

Managing Risk: Building and Preserving Wealth

~ James-Allen McPheeters

Though admittedly an oversimplification, from a particular angle, we can view life as an exercise in recognizing and effectively managing risk. On some level, we all understand this, whether the risks that we are managing are known risks—either known opportunities or known problems—or the unknown risks of unexpected occurrences. Much of what we do as attorneys and counselors of law is to help clients understand and manage risk.

A number of previous *Requisite* articles have focused on managing and addressing risks in specific situations. For example, John Wagner’s article, “Real Estate Joint Ventures: Considerations for Passive Investors” in *Requisite II*, considered the risks faced by passive investors in real estate; Lewis Hall’s article, “Protecting Your Interests in a Deadlocked or Mismanaged LLC” in *Requisite III*, addressed risks faced by an owner of a business entity when disputes with other owners occur; and Elizabeth Stamoulis’s article, “Intellectual Property Protection Abroad: What You Don’t Know Can Hurt You” in *Requisite V*, discussed the risks associated with a business’s protection of its intellectual property. While these articles and others in our *Requisite* series focus on managing risk in specific situations in which our clients often find themselves, it is worthwhile to consider broadly how to structure assets to manage risks as one builds and preserves wealth.

The phrase that may come to mind at this point is “asset protection.” But all too often, the concept of asset protection is something to which people cast their minds only when they are about to be sued or when a judgment against them is imminent. Those situations, which, as discussed below, may raise fraudulent transfer issues, require special thought and consideration that is beyond the scope of this article. Because the concepts involved in managing risks to build and preserve wealth span a number of areas of law—real estate, business, tax, estate planning, and debtor-creditor issues—the purpose of this article is to broadly identify issues to consider as you build and preserve wealth.

Take Stock of and Understand Your Assets and Your Risk

The first step in managing risk in this context is taking the time to list your assets and consider what known risks you face, or what unknown risks you might face, by virtue of your assets or your lifestyle. Look at how your assets are titled or owned. Do you have assets that inherently carry a greater amount of risk than others? Does either your lifestyle or your occupation subject you to a high level of risk? When considering the risks associated with your assets, be realistic not only about the probability that a risk will become a problem, but also about the actual impact that any problem may have on you and your assets.

Lawsuits and Judgments

The main concern people articulate in considering known and unknown risks to their assets is what happens if they get sued or if a judgment is entered against them or a business in which they have an ownership interest. In the context of an actual lawsuit, the answers to those questions depend on a number of very specific facts. However, in the absence of the specific facts of an actual lawsuit, there are a number of concepts you should keep in mind when evaluating general concerns regarding lawsuits and judgments.

Among the first steps you should follow after identifying a specific risk or concern is identifying (1) who would be the defendant in the event of a lawsuit and (2) what would be the reason or basis of the lawsuit. Once you identify the defendant and the basis of the hypothetical lawsuit, you will be able to walk through a series of questions to start evaluating your risk. For example: Would you be sued individually, such that some of your personal assets may be at risk? Would the lawsuit be against only a company owned by you where corporate formalities have been properly observed, such that only the company's assets are vulnerable to a judgment? Is there insurance that would cover any judgment or loss incurred by you or your company? Are there indemnifications in place that would compensate you or your company for any judgment or loss that may occur?

When asking yourself these questions and considering potential risks to your assets in the event of a lawsuit or judgment, it is helpful to keep in mind the practical and legal process through which a risk turns into a problem and results in a judgment. Though every situation varies, the process of a contested lawsuit generally proceeds as follows: (1) Something occurs to cause a known or unknown risk to become an actual problem that forms the legal basis for a lawsuit (for example, a car accident or a business dispute). (2) The problem rises to the level that

the prospective plaintiff sends the prospective defendant a demand letter or otherwise notifies the defendant that unless the plaintiff's demands are met, litigation will ensue. (3) The plaintiff moves forward with the filing of a lawsuit against the defendant. (4) The lawsuit survives potential motions to dismiss, motions for summary judgment, and defenses asserted by the defendant. (5) The court rules and enters judgment against the defendant. (6) Finally, the plaintiff executes on the judgment and attempts to collect money from the defendant.

While no one relishes the prospect of going through these steps—or spending the money to defend a lawsuit—it is important to keep these steps in mind when evaluating your risks and considering not only whether a risk will actually mature from a concern into an actual problem with a legal basis for a lawsuit, but also whether a lawsuit will result in the execution and collection of a judgment.

It is worth noting here that in instances where insurance proceeds apply, the risk exposure of concern is not the amount of the judgment a plaintiff obtains, but the amount of the judgment less any applicable insurance proceeds. It is also important to note that throughout the process outlined above, there may be multiple opportunities to address or settle the problem before it proceeds to a point where a plaintiff is empowered to execute and collect on a judgment against the defendant.

Titling of Assets/Exemptions

In looking at your assets and assessing risk, it is helpful to think of your assets in two basic groupings: (1) assets as the cause, or the subject, of liability risks or lawsuits; and (2) assets that are available to satisfy the claims of creditors as a result of a lawsuit or judgment. Similar to overlapping circles in a Venn diagram, specific assets may fall within both groupings, depending on the particular situation. How your assets are titled or owned, and how they fit into these two groupings, will dictate the level of risk associated with each asset.

Take, for instance, real property owned as an investment. Depending on the type of property—whether it is rental property or simply raw land—the property will inherently carry a greater or lesser degree of liability risk. And depending on whether you own the property in your individual name, as tenants by the entireties with your spouse, or through a business entity, you will have varying degrees of risk of (1) a lawsuit associated with the property putting your other assets at risk and (2) whether your interest in the property can be used to satisfy judgments or creditors that are unrelated to the property.

Florida recognizes a number of types of property ownership for personal property and real property, as well as a number of protections that may preclude, or exempt, a person's creditors from looking to certain assets to collect on a judgment. These protections, commonly referred to as "exemptions," include (1) homestead protections for a Florida resident's primary residence, (2) protections for real and personal property owned by spouses as tenants by the entireties, (3) protections for life insurance and annuity contracts, (4) protections for certain types of retirement or profit-sharing plans, and (5) protections for certain education and medical savings accounts.

By being thoughtful about the assets you own, how you own those assets, and the possible exemptions that may apply to those assets, you are better able to build and preserve wealth. Michael Hartenstine's article, "Protecting Your Assets Under Florida Homestead Exemption" in *Requisite IX*, provides a good example of the thought process and considerations surrounding the protections provided to one of Florida's most well-known protections: a Florida resident's homestead. Another protection of which to be mindful in looking at your assets is the protection Florida affords to spouses who own real or personal property as tenants by the entireties. When properly structured, tenants by the entireties property is generally protected from the individual creditors of a single spouse. Though it may not be advisable for spouses to own assets that have a high degree of liability risk as tenants by the entireties, in combination with spouses owning assets individually and other types of property ownership and exemptions, the creditor protection afforded to property owned as tenants by the entireties under Florida law can be significant in managing risk to build and preserve wealth.

Liability Insurance

When looking at your assets and considering the issues outlined above, keep in mind the ability to reduce risk and exposure to liability through automobile, homeowner, general liability, and umbrella insurance policies. To the extent applicable to your individual assets, each of these policies, as well as your insurance agent, is an important part of managing risk to build and preserve wealth. Make sure to read your insurance policies and ask your insurance agent questions so you are clear about (1) what risks are covered, (2) the amount of coverage for specific risks or claims, (3) whether the policy provides coverage for incidents that occurred during the term of the policy (known as an occurrence policy) or whether the policy provides coverage for claims made while the policy is in effect (known as a claims made policy), (4) whether the policy includes an obligation on the part of the insurer to provide you a defense to claims made,

(5) what notifications you have to give your insurance company in the event of a claim, and (6) specific actions that may void coverage under your policy. Though it is unlikely that you will totally eliminate risk, by integrating the appropriate liability insurance into your considerations regarding what assets you own and how you own them, you will be better equipped to manage risk.

Fraudulent Transfers

While the concepts in this article concern real estate, business, tax, estate planning, and debtor-creditor issues—each of which may implicate valid planning issues—in certain circumstances, where a debtor transfers assets to another party or converts nonexempt assets into exempt assets for the purpose of avoiding creditors, the transfer of the assets can be set aside. Among the transfers that can be set aside under Florida’s Fraudulent Transfers Acts are transfers (1) where a debtor transfers an asset with the actual intent to hinder, delay, or defraud a creditor; or (2) where a debtor transfers an asset for inadequate value at a time when the debtor was insolvent or was about to become insolvent. Though the nuances of fraudulent transfers and what options people have when they are about to be sued or a judgment is imminent are outside the scope of this article, we cannot overstate the importance of looking at your assets and implementing real estate, business, tax, estate, and debtor-creditor planning concepts to manage risk prior to the occurrence of facts that would support a fraudulent transfer claim.



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