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New York Court of Appeals Affirms Separate Entity Rule

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Introduction

On October 23, 2014, in *Motorola Credit Corp. v. Standard Chartered Bank*, 2014 NY Slip Op 07199 (N.Y. App. Div. Oct. 23, 2014), the New York Court of Appeals held in a 5-2 opinion that a “judgment creditor’s service of a restraining notice on a garnishee bank’s New York branch is ineffective . . . to freeze assets held in the bank’s foreign branches.”¹ This ruling provides further assurance to international banks with branch offices in New York that a restraining notice or turnover order served on a New York branch is only effective as to assets held at that branch and has no impact on assets held at foreign branches.² Accordingly, a New York court must have jurisdiction over the specific branch and the account(s) that hold the assets for a garnishment order to be effective.

Separate Entity Rule Under Scrutiny

The viability of the separate entity rule has been under scrutiny since the 2009 Court of Appeals decision in *Koehler v. Bank of Bermuda, Ltd.*³

¹ *Motorola Credit Corp. v. Standard Chartered Bank*, 2014 NY Slip Op 07199, *6.

² *Id.*

³ *Koehler v. Bank of Bermuda Ltd.*, 12 N.Y.3d 533 (2009); See e.g. *Tire Eng’g & Distrib., LLC v. Bank of China*, 740 F.3d 108, 115 (2d Cir. 2014) (expressing doubt that the Court of Appeals intended to silently overrule the longstanding application of the separate entity rule); *Ayyash v. Koleilat*, 38 Misc. 3d 916, 927 [Sup Ct, NY County 2012] (“Because *Koehler* did not involve the application of the separate entity rule, courts have rejected arguments that *Koehler* impliedly abrogated the separate entity rule in post-judgment enforcement proceedings.”); *Gliklad v. Bank Hapoalim, B.M.*, NO. 155195/2014 (N.Y. Sup. Ct. NY Co. Aug. 11, 2014) (“As the separate entity rule appears to have played no part in the analysis of the *Koehler* court, the court finds no reason to

In *Koehler*, the Court held if a bank consents to personal jurisdiction in New York, a turnover order issued under CPLR 52 could be used to seek stock certificates located outside the country.⁴ Without mentioning the separate entity rule, the Court in *Koehler* opened the door to a challenge of the doctrine when it stated that, “the Legislature intended CPLR 52 to have extraterritorial reach and . . . the key to the reach of the turnover is personal jurisdiction over a particular defendant.”⁵

Motorola’s Argument Against The Separate Entity Rule

In the latest challenge to the separate entity rule, Motorola Credit Corp sought to collect on a \$3.1 billion judgment entered in the United States District Court for the Southern District of New York against members of the Uzan family, who had fraudulently diverted billions of dollars in loans from Motorola. The District Court entered an order pursuant to CPLR 5222 in favor of Motorola, “restraining the Uzans and anyone with notice of the order from selling, assigning, or transferring their property.” (the “Order”)

Motorola served the Order on the New York branch of Standard Chartered Bank (“SCB”). A global search of its branch locations revealed that \$30 million of Uzan family assets were held at a branch in the United Arab Emirates (“UAE”), interpret that it either endorsed or abrogated the rule.”); *But see JW Oilfield Equip., LLC v. Commerzbank AG*, 764 F.Supp.2d 587, 595 (S.D.N.Y. 2011) (“*Koehler* indicates that New York courts will not apply the separate entity rule in post-judgment execution proceedings.”)

⁴ *Koehler*, 12 N.Y.3d at 536.

⁵ *Id.* at 545.

SCB froze the assets in accordance with the Order. However, regulatory authorities in the UAE intervened, disregarded the New York judgment, and unilaterally debited about \$30 million from SCB's account with the U.A.B. Central Bank.

In May 2013, SCB sought relief from the Order in District Court, claiming that under the separate entity rule, the Order was only effective with respect to assets located in accounts at SCB's New York branch. In opposition, Motorola argued that the separate entity rule was effectively abrogated in *Koehler* and no longer applied to post-judgment enforcement actions.⁶

The District Court held that the separate entity rule precluded Motorola from using the Order to restrain assets in foreign bank branches.⁷ Motorola appealed to the Second Circuit, which 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?⁸

The Court of Appeals Clarifies *Koehler* And Affirms The Separate Entity Rule

The Court of Appeals affirmed the separate entity rule, holding that, "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."⁹

⁹The Court primarily based its decision on the

following reasons: (i) "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"; (ii) to "protect banks from being subject to competing claims and the possibility of double liability", and (iii) "the intolerable burden that would otherwise be placed on banks to monitor and ascertain the status of bank accounts in numerous other branches."¹⁰

In rejecting Motorola's argument that *Koehler* abolished the separate entity rule, the Court of Appeals noted that the *Koehler* bank never raised the separate entity rule, thus the *Koehler* Court did not even address it, much less overturn the rule.¹¹ It noted that the *Koehler* case involved neither bank branches nor assets held in bank accounts, i.e. stock certificates. The *Motorola* Court also recognized that the rule is a long standing common-law doctrine functioning as a limiting principle in international banking, specifically in situations involving attempts to restrain assets held in a garnishee bank's foreign branches.¹² Accordingly, the Court of Appeals found that the separate entity rule is compatible with CPLR 5222, as it is a common law principle that predates the CPLR by several decades.¹³

In dissent, Judge Abdus-Salaam argued that the separate entity rule is antiquated and outdated because centralized banking and advanced technology have allowed for near instant communication between bank branches.¹⁴ The dissent further offered that, "every bank knows that it no longer exists in a world where it can shrug off a duly entered judgment for assets in

⁶ *Motorola Credit Corp. v. Standard Chartered Bank*, 2014 NY Slip Op 07199 at *2.

⁷ *Id.* at *2.

⁸ *Id.* at *1.

⁹ *Id.* at *2-3.

¹⁰ *Id.* at *3.

¹¹ *Id.* at *4.

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.* at *7.

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The Court of Appeals Affirmed the Separate Entity Rule Holding That, "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"

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its collective coffers on the theory that it would have to resort to a long game of international telephone tag, as opposed to a brief search of its computer database”¹⁵ The dissent’s policy considerations could be relevant when a New York court is asked to address the application of the separate entity rule to bank branches elsewhere in the United States – a question that is still unsettled.

Implications of *Motorola*

The Court’s decision in *Motorola* clarifies the holding in *Koehler* and puts to rest any question of the continued viability of the separate entity rule in New York. The decision is a significant victory for the banking community. It provides assurances to international banks with New York branches that restraining orders served on their New York branch offices will have no effect on assets held in foreign branches or accounts. It further removes banks from the unenviable position of choosing between contradictory directives in different jurisdictions, each with significant judicial, regulatory, and financial repercussions. ■

¹⁵ *Id.* at *8

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