Asset Protection Update: The Curci Investments, LLC Case

 

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<u>Introduction</u>

Curci Investments, LLC is a case where bad facts may result in possible changes in the law that may harm well intentioned planning for Californian debtors by allowing courts to invade LLCs owned by debtors, as opposed to having a charging order as the sole remedy.[1]

The debtor in *Curci* behaved in a manner that any professional would find objectionable, and he clearly controlled the LLC in question. There were major mistakes in ignoring the entity formalities, and seemingly little purpose in the entity other than to shield assets from a creditor who was owed only a small percentage of the value of the assets. The entities were controlled and used personally by a husband and wife who were both responsible for the debt, and the only owners of the LLC. It is also noteworthy that the court applied California law, without even considering whether Delaware law should have applied since the LLC was formed and maintained in Delaware.

Possible Implications

What will commentators and courts read into such a case? Will this result in a broadening of the attack on legitimate investment entities? There is also always a concern that other state courts may look at this case when evaluating how to handle similar situations. The real risk, however, is that when the courts dealing with asset protection cases reach to do justice, and prevent a bad actor from prevailing, the results could well be misinterpreted or misapplied to harm clients who have conducted themselves in a proper and ethical manner. While *Klabacka*[2] was a favorable case wherein a Nevada DAPT was upheld as protecting assets from both spousal support (alimony) and child support claims, a number of other recent cases successfully challenged LLCs and trusts used to protect assets. In *Leathers*, the court held that a taxpayer fraudulently transferred assets to a

[1] *Curci Investments, LLC v. Baldwin*, Court of Appeal, Fourth Dist., Div. 3, CA G052764 Aug. 10, 2017.
[2] *Klabacka v. Nelson*, 133 Nev. Advance Opinion 24 (5/25/2017).

trust to avoid tax debt.[3] Another reminder that creating entity structures (LLC, corporation, partnership, trust) to protect assets will not succeed if the debtor himself does not respect the integrity of those entities was provided in *Transfirst*.[4] A trust was held to be a mere nominee for the taxpayer and could be disregarded to satisfy a tax lien.[5] Whether the "weight" of *Curci* as another bad fact-bad law asset protection case will unduly tip the scales against clients who plan properly remains to be seen. The take home lesson for all practitioners may be to craft more careful and layered plans and emphasize to clients the vital importance of both proper motives and the proper administration of the plan.

Overview

In the *Curci Investments, LLC* case the California appellate court remanded the case to the trial court to determine whether reverse veil piercing would apply. Reverse veil piercing arises when the request for piercing comes from a third party outside the targeted business entity. The trial court had concluded that reverse piercing was not available, and that the sole remedy of the judgment creditor was a charging order. The debtor sought to add the creditor's investment LLC (JPBI) as a judgment debtor on a multi-million-dollar judgment it had against the creditor (Baldwin) personally. It warrants noting that the appellate court observed that the debtor's wife also was liable on the loan to the debtor to the extent that the husband and wife had California community property, and that the LLC was community property. This may turn out to be the distinguishing factor in permitting reverse piercing, which generally requires that a third-party has been harmed in an inequitable manner under circumstances where there is "such a unity of interest and ownership between the corporation and its equitable owner that the separate personalities of the corporation and the shareholder do not in reality exist."

The debtors did not have the LLC integrated with sound estate tax and multiple trust planning, and may have expected that they would be forced eventually to pay the creditor, given the relatively small percentage of their overall apparent net worth at the time of implementation. The planning these debtors undertook was unlikely to have been recommended or assisted by many California lawyers, given that California law and California Bar rules which make fraudulent transfers, and aiding and abetting fraudulent transfers, criminal acts.

Facts

In January 2004, the debtor created a Delaware limited liability company to hold and invest cash balances of the debtor and his wife. It had two members. The debtor husband held a 99% member interest and his wife held a 1% member interest. Debtor was the manager and the chief executive officer of the investment LLC. In these roles, and given his membership interest, he determined when, if at all, the investment LLC would make distributions. Practitioners are well aware that controlling distributions in an estate tax context may be inadvisable as it might result in estate inclusion. The *Curci* case points out that retaining control over distributions will similarly be a negative factor in the context of asset protection planning.

Two years after forming the investment LLC, the husband/debtor personally borrowed $5.5 million from the creditor's predecessor in interest. One month after executing the note, the debtor settled eight family trusts to provide for his grandchildren. The investment LLC loaned $42.6 million to three family general partnerships formed by debtor for estate planning purposes.

[3] *M.R. Leathers*, CA-10, 2017-1 USTC ¶50,212, May 4, 2017.
[4] *Transfirst Group, Inc. v. Magliarditi*, 2017 WL 2294288 (D. Nev., May 25, 2017).
[5] Balice, (DC NJ 8/9/2017) 119 AFTR 2d ¶ 2017-5134.

Although all of these loans were due to the investment LLC, the debtor and his wife listed them as "Notes Receivable" on their personal financial statements. This carelessness was interpreted by the court as yet another factor confirming the debtor's disregard of entity formalities. Practitioners should be alert to clients having financial statements prepared, or even more so preparing statements themselves to submit to lenders, and incorrectly listing trust or entity assets as their own. Similarly, schedules attached to a prenuptial agreement listing entity or trust assets as the clients might also serve to document that the client is disregarding the formalities of those trusts and entities. The challenge in many cases is to successfully educate clients to consult with counsel before undertaking such matters.

The creditor sued and obtained a judgment. The debtor did not respond to the discovery, and the creditor filed a motion to compel resulting in sanctions against the debtor. Antagonizing the court will rarely prove a positive step to enhancing the end result.

The debtor, as manager of the investment LLC, executed amendments to the family notes for $42.6 million to extend their terms by five years to July 2020, with no consideration. While the case did not explain why, presumably this was to further delay their repayment to defer the point in time when the investment LLC might have cash if the creditor pursued it. If a client is going to modify notes or other contractual arrangements, it would certainly be preferable that such steps be taken before the pendency of litigation. Further, any such steps should be taken under the guidance of the client's advisers who can take precautions to properly structure any changed terms, and to document the arm's length nature of the modifications or changes.

The creditor made a motion in August of 2014, and after that date any monetary distributions made by the investment LLC to the debtor, in his capacity as a member of the LLC, were ordered to be paid to the creditor instead. This is known as a charging order and has generally been viewed as the only remedy planners wish to permit potential claimants to have.

The creditor at the time of the trial had received no money as a result of the charging order. However, the debtor had caused the investment LLC to distribute $178 million to him and his wife, as members, between 2006 and 2012. There were no distributions made subsequent to the October 2012 entry of judgment on the note due to the creditor. These facts no doubt incurred the ire of the court both as to dollar amount and timing. The cessation of payments on the notes is perhaps somewhat similar to the cessation of distributions during the divorce in the *Pfannenstiehl* case. The lower court held for the ex-spouse in part perhaps because of the cessation of payments as soon as the divorce was known.[6] Fortunately for clients seeking asset protection, that holding was reversed. But the lesson to be more careful prior to and during litigation seemed to be lost on the defendants in *Curci*.

The creditor argued that the investment LLC was the debtor's alter ego, that the debtor was using the investment LLC to avoid paying the judgment and that an unjust result would occur unless that LLC's assets could be used to satisfy the creditor's personal debt.

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[6] Pfannenstiehl v. Pfannenstiehl, 88 Mass. App. Ct. 121 (2015), 37 N.E.3d 15.