will also want to make sure that it is not so long as to prevent you from considering other offers should this particular deal fall through. The inclusion of a binding "exclusivity/no-shop" provision in the LOI is further reason you will want your legal counsel to review the LOI before you sign it.

Confidentiality and Non-Solicitation

Much in the way the exclusivity provision protects a buyer's interests, the confidentiality provisions of an LOI are designed to protect your interests. An inherent aspect of a business transaction is the need for the buyer to have access to some of your information, much of which will be confidential. Whether it is financial records, employee information, or trade secrets, you need a certain level of protection during the due diligence period when your business is most exposed and

vulnerable. Such protection is provided for in the LOI through a binding confidentiality provision, which prevents the buyer from using your practice's confidential information learned during due diligence to its own advantage. That said, to the extent that parties to a transaction have signed a separate non-disclosure agreement, the non-disclosure agreement would suffice to protect your interests, and additional confidentiality provisions would not be necessary in the LOI.

Lance R. Plunkett, Esq.
General Counsel
New York State Dental Association
20 Corporate Woods Boulevard, #602
Albany, New York 12211
518-465-0044 (phone)
lplunkett@nysdental.org (e-mail)