

# DENTAL LEGAL UPDATE

## Financing Your Dental Practice: Tips & Terms

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### Special points of interest:

- Avoid Prepayment Penalties
- Beware of "Payable on Demand" Language

Financing your dental practice can be a confusing and intimidating process. Knowing factors affecting the banker's opinion and steps to take make the loan application easier. Also, knowing what types of agreements and collateral are typically required in a loan will help you strike the best deal.

#### Why and How Much to Borrow?

Determine the loan's purpose and how much financing you need. Your needs can be diverse, i.e. for practice acquisition, equipment, computer system, building, or working capital. With the assistance of your financial advisor, a conservative *pro forma* cash flow analysis should be performed to determine the level of debt service which your dental practice's operations can support. The cash flow analysis should take into account cash flow trends and a reasonable reserve for contingencies.

**Interest Rates:** Interest rates have fluctuated widely in the past decade, but are at low levels now. If you can capture a low fixed interest rate, that is a benefit. If your loan has an adjustable interest rate, you will want to evaluate the maximum spread of interest rates and your ability to service a changing loan payment.

**Banker Selection:** Careful selection of your banker is critical. Work with your financial advisor to interview bankers to find a good fit from financial, service, and personal standpoints.

Financial strength of the lender needs to be evaluated. Ask if the bank is presently under

governmental supervision. Unfortunately, in recent times, receivers of failed banks have declined to renew performing loans causing distress to good practices and businesses, if not bankruptcy.

Investigate the reputation of the bank and banker with borrowers, to see if fair business dealings occurred. The "service" orientation of the bank needs to be explored, since in return for the loan, many bankers will demand or suggest that the dental practice use the bank for other banking needs, such as credit card processing and other bank accounts and services. Because the bank will have a banker's lien, if you default on the loan, the bank will usually be able to freeze and attach your other bank accounts.

Be sure to ask if your banker is making new loans and expects to be able to make new loans in the future. With the plethora of bank failures in recent years, many banks have not been able to make new loans. Another question to ask is what level of down payment and collateral are needed for a new loan.

Ask if your loan will be payable over a specified period and not "payable on demand". Additionally, check to see that there will be no prepayment penalties.

Ask where the bank obtains its capital to provide loans and if the bank sells its loans. Many banks either sell the whole loans or sell "participations" in the loans to other banks or investors. In a participation arrangement,

**To minimize surprises, perform your own "self-audit" prior to applying for your loan and take corrective actions.**



**Loan Documents include:**

**Loan Commitment**

**Loan Agreement**

**Promissory Note**

**Security Agreement**

**UCC Financing Statement**

**Deed of Trust (Mortgage)**

**Pledges**

**Assignment of Life Insurance**

**Commercial Guaranty**

**Board Resolutions**

**Certificates of Corporate Secretary**

**Financing Your Dental Practice (cont.) --**

several banks may own a part of the loan. Then, one of the banks or a separate entity services the loan by collecting payments, determining compliance with the loan terms, and enforcing on default. Participations may provide additional capital opportunity, but mean your neighborhood banker may not be the person you talk to when the chips are down.

**Putting the Practice in Order:** Before making the loan, the lender will perform an underwriting analysis of your dental practice and its ownership. This intense scrutiny sometimes yields surprises and may force you to put your house in order. To minimize surprises, perform your own "self-audit" prior to applying for your loan and take corrective actions.

If you have not yet incorporated your practice, it is prudent to incorporate prior to taking out the loan. This saves you the cost of refinancing/restructuring the loan when you incorporate later. (See my article on dental practice incorporations in the June 2010 issue of the [Dental Legal Update](http://www.jeanine.com) at [www.jeanine.com](http://www.jeanine.com).)

You will need to provide financial statements for your dental practice and the dentist owners of the practice. If your dental practice is incorporated, corporate documents need to be up to date. If your dental practice is a partnership, the partnership agreement may need to be provided. Tax returns for your practice will need to be provided, as well as those of the dentist owners. Lien searches will be performed, so the dental practice must have clear title to its assets. Questions will be asked about lawsuits and compliance with applicable laws and regulations.

**Critical Loan Terms:** When negotiating your practice's loan, play the "what if" game and see if the contemplated loan provisions allow you and your successors and heirs the flexibility to manage or sell the practice, in good and

bad times.

**Pitfalls – Prepayment Penalties;**

**Payable on Demand:** If there is a prepayment penalty, the bank can charge you a penalty fee if you pay off your loan early (either by partial payment or payment in full). If possible, avoid prepayment penalties. Discuss at the outset that you do not want a prepayment penalty. Such a penalty penalizes you for paying off your loan early by paying extra each month, refinancing your loan to receive a lower interest rate, or following your personal banker with your practice loans, when that banker moves to another bank.

Some loans are "payable on demand". Payable on demand means when the bank demands payment, you need to pay in full immediately! Needless to say, a "payable on demand" loan can wreak havoc on your practice. Some loans may state that the payments are to be made over a scheduled term (for example, monthly payments over 36 months) or payable on demand. Those loans are also "payable on demand". Be very careful.

**Additional Financing:** The loan terms should be flexible enough to allow you to obtain additional financing, particularly to finance practice expansion, provided the underlying economics of your practice can support the debt service.

**Property Loss & Insurance**

**Proceeds:** Under many loans, you will be required to name your lender as an additional insured person under your practice's insurance policies. If your practice suffers a catastrophe such as a flood or fire, your lender has the right to receive the insurance payments up to the amount of the outstanding loan. Often the loan documents give your lender the option of deciding to keep the insurance payments or to allow you to receive the payments for necessary repairs. If your lender keeps the insurance proceeds under the view that the catastrophe is an opportunity for your

"prepayment" of the loan, your practice may be devastated. To prevent this calamity, you may want to negotiate terms that require the insurance proceeds to be paid to you for repairs when the loan is not in default.

**Death & Changes in Ownership Structure:** Loan documents often indicate that the death of the borrowing/guaranteeing dentist or changes in ownership structure of the practice will be events of default under the loan. Events of default can accelerate the loan resulting in you having to pay off the entire loan immediately. Therefore, life insurance or other financial protections need to be considered. Also, if you anticipate changing the practice's ownership structure, for example by selling part of the practice to an associate dentist, you will want to build that flexibility in at the outset in your agreements with your bank or be prepared to ask for the bank's consent to the change.

**Cross Default:** Very often, a lender will require a cross default clause. In this type of clause, if you default on any of your other loans, your lender can accelerate your loan and require you to pay the entire loan balance immediately.

**Notice of Default and Opportunities to Cure:** Under your practice's loan, you will be making many promises, or covenants, to your lender. It is often possible for you to have breached or violated one or more of these promises without knowing you did so. Usually, any default gives your lender the right to demand that the entire loan balance be paid immediately. Therefore, request a reasonable notice of default under the loan and the opportunity to cure the default.

**Financial Covenants and Reports:** Under many loans, your dental practice will be required to meet certain financial performance standards or reporting requirements under the loan's financial covenants. Your financial advisor should carefully evaluate these financial performance standards, before the loan is made, to determine if they are reasonable and achievable.

You may be required to provide your practice's financial statements to your lender during the term of the loan. When providing these financial reports, care is needed so that confidential patient information is not included in the reports and HIPAA compliance is satisfied.

**Personal Guarantees:** In most practice loans, the lender will require personal guarantees of the dentist owners of the practice. Under these guarantees, you and your colleagues will, generally, guaranty repayment and performance of the loan. Typically, your lender will ask you

to guaranty not only the principal balance of the loan, but also to guaranty interest, collection costs and other costs. You can request that the guarantees be limited to a percentage of the loan or otherwise be limited – particularly when there are multiple guarantors.

Many commercial loan guarantees are now "continuing guarantees". These guarantees apply to any loans with the bank and can spring back to life, even after the first loan is paid off, if another loan is taken out. When you sell your practice, it is important to work with your attorney to be sure that you are released from guarantees (if possible), including these springing "continuing guarantees".

**Legal Counsel:** Given the complexity of practice loans, hire a knowledgeable attorney to represent you before you enter into loan agreements.

Then, when there are practice changes, such as practice restructure, incorporation of practice, sale of entire practice, sale of stock to an associate dentist, sale of collateral (building, equipment, etc.), dentist retirement, or a move of the practice, your attorney needs to be consulted in advance to check that you are in compliance with the loan terms for these changes.

Finally, when that happy day arrives when your practice loan is paid in full, contact your attorney to have her check that the loan and guarantees have been properly retired in writing and that the liens have been removed from your practice's property.

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## Federal Law Updates

### Dental Practice Sale/Succession Workshops

Legal aspects of dental practice sale and succession:

- ✓ Legal Checkup
- ✓ Partner/Associate Recruitment
- ✓ Disability/Retirement
- ✓ Practice Sale
- ✓ Buy Sell Contract
- ✓ Real Estate Options
- ✓ Estate Planning

For information, call Jeanine Lehman at (512) 918-3435.

To receive the **Dental Legal Update** by email, call (512) 918-3435.

#### HIPAA – AIDS Alert

A U.S. Department of Health & Human Services Office for Civil Rights (“OCR”) HIPAA investigation confirmed allegations that a dental practice flagged some of its medical records with a red sticker with the word "AIDS" on the outside cover, and that records were handled so that other patients and staff without need to know could read the sticker. When notified of the complaint filed with OCR, the dental practice immediately removed the red AIDS sticker from the complainant's file. To resolve this matter, OCR also required the practice to revise its policies and operating procedures and to move medical alert stickers to the inside cover of the records. Further, the covered entity's Privacy Officer and other representatives met with the patient and apologized, and followed the meeting with a written apology.

#### Americans with Disability Act: Chemical Sensitivity

According to The Detroit News, an urban planner was awarded \$100,000 in a February 2010 settlement with her employer, the City of Detroit, resulting from an ADA lawsuit filed by the employee alleging that the City failed to accommodate her breathing sensitivity to chemical products, including a co-worker's perfume. News reports indicate that the employee repeatedly sought help to address other employees' refusal to stop wearing strong perfumes in her work area and about air fresheners (plug-ins), but was not able to get help from her employer. In addition to the monetary payment, the City will be placing signs, having a new employee handbook, and including workforce education in its ADA training.

This case reinforces the need to make reasonable accommodations for the disabilities of employees (and others, such as patients) and have workplace training.

In June 2009, the U.S. Centers for Disease Control & Prevention adopted an Indoor Environmental Quality Policy to protect the health of its workers and visitors. Included in this policy are prohibition of scented or fragranced products (which may be detrimental to the health of workers with chemical sensitivities, allergies, asthma, and chronic headaches/migraines), as well as requirements to use integrated pest management practices and other indoor air quality safeguards. The CDC's policy is available at <http://www.chemicalsensitivityfoundation.org/cdc-fragrance-free-policy.htm>

### About Our Firm ...

**Law Offices of Jeanine Lehman P.C.** is a Texas law firm headquartered in Austin with a state-wide health law practice. Our health law practice is focused on business law, transactional aspects of individual and group practices, such as contracts and incorporations, office/facility leases, building purchases/condos, and build-to-suits, practice sales/purchases/buy-ins, employment agreements, financing, and consultation concerning the day-to-day legal concerns of running a health care practice. The firm is owned by Texas Attorney **Jeanine Lehman**. Jeanine has over 25 years experience as an attorney. She has had one book and over 70 articles published. She speaks to professional and business groups concerning legal topics. Jeanine is blessed to have one dentist and three dental hygienists in her family. Contact us at (512) 918-3435, [jeanine@jeanine.com](mailto:jeanine@jeanine.com) or PO Box 202211, Austin, TX 78720, and visit our website at [www.jeanine.com](http://www.jeanine.com).