Early warnings when signing onto MSOs

William P. Prescott, MBA, JD, a partner with Wickens, Herzer & Panza of Cleveland, represents and consults with dentists and dental practices in practice transitions, valuations, and business and tax planning. He has written three books on dental practice materials and several articles on management services organizations (MSOs) and reviews contracts for dentists who are considering an MSO buyout.

The best piece of advice he gives to interested parties is to ***read the fine print***. "Many provisions are buried in the contract," he says. "MSOs can succeed only if they know how the dental industry works, however, many don't." MSOs are speculative and several issues should be considered before joining. A few are:

- In general, MSOs desire to buy assets versus stock. Dentists who operate their professional practices as a C corporation may be exposed to double taxation when selling such a practice: corporation rate of 35 percent and their individual rate.

- Dentists don't own their revenues in an MSO. Management fees are typically calculated as a percentage of collections, not profit. Therefore, a selling dentist needs to know the difference between actual profits and operating costs.

- Compensation usually is based on productivity or collections after the payment of management fees. If fees are not paid, the MSO may be able to offset the unpaid selling price, thus reducing the value of the stock and promissory notes. Former practice owners may not be compensated until all practice expenses are paid. Some contracts contain repurchase provisions if certain economic objectives are not met, for example; if the practice does not gross sufficient revenues to pay the management fees and operating expenses.

- In exchange for the purchase price, MSOs will buy practices for a small amount of cash and then combine it with stock and promissory notes. Dentists assume greater risk when accepting smaller amounts of cash in exchange for the practice assets. Mr. Prescott noted that where MSOs provide 100 percent cash, it is usually because they desire market entry. He warns to watch out for repurchase provisions, which may mean the dentist is required to buy back the practice for fair market value and assume the liability (management fees and debts) in cases where the MSO did not obtain desired practice performance.

- When accepting stock, dentists need to find about the "holding period". After an initial public offering,the Securities and Exchange Commission (SEC) requires that stock be held for a specified time period. This period is at least one year, but can be longer with staggered selling times. So even when MSOs go public, the doctor who buys into the company cannot sell the stock until the applicable holding period is satisfied.

- Selling dentists should ensure that an "unwind" provision is included, which allows them to reenter the practice facility and take over the practice in the event of a default, sale, or bankruptcy. The seller may also desire an unwind policy if there's a change in management or consolidation/merger.

- The MSO should be responsible for regulatory matters, specifically fraud, abuse, tax, SEC considerations and antitrust issues. Additionally, state fee splitting, splitting unbundling and unauthorized practice of dentistry regulations should be the responsibility of the MSO by way of an indemnification/hold harmless provision.

- Use due diligence in checking out the MSO to ensure that you are dealing with honorable people to minimize the risk of not being paid or risk the portion of the purchase price not paid in cash. Further, you will be working for the MSO for some period of time (i.e., five years) after the sale. The MSO will certainly do its due diligence on you.

contract rules change? "The average successful dentist will be sold and sold and resold in order to survive the MSO industry," believes Dr. Pride.

In the meantime, dentists who initially joined this profession to retain their independence and to run their own businesses may begin to wonder whether being alone is still the best way to go in this current climate of consolidation. It's not an easy decision. The charm of consolidation is that in the good times, the fortunes of affiliated dentists will rise together, but the treachery of consolidation is that in bad times, the fortunes of affiliated dentists will fall apart. **AGD**

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