

## VIEWPOINT

**The Ethics And Practice Of Asset Protection***By Lee Goldberg and Keith Northern, NachmanHaysBrownstein Inc.***Calamity is the test of integrity.***Samuel Richardson, 18th century English novelist**Lee Goldberg**Keith Northern*

One of a series of opinion columns by bankruptcy industry participants

**R**estructuring professionals often encounter a business owner who, after having signed a personal guaranty, now finds his business in default of loan agreements. Facing foreclosure, the panicked owner seeks to transfer or carve out personal assets, not realizing he couldn't have picked a worse time to try to protect his personal assets.

When a company is in bankruptcy, asset transfers are subject to intense scrutiny from lenders and creditors, as well as the U.S. trustee. Expert guidance is needed to develop an asset-protection plan that can withstand this scrutiny.

When a bank (or other lender) takes a security interest in a company's assets and requests that the owner sign a personal guaranty, the owner fully expects that, in the event the company defaults or is unable to repay the loan from operating cash flow, the lender will be paid out of the company's assets, not from pursuing its rights under the owner's personal guaranty. The lender, on the other hand, fully expects that payment in full will be obtained from the owner under the personal guaranty. Further, the lender usually has the right, under its documentation, to pursue both remedies simultaneously.

A business owner who has concerns about personal real estate or other assets should plan ahead and transfer assets into a separate legal entity. This should be done well in advance of preparing and signing a personal guaranty. Business owners who fail to adequately plan for asset protection and decide to transfer personal assets well after the personal guaranty has been prepared and signed may be sued to enforce the guarantee.

**What Asset Protection Is And Isn't**

In seeking to shield assets, guarantors must confront potential ethical and legal conflicts. Asset protection segregates and structures ownership of an individual's assets in a way that is both legal and ethical and that provides protection of current wealth from unforeseen future creditors. Asset protection isn't a way to hide assets or income, nor should it be viewed as a quick fix to shield personal assets from creditors.

A successful asset-protection plan takes a long-term approach to structuring the business owner's assets in a way that allows the owner to retain personal assets in the event of a creditor attack. The goal of an asset-protection plan is to make it impossible, or at least extremely difficult, for creditors to seize the client's assets, while bearing in mind that creditors or other parties-in-interest may challenge the plan. The court may unwind any plan shown to delay or hinder the collection of a debt via asset transfers, and order the assets or a reasonably equivalent value to be returned to the debtor and/or paid over to the creditor.

Effective asset-protection plans require the legal and organizational structuring typically reserved for estate and tax minimization purposes. Competent professionals should be retained to ensure proper structuring and compliance with the applicable state and federal laws. Consideration also must be given to assets that aren't currently in dispute or may be required to satisfy existing or reasonably foreseeable claims from creditors.

The U.S. Bankruptcy Code provides specific protections for a debtor's assets, such as homestead and retirement plan exemptions, but most asset-protection plans need to be structured well in advance of any creditor asserting a claim. The purpose, intent and solvency of asset-protection plans must be well documented to survive a challenge by creditors.

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## **Rules of Engagement: The 2005 Bankruptcy Act Effect**

The rules for asset protection changed when the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 was enacted. As a result of the act, the bankruptcy code offers a minimal amount of asset protection. The provisions of the act reduce time for the assumption, rejection and assignment of leases; assure payments to utilities; shorten exclusivity periods; limit court discretion in conversions to Chapter 7; increase reclamation rights for vendors; and limit executive compensation. The pendulum has swung in favor of creditors, creating additional considerations for debtors and bankruptcy practitioners.

Non-bankruptcy alternatives that might have been criticized a year ago are now more attractive because of the new rules of engagement under the bankruptcy act. Non-bankruptcy alternatives may include consensual workout, Uniform Commercial Code sale, assignment for the benefit of creditors and state or federal receivership. All of these, to varying degrees, may be more permissive and forgiving than bankruptcy after the 2005 act.

## **Rules of Engagement: Professional Standards**

Restructuring professionals are bound by rules of conduct such as the Turnaround Management Association Code of Ethics and rules of civil procedure. Therefore, care must be taken when determining how best to protect a client's assets and what type of asset protection should be pursued, if any.

Bankruptcy puts restructuring professionals, as well as the owners, officers and directors of the companies they represent, under a microscope and in the spotlight. Transactions that involve personal benefit or aren't arm's length receive special scrutiny and can give rise to rescission of the transaction, disgorgement of fees, and other sanctions, or even criminal prosecution. Transactions that are seen to hinder, delay or defraud creditors are especially troublesome. Restructuring professionals can easily be tarred with the same brush as the company if they aren't careful. Mistakes can lead to accusations, whether true or not, of ethical or legal violations. Various standards of the TMA Code of Ethics might get called into play in such situations.

## **Plan Development**

Asset-protection planning should be part of a financial, estate and tax-planning strategy. In particular, the development of an asset-protection plan requires thorough documentation. Financial statements will provide an accurate picture of the company's financial position at the plan's inception as well as potential future claims against the assets. Having a well-documented plan significantly increases the likelihood of prevailing over challenges by creditors.

A distressed business owner who has signed a personal guaranty is in the midst of a calamity. Restructuring professionals can respond to the calamity by offering to review a personal asset-protection plan to determine if it passes the company's integrity test.

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*(Opinions expressed are those of the author or authors, not of Dow Jones Newsletters.)*

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