ARTICLES

Separate Entity Rule for Foreign Banks Lives on in New York

By John P. McCahey

In a case of importance to international banks with branches in New York, the New York Court of Appeals answered "yes" in *Motorola Credit Corp. v. Standard Chartered Bank*, No. 162, 2014 N.Y. LEXIS 2946 (N.Y. Oct. 23, 2014), to the following question certified to it by the United States Second Circuit Court of Appeals in *Tire Eng'g & Distrib. v. Bank of China*, 740 F.3d 108, 118 (2d Cir. 2014):

> 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 New York Court, in its 7-2 decision, specifically declined to "cast aside" the separate entity rule as applied to foreign banks and made clear that its 2009 decision in *Koehler v. Bank of Bermuda Ltd.*, 12 N.Y.3d 533 (N.Y. 2009), did not abrogate that rule. *Motorola Credit* was the first time New York's highest court explicitly addressed the separate entity rule. *Motorola Credit*, 2014 N.Y. LEXIS 2946, at *4.

Motorola Credit arose out of judgments exceeding $3 billion that the plaintiff obtained in federal court in New York against several members of the Uzan family. Those defendants were found to have "perpetrated a huge fraud" by diverting monies loaned by plaintiff to a Turkish company the defendants controlled. The defendants were subject to arrest orders in the United States and United Kingdom and convicted of a multi-billion-dollar bank fraud in Turkey. In enforcing its judgments, plaintiff served a restraining notice in accordance with New York's judgment enforcement procedures (N.Y. CPLR § 5222) upon the New York branch of Standard Chartered Bank (SCB), a foreign bank incorporated and headquartered in the United Kingdom.

SCB did not have any Uzan property at its New York branch, but it located approximately $30 million in Uzan-related assets in its branches in the United Arab Emirates (U.A.E.). The foreign assets were frozen by SCB in accordance with the restraining notice. Regulatory authorities in the U.A.E. and Jordan responded to that freeze by seizing SCB documents and debiting SCB's account by $30 million. SCB eventually sought relief from the restraining notice in federal court relying on the separate entity rule. That proceeding led to the certified question above being presented to the New York Court of Appeals. *Motorola Credit*, 2014 N.Y. LEXIS 2946, at *1-4, 7.

The majority opinion in *Motorola Credit* described the separate entity rule as a nearly century-old New York common law rule developed by lower state courts and federal courts and applied mostly to foreign banks. Under that rule, even when a bank garnishee with a New York branch is subject to New York's personal jurisdiction, that bank's other branches are to be treated as separate entities for certain purposes, particularly with respect to prejudgment atb/c tachments and post-judgment restraining notices and turnover orders. *Id.* at *5-8. "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." *Id.* at *6.

Rejecting the argument that the separate entity rule was no longer justified and should be overruled, the majority found the rule was still necessary for reasons of international comity and to maintain New York's preeminence in global financial affairs. Foreign banks, without the rule, may be hesitant to establish New York branches and thereby subject themselves to risks of double liability in multiple jurisdictions and conflicts with foreign legal systems and regulatory authorities. Additionally, foreign banks may face an "intolerable burden" in having to monitor and ascertain the status of bank accounts at numerous other branches. *Id.* at *6-7, 12-15.

The majority also rejected the argument that the court's 2009 decision in *Koehler*, 12 N.Y.3d 533, had abrogated the separate entity rule. In that case, the court held that a judgment creditor could seek the turnover of stock certificates located overseas provided the Court had personal jurisdiction over the garnishee. The bank holding the stock certificates in *Koehler*, unlike SCB's foreign branches in *Motorola Credit*, had consented to personal jurisdiction in New York. Moreover, the separate entity rule was not argued by the parties in *Koehler* or discussed in the court's opinion, and the case did not involve bank branches or assets held in bank accounts. *Motorola Credit*, 2014 N.Y. LEXIS 2946, at *8-11.

The dissent strongly rejected the majority's reasoning and conclusion. *Id.* at *15-32. It opined, among other things, that the separate entity rule has no statutory basis and was created nearly a century ago for reasons that no longer exist. The risks and burdens that a foreign bank would encounter without the rule "will likely pale in comparison to banks' efforts to comply with the US Patriot Act and the Bank Secrecy Act." *Id.* at *26. In the dissent's view, "any burden imposed on the banks [in the absence of the separate entity rule] is far outweighed by the rights of creditors to enforce their judgment." *Id.*

Motorola Credit is a victory for foreign banks with branches in New York and a setback for judgment creditors seeking to enforce judgments. It is noteworthy that the court limited its analysis and holding to foreign banks having branches in New York and did not address whether the separate entity rule has any application to domestic bank branches or elsewhere in the United States. *Id.* at *6 n.2. If and when the court decides that issue, where neither international comity nor global relations will be at issue, the views held by both the dissent and the judgment creditors may find better traction.

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