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New York's Highest Court Endorses Application of "Separate Entity Rule" to International Banks

Landmark Ruling by Court of Appeals Confirms that Service of Asset Freeze Order on New York Branch of International Bank Does Not Reach Overseas Branches

SUMMARY

In *Motorola Credit Corporation* v. *Standard Chartered Bank*,[1] the New York Court of Appeals confirmed that the separate entity rule, which has existed for nearly 100 years, remains a valid rule of law. Specifically, the Court of Appeals held that "a judgment creditor's service of a restraining notice on a garnishee bank's New York branch is ineffective under the separate entity rule to freeze assets held in the bank's foreign branches."[2] As a result of this ruling, restraining notices served on the New York branches of international banks cannot reach assets held in bank accounts located at banks' foreign branches, meaning that judgment creditors seeking to restrain assets located in foreign bank branches must obtain formal recognition of restraining notices in the country in which the bank accounts that they seek to restrain are located. Sullivan & Cromwell LLP represented Standard Chartered Bank ("SCB") before the New York Court of Appeals, and has represented the Bank in all phases of this litigation.

BACKGROUND

Motorola involves a suit by Motorola, Inc. and Nokia Corporation to recover more than $2 billion that those companies loaned to a Turkish telecommunications company controlled by the Uzan family, which diverted a large portion of the loaned funds to themselves and other entities under their control (so-called "Uzan Proxies"). In 2003, the United States District Court for the Southern District of New York entered a judgment in Motorola's favor for compensatory damages of about $2.1 billion,[3] and three years later the

district court awarded another $1 billion in punitive damages.[4] The Uzans have refused to pay these judgments, and Motorola has pursued collection of these judgments through third-party discovery and post-judgment proceedings before the district court.

On February 13, 2013, the district court issued a Restraining Order that contained a restraining notice entered pursuant to C.P.L.R. § 5222.[5] The Restraining Order instructed those in receipt of the order to restrain assets of the Uzans themselves or over 100 Uzan Proxies, regardless of whether the assets were held in New York or elsewhere.[6] SCB, a bank incorporated and headquartered in the United Kingdom, performed a global search of its branches and found four interbank deposits made by Jordan Dubai Islamic Bank ("JDIB")—an entity previously designated as an Uzan Proxy in the Restraining Order[7]—at an SCB branch in the United Arab Emirates.[8] After Motorola informed SCB that it believed the Restraining Order required SCB to restrain JDIB's deposits in the U.A.E., SCB froze the outward processing of payments owed to JDIB but also sought an order from the district court confirming that the Restraining Order did not reach assets held in SCB's foreign branches.[9] Because the Restraining Order was not legalized and therefore not recognized in the U.A.E., the U.A.E. Central Bank unilaterally debited SCB's account at the Central Bank in the amount of the restrained deposits.[10]

SCB argued to the district court that New York's separate entity rule, which has long recognized that the service of a restraining notice upon a New York bank branch does not restrain property held at other branches, precluded the restraint of assets held at SCB branches abroad. Motorola argued that the New York Court of Appeals, in *Koehler* v. *Bank of Bermuda Ltd.,* 12 N.Y.3d 533 (2009), abrogated the separate entity rule *sub silentio* by holding that a New York court could order a bank over which it has *in personam* jurisdiction to turn over stock certificates, even when those certificates were held abroad. Motorola also argued that the separate entity rule was incompatible with the plain language of C.P.L.R. § 5222, which governs post-judgment restraining notices and which Motorola argued does not mention the separate entity rule.

The district court rejected Motorola's arguments and held that "the separate entity rule precludes Motorola from restraining JDIB's assets located at [SCB]'s UAE branch."[11] In particular, the district court recognized that the separate entity rule remains useful in "avoid[ing] undue disruption of routine banking practices" and "subject[ing] [banks] to double liability—to both debtor and creditor—if foreign law were to not recognize the validity of the action."[12] The district court stayed the release of the restrained funds pending an appeal by Motorola.[13] Motorola appealed to the United States Court of Appeals for the Second Circuit, and the Second Circuit in turn certified the following question to the New York Court of Appeals: "[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."[14] The New York Court of Appeals accepted certification.[15]

THE COURT'S DECISION

In a 5-2 decision, the Court of Appeals answered the certified question in the affirmative and held that "a judgment creditor's service of a restraining notice on a garnishee bank's New York branch is ineffective under the separate entity rule to freeze assets held in the bank's foreign branches."[16]

The Court explained that three main rationales support the separate entity rule: (i) under principles of international comity, "any banking operation in a foreign country is necessarily subject to the foreign sovereign's own laws and regulations," (ii) banks should be protected from competing claims and double liability, and (iii) it would be an "intolerable burden" for banks to have to monitor and ascertain the status of bank accounts in numerous other branches.[17] The court then traced the long history of the rule back to a 1916 First Department decision, *Chrzanowska* v. *Corn Exchange Bank*, in which the court held that different bank branches "were as separate and distinct from one another as from any other bank."[18]

The Court then rejected Motorola's argument that the separate entity rule had been abrogated by either *Kohler* or C.P.L.R. § 5222. First, the Court held that it did not abrogate the separate entity rule in *Koehler*, because (i) the international bank involved there did not raise the separate entity rule and so the Court had no occasion to examine the rule, and (ii) the separate entity rule would not have aided the bank because the case did not involve either bank branches or assets held in bank accounts.[19] Second, the Court rejected Motorola's argument that the separate entity rule was incompatible with the plain language of C.P.L.R. § 5222, because the separate entity rule is a common law rule that predated the C.P.L.R. by several decades. Thus, the Court reasoned that the issue was not one of statutory construction but of whether to retain the common law rule.[20]

The Court also rejected Motorola's argument that the separate entity rule is outdated and should be abolished, finding that the rule "has been a part of the common law of New York for nearly a century" and that "[u]ndoubtedly, 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.'"[21] Significantly, the Court emphasized principles of international comity, stating that "[t]he risk of competing claims and the possibility of double liability in separate jurisdictions remain significant concerns, as does the reality that foreign branches are subject to a multitude of legal and regulatory regimes. By limiting the reach of a CPLR 5222 restraining notice in the international banking context, the separate entity rule promotes international comity and serves to avoid conflicts among competing legal systems."[22]

The Court also observed that the facts of *Motorola* demonstrate why the separate entity rule still is vital. In particular, the Court noted that by complying with the Restraining Order, SCB's account with the U.A.E. Central Bank was debited in an amount equivalent to the frozen deposits, placing SCB "in the difficult position of attempting to comply with the contradictory directives of multiple sovereign nations."[23]

IMPLICATIONS

Although the Second Circuit now will consider the Court of Appeals' ruling in the context of Motorola's appeal of the district court's order preventing Motorola from restraining funds held at SCB's U.A.E. branch, the import of the Court's decision for international non-party banks served with restraining notices at their New York branches appears straightforward. *Motorola* makes clear that restraining notices served on the New York branches of international banks have no effect on assets held in bank accounts located at branches in foreign countries. With respect to assets held abroad, judgment creditors now will need to obtain formal recognition of their restraining notices in the countries where the assets they seek to restrain are located before their restraining notices will have any force or effect on foreign branches of a non-party international bank.

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ENDNOTES

1 No. 162 (N.Y. Oct. 23, 2014).

2 *Id.* at 13.

3 *Motorola Credit Corp.* v. *Uzan*, 274 F. Supp. 2d 481, 580 (S.D.N.Y. 2003).

4 *Motorola Credit Corp.* v. *Uzan*, 413 F. Supp. 2d 346, 353 (S.D.N.Y. 2006).

5 *Motorola Credit Corp.* v. *Uzan*, 978 F. Supp. 2d 205, 207 (S.D.N.Y. 2013).

6 *See id.*

7 The district court subsequently has ruled that JDIB is not an Uzan Proxy, *Motorola Credit Corp.* v. *Uzan*, 02-0666, 2014 WL 4243662, at *3 (S.D.N.Y. Aug. 26, 2014), although Motorola has appealed that ruling.

8 *Motorola*, 978 F. Supp. 2d at 207-08.

9 *Id.* at 208.

10 *Id.*

11 *Id.* at 214-15.

12 *Id.* at 213 (citation and internal quotation marks omitted).

13 *Id.* at 214-15.

14 *Tire Eng'g & Distribution L.L.C.* v. *Bank of China Ltd.,* 740 F.3d 108, 117-18 (2d Cir. 2014).

15 22 N.Y.3d 1113 (2014).

16 *Motorola*, slip op., at 13.

17 *Id.* at 6-7 (citations omitted).

18 173 A.D. 285, 291 (1st Dep't 1916), *aff'd* 225 N.Y. 728 (1919).

19 *Motorola*, slip op., at 9-10.

20 *Id.* at 10-11.

21 *Id.* at 11.

22 *Id.* at 11-12 (citation omitted).

23 *Id.* at 13.

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