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Court Decision, New NY Bill Imply Koehler Scale-Back

Law360, New York (June 27, 2013, 10:03 AM ET) -- A recent New York Court of Appeals decision in October 2012 sets an outer limit on the scope of asset turnover jurisdiction under Koehler v. Bank of Bermuda.

The decision in Commonwealth of the Northern Marianas Islands v. Canadian Imperial Bank of Commerce holds that judgment creditors may not reach beyond the corporate boundaries of the in-state garnishee to compel turnover of assets held by foreign subsidiaries of the garnishee. Meanwhile, a bill has been introduced in the New York State Senate that would codify that decision and also substantially scale back Koehler.

The judgment creditor in this case had sued Canadian bank CIBC through its New York branch, attempting to reach bank accounts that the judgment debtors held at CIBC subsidiary FirstCaribbean International Bank (Cayman) in the Cayman Islands. The creditor argued that CPLR 5225 of New York's civil practice rules permits garnishment of any person who has "possession or custody" of relevant assets, and that CIBC's alleged "control" over its indirect subsidiary was adequate. The district court disagreed, and the Second Circuit certified to the state Court of Appeals two questions: whether "control" is really part of the CPLR 5225 standard and, if so, what factors are relevant to finding control.

The Court of Appeals answered no to the first question and so did not reach the second. The opinion centers on the legislative history of CPLR 5225: the plaintiff had suggested that "possession or custody" was synonymous with "possession, custody or control," and that the omission of "control" was essentially inadvertent. The court rejected that reading, focusing on the plain language of the statute and observing that, while constructive possession suffices under disclosure statutes, it is not enough for asset turnover. Based on the state court decision, the Second Circuit has now affirmed the district court's denial of the turnover motion and vacated that court's injunction freezing the assets.

The new decision does little to clarify the status of the separate-entity rule. That rule treats bank branches as separate corporate entities for purposes of asset seizure, so that service on one branch does not necessarily reach assets held at another branch.

Some lower federal courts have held that Koehler abrogated the rule. Those courts have pointed to Koehler's holding that post-judgment execution requires only personal jurisdiction over the garnishee, not in rem jurisdiction over the asset. They reason that service on a single branch suffices to establish personal jurisdiction, and under Koehler, personal jurisdiction is enough for a court to order a garnishee to bring assets into New York for execution.

Other state and federal courts have emphasized (as Mayer Brown reported here) that Koehler did not mention the separate-entity rule, which is a judge-made doctrine and is independent of the CPLR turnover statutes that the Court of Appeals interpreted in both Koehler and in Northern Marianas Islands.

Though Judge Chester Straub asked about the separate-entity rule in the Second Circuit oral argument in this case, the Second Circuit's certified questions did not cover that issue, nor did the Court of Appeals' opinion address it.

The state court did mention Koehler, but only to say that it "does not require a different reading of section 5225(b)" than the one the court adopted. It emphasized that Koehler "is only significant in holding that personal jurisdiction is the linchpin of authority under section 5225(b)."

The court devoted a full page to showing that Koehler was unexceptional in that respect, citing three Appellate Division cases that it had also relied on in Koehler. None of those cases, however, involved bank garnishees that had invoked the separate entity rule, and, as Judge Robert Smith's Koehler dissent pointed out, none involved garnishees at all; in each case, the defendant was the judgment debtor.

It is unclear whether that discussion is a hint about the breadth of Koehler or the vitality of the separate-entity rule. The court certainly did not back away from Koehler and, indeed, made some effort to remind readers of its rationale.[1]

Though the Northern Marianas Islands decision does not resolve all of the open issues surrounding New York's turnover statutes, it does foreclose one avenue of expansion. At least as long as the New York entity is separately incorporated, and jurisdictional contacts cannot be imputed on the theory that one entity is the "mere department" of the other (akin to veil piercing), the reach of New York courts for turnover purposes will stop at the corporate borders of the garnishee that is subject to New York personal jurisdiction.

In parallel with the doctrinal development in the courts, the state legislature is considering a new bill that would sharply curtail New York courts' ability to order discovery and turnover relating to foreign assets.

Highlights of Senate bill S5734 include amending the CPLR to:

- Limit the effect of restraining notices on offshore assets or debts (CPLR 5222)
- Provide that a recipient of a subpoena relating to enforcement of a judgment cannot be compelled to disclose information in violation of non-US law (CPLR 5223)
- Provide that no one other than the judgment debtor may be compelled to transfer property or debt into the United States to satisfy a judgment (CPLR 5225)
- Provide that New York courts may not order that a debt payable outside the United States be paid over to a creditor (CPLR 5227)

The bill has been referred to the Senate Judiciary Committee, but no companion bill has yet been introduced in the New York State Assembly.

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[1] The court also did not decide whether CPLR 5225 — with its broad "possession or custody" language — even applies to bank accounts. (Koehler involved physical stock certificates.) An amicus brief that Mayer Brown filed for the Institute of International Bankers in the Second Circuit argued that, because bank accounts are debts, CPLR 5227 should apply instead, so that garnishment is available only against "any person who ... is or will become indebted to the judgment debtor." CIBC made this point, but the court declined to decide it, as not within the certified questions.