

# 9

This expert's tips will help to prevent surprises after the deal is done.

## Practice Sale Pitfalls to Avoid

**Vasilios J. Kalogredis, JD**

**D**eciding whether to sell your practice and enter into an employment agreement is tough, but negotiating the actual sale contract is even tougher. Physicians who enter into contract negotiations with their eyes open achieve the best results. Those who begin negotiations thinking they've already been through the hardest part – deciding whether to sell – inevitably wind up with contracts that cause them difficulty down the road. Practice sale negotiations include many potential traps for the unwary. Familiarizing yourself with the traps before it's too late is half the battle. The following nine pitfalls have proven to be especially hazardous:

### **1. Being too trusting**

In practice sale negotiations, quite often you'll deal with people you know or new acquaintances with whom you get along. When negotiations proceed amicably, the potential buyers may urge you to "just trust us." However, don't allow a sense of trust to prevent you from setting forth all details, no matter how minute, in the written

agreement. Remind the parties involved that although you do trust them (you wouldn't be at the negotiating table if you didn't), a written contract that clearly defines expectations is needed to protect everyone's interests.

### **2. Selling to an unknown buyer**

You must clearly understand to whom you are selling your practice. It is one thing to be selling to a large, financially viable organization and quite another to be selling to an entity established by that organization for reasons related to liability or economic efficiency. The latter may not have the financial wherewithal to provide you with adequate security down the road. Make sure the umbrella organization backs up the buyer's financial obligation to you by providing a written guarantee or a comfort letter stating that if the buyer cannot fulfill the terms of the agreement, the umbrella organization will pay your salary or make any remaining payments due you for the sale of your practice. You should also ask to see the buyer's financial statements and have them reviewed by your attorney or accountant.



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### 3. Focusing more on term than termination

Many physicians who sell their practices and enter into an employment agreement are looking for economic security. With that in mind, they begin contract negotiations focused on securing a lengthy contract term. A 45-year-old physician who wants to practice until he's 60 might reasonably negotiate for a six-year term that would give him the option of renewing the contract every two years.

While the term of the agreement is an important component of the contract, it is at least equally important to determine how secure your employment will be during that term. Try to limit the reasons for which the other party could terminate you to your acquiring a well-defined disability or losing your license to practice in the state in which the employment agreement is made. Prevent the other party from including clauses that would be open for interpretation (for example, providing for termination if you "do not perform all the material duties of the employment relationship") or clauses that seem overly protective (for example, providing for termination if you're charged with a crime). Above all, don't allow the other party to include a provision that would enable them to terminate you "without cause." At the same time, make sure the contract allows you some causal reasons

for terminating the relationship as well (for example, if they don't pay your salary or live up to other terms of the employment agreement).

### 4. Comparing apples to oranges in compensation

Chances are good that even if the proposed compensation package is clearly defined, it isn't defined like your current compensation arrangement. As much as possible, try to compare apples to apples. Salary and bonus figures may lend themselves to clear-cut comparisons, but fringe benefits and business expenses may not. There could be significant differences between the vacation time, pension plan, and health, life, and disability insurance you've been accustomed to and what you will be receiving.

Larger institutions tend to standardize the list of fringe benefits and business expenses they'll pay for because they have so many employees. They're afraid to individualize this part of compensation because the differences can be easily seen by other employees. Try to compensate for fewer perks by negotiating a higher guaranteed salary, ideally, factoring in tax differences.

Also, look beyond the first year. How might your compensation increase? Can it decrease? Some physicians, blinded by the great starting salary they'll be receiving,

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# Try to compensate for fewer perks by negotiating a higher guaranteed salary.

fail to secure the salary for the term of the contract and find it cut at the beginning of the second year.

Negotiate for a guaranteed minimum that's good for the term of the agreement, and don't allow your salary to be tied to revenues. Uncertainty about future revenues is the reason many physicians are selling their practices in the first place.

poration status would create, make sure you have a deferred-compensation plan in place that would allow you a final payment on leaving that could equal most or all of the practice's purchase price. In some cases, proceeds allocated for a covenant not to compete, a consulting fee, or a signing bonus may also be paid directly to the physician rather than to his or her C-corporation.

When evaluating your proposed post-sale salary, consider what you'll be paid for the entire term of the agreement, not just the starting salary.

Be sure that any items you want to keep are explicitly excluded from both the practice valuation and the sale.

Before you sell, devise a tax strategy that will help to maximize your profit.

## 5. Forgetting to specify what you aren't selling

A practice valuation usually includes hard assets, receivables, and goodwill. If you have a desk you'd like to use at home or a collectible that has sentimental value to you, be certain that it is expressly excluded from the hard assets both for the purposes of the practice valuation and for the sale. Be overly specific in this regard. The sale is likely to proceed much more smoothly if even the most minute details have been addressed.

## 6. Overlooking Uncle Sam

All too often, physicians become so focused on the selling price that they forget to consider the tax ramifications, which, if improperly managed, can assume gargantuan proportions. A tax adviser can help you maximize the amount you're able to pocket. The key is to allocate the price so that as much as possible will be considered capital gains, rather than taxed as ordinary income.

If your practice is classified as a C-corporation, you stand to lose more than half of your sale's proceeds unless you devise a careful tax strategy. Because a C-corporation must pay tax itself (35 percent on income and capital gains), the IRS could expect your corporation to pay tax on the sale proceeds and expect you to pay tax on the profit the corporation passed on to you.

To avoid the double-bind that your C-corporation

## 7. Failing to secure future payments

If you can't collect payment for the total acquisition price at settlement, try to get at least half, and look carefully at how the future payments are structured. If the balance is to be paid over time, the term for monthly payments should not exceed five years. Make sure you get a security agreement to back up your promissory note. Some buyers pledge assets such as certificates of deposit to secure the purchase.

It is equally important to get as much of the payment as possible in cash. If you are offered stock in the buyer's company as part of the payment, consult a broker to find out exactly what the stock is worth now — and what it's likely to be worth in the future — and don't accept more than 20 percent of the acquisition price in stock.

## 8. Consenting to a too-restrictive covenant

Most practice sale contracts include a restrictive covenant designed to prevent the seller from directly competing with the buyer of the practice at the end of the contract term. Critically assess just how restrictive the covenant might be, and try to limit the covenant as much as possible in terms of time, space, and definition. The covenant should not apply for any period longer than five years.

Geographic restrictions must be evaluated on a case-by-case basis; there are no hard-and-fast rules. For example, in a rural area, a

covenant that prohibits you from practicing within 40 miles might be reasonable. In a suburban area, a fair restriction might be five miles. If your practice is located in a densely populated urban area, the restriction needn't extend beyond a matter of blocks.

You should also make sure you understand exactly what the restrictive covenant will preclude you from doing and negotiate for a definition that's limited to your current mode of practice. A physician who was in private practice prior to the sale should not be prohibited from taking a teaching position or becoming a health plan medical director, for example.

Pay careful attention to the circumstances under which the restrictive covenant would apply. You may be able to negotiate a restrictive covenant that becomes null and void if, for example, the buyer fails to make agreed-upon payments, terminates your contract inappropriately, chooses not to renew your contract, or offers to renew your contract with terms that aren't as favorable as those in the initial contract.

In some cases, you may be able to negotiate a provision that would allow you to buy back your practice – essentially by buying out the restrictive covenant – either during or at the end of the term, according to your practice's fair market value.

## 9. Failing to guard against future owners

Most people don't think about the assignability of their contract, but given the rapid changes occurring in the marketplace, assignability should be a major concern. Say, for instance, that you sell your practice to Hospital X. You've been on the staff for a long time, you like the management, and you feel comfortable working there. Shortly after sign-

ing the agreement, Hospital X sells to Mega Hospital Management Corp., a national outfit with hospitals scattered all over the country. The atmosphere at the hospital is going to be drastically different, and you're not happy about it, but you're stuck because Hospital X assigned your contract to the new owner.

A simple contractual provision could prevent this scenario from happening. Negotiate for an agreement which states that the buyer of your practice cannot assign your employment to another organization without your consent; if they try to assign it to another organization, the contract should become null and void and you should regain your right to practice independently.

In many cases, the owner may want to assign your contract to an entity with which it is affiliated. This arrangement generally works well, provided that the original owner remains primarily liable for meeting the terms of your contract. It's a good idea to include this type of provision in your initial agreement.

The flip side of the assignability issue is that if your employer sells out, you don't want to find yourself out on the street because the buyer refused to accept assignment of your employment. The contract should require that you consent to the assignment, and it should make your current employer financially obligated to you if the new buyer fails to meet any of its obligations to you, especially financial commitments related to compensation and any outstanding payments due you for the purchase of your practice.

Negotiating a practice sale can take six months or more. In addition to entering into it with your eyes open, you should not go into it alone. The counsel of an experienced health care attorney, consultant, or accountant can make the difference between a secure future and an unhappy one. **FPM**

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[fpmedit@aafp.org](mailto:fpmedit@aafp.org).

*Editor's note: To enrich our online archive with some particularly useful "pre-web" articles, we are publishing updated versions of them. A version of this article first appeared in 1996.*

 If the balance of the acquisition price is to be paid over time, make sure future payments are secured.

 A restrictive covenant should be as limited as possible in terms of time, space, and definition. It should not extend beyond five years.

 Your contract should prevent the buyer from assigning your employment to another organization without your permission.

## ACOs ARE COMING: SHOULD YOU SELL YOUR PRACTICE?

Interest in acquiring family medicine practices has been increasing as hospitals and health systems focus on developing accountable care organizations (ACOs). In our March/April 2012 issue, Stanley Borg, DO, offered advice to practice owners who want to evaluate their options in the evolving marketplace. Read it online at <http://www.aafp.org/fpm/2012/0300/p15.html>.