

DENTAL LEGAL UPDATE

Buying a Dental Practice: Deal Points

by Jeanine Lehman, Attorney

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Special points of interest:

- Have lien searches performed
- Include contingencies in the purchase contract, including for financing

Dentists buy existing practices to shorten the time to build a practice or to expand their own practices. With either motivation for purchase, careful planning is essential.

Developing an Acquisition Plan: The first step is identifying acquisition criteria. General criteria include density of competing practices, location, gross revenues, number of employees, square footage, profitability, growth opportunities and trends, patient base, strength of balance sheet, including whether or not additional debt could be supported by the practice, purchase price range, and site demographics such as wealth and income of surrounding residents and work force, traffic counts, and development plans.

The prudent purchaser should ask "would I be better off starting a practice from scratch?" The purchaser should evaluate start-up costs, cash flows, and profitability for the new practice. The acquisition choice needs to be a better economic decision or the potential buyer should choose the start-up option.

Identifying Prospects: The buyer should begin by evaluating practices in his acquisition location. By word of mouth and from ads, he may be able to locate a practice.

The buyer may want to be more direct - contacting dental practice brokers, advertising for a practice wanted, letting dental society, banking, legal, accounting, and estate planning circles know he is seeking a practice.

Choosing Advisors: The buyer needs his team of advisors. His accountant should

evaluate the practice's books, including tax returns, to determine financial history and status. His attorney should prepare and review the agreements, assist in evaluating liabilities, and advise on structuring the acquisition. The buyer should also hire a management consultant knowledgeable in dentistry to evaluate feasibility and probable returns.

Due Diligence: Prior to signing a contract, the buyer should closely evaluate the demographics of the practice's site. He should also contact local, state, and federal highway departments to check traffic counts, patterns, and accessibility, as well as plans for future highway construction. A season's roadway construction could be very detrimental.

After or concurrently with the preliminary "outside" investigation, the buyer will need to have contact with the practice's owner. The seller may request that the buyer sign a confidentiality agreement concerning nondisclosure of certain information. Before signing, the agreement should be reviewed by the buyer's attorney. Even without such an agreement, the buyer should be discreet in his contacts and avoid notifying the practice's employees of the sale.

"Inside" information the buyer should acquire are the practice's books, records, and tax returns. With the assistance of his own accountant and business consultant, he will want to analyze the revenues and financial viability of the practice. The buyer will want to evaluate the seller's vendor relationships,

The buyer should obtain early assurance that the dentistry practice's lease can be assigned on favorable terms.



Website Favorites

Texas State Board of Dental Examiners:
www.tsbde.state.tx.us

IRS: www.irs.gov

Texas Workforce Commission:
www.twc.state.tx.us

Buying a Dental Practice (cont.) --

including with dental laboratories, and the seller's credit history. Poor relationships and payment history raise a red flag.

With the financial information, the buyer and his advisors should develop a business plan for operating the practice, including projections of cash flows and profitability for best, middle, and worst cases, at selected purchase prices and leverage levels to determine if the purchase is feasible. An organized business plan is helpful to obtain financing.

The buyer should obtain early assurance, if possible, that the practice's lease can be assigned on favorable terms, including assurance of adequate parking for patients and staff. If the lease cannot be assigned, in many cases, the buyer will want to identify another practice to purchase, unless he is willing and able to relocate. While the seller may be hesitant to discuss the sale with his landlord prior to having a contract in place, the buyer should press for assurance of assignability. Otherwise, the buyer can spend significant resources on accountants', attorneys', and consultants' fees and many hours of the buyer's own time - only to have the deal die at the eleventh hour because the lease cannot be assigned. (See March 2010 issue of Dental Legal Update on Dental Office Leases at www.jeanine.com)

The buyer will also want to have inspections of the dental equipment performed by a qualified technician and have inspections of the real estate performed by a property inspector.

Practice Entity: If the buyer's practice is not yet incorporated, there is great benefit in incorporating prior to signing documents and having the incorporated practice entity be the named party in all contracts and be the holder of all accounts. (See June 2010 issue of Dental Legal Update on practice Ownership Options at www.jeanine.com) If the buyer is buying the shares of stock of

the seller's practice, then this may not apply.

The Letter of Intent: To most efficiently reach agreement on the major deal points, such as purchase price, owner financing, and assets to be transferred, a letter of intent is used. The letter of intent is a nonbinding expression of intent to buy the practice on certain major terms, with the requirement for the parties to sign a subsequent contract if the purchaser and seller can "agree to agree". The letter of intent should be drafted with the help of the purchaser's attorney so that it is not, inadvertently, a binding contract.

Important Contract Terms and Contract "Walks": Once the buyer and seller have agreed to agree, with the assistance of their respective attorneys, they should develop the terms of a purchase contract.

Price and payment terms are key deal points. The allocation and level of closing costs are also essential monetary terms to include in the contract as well as the proration date for prorated items.

The contract should specify exactly what is being purchased. For example, if the practice is incorporated, the buyer can either buy the corporation itself via the shares of stock or buy the assets owned by the corporation. The buyer faces less liability if he buys only the assets, because when the corporation itself is purchased, the contingent and existing liabilities of the corporation, also generally transfer. This liability transfer can be very expensive, for example, when a lawsuit is filed months after the purchase, and the new owner is left to defend. With the assistance of his tax advisor, the buyer will also want to allocate the purchase price among the different assets being acquired.

The buyer will want a list of the assets of the practice included in the contract, along with a method for taking and valuing

inventory at a given date and handling outstanding accounts receivable. He will also want a list of the liabilities, known or threatened litigation or disputes, employees, and contracts of the practice included in the contract, with a method for handling the liabilities. Along with the listings of assets and liabilities, he will want warranties from the owner concerning the status of title to the assets and the record and status of performance on all liabilities and other material matters.

The buyer will probably also want certain contingencies or "walks" in the contract. For example, he will want his obligation to perform under the contract to be contingent on his lien searches revealing clear ownership of the assets. If the practice is in a leased location, he will want the contract to be contingent on the lease being assignable on specified terms. If financing is necessary for the purchase, he will want a financing contingency built into the contract. Finally, if other contracts are key to the operation of the practice, including for example, supply or key employee contracts, he may desire contingencies requiring these contracts to be assigned on specified terms. The buyer will want to check if any promises have been made to the staff concerning benefits or other matters. Of course, the number and scope of these contingencies are determined through negotiation between the buyer and seller and if the buyer attempts to overreach, the seller may not sign.

To preserve goodwill and for a smooth transition, the buyer may want to consider having his contract restrict the former owner from having a competing practice for a reasonable period of time in the same area as the practice being purchased. He may also want the prior owner to agree to consult with him to facilitate operations and patient relations under his new ownership. Transfer of dental records needs to comply with the Texas State Board of Dental Examiners' requirements. If controlled substances are involved, compliance with DEA and Texas DPS requirements is needed.

The seller may require the buyer to pay earnest money to secure the buyer's performance of the contract. The earnest money should be reasonable in relation to the price of the practice and risk to the seller.

Checking Title: Prior to closing, the buyer should have the title to the assets of the practice checked via lien searches, including UCC searches.

Closing the Purchase: At closing, both the buyer and seller sign the necessary documents and place those documents along with their respective payments, usually in the form of a cashier's check or wire transfer of funds, in

escrow. The buyer will want to request the documents and settlement statement showing the disbursement of money prior to the closing so that he can review those documents with his advisors. When all the escrow conditions, including funding of new loans, are satisfied, the escrow agent disburses funds to the appropriate persons and arranges to have the transfer of title documents recorded in the public records.

Post-Closing Matters: After the closing, the buyer will want to be sure he receives originals or, if applicable, copies of all the closing documents, his title insurance policy, if he bought the real estate with the practice, and his insurance policy. He will also want to be sure he receives the keys and any passwords or combinations, including to computer systems. After he takes possession, he may want to change the locks (with the permission of his landlord), passwords, and combinations. He should be sure that he has all necessary permits and provider numbers for his operation of the practice. If not previously done, the telephone and other utility accounts should be transferred to his name. He will then want to immediately meet with his accountant to set up his books and to begin reporting and depositing taxes. Similarly, he will want to meet with his attorney to ascertain that the closing matters and new operational contracts are complete, including transfer documents such as assignments of leases and other contracts.

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Jeanine Lehman is an Austin, TX attorney who practices health, corporate, business, and real estate law. For reprints, please call Jeanine at (512) 918-3435 or write her at jeanine@jeanine.com or PO Box 202211, Austin, TX 78720.

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- ✓ **Your Dental Office Lease: Watch the Terms**
- ✓ **Ownership Options for Your Dental Practice**
- ✓ **Financing Your Dental Practice: Tips & Terms**

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Federal Law Updates

Dental Practice Sale/Succession Workshops

Legal aspects of dental practice sale and succession:

- ✓ Legal Checkup
- ✓ Partner/Associate Recruitment
- ✓ Disability/Retirement
- ✓ Practice Sale
- ✓ Buy Sell Contract
- ✓ Real Estate Options
- ✓ Estate Planning

For information, call Jeanine Lehman at (512) 918-3435.

To receive the **Dental Legal Update** by email, call (512) 918-3435.

Medicaid/CHIP/Medicare Compliance Plan

The Patient Protection & Affordable Care Act (federal health reform law) requires that all Medicaid, Medicare & CHIP providers have a compliance plan. This includes dentistry practices participating in those programs. On September 23, 2010, the U.S. Department of Health & Human Services issued proposed rules, with a request for comments on the core elements to include in the compliance plans. As a starting point, HHS proposed using seven core elements from the Federal Sentencing Guide Manual in compliance plans. See Federal Register vol. 75, no. 184, page 58228 (9-23-2010). Given the concern with fraud, expect more screening and prepare for stringent requirements for compliance plans in the final rule, including audits, written policies, compliance officer, screening of dental practice employees for criminal and fraud history, and more.

EPA - Mercury from Dental Offices Rule

On 9/27/10, the U.S. Environmental Protection Agency (EPA) announced it will propose a rule to reduce dental offices' mercury waste in 2011 and finalize the rule in 2012. Dental amalgams account for 3.7 tons of mercury discharged from dental offices each year. The mercury waste results when old mercury fillings are replaced. The mercury in dental fillings is flushed into chair-side drains, enters wastewater systems, and enters the environment through discharges to rivers and lakes, incineration or land application of sewage sludge.

Dental offices will be able to use existing technology to meet the proposed rule. Amalgam separators can separate out 95% of the mercury normally discharged to the local waste treatment plant. The separator captures the mercury, which is then recycled and reused.

Until the rule is final, EPA encourages dental offices to voluntarily install amalgam separators and reports twelve states and several municipalities already require the installation of amalgam separators in dental offices.

The EPA reports that about 50% of mercury entering local waste treatment plants comes from dental amalgam waste. Once deposited, certain microorganisms can change elemental mercury into methylmercury, a highly toxic form that builds up in fish, shellfish and animals that eat fish.

Fish and shellfish are the main sources of human methylmercury exposure. Methylmercury can damage children's developing brains and nervous systems even in utero.

Mercury - dental offices: water.epa.gov/scitech/wastetech/guide/dental/index.cfm
Mercury - environment: www.epa.gov/mercury/index.html

About Our Firm ...

Law Offices of Jeanine Lehman P.C. is a Texas law firm headquartered in Austin with a state-wide health law practice, including representation of Texas dentists. Our health law practice is focused on business law, transactional aspects of individual and group practices, such as contracts and incorporations, office/facility leases, building purchases/condos, and build-to-suits, practice sales/purchases/buy-ins, employment agreements, financing, and consultation concerning the day-to-day legal concerns of running a health care practice. The firm is owned by Texas Attorney **Jeanine Lehman**. Jeanine has over 25 years experience as a Texas attorney. She has had one book and over 70 articles published. She speaks to professional and business groups concerning legal topics. Jeanine is blessed to have one dentist and three dental hygienists in her family. Contact us at (512) 918-3435, jeanine@jeanine.com or PO Box 202211, Austin, TX 78720, and visit our website at www.jeanine.com