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New York Court Reaffirms Protections Afforded to Financial Institutions under the "Separate Entity" Rule

New York's "separate entity" rule has historically barred judgment creditors from seeking pre-judgment attachment and post-judgment execution on assets located at a bank's foreign branch, where service was made solely on the bank's New York branch. The continued viability of that rule in post-judgment garnishment proceedings has been called into question and subject to conflicting rulings since the 2009 New York Court of Appeals decision in *Koehler v. Bank of Bermuda*. On October 22, 2012, in *Ayyash v. Koleilat*,[1] the Supreme Court, New York County, ruled in favor of Shearman & Sterling clients in not only reaffirming the continued viability of the separate entity rule but also clearly stating its expansive scope. This note provides an overview of this decision and applicable law.

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.[2] 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.

[1] *Adnan Abu Ayyash v. Rana Abdul Rahim Koleilat*, No. 151471/2012 (Sup. Ct. New York County Oct. 22, 2012).

[2] *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).

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.*[3] 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 [4] 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.[5] 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.[6]

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.

While that position has been adopted to some degree by a few federal decisions,[7] 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.[8]

This split in the case law was explicitly addressed by the March 2012 decision in *Shaheen Sports, Inc. v. Asia Ins. Co.*,[9] 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.

The *Ayyash* Decision

On October 22, 2012, Justice Ellen Coin of the Supreme Court, New York County, issued the latest decision to address 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

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

[4] 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.

[5] New York C.P.L.R. Art. 52.

[6] *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").

[7] *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).

[8] *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).

[9] *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).

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*, reaffirms 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."[10]

More notably, however, the decision holds 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 is a small but important expansion of the protection afforded by the separate entity rule. This ruling adopts 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."[11]

Additionally, as an alternative ground for denying Ayyash's discovery requests, Justice Coin cites 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 notes 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.[12] 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 states 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.[13]

Conclusion

The *Ayyash* decision is an important decision for global financial institutions. The ruling reaffirms the protection that the separate entity rule confers on global banks that maintain a New York branch. Additionally, the court's holding that compelling discovery would violate international comity will serve as useful precedent on requests seeking foreign material in other contexts.

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

[11] *Id.* at 12.

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

[13] *Id.* at 12.

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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