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New York Court Affirms Separate Entity Ruling on Appeal

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On March 11, 2014, a New York state appellate court affirmed an important decision on the "separate entity" rule that is favorable to all multinational banks that maintain a New York branch. New York's separate entity rule protects banks from judgment creditors who seek to restrain or attach assets located outside of New York by serving process on a bank's New York branch. The continued viability of that rule has been called into question since the 2009 Court of Appeals decision in *Koehler v. Bank of Bermuda*. On October 22, 2012, in *Ayyash v. Koleilat*,[1] a New York court ruled in favor of Shearman & Sterling clients in reaffirming the continued viability of the separate entity rule and applying it to bar extraterritorial enforcement and discovery requests. The Appellate Division, First Department, affirmed that decision this week on alternative grounds.[2] The favorable decision in *Ayyash* adds to the tally of cases that have found that the separate entity rule survived *Koehler*. The increasing weight of authority that has reached this conclusion may influence the Court of Appeals when it has occasion to resolve the issue once and for all—which is likely to happen sooner rather than later (likely early 2015) in light of the Second Circuit's recent certification of the issue in *Tire Engineering v. Bank of China*. This note provides an overview of the *Ayyash* decisions and applicable law.

1 *Adnan Abu Ayyash v. Rana Abdul Rahim Koleilat,* No. 151471/2012 (Sup. Ct. New York County Oct. 22, 2012); you may also wish to refer to our Nov. 6, 2012 Shearman & Sterling Client Publication: New York Court Reaffirms Protections Afforded to Financial Institutions under the "Separate Entity" Rule.

2 *Adnan Abu Ayyash v. Rana Abdul Rahim Koleilat*, No. 151471/2012 (1st Dep't Mar. 11, 2014).

Background

New York courts have long provided banks the protection of the "separate entity" rule, pursuant to which the individual branches of a bank are treated as separate legal entities for purposes of attachment and execution, distinct from their corporate headquarters and other branches.[3] This is an exception to the general rule that New York courts have jurisdiction over a bank as a whole if it maintains a branch in New York. As a result, judgment creditors seeking to enforce money judgments in New York have traditionally been unable to reach assets held in accounts outside of the United States simply by serving process on a bank's New York branch. Instead, New York courts must have jurisdiction over the specific bank branch holding the sought-after assets before ordering the attachment or turnover of those assets.

As Shearman & Sterling noted in briefing the *Ayyash* matter, the separate entity rule has played an important role in facilitating the ability of banks to do business in New York for more than a century, "evolv[ing] into a key backbone of the modern system of global banking and international finance."[4] Courts have long recognized that a contrary rule would "enormously increase the expense of conducting the banking business," "be fraught with great risks to the bank," and cause "endless difficulties, inconvenience, and confusion."[5]

Recent Controversy Regarding the Continuing Viability of the Separate Entity Rule

In 2009, the New York Court of Appeals issued a decision in *Koehler v. Bank of Bermuda, Ltd.*[6] that led some attorneys and courts to question whether the separate entity rule is still good law. In *Koehler*, the Court of Appeals, in responding to a certified question from the Second Circuit, held that Art. 52 of New York's Civil Practice Laws and Rules[7] has extraterritorial reach and thus does not prohibit the turnover of assets held outside of the United States where the court sitting in New York has personal jurisdiction over a garnishee bank. Importantly, Bank of Bermuda Ltd. had consented to the court's personal jurisdiction in *Koehler*, and the separate entity rule was never mentioned, much less considered, in the majority opinion.[8]

Nevertheless, judgment creditors have subsequently argued that the Court of Appeals in *Koehler* had impliedly eliminated (or greatly abrogated) the separate entity rule, such that service on a New York branch is sufficient to compel the provision of material related to, and the eventual turnover of, assets held in branches located anywhere in the world.

3 *Cronan v. Schilling*, 100 N.Y.S.2d 474, 476 (Sup. Ct. New York County 1950) ("Each branch of a bank is a separate entity, in no way concerned with accounts maintained by depositors in other branches or at the home office."), *aff'd*, 126 N.Y.S.2d 192 (1st Dep't 1953).

4 Geoffrey Sant, The Rejection of the Separate Entity Rule Validates the Separate Entity Rule, 65 S.M.U.L. Rev. 813, 824 (2012).

5 *Chrzanowska v. Corn Exch. Bank*, 159 N.Y.S. 385, 388 (1st Dep't 1916).

6 *Koehler v. Bank of Bermuda Ltd.*, 12 N.Y.3d 533 (2009).

7 Article 52 of New York's Civil Practice Laws and Rules (the "CPLR") governs the enforcement of money judgments in NY state and federal courts. Specifically, CPLR § 5225(b) authorizes New York courts to attach and turn over assets held on behalf of judgment debtors, while CPLR § 5224 governs discovery demands related to those assets.

8 *Cf. Koehler*, 12 N.Y.3d at 542 (Smith, J., dissenting) (noting that "[t]he majority's holding opens a forum-shopping opportunity for any judgment creditor trying to reach an asset of any judgment debtor held by a bank (or other garnishee) anywhere in the world," and describing the majority opinion as a "recipe for trouble").

While that position has been adopted to some degree by a few federal decisions, [9] New York state courts considering the issue have consistently continued to apply the separate entity rule to post-judgment execution orders, rejecting the argument that *Koehler* had overruled the separate entity rule.[10]

This split in the case law was explicitly addressed by the March 2012 decision in *Shaheen Sports, Inc. v. Asia Ins. Co.,*[11] in which the Southern District of New York, at the urging of Shearman & Sterling attorneys, held that the separate entity rule was still good law and prohibited a judgment creditor from executing on overseas assets through service on a bank's New York branch.

A final resolution of this dispute over Koehler's impact on the separate entity rule will require a ruling by New York's Court of Appeals. That ruling is likely to be issued in the near future in light of the Second Circuit's recent certification of just this issue to the Court of Appeals.[12]

The Lower Court's *Ayyash* Decision

On October 22, 2012, Justice Ellen Coin of the Supreme Court, New York County, issued a decision addressing the separate entity rule in *Ayyash v. Koleilat*. The *Ayyash* case arose from a Lebanese money judgment obtained by a Lebanese judgment creditor against a Lebanese debtor. Adnan Abu Ayyash, the judgment creditor, sought to enforce this judgment in New York by serving the New York branches or subsidiaries of a number of banks with subpoenas demanding that they conduct a search for assets at their operations globally, freeze such assets and produce information and documents concerning such assets. After most of the banks responded to his demands solely on behalf of their New York entities, Ayyash brought an order to show cause seeking an order compelling the banks to respond to his requests with respect to assets, information and documents held at any branch, anywhere in the world.

The *Ayyash* decision, relying in significant part on the S.D.N.Y.'s decision in *Shaheen*, reaffirmed that the separate entity rule is still good law post-*Koehler*. The court quoted *Shaheen's* conclusion that "[i]n light of the significant policy principles underlying the separate entity rule and its lengthy history in New York courts, [i]t is not unreasonable to expect that if the New York Court of Appeals had chosen to eliminate it, it would have said so."[13]

[9] *See, e.g., JW Oilfield Equip., LLC v. Commerzbank AG*, No. 18 MS 0302, 2011 WL 507266 (S.D.N.Y. Jan. 14, 2011); *Eitzen Bulk v. Bank of India*, 827 F.Supp.2d 234 (S.D.N.Y. 2011).

[10] *See Global Technology, Inc. v. Royal Bank of Canada*, 34 Misc. 3d 1209A (Sup. Ct. New York County 2012); *Samsun Logix Corp. v. Bank of China*, 31 Misc. 3d 1226A (Sup. Ct. New York County 2011); *Parbulk II AS v. Heritage Maritime*, S.A., 35 Misc.3d 235 (Sup. Ct. New York County 2011). *See also International Legal Consulting Ltd. v. Malabu Oil and Gas Ltd.*, 35 Misc.3d 1203(A) (Sup. Ct. New York County 2012) (applying the separate entity rule in prejudgment attachment proceedings).

[11] *Shaheen Sports, Inc. v. Asia Ins. Co., Ltd.*, 2012 WL 919664 (S.D.N.Y. Mar. 14, 2012), *app. dismissed*, 2012 WL 4017287 (2d Cir. Aug. 14, 2012).

[12] *Tire Engineering and Distribution LLC v. Bank of China, Ltd.*, Nos. 13-1519-cv, 13-2535-cv(L), 13-2639-cv(con), 2014 WL 114285, at *1 (2d Cir. Jan. 14, 2014). The New York Court of Appeals accepted certification. Docket No. CTQ-2014-00001.

[13] *Ayyash*, No. 151471/2012 at 10 (citing *Shaheen Sports*, 2012 WL 919664 at *12).

More notably, however, the decision held that the separate entity rule not only prevents a judgment creditor from executing on assets located at a foreign branch, but also bars requests for information and documents outside of New York relating to those assets. This was a small but important expansion of the protection afforded by the separate entity rule. This ruling adopted the common sense view that such a distinction is untenable where the discovery sought relates to attachment efforts. As Justice Coin put it, where discovery is "but a first step in the proceeding, with the ultimate goal of subsequent attachment and turn-over[,]" it "would be an unproductive waste of judicial resources" for "the Court to start down this path, knowing that the ultimate goal is unavailable in this jurisdiction."[14]

Additionally, Justice Coin identified two alternative grounds for denying Ayyash's requests. First, Justice Coin cited to principles of international comity in holding that the court would exercise its discretion to bar disclosure even absent the separate entity rule. Justice Coin noted that an order compelling discovery under such circumstances would frequently require bank branches located outside the United States to choose between complying with that order and violating the bank secrecy and data protection laws of the countries in which they operate.[15] Thus, in rejecting Ayyash's attempt to use the New York courts "to launch a massive, multi-jurisdictional, international exercise in supplementary proceedings," Justice Coin stated that the sought-after discovery is obtainable solely through the Hague Convention on Taking of Evidence Abroad in Civil or Commercial Cases or under the applicable laws of the countries in which the assets are actually located. Second, Justice Coin invoked CPLR 5240, which gives courts broad discretion to reject post-judgment enforcement requests, as an alternative basis for denying Ayyash's requests.

The First Department's *Ayyash* Decision

On March 11, 2014, following briefing by the parties and several amici,[16] New York's Appellate Division, First Department, affirmed Justice Coin's decision. As is not uncommon in this Court, the decision is very short (spanning little more than a page) and contains little analysis. The First Department found that the lower court had "providently exercised its discretion, pursuant to CPLR 5240, in denying the enforcement procedures sought by plaintiff since they would likely cause great annoyance and expense to respondents or their employees or agents." It also found that, "[i]n addition, the denial of plaintiff's motion is warranted based on principles of international comity since the underlying dispute did not originate in the United States, the Hague Convention on the Taking of Evidence Abroad in Civil and Commercial Matters provides an alternative recourse, and ordering compliance raises the risk of undermining important interests of other nations by potentially conflicting with their privacy laws or regulations."

The First Department did not address the separate entity rule dispute. As a result, the analysis of those issues in Justice Coin's decision below remains good law.

[14] *Id.* at 12.

[15] *Id.* at 13 (citing cases).

[16] The Institute of International Bankers, The Clearing House Association L.L.C., the European Banking Federation, and the New York Bankers Association filed a brief as *amici curiae* with the First Department urging it to uphold Justice Coin's decision.

Conclusion

Justice Coin's *Ayyash* decision reaffirmed the protection that the separate entity rule confers on global banks that maintain a New York branch. It is an important decision for global financial institutions in that it further added to the weight of authority rejecting the argument that *Koehler* eliminated the separate entity rule. This weight may influence the Court of Appeals when it has occasion to finally resolve the separate entity rule's continued viability. The time for that resolution may be relatively soon: in January of this year, the Second Circuit referred this very question—*i.e.*, whether the separate entity rule still applies to bar extraterritorial asset turnover and restraint requests post-*Koehler*—to the Court of Appeals in *Tire Engineering and Distribution LLC v. Bank of China, Ltd.* If the Court of Appeals affirms the separate entity rule's viability, Justice Coin's decision in Ayyash will remain important for its application of the separate entity rule to bar extraterritorial discovery in aid of attachment, which is an issue beyond the scope of the questions recently referred by the Second Circuit and which thus may not be resolved by New York's highest court in the near term.

Moreover, Justice Coin's holding that compelling discovery would violate international comity will serve as useful precedent on requests seeking foreign material in other contexts. The First Department's affirmance of the ruling will further help banks combat attempts by judgment creditors to engage in global fishing expeditions for assets through service of process on New York branches.

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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