Sellers have many choices to make in planning and implementing the transition of their orthodontic practice. The following comments will present a number of the more important concerns. Who is in charge of the transaction, how to determine a value for the assets being sold, what type of transition is best, why the terms can be more important than the price, developing a covenant not to compete, and cases in progress are among the items discussed. Although the listing is not intended to be comprehensive, it is intended to provide an overview of these topics in a sequence that should prove helpful for any seller. (Semin Orthod 2002;8:243-248.) Copyright 2002, Elsevier Science (USA). All rights reserved.

Concern for the Buyer or Not?

This is related to the previously mentioned issue but is different. In a professional practice transfer and sale, unlike a more routine commercial business sale, one of the major differences is, or should be, the continuity of care for the patients who have trusted a chosen practitioner. Viewed from this perspective, the question arises, how does the exiting practice founder, owner, or partner assure continuity of a similar commitment to treatment, both philosophically and mechanotherapeutically? In other words, for some doctors, it is very important to find a buyer or new partner who shares their philosophy of care and commitment to the mission of the practice. Others are far less concerned about philosophy and more concerned about technique and how cases will finish. If a seller is very concerned about either of these issues then it is important to get the issue out in the open and spend adequate time qualifying a prospective buyer to reduce this risk of remorse during or after the transition.

Who’s in Charge?

In many routine commercial business sales, outside of professional practice transfers, the buyers...
and their advisors are in charge. They make the offer, they question or assert value, they do their due diligence, and they propose terms and often take control of document drafting. I have found that generally because of the inexperience of the new orthodontist in building a team of advisors and the wide range of items to undertake coupled with limited financial resources, orthodontic practice buyers generally do not take control of the process. Therefore, sellers and their advisors very often put the transaction together. However, as noted later, these transactions can fail if the deal’s terms and documents are or appear to be unduly one-sided in favor of the seller and the buyer does not feel that an equitable transaction is occurring. A word to the wise is to be solicitous in inviting comments on the valuation methodology and the development of the terms for the transaction. Direct your legal counsel to drop unnecessary legalese and draft documents in an evenhanded manner. This will go far in making the deal come together quicker and in a pleasant manner.

**Seller’s Fundamental Considerations**

**How to Get to Practice Value?**

Of all of the many considerations leading up to a consummated practice transfer or equity interest purchase, valuation was once, and still can be, the toughest. Thankfully, in contrast to 20 some years ago when I started in the area of practice transfer, there are now good resources to guide both the buyer and seller, first to understand the theory of professional practice valuation and second how to apply it to formulate the value of the practice. In the case of orthodontists, the American Association of Orthodontists has developed the Practice Transition Alternatives binders, one for owners and one for younger professionals. In each binder, there is a monograph entitled *Guide to Orthodontic Practice Valuation.* The guide discusses valuation options but emphasizes the earnings based methods, particularly the capitalized earnings method. The reason for this emphasis is that by using a practice’s determined net income to arrive at value, a buyer can identify how much of that net they can use to pay for the debt service and therefore be able to project how much income they will have to live on.

Consequently, today many buyers and their advisors are very interested in pinning down the net and using an earnings method to arrive at value. For sellers to apply any other method for arriving at value simply begs the question of how can the buyer pay for the practice debt and meet living expenses, which will have to be answered sooner or later and will ultimately result in using some form of net analysis to arrive at value. In short, it is my advice to sellers that it is much easier and more direct to simply use a professional earning-based valuation at the start and be done with it.

At the same time that sellers grapple with how to arrive at value, they need to bear in mind that value is not price. Value can be arrived at using a valuation methodology or a group of comparables. But price is what is negotiated when the value is known and usually takes into account other considerations such as the tax-planning strategies of the parties, the goals of each party, and the terms of the deal.

**What Form of Transaction to Use?**

Form is a basic decision but one that must be made and in the case of orthodontic practice transfers often seems to be made by the sellers. What is being sold and how it is to be purchased leads to the time-honored debate that sellers and their advisors enter into year in and year out. Namely, is the form of the transaction best set up as a sale of assets, in the case of an incorporated practice a sale of the stock of the professional corporation, or if the practice is a partnership, the sale of either the partnership’s assets or the partnership interest of the partner(s)? The various factors favoring an asset, stock, or partnership interest sale depend on who is making the decision, and the answer can be dramatically different for the seller and the buyer engaged in the same transaction. The reason I find sellers generally making the call is that in orthodontic transfers, particularly of larger practices that have a long-term buyout, immediate asset sales often make little sense because the longer transfer time frame usually pushes the sale into either an equity (stock or partnership interest) transfer. Further, sellers generally will prefer to sell stock or a partnership interest because they receive capital gains treatment on any receipts from the transfer. However, the pur-
chaser of an equity interest takes the practice subject to all liabilities including tax, contingent, and unknown. Purchaser's counsel will often seek to exclude certain liability categories between the buyer and seller via indemnity (it will not apply to third-party creditors), and this is generally a reasonable request.

Often overlooked, but of equal importance, is what is not going to be sold. This is sometimes thought of in the context of orthodontic cases that will be completed by the seller in a few months after closing or personal items that will be taken by the seller. Attorneys refer to what is not to be sold as the liabilities and responsibilities a purchaser retains after the sale. My experience is that both areas must be addressed early in the process of coming to terms for the parties' proposed transaction. Cases to be completed ties directly to risk-management concerns by the purchaser. For example, it is far better for the purchaser to never touch a case in the last 4 to 6 months of treatment than to have a purchaser share portions of the patient's treatment. In the worst-case scenario, the parties get involved with finger pointing regarding who did what, should the patient be disgruntled or a professional malpractice action occur. Active and retention cases to be transferred should be listed in an exhibit to the transition agreement along with all assumed liabilities.

**Being mindful of tax considerations.** Preliminarily, sellers need to bear in mind that although many of the once common tax-planning techniques are history because of legislative tax reform changes, some planning options still remain. However, if either side pushes too hard for their best tax result, it can result in breaking the deal. Very different tax consequences can result from a purchase of assets or stock, but they are best left for discussion within the context of your personal situation with your accountant or tax advisor.²

Rather than rehash general tax considerations, it is better to focus on a couple of areas that can make a significant impact. One has been eluded to, specifically, admonish your tax advisor or transaction advisor to come up with a balanced tax approach that does not severely disadvantage either seller or purchaser. Next, pay attention to all allocations of the purchase price but not late in the discussion, as many seem to do. Instead, do it early on. A good time is actually after you have secured your practice valuation and started to weigh what the actual purchase price will be.

If you are using a long-term transition, particularly if it involves the sale of stock, significant balancing of interests can be done to allocate a portion of the purchase price to the interest equity (allowing for capital gains) and another amount to management services (generally ordinary income but currently deductible to the payor). This type of allocation is not done as fluff but in fact recognizes the time-consuming mentoring that is necessary for a new practitioner to educate himself/herself to sufficiently take over the management aspects associated with running a significant practice such as the necessary orientation to practice administration and clinical skill refinement. Comparable approaches can be fashioned for partnership transfers. One should have a third-party arms length negotiation of any allocation should any after closing taxing authority question the asset allocation. Obviously, the ultimate allocation should be stated clearly in the transition agreement.

**Will You Get Paid?**

In most orthodontic practice transfers, other than those that are immediate purchase and sales, regardless of how they are to be financed, debt-encumbered purchasers are often at a loss to come up with much of a downpayment. Transitions that are immediate purchase and sales, if fairly valued and if structured properly, find the seller to be generally well protected using relatively standard agreement provisions. For those that are not immediate transfers, the lack of a down payment throws out the old axiom that a purchaser should put 10% to 20% down. Further, although the amount of money a purchaser can put down should have a bearing on the sale price, transition experiences over the last 5 years show it does not. This is because in part of the fact that a virtual purchaser's market exists (due to fewer purchasers) where purchasers and their advisors are driving harder bargains, despite the buyer's lack of resources.

An illustration of the sequence of steps to follow in practice transitions and how they might progress follows. First, the seller should secure a third-party professional valuation. This valuation must ultimately be agreed to by both parties.
Second, the parties must negotiate terms for a multiyear buyin/out in which the cash flow is tied to the valuation and the terms. Next, each parties tax advisors should agree on the asset allocation via the purchase price. This is followed by the document drafting. It is important that the placement of a downpayment be deemphasized; for, in reality, it is nothing more than one more of the transition’s terms. This does not mean that a seller is not well advised to pay attention to a buyer’s creditworthiness, character, personality (yes personality), and capability to take over the size of the practice under consideration. These are areas that if the seller fails to investigate, he/she does so at his/her peril. I have seen transfers flounder with an introvert purchaser taking over an extrovert seller’s practice because in part of the fact that the referral sources and the patient base have substantially different expectations of the purchaser than was in fact the case. Often, transitions involve a structure that is detailed, well documented, and carry a purchase period for an initial equity interest followed by a sale of the remaining equity interest. Likewise, any compensation and purchase payments must be properly structured and documented to take advantage of existing tax laws.

What Is the Best Process?

For those sellers who are concerned about how to make a deal or those wanting to avoid elementary mistakes relating to process, other commentary exists. Specific helpful pointers on good process to follow in structuring a proposed practice transfer, whether it be a buyin/out or a more immediate variation of transferring or transitioning from an associateship relationship into an equity interest are provided below.

Terms not documents. In my view, doctors are well advised to first get down what is important to them in the form of a terms listing. This could start with the seller identifying key items that make it worthwhile to go through all the cost and time of developing the practice transition. It can also start with both parties using a facilitator to guide them in raising key issues and items for their mutual consideration. Only after the terms are fairly well established and agreed to in principle should the seller proceed to have a set of documents prepared to reflect the parties’ terms. Drawing up the documents before agreeing to the terms is time-consuming and expensive, and starting with them followed by subsequent refinement after review by both parties and their advisors is a far more torturous path. Starting with a term sheet ensures that the buyer and seller have agreed on the key points before incurring costs for attorneys and other advisors to analyze and document the deal.

Advisors. The previous statements raise the critical issue of getting the right advisors in the first place. It can be tempting for a seller to use a long-time advisor, even if that person has no experience in this area. This can be a mistake simply by virtue of using someone who has a lesser degree of expertise concerning what is required to effect the transition. This will have a direct impact on the time and cost of getting the transition accomplished. It is often better to use the services of a transition consultant and/or a corporate, business law, tax law, or health care law attorney. After consultation with experienced advisors, if desired, have the long-time advisor review matters with you. Buyers sometimes are tempted to use family members or go it alone until the last minute when they become overwhelmed and finally seek counsel. The parties usually fare better if they have competent counsel, ready to review in a timely manner, the terms that are worked out by the parties themselves rather than to wait too long. Both parties should avoid strident my-way-only advisors. Deal makers are usually better representatives than deal breakers. Finally, have a clear understanding of the roles that your advisors will play right from the beginning. Namely, it should be the seller’s transition consultants, accountant, lawyer, and other advisors who prepare all financial, tax, and valuation materials for the review by the buyer or prospective partner. A buyer’s review should not include remaking the deal that parties have articulated in principle. It can take strong nerves and competent advisors on the seller’s side to stay the course and not get side tracked.

There is a difference. Should you seek an associateship first for a longer period of time or a more immediate buyin/out? Without a long explanation, it is worthwhile to explore with a seller’s advisors, given the particulars of a practice’s situation and the desires of the seller, how best to approach the planned transition. There is no
question that certain practice transition situations benefit from a more immediate transfer approach. If this is the case, more needs to be done in a shorter period of time. This includes preparing a well-developed transition plan that is tied to a timeline indicating to buyer and all of his advisors when valuation, cash flow, terms, financing, document drafts, and closing dates are expected or anticipated.

Seller’s Additional Issues

When any seller of an equity interest in a practice or sale of the entire practice moves past valuation and negotiation of preliminary terms, there are still additional issues that need to be addressed prior to drafting the written agreement. Some of the more important areas for a seller are as follows.

Covenant not to compete. Nothing other than reasonableness dictates a geographic radius or other area and an amount of time for the covenant. What considerations go into the terms of such a covenant? In part, an appropriate geographic and temporal restriction should be sufficient to protect the asset value of the practice. Consideration needs to be made if there is any area that a seller would want to practice in after the sale or a buyout. Should a covenant against a seller still apply if the purchaser defaults on the purchase? The answer is generally no. These issues illustrate the range of items that should be specifically addressed in the transition documents. Be aware that most buyers want the benefit of their bargain, and they will want a geographic area and time period sufficient to protect the purchase of the goodwill they have made. Be prepared to be reasonable.

Disputes and their resolution. In any long-term transition with a phased buyin/out, having a stated approach to resolving disputes is advantageous. Rather than resorting to litigation, a better strategy might be mediation followed by binding arbitration. My reasoning, in contrast to some members of the litigation bar, is that the community of orthodontists is too small of a professional population and patients too attentive to their doctors’ circumstances to warrant allowing a dispute of this sort to become public via a trial. There are a variety of arbitration forms available these days and your legal advisor can recommend a specific form based on his/her experience.

Representations and warranties of the parties. Some sellers, and some advisors too, unfortunately do not give the weight necessary to tailoring the representations and warranties made to specific transactions. In fact, it is these provisions that are the foundation on which each side relies on as evidence of the basis on which their bargain was made. In other words, it is the representations or promises that each side makes that form the basis for the transition under consideration. Particular care should be made, aside from more routine items, in representing the financial status of the practice (what is true and accurate as to any financial, patient, or treatment status for cases completed, in progress, or in recall, in addition to whether or not the staff is staying with the practice, the referral base is stable, and so on). Sellers too should seek representations and warranties from the purchaser. One such significant item is that a buyer understands that an ownership change in the practice is a major event, and, particularly in the situation of the sale of an entire practice, there is no assurance that any projected result will occur. This is particularly the case in the specialty of orthodontics because most practices are heavily dependent on referral relationships that have been either cultivated over time, age relative, or those that are personality dependent. This aspect must be recognized since loyalties often change when ownership changes occur.

Orthodontic cases in treatment and a listing of patients. Sellers are well advised to protect their records. There is seldom reason to leave all records at the practice premises when leaving the practice. Although it can be nice not to have to store records, it has the potential to leave sellers particularly vulnerable. All active patients, defined as those with an appliance in the mouth; recall patients, defined as patients who have been examined but who have not started treatment yet and are subject to regularly scheduled recall examinations; and retention patients, defined as those patients who are within 12 months after the end of a full-treatment case, should be listed on an exhibit to the appropriate transition document. All others patient records should be removed to storage. Furthermore, if the purchaser ever deems it appropriate to dispose of records that were active when the pur-
chase was made, notice to the seller should be given coupled with a window of time during which the records can be secured before their destruction.

**Conclusion**

It takes a good deal of advanced planning, considering all of the choices sellers have to make, for the transition of one’s orthodontic practice to be well thought out and executed wisely. Without taking adequate time to plan, transitioning a practice can be a harrowing experience and a rough road to travel. Far too often over my 22 years of facilitating transitions, I have encountered doctors who think the practice will transfer with little problem and that they will be hired back as employees or consultants for as long as they desire. One common problem is the seller’s perception that any buyer should be able to see and appreciate the value of his/her practice and that any young professional will agree to almost any terms just to be a part of the best practice around. It often comes as a rude awakening that buyers today are better prepared, are more capable of assessing the tenor of a practice, and can be downright picky about accepting a stated value and negotiating terms than at any time in past. Believing otherwise tends to protract the negotiation and document preparation period. In short, advance planning, having a thoughtful approach to meeting both parties’ needs, and the securing of competent advisors can result in a wonderful and rewarding experience for both sellers and buyers.

**References**

4. Berning RK: “Common Mistakes to Avoid”, Practice Transition Alternatives for Owners, American Association of Orthodontists, St. Louis MO, 1999