Presenting Value, Perceiving Value: Understanding practice transitions from the perspective of both buyer and seller.
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Practice Transitions:
Legal and Practical Issues for the Buyer and the Seller

Presented by:
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Resume

- Amherst College, B.A., 1979
- U. of Pittsburgh Dental, 1983
- Fairleigh Dickenson U., Ortho., 1985
- Pace Law, 1990
- Associate Professor, NYU Dept. of Orthodontics, 1989 – present
- Private practice of orthodontics, Brooklyn
- Private practice of law, New York, NY

Why am I Speaking to You Today?

- To explore legal issues in a transition from both the buyer’s and seller’s perspective
- To answer some of your questions about the legal issues of a practice transition
- To join my distinguished colleagues in a forum on practice transitions
Objective

This presentation is designed to give both buyers and sellers a brief overview of some of the legal issues to consider when transitioning into or out of a dental practice.

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Life Cycle of a Transition

1. Putting together your transition team
2. Hire an associate
3. Associate buys in
4. Associate buys out senior doctor
5. Senior doctor becomes the associate
### Seller’s Transition Team
- Accountant
- Attorney
- Financial Planner
- Practice Broker
- Transition Consultant

### Buyer’s Transition Team
- Accountant
- Attorney
- Finance Source
- Practice Broker
- Transition Consultant
- Insurance Broker

### Attorney’s Role
- Evaluates: legal issues, employment issues, legal structure of practice, documents
- advisor
- negotiator
- document drafter
- document reviewer
Legal Considerations

Things to consider and have in place when contemplating a transition . . .

Seller’s Entity Status

- “C” or “S” corporation?
- If a “C” corp, consider switching to “S” status 10 years prior to transition.
- “C” corp makes a transition more difficult due to tax consequences for both parties
Seller’s Employment by Corporation

- If you are a C corp and have an employment contract with your corporation, “resign” from corporation at least a year prior to sale.
- This will help ensure the goodwill value is personal to you and not a corporate asset.

Buyer’s Entity Status

In conjunction with your accountant, choose the appropriate entity:
- Sole Proprietor
- Professional Corporation (s-corp election)
- Professional Limited Liability Company
Lease Issues: Buyer and Seller

- Pay careful attention to your lease years in advance. Negotiate hard.
- Put your lease where you can find it.
- READ THE LEASE
- You must have at least five to seven years left on your lease when you are ready to sell. Buyer cannot get financing without a lease of this duration.

Lease Issues

- Never assume the landlord will cooperate even if he is your patient, friend or brother.

- Make absolutely sure you can assign and sublet to your buyer. Key words in lease are “such consent shall not be unreasonably withheld, conditioned or delayed.”
Lease Issues

- Seller: do not assign your lease unless you close
- Buyer: do not close unless the lease is assigned to you

Lease Zingers

- right of landlord to recapture space
- large assignment commission to landlord
- unobtainable standards for assignment
- “time is of the essence” clauses
- costly holdover rates
Seller: Restrictive Covenants

- Make sure all associates have employment contracts with restrictive covenants
- Never hire an associate with the idea you will prepare a contract later
- Lack of restrictive covenant will hurt practice marketability

Buyer: Restrictive Covenants

- Restrictive covenants are enforceable: don’t sign one if you don’t intend to adhere to it.
- Be careful about a “bait and switch” restrictive covenant.
- You will be asked to sign a restrictive covenant: look for creative solutions to difficult issues.
Financial Policy, Accounts Receivable

- Tighten up your financial policies at least a year in advance.
- Make an effort to collect your accounts receivable at least six months in advance. This may be money left on the table after the transition.
- Buyer does not want to collect your a/r. Once you sell, you will not be in a strong position to collect them yourself.

Practice Liens and Loans

- Review and begin to pay off any outstanding debt on practice.
- Do not enter into any long-term leases or contracts. The buyer may not want to assume these and you may have to absorb them.
  - examples include: yellow page ad, digital x-ray/cbct, postage meter, water cooler, laundry service, sharps pick-up, alarm system, software maintenance.
Practice Statistics: Charts and Computer Entries

- Be diligent about entering computer stats.
- Inaccurate stats present an incomplete picture of the practice.
- Improve your charting. Take progress records.
- Buyer will do a chart audit. Do not be offended or defensive. Neat charts improve value and buyer confidence.

Pre-Sale Patient Management and Care

- Start treatment on any patient who is ready to begin.
- Increase your initial fee and make sure patients adhere to your fee schedule.
- Avoid excessive prepayments and excessive use of third-party financing.
- Avoid a last minute “fire sale” on treatment. Buyer’s can spot that and will look unfavorably on it.
Tax Returns/Financial Data

- Clean up your books.
- Slow down on the personal deductions to show more income.
- Report cash in the unlikely event you haven’t been.
- Have tax returns and P&L ready for buyer.
- Work with your accountant to have all the financial data ready for buyer.

Post-Transition Employment

- Does seller want to work for buyer?
- Does buyer want to employ seller?
- If yes, how much and in what capacity? As an independent contractor or an employee?
- Will Seller close P.C. or have P.C. work for buyer?
- Seller: how you treat buyer will be how buyer will treat you.
Personal and Financial Issues/ Seller

- Can I afford to retire?
- Am I burned out?
- Do I have something else I would rather be doing?
- Is my spouse on-board with the sale? (For better or worse, but not for lunch.)

Personal and Financial Issues/ Buyer

Know seller’s answers to the previous questions and ask yourself:

- Can I afford this practice?
- Do I need to work somewhere else?
- Am I ready to run a practice?
- Is my spouse as excited as I am?
There are three parties to every transition:

- Seller
- Buyer
- IRS

- goodwill
- restrictive covenants
- fixed (tangible) assets
- supplies and instruments
- leasehold improvements
- stock transfer
Goodwill

- best for seller
  - buyer: straight-line 15 year amortization
  - seller:
    - capital gain for unincorporated, S-corp, LLC
    - double tax if C corp
      - 35% corp tax plus personal income tax rate

Restrictive Covenants

- allocation unfavorable to both parties
  - buyer: straight-line 15 year amortization
  - seller: ordinary income

  (If restrictive covenants are merged into goodwill, capital gains treatment is possible.)
Fixed (Tangible) Assets

- good for buyer
- dental and office equipment, furniture, fixtures
  - buyer: depreciates annually according to schedule (Section 179) $25,000/yr
  - buyer may pay sales tax on value of assets
  - seller: ordinary income

Supplies and Instruments

- great for buyer
  - buyer:
    - immediately deductible
    - no sales tax
  - seller: ordinary income
Leasehold Improvements

- So-so for buyer
- 39 years → 15 years → Section 179

Stock Sale

- Great for seller, terrible for buyer.
- Buyer: no deduction, becomes “basis”
- Seller: capital gain above basis
Fractional (Stock) Buy-In

Limited value assigned to stock in a fractional buy-in to reduce unfavorable tax outcome to purchaser

Psychological Issues

- Seller’s Concerns
- Buyer’s Concerns
Seller

- Your practice is probably not worth 1x gross despite how great you feel it is
- You probably aren’t worth $1,500/day despite how great you think you are
- Don’t stay too long, sell while your practice still has real value
- Even though you just “hung out a shingle” and did well, it is a different environment today.

Buyer

- Seller’s practice is worth more than 25% of gross despite how antiquated you feel the physical plant is
- Somehow, seller managed to make a great living with that dowdy old office
- You probably aren’t worth $1,500/day despite how great you think you are
- It will take you a year or two to realize you don’t know everything
Formal Document Drafting

- asset, stock or interest purchase agreement
- new lease or lease assignment and assumption
- employment agreement for seller
- consulting agreement for seller
- deferred compensation agreement for seller
- stock purchase agreement
- stock pledge agreement
- goodwill assignment agreement
- restrictive covenants
- promissory note
- bill of sale
- security agreement
- escrow agreement
- lien search/title search

Formal Document Drafting

- letter of intent
- parties negotiate issues
- formal documents are drawn up, usually by seller's attorney
- documents can be drawn up by broker, consultant or buyer’s attorney
- other attorney reviews and comments
Sailing to Iceland

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Choosing and Working with an Attorney
Choosing an Attorney

- Attorney is your advocate and can represent only you.
- Probe for possible conflicts of interest.
- Attorney can be hired by both parties to mediate and draft a mutually-agreeable contract, but . . .
- Each party must then hire a personal attorney to review contracts.

Attorney must . . .

- be familiar with dental practice transitions
- be knowledgeable about dental issues
- have excellent references
- have a good support team
Working with an Attorney

- Do your homework--be prepared
- Educate yourself
- Plan early
- Be your own best advocate
- Be reasonable
- Be the client you would want as a patient
- Avoid false economies
- Pay your bill

Working with an Attorney:

- Your attorney is your ally but not your friend.
- You have a business relationship.
- You are paying for attorney's time.
- Each phone call costs you money.
- Stay on point (make small talk off-the-clock).
- Even a “busted” deal costs you money.
- There is no such thing as a “quick peek.”
Working with an Attorney: Legal Costs

Written agreement outlining fees:

- initial retainer (refundable if unearned)
- hourly: $300 - $400/hr
- flat fee
  - seller: $6,000 - $20,000
  - buyer: $4,500 - $8,500

Choose an attorney who is:

- knowledgeable
- experienced
- compatible with you
- able to work with others
- dentally savvy
- fair and reasonable
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