

New York Court of Appeals Holds That Separate Entity Rule Prevents Restraint of Assets Held in Foreign Banks' Branch Accounts By New York Courts

On October 23, 2014, New York's highest court issued a ruling answering a question certified to it by the United States Second Circuit Court of Appeals regarding whether the "separate entity rule" precludes a judgment creditor from ordering a garnishee bank operating branches in New York to restrain a debtor's assets held in branches of the bank outside of New York. The New York Court of Appeals answered in the affirmative, holding that "a judgment creditor's service of a restraining notice on a garnishee bank's New York branch is ineffective under the separate entity rule to freeze assets held in the bank's foreign branches."

Background

Under New York C.P.L.R. Article 52, a judgment creditor can serve a notice to prevent a third party holding a judgment debtor's assets from transferring those assets (a "restraining notice") and can seek an order from the court requiring that those assets be surrendered to the judgment creditor (a "turnover order"). New York's separate entity rule is a judicially created doctrine that limits the obligations of third-party banks in judgment enforcement proceedings. As summarized by the New York Court of Appeals in its decision, the rule "provides that even when a bank garnishee with a New York branch is subject to personal jurisdiction, its other branches are to be treated as separate entities for certain purposes," including with respect to prejudgment attachment orders and post-judgment restraining notices and turnover orders. As a result, a bank involved in judgment enforcement proceedings need only freeze and turn over funds held in New York branch accounts and not those funds held by foreign branches.

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New York's lower courts have applied the separate entity rule for almost a century, but New York's highest court had never addressed the existence of the rule. Judgment creditors have been attacking the continued viability of the rule since 2009, when the New York Court of Appeals cast some doubt on the rule in *Koehler v. Bank of Bermuda Ltd.*, 12 N.Y.3d 533. In *Koehler*, the New York Court of Appeals held that a New York court could order a Bermuda bank over which it had personal jurisdiction to deliver stock certificates owned by a judgment debtor even when the stock certificates were located outside of New York. It held that a New York court "has the authority to issue a turnover order pertaining to extraterritorial property, if it has personal jurisdiction over a judgment debtor in possession of the property." *Id.* at 540. Notably, the *Koehler* opinion never mentioned the applicability of the separate entity rule.

The Second Circuit encountered a post-*Koehler* dispute over the ongoing viability of the separate entity rule in *Motorola Credit Corporation v. Standard Chartered Bank*. In that case, Motorola Credit won over \$3 billion against members of the Uzan family. Motorola Credit learned that the Uzan family had assets in Standard Chartered Bank, a UK bank with a New York branch. In post-judgment proceedings, a federal district court issued a restraining order to cause Standard Chartered to restrain the Uzan family's assets. Standard Chartered's New York branch did not have any Uzan property, but its branch in the UAE identified approximately \$30 million in deposits made by an entity designated as an Uzan proxy in the restraining order. Standard Chartered froze those UAE assets, but the UAE Central Bank unilaterally debited \$30 million from Standard Chartered's account with the bank in response. The Central Bank of Jordan also directed Standard Chartered to unfreeze the assets. Arguing that the restraining order violated foreign law and was inconsistent with the separate entity rule, Standard Chartered sought relief from the district court. The district court agreed, finding that the separate entity rule precluded Motorola Credit from restraining assets held by Standard Chartered's foreign branches.

The Second Circuit asked the New York Court of Appeals to resolve definitively whether the separate entity rule continued to limit the scope of a bank's judgment enforcement obligations.

Decision

The Court of Appeals upheld the continued viability of the separate entity rule. It noted that the separate entity rule "has been a part of the common law of New York for nearly a century" and that "the underlying reasons that led to the adoption of the separate entity rule still ring true today." Namely, the separate entity rule promotes international comity, as the "risk of competing claims and the possibility of double liability in separate jurisdictions," along with "the reality that foreign branches are subject to a multitude of legal and regulatory regimes" are both real problems that international banks would face absent recognition of the separate entity rule. Moreover, while Motorola Credit emphasized that advances in technology rendered the separate entity rule outdated, the Court noted the continued issue of "the practical constraints and costs associated with conducting a worldwide search for a judgment debtor's assets." In short, "abolition of the separate entity rule would result in serious consequences in the realm of international banking to the detriment of New York's preeminence in global financial affairs."

In upholding the viability of the separate entity rule, the Court of Appeals distinguished *Koehler*. First, the Court noted that the foreign bank did not raise the separate entity rule in *Koehler*. Second, the Court noted that the separate entity rule would not have helped the bank in *Koehler* because that case "involved neither bank branches nor assets held in bank accounts," whereas "the separate entity rule functions as a limiting principle in the context of international banking, particularly in situations involving attempts to restrain assets held in a garnishee bank's foreign branches." Third, the Court explained that "the judgment creditor in *Koehler* also served the bank itself in Bermuda, not only its New York subsidiary, providing yet another reason for the inapplicability of the separate entity rule in that case."

Implications

The New York Court of Appeals decision in *Motorola Credit* firmly establishes the separate entity rule's limits on banks' obligations in judgment enforcement proceedings. In short, a New York branch served with a restraining notice or a turnover order need not search for assets held in bank accounts located in foreign branches.

The reach of the separate entity rule, however, remains uncertain, especially in light of the Court's attempts to distinguish *Koehler*. First, it is not clear whether the rule extends only to assets held in bank accounts or whether it also applies to other types of assets that a bank may hold. Second, if a foreign bank branch is subject to personal jurisdiction in New York and is served directly, the separate entity rule may not bar restraining notices and turnover orders. Third, the rule applies to assets held in foreign bank accounts held in a garnishee bank's foreign branch, but it is not clear whether it would limit enforcement where the structure of the foreign organization is not a bank branch. In circumstances where a New York bank (or a New York branch of a foreign bank) receives a notice or order pursuant to Article 52, the bank should search those assets held in the New York branch (and not those assets in all foreign branch accounts) to comply with the notice or order. If there is a question as to whether the separate entity rule applies, counsel should be consulted immediately.

Of note, this decision concerns only a court's authority under New York law to require restraint or seizure of assets in post-judgment proceedings involving foreign bank branches. Other statutes continue to have extraterritorial reach. For example, federal forfeiture law permits the United States to seize funds from a foreign bank's correspondent account. Moreover, the *Motorola Credit* decision does not limit a bank's obligations to collect and produce documents possessed abroad pursuant to a subpoena served on a New York branch.

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