Issues & Updates

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Due Diligence for Practice Purchases

By: Daniel M. Bernick, JD, MBA

Most doctors and office managers know that "due diligence" is important when buying a medical practice. But what is less clear is exactly what due diligence should be done.

On one hand, "the sky is the limit" in terms of things that you could, conceivably, check. Are there malpractice suits lurking in those charts? What about carrier audits, in those past claims submissions? Tax problems, in the corporate returns? Employment liabilities, for past personnel issues? Legal problems, for failure to comply with Stark, Anti-Kickback, or state "mini-Stark" stat-

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Top 10 Things NOT to Do When Contracting With a New Associate

By: Mark E. Kropiewnicki, JD, LLM

From an attorney's viewpoint, new associate employment agreements are relatively simple compared to more complex documents such as asset purchase, buy–sell, or merger agreements. Yet this simplicity is deceptive. The business and legal choices made in a new associate's initial employment agreement are extremely important for the parties' future relationship. Mistakes made in the new associate's employment agreement can be difficult to remedy later on.

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Due Diligence for Practice Purchases

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utes? Title issues, for intellectual property? Are there liens on the corporate assets, from past bank loans, that have never been released? The worries go on and on.

On the other hand, there will never be enough money and time to check everything, exhaustively. To be cost effective, you must pick and choose, and look for red flags. Here are some key things on which to focus:

1. Financial. Ask for financials for the past 2-3 completed tax years and current year-to-date revenues. These include tax returns for the target practice, internally generated Quicken or other income statements, and accountant statements. Tax returns are the best way to verify revenue and profits; nobody paints a rosy picture for the IRS. If anything, the tax return may understate profit: look for rent paid on a doctor-owned office (rent may be overstated to reduce the owner's payroll taxes); family members on the payroll at above market rates; and front-loaded depreciation deductions on equipment purchases. Internally-generated Quicken financials and accountant-prepared financials may provide more detail on specific revenue or expense lines, especially shareholder fringe benefits (e.g., retirement expense), auto lease payments, health insurance, and seminar spending. Also, look at the big ticket expense items; staff payroll/taxes/benefits is always on the list, rent may be a major item, and medical supplies can be costly for some specialties.

2. Productivity. If you will be hiring the selling physician, carefully review the target practice's productivity reports for the past several years and monthly year-to-date. These will detail collections broken down by provider. How much of the revenue is generated by providers who you will be hiring versus those who may be departing?

3. Payor Mix. Ask for a breakdown of revenues by payor. Are you (buyer) credentialed with the same payors, so that all revenue streams can be transitioned to the buying practice? Are there any revenue sources that will not carry over to buyer, for whatever reason? Does the target practice have more Medicaid or other lower-reimbursing insurances than you, as buyer, are willing to accept?

4. CPT Volume Report. This can be a very illuminating document. It shows the number of each type of service provided in the selling practice (ideally broken down by provider). Look for potential upcoding and excessive utilization of testing. You may need the help of a billing consultant to properly assess this. Also, consider sheer volume of services. Is the seller seeing 80 patients a day while buyer's providers can only see 40 patients per day? If so, past revenues may not continue at the high prior rate.

5. Liens. Your attorney can arrange for a vendor to do a search for liens on the target practice's assets. Cost of the search is typically a few hundred dollars. This will turn up any liens or clouds on title from current or previous bank debt, equipment purchases or capital leases, or even medical supply vendors. All such liens will need to be removed in order for buyer to get clean title. The lien search should include tax and other judgment liens. Tax liens are especially worrisome, and may be a deal killer if buyer is unwilling to pay them in full. Also, multiple tax or judgement liens suggests a cavalier attitude about legal matters; perhaps seller has done other things that you don't know about which may generate future legal troubles for you as buyer.

6. Clinical. Have a doctor who is on the due diligence team spot check a sampling of charts. Look for complications or other evidence of potential patient care problems. Has the care provided been up to your clinical standards? If you (buyer) take over the target practice, are you going to be comfortable taking over where seller

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Due Diligence for Practice Purchases

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left off? Or will you have to "fix" a bunch of badly treated problems, and defend care that you feel has been poor?

7. Audits and Recoupments. Quiz multiple staff in the target practice about any audits or recoupments, either ongoing, or in the past. Excessive problems in this regard could be a legal problem for the buyer, even in an asset purchase transaction, and also cast doubt on the "quality" of profits that have been reported by the target practice.

8. Litigation and Investigations. Are there any lawsuits pending? A malpractice claim or two is usually explainable, but multiple suits are more worrisome. Be especially concerned about lawsuits filed by departed shareholders. These can be very difficult to resolve, and could be a major distraction moving forward. Are there any government investigations, past or present?

9. Leases and Vendor Contracts. Ask for any contracts of any kind to which target Practice is a party. Do you want to assume any of these contracts, such as (perhaps) the existing office lease, or equipment leases? Have your lawyer review the contracts that you may want to assume to see if they can be assigned to you, or whether the vendor/landlord's consent is needed.

10. Employment Contracts. You, as buyer, may wish to continue the services of various provider-employees of seller. Do these associate physicians or mid-levels have employment agreements that can be assumed by buyer? Can you afford the salaries being paid to these providers? Do these employment agreements have non-compete clauses? Such clauses provide assurance that your new provider-employee cannot walk across the street and take his or her patients with him or her.

11. Condition of Equipment. Do a walk through with seller in each exam room to inspect the equipment, and more importantly to quiz the seller, face-to-face, as to whether all items in each exam room work.

12. Seller Health and Motivations. Be sure you understand why seller is selling, especially if you (buyer) plan to employ the selling physician. Are there any health issues? Does seller's time frame to retirement match your needs for his or her continued services? Do you sense that he or she will function well as an employee in your practice, as opposed to being the sole owner?

13. Contractual Protections. It is better to uncover and deal with any issues before you buy, via due diligence, but the legal documents for the purchase can provide some back-up protection, if problems crop up after purchase. Here are some basic protections:

a. Do an asset purchase as opposed to a stock purchase. With an asset purchase, you can disclaim any and all liabilities of the selling practice. With a stock purchase, you will, as buyer, inherit these liabilities.

b. Include appropriate representations and warranties in the asset purchase agreement. For example, the seller should represent and warrant that the selling entity has good title to all assets sold, that there are no government investigations, that the financials presented are true and correct, that no taxes are owed by seller, that seller has disclosed all material contracts, and so forth. If it turns out that any of these representations and warranties is untrue, you, as buyer, may be entitled to some compensation.

c. Take special care with any agreement for employment of the selling physician after sale. Key terms are: compensation (consider a pure productivity formula to ensure that the selling physician does not slow down), termination rights (if the selling physician is not a good employee), and adequate non-compete protection for buyer (because the selling physician can completely undermine the sale if he or she competes).■

Top 10 Things NOT to Do When Contracting With a New Associate

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Here is our "Top 10 List" of mistakes to avoid, based on many years of working with medical and dental practices throughout the country.

10. Do not contract with the associate as an independent contractor. No full-time associate should be treated as an independent contractor. There are two issues here. One is tax liability. Under the applicable rules, the IRS will likely—on audit—view a full-time associate as an employee. That means you could be liable for (employer/employee) employment taxes, as well as interest and significant penalties.

The second issue is that independent contractor status encourages a "my practice, your practice" mentality. For example, occasionally the new associate wants to contract with your practice through his/her separate professional practice entity, so that s/he can deduct various business expenses through that professional practice entity. An associate's independent contractor status often leads to the flawed view that "my (the associate's) practice" and "your practice" have equal status and rights. Obviously this is not true. As the hiring doctor or group practice, you are assuming considerable financial risk and providing a patient base. Don't play into erroneous expectations. Hire the associate as an employee.

9. Do not promise partnership. Never say, "after two years of employment, Doctor will be offered the opportunity to purchase shares in the Practice for $_____." That could be construed as a legally binding and unconditional promise of partnership. What if the associate turns out to be an acceptable associate, but not an acceptable partner? Don't lock yourself in. The proper phrasing is, "after ___ years, assuming that Doctor has met the various criteria to be considered for partnership outlined in this agreement [such as strong productivity, good rapport with patients and referrers, board certification, entrepreneurial interest in the Practice, etc.], the parties will discuss terms of partnership. No promise of partnership can be made at this time, but if the parties mutually agree, in their sole discretion, to proceed with partnership, in writing, the terms are agreed to be as follows: _____."

8. Do not fail to specify the handling of malpractice insurance "tail" coverage. Most practices are now familiar with handling the purchase of and payment for appropriate reporting endorsement (known as "tail" coverage) for an associate's "claims-made" malpractice insurance policy. Make clear who is responsible for obtaining and paying for the appropriate reporting endorsement (known as "tail" coverage) for the associate's "claims-made" malpractice insurance policy upon termination of employment. If you require the associate to buy the "tail" coverage, also include a provision providing that, if the associate fails to do so, you can purchase it on his/her behalf and then deduct the cost from the associate's final pay or seek reimbursement. Otherwise, the associate may not purchase the tail, leaving both of you uninsured for the associate's acts and omissions as your employee.

7. Do not fail to include a non-solicitation covenant. The non-solicitation covenant supplements a non-compete covenant, discussed below. Suppose a departing associate locates his/her new, competitive practice just outside the non-compete restricted area, and then sends a direct mail solicitation (using a list taken from your office) to all your patients, including those patients within the non-compete restricted area. A properly worded non-solicitation covenant prohibits this and other bad acts, such as theft of a patient list or solicitation/hiring of your valuable employees or referral sources.

6. Do not agree to a "No Cut" contract. A "No Cut" contract is for a fixed term of 1, 2, or 3 years and the employer may not terminate except for "cause." The problem is that, in reality, most employment terminations are "without cause." The typical termination scenario involves an associate who lacks a strong work ethic; relates poorly to staff, patients, or referrers; is clinically subpar; or

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Top 10 Things NOT to Do When Contracting With a New Associate

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refuses a reasonable buy-in. None of these are "cause" events. If you do not have a right to terminate the associate's employment "without cause" on 60 or 90 days' written notice, you are vulnerable to a lawsuit for "breach of contract" and possible unenforceability of any non-compete and non-solicitation provisions in the agreement.

5. Do not agree to an "expiring" contract. Some contracts have a fixed employment term of 1, 2, or 3 years (generally the period prior to partnership), but do not provide for automatic renewal. They assume the expiring associate contract will be replaced by new partnership documents. However, you may have problems if new documents are not fully executed—whether due to inaction, inadvertence, attorney delay, or a decision to defer the date of partnership—by the conclusion of the initial agreement's fixed term. Without an in-force, binding contract, both of you will be in a contractual "no man's land." If the associate then decides to leave rather than buy-in, it will be unclear whether the expired initial employment agreement, along with its non-compete, non-solicitation, and other protections, still applies.

Include an "evergreen" provision specifying that after the initial term, the contract automatically renews unless notice is given prior to the termination date that one party or the other does not wish to renew.

4. Do not overpay. A high initial salary, a high percentage of collections, or an overly generous incentive compensation arrangement unquestionably makes the associate recruiting/hiring process easier. However, excessive generosity on the front end of your relationship with the associate may come back to haunt you. Specifically, how will you be able to convince an associate to buy-in if s/he is already being paid the entire profit on their services? Overpaying the associate may necessitate an (undesirable) pay cut for the buy-in to occur, or may even prevent a buy-in from happening at all (even more undesirable to the practice).

Consult with an experienced healthcare attorney or consultant for advice on appropriate starting salaries and incentive compensation arrangements for doctors in your specific geographic location. Practices in major metropolitan areas or other desirable locations may be able to pay lower salaries and provide less generous incentive compensation arrangements, while practices in rural or otherwise less desirable locations will likely need to offer higher salaries and more generous incentive compensation arrangements to qualified candidates, to induce them to relocate.

3. Do not get greedy on the non-compete restricted area. If permitted in your state (more states are now prohibiting them), we strongly urge including a non-compete covenant. However, don't demand more geographic protection than you absolutely need. Restricting more than perhaps 85% of the practice's core patient service area risks a court invalidating the non-compete covenant as "unreasonable" or "overbroad." Check with an experienced healthcare or local attorney to make sure your selected restricted area will likely be considered "reasonable" under the applicable state law.

2. Do not concede that the non-compete will not apply if the associate is terminated "without cause." This frequently requested concession sounds reasonable ("you are terminating me arbitrarily, without any fault on my part"), but will seriously dilute the protection provided by a solid non-compete covenant. From the practice's standpoint, the associate's competition will hurt the practice regardless of the reason the associate's employment is terminated. Since most employment terminations are "without cause," your decision to terminate—rarely an easy one—will be made all the more difficult if the "price tag" for your decision includes allowing the associate to set up a competing practice.

1. Do not renege on promises. Unless your initial error—once recognized—is an absolute deal breaker for you, stick with any written or verbal promises you make. The short-term benefit of going back on a promise generally is not worth the long-term damage to your relationship with a future partner. ■

Structuring the Sale or Purchase of a Medical Practice as an Asset Sale Versus and Equity Sale

By Jennifer B. Cohen, JD

You are thinking about selling your medical practice, you have found an entrepreneurial physician group interested in buying it, and both parties are seeking the advice of legal counsel. Both the buyer and seller want the best deal. But, medical practice sales are a complicated landscape, where the buyer and seller often have adverse interests. Before proceeding to the terms, the parties need to agree on the structure of the deal; that is, will the transaction be structured as an asset sale or the sale of equity?

In an asset sale, the seller retains possession of the legal entity but sells the entity's individual assets, such as equipment, fixtures, leasehold improvements, inventory, and goodwill, to the buyer. Typically, to achieve a cash-free, debt-free transaction, an asset sale specifically excludes long-term liabilities, cash, and accounts receivable. The buyer has the discretion to assume the assets and liabilities that the buyer wants and leave the rest for the seller.

In an equity sale, the buyer purchases the seller's shares of the corporation or equity interest in the limited liability company, partnership, or sole proprietorship, thereby attaining an ownership interest in the seller's legal entity. With that comes an ownership interest in all of the assets and liabilities of the seller's entity (unless they are specifically excluded in the document).

Will the transaction occur via an asset sale or will it be an equity sale? The answer to this question has tax, liability, and assignability / credentialing implications for both parties so it is critical that it be addressed at the onset. In general, sellers prefer equity sales whereas buyers prefer asset sales.

Tax Implications

In an asset sale, the purchase price is allocated to the different assets and liabilities being transferred and the buyer records the acquired assets and liabilities at the value specified in the allocation. This can have an effect on the amount of depreciation realized by the buyer. Buyers generally benefit in an asset sale because they acquire a stepped-up basis for the purchased assets. If high values are allocated to quickly depreciating assets (for example, equipment) while lower values are allocated to assets that amortize slowly (for example, goodwill), the buyer realizes tax benefits because taxes will be reduced sooner, resulting in greater cash flow. Conversely, the seller is interested in allocating more to goodwill because it is taxed at the much lower capital gains rate and less to hard assets, which are taxed as ordinary income. In order to escape IRS scrutiny, the purchase price allocation should be grounded in reality and the buyer and seller should file matching 8594 forms.

In an asset sale, if the selling entity is a corporation, the corporation's income tax treatment must also be considered. Because C corporations are subject to double taxation (both at the corporate level as a tax on the sale of the assets and at the individual shareholder level as a tax on proceeds from the sale, distributed as dividends), there should be specific focus on the tax implications of a transaction because the net purchase price after taxes for shareholders of a C-corporation may be substantially less than that for S corporation shareholders.

In an equity sale, the book value of the assets at the time of the sale determines the depreciation basis for the buyer. Unlike in an asset sale, the buyer does not gain a stepped-up basis in the acquired assets. Thus, the buyer realizes a lower depreciation expense in an equity sale, triggering potential higher future taxes. However, the seller prefers an equity sale because the entire purchase price is taxed at the lower capital gains rate, as opposed to a combination of capital gains and ordinary income, as in an asset sale.

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Structuring the Sale or Purchase of a Medical Practice as an Asset Sale Versus and Equity Sale

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Liability

Sellers benefit from a liability perspective when they sell equity because, in an equity sale, all of the liabilities associated with that equity, for example tax liabilities and contractual obligations, are transferred to the buyer. Thus, the seller is able to relieve itself of obligations as the buyer steps into the place of the seller. From the buyer's perspective, this can be risky; even comprehensive due diligence can miss liabilities and, therefore, the buyer may become liable for obligations of which the buyer had no knowledge prior to closing. Such obligations include liabilities that were undisclosed or even unknown to the seller prior to closing, for example, future lawsuits resulting from pre-closing activities of the seller. While these concerns can be mitigated by well-drafted representations and warranties and indemnity provisions, the buyer is still presented with the risk that, years later, the seller doesn't have the wherewithal to indemnify the buyer.

Liability can also extend beyond legal liabilities and include responsibility for third party overpayments received by the seller and associated clawbacks. These risks are largely mitigated where the buyer acquires assets (and excludes liabilities) instead of equity.

Buyers should also be aware of liabilities that could affect purchased assets. For example, if assets are subject to a lien, the lien of the seller's creditors may attach to the assets previously owned by the seller even after the transaction, which could result in the purchase agreement being set aside. To protect against this, the buyer should conduct a comprehensive lien search prior to closing.

Assignment and Credentialing

Credentialing with providers and payors is unique to health care transactions. Buyers may attain significant benefits in equity sales because there is no need to assign contracts and other difficult to transfer assets such as Medicare licenses or thirty-party payor arrangements; instead, the buyer steps into the shoes of the seller. If the transaction were structured as an asset sale, the buyer would have to apply and wait for its own provider numbers. Likewise, the buyer and its physicians would have to be credentialed with third party payors. This could result in a number of issues. First, cash flows may be interrupted during the time while the buyer's physicians are being credentialed. Second, favorable rates negotiated by the seller may not be available to the buyer at the time that the buyer is attempting to get credentialed. For these reasons, an equity transaction may be preferable to a buyer, even if it means foregoing the tax benefits of an asset purchase described above.

Equity sales are especially beneficial to the buyer when the seller has contracts or licenses that are favorable and not assignable. A thorough check of the seller's material contracts will help the buyer determine if this is the case.

Due Diligence

One of the best ways to protect your business decision is to conduct thorough due diligence; therefore, you should contact an experienced attorney and accountant to get help structuring your sale or purchase.■

Subspecialty Dentists - Gateway to Practice

Practice Models for New Oral Surgeons, Periodontists, Orthodontist and Other Specialists

By: Joseph W. Gallagher, JD, LLM

As you consider the prospects for starting your career as a dental subspecialist, a variety of factors will inform your planning and decision making. Although the spectrum of career paths for you includes numerous options (including choices for academic, military or public health positions), this article is focused on entry into some type of private practice setting and the models which exist to facilitate your becoming a private practice dental subspecialist.

While each doctor's situation is unique, there are fundamental aspects to every job search with which practically all specialists are dealing as they analyze their options, career choices and practice opportunities. These include the compensation package, the practice location and setting, the overall fit and compatibility with practice owners, associates and personnel, and the prospects for eventual partnership in, and increased earnings from, the practice.

As you are probably aware, the traditional approaches to a starting a career as a dental subspecialist have been around for decades and include choosing from (i) joining an established practice as an associate with a track to partnership, and (ii) purchasing an existing practice from a specialist who is fully retiring or transitioning from full-time status to partial retirement.

More recently, other avenues tied to the evolving practice models in the dental industry have been seen with dental subspecialists joining multi-specialty groups or participating in practices sponsored and supported by a "dental support organization" or "DSO."

I. <u>WORKING IN A MULTI-SPECIALTY OR DSO SETTING</u>

The multi-specialty or DSO models come in a variety of formats ranging from large "corporate dentistry" entities operating on a multi-state basis to smaller more localized organizations. Practicing in a multi-specialty or DSO model is basically a structure in which you sign on to become the organization's specialty "division" (or a member of its specialty division if there are multiple doctors in the division on board). Both multi-specialty and DSO organizations offer the dental subspecialists and other providers a collaborative practice model designed to free you from the administrative and operational duties of the "business" side of practice. Thus, a major selling point touted by such organizations is that the doctors have much more personal or family time than the other practice settings. You would be focused squarely on generating revenues without having to spend your time on such issues as employing and managing staff personnel, selecting equipment or a billing system, or dealing with landlords, third party payers, supply vendors, insurance agents, retirement plan administrators, etc.

Proponents of this collaborative approach suggest that the model offers specialists a captive patient referral base and that they benefit from shared teams and shared facility overhead, which helps improve efficiency and productivity. By increasing production and decreasing overhead, profitability can be increased (it is assumed). Obviously, the general practitioner dentists will benefit from keeping referrals in-house and from more collaboration with specialists on cases. For patients, they advertise as a "one-stop shop." These practices are motivated to add specialists to their provider rosters to enhance the "one stop" concept and satisfy a broad scope of services (general, cosmetic, periodontics, endodontics, orthodontics, pediatric and oral surgery).

Analyzing the Multi-Specialty and DSO Models

From the perspective of a new dental subspecialist, making an intelligent decision on a position in a multi-specialty or DSO practice organization demands "due diligence" on your part in researching the strengths and weaknesses of the opportunity and comparing your findings to other pathways (joining a single specialty practice as an associate leading to partnership or purchasing a practice from a specialist at or near the end of his/her career).

Perhaps the most challenging task on a new special-

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ist's "due diligence" checklist is assessing the market conditions for his specialty's services in the town, city, county, etc. in which she or he desires to work. The current and expected demand for services is, of course, impacted by demographics (including overall population levels, population density and the economic strength or weakness of the region).

You need to learn about the "supply side" of the equation by researching the dental community. Does it consist of many independent solo or small group practices, or has it begun to consolidate into larger entities such as multi-specialty groups or DSO affiliations?

Similarly, you need to assess the existing roster of providers of your specialty in the community. Learn as much as you can about them, including approximate age ranges, how long they have practiced in the community and the scope of services that they offer.

Having this type of information will help you make a more informed prediction about the patient referral picture in the service area and whether one can expect it to remain stable, or to start trending downward (or upward).

Learning about the market and the general dentistry and specialty services offered in the area can be accomplished in a variety of ways including asking questions of the doctors whom you interview with, as well as other providers or individuals you may know in the area. You can also use the internet to search practice web sites, demographic data and the like.

Also, as you move through the interviewing process with potential employers, try to obtain insight on each practice's financial condition and the earnings/profits which the practice yields to its owners. Keep in mind that many practice owners and their advisors may be reluctant to open the books for your inspections (which is understandable); however, it should be feasible for the practice to share with you at least some general figures, such as historical ranges of gross revenues, overhead percentages and owner earnings.

Key Factors to Consider and Compare

In your analysis of multi-specialty or DSO practice options, you will want to consider how the practice setting compares with the other (single specialty) options available to you in the context of the following factors:

- Compensation Package
- Scope of Services
- Clinical Autonomy and Independence
- Availability of Mentoring
- Facilities, Equipment and Support Personnel
- Marketing
- Opportunity for Ownership

Compensation Package

Obviously, the level of compensation a practice is willing to pay is critical to your decision to accept or reject the position. Compensation packages can be structured as a fixed dollar salary or as a percentage of charges or collections generated by your patient services. The compensation package can also include an incentive or bonus formula tied to individual and/or overall group production in which the percentage of production paid to the doctor increases as target levels or ranges of charges or collections are achieved.

In very general terms, the compensation structure implemented by a multi-specialty practice or DSO entity (or any practice for that matter) can be a telling sign of the organization's current and anticipated financial condition. For example, it's not difficult to understand that a multi-specialty practice which offers a starting annual base salary of $350,000 or higher to an oral surgeon just out of training considers the oral surgery part of the business to be vi-

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brant and stable. In contrast, if the practice desires to base compensation strictly on an "eat what you kill" model, it is much more likely that that organizational confidence in the OMS service line is not as high. In any event, it is critical for you to gain a reliable sense of the volumes and case mixes you can anticipate in working for the practice. That means you need to see some recent production data from the practice in order to project how busy you will be. You will also need to determine what benefits and expenses the practice will cover as part of the package, such as health or life insurance, retirement plan contributions, malpractice insurance, state licensure and hospital staff fees, board certification costs, continuing education expenses, society dues and possibly a promotional/marketing allowance. A practice may offer a salary in the lower part of salary ranges but be willing to pay all or most of the typical benefits and expenses. In contrast, the practice may pay the dental subspecialist a higher than average base salary (or a high percentage of production) and shift the cost of some or all of the benefits and expenses to the employee to be paid out of her/his base compensation.

Scope of Services

Consider your goals and objectives for the types of cases you would truly love to be handling as a specialist. You have put in the time and been trained as a specialist in the full range of procedures, so it is important for you to inquire if the practice you are considering joining has a sufficient demand allowing to work in your specialty on a full-time basis (if not, you may be required to work as a generalist in order to stay busy).

Clinical Autonomy and Independence

Have a clear picture of how the DSO or multi-specialty practice may impact your clinical judgments and decision-making. Are there practice protocols or administrative expectations established within the organization which require input from non-specialists (or lay management) on how you treat the patient clinically? If so, can you work in this type of professional setting if it means that a non-specialist or even a business manager is helping to guide the process?

Availability of Mentoring

Depending on the make-up of the specialty division within a DSO or multi-specialty setting, you may or may not be practicing with other doctors who have experience in the specialty over a significant number of years. You may be the lone specialist in the division, or you may be one of multiple, less experienced specialists on the staff. In either case, the setting presents an obvious drawback compared to joining an established single specialty group in which you practice side by side with a seasoned specialist and enjoy the benefits of her or his oversight, input and feedback on patient treatment, surgical methods and clinical decision-making. Similarly, it should be noted that mentoring may also be available in a practice purchase/sale scenario if the selling specialist intends to continue to work in the practice for a transitional period, or as a longer-term part-time provider.

Facilities, Equipment and Support Personnel

When you visit the DSO or multi-specialty practice offices, you want to be sure and assess the physical characteristics of the office(s), as well as take note of the equipment available for use in the specialty division. Is the office properly laid out and equipped for the delivery of specialty services or is it poorly designed or lacking critical physical assets essential to your performing demanding and intricate patient procedures? What about the instruments? What about IV sedation capacity? Is there a dedicated space for patient recovery and a separate exit from the office for sedated patients not visible from the main entry to the facility?

You also need to consider the clinical support staff you will have available. Is the support staff knowledgeable and trained in the criteria of surgical or

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other specialty procedures? Are members of the support staff credentialed for expanded functions beyond the typical support roles found in general dentistry?

Marketing

A DSO or multi-specialty practice relies on a vibrant general dentistry patient base in order to identify the needs or desires of patients for more specialized services (using the "one stop" aspect as a major attraction). You need to address whether the practice has an active and strong marketing function, including advertising on TV, radio, online and in print. Does the advertising sufficiently broadcast the procedures and treatments of your specialty, including elective and non-elective treatments that you can perform for the organization?

Opportunity for Ownership and Participation in Profits

It is very difficult to generalize about the ownership potential and opportunity for profit sharing available to a dental subspecialist in the multi-specialty or DSO setting due to the great variety of ownership structures and income division methods employed by such organizations. While more localized entities are more likely to make ownership and profit sharing available to their doctors, many of the larger DSO entity structures do not lend themselves to this benefit. You need to ask about the possibility and learn the criteria, timing and possible buy-in price for an interest.

II. JOINING AN ESTABLISHED SPECIALTY PRACTICE

Joining an existing dental specialty practice is certainly the "tried and tested" approach which has launched many a successful careers. In the great majority of arrangements, the new doctor joins as and "employee" for tax purposes; in some cases, limited circumstances, the new doctor may be an "independent contractor" under the tax law, however this occurs in a very small percentage of contracts. It is important to remember that the initial employment agreement with a practice can be the basis for a long, productive and fulfilling relationship. Therefore it is essential that your initial employment agreement cover all the reasonable contingencies -- from your first day of employment to the time you become a "partner", if an ownership opportunity is part of the arrangement.

While all of the factors mentioned above in the multi-specialty and DSO discussion are important in the context of joining an established single specialty practice, as a practical matter the issues of clinical autonomy and availability of mentoring should *not* be of concern.

Of course, you will want to know that there will likely be compatibility between you and your co-workers (owners, associates, staff and management), as well as the environment in which you will work.

These days, in my experiences of having handled the new associate contract discussions (from both sides of the relationship), the most time spent by the parties will be in the areas of the compensation package and the opportunity for ownership in the practice

Compensation Package

Base Salary: The employment agreement should spell out the total compensation you will be paid during the entire term of your employment. This should include not only your base salary but also any incentive or other bonus arrangements the practice has offered. If possible, negotiate that future increases in compensation are written into your contract for each subsequent year of employment during the remaining term of employee status. A $10,000-$15,000 annual increase in base salary is not uncommon for each subsequent year

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of employment, assuming of course you meet the production expectations, as well as remain in full compliance with all of your employment contract duties.

Base plus Incentive: Incentive compensation provisions are quite typical in new specialist employment agreements and, when combined with your base pay, can be an important part of your total compensation arrangements. An often used incentive compensation arrangement is based on your being paid a percentage of the gross income the practice actually collects for the professional services you generate in excess of 2 to 3 times the practice's cost to employ you. For example, if your base salary is $200,000, you might be entitled to an incentive compensation bonus of 25% of actual collections for your services in excess of $500,000 ($200,000 times 2.5).

Straight Production: Instead of base salary (or base coupled with an incentive), some practices prefer to compensate associates on a percentage of your production (which can be measured in terms of charges or collections for your services); given the uncertainty of just how busy you may be, it is understandable why these percentage deals may create some angst; on the other hand, in the right practice, the deal can be quite rewarding compared to a base salary approach. Percentage deals require careful review along with an advisor who is familiar with the typical finances of the specialty; you are going to need to see historical data and other reports from the practice to gain a comfort level with this type of arrangement.

Benefits and Expenses: All of the factors mentioned above in the multi-specialty and DSO discussion concerning benefits and expenses are important in the context of joining an established OMS practice as an associate employee.

Opportunity for Ownership

Whether your initial contract contains any provisions for a possible future buy-in often depends on how close the owner(s) is/are to retirement age and/or whether a buy-out plan is already in place among the current ownership group. In representing an associate joining a practice, I typically recommend that your employment agreement include an outline of the buy-in, income division and future co-ownership arrangements. Look for at least a broad outline of the process and factors the practice will use to evaluate your potential for co-ownership. Such a future co-ownership provision may even refer to the valuation of the practice for determining the purchase price. It should also include a specific date by which the practice will initiate the future co-ownership discussions, and another date by which the practice's current owner(s) will make a firm decision about offering you co-ownership.

The general co-ownership terms should include an explanation of how the price of an equity interest in the practice will be determined, the formula to be used to set the dollar value of the equity interest, and how much of an equity interest you are to purchase.

In addition, if part of the buy-in is to be accomplished on a pre-tax or “sweat equity” basis, the future co-ownership provision should set out the rough details of how your share of practice income (profits) will be discounted during the initial period of co-ownership.

III. BUYING A SPECIALTY PRACTICE

Buying a practice can be a superior alternative to joining one or starting one, if the purchase is at a fair price. Generally speaking, it is less expensive to buy a practice at or below fair market value than to start your own. When you buy a practice, you do not need to deal with the expense, headaches and challenges of a startup and a practice sale normally

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provides you with a foundation of referral sources upon which to build. A practice purchase also produces quicker cash-flow and lessens your marketing needs, especially in a competitive market/region

On the other hand, as for potential drawbacks, these can include inheriting antiquated systems in need of replacement, a staff that is difficult and "entrenched," and possibly a poor office facility. In addition, one challenge that you will be taking on is management responsibility for every aspect of practice operations. Remember, even if you employ extremely capable office management personnel, you will always have oversight responsibility for all phases of practice administration.

Sale Price and Goodwill

Potential buyers of a specialty practice face two major hurdles: establishing that a fair price is paid, and assuring that the practice's goodwill is actually transferred to the buyer. Arriving at the fair sales price can be a perplexing process, because practices do not routinely sell for a "standard" percentage of gross or net income. Each sale depends on so many considerations -- including practice size, the level of competition, the personalities of the doctors involved, and so on -- that given formulae and standard approaches provide only "benchmarks" for estimating the reasonableness of a proposed transaction.

Typically the price for "hard assets" -- furniture and equipment -- will be based on either an independent appraisal or the original cost less depreciation.

Goodwill, on the other hand, has no set value and can vary from zero to more than one year's worth of the seller's earnings and profits. The purchase price will usually *not* include the practice's accounts receivable. Nonetheless, it will benefit both parties if the purchaser bills and collects outstanding patient accounts for the retiring doctor. The purchasing practice gains a natural way to communicate with patients; while the retiring doctor gains a better collection rate than if she or he attempted to bill after withdrawing from active practice.

Transitioning the Goodwill

The problem of converting the purchased practice's referral sources must be addressed during the price negotiations. A practice's goodwill value depends substantially on a variety of "convertibility factors." These determine how many referral sources are likely to stay with the practice, and thus establish the practice's actual goodwill value to the buyer. Provision for those conversion factors is often made in the sales agreement, and thus must be considered up front.

The best way to bolster conversion is for the buyer and seller to associate formally in providing care to patients for six to twelve months after the sale (even if the selling doctor is actually very part-time). During this interim period, the doctors can present themselves as "partners" so that the buyer's continuation of the practice seems a natural event. To assure maximum effect, this period should be long enough for all regular referral to be exposed to the purchasing doctor.

Structuring the Purchase

The structure of the practice purchase must be carefully planned to avoid legal pitfalls.
It is essential to have good tax advice. The allocation of the purchase price among the practice's assets can have significant tax consequences, and there are many nuances.

Sellers love "stock" sales since all the gain becomes taxable to them at capital gains rates. However, stock sales are bad for buyers because stock is not a depreciable asset. Buyer gets no tax deductions for

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any of the purchase price. Therefore, buyers almost invariably want to buy assets rather than stock. Depending on the tax allocation of the purchase price among the assets acquired (equipment, supplies, receivables, goodwill, consulting payments), the buyer can dramatically increase the write-offs from the transaction, thereby greatly reducing the after-tax cost of the purchase.

Another thing about stock sales: they carry with them not only the assets of the former practice entity, but also its liabilities. This includes not only the accounts payable, but also such latent items as not-yet-filed malpractice lawsuits or government investigations into previously submitted claims. This is yet another reason why buyers prefer asset sales, in which all liabilities can be specifically excluded.

IV. SUMMARY

In closing, keep in mind that the process to choosing a practice setting and your first position as an subspecialist will be time consuming, somewhat complicated and a little frightening. Be sure that you start your search and "due diligence" as early as possible and enlist the advice and support of knowledgeable professionals, including an attorney, accountant and recruiting specialist.■

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