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Court of Appeals Breathes New Life into 'Separate Entity Rule'

On April 30, 2013, the New York State Court of Appeals issued a decision about the scope of post-judgment asset turnover orders under CPLR § 5225. In *Commonwealth of Northern Marianas Islands v. Canadian Imperial Bank of Commerce*, the Court of Appeals held that a turnover order issued to a parent bank under CPLR § 5225(b) is not enforceable against the bank's subsidiary unless the parent has "actual possession" of the assets sought.[1] Answering a certified question from the U.S. Court of Appeals for the Second Circuit, the Court ruled that a parent bank's "constructive possession or custody" over assets in the actual possession of its subsidiary is insufficient to compel the parent to surrender those assets to a judgment creditor.

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Marianas was an important decision for the banking industry. Parent banks no longer need to bear the administrative burden and potential liability associated with identifying and turning over assets in the possession of far-flung subsidiaries simply because of the parent-subsidiary relationship. But the unstated implications of *Marianas* may prove even more favorable to banks. Above all, the holding in *Marianas* appears to breathe new life into the "separate entity rule."

The "separate entity rule" is a common-law doctrine applicable in post-judgment turnover proceedings involving assets in which the judgment debtor has an interest in the possession of banks. Pursuant to the separate entity rule, each bank branch is treated as a separate entity for attachment or garnishment purposes.[2] Under the rule, to attach the assets of a judgment debtor, the judgment creditor must serve a restraining notice, turnover petition or similar process on the office of the specific bank branch where the debtor maintains its account.[3] In its pure form, the "separate entity rule" meant that if the judgment debtor's assets were on deposit in an out-of-state bank branch, they were not subject to turnover in New York, even if the bank's main office was located in New York and subject to personal jurisdiction.

Over the past three decades, the "separate entity rule" has been eroded somewhat, particularly in federal court. In *Digitrex, Inc. v. Johnson*, the Southern District ruled that New York law does not necessarily require a restraining notice to be served upon the particular branch at which the judgment debtor maintains its account for the restraint to be effective.[4] The court expressed its belief that the "separate entity rule" was "no longer valid" and "obsolete" due to banks' interconnectedness via high speed computers and sophisticated communications equipment to track depositors' accounts. The court held that a judgment creditor's service of a restraining order upon a bank's "main office" is sufficient to restrain assets in the possession of another branch of the bank within New York. In 1996, the First Department appeared to adopt the rule in *Digitrex*.[5]

The Court of Appeals has never considered whether the "separate entity rule" remains the law after *Digitrex*. In 2009, however, the Court of Appeals issued a decision with practical implications for the "separate entity rule." In *Koehler v. Bank of Bermuda Ltd.*, which was also based upon a certified question from the Second Circuit, the Court of Appeals held that CPLR § 5225 authorizes a New York court to require a bank over which it has personal jurisdiction to turn over assets in New York, even if those assets are physically located outside of the state.[6] In *Koehler*, the Court of Appeals quoted a First Department decision in which the Court held that "New York courts have the power to command a garnishee present in the state to bring out-of-state assets under the garnishee's control into the state."[7] The Court of Appeals also relied upon *Matter of National Union Fire Ins. Co. of Pittsburgh, Pa. v. Advanced Empl. Concepts, Inc.*, in which the First Department discussed the holding in *Digitrex*.[8] Above all, *Koehler* seemed to undermine the central tenet of the "separate entity rule" that the "situs of a bank account is fixed at the branch of the bank where the account is carried."[9] Under *Koehler*, so long as the garnishee has a jurisdictional presence in New

York, it may be compelled to turn over the judgment debtor's property, even if the property is located out-of-state, potentially in the actual possession of a satellite branch.

Some judges speculated that *Koehler* meant the end of the "separate entity rule." One court stated that "*Koehler* indicates that New York courts will not apply the "separate entity rule" in post-judgment execution proceedings."[10] Others courts argued that if the Court of Appeals meant to overturn the "separate entity rule," "it would have said so."[11] The law remains unclear, even now, because there have been "no appellate decisions in the New York State courts to resolve the question of whether the 'separate entity rule' still survives in the aftermath of the *Koehler* decision."[12]

Marianas did not explicitly address the "separate entity rule," but it has obvious implications for the doctrine because the Court of Appeals expressly rejected the notion that a bank's control over a judgment debtor's assets is sufficient, on its own, to require the bank to turn over those assets. Indeed, in *Marianas* the Court explicitly rejected a "practical control test" proposed by the plaintiff. Under the proposed "practical control test," courts would be asked to inquire "whether the bank could practically order its subsidiary to turn over the assets of the judgment debtor." For the Court of Appeals, practical control is not enough: actual possession or custody of a judgment debtor's assets

is an essential precondition to compel a bank to turn over assets.

In contrast, the basic premise of *Digitrex* and its progeny is that if a bank's main office is linked to its branches with modern computers and communications equipment, the main branch has the practical ability to require those branches to turn over deposits in their possession. Under *Digitrex*, this practical control is sufficient, by itself, to compel the turnover of assets in the possession of the unserved bank branch. Under *Marianas*, however, control, without actual possession or custody, is inadequate to compel judicial turnover of bank assets. In other words, *Marianas* reaffirms the basic principle of the "separate entity rule" that the physical situs of a judgment debtor's bank accounts deposit is the central inquiry for determining whether the court has the power under CPLR § 5225 to compel the bank to turn over those assets.

The Court of Appeals has not addressed the "separate entity rule" in more than 50 years. After the decision in *Marianas*, the "separate entity rule" is a strong candidate for consideration by New York's highest court, perhaps, like *Koehler* and *Marianas*, based upon a certified question from the Second Circuit. If *Marianas* is any guide, the "separate entity rule" is likely to remain the law in New York.

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1. _ N.Y.3d _, 2013 WL 1798585 (Apr. 30, 2013).
2. *See, e.g., McCloskey v. Chase Manhattan Bank*, 11 N.Y.2d 936 (1962).
3. *Therm-X-Chem. & Oil Corp. v. Extebank*, 84 A.D.2d 787 (2d Dept. 1981).
4. 491 F. Supp. 66 (S.D.N.Y. 1980).
5. *See S & S Mach. Corp. v. Manufacturers Hanover Trust Co.*, 219 A.D.2d 249 (1st Dept. 1996).
6. 12 N.Y.3d 533 (2009).
7. *Id.* at 540 (quoting *Morgenthau v. Avion Res. Ltd.*, 49 A.D.3d 50, 54 (1st Dept. 2007)).
8. 269 A.D.2d 101 (1st Dept. 2000).
9. *International Legal Consulting Ltd. v. Malabu Oil and Gas Ltd.*, 35 Misc. 3d 1203(A) (Sup. Ct., N.Y. Co. 2012).
10. *JW Oilfield Equip., LLC v. Commerzbank, AG*, 764 F. Supp. 2d 587 (S.D.N.Y. 2011).
11. *Shaheen Sports, Inc. v. Asia Ins. Co., Ltd.*, 2012 WL 919664 (S.D.N.Y. Oct. 22, 2012).
12. *Dewar v. Bank Pub. Co. Ltd.*, N.Y. Branch, 37 Misc. 3d 1231(A) (Sup. Ct., N.Y. Co. 2012).

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