

## *"Successful Strategies in Purchasing or Selling Your Dental Practice: Part 1"*

By Law Offices of Barry H. Josselson, A Professional Law Corporation \*

The purchase and sale of a dental practice is obviously one of the most significant events in a dentist's career. While the process of finding that "perfect" practice to purchase or the "appropriate" buyer to whom to sell is of critical importance, the correct and precise drafting and negotiation of the dentist's purchase and sale agreement have significant financial, tax and liability consequences to the dentist for years to come.

This two-part article will briefly identify those necessary procedures to employ when purchasing or selling a dental practice and the critical terms and conditions to be drafted in your acquisition document.

1. Letter of intent. Most transactions effected by a dental practice broker and private party transactions (without such a broker) commence with a letter of intent signed by the parties. The purpose of such letter of intent is to memorialize the major terms to be agreed upon between the parties such as the purchase price, date of transfer of the practice, inclusion or exclusion of accounts receivable in the transfer, time periods within which the buyer's accountant is to approve the practice's financial information and the buyer's lender is to provide financing, and the time period within which the buyer secures a new office lease or assumes the seller's existing lease. The letter of intent is usually non-binding, and any deposit provided by the buyer is refundable unless certain time periods have passed or certain events have already occurred.

Make sure that your letter of intent provides that all of the information obtained by the parties and their respective advisors shall be kept confidential irrespective of the outcome of any negotiations between the dentists. You certainly do not want collection and production reports being discussed among your colleagues at the local component dental society meeting if you are the seller or have your personal financial statement and balance sheet discussed among your peers if your lender or landlord decline to lend money or lease the premises to you.

2. Allocation of purchase price. Most dental practice transactions result in the buyer purchasing the assets of the dental practice (for example, equipment, supplies, patients' charts and records, seller's telephone number) and not the stock of the seller's professional dental corporation. When you purchase the dental practice assets, your accountant and attorney will allocate the purchase price among all of the assets of the dental practice you are acquiring including, but not limited to, the goodwill and a covenant not to compete binding the seller. Your goal is to recover the maximum amount of your purchase price over a short period of time by way of expensing, depreciating or amortizing the assets. For example, the amount of the

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purchase price that you allocate to the seller's goodwill and covenant not to compete can be depreciated only over 15 years irrespective of the actual term of your seller's covenant not to compete (for example, 5 years). Certain dental office furniture and equipment, however, can be depreciated over 5 or 7 years.

3. Contingencies. Your acquisition agreement should indicate that certain events must occur for the transaction to be consummated and, in the absence of such occurrence, you shall be relieved of your obligation to purchase the dental practice and *have no resulting liability*. One of the more important contingencies is your assuming the seller's existing lease with terms acceptable to you or entering into a new lease whose terms meet the prerequisites of your lender (for example, the lease term with any options to renew have to equal in length the term of your dental practice purchase loan). Your (i) accountant's approval of the practice's books and records, (ii) obtaining a loan in the amount, interest rate and term you desire, and (iii) attorney drafting or approving the purchase acquisition agreement are all contingencies which must *first* be met *prior* to transfer of title to the practice occurring. Make sure such contingencies are expressly spelled out in your document so that your good faith deposit shall not be wrongfully withheld (by any disgruntled seller or practice broker) if you choose to withdraw from the transaction due to one or more of these contingencies having *not* been satisfied.

4. Covenant not to compete. Your having included in the purchase and sale document a covenant not to compete restricting the seller from practicing dentistry for a reasonable period of time and within a reasonable geographic radius from the practice is a *critical* provision in any dental purchase agreement. While restrictions placed on one's ability to practice dentistry as an associate, employee, independent contractor or otherwise are generally deemed illegal and unenforceable under current California law, *the law permits buyers to restrict the competitive activities of a seller when the purchase of the selling dentist's practice includes the goodwill of such dental practice*. Accordingly, take extra caution when negotiating and drafting a very detailed and comprehensive covenant not to compete restricting the selling dentist's activities subsequent to the practice purchase. Even if the selling dentist no longer owns another dental practice, you want to make sure that any dental activities in which he may engage (such as a part-time associate dentist, partner, shareholder, director, officer, consultant, employee, independent contractor or agent of any other dentist or dental practice) have been clearly addressed as either acceptable or prohibited. The time to ascertain whether such activities are competitive with you and your recently-acquired practice is *not after you have paid a full purchase price* to the seller and patient attrition ensues because of a seller's unforeseen competitive endeavors.

If your seller stays on in a part-time capacity as an associate in your newly-acquired dental practice, make sure that the covenant not to compete starts from his last day of employment with you and *not* from the date that you acquire the dental practice (possibly two or three years earlier). In such case, the protection of having a reasonably long covenant period is negated while your selling dentist is continuing to treat and bond with his former patients in your new dental practice.

Next month's second part of this article will examine (i) allocating responsibility between seller and buyer to collect seller's accounts receivables after the purchase is consummated; (ii) determining responsibility and liability between the parties for defective dentistry; (iii) appropriate warranties in your purchase agreement to protect the purchasing dentist or selling

dentist; and (iv) remaining significant business issues to address before the transaction is completed (for example, office lease negotiations or review, becoming a professional dental corporation, and employee policy and procedure manuals).

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## ***"Successful Strategies in Purchasing or Selling Your Dental Practice: Part 2"***

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The purchase or sale of a dental practice remains one of the most significant events in a dentist's career. The astute negotiating of and the precise drafting of the dentist's purchase and sale agreement will have significant economic, tax, and liability consequences to the dentist for years to come.

Last month's first part of this article briefly identified those necessary procedures (for example, letters of intent, contingencies, and appropriate allocations of values among the dental assets purchased) to employ when purchasing or selling a dental practice. This month's second part addresses the critical terms and conditions to be drafted in your purchase and sale document.

1. Collection of seller's accounts receivable. The buyer can purchase some, all or none of the selling dentist's accounts receivable. If accounts receivable are not purchased by you, provisions need to be made in the document for the collection of the accounts receivable. It is in your and the seller's best interest not to have the seller collect the accounts receivable. The seller's collection rate drops substantially if patients are reminded on a monthly basis to remit payment to an address, post office box or some remote location other than their present dental practice. Patients are inadvertently given the subtle message that the seller has left the practice. Any incentive not to pay to the departing seller the patient's outstanding balance is encouraged by such action. Instead, the buyer is motivated (i) to maintain all patient goodwill, (ii) to keep an overzealous seller from aggressively or improperly collecting his or her accounts receivable, and (iii) to have as many positive patient interactions as possible subsequent to the closing. Your document needs to clearly delineate the period of time that the seller's accounts receivable shall be collected, the normal collection fee (5%-10%) for the buyer's providing such collection services to the seller, and how patients' payments are to be allocated to new dentistry performed by the buyer when the patient has an outstanding balance still due the seller.

2. Re-do of defective dentistry. Buyers of dental practices should expect to re-do at no charge to the patient any failed dentistry presented to the buyer after the closing. The real issue is if there exists significant work which has failed, who is obligated to re-do such work and at what charge? Well-drafted purchase agreements allocate such responsibilities between the seller and buyer. It is common to provide that the seller has the option to return to the practice to re-do such work or pay the buyer (50%-75% of the buyer's normal and customary fee) to re-do any failed work. Also, the period of time within which

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the seller retains such election and the procedures by which the buyer notifies the seller of such failed work need to be addressed in your agreement.

3. Warranties and representations. The selling dentist's warranties and representations regarding the practice being sold to the buyer may be the most important part of the purchase agreement. Warranties are statements made by the seller upon which the buyer reasonably relies in determining to purchase the dental practice. If such representations were not accurate, the buyer obviously would have negotiated a different purchase price or possibly elected not to proceed with the acquisition. Accordingly, such verbal statements made to the buyer or the practice broker must be memorialized in writing so that the parties may be assured of their accuracy and integrity. Common warranties made by the seller and upon which the buyer reasonably relies are matters such as (i) the practice assets having no liens or encumbrance on them, (ii) the seller never having had his or her license to practice dentistry be suspended or revoked, (iii) the seller's income and expenses being materially true and correct, and (iv) the seller not having engaged in any practice billing procedures which may violate the terms of any third party insurance contract (for example, the uniform practice of waiving patient co-payments). The buyer rarely has the opportunity to be an associate in the dental practice being purchased or to be cognizant of the real goings-on in the practice. Accordingly, it is reasonable for the buyer to seek broad warranties from the seller assuring the buyer that the practice being acquired and for which the buyer is paying considerable money is not in disguise "damaged goods".

4. Other significant business issues: dental incorporation, office lease analysis, employee policy and procedure manual. The purchase of a dental practice is merely the first step in an anticipated long and happy career in dentistry. However, your personal joy and financial satisfaction can be enhanced with your taking charge of the other areas in your professional career in much the same way that you have been pro-active in negotiating or obtaining a fair and properly drafted purchase agreement.

(a) Dental corporations. Corporations continue to be viable entities by which dentists practice their profession. Unlike practicing as a sole proprietor or partnership, your professional dental corporation protects your personal assets from any practice or business liabilities (such as breach of contract matters or wrongful termination litigation) with the exception of dental malpractice claims. Also, you are able to pay for fringe benefit programs such as disability income insurance and health insurance with pre-tax corporate dollars (therefore, you are never taxed on such expenditures) as opposed to paying for such benefits with personal, after-tax dollars. Lastly, the likelihood of being audited by the Internal Revenue Service is substantially less when you practice as a dental corporation as opposed to practicing as a sole proprietor.

(b) Office lease. Even if you are assuming the seller's existing office lease, you have to analyze it and understand its liabilities prior to agreeing to be bound by it. Do not make the mistake of believing that your seller's signing such office lease means that such document is fair or lacks dangerous or onerous terms and provisions. Most office leases do not permit the buyer of a dental practice to exercise the seller's option to renew the office lease. Most leases also permit the landlord to recapture the premises if you merely ask the landlord's consent to assign the lease to another party. Many landlords have also discreetly

included in their leases the right to relocate any tenant at the landlord's discretion or not to release the dentist from his or her office lease if the building or premises has been destroyed by fire, earthquake or other catastrophe. Do not let the prior dentist's legal unsophistication impact your practice's profitability by your not having your dental real estate attorney peruse any agreements (office leases, equipment leases, practice purchase loans, capitation or PPO contracts) whose terms you shall be assuming.

(c) Employee policy handbook. California is a litigious state, and staff, patients and other individuals are not reluctant to threaten litigation or actually file lawsuits. Employers must post certain notices within their workplace (for example, their policy against sexual harassment), and one way to reduce the likelihood of staff litigation and to increase office morale is to have drafted your own office policy and procedure manual. By addressing formally in writing your office policy regarding critical issues (such as paid vacation, paid holidays, paid sick leave) or sensitive issues (such as termination of staff, sexual harassment, alternative work week schedules or pregnancy disability leave), you are making more efficient and less ambiguous your office policies. This then translates into reduced risk of litigation by current staff or terminated staff. It makes the sale of the dentist's practice easier and more efficient.

5. Your purchase of a dental practice is a first step in your becoming immersed in the business and legal issues involved with being your own employer and owner of a dental practice! Your sale of a dental practice is the final step of realizing the equity of your dental practice investment and should be accomplished without the anxiety or fear of subsequent litigation by a disgruntled, under-achieving buyer of your practice. The rewards are substantially greater if you seek and follow the advice of experienced dental legal counsel before signing or negotiating any agreements.