



Buyer and Seller Beware: Why You Need a Transition Attorney for Your Dental Practice Transition

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ABSTRACT Buyers *and* sellers of dental practices have much to lose by not hiring an attorney who specializes in dental practice transitions for the sale. Such an attorney can (1) protect the dentist with language that should be (but isn't) in the contract; (2) help address any organizational, regulatory and tax issues that arise; and (3) provide far more thorough services than could nonspecializing attorneys, practice brokers, or colleagues. Otherwise, let the buyer and seller beware.

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Everyone has heard the expression “Let the buyer beware!” It warns the buyer to be on guard against a possibly unscrupulous seller. However, in the context of practice transitions this admonition should not be so limited. The buyer and seller both need to be wary, and not just of each other.

That “standard contract” provided by the broker or a helpful colleague is by no means exactly the right contract for this specific practice transition. It contains land mines, accidental or intentional, that only an attorney who specializes in dental practice transitions in the transaction (henceforth a “transition attorney”) can identify, and, if not corrected, can place the buyer and seller in serious financial and professional

danger. This article contains real-life examples of contracts reviewed by the author, discussion of the potential problems lurking in those contracts, and how those problems can be averted.

It would also be remiss not to emphasize that dentists place themselves in a dangerous position if they choose to represent themselves in their own practice transitions. Dentists certainly are intelligent, well-trained, and capable individuals. Many have gained extensive experience in running a dental practice, dealt with some of the pitfalls of practice management, and even gone through one or more practice transitions in the past. They have read many contracts in their day and generally know what the words in the contract mean. The dentist may even want to use the contract used in

their prior practice transition. However, it is dangerous for dentists, smart as they may be, to take it upon themselves to complete their practice transition without assistance from a transition attorney.

The danger isn't so much a lack of general familiarity and capability in understanding the actual terms of the contract, but rather what terms are *not* in the contract. Desirable protections for the buyer and/or the seller have probably been omitted, whether by accident or intention.

Also, the specific dentist's situation may call for entirely different contractual approaches than provided in the contract; one size does not fit all. Laws and practical considerations also change over time, and the contractual language in use two years ago may now be seen as inappropriate or even dangerous today.

Finally, specialized legal experience is necessary to identify issues that are not directly related to the contract itself. Leasing, tax, and organizational issues arise in almost every practice transition.

Example No. 1

Retreatment Issues. The seller's main goals when selling a practice are getting paid in full and being left alone to enjoy retirement. This generally requires that the dentists agree, in advance, how to handle the many postsale issues that can arise between the parties. If the dentists do not have agreement on these issues before the sale is completed, it can push the two into a costly and completely unnecessary lawsuit.

One of these issues is that of retreatment of failed or defective dentistry. It is highly unlikely that even an experienced business transactional attorney will identify this issue at all. And although the dentist client can raise the issue, the attorney will not have the necessary experience with

dental practice transitions to come up with any practical solutions.

To say the issue will be resolved "as mutually agreed" only puts off the day of reckoning. That prospective dispute can be, and should be, dealt with at the time the contract is drafted, and not left for that future time when the buyer and seller no longer can "mutually agree."

This is where the transition attorney would be of tremendous value. The fol-

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lowing approach (in italics provided by a transition attorney), though by no means complete, provides an example of how some parts of this issue could be resolved:

"For one year after the closing, if buyer reasonably believes the patient should not be fully charged for nonemergency retreatment relating to services provided by seller during the one year prior to the date of retreatment, buyer will first notify seller of the need for retreatment. Seller then may notify buyer within three days if the seller chooses to complete the retreatment personally. If the patient then consents to seller conducting the retreatment, the parties will mutually schedule a time for the retreatment, and seller will pay buyer only the hard costs incurred for the retreatment, within 10 days of retreatment. If seller does not conduct the retreatment and agrees to buyer conducting the retreatment, or if the retreatment is an emergency, buyer will conduct the retreatment and bill seller for ___% of buyer's usual customary and reasonable fee for the retreatment."

Example No. 2

Warranty and Representations Issues.

The buyer's main goal when buying a practice is receiving the full value paid for the practice. Usually this requires two things. Firstly, the seller must promise not to compete with or otherwise dissipate the value of the practice after the transition. Secondly, the seller must make promises concerning the operation and condition of the practice. It is this second requirement that will be addressed.

An experienced business transactional attorney could point out a number of important seller warranties and representations that the buyer may not notice are missing from the contract. For example, what if the seller knows that there are liens against the practice's equipment or that the air-conditioning unit is broken? Representations to reveal these and other typical business deficiencies could be added by the attorney.

However, what if the seller has been notified of a pending Medi-Cal audit and the buyer plans to continue taking Medi-Cal patients? What if the practice's annual income has been so bloated with insurance overbillings that the practice should have earned only 80 percent the amount it did? Either of these situations would seriously impact the value of the practice, and it is crucial to get seller representations denying these problems in the practice:

"There are no violations, investigations, audits, proceedings or claims pending or threatened against seller. Seller does not reasonably believe that any such potential violation, investigation, audit, proceeding or claim may exist, will commence or be threatened in the near future."

"Seller has not billed any practice patients, insurers, or governmental agencies for goods or services for which seller is not entitled to compensation, nor has waived any

co-payments or deductibles as required by insurance.”

Only a transition attorney will have the experience necessary to protect the buyer from these and many other otherwise hidden problems.

Example No. 3

Employee Issues. Employee issues raise serious risks for both buyers and sellers. What happens to the practice’s employees and dental associates when a practice is sold? The assumption may be that those people will continue with the practice, under the same or slightly different terms as before. Unless it has been addressed explicitly in the contract, the typical dentist will not realize how important it is to have a clean break between presale and postsale employment.

In this case, an employment law attorney, or an experienced business transactional attorney, would be of great help to the seller. The attorney would point out the need to have the employees terminated formally, preferably in writing, and that all compensation (including accrued vacation pay) must be paid immediately upon that termination (California Labor Code ‘201). Then, and only then, are employees to be rehired, if at all, and on whatever terms the buyer and those employees may agree.

Had the seller not consulted with such an attorney, serious labor law violations would have been committed. If an employee is not paid all their accrued wages (including vacation pay) at termination, the employee could file a claim to receive one full day worth of wages (including unused vacation pay) for every day final payment was late, up to a maximum of 30 working days (California Labor Code ‘203). This means that for each \$25 per hour employee that isn’t paid its full accrued vacation time, the seller could

be held liable for \$6,000 per employee.

The buyer doesn’t escape the danger here either. The risk is that employees may believe the buyer has taken on all of the seller’s responsibilities, both past and future. This can lead to many problems. One such problem is that employees may misunderstand they are entitled to paid vacation for time accrued prior to the sale — even if the seller paid them for their unused vacation time upon

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termination. However, much larger risks await a buyer when employees are not properly terminated and rehired.

For example, California law provides that an employer who doesn’t allow its full-time employees the full paid away-from-the-desk 10-minute breaks (two per day) and half-hour meal period must pay a penalty of one hour of normal wages per violation, going back a full three years (Murphy vs. Kenneth Cole Productions, Inc. (2007) 40 Cal.4th 1094; California Labor Code ‘226.7; Industrial Wage Commission Order #4-2001, §11 and §12; and California Code of Civil Procedure ‘338).

Certainly, the seller should be liable for any such presale claim. However, if the employee was never formally terminated, the buyer could be considered to have taken on “successor liability” to the seller’s violations, especially if the seller cannot be located. The above penalties could total as much as \$56,000 per \$25 per hour employ-

ee. Even if the “successor liability” claim is a thin one, that will not prevent the buyer from spending tens of thousands of dollars to fight this kind of frivolous claim.

Review by an employment law attorney, or an experienced business transactional attorney, would reveal that the contract needs a “termination of employees” provision, and both buyer and seller would have been protected against this risk. However, this attorney, not specializing in practice transitions, may not see some potentially greater risks.

Certain employees of a dental practice are of far greater importance to the future success of the practice than is the typical business employee. For example, the receptionist is the main point of contact between that practice and its patients. She makes those telephone calls to remind patients of their appointments, greets them when they arrive, schedules their next appointments, and says goodbye as they leave. A genuine relationship can develop between that receptionist and the patients, and it is unwise to discount its value to the practice. Similar value may also reside in the continued employment of the office manager, hygienists, and contract dentists.

This is not to say that a buyer should always rehire the entire staff, but it is unwise to ignore that potential value. Unfortunately, even an experienced business transactional attorney is unlikely to recognize this value, and the significant harm that can occur if one or more of these employees leave prematurely. Therefore, a transition attorney will include representations by the seller concerning the status of those employees, as well as other representations designed to improve the receptiveness of the employees to the impending practice transition.

Compare now the absence of any employee language in a contract to

those provided by an employment law attorney or experienced business transactional attorney (regular text), and further to the additional language provided by a transition attorney (italized). The differences are alarming:

“All practice employees will be terminated by seller in writing as of the closing, and seller will be responsible for payment of all employee compensation, accrued vacation and other benefits, payroll taxes, and other employee costs up to the closing. *Seller has not in anticipation of the sale of the practice raised, nor will prior to the closing raise, any salary of any employee prior to the closing other than regularly scheduled raises, nor will seller promise any employee that their compensation or benefits will be raised or maintained.* Buyer is not required to rehire any practice employee after the closing. *Seller cannot guarantee that any employee will accept employment after the closing, but seller subjectively believes that all employees intend to continue their employment at the practice. Furthermore, seller will not solicit or hire any preclosing practice employee within one year after the closing.*”

Example No. 4

“*Standard Form*” Contracts. Frequently, the parties have access to some version of a practice sale agreement. The source may be a document someone used in a prior transition, or the seller’s broker will provide a “standard form” contract. It may even be stated that a transition attorney has already reviewed and approved the contract. In this case, a buyer or seller could quite reasonably ask “if this is a standard form contract, reviewed by a transition attorney, why is any further review necessary?”

The answer is simple: Review is necessary because there is no such thing as a standard form contract and the contract was not reviewed by your transition at-

torney. When a buyer or seller receives that contract, it is important to consider the precise *circumstances* and *motivations* surrounding the drafting of that contract.

For example, the dentist who uses a contract drafted by its transition attorney when that dentist first bought the practice has a contract focused on protecting the buyer. Now that the dentist is the seller, the plethora of buyer-oriented language and provisions, and the lack of seller-oriented language and provisions, makes the contract inadequate, even dangerous, to use again.

Another example of why review is necessary comes up where the form

contract suggests a specific approach to handling incomplete dental treatment:

“Seller will identify the amount of time needed to complete treatment on the patients described at Exhibit E, and the parties will mutually schedule a time for seller to complete that work in progress at the premises. Seller will pay buyer only the hard costs incurred (such as lab fees, supply expense, and chairside costs) within 10 days of treatment.”

While this approach works well in many circumstances, it is inappropriate if the seller will be unavailable after the sale. Consider what happens with a patient who is scheduled to have their

treatment completed one month after the practice is sold. The patient prepaid for the entire treatment two months ago. The seller is now retired in North Carolina. The patient wants the buyer to complete the work at no further charge.

Does the buyer have to complete treatment on this patient? Does the seller have to pay the buyer to finish the work, and if so how much? What does the buyer do if the seller's prior work was defective? Completely new language is needed. Unfortunately, no alternate approaches were provided in the "standard form" contract, and the parties are likely to be at a loss as to how to resolve it. Frequently the parties ignore the problem, which in turn creates a postsale dispute.

Without a transition attorney to suggest alternative approaches to the problems "standard form" contracts create, hidden issues will be missed and the parties may ultimately be forced into a dispute that should have been resolved in the contract.

Example No. 5

Outside Issues. Both buyers and sellers need to be wary of the many pitfalls awaiting them in a practice transition, particularly since focusing on the terms of the contract can cause the parties to miss numerous ancillary issues that only the transition attorney can identify and discuss. These are generally known as the ORATS! issues (since this or a similar exclamation is used later if the issues are ignored now): Organization, Regulation, Accounting, Tax, and Securities.

Organization. It matters greatly whether the buyer and/or seller are incorporated, and whether those corporations are or should be S corporations. The answers dictate entire discussions about limited liability, accounting needs, tax issues, and the proposed timing of incor-

poration or dissolution as it relates to the closing date of the practice transition.

Regulation. The legality and registration of corporate names and fictitious business names are prime sources of confusion, delay, and risk. Proposed interests held by nondentists in a dental practice are extremely dangerous and need to be thoroughly discussed.

Accounting. If a buyer does not have a CPA before going into a transaction, a transition attorney will have a list of dental specialist CPAs to review tax returns and bank accounts, discuss the possible benefits of a corporation, and to review the proposed purchase price allocation. A transition attorney will also remind sellers to have their CPA review the purchase price allocation and to determine the closing date of the practice transition and/or the timing of their corporate dissolution.

Tax. There are significant interrelated tax consequences relating to the parties' tax status (S corporation, C corporation, or sole proprietor), the allocation of the purchase price, and the closing date of the practice transition. Occasionally one party is using a tax-deferred 1031 exchange (26 U. S. Code '1031), or had a recent practice transition that reverses the usual logic of purchase price allocation. Payroll tax clearance must also be addressed since the buyer could be required to pay any unpaid taxes as "successor" to the seller up to the amount of the purchase price (California Unemployment Insurance Code '1731). This last issue is frequently ignored by even the most experienced lenders and brokers.

Securities. This issue only comes up rarely, when stock in a dental corporation is being sold or outside investors are involved. However, when the issue does arise it is extremely serious. Securities law violations are not just disciplinary or financial problems; they can land a

person in jail. Discussing the practice transition with a transition attorney is absolutely essential in this situation.

Conclusion

It is often said that if nothing ever went wrong, there would be no need to put any agreement in writing. Unfortunately, things do go wrong. People misinterpret or forget what others say, or in some cases are deliberately dishonest. Landlords are frequently unhelpful. The Internal Revenue Service and the Dental Board of California are real dangers. Without qualified legal help, dentists leave their professional and financial futures at risk in an area fraught with pitfalls. Please don't be one of them. Get recommendations, ask pertinent questions, and call one of the many transition attorneys available in California before venturing into any practice transition. ■■■■

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