strategies

Why Not Just Insurance?

This article discusses various asset protection planning strategies, including the need for insurance. This article also discusses certain nuances under state law regarding gifting to a spouse, professional corporations, retirement plans and certain state exemptions.

Background

In many cases, various forms of insurance will be sufficient to cover some and perhaps all of the many types of claims that a physician or surgeon may encounter. However, what if they are not? Are you willing to risk everything you have worked for under any of the following real life situations?

Take the case of the plastic surgeon that never had a claim for malpractice in ten years of his practice. He carried $5 million of malpractice insurance. After the recent research developments regarding breast implants were disclosed, he was subject to twenty-seven malpractice claims within a six-month period. The plastic surgeon's $5 million dollar policy would not even begin to cover a fraction of the anticipated liability.

Unfortunately, malpractice judgments exceeding the amount of insurance coverage are not an unusual circumstance. Most physicians or surgeons carry $1 million to $2 million in malpractice insurance. However, awards have been in excess of these limits since 1999 when the "average jury awards for malpractice rose to $3.49 million" (New York Times, 9-13-01) and it has continued to increase every year thereafter. In recent malpractice cases, juries have made the following awards:

- $606 million for the family of a Texas man who died from a chemotherapy overdose which was the largest medical award of 2005.
- $212.58 million for a brain injury to a newborn during a vaginal birth after Caesarean. This was the second largest med mal verdict of 2005.
- $111.7 million dollars - and no punitive damages were included! (*Reden v. Wagner*, NY Jan 26, 2004). This was the largest medical verdict of 2004.
- $94.8 million against two hospitals and three doctors for a premature baby who developed cerebral palsy. The three doctors were primarily liable. This was the largest med mal award in 2002 but was only the 25th of the top 100 verdicts. *Perez v. St. John's Episcopal Hospital et.al.*, No. 26675/96 (Kings Co., N.Y., Sup. Ct.)
- $90.94 million for a brain-injured baby girl. The jury only awarded $760,000 for pain and suffering, $2 million for future income and the remainder for care of the child. *Wise v. McCalla*, No. 35110/99 (Kings Co., N.Y., Sup. Ct.) (12/2/02)
- $30 million against an obstetrician (*Bryant v. LaGrange Memorial Hospital*, No. 96L11679 (Cook Co. Ill., Cir. Ct.))
- $22.6 million in January for a taxi driver whose legs were amputated as the result of heart surgery complications. Verdict was against Rush-Presbyterian St. Luke's Hospital in Chicago and two doctors, Timothy James and Elaine Winkel.
- $3.7 million for misdiagnosis of lung cancer for a 64-year-old smoker (*Birbeck v. Central Brooklyn Medical Group P.C.*, No. 4598/97 (Kings Co. N.Y., Sup. Ct..))
- $1.6 million for failure to fully inform a 53-year old decedent for proper follow-up with a cardiologist (*Labanca v. Hamden Internal Medical Associates*, No. 96-0388716S (New Haven Co. Conn., Super. Ct.))
- $6.5 million for administering wrong medication to a 10-year-old boy resulting in brain damage. (*Reben v. Ely, 146 Ariz. 309, App 1985*)
- $78.5 million for misdiagnosing a woman's liver tumor as a gallbladder attack. Shellow-McGee v. Orlando Regional Health Care System Inc., No. CI-000-4009 (Orange Co., Fla., Cir. Ct. (Decided 3/13/2002))
- $1.5 million for inadequate treatment of a patient's pain. (*Bergman v. Eden Medical Center*, No. H205732-1 (Super. Ct., Alameda Co., Calif.) This case is of particular importance to all doctors, because if the doctor had prescribed stronger pain relief medicine, the patient could have easily died due

to the dosage. However, because the doctor took the more conservative approach, he was held liable.

- $6.6 million settlement in May of 2002 in Cook County, Illinois (*Somoyes v. Hinsdale Family Medicine Center and Hinsdale Hospital*) for failure to diagnose a pregnancy complication. "The medical issues were so complex and the child's situation so tragic that it was best to reach a negotiated conclusion without an admission of wrongdoing". The settlement was reached despite having a strong defense to the underlying claim. The desire to settle to avoid large unexpected jury verdicts is certainly understandable and frequently advisable; however, when it is yourself that is accused of wrongdoing, it is very difficult to accept such a resolution when you know that you have not done anything improperly.

What about the surgeon who supervised an operation and during the operation an assistant performed an act of gross negligence? Did you know that most malpractice insurance policies cover "***negligence***," but not "***gross negligence***."? Since the surgeon was directing the operation, he was held liable for the assistant's gross negligence and was also found liable for the full amount of the damages. The insurance company paid only the legal defense fees.

Did you know that "gross negligence" is asserted in almost every legal action? This is because unless gross negligence is asserted, a plaintiff cannot ask for punitive damages. Further, by asserting gross negligence, a plaintiff can more easily negotiate (extort?) a settlement from a defendant who is reluctant to defend the case due to the potential personal liability not covered by insurance.

Even when gross negligence is not an issue and when the policy amount has not been exceeded, a large risk exists because insurance policies unfortunately do not cover all events. Take the case of the executive that was working from his home one weekend and had a business delivery at his house. The UPS delivery person slipped on the homeowner's son's skateboard and broke his back. The company insurance did not cover the accident because it occurred off business premises. Neither the homeowner's insurance nor the executive's umbrella insurance covered the accident because it was a business delivery and outside the protection of the homeowner's policy. Instead, the executive was personally liable for the entire judgment amount.

Further compounding the concern that insurance should not be used as a sole asset protection planning tool is the continued failure of insurance carriers. In 1998, PIE Mutual Insurance Co., Ohio's largest medical malpractice insurer, declared bankruptcy, leaving 18,000 doctors without any insurance coverage. In 2001, "one of the largest insurance companies, Phico, which sells insurance nationally but concentrates on New Jersey and Pennsylvania, was taken over in August by regulators . . . when claims threatened to outrun the company's ability to pay." (New York Times, 9-10-01). The possible bankruptcy of insurance carriers was further magnified by the tragedy that occurred on September 11, 2001. Estimates were made that the claims "might cost insurers as much as $30 billion." "Property and casualty rates are sure to rise . . . . The greatest risk may be facing companies that cover health costs, life, and worker's compensation." (Business Week, 9-13-01). Unfortunately, it appears we are entering a time similar to the 1980s where, due to unforeseen circumstances, the solvency of many insurance carriers will be at issue.

The Wall Street Journal on May 17, 2002 contained an editorial explaining how the New Jersey's largest malpractice insurer, the MIIX Group, "announced that it has essentially decided to fold up shop" leaving 9,000 physicians (37% of the New Jersey doctors) without insurance. What makes this remarkable, is that MIIX was not a for-profit entity, it was an association of physicians organized to provide malpractice insurance to doctors. It lost over $200 million dollars in the last fifteen months that they were in business. The article continued to note that malpractice insurance premiums have jumped an average of 250% over the past three years. In June of 2001 three malpractice insurers stopped doing business in the state. This trend continues across the United States as we find doctors protesting the lack of insurance, the high cost of insurance or in some cases, fleeing jurisdictions, such as Texas and Mississippi. Illinois and many other states have been experiencing their own insurance problems with many doctors being unable to purchase adequate insurance coverage at any price and policies in excess of $1,000,000 not being offered. These physicians are also being confronted with astronomical increases in premiums for their existing policies at the same time that the verdicts are increasing.

While insurance is always an important product for all physicians and surgeons, it was never designed to solve all problems. There is no such thing as an "all perils" insurance policy! And, the fact that you might lose all that you worked so long and hard for is magnified by the attitude of many who have less than you. As Richard Duff, a financial consultant and Certified Life Underwriter (CLU), stated in his article, How to Become an Invisible Financial Target (Broker's World 1997):

"The wealthiest of you are also the most vulnerable to outsiders who want your money. That's because there are many who envy wealth, who are seeking an easy way out and who won't hesitate to trump up charges to get what they want. Opportunistic lawyers, who can smell cold cash from miles away, also contribute to the social disease. That is why there is a need for asset protection planning."

By now, most physicians and surgeons will have heard of a variety of asset protection methods such as gifting to one's spouse, state exemptions, the family limited partnership, limited liability companies and the asset protection trust (whether it be a domestic or offshore asset protection trust). Unfortunately, regarding the protection of one's assets, most state laws do not provide adequate protection. The result is that unless a physician or surgeon wishes to risk most of what he or she has worked so hard to obtain to the vagaries of the U.S. court system, he or she should explore the various available asset protection tools. The remainder of this article discusses some of the nuances of state law regarding asset protection.

State Law

Some "planners" advocate that physicians and surgeons protect their assets by transferring them to their spouse. This is almost

always the worst thing that a person could do because in the majority of states a gift is exempt from the definition of marital or community property. With over half of the marriages resulting in divorce, the risk of losing assets in a spouse's name is quite large. In a divorce, the spouse gets to keep "gifted" property and the gifting physician or surgeon gets nothing in return for property gifted. Even if state law was revised to extend protection to gifts between spouses, this protection would be lost if you moved or retired to another state that follows the more common majority rule. Finally, a physician's spouse may also be the subject of a lawsuit. If the spouse is driving the car, or someone slips in the driveway, or the roofer breaks his back falling off the roof, they will sue the spouse who owns some or all of the property. For these reasons, few, if any, asset protection planners recommend gifting as a form of asset protection.

Other planners have indicated that certain exemption statutes may provide some relief. Unfortunately, as noted above, most states' exemption statutes are relatively weak and the new bankruptcy law has limited state exemptions in other states. Professional corporations provide some degree of protection against possible tort claims of employees; however, it does not appear that there is any protection for a physician's or surgeon's malpractice and negligence claims. This being the case, a physician or surgeon would be individually liable for any malpractice judgment of the professional corporation, since typically you cannot protect yourself from your own negligence.

Some states provide an exemption for life insurance if a spouse or child is named as the beneficiary. However, this will not protect business insurance or insurance funding buy-sell agreements with partners and non-family beneficiaries. Many qualified retirement plans are protected during the accumulation stage at the federal level through ERISA; however, we have seen many physicians who had excellent qualified plans in place, terminate the plan and roll the previously protected assets into an IRA which is not a qualified plan under ERISA and not protected at the federal level from creditor claims as well as others who have found that their retirement funds are not protected when in the "payout" stage. In other states, retirement plans have little or no protection by state law. The new Bankruptcy Act also affects creditor rights in retirement accounts and must be carefully considered along with any protection afforded by state law.

In a few states, a stand-alone family limited partnership or limited liability company may provide a degree of asset protection; however, in most states, statutory protection doesn't exist and the trend for many years has been to permit judicial foreclosure of the partnership interest. We normally recommend creating these entities in Arizona or Delaware because these are two of the few states which statutorily restrict the creditor's sole remedy to a charging order of protection which is simply the right to receive distributions when and if a distribution is made. This minimizes the possibility of a judicial foreclosure which is a permitted remedy in most states.

Asset Protection Planning Tools

So how is a physician or surgeon supposed to protect that what they have worked their entire life for? Insurance is and should always continue to be at the foundation of any physician's or surgeon's asset protection plan. You must, however, recognize that insurance does not cover many types of liabilities or risks. When one is concerned with protecting their wealth, a solution other than insurance will be required, especially for those who realize that lost assets later in their careers cannot be replaced due to the unlikely chance of finding the same business opportunities later in life and due to the fact that fewer working years are available to reacquire after-tax income.

First, most professionals consider an offshore asset protection trust as the strongest form of protection for many types of assets. As to this asset protection planning tool, there are many common misconceptions, such as the client must invest abroad, the client loses all control, there are tax advantages with these trusts, or they are only for the super wealthy. Once these myths regarding offshore asset protection trusts have been dispelled, many physicians and surgeons with a net worth of greater than $1 million use this vehicle for their asset protection needs.

Second, while not believed to be as protective as an offshore asset protection trust, eight states have now passed domestic asset protection trust legislation.

Finally, the offshore limited liability company has become the entity of choice for protecting investment assets, retirement plan benefits and deferred compensation plans. These entities are also often used in combination with an asset protection trust which provides an additional level of protection.

Robert D. Gillen is an attorney who works extensively with physicians on asset protection planning. Mr. Gillen has taught and lectured internationally and nationally on asset protection; spoken at the annual conferences of the American Association of Neurological Surgeons, Congress of Neurological Surgeons, WealthCounsel, American College of Cardiology, numerous hospitals and professional associations, Staff Instructor for The National Tax Institute, the Center for Professional Education as an instructor for CPAs, various banks and financial institutions including Northern Trust Bank, Harris Bank, Bank One (Chase), Merrill Lynch, numerous estate planning councils and bar associations, as well as having authored materials for seminars, had articles published on asset protection planning for the American Medical Association, American Bar Association, WealthCounsel, Estate Planning Magazine, Financial Guide Post, Trust and Estates, CCH Journal of Pass Through Entities, Leimberg's Estate Planning Newsletter and other professional, legal and tax publications.

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