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DC Circ. TRIA Decision Could Ease Garnishment Burden

Law360, New York (December 12, 2013, 1:20 PM ET) -- A recent decision from the U.S. Court of Appeals for the District of Columbia Circuit is good news for banks facing an ongoing crush of garnishment litigation. The decision in Heiser v. Islamic Republic of Iran reduces the universe of blocked accounts that are subject to turnover under the Terrorism Risk Insurance Act and may persuade the Court of Appeal for the Second Circuit to take the same approach in an appeal before that court raising similar issues.

Various federal sanctions programs require banks to freeze funds in which foreign governments or other entities linked to terrorism or nuclear proliferation may have an interest. Many of those parties are subject to huge default judgments for acts of terrorism, and the frozen assets are among the few U.S. assets that can be reached to satisfy those judgments. The Terrorism Risk Insurance Act allows plaintiffs to execute judgments for compensatory damages on "blocked assets of that terrorist party" "[n]otwithstanding any other provision of law."

Federal district courts have endorsed two different reading of this language.[1] The D.C. District,[2] along with Judge Denise Cote in the Southern District of New York in Calderon-Cardona v. JP Morgan Chase Bank,[3] had tried to reconcile TRIA with generally applicable asset turnover law, holding that "blocked assets of that terrorist party" are blocked assets that the terrorist party owns. Ownership, in turn, must be determined by otherwise-applicable property law. Those courts would read the "[n]otwithstanding" clause to override only sovereign immunity and perhaps the blocking regulations.

At least two other courts in the Southern District of New York (in Levin v. Bank of New York and Hausler v. JP Morgan Chase Bank) have held instead that TRIA allows judgment creditors to seize any asset that was blocked because of a nexus with the terrorist party against which they hold a judgment. They point to the "[n]otwithstanding" clause as overriding any other law that might make a blocked asset not "subject to execution," including any property law that holds the asset not to belong to the judgment debtor.

Whether the creditors' rights depend on ownership makes a big difference for some frozen assets, especially blocked wire transfers. Treasury regulations require banks to block any wire in which a sanctioned party has any connection, whether as originator, beneficiary or in any other role in the wire transfer chain. As the D.C. Circuit observed in Heiser, "assets may be blocked on the basis of Iranian interests far less significant than ownership."

As a result of the broad reading of TRIA given by some courts, plaintiffs have sought to execute on every blocked account with any connection to their judgment debtor. Garnishee-banks typically have responded by interpleading every party with any connection to the frozen assets. The expense and delay of serving so many parties on so many accounts, and the uncertainty over which accounts are properly in play, has rendered many TRIA turnover cases lengthy and expensive for all parties.

In Heiser, the D.C. Circuit affirmed its district court on two points, coming down solidly on the side of the garnishee-banks. First, it read TRIA to limit turnover to blocked assets owned by the terrorist defendant. It noted the divergence of views over whether the word "of" (here, used in the phrase "blocked assets of that terrorist party") invariably denotes ownership. Instead, it treated TRIA as an asset-turnover statute and pointed to the "established principle that 'a judgment creditor cannot acquire more property rights in a property than those already held by the judgment debtor.'"[4]

The court also pointed out that the alternative reading not only "risks punishing innocent third parties," those that own the blocked assets but are not terrorists, it also gives a windfall to terrorists because "[t]o the extent innocent parties pay some part of a terrorist state's judgment debt, the terrorist state's liability is ultimately reduced. Congress could not have intended such a result." Supporting that view was a statement of interest filed by the U.S. government (which took the same position in the Second Circuit last year).

Having first held that ownership was relevant, the court then turned to the question of how to determine ownership. With respect to wire transfers, many banks have sought to use Article 4A of the Uniform Commercial Code in these cases. While the court agreed with the creditors that that statute does not apply of its own accord to cases under TRIA, it chose to adopt Article 4A as a federal rule of decision. Under that rule, it found that a blocked wire is not the property of the beneficiary's bank: "Legal title does not pass to the beneficiary's bank until it accepts the payment order from the intermediary bank,"[5] which did not happen here because the wire was blocked at the intermediary.

The court also cited "Article 4A's subrogation provisions," which state that "[i]f the intermediary bank is prohibited from completing a transfer, then the originator is subrogated to its bank's right to a refund."[6] From these sources, the court reasoned that "claims on an interrupted funds transfer ultimately belong to the originator, not the beneficiary or its bank." Because the only Iranian connection to the accounts at issue was the Iranian government ownership of the beneficiary's bank, the court found that the creditors could not execute on those assets.

Heiser brings closure, at least in one circuit, to the scope of TRIA asset turnover and excludes at least those accounts on which the sanctioned party is an intermediary bank (downstream of the blocking), the beneficiary's bank or the beneficiary. It may also suggest that beneficiary-side parties lack a substantial enough claim to warrant their interpleader on accounts that remain subject to turnover. Some banks have already taken this position. Still pending, though, are two appeals in the Second Circuit: Calderon-Cardona and Hausler v. Republic of Cuba.

The parties in both cases sprang to file Rule 28(j) letters within days of the Heiser decision, with the Hausler plaintiffs pointing to differences between the Iranian sanctions regime at issue in Heiser and the Cuban sanctions in Hausler. They also suggested that the D.C. Circuit's warning about "innocent parties" should prevent its holding from extending to cases in which the non-sanctioned owner of a wire transfer had deliberately violated a trade embargo. The Second Circuit appeals were argued last winter, and a decision could come out at any time.

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[1] For more information, see our Jan. 20, 2012, legal update, "Court Rules that Blocked Electronic Fund Transfers Are Not Attachable under New York Property Law, Creates Split in Southern District of New York."

[2] Heiser v. Islamic Republic of Iran, 885 F. Supp. 429 (D.D.C. 2012).

[3] 867 F. Supp. 2d 389 (S.D.N.Y. 2011).

[4] Quoting C.J.S. Judgments § 787 (2013).

[5] Quoting the decision below, 885 F. Supp. at 448 and citing Shipping Corp. of India Ltd. v. Jaldhi Overseas Pte Ltd., 585 F.3d 58, 71 (2d Cir. 2009).

[6] Citing U.C.C. § 4A-402(d)-(e).