Asset Protection and Lawsuit Prevention

When the Marriott Corporation split itself into two separate corporations in the early 1990s, it did so to divide cash-rich assets from its lawsuit-prone operations. Business pundits approvingly dubbed the divided corporations "good Marriott, bad Marriott." That's a lesson dentists can take to the bank.

All over the country, corporations and professionals alike are finding it pays to set up multiple legal entities to diversify their risk of civil litigation. One Colorado ski resort recently set up six separate corporations: one for each ski run. A New York City cab agency that owned 40 taxi cabs set up 20 corporations: each owns two taxi cabs. Should dentists do the same?

Application for dentists

While most dentists will not be sued as often as global hotel chains, plaintiffs are winning million-dollar judgments against dentists. Cases involving allergic reactions to anesthesia, failure to diagnose ailments, and procedures resulting in permanent nerve damage have produced significant judgments.

And lawsuits against dentists unrelated to dental care can be just as real (slip, trip, and fall lawsuits; wrongful termination lawsuits, sexual harassment, and discrimination claims). In today's litigious environment, one would think that few dentists would be shortsighted enough to operate as sole proprietorships or general partnerships, leaving themselves personally liable for a judgment.

However, an American Dental Association survey in 2001 found that more than 50 percent of dentists were practicing without the benefit of legal structures and were left vulnerable to a host of non-medical liabilities. If 50 percent of U.S. dentists practice as sole proprietorships, they are personally exposed to unlimited legal liability in their business operations. Being in business without legal protection is like driving a car without seatbelts — you just shouldn't do it.

What might not be obvious to the other 50 percent of dentists is that operating under just one all-inclusive legal identity — such as a professional corporation, or PC, a professional association, or PA, a C-corp, an Scorp, a limited liability company — could be just as risky. I knew one doctor who had more than $2 million in his professional corporation's accounts receivable. Another dentist told me he held almost $1 million worth of real estate owned by his professional corporation. One lawsuit against these professional corporations could result in a total loss of the corporation's assets.

Wall Street corporations have learned that if their business assets are carelessly lumped together with their business operations in one legal entity, they risk losing everything in one lawsuit.

The new rule of lawsuit protection is simple: Keep your business assets separate from your business operations. This means that cash-rich assets such as buildings and land should be kept in separate legal entities, such as limited partnerships. Otherwise, one lawsuit against a dentist can drain his or her corporation entirely. Instead, professional corporations should own as few assets as possible so they do not become a target of litigation.

There is no right or wrong way to diversify. There are many variables to consider: How many dentists participate in the practice? Are the building and land owned or leased? What is the value of the professional equipment? Following are some general principles dentists can use to protect themselves from lawsuits directed at either the practice or the dentist specifically.

Legally separate dentists

Some time ago, a dental office in the Midwest had five dentists working together with no legal distinction between their practices. One of the dentists administered nitrous oxide to a child patient who experienced a severe allergic reaction and died before the medics could get him to the emergency room. Although only one dentist was responsible, all five dentists were included in the malpractice lawsuit.

Two or more dentists working in a single practice each should have a separate PC or PA. Otherwise, a lawsuit against one dentist can subject all other dentists in the practice to liability.

Legally separate the property from the practice

If you own land, buildings, or both, talk to your legal advisor about holding them in a distinct legal entity from your dental practice. If the same corporation owns property and operates the business, both are jeopardized by one lawsuit. Just as Marriott divided its assets into two corporations, you can limit what assets are exposed to a lawsuit by dividing your real property from your professional practice.

My entity of choice for holding assets is a limited partnership, or LP. Your LP then leases the land, building, or dental equipment it owns to your professional practice corporation. Your professional practice corporation now owns no assets, but functions as your operating company: it employs your employees, pays expenses, bills insurance companies, and collects fees. Now, when a patient sues your professional corporation, it has no assets to be seized in the lawsuit.

Legally separate equipment from practice

Depending on the value of the equipment in your practice, you might want to use the same principle in owning your office equipment. If everything from the lobby chairs to the digital X-ray machine is owned by your LP and leased to the practice, then all of your business assets are insulated from lawsuits. With the fast rate at which dental equipment traditionally depreciates, however, smaller offices may find this unnecessary.

Let's say a dental office owns $200,000 in new equipment. That year, a lawsuit against the dental practice forces a sale of the dental equipment to pay the judgment. One lawsuit effectively shuts down the dental practice. In a different scenario, let's say the same dental practice is sued, but this time all of its assets are owned by a separate entity — your limited partnership. Under this scenario, a plaintiff's attorney cannot touch the business assets. If the dental corporation is shut down, the dentist is free to reopen under a different corporation and lease all the same equipment back to the new practice without losing a cent.

Legally separate family life from the practice

"Too many dentists operate their practices like a family business," says Dr. Larry Caplin, CEO of National Dental Company, a professional services organization that assists dentists in setting up their business operations. Having advised thousands of dentists on setting up their business and legal structures, Caplin observes that this area "trips up" more dentists than any other.

"If dentists want to have corporations, they need to run them like corporations. This means yearly meetings of corporate officers. It means minutes are recorded and filed at all meetings. And above all, it means spouses cannot go grocery shopping with the corporation's checkbook." Dr. Caplin is dead on. Courts can "pierce the corporate veil" all too easily when dentists are lazy about attending to the details of their PCs.

In case after case, dentists open themselves up for trouble when they mingle their family finances with their dental business. I knew of one dentist who sometimes treated patients in his home. This is legal suicide in the case of a lawsuit.

Also, remember that liability insurance is not perfect. Judgments may not be entirely covered by insurance policies because of payout caps or exclusions. Consider Dr. Schreiner, whose insurance carrier decided that a lawsuit filed against him fell under a policy exclusion. This Wisconsin oral surgeon was held personally responsible for more than $300,000 in a judgment. The lesson is clear: Although you may faithfully pay your malpractice premiums, nevertheless, you could have to pay a large judgment with your personal assets.

In the past, dentists sometimes tried to protect their homes from lawsuits by deeding it to their spouses. But courts now consider deeding your house to your spouse in response to a lawsuit to be a form of fraud in most states. For this reason, a growing number of dentists title their homes, savings accounts, and investments to separate legal entities. Much like dividing land and buildings from a dental practice, some dentists wisely title their family assets to trusts, limited partnerships, or corporations. If your home is owned by a correctly drafted legal entity, it is much harder for a court to seize.

Some forms of ownership, such as the LP, even can serve as a deterrent from lawsuits ever being filed against you. An LP includes wording that not only makes assets held in the partnership almost impossible to seize, but also may require the plaintiffs to pay the taxes on these items. I have had some of the top plaintiff attorneys in the country tell me that if a limited partnership is discovered during pretrial investigations, they will drop the lawsuit immediately.

The principles are simple

First, divide your business assets from your business operations. Review carefully the nature of your business and professional activities. Can you logically divide the business or professional activity into two or more separate entities? For example, why does the dental practice have to include the laboratory? Why can't the A/R be kept separate from the PC? Why must your PC also own your office? Dividing the ownership of your assets can literally save them when a lawsuit strikes.

Second, keep your personal life separate from your professional life. If private and professional assets are mixed, both are made vulnerable in lawsuits. Third, structure yourself to withstand litigation before a lawsuit occurs. Any steps to rearrange your assets after a potential lawsuit occurs can be ruled fraudulent by the courts. Using asset-protection principles before a problem arises, however, is seen as smart and strategic. The same measures taken after a lawsuit-prone incident occurs can be ruled evasive and fraudulent.

As you restructure your assets, make sure your lawyer is fully versed in modern asset-protection principles. Statistically, less than one-tenth of 1 percent of all lawyers even claim to specialize in this area. Asset protection has become too vitally important for today's professionals to leave to chance. Few professionals have as much to gain from asset protection as private-practice dentists today operating with both business and malpractice liabilities. Dentists are realizing that they can use the legal system to protect themselves instead of being abused by it.

ABOUT THE AMERICAN SOCIETY FOR ASSET PROTECTION (ASAP)

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To receive a free video presentation on DVD and audio presentation on CD that presents additional asset-protection strategies, please send an email to the American Society for Asset Protection (info@americansocietyap.org) and provide the following information:

1. Your first and last name
2. Mailing address where the CD and DVD can be sent

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