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De-Mystifying the Complex World of Dental Practice Purchases and Sales: New Strategies to Accomplish Your Goals (Part 2 of 3 Part Series)

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The *process by which you find a buyer* to whom you sell your dental practice or, conversely, the *steps you take to acquire a dental practice* can be *challenging, complex, and time-consuming*. Your finding the “perfect practice” to purchase or the “right buyer” to whom to sell demands (i) an understanding of the chronology of steps to be completed in this process and (ii) a recognition of the significant *economic, tax, and liability consequences* to you for years to come resulting from such a purchase or sale.

Dental practice purchases and sales are *fraught with peril* in the form of (i) undisclosed equipment liens, (ii) office leases with limited rights by a seller to transfer the lease to the purchasing dentist, (iii) uncompleted or failed dentistry to be performed or redone by the seller or buyer, (iv) accounts receivable to remain owned by the seller or to be collected by the buyer, and (v) restrictions on the seller’s right to practice dentistry, solicit staff, or treat patients subsequent to any transfer of the practice to a buyer. *This 3-part article serves as a compass to help you to navigate into safe harbors and to avoid the precarious shoals and hidden dangers of dental practice purchase and sale transactions.*

Last month’s Part 1 briefly summarized which advisors to engage and those *necessary steps* to follow when purchasing or selling your dental practice. Part 2 in this month’s issue identifies the *related entities* (such as a dental corporation) which need to be created or the *related legal documents* (such as your *office lease* and office employee manual) which need to be prudently prepared, analyzed, and signed in addition to your practice purchase and sale agreement. Next issue’s Part 3 shall explain the *essential* (albeit often over-looked) *provisions* to be drafted in your practice purchase and sale agreement.

1. Dental non-disclosure and confidentiality agreements. Make sure that *all of the information provided by you to the other dentist and their advisors shall be kept confidential irrespective of the outcome* of any negotiations regarding your dental practice purchase and sale transaction.

If you are the *seller*, you certainly do not want collection and production reports being discussed among your colleagues at local component dental society meetings. If you are the *buyer*, you obviously do not want to have your personal

financial statement and balance sheet discussed among your peers if your lender or landlord, respectively, declines to finance the practice purchase or lease the premises to you.

As the *seller*, the best way to assure your goal of confidentiality is to have your buyer sign a short but thorough agreement setting forth that (i) *all information* (not only practice financial data but also the terms of any office lease, associate dentist, or space-sharing relationships, fee schedules, marketing strategies, or self-created practice promotional materials) provided to the buyer is *confidential and not to be disclosed to others* (except for the buyer's advisors) or *used by the buyer* to your detriment, (ii) all such information shall be *returned* to you at your request *regardless* of whether negotiations have terminated or are in progress, (iii) the buyer's obligation to maintain the confidential nature of the information *shall continue* even if the purchase and sale is not consummated; and (iv) the buyer shall instruct his or her *advisors* (practice broker, attorney, accountant, dental consultant, and lender) that they are *also bound* by the terms of your nondisclosure and confidentiality agreement.

As the *buyer*, the best way to assure your goal of confidentiality is not only to have your seller sign the agreement for the same reasons listed above but also to have the agreement emphasize and clarify two areas rarely addressed: (i) differentiate between information claimed by your seller to be "confidential" and that which is already out in the "public domain" and (ii) define what is the inappropriate use of your financial information (e.g., net worth) by your dental lender with the practice broker or by your practice broker with the seller. Most confidentiality agreements fail to carve out as an *exception* to the seller's broad definition of "confidential information" any data which *already exists* in the "public domain" (e.g., patients' phone numbers and addresses or marketing/promotional materials). Also, nearly all confidentiality agreements omit specifying your lender's obligation *not* to divulge to any party (including the practice broker) your personal financial information. This is especially important if your seller's willingness to negotiate financial terms (e.g., purchase price or seller's carry back of a promissory note) will be substantially determined by your perceived financial condition.

2. Letters of intent; deposit receipt agreements. Some transactions involving a dental practice broker but many private party transactions (without a broker) *commence with a letter of intent* signed by the parties. Its purpose is to *memorialize the major terms* which have been agreed upon between the parties such as the purchase price, date of transfer of the practice, inclusion or exclusion of the seller's accounts receivable in the transfer, and time periods within which (i) the buyer's accountant is to approve the practice's financial information, (ii) the buyer's lender is to provide financing, and (iii) the buyer is to secure a new office lease or assume the seller's existing lease. *The letter of intent is usually non-binding*; therefore, any deposit provided by the buyer is *refundable* unless specific time periods have passed or certain events have already occurred. A

deposit receipt agreement, on the other hand, usually states that the agreement's terms are *binding on each party, liability will result* if a party does not perform according to the contract's provisions, and the *buyer's deposit* made at the time of signing the agreement is *subject to forfeiture*.

3. Other significant business issues: dental incorporation, office lease analysis, employee policy and procedure manual. Your purchase of a dental practice is merely the first step in an anticipated long and fulfilling 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 the same way that you have been pro-active in negotiating or obtaining a fair and properly drafted purchase agreement.

(a) Dental corporations; LLC's. Professional dental 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* unlike your practicing as a high income earning sole proprietor. Nearly all states permit dentists to practice dentistry as a professional limited liability company; however, *California is an exception*. It prohibits dentists, physicians, and almost all other health care providers from practicing their profession as an LLC.

(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 an office lease means that such document is fair or lacks dangerous or onerous terms and provisions. For example, 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 for the landlord's consent to assign the lease to another dentist. Many landlords have also discreetly included in their leases *the right to relocate* any tenant in the landlord's discretion or *not to release the dentist* from his or her office lease if the building or premises have been destroyed by fire, earthquake, or other catastrophe. Do *not* let the prior dentist's lack of legal acumen impact your practice's profitability by your not having your dental real estate attorney examine any agreements (i.e., office leases, equipment leases, practice purchase loans, capitation or PPO contracts) whose terms you shall be assuming.

*As the seller, you want to limit any future liability you may have to the landlord after your sale of the practice. Therefore, include a **release of liability provision** in any office lease assignment document to be signed by you, the buyer, and the landlord. Also, if the buyer is entering into a new lease with your landlord, obtain a **termination of lease agreement** signed by you and the landlord. Such document would set forth the cessation of all liabilities (present and future) between you (as a tenant) and your former landlord.*

(c) Employee policy and procedure manual. California is a litigious state. Employees, patients, and other individuals are *not* reluctant to threaten litigation or actually file lawsuits. Employers must post certain notices within their workplace (i.e., their policy against sexual harassment), and one way to reduce the likelihood of employee litigation and to increase office morale is to have your own “custom drafted” office policy and procedure manual. By addressing formally in writing your office policy regarding important issues (i.e., vacation, paid holidays, paid sick leave) or sensitive issues (i.e., termination of employment, sexual harassment, alternative work week schedules, or pregnancy disability leave), you are making unambiguous your office policies. *This then translates into reduced risk of litigation by current staff or terminated employees. It makes the sale or purchase of your dental practice easier and more efficient.*

Next issue: The third and final part of this article will examine those critically important items to be negotiated and drafted in your purchase and sale document as follows: (i) determining responsibility and *liability between the parties for defective dentistry*; (ii) the scope and duration of the *seller’s covenant not to compete*; (iii) appropriate *warranties* in your purchase and sale agreement *to protect* the purchasing dentist or selling dentist; and (iv) allocating responsibility between seller and buyer to collect *seller’s accounts receivables* after the purchase is consummated.

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