

Dental divorce and dental disputes

Huge legal costs generated by poor choice of lawyers and practice valuers

By Graham Middleton, BA, MBA



“Lawyers often talk about family court proceedings but only about 2% of matrimonial property disputes are actually solved by a court judgement...”

While there are many honourable lawyers who do their best to assist clients caught up in marital or business disputes, regrettably there are some who prolong disputes and steer clients towards valuers who have no knowledge of dental practice and who charge very high fees for sub-standard work. These lawyers are comfortable in the knowledge that their clients are never likely to consult them again, so it doesn't matter that their disputes are prolonged and that their fees rise accordingly. Over the years, I have dealt with the good and the bad and on numerous occasions, have been requested to review a valuation report on a practice which is clearly wrong by a substantial amount. In doing so, it has betrayed the so-called forensic accountant who wrote it as having too little knowledge of dental practice, if any, to ask the right questions or get close to a legitimate value. Among all the assets of a marriage or a business partnership, the most intangible is usually the dental practice and hence squabbling over its value can be used to prolong a dispute. The following article portrays actual situations, but obviously names and some details have been changed so as not to be confused with any particular dentist who has been in this unfortunate situation.

Robbie and Trish

Robbie was a successful dentist. Trish had qualified as a speech therapist but had taken time off to bear and nurture their three children, returning to part time practice once able. By the time they had reached their mid 40s, they had reached the empty nest stage of life.

Practice purchase

Robbie had originally acquired a modest practice from an aging dentist who had a part time assistant. He had quickly realised that the previous owner had confined himself to basic drill and fill dentistry for many years but had been popular with patients. The result had been that the practice had many patients who needed more advanced restorative dentistry. Fortunately, the demographics of the population surrounding the practice indicated that most could afford better dental care.

Practice thrives

Robbie had thrived and had quickly built the practice to three surgeries and later four. His own operatory had been the busiest. He had great chairside manners and had invested in upgrading

the fitout and furnishings and kept the practice looking great. Rapport with his patients was excellent and, in the days before the incursion of health funds, he had solidified his own client list. Although the explosion in dental numbers had caused several practices to open nearby, Robbie's patient list had stayed loyal and he continued to receive good referrals.

Robbie saw where dentistry was headed so he and his team had gently persuaded patients to drop extras cover and pay for treatment themselves. Most patients who had been led to preferred provider dentists by large health funds quickly grasped the qualitative differences and returned to Robbie's practice.

Robbie and Trish

Meanwhile, Trish had returned to full time practice as a speech therapist and although her income was far below Robbie's, the work was enjoyable and she got a big kick out of the huge improvement she created in correcting the speech defects of children.

Bit by bit, Robbie and Trish drifted apart without either realising it was happening. Their hobbies and interests tended to be mutually exclusive. There had been a few issues and flare ups, but in truth neither were strongly at fault. However, one day they realised that their feelings for each other had dissipated and they were moving in different social circles.

Smirk v Sluggit

Trish confided in a friend who was divorced who recommended a family court lawyer, Smirk of Smirk & Sledge Family Lawyers. Smirk saw the opportunity to create a legal confrontation and immediately served a list of demands on Robbie before Trish had time to reconsider. Robbie was caught by surprise and proceeded, too hurriedly, to engage lawyer Sluggit from rival firm Sluggit and Slammer Family Lawyers. In reality, Trish and Robbie had engaged lawyers far too early. They could have solved a fair number of the issues themselves with the help of the firm they used for accounting and financial services. Their accountants and financial advisors would have advised some elementary steps in simplifying issues and to align their thinking on a likely financial settlement.

The legal trap

Both lawyers saw the opportunity to create fat fee earning files. Smirk served a long list of demands on Robbie and Robbie's lawyer, Sluggit, fired back a hefty legal response with a list of counter-demands. Both were acutely aware of the game they were playing. Both knew that if they could concentrate on an asset with an intangible element to its value, they could engage in a lengthy process concerning its value. Both Smirk and Sluggit judge their state of wellbeing by the number of juicy family court related property disputes they had in process. The longer the process, the fatter the legal files, the bigger the fees.

Robbie and Trish's assets

Their assets included:

1. A successful dental practice of which Robbie was a key person. The practice was a busy four-chair operation;
2. A home at a good address;
3. A well-situated and well-fitted out dental practice premises;
4. A superannuation fund;
5. A family trust which included an investment property;
6. Some miscellaneous shares which had come to them through various public offers including shares in Telstra, AMP, Woolworths, CSL and Medibank Private;
7. A modest amount of cash; and
8. Cars, furniture and personal effects including a well-stocked wine cellar.

Robbie and Trish's debt

Their home had been paid off some years earlier but it had been used as security for the practice and premises purchase and there were still long term loans outstanding on those assets, but they had good equity. There were leases and chattel mortgages over various items of practice equipment, fitout, fixtures and fittings, etc, arising from a relatively recent comprehensive renovation of the practice premises.

Raising the temperature

The exchange of legal correspondence was raising the temperature on both sides. Inevitably, some responses were incomplete, or appeared to be incomplete,

at first sounding and it allowed Smirk to suggest to Trish that some of Robbie's assets were being hidden. The two lawyers were fattening their files and their legal fees at a face pace. Both Smirk and Sluggit were quick to jump on any apparent slackness from the other side. In reality, they were running the dispute to a predictable script. Smirk from long experience knew that the asset which offered the greatest subjectivity as to its value would be the likely issue to lead to the longest fight. Home, premises and superannuation funds were likely to be easier to resolve. Whereas Smirk was unsure as to the true value of the dental practice and that suited him fine.

Valuing the dental practice

Trish hadn't thought about the value of the dental practice during their marriage and had taken for granted that Robbie earned enough to provide the family with a good standard of living and a good education for their children. Besides, she had worked part time when able, kept the household going and only comparatively recently returned to full time work. Some of her friends suggested that the practice might be worth "a lot of money". Hence, it got into her head that the practice was worth far more than was actually the case, particularly as a sale to a dental corporate would have meant Robbie had to sign on as a lead dentist under a corporate contract. The other issue was that Robbie's impact on the practice was huge as his bond with the patients would have meant that his removal would cause a substantial fee fallout.

Smirk demanded a valuation of the practice by an independent valuer, a valuation of the practice premises, a detailed appraisal of the family trust, the balance sheet of the company which operated the practice on Robbie's behalf under licence and other miscellaneous assets down to and including an appraisal of the wine cellar by an expert. The practice was the asset most likely to be disputed as to its value and Smirk had minimal interest in some of the other things he demanded.

Had Trish and Robbie sat down with their advisors and accountants, the issues would have been advised to them along these lines:

1. As neither of you wish to stay in the family home, put it on the market and you can both downsize to a dwelling which suits your own needs;
2. Toss a coin and take pick for pick in the wine cellar until you have half each;
3. Sell the shares and reduce debt, after allowing for capital gains tax;
4. Sell the miscellaneous assets in the family trust including the rental house. Pay out the debt and, after allowing for any taxes, use the net proceeds towards the financial settlement;
5. Toss a coin and take pick for pick of the furniture and effects, taking care that any objects of sentimental value to a particular partner stays with that partner;
6. They recommended an expert in valuing dental practices who they would engage on Robbie and Trish's behalf;
7. The accountants suggested an independent property valuer who would value the dental premises;
8. The superannuation fund value would be taken into account when dividing the overall assets, using the firm's software and accounting expertise to assign assets and tax liabilities in the fund, in an equitable manner; and
9. Finally, with this done, they would recommend an appropriate distribution of assets within the marriage including Robbie holding on to the dental practice and practice premises, but shouldering additional debt to even the distribution of assets, with a share of the superannuation fund and miscellaneous assets being assigned to Trish.

This would result in lowering the temperature. This was highly important as Robbie and Trish's children had let it be known that they wanted their parents to settle their differences.

Smirk and Sluggit's reactions

Lawyers don't make much income from quick settlements, hence Smirk urged Trish to engage a forensic accountant to go through Robbie's practice operations in detail hinting strongly that there could be hidden assets and hidden value. Unfortunately, Trish agreed to Smirk's suggestion and Sluggit jumped on it. The lawyers exchanged lists of potential practice valuers, none of which had ever valued a dental practice, but who had impressive CV's as "forensic accountants".

Nurk the forensic accountant

Without too much effort, the respective lawyers advised both clients to accept Nurk, an accountant on their list of forensic accountants. The lawyers knew which valuers would be likely to build in delays and enhance their legal bills so they chose accordingly.

Nurk had quoted a vastly higher valuation fee than the far more experienced valuers who had expertise in dental practice valuations. He then started out by demanding a huge amount of information from Robbie, much of it trivial and of an immaterial impact on value. He served a series of demands on their accountant to provide all manner of documents and when the accountants couldn't find a document to justify a couple of entries of long ago on the practice's balance sheet, he wrote an interim report suggesting that the value of the practice was:

- a. Very high; and
- b. Might be higher still if certain matters could be clarified.

Dental premises confused with medical premises

Meanwhile, both parties tendered real estate valuations on the family home and on the practice premises which were a long way apart. Neither of the valuations on the practice premises quoted comparable sales of dental premises, which are hard to find as most dental premises are sold from one dentist to their successor. Instead, the valuers used inappropriate comparisons with medical premises not realising that whereas medical GP's did few, if any, procedures simply referring patients outwards to various specialists, dentists spend their day in surgeries doing procedures.

Four lawyers!

By this time, both Smirk and Sluggit had recommended that their clients engage barristers who would represent them in the family court. Lawyers, as they now realised, came in quads. Each party's lawyer and each party's barrister. Smirk and Sluggit then continued to write to each other, making new demands and copying in the barristers on anything that appeared to be even remotely contentious. The barristers asked for the updated financials, copies of company articles,

memorandums, trust deeds of the superfund and the family trust, etc. Much of this information gathered dust in the corner of the barrister's offices as the barristers weren't particularly interested in reading it in detail but they assisted Smirk and Sluggit to draw matters out.

Costs rising uncontrollably

Meanwhile, Robbie and Trish's lawyer bills, barrister bills, valuation bills and accounting bills were multiplying and 18 months had now passed without any sign that the matter would be resolved. There were vague references to a family court hearing and various preliminary stages. Dates changed because a judge or one of the barristers had other work and sometimes dates changed without explanation. 30 June came and went and fresh financials were demanded so that Nurk could complete his work.

Two percent!

In reality, Smirk, Sluggit and the two barristers knew that there was little chance of the matter going before the court. It was too obvious that the lawyer's should have been able to resolve it without going to court. Only 2% of family court property settlements occur as a result of a hearing before a judge. Judges have been known to be very frustrated with lawyers and solicitors who bring matters to court which the judges believe should have been settled through normal negotiations. This was a fact that neither Smirk nor Sluggit chose to communicate to their clients.

Nurk's valuation

Nurk's practice valuation took many weeks and cost about four times as much as a valuation from a firm experienced in dental valuations, but it raised more questions than it answered. There was a huge amount of padding in the report including Nurk's experience in valuing a variety of businesses. Notably none of the businesses he had valued were dental practices. There was also a lot of padding concerning numbers of dentists and dental practices, intending to add a touch of authenticity to his valuation, but when it came to the actual examination of the practices outcomes it was obvious to experienced eyes that Nurk did

not comprehend the business practice of dentistry. The report contained a number of inaccurate statements about dental corporates and about practice rent. Nurk failed to breakout Robbie's fees from the employed dentists and hygienists and got them mixed up with administrative staff, even though they generated fees. He failed to recognise that the volume of fees generated in Robbie's surgery were as much as the two employed dentists. He underestimated Robbie's opportunity costs and salary and overestimated EBIDTA as a result. He failed to apply a proper rental and again swelled the apparent profit of the practice and hence its value. This resulted in a gross over valuation of the practice and inevitably Robbie sought informed advice.

In truth, Nurk didn't have much concern as to whether his report had overvalued the practice or whether it was challenged. If a dispute broke out concerning his valuations, he charged extra for responding and if the matter went to court, he charged much more again for standing by as an expert witness and re-reading the file.

Nurk also indicated that Robbie's practice value was aligned with that being paid by dental corporates at the top of the market for good practices in which the practice owners had agreed to sign a five year employment agreement as lead dentist and had agreed to a significant amount of the purchase price being held in escrow until the vendor had fulfilled the operating fee targets set out in the contract. In reality, the true value of the practice if sold to another dentist on an arm's length basis with a normal handover was much lower.

By this stage, the dispute had been building for over 18 months, which suited Smirk who was sending regular bills to Trish and which suited Sluggit who was likewise regularly billing Robbie. Robbie and Trish's children, who were young adults, were seriously affected by their parents' dispute. Trish was beginning to wonder why she consulted Smirk and Robbie was wondering whether it would ever end. Their lawyers were still talking about a day in court and although they expected that they would engineer a settlement on the steps of the court, they had not communicated this to their clients. The barristers occasionally put their heads up, asked for an updated document or two then sent more bills.

Their accountants and advisors

Fortunately Robbie and Trish both still respected the firm which had provided their accounting and financial advice over a long period and each had mentioned to a partner of the firm what was happening. The firms' partners consulted each other and asked Robbie and Trish to meet with them, with one partner advising each, to determine whether they could come to an amicable settlement. The partners explained there was no guarantee of an early legal solution unless they agreed to breakout of the vortex which they had been sucked into by Smirk and Sluggit. The partners also explained that they saw obvious inaccuracies in Nurks'

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practice valuation. The partners asked Robbie and Trish to sign letters to their lawyers telling them to hold any further action while they explored other avenues. The partners then advised Robbie and Trish:

1. To sell any extraneous assets such as shares and their rental property from the trust, then wind up their trust;
2. They were to sell their family house and each downsize to smaller dwellings;
3. Separate out the items of furniture by tossing a coin and taking pick for pick, doing likewise with the wine cellar; and
4. Robbie was to retain the practice premises and practice, but take on additional debt to ensure Trish got a defined share of the assets.

Trish received a major portion of the superannuation fund and half the proceeds of sale of the house, a share of the furnishings and personal effects and a substantial sum which Robbie had borrowed.

Robbie and Trish realised that they were being advised down a reasonable path and in the background, their children had expressed their wish that they settle the matter in this manner. Having shook hands on the agreement with their accountants and advisors, Robbie and Trish took their children to dinner and explained what they had agreed on.

Smirk and Sluggit both wrote letters begging Robbie and Trish to continue their legal action to gain a greater share of their joint assets, but fortunately they had no wish to restart the fight. The partners of the accounting practice asked two solicitors they knew well to sit with Robbie and Trish while they took them through the proposed settlement agreement. The solicitor's signed off on the fact that they had received appropriate legal and accounting advice and the necessary agreement was submitted to the family court to be ratified.

By adopting this solution, Robbie and Trish pulled back from the abyss of battling it out towards a court appearance, pleased their children and saved a further large tranche of legal and other fees.

The lessons

1. Taking a property dispute into court is rarely advantageous. The additional barristers and lawyer fees, valuer's fees, expert witness fees and court costs typically eat up any advantage that might be won;
2. Lawyers often talk about family court proceedings but only about 2% of matrimonial property disputes are actually solved by a court judgement;
3. Judges hate complex accounting arguments about practice values. This is not accidental as the legal profession is generally not noted for its knowledge of mathematics, accounting or economics. Rather most lawyers, including judges, did best at subjects like English literature at high school and many have little mathematical schooling and feel uncomfortable with numbers and accounts;

4. Most accountants who claim to be expert valuers have no, or negligible, experience in valuing dental practices. What they are really saying is that they value some miscellaneous small businesses and think that they can apply the same principles to a dental practice. Frequently, they make significant errors and this causes their initial report to be challenged by more expert valuers and results in delays. At Synstrat, we regularly get asked to examine valuations from valuers, who were jointly appointed by both parties, which on close examination fall apart as having been bizarrely inaccurate. However, we only value practices in professions we know well, have worked with for many years and which we keep updated benchmark statistics and knowledge of actual practice sales;
5. When emotional issues are involved in property disputes, it tends to drive out rational thought from the parties;
6. While some family court lawyers are honourable people who advise their clients towards reasonable and reasonably quick settlements, there are others that play on emotions to draw out disputes and multiply their billable hours; and
7. Since the dental practice goodwill is usually the most intangible of the assets in dispute, it often becomes a forum of any drawn out dispute. There is no substitute for having a practice valued as early as possible by the most experienced dental practice valuers available, as this diminishes the probability of a drawn out dispute, speeds up settlement and saves vast amounts of money.

Partnership and associateship disputes

Many of the lessons from the family court dispute arena are also valid for dental partner and dental associate fallouts, as fights over value can be just as significant in these situations. Early consultation with advisors experienced in valuing practices and assisting dentists resolve disputes and save time and emotional angst. It will also save money by greatly narrowing the view as to practice value

and by putting in place reasonable steps to resolve other matters, without recourse to either the courts or legal mediation. Legal mediation can be horrendously expensive as it usually involves both parties meeting with an agreed mediator together with their barristers, solicitors, accountants and advisors for each party. A vast amount of money can be burned in a single day's mediation and many mediations end with the parties agreeing to an outcome which neither believed was fair or rational, but which was extremely costly.

About the author

Graham Middleton personally has been advising dentists on strategic, practice management, valuation and conflict resolution processes for 30 years, the last 23 as a founding partner and director of Synstrat Management Pty Ltd and Synstrat Accounting Pty Ltd. He was once a regular army officer, and later a Human Resources Manager, at the Attorney General's Department of Victoria. He is considered an expert on dental practice valuation and practice performance benchmarking. He has spent many years advising dentists in respect of their business and financial strategy and measuring their practice and financial performance. He is the author of Synstrat Dental Stories, the Synstrat Guide to Practice Management, 50 Rules for Success as a Dentist and Buying & Selling General & Specialist Dental Practices. He is a long-term contributor to the Australasian Dental Practice magazine. The Synstrat Group is an independent data-based organisation providing management, benchmarking, valuation, financial and accounting services to the dental profession. Synstrat Management Pty Ltd is a licensed financial services company. Both Synstrat companies are owned by the same directors who work within the Synstrat Group. For more information, call (03) 9843-7777 Fax: (03) 9843-7799 Email: dental@synstrat.com.au or visit www.synstrat.com.au.

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