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NEWSLETTER

By : Schnader Harrison Segal & Lewis LLP

Law Office YANG & CO in association with Schnader

THE "SEPARATE ENTITY RULE" REMAINS ALIVE AND WELL IN NEW YORK STATE

On October 23, 2014, in Motorola Credit Corp. v. Standard Chartered Bank, No. 162, 2014 N.Y. LEXIS 2946 (2014), the New York State Court of Appeals, New York's highest court, answered in the affirmative the following question certified to the court by the U.S. Court of Appeals for the Second Circuit:

"[W]hether 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."

(Tire Engineering and Distribution LLC v. Bank of China Ltd., 740 F.3d 108, 118 (2d Cir. 2014).[1]

[1] The U.S. Court of Appeals for the Second Circuit also certified to the New York State Court of Appeals, in the same order, the question as to whether the separate entity rule precludes a judgment creditor from ordering a garnishee bank operating branches in New York to turn over a debtor's assets held in a foreign branch of that bank. That certified question was subsequently withdrawn by the Second Circuit.

While some observers believed the separate entity rule had been abrogated by the court's decision in Koehler v. Bank of Bermuda Ltd., 12 N.Y.3d 533 (2009), the Motorola 5-2 decision establishes that the rule is indeed alive, and that, under New York law, a bank having a branch in New York that has been served with a judgment creditor's restraining notice or orders is not permitted to restrain the judgment debtor's assets held in a branch of the bank located in a foreign country. Stated another way, a judgment debtor need not fear that its assets in a foreign bank account will be subject to restraint based on a restraining notice and order served on a New York branch of the bank. The New York and foreign branches of the same bank are treated as legally separate entities.

The separate entity rule, a product of common law tracing back to a 1916 decision of an intermediate New York appellate court (Chrzanowska v. Corn Exch. Bank, 173 A.D. 285 (1st Dep't 1916), aff'd without opn, 225 N.Y. 728 (1919)), as utilized by New York State courts and federal courts in applying New York law, provides that branches of a garnishee bank are to be treated as separate entities for purposes of CPLR Article 62 (Attachment) pre-judgment attachments and CPLR Article 52 (Enforcement of Money Judgments) post-judgment restraining notices and orders, so that writs of attachment and restraining notices and orders are effective only as to assets held in the specific branch or branches served with the writ of attachment or restraining notice or order in New York. Accordingly, under the separate entity rule, foreign branches of a garnishee New York bank are to be treated as separate entities from the New York branch with respect to pre-judgment attachments and post-judgment restraining notices and orders, although the New York bank branch is subject to personal jurisdiction in New York State and federal courts. The court's decision in Koehler (discussed below), however, placed the continuing vitality of the separate entity rule in doubt.

The Motorola case concerned a loan of more than $2 billion issued by Motorola Credit Corporation to Cem Uzan and members of his family, a wealthy Turkish family with several telecommunications and media holdings. In 2003, the U.S. District Court for the Southern District of New York, finding that the Uzan Family engaged in a scheme to fraudulently divert funds of over $2 billion loaned by Motorola Credit to the Uzan Family, and concealed their scheme through "an almost endless series of lies, threats, and chicanery," entered a judgment against the Uzan Family of approximately $2.1 billion. Motorola Credit Corp. v. Uzan, 274 F. Supp. 2d 481, 580 (S.D.N.Y. 2003). Upon a subsequent imposition of punitive damages, that award was increased by the District Court by an additional $1 billion. Motorola Credit Corp. v. Uzan, 413 F. Supp. 2d 346 (S.D.N.Y. 2006).

In an effort to collect on its judgment, Motorola Credit served a restraining order under CPLR 5222 on the New York branch of Standard Chartered Bank (SCB), a foreign bank incorporated and headquartered in the United Kingdom. The SCB branch in New York was unable to locate any assets owned by the Uzan Family held in its branch. However, a global search of the Uzan Family's assets identified approximately $30 million in SCB branches located in the United Arab Emirates (UAE). Complying with the restraining order, SCB froze $30 million in the UAE accounts. The Central Bank of UAE, having regulatory authority over SCB, upon being notified of SCB's UAE branch's compliance with the New York restraining order, responded by debiting SCB's account in the same approximate $30 million amount. The Central Bank of UAE asserted that debiting SCB's account was necessary to protect claims by potential creditors other than Motorola Credit.

SCB, finding itself between the proverbial rock and a hard place, and at risk to lose $30 million of its own money by twice paying Uzan Family creditors, moved in federal district court in the Southern District of New York for a protective order. SCB argued that the separate entity rule prevented the District Court from ordering the restraint of property outside of SCB New York's accounts. The District Court agreed with SCB but stayed the release of the restraint pending resolution of Motorola Credit's appeal to the Second Circuit. The Second Circuit then certified its question to the New York Court of Appeals.

In a majority opinion authored by Judge Graffeo[2], the court confirmed the separate entity rule's continuing vitality in New York. The Motorola majority reaffirmed the justifications for the rule that have been oft cited by lower courts since the doctrine's inception nearly one hundred years ago. First, the court confirmed that the separate entity rule is still necessary for the promotion of international comity. Recognizing that a bank's branch in a foreign country is subject to the foreign sovereign's own laws and regulations, the court reasoned that it would be improvident to impose New York court restraining orders upon foreign bank branches that might contravene the laws of the foreign country. The court expressed concern about the risk of "competing claims and the possibility of double liability in separate jurisdictions" in the absence of the protections afforded garnishees under the separate entity rule. Second, the court further reasoned that abolishing the separate entity rule would have a negative impact on New York's preeminent position as a commercial banking center. "Undoubtedly, international banks have considered the doctrine's benefits when deciding to open branches in New York, which in turn has played a role in shaping New York's 'status as the preeminent commercial and financial nerve center of the Nation and the world.'" *Motorola* (citing *Ehrlich-Bober & Co*. v. *Univ. of Houston*, 49 N.Y.2d 574, 581 (1980)). Finally, the court acknowledged the "intolerable burden" that would result from abolishing the rule,

particularly the imposition upon banks to constantly "monitor and ascertain the status of bank accounts in numerous other branches."[3]

[2] *Judge Graffeo was joined by Chief Judge Lippman and Judges Read, Smith and Rivera.*

[3] *In a footnote, the Motorola majority recognized that, although most cases analyzing the separate entity rule involved bank branches in foreign countries, some courts have applied the rule to bar restraints even where the unserved branch was located in New York. The Motorola majority limited its treatment of the separate entity rule to situations involving foreign country bank branches, declining to rule on the application of the separate entity rule to domestic bank branches in the United States.*

Judge Abdus-Salaam dissented.[4] Focusing on the alleged contumacious conduct of the Uzan Family, the dissent criticized the majority for rendering an opinion which "permits banks doing business in New York to shield customer accounts held in branches outside of this country, thwarts efforts by judgment creditors to collect judgments, and allows even the most egregious and flagrant judgment debtors to make a mockery of our courts' duly entered judgments." Judge Abdus-Salaam identified four arguments which she contended undermined the majority's answer to the certified question: (i) the absence of any explicit or implied mention of the separate entity rule in Article 52 of the CPLR; (ii) the obsolescence of a separate entity rule in an environment where banks overwhelmingly centralize their computer management systems, facilitating ease of effort to track account holders' assets worldwide; (iii) the overbreadth of the separate entity rule inasmuch as many foreign countries have laws that would permit recognition of a New York restraining order and, therefore, the rule does little to promote international comity; and (iv) the Motorola majority decision cannot be reconciled with the court's holding in *Koehler*.

[4] *Judge Pigott, who authored the Court's opinion in Koehler, joined in the dissent.*

Rebutting the dissent's first three arguments, the Motorola majority found that (i) because the separate entity rule predates the CPLR and is necessarily a creation of common law, its absence from mention in the CPLR is of no moment; (ii) the dissent's faith in the technological advancement of the international banking industry since the rule was created is belied by the real-world limitations (including costs) associated with a bank's worldwide search for assets; and (iii) the separate entity rule's promotion of comity is its paramount rationale, and, as such, the rule serves to avoid conflicts among competing legal systems.

The *Motorola* majority took issue with the dissent's fourth argument that the court abrogated the separate entity rule in its 2009 decision in Koehler. In Koehler, the New York Court of Appeals answered in the affirmative the Second Circuit's certified question as to whether a New York court may order a foreign garnishee bank over which it has personal jurisdiction to deliver stock certificates owned by the judgment debtor, but located in the garnishee bank outside of the country. The *Motorola* majority emphasized that Koehler is limited to the issue of whether CPLR Article 52 has extraterritorial reach when the court has personal jurisdiction over the garnishee. The majority also noted that the garnishee foreign bank in Koehler failed to raise the separate entity rule. The *Motorola* majority further acknowledged that the cases were distinct, given that Koehler "involved neither bank branches nor assets held in bank accounts."

Motorola has put to rest important questions following Koehler as to whether the separate entity rule survived that 2009 decision. The separate entity rule indeed lives on – at least where bank branches in foreign countries are involved.

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For more information about Schnader's Financial Services Litigation group or to speak with a member of the firm, please contact:

Steve Fogdall
Financial Services Litigation Co-Chair
215-751-2581
sfogdall@schnader.com

Steve Shapiro
Financial Services Litigation Co-Chair
215-751-2259
sshapiro@schnader.com

Kenneth R. Puhala
212-973-8140
kpuhala@schnader.com

Theodore L. Hecht
212-973-8160
thecht@schnader.com

Eric A. Boden
212-973-8015
eboden@schnader.com

Marcia Wibisono
021-2938-0878
mwibisono@yangandco.com

www.yangandco.com

www.schnader.com