Practice Update

New York Court of Appeals Reaffirms the Separate Entity Rule

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On October 23, 2014, the New York Court of Appeals issued an opinion in *Motorola Credit Corp. v. Standard Chartered Bank*, --- N.E.3d ----, 2014 WL 5368774, 2014 N.Y. Slip Op. 07199 (N.Y. Oct. 23, 2014), reaffirming New York's "separate entity rule." This opinion will impact a judgment-creditor's ability to restrain assets and collect upon a judgment against a judgment-debtor that has assets located in foreign branches of an international financial institution, even if the financial institution also has a branch located in New York.

Background

This case has a long and winding history. Between April 1998 and September 2000, several members of the Uzan family induced Motorola Credit Corporation ("Motorola") to loan over $2 billion to a Turkish telecommunications company they controlled and then, unbeknownst to Motorola, diverted a substantial portion of these funds to themselves and entities they controlled. In 2003, the Southern District of New York entered judgment in Motorola's favor for compensatory damages for approximately $2.1 billion and then entered a subsequent judgment in Motorola's favor for $1 billion in punitive damages.

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The Uzan family avoided satisfying the judgments and remained in contempt for failure to comply with several of the District Court's orders, subjecting them to arrest if they enter the U.S. In February 2013, the District Court entered an order pursuant to Rules 65 and 69 and C.P.L.R. 5222 restraining the Uzans and anyone with notice of the order from selling, assigning or transferring their property. Thereafter, Motorola served a restraining notice on the New York branch of Standard Chartered Bank ("SCB"), a bank organized and headquartered in the United Kingdom.

A global search of SCB's branches found roughly $30 million in Uzan-related assets in SCB's branches in the United Arab Emirates ("U.A.E."). SCB froze those assets in accordance with the restraining notice, but regulatory authorities in the U.A.E. and Jordan quickly intervened in opposition. In May 2013, SCB sought relief from the restraining notice, claiming that the restraint of the $30 million in assets violated U.A.E. law and subjected it to double liability. SCB also contended that, under New York's separate entity rule, service of the restraining notice on SCB's New York branch was effective only as to assets located in accounts at that domestic branch and could not freeze assets situated in foreign branches.

In a sealed order, the District Court agreed with SCB and concluded that the separate entity rule precluded Motorola from restraining assets at SCB's foreign branches but stayed the release of the restraint pending the outcome of Motorola's appeal. The Second Circuit certified the following question to the New York Court of Appeals:

"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 foreign branches of the bank."

The Court of Appeals' Holding

The Court of Appeals answer the question in the affirmative. Writing for the majority, Judge Graffeo held that the separate entity 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, particularly with respect to CPLR article 62 prejudgment attachments and article 52 postjudgment restraining notices and turnover orders." In other words, "a restraining notice or turnover order served on a New York branch will be effective for assets held in accounts at that branch but will have no impact on assets in other branches." [1]

In applying the separate entity rule to this case, the Court of Appeals emphasized New York's common law jurisprudence and the long history of this rule, finding that "[b]y [the] 1950s and 1960s, the separate entity rule was described by state and federal courts as well established and supported by a consistent line of authority." Therefore, "it is a firmly established principle of New York law, with a history of application both before and after the 1962 adoption of the CPLR."

The Court of Appeals also rejected Motorola's argument that it had previously abrogated the separate entity rule in *Koehler v. Bank of Bermuda Ltd.*, 12 N.Y.3d 533 (2009). In *Koehler*, a judgment creditor secured a turnover order, pursuant to CPLR 5225, directing a garnishee bank in Bermuda to deliver stock certificates belonging to the judgment debtor. The Bermuda bank consented to personal jurisdiction based on the presence of a subsidiary in New York. The question certified to the Court of Appeals by the Second Circuit was "whether a court sitting in New York may order a bank over which it has personal jurisdiction to deliver stock certificates owned by a judgment debtor (or cash equal to their value) to a judgment creditor, pursuant to CPLR article 52, when those stock certificates are located outside New York." *Koehler*, 12 N.Y.3d at 536. Thus, in *Koehler*, the Court of Appeals answered that question in the affirmative, concluding that the "the Legislature intended CPLR article 52 to have extraterritorial reach" and that "the key to the reach of the turnover order is personal jurisdiction over a particular defendant." *Id.* at 539-40.

In *Motorola*, the Court of Appeals distinguished *Koehler* because *Koehler* lacked any discussion of the separate entity rule. The Court recognized three reasons for its silence in *Koehler*: (1) the foreign bank did not raise the issue; (2) the separate entity rule would not have aided the foreign bank in *Koehler* because that case involved neither bank branches nor assets held in foreign bank accounts; and (3) the judgment creditor in *Koehler* apparently served the bank in Bermuda, not only its New York subsidiary. *Motorola*, n.5.[2]

Finally, the Court of Appeals was very mindful of the impact of the separate entity rule upon New York's "status as the preeminent commercial and financial nerve center of the Nation and the world." By rejecting the separate entity rule, foreign banks choosing to open branches in New York would face the risk of encountering competing claims in local and foreign jurisdictions, suffering the possibility of double liability in these separate jurisdictions, and would ignore the reality that foreign banks are subject to a multitude of legal and regulatory regimes. Consequently, the Court of Appeals concluded 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.

Implications

Virtually every bank of international significance likely has at least one branch located in New York. Now, after *Motorola*, however, the ability for a judgment-creditor to reach, restrain, and compel the turnover of a judgment-debtor's foreign assets through the New York branch of an international bank is diminished. At the same time, two other aspects of the *Motorola* opinion are worth additional consideration.

First, *Motorola* and most cases which apply the separate entity rule involve banks branches in foreign countries. But *Motorola* notes that some cases have applied the rule to bar a restraint even where a domestic bank also have a branch located in New York. The Court of Appeals declined to address the domestic application of the separate entity rule in Motorola since the Court's analysis was limited to "whether the rule prevents the restraint of assets held in foreign branch accounts." In practice, however, one should be well-advised to follow the state-specific domestication requirements for a state-issued judgment or to register a federal judgment pursuant to 28 U.S.C. § 1963 to avoid unnecessary litigation over enforcement of the judgment.

Second, in distinguishing *Koehler*, the Court of Appeals left open the possibility that the acquisition of personal jurisdiction over a foreign bank, coupled with the service of the restraining notice upon its headquarters and branch holding the relevant assets, may provide a basis for enforcing the restraining notice. The Court of Appeals complicates this analysis, however, by referencing the U.S. Supreme Court's recent decision in *Daimler AG v. Bauman*, 134 S. Ct. 746, 761 (2014) (holding that general jurisdiction over a foreign corporation may not be predicated solely on the grounds that the corporation "engages in a substantial, continuous, and systematic course of business" in the State, but general jurisdiction exists only if the corporation is "essentially at home in the forum State."). In *Motorola*, the District Court asserted jurisdiction over SCB because of the presence of its New York branch, and was silent as to whether specific jurisdiction existed sufficient to meet the standard under *Koehler*. Thus, the possibility of enforcing a turnover order against a foreign bank once jurisdiction exists and service is accomplished should remain open to future judgment creditors.

[1] The Court of Appeals cited three rationales for the separate entity rule: (1) the importance of international comity and the fact that any banking operation in a foreign country is necessarily subject to the foreign sovereign's own laws and regulations; (2) the protection of banks from being subject to competing claims and the possibility of double liability; and (3) the intolerable burden that would otherwise be placed on banks to monitor and ascertain the status of bank accounts in numerous other branches.

[2] The Court of Appeals also rejected the argument that the separate entity rule could not apply to preclude enforcement of the restraining notice because the rule is not embodied within the text of CPLR Article 52. The separate entity rule predated the enactment of the CPLR by several decades, and, thus, the Court of Appeals determined that the issue before it was not one of statutory construction but rather whether this common-law rule was retained within the subsequent statutory enactment.
