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Practice Management Information for Implant Dentists

**“De-Mystifying the Complex World of Dental Practice Purchases and Sales: New Strategies to Accomplish Your Goals”**  
(Part 3 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 2 of this article (i) identified the legal documents to be analyzed and entered into (e.g., dental non-disclosure and confidentiality agreements, letters of intent, and deposit receipt agreements) when purchasing or selling a dental practice and (ii) described the remaining significant business issues to address before the transaction is completed (e.g., office lease negotiations or review, establishing a professional dental corporation, and creating employee policy and procedure manuals). This month’s Part 3 focuses on the essential (but often overlooked) provisions and conditions to be included in your purchase and sale document.

**1. Allocation of purchase price.** Most dental practice transactions result in the buyer purchasing the assets of the dental practice (e.g., equipment, supplies, patients'charts and records, seller's telephone number) and not the stock of the seller's dental corporation. When you purchase the dental practice assets, your accountant will allocate the purchase price among all of the dental practice’s assets you are acquiring (including the seller’s goodwill and a covenant not to compete binding the seller). As the buyer, 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 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 the seller's covenant not to compete (e.g., 5 years). Certain dental office furniture and equipment, however, can be depreciated over 5 or 7 years. As the seller, your goal is to allocate as much of the purchase price to the assets resulting in favorable capital gain tax treatment as opposed to ordinary income tax treatment (resulting in substantially greater tax liability).

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

**3. Covenants not to compete.** 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 an essential provision in your document. While restrictions placed on one's right to practice dentistry as an associate, employee, independent contractor, or otherwise are not enforceable under current California law, the law permits buyers to restrict the competitive activities of a seller when the purchase of the dentist's practice includes the seller's goodwill.

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 not own another dental practice, the buyer shall want to be assured that any new dental roles that the seller may assume (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 roles are competitive with those of the buyer and the buyer's recently-acquired practice is not after the parties have paid or received the full purchase price and patient attrition results from the seller's unforeseen competitive endeavors.

If the seller stays on in a part-time capacity as an associate in the buyer's newly-acquired dental practice, it is reasonable to have the covenant not to compete start from the seller's last day of employment with the buyer and not from the date that the buyer

acquires the dental practice (possibly 2 or 3 years earlier). Otherwise, the protection of having a reasonably long covenant period is negated if the seller continues to treat and bond with former patients in the buyer's new dental practice.

**4. Re-do of defective dentistry.** Buyers of dental practices should expect to re-do at no charge to the patient any insignificant or minor failed dentistry presented to the buyer after the closing. The real issue is if there exists substantial or 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 either to return to the practice to re-do such work or to 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 the seller retains such election and the procedures by which the buyer notifies the seller of such failed work need to be **clearly** addressed in your agreement.

**5. Warranties and representations.** The selling dentist's warranties and representations regarding the practice are the most important part of the purchase agreement. Warranties are statements made by the seller upon which the buyer reasonably relies in determining whether 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, verbal representations about the practice made to the buyer or the practice broker must be memorialized in your agreement 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 the following: (i) the practice assets having no liens or encumbrance on them, (ii) the seller's license to practice dentistry never having been 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 (e.g., 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 fully 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". The seller, on the other hand, appropriately desires to limit their scope and not make warranties about the practice's history or financial condition which could create unnecessary liability for the seller.

**6. 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 their collection. It is in each party's best interest not to have the seller collect the accounts receivable after the practice transfers to the buyer. 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. On the other hand, the buyer is motivated (i) to maintain all patient goodwill, (ii) to keep a possibly 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. Both the seller and buyer desire that their document clearly delineate (i) the period of time that the seller's accounts receivable shall be collected, (ii) the normal collection fee (5%-10%) for the buyer's providing such collection services to the seller, and (iii) 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.

Your purchase of a dental practice is a first step in your becoming immersed in those 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 possible disgruntled or under-achieving buyer of your practice. The rewards are substantially greater if you seek and follow the advice of an experienced dental attorney before signing or negotiating any agreements.

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