

WHY AN ATTORNEY CANNOT REPRESENT BOTH SIDES OF A PRACTICE SALE

By Patrick J. Wood, B.A., J.D. and Jason P. Wood, B.A., J.D.

Most veterinarians have very little business interaction with lawyers during their career. As a result, many of them feel that on those occasions when 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 veterinarians 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 veterinarian 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 veterinarian 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. They include:

1. Purchase Price. More than half of all veterinarian 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 veterinarian 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 averse to one of the clients.
2. Tax Issues. The amount that is paid for a veterinarian practice is required to be reported to the IRS,¹ and IRS regulations allow the parties to select from a variety of reporting categories that may benefit either the buyer or the seller.² Generally speaking, the seller will want most of the purchase price allocated to goodwill, a category that allows the seller to pay the lower 15% federal capital gains rate on the amount allocated to goodwill.³ However, the buyer may only write off this amount over 15 years.⁴ By contrast, the buyer would like a significant amount of the purchase price allocated to supplies, a consulting agreement, and even to accounts receivable, as they can be written off in the first year.⁵ In addition, IRS rules currently allow a \$500,000 first year write off on equipment,⁶ and any additional amounts allocated to equipment can be written off over 5 years.⁷ However, these latter categories subject the seller to ordinary income tax and significantly increase the seller's tax liability.⁸ At a minimum, the attorney should advise the 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 veterinarian 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 veterinarian practice's goodwill,

and wants the selling veterinarian to redo the work or to 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,⁹ there is a four-year statute for breach of a contract.¹⁰ How does the lawyer representing both the buyer and seller properly counsel them in this situation?

4. Covenant Not to Compete. A properly drafted purchase agreement will contain a covenant prohibiting the seller from competing with the buyer post-closing. California law requires that the radius and the length of the covenant must be reasonable.¹¹ The selling veterinarian may plan on opening another practice in a nearby area and the buyer may feel threatened and insist on a wide covenant radius. What should the attorney advise his clients who have conflicting goals? Frequently, the buyer will seek monetary penalties for violating this covenant, but who should advise the clients on what is reasonable? Furthermore, if a violation does occur and the buyer seeks a restraining order, one of the prerequisites is that the buyer prove actual damages,¹² which can be very difficult since the seller's patients generally will not cooperate with the buyer or buyer's counsel. A properly drafted covenant would contain a waiver of this requirement, but drafting such a waiver would be averse to the seller's interest.
5. Covenant Not to Treat. In urban areas, most purchase agreements will have a fifteen mile covenant area in which the seller cannot practice. The seller may be opening a practice just outside of this covenant area and will expect that some of the patients will either seek the seller out or will see the seller's advertisements and transfer to the new office. Any loss of patients will be harmful to the buyer and the buyer should want to greatly limit the seller's ability to treat former patients at another location. While an absolute ban on treating the patients at another location is not enforceable,¹³ a prohibition on treating them within certain areas (larger than the covenant not to compete area) is permissible. How should the attorney advise the respective clients on the subject, particularly if the seller hasn't even raised it as a possibility? The attorney has a duty to anticipate situations which, in his or her experience, may become a problem for one of the clients, and advise them appropriately. However, this attorney representing both sides is sure to offend the seller, whether or not the seller plans on opening another practice.
6. Contingencies. Most sellers want a simple transaction that will close quickly. Most buyers want to have an ample opportunity to review books and records, charts, obtain a satisfactory lease, process and obtain a favorable loan, and have sufficient time in which to do so. There would typically be a security deposit which would be forfeited to the seller at the end of a contingency period so that the seller knows that the deal is likely to close. The buyer will try to push the contingency dates out as far as possible. What should the attorney representing both sides of the transaction advise?

Many veterinarians see dual representation of the buyer and seller as a way of saving money. Since the interests of the buyer and seller in many instances are diametrically opposed, how can an ethical attorney truly represent both sides of a deal when their best interests may be in direct conflict?

In most cases, the California State Bar limits an attorney where such conflicts exist. For instance, under California Rules of Professional Conduct, at Rule 3-310, a lawyer is not allowed to accept representation of more than one client in a particular manner where the interests of the clients potentially conflict without the “informed written consent of each client.”¹⁴ Furthermore, if during the course of representation, it becomes apparent that the interest of the clients actually conflict, the attorney must again obtain an informed, written consent from each client.¹⁵ The key element in this rule is that the client must give an informed, written consent, specifying the nature of the conflict. However, it is almost impossible for a veterinarian to give an informed consent when so many different conflicts can arise in a simple veterinarian practice sale. More importantly, if the attorney isn’t even familiar with the few examples set forth above in this article, how well are the parties’ interests being represented?

It may seem attractive to a buyer and seller to hire just one attorney in a veterinarian practice sale, particularly when they usually think it’s just a “simple transaction.” or because 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, one or both of the masters would likely resent such dual representation when a real problem arises.

Bio

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1. IRS Form 8594
 2. IRC §1060
 3. IRC §1(h)
 4. IRC §197
 5. IRC §197
 6. IRC §179
 7. IRC §168; IRS Revenue Procedure 87-56
 8. IRS Revenue Procedure 87-56
 9. California Code of Civil Procedure §340 and California Code of Civil Procedure §340.5
 10. California Code of Civil Procedure §337
 11. California Business & Professions Code, §16601
 12. California Code of Civil Procedure, §526
 13. California Business & Professions Code, §16601
 14. California Rules of Professional Conduct, Rule 3-310; Cal. Jur. 3d (Rev) Attorneys at Law, §89, et. seq.
 15. California Rules of Professional Conduct, Rule 3-310; Cal. Jur. 3d (Rev) Attorneys at Law, §89 et. seq.