

Quarterly Supplement To

Business, Legal, And Tax Planning for the Dental Law

Second Edition

The purpose of the Quarterly Supplement is to continually update the material contained in **Business, Legal, And Tax Planning for the Dental Law**, Second Edition, as "free-standing" articles relative to current business, legal, tax and pending legislative matters that affect your practice. These Quarterly Supplements also reflect my ongoing experiences as an attorney representing dental and dental specialty practices. At times, articles will be written by friends who consist of tax attorneys, accountants, actuaries and dentists. The articles contained in the Quarterly Supplements are consistent with the chapters contained in my book, which you may download at no charge at www.wickenslaw.com — click Dental Law.



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Associate Employment

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The reason for writing this article is to provide you with an understanding of important associate employment considerations and a summary of the provisions.

Associate employment Considerations

The relationship of an associate dentist or specialist in almost any practice is that of an employer/employee. There are few exceptions. Last summer, I was asked to participate on a panel as a practicing attorney with four Internal Revenue Service ("IRS") representatives at the first Office of Chief Counsel Program of the IRS in Atlanta. The audience was comprised of IRS attorneys and our topic was worker classification. The end result was that where the associate doctor is subject to a restrictive covenant, where the practice schedules and bills the patients and pays the incoming or retired dentist or specialist, there is an employer/employee relationship and not an independent contractor relationship. There are situations where an independent contractor relationship can exist, but they are exceptions. Just note that misclassification can be very expensive for everyone concerned. One panelist addressed a question I hear from consultants routinely. That is, "if the associate pays his, her or its taxes and the practice pays all applicable taxes, no harm no foul, right?" No, for the practice, it would be charged the Federal income tax, irrespective of whether the misclassified worker has paid the tax, plus penalties and interest. For the misclassified worker, the direct business expenses and benefits would be included in income, with very limited deductibility. Associates, including retired doctors working as associates after the practice sale, like working as independent contractors because the practice cannot afford to pay "fair" or "market" compensation, plus direct business expenses and benefits. A way around this is to classify the worker as an employee and reduce the compensation by the cost of the direct business expenses and benefits. No risk here!

Second, there are some advisors who believe that an employment contract is not necessary for the first six months of employment, that just a letter of employment terms is sufficient. I respectfully disagree. Almost every time we attempt to get an employment agreement signed after employment has commenced, we have disagreements over the terms of the restrictive covenant provisions. I just do not see sufficient detail in an employment terms letter to eliminate negotiations on this and other issues. For example, there may be a two-year, five-mile restrictive covenant, with non-solicitation provisions contained in the letter. However, opposing counsel may attempt to negotiate that the covenant should not be in effect if the practice terminates the associate's employment without "cause". Additionally, there is an argument that after the employment has commenced, there is no consideration for the later promise not to compete without a meaningful increase in compensation or signing bonus.

Third, from the employer's perspective, the primary reason for preparing an employment agreement is for a restrictive covenant to be in effect. This protects the value of the practice from being diluted should the employee/doctor leave for any reason. From the employee/young doctor's perspective, if the restrictive covenant is too restrictive, the young doctor will have to relocate should the relationship not be successful. As a new doctor, I would also want my compensation, payment of direct business expenses and benefits to be in writing.

Unless the employer/employee relationship is that of a permanent associate, I recommend that the practice owner's exit or succession strategy be in place, valuation of the practice completed and the new doctor's practice entry plan established prior to picking up a handpiece. Waiting until ownership is contemplated will only result in a dispute over the purchase price, business and tax structure of any associate buy-in and the buy-out formula, business and tax structure of any owner buy-out.

Finally, an "associate needs analysis" is required, but almost never prepared. Both the practice owner and incoming associate need to know whether the practice needs an additional doctor, whether and to what extent the new doctor is required to build a practice within a practice and what the practice can afford to pay the associate and earn a "sufficient" administrative profit. In my experience, most practice owners who think an associate is needed so that they can reduce stress, take time-off, better serve patients and make more money, really need systems management and not an associate. Yes, there are exceptions. It is interesting how the facility plays a part in the hiring of an associate. If the practice has not yet relocated or expanded, there are usually an insufficient number of treatment rooms to accommodate another doctor. If the practice has relocated or expanded, the decision to hire or not to hire an associate has already been made, consciously or unconsciously. Also, what impact did or will any economic conditions have upon this hiring decision given the practice facility and overhead expense level? One lesson that should be learned from the late 2008 economic crisis is that good economic times should not be taken "for granted" in that a contingency plan should be built into the strategic business plan. Professional practices do need strategic business plans! All of these matters should be considered in the "associate needs analysis".

Employment Agreement Provisions

Not surprisingly, the two provisions in any associate employment agreement that require the most attention and detail are compensation and the restrictive covenant provisions. The important provisions of associate employment agreements are as follows.

Employment

The agreement should provide that the entire employment relationship is covered by the agreement itself and that in the event of a dispute, no other verbal or written evidence may be admitted to trial other than the terms of the employment agreement. This provision was a key factor in a case which was successfully litigated by my partner, Richard D. Panza, Esq., in *Wall v. Firelands Radiology, Inc.* [1995], 106 Ohio App.3d 313. This case involved a restrictive covenant provision, among other issues, whereby an associate physician was precluded from admitting evidence regarding the employment relationship which was not covered in the employment agreement.

The agreement needs to survive its term so that the restrictive covenants/nondisclosure provisions remain in effect should the associate leave the practice.

There should be a promise that the associate is not currently a party to any prior employment agreement. In the event that the associate would be violating a restrictive covenant by joining a particular practice, the practice and/or the practice owner could be liable to the other practice or owner that the associate left for intentional interference with contract.

Employment Term

The employment agreement would commence on a certain date, provided that the associate is licensed to practice in the particular state. The employment term would continue until the earlier of a specified date or until provided in the termination provisions. Recently, a young specialist was asked to commit to a five year employment term where the incoming specialist could not quit. Fortunately, the young doctor chose another practice option. This was requested because the busy practice owner was concerned about locating another specialist if the young doctor would leave. Granted, the practice owner could not fire the young doctor, except for "cause". But what if one or the other doctor did not want to work with the other for whatever reason?

Associate Compensation

Associate compensation can and should be determined in advance of the hiring process through an analysis of what the practice can afford to pay with the owner(s) making a 5% to 15% administrative profit, in light of market conditions and whereby quality candidates may be difficult to locate in certain geographical areas. Market conditions currently provide for a relatively high level of compensation to both general dentists and specialists. Why? There will be a shortage of incoming doctors, particularly specialty practitioners.

As an example, let's say that the incoming doctor is overpaid. Assume that the practice owner earns 40% of gross revenues as owner compensation in all forms and agrees to pay the greater of: (a) \$7,000.00 per month; or (b) 35% of production. The associate receives credit for hygiene examinations, but not hygiene services or x-rays performed by the hygienist(s) of the practice. Assume further that the practice pays the associate's malpractice insurance, one-half of individual health insurance premiums and \$1,000.00 toward the cost of continuing education for each consecutive twelve months of the associateship. This seems like a fairly good compensation package for the associate. But how does the associate become an owner? The associate will not want to incur a reduction in pay to become an owner and there may not be a sufficient "spread" between owner compensation in all forms and the associate's compensation to allow for future ownership. Further, the practice owner may earn little, if any, administrative profit during the term of the associateship. What if the associate earns 28% or 30% of production? Then the practice owner will hopefully earn an administrative profit on the associate and a sufficient profit will hopefully be available to allow the associate to be elevated to ownership, pay for the ownership interest and not incur a reduction in pay. This assumes that the ownership interest is paid for within an agreed upon and measured period of time, e.g. five or seven years. Fortunately, this can be quantified based upon anticipated collections and practice overhead percentage.

What is an appropriate rate of compensation? The greater of a monthly base salary for a full-time associate or a daily or hourly rate for a part-time associate equal to 25% to 35% of "adjusted production" or collections for a general dentist and 30% to 45% of adjusted production or collections for a specialist. Another way to pay the associate is 25% of adjusted production, inclusive of all hygiene services. This should not be a "draw" unless you want to see a "sad" associate. Adjusted production means the associate's production, less write-offs, refunds, uncollectible accounts and/or laboratory remakes. Once predetermined production levels are consistently reached, the base salary becomes irrelevant, which may be in effect only for a limited period of time, e.g., 90 to 180 days.

If the practice owner and associate do agree to a "draw" against future collections, the parties, particularly the associate, should agree to a provision whereby the associate does not have to repay the draw should the associate leave the practice. Similarly, if the associate is paid on collections, the employment agreement should contain a provision that collections would continue to be paid for some period of time after the employment term ends and should also provide for a monthly "accounting" of those collections.

In a general practice, the methodology for payment of laboratory expenses should be delineated. For example, 35% of collections, less 35% of laboratory costs is different from collections, less 35% of laboratory costs, multiplied by 35%. It may be helpful to include any laboratory expense calculation, as well as any bonus calculation, as an example in a schedule to the agreement.

Bonuses are designed to economically reward work over and above the standards expected by the employer. In dental practices, bonuses usually take the form of a reward for exceeding a predetermined level of collection or productivity. Designing a bonus formula only based upon collections or productivity is one dimensional. Consider designing associate bonuses to measure and reward quality of work, effort, attitude, overall performance, yet consider the cash and financial position of the practice. In short, bonuses should be discretionary for associates. The associate should benefit from such a formula in that important criteria in addition to productivity, e.g., quality of services, are evaluated. Because the associate period is a time of mutual evaluation for both parties, the associate can and should assess the fairness of the practice owner and vice-versa. Design an evaluation form, evaluate the performance in writing and discuss the evaluation with the associate.

Employee's Duties And Responsibilities

This section defines the associate's work schedule, full or part-time, exclusive or non-exclusive employment, on-call time and the authority and responsibility of the practice owner for the activities of the associate/doctor.

Employee's Non-Disclosure and Non-Competition Promises

The non-disclosure promises specifically define "confidential information" such as patient lists/referral source lists, as well as practice forms, business and development plans and computer information. The associate may not retain or disclose this information which is owned by the practice to any outside party. The associate should be required to return any confidential information to the practice in the event that the employment terminates for any reason.

The non-competition promises provide that the associate may not compete with the practice during the term of employment or for a specified period of time thereafter within a specific geographic radius. A map rather than a mileage radius can be attached as an exhibit to the employment agreement that specifies the restricted area. Further, the associate may not, directly or indirectly (consider internet sites), solicit patients and/or referral sources of the practice and may not hire employees of the practice for a specified period of time after the employment terminates for any reason. In those states where permitted, this section should grant a court authority to redefine the restrictive covenant provisions in the event that the court considers the restrictions too broad.

The incoming doctor may negotiate with the practice owner that the restrictive covenant not commence for some period of time, e.g., six months. However, most practice owners, especially specialty practice owners, will not agree to this provision because they think it will dilute practice value should the new doctor quit. If the associate is from the geographical area where the practice is located, the parties may negotiate a buy-out of the restrictive covenant based upon the revenues generated by the associate, e.g., 40% of one year's gross revenues, with a minimum sum should the associate leave within a short time of starting.

Recent negotiations with a lawyer representing a new specialist where I represented the practice involved significant discussions about restrictive covenant provisions. First, counsel wanted a limited restricted area for the specialist. The radius or mapped-out area in a specialty practice is generally greater than in a general practice due to the wide area where the referral sources are located. My response was that the doctors need to agree upon the radius or mapped area so that the associate would not have to relocate should the relationship fail. Second, opposing counsel wanted the restrictive covenant eliminated should the employer terminate the relationship without "cause". The answer was no because the employer did not want to have to prove "cause" to terminate the relationship through an expensive and time consuming court proceeding. Third, the employment was part-time and opposing counsel wanted the associate to have the ability to work for another specialty practice within the restricted area. Again, the answer was no. Next, opposing counsel did not want any restrictive covenant for the first six months of the employment term. The answer was no because the associate could inspect the area demographics and easily open a practice, perhaps in an unoccupied space that previously was a dental practice for an inexpensive start-up. Finally, opposing counsel wanted the young specialist to retain the ability to solicit referral sources and patients of the employer from outside the restricted area should the relationship terminate for any reason. This would dilute the value of the employer's practice and the answer was no.

Vacation and Other Time-Off

These provisions provide for vacation time-off, with or without compensation, for each consecutive calendar year or twelve months of the employment term. The time-off may also be non-cumulative and forfeited if not taken within the applicable twelve monthly period. Further, the time-off may not interfere with the time-off scheduled for the practice owner.

Educational time-off may be granted by the employer, with or without compensation, for the associate's attendance at meetings, conventions, seminars, and/or post-graduate courses reasonably related to the associate's duties and obligations under the employment agreement, provided that the time-off is approved, in advance, by the practice.

Other time-off may be granted and paid or unpaid. Other time-off would include military reserve duty, pregnancy leave, time to study for board certifications, moving or relocation time-off, specified holidays, illness or sick days, jury duty or sabbatical time-off.

Fringe Benefits, Expenses and Insurance

The fringe benefits, expenses and insurance provisions provide for any fringe benefits, expenses and/or insurances, health and professional liability, either paid by the practice or the associate during each consecutive twelve month period or calendar year of the employment term. The associate's compensation may be reduced by some portion or all of the cost of the specific benefit, expense or insurance.

Prohibition Against Transfer

Prohibition against transfer provides that the associate cannot assign the associate's duties and responsibilities under the employment agreement to another. Without these provisions, the associate could "arguably" assign the associate's non-disclosure/non-competition promises to another.

Termination of Employment

Termination by notice allows either the practice or associate to terminate the employment relationship with advance notice, e.g. 30, 60 or 90 days. Unfortunately, sometimes the notice period is longer for the associate than for the employer. However, if the practice terminates the employment term and does not desire for the associate to continue to render professional services, the employment agreement may provide that the associate will not be permitted to continue to work, subject to patient abandonment concerns, and will be paid at a predetermined rate with benefits during any notice period. If the associate is compensated as a percentage of "adjusted production" or collections, the notice period compensation may equal the average monthly compensation for the three month period immediately preceding the termination of employment or a specified sum for each month of the notice period. Finally, these provisions should provide for the period of time that any accrued compensation and/or bonus will be paid, e.g., 90 days, along with a delineation of any accounting to be provided on a monthly basis to the former associate. The associate should be employed on the last day of the calendar or fiscal year to be eligible for any bonus.

In the event of the associate's death or disability, the practice should retain the option to terminate the employment term. Disability would mean any physical or mental condition resulting from accident or illness which would be reasonably expected to prevent the associate from performing the associate's profession for more than a specified period of time, e.g., one year. The process of selection of the physician should also be delineated in the agreement.

Breach by the associate-employee "for cause" should grant the practice with the option to immediately terminate the employment term without notice. Such a provision may read as follows: "notwithstanding any other provision of this Agreement, Employer may immediately terminate the Employment Term at any time and without prior demand or notice if: (a) Employee fails to perform, for any reason, any of Employee's obligations, duties, promises or representations; or (b) Employee commits a crime against Employer, or any of the Officers, Directors, employees, patients or agents of Employer; or (c) Employee commits any other crime, except a minor traffic violation, or any act involving fraud, dishonesty or moral turpitude; or (d) Employee fails to follow any employment directive or policy issued by Corporation." The point here is, "for cause" termination should be defined and negotiated by the parties prior to the employment agreement being signed. Item (d), or others, may include a "cure" period, e.g., 30 days.

Should the practice materially breach any of its promises to the associate, the associate should have the ability to terminate the employment term without notice.

The practice should also retain the ability to terminate the employment term without notice in the event that the associate is suspended or disqualified from practicing dentistry or the associate's specialty. This provision may provide that the suspension or disqualification last longer than a specified period of time period, e.g., 30 days.

Finally, the practice may retain a discretionary termination option which would terminate the employment term without prior demand or notice in the sole discretion of the practice. Such a provision is typically in effect for the first 90 to 180 days of the employment term.

Indemnification and Contribution

An indemnification provision provides that the associate will "hold harmless" the practice and practice owner(s) as from any liability created by the associate relative to the associate's employment with the practice. The employee may request a reciprocal provision from the practice and practice owner(s).

Miscellaneous

This section provides for the application of the laws of a particular state in the event of a dispute and provides the place where the dispute will be decided. It also provides for any revisions or modifications to the agreement to be in writing.

Equity Purchase Provision

This section may be included to provide that upon meeting predetermined quality and performance standards or sometimes on or before a specified date, the associate would have the option to acquire an interest in the practice, assuming that the associate remains employed at such time. The purchase price, payment terms, business and tax structure of the transaction should be specifically delineated. The equity provisions where "partnership" is offered should be contingent upon the associate entering into a mutually agreeable: (a) owner employment agreement; (b) close corporation, shareholder or operating agreement defining decision making control or "founder's rights" in the event of a voting deadlock or dispute; and (c) buy-sell agreement(s), providing for the obligation or option of the other owner(s) or practice to acquire the interest of the departing owner in the event of death, permanent disability, retirement, dispute or other termination of employment. The equity provision may also take the form of a freestanding option agreement with the corresponding agreements as schedules. The equity provision may be in the form of a detailed letter of understanding, which outlines the key provisions of any contemplated ownership.

The practice owner may consider a buy-sell agreement with the associate in the event of the owner's death or permanent disability. Insurance should be considered as a funding mechanism, subject to health, cost and availability. In the event of a catastrophe, the practice owner and his or her family members won't have to negotiate the sale of the practice under adverse circumstances. From the associate's perspective, he or she should understand that the deceased or permanently disabled doctor's practice won't be sold to another.

Retiring Doctor

Where a retiring "partner" contemplates becoming an associate, the post-retirement employment agreement should be prepared as part of the "partnership" agreements. Otherwise, negotiating the terms of post-retirement employment or whether employment will be offered may be very difficult.

Where a dentist sells his or her practice outright, the post-closing employment agreement should distinguish between the performance of professional services and introductory services on a specified schedule, e.g., not to exceed 20 hours per week. While the former owner would agree to remain employed by the practice for some period of time, e.g., six months, the purchaser should retain the ability to terminate the relationship should the services of the selling dentist no longer be needed. If you, as the selling dentist, need to remain employed in the practice, don't sell it!

Final Thoughts

Failed employment relationships are costly for both the employer and employee. A thorough understanding of the relationship through a signed employment agreement minimizes unmet expectations.