Typical Legal Documents Necessary for Practice Transition

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Often our clients ask what type of legal documents must be prepared and signed to complete the purchase and sale transaction or the partnership arrangement in the event of a partial sale. Definitive documentation for an orthodontic practice transition is entirely dependent upon the actual structure of the transition itself (stock sale versus asset sale, 100% sale versus partial sale, etc.), as well as the actual terms that are agreed upon between the parties to the transition. With this in mind, typical documents will include many of the following:

Letter of Intent/Term Sheet

A letter of intent, or term sheet, is the preliminary document prepared to outline the significant terms of the transaction, including, but not limited to, purchase price, purchase price allocation, assets to be purchased, payment terms, buy/sell arrangements, operating structure, compensation arrangements, days worked, and length of association (if any). Bentson Clark believes that this document is an essential and important part in any transition. If agreement on the major points cannot be reached by the various parties involved, it usually becomes apparent while preparing the Term Sheet. This document sets the stage for the smooth development of the more complex definitive documents listed below.

Asset Purchase Agreement/Stock Purchase Agreement

This document will serve as the foundation of the documentation. It outlines the purchase price, payment terms, regular and customary legal representations and warranties, etc. If the transition is structured as an asset purchase, an asset purchase agreement will be prepared whereby the buyer will purchase substantially all of the seller's tangible and intangible assets of his or her orthodontic practice (or perhaps only a portion of seller's assets if the transition is a buy-in where the buyer will be joining the seller in the practice). If the transition is structured as a stock purchase transition, a stock purchase agreement will be prepared whereby the buyer will purchase all or a portion of the seller's capital stock in the corporation.

"from the seller's viewpoint, the buyer's spouse joins in the guaranty"

Promissory Note

If the seller will be financing all or any portion of the purchase price for the buyer, a promissory note in customary form will be prepared to document the obligation and the terms of repayment.

Security Documents

If the transition takes the form of an asset purchase, the collateral to be posted by the buyer as security for his or her promise to faithfully pay the terms of the promissory note will usually take the form of a security agreement for the purpose of posting a first lien security interest on the assets of the practice being purchased by the buyer. Additionally, the seller files financing statements in compliance with the Uniform Commercial Code in the appropriate public offices in order to perfect the security interests created by the security agreement. If the transition takes the form of a stock purchase, the collateral to be proposed by the buyer as security of his or her promise to faithfully pay the terms of the promissory note will usually take the form of a stock pledge agreement whereby the buyer will grant to the seller a first lien security interest on the shares of stock being acquired from the seller. A pledge agreement is often accompanied by a stock power, which is an instrument that allows the seller to unilaterally transfer title to the pledged stock in the event of a default by the buyer under the related promissory note. In addition, the seller will usually require the buyer to assign a collateral interest in a life insurance policy and/or a disability insurance policy on the buyer to fund the remainder of the purchase price in the event of the death or disability of the buyer during the term of the payout period.

"One or more employment agreements are typically prepared to address the buyer's employment."

Personal Guaranty

If the obligor under the promissory note is other than the buyer individually, for example a corporation or limited liability company that the buyer owns, then the seller often requires the buyer to personally guaranty the note. Ideally, from the seller's viewpoint, the buyer's spouse joins in the guaranty. Every institutional lender would insist upon such a guaranty if it were lending the money for the purchase price of the practice; therefore, it is recommended that any seller financing all or any part of the purchase price should insist upon this provision.

Assignment of Personal Goodwill and Covenant not to Compete

Often, a portion of the purchase price consideration will be allocated to the seller's personal goodwill or a related covenant not to compete. The reason for including a non-compete agreement from a tax standpoint is that the seller will receive long-term capital gains treatment for this portion of the purchase price consideration, and the buyer will be able to deduct this amount over a period of 15 years (as opposed to no deduction at all if allocated to the purchase of capital stock). Here, the seller agrees to convey all of his or her personal goodwill to the buyer and further agrees not to compete with

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the buyer's practice for an agreed upon period of time within an agreed upon area. As the terms of the non-competition and non-solicitation agreements may vary widely from state to state based on local court decisions, Bentson Clark requests that local counsel assist in preparing these agreements. Such agreements usually also contain provisions restricting the seller's ability to hire employees of the buyer's practice.

Shareholders' Agreement

In the case that the buyer is buying into the seller's existing practice through a joint ownership arrangement for a period of time, a shareholders' agreement will be prepared to set forth the rights, duties and obligations of the practitioners with respect to one another, so that each party is protected in the event that the other party should die or withdraw from the corporation during the joint ownership period (this agreement may also be referred to as a partnership agreement in the event of a general or limited partnership arrangement or an operating agreement in the event of a limited liability company). Provisions typical to such an agreement include rights of first refusal regarding transfers of equity interests, the ability to recover equity interests lost through involuntary transfers (such as from a divorce or a bankruptcy), and tax provisions.

> **"The assignment of an office lease should not obligate the buyer to assume the seller's obligations."**

Employment Agreements

One or more employment agreements are typically prepared to address the buyer's employment by the seller pending the closing (if applicable), to cover the buyer's and seller's employment by the practice if the structure contemplates a period of joint ownership, or to cover the seller's engagement by the buyer following the closing (if applicable). The employment agreements set forth the various terms of engagement, including compensation issues, benefits, and contemplated work schedules. If the parties elect to enter into an independent contractor arrangement rather than an employment arrangement, this agreement would be replaced with an independent contractor agreement.

Bill of Sale

If the transaction is an asset purchase arrangement, a bill of sale will be prepared whereby the seller will formally convey to the buyer, at closing, all of the assets to be conveyed with the practice. In the event the transaction is a stock sale arrangement, certificate(s) of stock will typically be issued from the seller's existing corporate minute book by the seller's attorney at closing.

Assignment and Assumption Agreement

If the transaction is an asset purchase arrangement, there may be some contracts which the buyer will want to assume from the seller, such as equipment leases, office leases, outsourced payroll services, and the like. Such contracts are transferred from the seller to the buyer pursuant to an assignment and assumption agreement. Such an agreement must be carefully drafted to ensure that the buyer is only assuming the seller's obligations for matters that arise from and after the closing date. For example, the assignment of an office lease should not obligate the buyer to assume the seller's obligations for past-due rent that exists as of the closing date of the asset transaction. Also, many contracts, especially real property leases, expressly state that they cannot be assigned absent the consent of the other party to the contract. One such instance is that the landlord's consent is almost always required before an office lease may be assigned. Therefore, reasonably in advance of the closing, the seller and the buyer should identify and seek to obtain such consents.

Certificates

In a stock sale or a sale of membership interests in a limited liability company, the seller's certificates representing such equity interests should be endorsed over to the buyer at the closing. If such certificates have been lost or were never issued in the first place, the seller should be required to sign an affidavit and indemnity agreement to that effect, which will protect the buyer in the event that certificates that were thought to be lost or thought to have never been issued somehow turn up after the closing.

Note: Much of the above information is included in Bentson Clark's Transition Guide. You may request a complete copy of this document by contacting our office or downloading it from our website at www.bentsonclark.com.

Doug Copple CPA, CVA, is a partner at Bentson Clark. Doug has excellent knowledge in both valuation methodology and tax allocation/negotiations in the transition process.

Mr. Daniel Sroka practices business and corporate law in Greensboro, North Carolina. His experience includes mergers and acquisitions, finance and capitalization, business formation, succession planning, and other areas of corporate and commercial law.