
TrustCo Bank v. Susan M. Mathews C.A. No. 8374-VCP, V.C. Parsons (Del. Ch. Jan. 22, 2015)

Introduction

The Delaware Court of Chancery (the “Court”) recently issued a Memorandum Opinion in TrustCo Bank v. Susan M. Mathews, C.A. No. 8374-VCP, V.C. Parsons (Del. Ch. Jan. 22, 2015), granting the Defendants’ motion for partial summary judgment in a fraudulent transfer action against the Delaware trustee of three Delaware asset protection trusts, the grantor of the trusts and other beneficiaries of the trusts, after concluding that the Plaintiffs’ claims against the Defendants were time barred.

Background

In June of 2006, Plaintiff, TrustCo Bank (“TrustCo”), a federal savings bank with a principal place of business in New York, provided a \$9.3 million construction loan to StoreSmart of North Ft. Pierce, LLC (“StoreSmart”), a Florida limited liability company, for the purpose of constructing a self-storage facility in St. Lucie, Florida (the “Loan”). Defendant, Susan M. Mathews (“Susan”), a manager and member of StoreSmart, personally guaranteed the Loan. On December 21, 2006, Susan created three Delaware asset protection trusts (the “Trusts”) pursuant to Delaware’s Qualified Dispositions in Trust Act (the “Act”), with RBC Trust Company (Delaware) Limited, a Delaware corporation having a principal place of business in Wilmington, Delaware, as the trustee (“Trustee”). Susan, her issue, and two other individuals were named as the initial class of beneficiaries of the Trusts. The beneficiaries were eligible to receive distributions of principal and income from the Trusts as directed by a “Distribution Committee” in its sole discretion. The Distribution Committee was initially comprised of three beneficiaries of the Trusts, and had the authority to direct distributions by either a unanimous vote among the Distribution Committee members or by one member of the Distribution Committee with the consent of Susan.

TrustCo’s Loan to StoreSmart was modified in 2008 and 2009, and in April of 2011 StoreSmart defaulted on the Loan. As a result, TrustCo filed a foreclosure action against StoreSmart and Susan in Florida, which resulted in a judgment in July 2011 in favor of TrustCo of \$8.2 Million plus interest (the “Foreclosure Judgment”). In the following year, TrustCo assigned its rights, title and interest in the Loan and related security agreements and in the Foreclosure Judgment to ORE Property Two, Inc. (“ORE”), a Florida corporation and a co-Plaintiff. Susan, StoreSmart and the Plaintiffs agreed to entry of a deficiency judgment of \$2.3 Million, which was approved by a Florida court in February of 2013 (the “Deficiency Judgment”).

Susan made several significant transfers to the Trusts in the years following their creation in 2006. Susan transferred her stock in a company called ITRAX (which was purchased by Walgreens in 2008) to two of the Trusts in January of 2007 (the “ITRAX Transfers”). Susan’s ITRAX stock was a significant, if not the primary, source of her wealth. Susan also held an interest in Terra Optima Ventures, LLC (“TOV”), an investment vehicle for a business owned by her son. Susan sold her interest in TOV to one of the Trusts in March of 2010 for \$63,000, although the TOV interests had been valued at around \$500,000 only about one year prior (the “TOV Transfer”).

The Plaintiffs filed an initial complaint in the Court on March 1, 2013 and an amended complaint on May 28, 2013 alleging that the ITRAX Transfers and the TOV Transfer were fraudulent and asserting that the transfers were effected to place Susan’s assets out of their reach to prevent them from collecting on Susan’s guaranty. The Defendants contended that

Susan created the Trusts as part of her estate planning, which was underway before Susan guaranteed the Loan. However, the Court determined that it need not resolve this dispute for purposes of the summary judgment motion and therefore it assumed, without deciding, that the transfers to the Trusts were fraudulent.

The Court held that whichever statute of limitations period applies to the claims would determine whether the Plaintiffs delayed unreasonably in filing suit for purposes of the Defendants' laches defense. The Court found that the TOV Transfer was not barred by laches given the more recent date of that transfer, and it was not part of the Defendants' motion for partial summary judgment. The Court then considered which limitations period applied with respect to the Plaintiffs' claims against the ITRAX Transfers and whether the statute of limitations barred such claims.

The Plaintiffs argued that New York's six-year or two-years-from-discovery statute of limitations governed their claims. The Defendants argued that the four-year or one-year-from-notice statutes of limitations under Delaware law, or alternatively, Florida law, controlled the Plaintiffs' claims related to the ITRAX Transfers. The parties also disagreed as to when the Plaintiffs had notice of the ITRAX Transfers. The Plaintiffs asserted that they had notice of the ITRAX Transfers on July 19, 2011, but the Defendants asserted that Plaintiffs had notice of the transfers by May of 2010 at the latest.

The Court concluded that the Plaintiffs' fraudulent transfer claims against the ITRAX Transfers were time barred under Florida's statute of limitations, and alternatively, under Delaware's statute of limitations, and granted the Defendants' motion for partial summary judgment. The Court also independently concluded that even if the longer New York statute of limitations period applied, the Plaintiffs' claims relating to the ITRAX Transfers were untimely.

General Choice of Law Rule

The Court stated that, as a general rule, the forum state's statute of limitations applies, although an exception to the rule arises when "the procedural law of the foreign state is so inseparably interwoven with substantive rights as to render a modification of the foregoing rule necessary, lest a party be thereby deprived of his legal rights." The Court found this exception to be inapplicable in TrustCo, but indicated that the general rule might be modified by Delaware's borrowing statute, 10 Del. C. § 8121 (the "Borrowing Statute"), or the Act.

The Borrowing Statute provides that where a cause of action arises outside of Delaware, such action cannot be brought in a Delaware court after the expiration of whichever period for bringing an action is shorter: the time limited by the law of the State of Delaware or the time limited by the law of the state or country where the cause of action arose. Delaware case law interpreting the statute described by the Court suggests that the Borrowing Statute may not apply in certain situations, such as in situations where there is no evidence of forum shopping (although the Court indicated that it disagreed with this interpretation of the statute), where a literal application of the statute would lead to an absurd and unjust result, or where the contacts with another state are so innumerable that the application of Delaware's Borrowing Statute would be inequitable.

Section 3572 of the Act generally provides that creditors' claims against transfers made to a Delaware asset protection trust must be brought pursuant to 6 Del. C. §§ 1304 or 1305 (Delaware's fraudulent transfer statute), and that, in cases where a creditor's claim arose before the qualified disposition was made, the creditor's claim shall be extinguished unless it is brought within the limitations period under 6 Del. C. § 1309 in effect on the later of the date of the transfer or August 1, 2000.

Most Significant Contacts Tests

The Court noted that in order for the Borrowing Statute to apply, the causes of action would have to have arisen outside of Delaware, and then looked to Delaware conflict of law rules to answer this question. Delaware conflict of law rules direct that the most significant relationship test set forth in the Restatement (Second) Conflict of Laws (the "Restatement") determines where a plaintiff's claim arose. However, the Restatement's test differs depending on whether the alleged wrong is tort-based or contract-based. The Court determined that a fraudulent transfer bears some resemblance to both tort and contract claims, but does not fit into either category. Thus, the Court considered the Restatement's test for both torts and contracts.

The Court concluded that Florida had the most significant relationship for purposes of the Restatement's test for tort matters, with Delaware having the next strongest connection. In drawing its conclusion, the Court considered the place

of injury, the place of conduct that caused the injury, the domicile, residence, place of incorporation and place of business of the parties, and the place where the relationship between the parties was centered.

The Court determined that the place of injury was neutral as between New York and Florida, after it considered that TrustCo was headquartered in New York and had its operations in New York, Florida, and other states, that ORE was a Florida corporation with its principal place of business in Florida, and that TrustCo assigned its rights in the Florida Deficiency Judgment to ORE, located in Florida. The Court determined that the conduct causing the injury occurred mostly in Florida and Delaware, citing the failure of StoreSmart's business endeavor in Florida and the transfers to the Trusts as the pivotal events leading to the dispute in TrustCo. The Court determined that the factor related to the domicile, residence, place of incorporation and place of business of the parties (a factor in both the tort and contract analysis) weighed slightly in favor of Delaware as the state with the most significant relationship. Notably, the Court stated that the location of, and law governing, the Trusts may weigh the domicile factor slightly in favor of Delaware for the reason that the primary purpose of the Plaintiffs' claims was to claw back the proceeds of the ITRAX stock from the Trusts or their beneficiaries. Finally, the Court determined that the parties' relationship was probably centered in Florida, given that StoreSmart was a Florida entity operating its business in Florida, the Deficiency Judgment was a Florida judgment, and ORE was a Florida corporation. However, the Court indicated that the relationship of the parties may also be centered in Delaware where the Trusts were located, for the reason that it is money held by those Trusts that Plaintiffs were seeking to recover.

The Court determined that New York and Florida were essentially tied for the most significant relationship to the action under the Restatement's test for contract matters, acknowledging that New York may be weakly favored. The Court considered the place of contracting, negotiating and performance of the contract, the location of the contract's subject matter, and the domicile, residence, place of incorporation and place of business of the parties.

After considering all relevant contacts under both of the Restatement tests, the Court found that Florida had the most significant relationship to the matter, with Delaware being close behind. The Court observed that because both states have identical statutes of limitations, the choice of Florida over Delaware had minimal importance to the outcome of the motion for partial summary judgment and the Borrowing Statute would not be applicable. As a third alternative, the Court determined that even if New York did have the most significant relationship to the Plaintiffs' action, the Borrowing Statute would be triggered and the Delaware statute of limitations nevertheless would apply. The Court further held that the Plaintiffs' fraudulent transfer claims regarding the ITRAX Transfers were barred by laches because the Plaintiffs did not file their action until after the expiration of Florida (and Delaware's) statute of limitations period.

Qualified Dispositions in Trust ACT

The Defendants in TrustCo argued that Delaware's statute of limitations applies for the independent reason that the ACT controlled the dispute, and that the ACT requires both that the Plaintiffs file suit in Delaware (and in the Court of Chancery specifically), and that the Court apply the statute of limitations in Section 1309 of Title 6 of the Delaware Code 6 Del. C. § 1309 without regard to any most significant relationship analysis. The Plaintiffs contended that the ACT was inapplicable because Susan maintained impermissible control over the property transferred to the Trusts.

Already having sufficient basis for holding that the Plaintiffs' claims against the ITRAX Transfers were time-barred, the Court found it unnecessary and declined to determine whether the ACT applied and required the application of Delaware's fraudulent transfer statute of limitations without regard to the general choice of law analysis or the Borrowing Statute. The Court identified three reasons for declining to address the parties' argument related to the ACT: (1) there is little case law interpreting the ACT, and some of the issues implicated in TrustCo appeared to be of first impression; (2) citing *In re Daniel Kloiber Dynasty Trust*, 2014 WL 3924309 (Del. Ch. Aug. 6, 2014), the Court had already rejected the argument that the ACT requires creditor claims to be brought exclusively in Delaware; and (3) whether Susan held impermissible control over the assets of the Trusts presented a material question of disputed fact not appropriate for summary judgment.

New York Statute of Limitations

Finally, the Court held that summary judgment is also appropriate for the independent reason that Plaintiffs' claims were untimely even if New York's statute of limitations applied. New York's statute of limitations to avoid a fraudulent

transfer is “the greater of six years from the date the cause of action accrued or two years from the time the plaintiff or the person under whom the plaintiff claims discovered the fraud, or could with reasonable diligence have discovered it.” Whether a plaintiff could, with reasonable diligence, have discovered the fraud turns on whether the plaintiff was “possessed of knowledge of facts from which [the fraud] could be reasonably inferred.” The Court stated that New York law imposes a duty of inquiry into the alleged fraud. Although the Court first assumed a July 19, 2011 discovery date for the ITRAX Transfers based on the Plaintiffs’ concessions that they had at least inquiry notice of the alleged fraud by that date, the Court considered additional evidence in the record to determine whether the Plaintiffs’ claims were untimely under the New York limitations period. The Plaintiffs filed their initial complaint on March 1, 2013, more than six years after the ITRAX Transfers occurred. Thus, even under New York law, the Plaintiffs relied on having filed within two years of discovery of the ITRAX Transfers in order for their claims to survive under the New York statute of limitations period.

Although the Plaintiffs argued that the date they discovered the fraud was July 19, 2011, the Defendants claimed that the discovery was much earlier. Susan claimed that in connection with her discussions with TrustCo leading up to the first modification of the Loan in June of 2008, she submitted a revised net worth statement in April of 2008 that included an annotation indicating that she was the discretionary beneficiary of the three Delaware trusts that had been established as part of estate planning. In response, TrustCo requested in May of 2008 that Susan either guarantee the Loan with the Trusts or put up another \$1 million in collateral. The loan modification did include an additional \$1 million in collateral. In addition, Susan and a TrustCo Vice President had a series of conversations in May, June and July of 2010 concerning Susan’s transfers to Delaware trusts. TrustCo’s own Vice President testified in her deposition that she understood those transfers rendered Susan insolvent. In addition, a Senior Vice President of TrustCo testified in his deposition that at a May 2010 meeting, Susan informed him that she “took moneys and put them in a trust to hide them from creditors.” Following this conversation, TrustCo requested that Susan provide to TrustCo all documents relating to the trust accounts in a letter dated June 21, 2010. Finally, Plaintiffs’ own interrogatory response referred to a June 2010 discovery date.

The Court determined that the Plaintiffs failed to present any evidence that would contradict the sworn deposition testimony of their own deponents, nor any persuasive rationale for disregarding their interrogatory response referencing a June 2010 discovery date. The Court concluded that the Plaintiffs were on inquiry notice of the ITRAX Transfers by July of 2010 at the latest, and held that even under New York’s statute of limitations the Plaintiffs claims were untimely.

Comments

TrustCo provides insight into how the Delaware Court of Chancery will determine and apply the applicable statute of limitations period for alleged fraudulent transfers to Delaware asset protection trusts in cases where the trust’s settlor is not a Delaware resident. Although the transfers to the Trusts in TrustCo began in New York and ended in Delaware, the Court engaged in a significant contacts test, determining that Florida had the most contacts with the transaction as a whole. The Court dismissed New York as having significant contacts with the alleged fraudulent transfers, even though the initial creditor was located there, the settlor resided there at the time of the transfers, and the lending transaction was entered into there. However, the Court placed great weight on the fact that the Trusts that received the transfers were Delaware trusts governed by Delaware law, even though there were no other known contacts with the State of Delaware. The Court declined to determine whether the Act modified the general rule pertaining to the statute of limitations for actions against fraudulent transfers to Delaware asset protection trusts where there was a sufficient other basis to dismiss the claims under the general conflict of law rules. The TrustCo decision is particularly important because the Delaware asset protection trust planning deployed by the settlor was ultimately successful, and the Court rejected the creditor claims under a laches (statute of limitations) defense, even in the face of presumed fraudulent transfers.

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