

SOUTHERN DISTRICT CIVIL PRACTICE ROUNDUP

Expert Analysis

Judgment Enforcement And the Separate Entity Rule

The “separate entity rule” is a long-standing judge-made rule requiring that each branch of a bank be treated as a separate entity for purposes of attachment and execution in New York courts.¹ Following a 2009 decision by the New York Court of Appeals in *Koehler v. Bank of Bermuda*,² confirming that New York’s judgment enforcement statute reaches assets held outside the jurisdiction by a garnishee over whom the court has personal jurisdiction, New York courts have reached varying conclusions as to the continued application of the separate entity rule in the post-judgment enforcement context. Most recently, Southern District Judge Jed S. Rakoff held that the separate entity rule survives *Koehler* and protects banks subject to personal jurisdiction in New York from being ordered to restrain or turn over a judgment debtor’s assets held by branches outside the jurisdiction.

In our April 2011 column titled “Broad Judgment Enforcement in New York Federal Courts,”³ we reported, it now appears prematurely, the death knell of the separate entity rule in the context of judgment enforcement efforts directed at New York banks with assets of a judgment debtor held outside the jurisdiction. In that column, we discussed the then recent Southern District decision in *JW Oilfield Equip. v. Commerzbank*⁴ which relied



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on *Koehler* to reject application of the separate entity rule in post-judgment proceedings. Indeed, even the bank in that case, which vigorously resisted the turnover order, conceded that *Koehler* had “effectively preempt[ed]” the separate entity rule in that context.⁵

The ‘Motorola’ Decision

Rakoff’s decision in *Motorola Credit v. Uzan*⁶ reached the opposite conclusion. That decision was issued as part of a decade-long saga involving Motorola’s efforts to collect on a \$2 billion judgment against a group of defendants (the Uzans) who diverted loans made by Motorola to a Turkish telecommunications company they controlled. In an earlier ruling, Rakoff issued an injunction and restraining order which, in part, required any subpoenaed party in possession of assets belonging to the Uzans or their agents to freeze and restrain access to such property. The Jordan Dubai Islamic Bank (JDIB) was identified as an “Uzan proxy,” making it an agent of the Uzans for purposes of the order.

Motorola served a copy of the injunction and restraining order on the New York branch of Standard Chartered Bank, an international bank headquartered in the

United Kingdom. Standard Chartered initially sought to comply with the subpoena and conducted a global search for assets belonging to the Uzans and their identified proxies, locating and freezing assets worth approximately \$30 million belonging to JDIB in its branch in the United Arab Emirates (UAE).

Standard Chartered characterized the assets as interbank deposits which are short-term transfers between banks to be repaid with interest.⁷ When Standard Chartered refused to make its scheduled repayments to JDIB, the UAE Central Bank debited the total amount of JDIB’s assets from Standard Chartered’s account with the Central Bank. Standard Chartered then sought relief from Rakoff’s injunction and a restraining order.

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Rakoff declined to modify his injunction and restraining order on equitable grounds to protect Standard Chartered from double liability. He was unpersuaded by Standard Chartered’s “dire predictions” of having to turn over JDIB’s assets to Motorola while being required to repay the same funds to JDIB under UAE law, but held that even in those circumstances “under New York law...banks assume the risk

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of double liability as an ordinary cost of doing business in multiple jurisdictions.”⁸

Application of the Rule

Rakoff tempered this harsh result, however, finding that the separate entity rule saved Standard Chartered from having to restrain assets held by its foreign branches. Specifically, he rejected Motorola’s argument that *Koehler* had overruled the separate entity rule, as well as Judge P. Kevin Castel’s reasoning in *JW Oilfield v. Commerzbank*.

Rakoff found that *Koehler* did not even concern the separate entity rule because in that case, the Bermuda bank branch that held the judgment debtor’s assets had itself consented to jurisdiction in New York, so that unlike the Standard Chartered UAE branch, the foreign branch in *Koehler* was subject to the New York court’s jurisdiction. Indeed, *Koehler* does not mention the separate entity rule at all.

of the fact that other New York statutes codified treatment of banking branches as separate entities.¹¹ Rakoff was unpersuaded, observing that “given the over fifty-year lifespan of the separate entity rule, it is equally reasonable to assume that the legislature has intentionally acquiesced in—and indeed expanded upon—the separate entity rule’s application in the enforcement context.”¹²

Rakoff was similarly unswayed by Motorola’s argument that the separate entity rule has been rendered obsolete by modern technology. Specifically, Motorola noted that the rationale for creation of the separate entity rule 50 years ago was that banks lacked the ability to communicate quickly regarding attachments and thus “no branch could safely pay a check drawn by its depositor without checking with all other branches and the main office to make sure that no warrant of attachment had been served upon any of them,” placing an “intolerable burden upon banking and commerce.”¹³ Motorola contended that modern communications erased any need for the “legal fiction” treating banks differently than other multinational entities holding the property of a judgment debtor.

Rakoff found that the separate entity rule was based not just on access to information, but on the need to avoid undue disruption to routine banking practices, which even with the advent of global telecommunications “may still carry weight when the requested transfers involve banks subject to foreign laws and practices.”¹⁴ Resurrecting the very double-liability argument he had rejected as a basis for declining to modify the injunction on equitable grounds, Rakoff found that without the separate entity rule a bank that freezes or turns over a debtor’s assets held at a foreign branch risked violating local law if the foreign law did not recognize the validity of the turnover action.

He noted that Standard Chartered had raised precisely these concerns in this case, and found that the action had already disrupted Standard Chartered’s operations in the UAE and Jordan. Rakoff concluded that “the policies implicated by the separate entity rule run much deeper than the ability to communicate across branches.” Absent express guidance from the New York Court of Appeals or the Legislature, he declined to

make the “sorts of policy determinations” underpinning Motorola’s arguments.

Mindful that release of the asset freeze would jeopardize Motorola’s prospects of recovering assets from JDIB and in recognition of the fact that the status of the separate entity rule in the context of judgment enforcement proceedings remains an “open and hotly-contested issue in the wake of *Koehler*,” Rakoff granted a temporary injunction staying release of JDIB’s assets pending Motorola’s appeal of his order.¹⁵

Conclusion

If these decisions applying the separate entity rule in the post-judgment context withstand appeal,¹⁶ they will provide some relief to international banks with New York branches who find themselves caught not just between judgment debtor and creditor, but between competing legal systems with inconsistent banking regulations and attitudes toward enforcement of foreign judgments.

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1. *Cronan v. Schilling*, 100 N.Y.S.2d 474, 476 (Sup. Ct. 1950), aff’d, 126 N.Y.S.2d 192 (1st Dept. 1953). See also *Shaheen Sports v. Asia Ins.*, 2012 WL 919664, at *3 (S.D.N.Y. March 14, 2012) (Preska, C.J.).

2. 12 N.Y.S.2d 533 (2009).

3. NYLJ April 19, 2011.

4. 764 F.Supp.2d 587 (S.D.N.Y. 2011) (Castel, J.).

5. 764 F.Supp.2d at 595.

6. 2013 WL 4452014 (S.D.N.Y. Aug. 21, 2013).

7. The parties disputed the nature of the assets, which were actually a series of commodities trades designed to permit interbank transfers that complied with the prohibition of paying interest under Islamic law. Rakoff held that the assets were either the commodities or proceeds of those trades belonging to JDIB, but that even if he were to accept Standard Chartered’s characterization of the assets as interbank deposits, they would nevertheless constitute assets subject to restraint under New York’s broad judgment enforcement statute permitting service of a restraining order on a garnishee owing a debt to a judgment debtor. Id. at *3 (citing NYCPLR §5222(b)).

8. 2013 WL 4452014, at *4 (citing *Petrogradsky Mejdunarodny Kommerchesky Bank v. Nat’l City Bank of N.Y.*, 170 N.E. 479, 485 (1930); *JPMorgan Chase Bank v. Motorola*, 846 N.Y.S.2d 171, 184 (App. Div. 2007)).

9. 2012 WL 919664 (S.D.N.Y. March 14, 2012).

10. 929 N.Y.S.2d 202 (Sup. Ct. 2011).

11. 2013 WL 4452014, at *6 (citing N.Y.U.C.C. §4-A-105(1)(b) as an example of a New York statute defining each branch or office of a bank as a separate bank for purposes of the statute).

12. 2013 WL 4452014, at *6.

13. Id. (quoting *Cronan v. Schilling*, 100 N.Y.S.2d at 476).

14. Id. (quoting from an earlier decision in the same matter, 288 F.Supp.2d 558, 561 (S.D.N.Y. 2003)).

15. Id. at *9-10.

16. Rakoff’s decision in *Motorola Credit v. Uzan*, issued as a “bottom-line” order on May 30, 2013, and explained in a written opinion at 2013 WL 4452014 (S.D.N.Y. Aug. 21, 2013), as well as an earlier decision by Judge Andrew L. Carter Jr. in *Tire Engineering and Distrib. v. Bank of China*, 12 Civ. 9208 (S.D.N.Y. April 12, 2013) reaching a similar result, have both been appealed and were argued on Oct. 11, 2013.

Rakoff reasoned that given the long history and important policy interests embodied by the separate entity rule, the Court of Appeals would have been explicit had it intended to overrule ‘*Koehler*.’

Relying heavily on an earlier decision by Chief Judge Loretta A. Preska in *Shaheen Sports v. Asia Ins.*,⁹ as well as on a post-*Koehler* New York State Supreme Court decision in *Samsun Logix v. Bank of China*,¹⁰ Rakoff went on to reason that given the long history and important policy interests embodied by the separate entity rule, the Court of Appeals would have been explicit had it intended to overrule *Koehler*.

Motorola raised a number of challenges to the separate entity rule, independent of *Koehler*, each of which Rakoff also rejected in turn. First, Motorola argued that the absence of statutory reference to the separate entity rule in CPLR Article 52—New York’s expansive judgment enforcement statute—was an indication that the Legislature did not intend for the separate entity rule to apply to judgment enforcement efforts under CPLR §5222(b), particularly in light