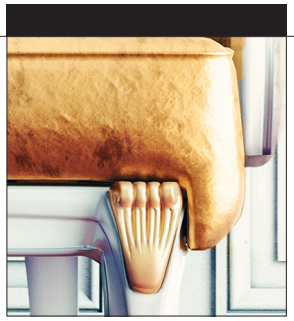

Delaware Attachment Law Reinforces Asset Protection

A long-standing but underappreciated statute that protects banks and trust companies from having their deposits attached also helps depositors avoid claims.

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This past summer, *Wonder Woman* became one of the highest grossing box office releases of all time.[1] The plot centers around Princess Diana's quest to seek out and defeat the god Ares, bringing peace to humankind. As those who experienced the movie know, Diana is a formidable foe in her own right—extremely strong, brave, and agile. She also travels with several pieces of armament critical to her success—a lasso of truth, indestructible bracelets, a sword, and a shield.

Delaware's trust and asset protection laws are similarly fortified. Strong and agile in and of themselves, they are reinforced by other aspects of Delaware's legal and trust industry: its venerable Court of Chancery, the quality and bench strength of its trusts and estates professionals and its lawyers more generally, and several asset protection and other laws that apply both to trusts and more broadly. The strength of Delaware's trust and asset protection laws and some of these reinforcements are well known. Less attention has been paid, however, to a procedural provision that can enhance the creditor protection of assets held in a Delaware trust or entity. This law has existed since 1871 and is considered in Delaware to be a significant shield against the attacks of creditors.

Protective statute

Fundamentally unchanged since its enactment nearly 150 years ago, 12 Del. C. § 3502(b) reads:

> Banks, trust companies, savings institutions and loan associations, except only as to a wage attachment against the wages of an employee of the bank, trust company, savings institution or loan association, shall not be subject to the operations of the attachment laws of this State.

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This means that in addition to having to break through the various obstacles a Delaware trust or entity would present to a creditor of a beneficiary, member, or shareholder, a creditor could still leave Delaware empty-handed if the trust's or entity's deposits were held in a Delaware bank or trust company. After all, a well-designed asset protection plan is one that is implemented as far in advance of any potential creditor claim as possible and that is multi-layered in its construct—involving insurance, creditor-protected investment vehicles such as life insurance and retirement accounts, homestead laws, asset titling, entities, and trusts. The more obstacles a creditor will find itself having to break through to successfully enforce a claim, the higher the likelihood the creditor will settle its claim in the first instance, preserving assets for the client.

The purpose of § 3502 is to "aid [banks and trust companies] in the

performance of their duties, and mainly by preventing the attachment of their deposits," and not to assist debtors in avoiding claims.[2] However, for a trust with a beneficiary who is particularly vulnerable to potential creditors, or an LLC for a business exposed to a higher-than-average level of risk, holding the trust's or LLC's cash account in a Delaware bank or trust company (if it is a depository institution) would add an extra layer of protection.

Case law

In the case of *Provident Trust Co. v. Banks*,[3] § 3502 was applied to funds held in a self-settled spendthrift trust (before they were recognized by statute in Delaware in 1997). In this case, Adelaide Banks had two judgments entered against her in the Superior Court of Delaware, neither of which she paid. She received proceeds from an insurance policy upon the death of her husband, which she deposited into an account at Wilmington Trust Company. Later, Ms. Banks transferred the funds to a trust with Wilmington Trust Company as trustee from which she would receive the income for her life, and at her death, any remaining assets would be distributed to her issue. The court found that although assets held in a trust created by a debtor for his or her own benefit are usually subject to seizure by a creditor (again, before the recognition of self-settled spendthrift trusts), because the assets were held in a bank, they were not subject to attachment, whether at law or in equity.

Delaware courts have also extended § 3502 to motions to enjoin deposits in a bank account from being withdrawn, transferred, or encumbered. In *Delaware Trust Company v. Partial*,[4] the creditor bank—Delaware Trust Company—sued the debtor for repayment of funds and added the debtor's bank—Wilmington Trust Company—as a defendant seeking to enjoin it from allowing funds to be removed from the debtor's account. The court opined that an injunction is the substantial equivalent of a garnishment in light of the policy behind § 3502 (even though it would not result in a lien on the property being enjoined, as would a garnishment) and, as such, would not enjoin the account. In so holding, the court recognized the result was seemingly unfortunate given the facts:

> In the circumstances thus shown, the utility to plaintiff of the relief sought is apparent and, indeed, assuming those facts to be true, the common-sense appeal of simply freezing the money that Partial is now wrongfully retaining until legal rights in it may be determined is powerful. Unhappily for plaintiff, however, the granting of relief sought is, in my opinion, precluded by the legislative policy reflected in the statute that exempts banks in the state from the operation of the attachment and garnishment laws of this state.

Unlike Diana's shield in *Wonder Woman*, which can deflect machine gun fire, the shield offered by § 3502 is not completely impervious to attack. For example, in *Garretson v. Garretson*,[5] the Delaware Supreme Court allowed for the sequestration of a beneficiary's income interest in a trust as part of proceedings involving the validity of a Mexican divorce between the parties. In *Garretson*, the court declined to apply § 3502 to the request for sequestration of trust income, because sequestration is an equitable remedy available only in the Court of Chancery and not a remedy at law (as are attachment and garnishment). As noted in *Delaware Trust Company v. Partial*, *Garretson* is limited to a seizure of assets to compel a court appearance.

The sequestration in *Garretson* did not involve the bank restricting access to an account or transferring the assets of an account to another person; rather, it resulted in the bank paying to the court trust income that it otherwise would have distributed to the beneficiary.[6] Further, a sequestration to compel an appearance is intended to be a temporary hold on assets, not a permanent transfer to a third party.

Nonresidents establishing Delaware trusts or entities should arrange for a cash account at a depository institution located in Delaware.

Additionally, the policy underlying § 3502 has not been extended to broker-dealers. In fact, Delaware courts have expressly declined to apply § 3502 to broker dealers.[7] Because the policy behind the law is to protect a bank's or trust company's deposits, it also likely would not extend to securities even if they are held at a bank

1 "Wonder Woman Becomes Top Earning Summer Movie at the Domestic Box Office," *Variety*, 7/23/2017.

2 Tekstrom, Inc. v. Savla, 2007 WL 3231632, *3 (Del. Com. Pl. Ct. 2007).

3 9 A.2d 260 (Del. Ch. 1939).

4 517 A.2d 259 (Del. Ch. 1986).

5 306 A.2d 737 (Del. 1973).

6 Garretson does not stand for the proposition that a Delaware spendthrift trust is vulnerable to the claims of former spouses as creditors. Garretson involved a husband who abandoned his still current wife, and as such owed to her an obligation of support, and was not a creditor. Former spouses can be considered creditors of the other under Delaware law, subject to Delaware's spendthrift laws. See Jocelyn Borowsky and Jennifer Wallace on *In re Garretson*, *Asset Protection Planning Newsletter* #221 (2/28/2013), at http://www.leimbergservices.com/.

7 See Lawrence E. Mergenthaler v. Triumph Mortgage Corp., 2017 WL 1550252, *8 (Del. Super. Ct. 2017).

or trust company.[8] Further, § 3502 will not prevent the discovery of funds held in a Delaware bank or trust company in litigation.[9]

Implications for nonresidents

What does it mean to have deposits held in a Delaware bank or trust institution for a nonresident of Delaware? It has been said that monies held in a bank are merely communications whose location comes down to a conflict-of-laws analysis.[10] Key to the analysis will likely be a determination of which state has the "most significant relationship" to the account and the parties.[11] The expectation of the person opening an account will factor heavily in any such determination. Opening an account at an institution with locations only within the State of Delaware would certainly provide clarity on the question.[12] Doing so, however, is not the sole means of ensuring the account is located in Delaware. The institution does not have to be state-chartered for the law to apply: A creditor's ability to attach an account at a national or regional bank when Delaware law applies will not be preempted by federal banking law.[13]

In the case of a trust with a Delaware non-depository trustee that arranges for a cash account at a depository institution in Delaware, the trust's situs in Delaware will weigh heavily in favor of a finding that the cash account is in Delaware. Nonresidents establishing Delaware entities should arrange for a cash account at a depository institution located in Delaware rather than opening the account at a location outside of Delaware (even if that institution has locations in Delaware). After an account has been opened, other considerations may apply, for example, how and where the interest is reported for tax purposes. If a Delaware trust or entity is the account holder, its address should be the one associated with the account. This, in turn, will often determine the tax reporting.

One of the risks sometimes associated with a non-Delaware resident establishing a Delaware trust or Delaware entity is that if a case were brought attacking it in the local jurisdiction, a judge may apply the substantive law of the local forum citing that jurisdiction's strong public policy regarding the particular issue in question to breach the trust or entity.[14] Even if this were to occur, § 3502 would still be applied when the creditor attempted to execute on the judgment against the Delaware account.[15] Therefore, having a trust or entity hold its cash deposits at a Delaware bank or trust company can mitigate against this potential risk.

Conclusion

When creating or transferring a trust to Delaware, or when establishing a Delaware entity, taking the extra step of opening a depository account at a bank in the State of Delaware has the benefit of reinforcing the creditor protection of the structure, with little to no downside. If the structure comes under attack at some point in the future, whether or not Delaware substantive law is applied, this additional precaution may prove an invaluable shield and a last layer of defense. ■

8 See Sterling v. Tantum, 94 A. 176 (Del. Super. 1915) ("In 1871 when the attachment statute was passed there were very few banks in this state, and they were doing a purely banking business. Practically all the property they held that could be attached were deposits of money, and manifestly such was the property the legislature meant to exempt. The exception of moneys and credits that were in no way connected with banking, but held in other and separate departments of a modern trust company, could not have been contemplated at all. In the light of conditions existing at the time it may be fairly assumed that all the law making body sought or intended to do was to exempt deposits connected with banking business.")

9 See *Tekstrom*.

10 Sommer, "Where is a Bank Account?," 57 Md. L. Rev. 1 (1998), available at: http://digitalcommons.law.umaryland.edu/mlr/vol57/iss1/4.

11 Restatement (Second) of Conflict of Laws § 222 (1971).

12 For a list of such institutions, go to http://banking.delaware.gov/wp-content/uploads/sites/73/2017/06/Bank-Assets-Deposit-Income-2016.pdf.

13 12 C.F.R. § 7.4007.

14 This risk is cited most frequently when discussing how it is often bad facts that make bad law.

15 Restatement (Second) Conflicts of Laws § § 99 and 122.