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Separate Entity Rule

Banks headquartered outside the United States have long found it beneficial to have a foothold in New York, often in the form of a single, unincorporated bank branch. Pursuant to a well-established doctrine known as the separate entity rule, such international bank branches have been considered to be separate legal entities under New York law, distinct from their corporate headquarters and sister branches abroad. As a result, international banking clients have been able to trust that assets deposited with branches outside of the United States could not be reached by judgment creditors in New York simply because the particular bank had a branch in the state.

In 2009, however, the New York Court of Appeals issued a decision in the case of *Koehler v. Bank of Bermuda* in which it stated that "a court sitting in New York that has personal jurisdiction over a garnishee bank can order the bank to produce stock certificates located outside New York."[1] Although the *Koehler* case did not specifically address the separate entity rule, a number of federal courts have since relied on the case in holding that international banks otherwise subject to jurisdiction in New York can be compelled by a court in New York to provide information about, freeze, transfer, and/or turn over assets held in other countries.

The continued viability of the separate entity rule is currently on appeal to the United States Court of Appeals for the Second Circuit. Until the issue is finally resolved, however, international businesses should be aware of the possibility that adverse judgments may be executed against them in New York, through the New York bank branches of international banks, irrespective of the location of the assets at issue.

The Separate Entity Rule: Rationale and Application

Article 52 of New York's Civil Practice Law and Rules ("CPLR") governs the enforcement of money judgments in both state and federal courts sitting in New York. CPLR § 5225(b), in particular, authorizes a court to order a garnishee – including a bank – to turn over the property of a judgment debtor. CPLR § 301, in turn, accords courts personal jurisdiction over foreign corporations doing business in New York.

But, despite having jurisdiction under CPLR § 301 over international banks that do business in New York through unincorporated branches, courts have long declined to reach beyond assets held in New York branches to satisfy judgments. Instead, under the separate entity rule, "each branch of a bank is a separate entity, [and is] in no way concerned with accounts maintained by depositors in other branches or at the home office."[2]

The rationale underlying the separate entity rule is simple: unless each branch of a bank is treated as a distinct entity for purposes of attachment and the execution of judgments, no branch could safely pay a check or permit a depositor to withdraw funds without first satisfying itself that there had been no order attaching or restraining the depositor's funds served at any sister branch, anywhere in the world. Particularly where banks operate many branches, courts long ago determined that the burden that would be imposed by permitting service on one branch to cause the restraint, attachment, or turnover of funds deposited at all other branches – wherever located – would be intolerable.

Furthermore, without the separate entity rule, the burden on international banks would be even more onerous. Because non-United States bank branches are subject to foreign laws and

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varying banking practices, an order attaching or requiring the turnover of funds deposited in non-United States bank branches might require a bank to choose between violating the laws of its home country or another nation in which it does business, and facing potential contempt sanctions if it does not immediately transfer a judgment debtor's assets to the bank's New York branch.

The Koehler Decision: Does The Separate Entity Rule Still Stand?

Although the New York Court of Appeals' 2009 *Koehler* decision never mentioned the separate entity rule, it has cast doubt on the doctrine's continuing viability – and judgment creditors have been relying on the decision to try to reach assets held in bank branches outside of the United States simply by serving process on a bank branch in New York.

In *Koehler*, the petitioner obtained a default judgment in federal district court in Maryland against his former business partner. The judgment debtor, a resident of Bermuda, owned stock in a Bermuda corporation, and certificates representing those shares were in the possession of the Bank of Bermuda Limited ("BBL"), also located in Bermuda. Pursuant to CPLR Article 52, the petitioner filed a petition in the U.S. District Court for the Southern District of New York demanding delivery of the certificates, and served the petition on a New York subsidiary – not a branch – of BBL. BBL itself – the Bermuda-based entity – consented to the court's personal jurisdiction.

During the course of litigation, the U.S. Court of Appeals for the Second Circuit certified a question to the New York Court of Appeals, asking whether, under CPLR Article 52, a court in New York could order a bank over which it has personal jurisdiction to deliver to a judgment creditor the stock certificates of a judgment debtor (or their cash equivalent) when the certificates are located outside of New York. In a split decision, the Court of Appeals determined that, in Article 52 proceedings, "the key to the reach of [a] turnover order is personal jurisdiction over a particular defendant. . . . [A] court sitting in New York that has personal jurisdiction over a garnishee bank can order the bank to produce stock certificates located outside New York."

Yet, the Court of Appeals did not mention the separate entity rule, which has long operated as an overlay to Article 52 where bank branches are concerned, and was silent as to whether its ruling extended to assets in worldwide branches of international banks. Nevertheless, judgment creditors have relied on *Koehler* in serving New York branches of international banks with demands that the banks provide information about, freeze, and ultimately turn over funds deposited in branches located anywhere in the world.

New York's State and Federal Courts Are Divided

International banks have countered that trial courts should not presume that *Koehler* abrogated the rule absent a clear indication to the contrary. It appears that all of the state trial courts addressing this issue since *Koehler* have agreed with the banks' position. For example, in a January 2012 decision issued in the case of *Global Technology, Inc. v. Royal Bank of Canada*,[3] the state trial court harmonized the separate entity rule with *Koehler* by equating the rule to one governing service of process and concluding that the service of a notice to restrain a judgment debtor's assets must be made upon the bank branch at which the account holding those assets is maintained.[4]

In contrast, however, several federal courts have disagreed with these state court rulings. For example, in the first decision – federal or state – to address the effect of *Koehler* on the

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separate entity rule, a federal district court in the matter of *JW Oilfield Equipment v. Commerzbank AG*[5] determined that a court with general personal jurisdiction over a bank pursuant to CPLR § 301 could issue an order to an international bank to turnover assets held by that bank at branches outside of New York. While the *JW Oilfield* Court incorrectly predicted that New York state courts would draw the same conclusion, at least two other district courts have followed the rationale applied by the court in *JW Oilfield*.[6] And, in one of those subsequent federal cases, the district court judge found it important that the two non-U.S. entities involved in the underlying litigation agreed that their contract would be governed by New York law and that any dispute between them would be subject to arbitration in the state.

Yet Chief Judge Preska of the Southern District of New York adopted the rationale applied by the post-*Koehler* state trial court judges and not her other federal colleagues in a March 2012 ruling in *Shaheen Sports, Inc. v. Asia Ins. Co.*[7] Judge Preska acknowledged that the New York Court of Appeals in *Koehler* noted that a trial court could exercise personal jurisdiction over a garnishee bank and, therefore, reach a judgment debtor's assets held anywhere by the garnishee. Nevertheless, she concluded that in the branch banking context, the separate entity rule has long been considered settled law in New York, requiring a court to obtain jurisdiction over the specific bank branch holding an asset before it may order turnover, "notwithstanding its general jurisdiction over the banking entity by virtue of its New York branch." Harmonizing *Koehler* and the separate entity rule, Judge Preska then explained that the rule is a "qualifier on the court's attachment power . . . in the specific context of extraterritorial banking."

Implications for International Banks and Their Clients

The effect of *Koehler* on the separate entity rule is currently before the U.S. Court of Appeals for the Second Circuit. However, until the federal and state appellate courts clarify the scope of the rule, it appears that counsel for judgment creditors may continue to seek assets of judgment debtors held outside of the United States through the service of process in New York. And, it also appears that the success of those efforts may, in the first instance, depend upon whether the claims are pursued in state or federal court – as, to date, no state trial court has held that *Koehler* abrogated the separate entity rule.

In the meantime, international banks may face the uncertainty of having to comply with potentially conflicting laws and may also face the potential for double liability – having to provide the assets to the judgment creditor in New York and the depositor in the country in which the assets are maintained. In order to address these uncertainties, banks may want to seek the advice of counsel as to whether, and to what extent, provisions addressing these issues should be added to depositor and other customer agreements. The banks may also want to explore whether to incorporate subsidiary operations in New York (or other U.S. jurisdictions).

Due to the uncertainties regarding the separate entity rule, international businesses may find themselves subject to enforcement proceedings in New York even though they have no other dealings there. As such, businesses may want to consider whether, and to what extent, their contracts should include venue and choice of law provisions that exclude New York. International businesses may also want to discuss with counsel whether, and to what extent, their contracts should include provisions specifically addressing where any adverse judgments can be enforced.

At the very least, international banks and businesses should be aware of this issue and the potential implications it may have on their respective business dealings.

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[1] 12 N.Y.3d 533 (2009).

[2] *Cronan v. Schilling*, 100 N.Y.S.2d 474, 476 (Sup. Ct. 1950), *aff'd without opinion*, 282 A.D.940, 126 N.Y.S.2d 192 (1st Dep't 1953).

[3] 34 Misc. 3d 1209A, 2012 N.Y. Misc. LEXIS 47 (Sup. Ct. New York County Jan. 11, 2012).

[4] *See also Samsun Logix Corp. v. Bank of China*, 2011 NY Slip Op 50861U, 31 Misc. 3d 1226A, 929 N.Y.S.2d 202 (Sup. Ct. New York County 2011) (applying separate entity rule post-*Koehler*); *Parbulk II AS v. Heritage Maritime, SA*, 935 N.Y.S.2d 829 (Sup. Ct. New York County 2011) (same).

[5] 764 F. Supp. 2d 587 (S.D.N.Y. 2011).

[6] *See Eitzen Bulk v. Bank of India*, No. 09 Civ. 10118, 2011 U.S. Dist. LEXIS 115002 (S.D.N.Y. Oct. 5, 2011) and *Amaprop Limited v. ICICI Bank Limited*, No. 1:11-cv-02001-PGG, Order at Docket No. 46 and Transcript of Oral Ruling at Docket No. 79 (S.D.N.Y. Feb. 16, 2012), *on appeal*, No. 12-788(L) (2dCir.).

[7] Nos. 98-cv-5951 (LAP) & 11-cv-920 (LAP), 2012 U.S. Dist. LEXIS 36720 (S.D.N.Y. Mar. 14, 2012), *on appeal sub nom. Hamid v. Habib Bank Ltd.*, No. 12-1481 (2d Cir.).

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