How to Stop a Frivolous Lawsuit From Sinking Your Business

You may think you are protected from a frivolous lawsuit, but remember the McDonald's hot coffee case?

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What would happen if you were sued?

Now, you might say there's no reason for someone to sue you. And while there might not be a legitimate reason, business owners are sued all the time. Just because a lawsuit is unfounded doesn't mean you won't find yourself in the middle of one. What's more, lawsuits can be stressful and financially disastrous — even if you did nothing wrong.

The way to mitigate the possibility of being sued — as well as the longer-term impact of an undeserved lawsuit — is through a formal process of asset protection planning.

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Asset protection planning is pre-litigation risk management intended to deter and discourage lawsuits in the first place. If that's not possible, asset protection planning seeks to get your creditors to agree to a settlement you find favorable — leaving them with less than they sought to get.

You're probably already taking steps that protect your assets

from the impact of litigation, but many entrepreneurs fail to do so in a holistic way, with an asset protection plan that is far-reaching. With that in mind, here's a look at how you might design a comprehensive plan to shield assets.

Start with liability insurance

The most cost-effective form of asset protection is good liability coverage for your business and yourself. But while business owners often have liability insurance, many tend to not have the right kind in the right amount. That's because liability insurance isn't something most entrepreneurs pay close attention to. They get some, check it off their financial to-do list, and move on. That's the case with other types of insurance, too.

For example, business owners usually make sure they have commercial liability coverage, but often don't realize that their businesses can be devastated if they are involved in a personal lawsuit.

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One possible solution is a personal umbrella policy, which is generally the most inexpensive way to protect your personal wealth, including your business. But many entrepreneurs — especially highly successful ones — are underinsured, or their policies don't cover them adequately. The reason: Many insurance companies cap the size of their umbrella policies at $5 million, and any serious accident will likely cost more. "If the business owner's net worth including his or her share of the company is greater than $5 million, there can be serious consequences. The answer, in that case, is a larger umbrella policy," says Joseph Weiss, a leading authority on liability insurance with Bruce Gendelman Insurance Services.

Legal strategies for frivolous lawsuits

Once you're certain you've got the appropriate liability coverage in place for your business and yourself, there are a number of legal strategies you can employ to further insulate your wealth from frivolous lawsuits.

One option to consider is an asset protection trust. Assets in this type of trust are generally out of reach of creditors. But, warns Peter Sasaki, Managing Member of SDS Family Office, "the rules governing these trusts vary greatly depending on the jurisdiction you select. Understanding the specifics of the jurisdiction is therefore critical."

You might also consider establishing various types of corporate entities to insulate different assets. For example, if you have multiple companies, it's usually a good idea to put them in separate corporate structures. That way, a lawsuit tied to one of the companies will not affect the others. This is a commonly used strategy in the real estate business, where every property is placed in its own corporate entity.

The best legal approach will depend on the specifics of each scenario, of course, but the good news is that you probably have a number of options that could help protect and shield your assets.

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Work with a talented professional

The most potent asset protection plans are never even contested. Creditors throw up their hands and litigation is avoided, or everything is settled before there are any judgments. However, creating an asset protection plan like

this can be problematic. There are strategies that work but many that don’t, so knowing what’s viable in any situation is crucial.

Unfortunately, far too many legal and financial professionals aren’t in a position to provide guidance on – and implementation of – many effective asset protection solutions. “There are some so-called professionals pitching very questionable and sometimes outright illegal asset protection strategies,” notes Edward Renn, a senior partner at Withers Bergman, a leading international authority on asset protection planning. “What’s essential is that business owners clearly understand the steps being taken to protect their wealth and that they are comfortable with the likely outcomes in case of a lawsuit.”

Ultimately, you probably need an asset protection plan to help ensure your business and you are not financially crippled by dubious lawsuits. But tread carefully, and get guidance only from professionals whom you trust and who have impeccable reputations.

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