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Recent Appellate Decisions Limit Access To Customer Assets Held At Foreign Bank Branches

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On October 23, 2014, the New York Court of Appeals held for the first time that, under New York law, the "separate entity" rule prevents a court from ordering a foreign bank operating branches in New York from restraining a judgment debtor's assets held in foreign branches of the bank. *Motorola Credit Corp.* v. *Standard Chartered Bank,* No. 162 (N.Y. Oct. 23, 2014). Just over one month ago, and without reference to the separate entity rule, the Second Circuit articulated its own jurisdictional standard for determining whether foreign financial institutions may be subject to a court order freezing a customer's non-U.S. assets or requiring the production of discovery located outside the U.S. *Gucci Am., Inc.* v. *Bank of China*, No. 11-cv-3934, F.3d, 2014 WL 4629049 (2d Cir. Sept. 17, 2014).

The *Standard Chartered* Decision

In *Standard Chartered*, plaintiffs sought to freeze defendants' assets, including assets the defendants held at foreign branches of Standard Chartered Bank ("SCB"). The district court found New York's separate entity rule precluded plaintiff from freezing assets held by a foreign SCB branch, *see Motorola Credit Corp.* v. *Uzan*, 978 F. Supp. 2d 205 (S.D.N.Y. 2013),and, on appeal, the Second Circuit certified that issue for resolution by the New York Court of Appeals *Motorola Credit Corp.* v. *Standard Chartered Bank*, 740 F.3d 108 (2d Cir. 2014). In a seminal ruling of tremendous importance to international financial institutions, the New York Court of Appeals agreed that under New York law, the plaintiff could not require a multinational bank to freeze assets of the defendant held at the bank's foreign branches.

In 2003, the district court entered a judgment against Kemal Uzan and his family, awarding compensatory damages of over $2 billion to the plaintiff and finding that the defendants had perpetrated a fraud in connection with a $2.1 billion loan to a Turkish telecommunications company. When defendants did not satisfy the judgment, the district court issued an injunction and restraining order: (i) enjoining defendants and their agents, and anyone that received notice of the order, from transferring any of defendants' assets until the judgment had been paid in full; and (ii) requiring any noticed party in possession of defendants' property to immediately freeze the assets. *See Uzan*, F. Supp. 2d at 207.

Plaintiff served the restraining order on the New York branch of SCB, which froze approximately $30,000,000 of defendants' assets in the form of four interbank deposits at SCB's United Arab Emirates ("UAE") branch. So as to remain in compliance with the restraining order, SCB refused to make a required transfer of funds from the account at its UAE branch to the Jordan Dubai Islamic Bank. In consequence, SCB was subjected to regulatory intervention in the UAE, including action by the UAE Central Bank which unilaterally debited approximately $30,000,000 from SCB's account notwithstanding the restraining order.

Faced with regulatory action in the UAE that was inconsistent with the order issued in the U.S., SCB filed a motion in the district court seeking relief from the restraining order. The district court found that under New York's separate entity rule a court "must treat 'each branch of a bank [as] a separate entity, in no way concerned with accounts maintained by depositors in other branches or at the home office.'" *Uzan*, 978 F. Supp. 2d at 210 (quoting *Cronan* v. *Schilling*, 100 N.Y.S.2d 474, 476 (Sup. Ct. N.Y. Cnty. 1950)). As such, service of the restraining order on SCB's New York branch, where defendants did not maintain assets, did not require SCB to freeze defendants' assets located outside of the U.S.

On appeal, the Second Circuit recognized that the New York Court of Appeals had never directly addressed the separate entity rule and that there were substantial questions as to whether the rule, as articulated by lower New York State courts, survived the 2009 New York Court of Appeals decision in *Koehler* v. *Bank of Bermuda, Ltd.*, 12 N.Y.3d 533 (2009). In an opinion that did not address the separate entity rule, the *Koehler* court held that a state court with personal jurisdictionover a foreign bank could order that bank to turn over certain assets held by the bank outside New York. Given the uncertainty as to New York law in light of *Koehler*, the Second Circuit certified to the New York Court of Appeals the question of whether the separate entity rule precludes "a judgment creditor from ordering a garnishee bank operating branches in New York to restrain the debtor's assets held in foreign branches of the bank." *Standard Chartered*, 740 F.3d at 117-18.

In a 5 to 2 decision written by Judge Graffeo, the Court of Appeals answered the certified question in the affirmative, holding that the "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." *Standard Chartered*, No. 162 at 13. The Court of Appeals reasoned that the separate entity rule has been a firmly established principle of New York law for almost 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."

Id. at 11 (quoting *Ehrlich-Bober and Co.* v. *Univ. of Houston*,49 N.Y.2d 574, 581 (1980)). Emphasizing the importance of international comity and the necessity of protecting banks from the "intolerable burden" associated with competing claims and potential double liability, the Court of Appeals held that "abolition of the separate entity rule would result in serious consequences in the realm of international banking to the detriment of New York's preeminence in global financial affairs" and for that reason, must remain in effect. *Standard Chartered*, No. 162 at 13.

With regard to *Koehler*, the Court of Appeals explained that the separate entity rule had not been raised by the foreign bank in that case, and the *Koehler* court therefore did not have the opportunity to analyze or consider the rule. The Court also explained that the separate entity rule would not have affected the result in *Koehler* because that case did not involve bank branches, and the customer assets at issue in that case, stock certificates, were not held in bank accounts.

As set forth in a separate dissent, Judge Abdus-Salaam and Judge Pigott would have abolished the separate entity rule in its entirety. The dissent argued that the rule has no statutory basis, that it is based on an outmoded rationale formulated by the lower courts nearly a century ago that has no application in modern times of electronic communication, and that it is inconsistent with the Court's decision in *Koehler*.

The *Bank of China* Decision

Bank of China, decided approximately one month before *Standard Chartered*, involved similar facts. In that case, plaintiffs sought to freeze defendants' assets, including assets held by the Bank of China ("BOC"), a nonparty foreign entity, and to obtain documents from BOC regarding defendants' assets. The district court found that it had general jurisdiction over BOC, and ordered the bank, including its China-based branches, to comply with plaintiffs' document subpoena and asset freeze injunction.

The Second Circuit reversed, holding that the district court erred in subjecting BOC to all-purpose general jurisdiction in light of the Supreme Court's decision in *Daimler AG v. Bauman*, 134 S. Ct. 746 (2014). In *Daimler*, the Supreme Court held that a foreign corporation may be subjected to a court's general jurisdiction based on the contacts of its in-state subsidiary only where its contacts are "so continuous and systematic as to render [it] essentially at home" in that forum. *Daimler*, 134 S. Ct. at 751. Absent exceptional circumstances, the Supreme Court stated that a corporation is "at home" and thus subject to general jurisdiction, only in a state that is the company's place of incorporation or its principal place of business. *Id*. at 760. Applying the *Daimler* standard, the Second Circuit held that there was no basis, consistent with due process, for exercising general jurisdiction over BOC. Although BOC had branch offices in the United States (including New York), it was incorporated and headquartered elsewhere.

The absence of general jurisdiction, however, was not the end of the matter. The Second Circuit determined that even without general jurisdiction over the institution, a court may nevertheless order a non-party foreign financial institution to freeze customer assets held at a non-U.S. branch and produce discovery from outside the U.S. where (i) the foreign bank's contacts with the forum were sufficient for the court to assert specific jurisdiction over the bank related to the relief requested; and (ii) the court's exercise of jurisdiction would be consistent with principles of international comity.

The Second Circuit also explained that specific jurisdiction requires a court to conduct a two-step analysis. First, the court must decide if the defendant has purposefully directed his activities at the forum and the litigation arises out of or relates to those activities. Second, it must determine whether the assertion of personal jurisdiction would comport with fair play and substantial justice. The doctrine of international comity, as articulated by the Second Circuit, requires a court to consider a party's legal obligations under foreign law before compelling it to comply with an order. The analysis requires a court to consider whether the exercise of its jurisdiction is unreasonable in a given case by applying the eight non-exclusive factors set out in § 403 of the Restatement (Third) of Foreign Relations Law.

Although the facts appear to involve bank accounts at foreign branches that may implicate the separate entity rule, the *Bank of China* decision did not address that legal principal. The Second Circuit remanded the matter for the district court to determine whether BOC's contacts with New York were sufficient for the court to exercise specific jurisdiction and, if so, to apply principles of comity. In light of the recent *Standard Chartered* decision, the district court, on remand, may have the opportunity to consider the potential applicability of that rule.

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Both the *Standard Chartered* and *Bank of China* decisions establish frameworks for determining when a court may exercise authority over a foreign financial institution and require the institution to freeze non-U.S. assets or produce information relating to non-U.S. accounts. The district courts and New York trial courts can now be expected to further develop the law in this area by applying these standards in differing factual circumstances.