Why an Attorney Cannot Represent Both Side of a Practice Sale

Part One of a Two-Part Series

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Most dentists have very little business interaction with lawyers during their career. As a result, many of them feel that on those occasions where they do need legal representation, they can utilize just one attorney even when it involves a transaction with two or more parties who may have adverse interests. Even some lawyers fail to recognize the inherent conflicts that can arise in what appear to be simple transactions.

Of course, not every transaction requires that each side be represented by an attorney. For instance, an attorney may ethically represent two dentists when forming a corporation where they will have equal ownership interests. By contrast, an attorney should never attempt to represent the buyer and the seller in a dental practice sale, because, whether they know it or not, their goals are in direct conflict with each other.

The following is a brief summary of some of the conflicts that occur in a “simple” dental practice sale transaction, but by no means is this article intended to cover every conflict that a lawyer should recognize when asked to represent both parties in a transaction.

1. Purchase Price

More than half of all dental practice sales involve no broker, often being sales by the owner to his or her associate. In many of these instances, the parties will not have the benefit of a detailed broker appraisal and will contact an attorney to do the paperwork. If the attorney has a substantial background in dental practice sales and knows that the purchase price is significantly above or below the market rate, the attorney should disclose this, even though the disclosure is directly adverse to one of the clients. This statement – or even worse, complete silence – immediately creates an unwaiveable conflict simply because it harms one party!

2. Tax Issues

The amount that is paid for a dental practice is required to be reported to the IRS, and IRS regulations allow the parties to select from a variety of reporting categories that may benefit either the buyer or the seller. Generally speaking, the seller will want most of the purchase price allocated into goodwill, a category that allows the seller to pay the lower 15% federal capital gains rate on the amount allocated to goodwill. However, the buyer may only write off this amount over 15 years.

By contrast, the buyer would like a significant amount of the purchase price allocated to supplies, equipment (up to a certain amount which fluctuates yearly), a consulting agreement, and even to accounts receivable, as they can be written off in the first year. However, these latter categories subject the seller to ordinary income tax and significantly increase the seller’s tax liability. At a minimum, the attorney should advise clients of the significance of these allocation elections, and should try to get the clients to retain qualified CPA’s to separately advise them.

3. Redo Work

Often, a retiring dentist may be moving out of the area and won’t want to be saddled with having to redo bad work. At times, the seller simply wants to narrow the window during which he or she will be responsible for redoing such work. By contrast, the buyer has paid a significant price for the dental practice’s goodwill, and wants the selling dentist to redo the work or pay the buyer to redo it, in order to retain a satisfied patient. While there is generally a one year statute of limitations on personal injury lawsuits, there is a four year statute for breach of a contract, and most insurance companies will pay for certain procedures no more than once every five years. How does the lawyer representing both the buyer and seller properly counsel them in this situation?

It may seem attractive to a buyer and seller to hire just one attorney in a dental practice sale, particularly when they think it’s just a simple transaction and they are getting along very well during this “courtship”. However, like so many courtships, differences later develop, and if the purchase document was drafted by one attorney trying to serve two masters, both sides will feel that they have been taken for a ride.

In my next article, we’ll review three more conflicts that may occur in a “simple” dental practice sale transaction.

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