Protecting Assets

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To engage in Exit Planning, you must have a business to exit. Exit Planning assumes that the better the business, the easier and more successful the exit. Exit Planning also assumes that good businesses are not only profitable and well managed, but that they are protected from liability risks. Failing to protect your business value from legal liabilities is a fundamental Exit Planning failure.

Joe Smith was worried, although you would have thought he'd be thrilled. He'd just watched his biggest competitor go out of business after unsuccessfully fighting a multiple plaintiff employment discrimination lawsuit. His worry about protecting his assets prompted our meeting. Joe wanted to know how to protect, not just his personal assets but, most importantly, the business's assets. Like most owners, Joe's business comprised the bulk of his personal net worth. If he lost the business, he'd lose most everything. I confirmed Joe's worst suspicions, "You're a smart businessman, but you expose your company's entire net worth to every risk."

Joe responded a bit defensively, "What do you mean? I run a tight ship. Sure, I have a lot of business risk, but my business is a corporation. Doesn't that give me liability protection?"

I explained that indeed, operating as a corporation provides a layer of personal protection but 80 percent of Joe's wealth was concentrated in his business. "If creditors take the business assets, you're left with very little. Let's work to protect both your personal and your business assets."

Joe is hardly the exception: many, if not most, business owners expose their assets to annihilation by a successful lawsuit. In Joe's case, the bulk of the company's net worth, represented by an inventory of $5 million could be insulated from the operational liabilities.

Here's what Joe did to accomplish that insulation. Check with your tax and legal advisors to see if this particular strategy is appropriate for your situation.

First, we separated the operation of Joe's business from its assets. Or, we severed that part of the business likeliest to create liability exposure (operations) from the bulk of the business's net worth (the inventory, cash, trade secrets, etc.). To accomplish this, we retained the existing corporate shell and formed a new, Limited Liability Company (LLC). In the LLC resided the operations of the company. As its name implies, an LLC generally limits liability for acts of the LLC to the assets of the LLC. The bulk of Joe's business assets (remaining in the original corporation) are thus protected. They aren't part of the LLC, therefore they cannot be attacked for any actions of the LLC.

Second, we removed Joe's personal guarantees from every lease, promissory note, and financing agreement. While Joe's guarantee had been vital during his start up years, we were able to negotiate its removal with most of Joe's lenders.

Third, Joe's insurance advisor initiated a full review of Joe's casualty and liability coverage. We scheduled a subsequent meeting with all of Joe's advisors to discuss the insurance advisor's findings and recommendations.

Finally, we amended Joe's Fiscal Year End agenda to include the discussion of offshore trusts and lowest defensible value. Specifically, Joe's accountant was charged with the task of providing a valuation to Joe's team of advisors at the upcoming fiscal year end meeting so that we could discuss additional asset protection measures.