The New York Court of Appeals Affirms the Continued Vitality of the "Separate Entity" Rule in the International Banking Context

On October 23, 2014, in *Motorola Credit Corp. v. Standard Chartered Bank*[1], New York's highest court answered a question certified to it by the United States Court of Appeals for the Second Circuit in the affirmative, holding that the "separate entity" rule precludes judgment creditors from ordering multinational banks operating branches in New York to restrain or attach a judgment debtor's assets held in a foreign branch of the bank. In doing so, the New York Court of Appeals rejected the claim that its ruling in *Koehler v. Bank of Bermuda Ltd.* [2] abolished the rule.

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 C.P.L.R. Article 62 prejudgment attachments and Article 52 postjudgment restraining notices and turnover orders.[3] Thus, restraining notices or turnover orders served on a New York branch will be effective only for assets held in accounts at that branch, and will have no effect on assets held in foreign branches.

I. Background

The question came to the New York Court of Appeals from a case filed in the United States District Court for the Southern District of New York. In that case, plaintiff Motorola Credit Corporation ("Motorola") served a restraining notice issued under C.P.L.R. Article 52 on the New York branch of UK-based defendant Standard Chartered Bank ("SCB"). SCB then executed a global search for the judgment debtors' assets, finding no assets of the judgment debtors in its New York branch, but identifying and freezing $30 million of the judgment debtors' assets at its branch in the United Arab Emirates ("U.A.E."). However, the U.A.E. government objected to the application of the restraining order in its jurisdiction, and the U.A.E. Central Bank immediately debited the equivalent sum from SCB's account with the Central Bank.

In May of 2013, SCB sought relief from the restraining order in the Southern District of New York, claiming the order violated U.A.E. law, subjected the bank to double liability, and violated New York's separate entity rule. Opposing SCB's request for relief, Motorola argued that the New York Court of Appeals' decision in *Koehler*, permitting a judgment creditor to seek the turnover of stock certificates located outside the country so long as the court had personal jurisdiction over the garnishee, invalidated the separate entity rule.[4]

The district court ruled in favor of SCB, concluding that the separate entity rule barred international application of the restraining order to assets held in SCB's U.A.E. branch. However, the Second Circuit, citing *Koehler*, concluded that New York law was uncertain in this area and requested the New York Court of Appeals' ruling on the continuing viability of the separate entity rule. This Court of Appeals decision was the answer to the question posed by the Second Circuit.

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[1] *Motorola Credit Corp. v. Standard Chartered Bank*, No. 162 (N.Y. October 23, 2014), *available at* https://www.nycourts.gov/ctapps/Decisions/2014/Oct14/162opn14-Decision.pdf (the "*Opinion*").

[2] *Koehler v. Bank of Bermuda*, 12 N.Y.3d 553 (2009).

[3] *See Matter of National Union Fire Ins. Co. of Pittsburgh, Pa. v. Advanced Empl. Concepts*, 269 A.D.2d 101 (1st Dept. 2000); N.Y. C.P.L.R. § 6222 and § 5222.

[4] *Koehler*, 12 N.Y.3d 553.

II. The Court of Appeals' Decision

In a 5-2 decision, the Court of Appeals ruled in favor of SCB and reaffirmed the state's separate entity rule. Writing for the majority, Judge Victoria Graffeo noted the rule "has been part of the common law of New York for nearly a century" and the rationale for the rule "still ring[s] true today."[5] First, the rule promotes international comity and the reality that foreign banking operations are already subject to the foreign sovereign's individual laws and regulations. Second, the rule protects banks from being subject to competing legal claims or the potential of double liability. Finally, the rule removes the otherwise "intolerable burden" of determining the status of bank accounts in various other branches.[6]

The separate entity rule traces its existence in New York common law back to a 1916 decision[7], where the Appellate Division concluded "different branches were as separate and distinct from one another as from any other bank."[8] Decades later, the rule was applied in the postjudgment context, where a New York court held that a restraining order served on a New York branch of a foreign bank garnishee did not extend to a judgment debtor's account in the bank's Mexican branch.[9] By the 1950s and 1960s, the separate entity rule was "well established,"[10] and the rule endured into the 21st century in the postjudgment context.[11]

In the current case, the Court said the separate entity rule continued to apply despite the *Koehler* decision and the fact that it is not explicitly stated in the C.P.L.R.. The Court distinguished *Koehler*, stating first that the case contained no discussion of the separate entity rule. It concluded that the reason for such silence was, first, because the issue was not raised by the foreign bank plaintiff in that case, and second, because the case involved neither bank branches nor assets held in bank accounts. It added that the judgment creditor in *Koehler* also served restraining notices on both the bank in Bermuda and the New York subsidiary. Thus, according to the majority, *Koehler* did not analyze or overrule the separate entity rule. Furthermore, the Court explained that the separate entity rule is not irreconcilable with the holding in *Koehler*, that the scope of C.P.L.R. Article 52 is generally tied to the exercise of personal jurisdiction over a garnishee, because it serves as a "limiting principle" in the international banking context.[12]

The Court also disposed of Motorola's argument that the separate entity rule was incompatible with C.P.L.R. Article 52 because the rule was not explicitly embraced by the statute. The Court explained that Motorola's reliance on the plain meaning of the statute's language was misplaced, as the separate entity rule predated the C.P.L.R. by several decades.

Finally, the Court refused Motorola's request to abolish the separate entity rule entirely. It cited the enduring nature of the rule and the benefits it guarantees international banks in establishing New York branches, thereby allowing New York to retain its place of "preeminence in global financial affairs."[13] The Court expanded

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[5] *Opinion* at 5.

[6] *Id.* at 7, *citing Cronan v. Schilling*, 100 N.Y.S.2d 474, 476 (Sup. Ct. 1950), *aff'd without opn*, 282 App Div 940 (1st Dept. 1953).

[7] *Chrzanowska v. Corn Exch. Bank*, 173 App Div 285 (1st Dept. 1916).

[8] *Id.* at 291.

[9] *Walsh v. Bustos*, 46 N.Y.S.2d 240 (City Ct., N.Y. County).

[10] *Opinion* at 7, *citing Cronan* at 476.

[11] *Id.* at 7, *citing Gliklad v. Bank Hapoalim B.M.*, 2014 WL 3899209 (Sup. Ct., N.Y. County 2014).

[12] *Id.* at 10.

[13] *Opinion* at 13.

on this line of reasoning, stating that much of the rationale for the adoption of the separate entity rule still exists today. Banks are still at risk of competing claims and the possibility of double liability in separate jurisdictions, and foreign branches are still subject to numerous legal and regulatory rules. Accordingly, the limitation imposed by the separate entity rule "promotes international comity and serves to avoid conflicts among competing legal systems."[14] The Court explained that eradicating such a rule would have significant ramifications in the area of multinational banking, negatively affecting New York's status as the financial capital of the world.

III. The Court of Appeals' Dissent

Writing for the dissent, Judge Sheila Abdus-Salaam argued that the separate entity rule has no role in the modern digital age. She challenged the majority's holding, noting that it permits banks doing business in New York to insulate customer accounts held in foreign branches, frustrates the collection efforts of judgment creditors, and allows judgment debtors to avoid satisfying the claims against them.[15]

First, the dissent contended that C.P.L.R. Article 52 neither expressly nor impliedly incorporates the separate entity rule. It noted that "nothing in the statute exempts . . . banks, or branches of banks, from complying with the restraining notice."[16] Further, it found the majority's argument that the rule predates C.P.L.R. Article 52 a good reason to reject the rule, rather than embrace it.

Second, the dissent argued that the separate entity rule is obsolete and runs counter to public policy. It explained that the reasoning behind the rule is inapplicable in this day of integrated banking and cutting-edge technology, where bank branches can communicate almost instantaneously.[17] Such technology, the dissent argued, eviscerates the once "intolerable burden" on banks cited by the majority.[18] Judge Abdus-Salaam further claimed that "any burden imposed on the banks is far outweighed by the rights of judgment creditors to enforce their judgments."[19]

Third, the dissent stated that a blanket, all-encompassing separate entity rule is not necessary to promote public policy. In response to the majority's argument that the rule promotes comity, the dissent noted that, in many countries banks would not face conflicting laws, and compliance with a restraining notice would be consistent with the law of the foreign sovereign. Thus, the dissent argued, the majority's decision is notably overbroad and unnecessary to promote comity.[20]

Finally, the dissent stated that the majority's reasoning is irreconcilable with *Koehler*. In *Koehler*, the Court of Appeals stated that C.P.L.R. Article 52 was intended to have "extraterritorial reach" and a judgment from a New York court "ordering the turnover of out-of-state assets…applies equally to garnishees."[21] Accordingly, the dissent found the separate entity rule wholly inconsistent with *Koehler*, and declared that any implementation of the rule must be through legislative amendment to C.P.L.R. Article 52.

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[14] *Id.* at 12.

[15] *Dissent* at 2.

[16] *Id.*at 3.

[17] *Id.* at 7.

[18] *Id.*

[19] *Id.* at 10.

[20] *Id.* at 11.

[21] *Id.* at 12.

IV. Significance of the Decision

The New York Court of Appeals' ruling in *Motorola Credit* solidifies the continued viability of the separate entity rule and the limited burden it places on banks to enforce a judgment. Simply put, a New York bank branch may not be compelled by a restraining notice or turnover order to produce a debtor's assets located in an account in one of the bank's foreign branches.

However, the scope of the rule remains in question given the majority's effort to distinguish *Koehler*. The opinion does not specify whether the rule applies solely to those assets held in bank accounts or whether it extends to other types of assets held by the branch. The ruling also leaves open the possibility that a foreign bank branch, subject to personal jurisdiction in New York, that is issued a restraining notice or turnover order would not be protected by the separate entity rule. Finally, it is uncertain whether the rule could shield assets held by foreign entities other than banks.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; or John Schuster at 212.701.3323 or jschuster@cahill.com.

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