# Financial Fraud Law Report

AN A.S. PRATT & SONS PUBLICATION FEBRUARY 2015



LexisNexis

**QUESTIONS ABOUT THIS PUBLICATION?**

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call:

Catherine Dillon at ..... 908-673-1531
Email: ..... catherine.dillon@lexisnexis.com

For assistance with replacement pages, shipments, billing or other customer service matters, please call:

Customer Services Department at . . . . . (800) 833-9844
Outside the United States and Canada, please call . . . . . (518) 487-3000
Fax Number . . . . . (518) 487-3584
Customer Service Web site . . . . . http://www.lexisnexis.com/custserv/

For information on other Matthew Bender publications, please call

Your account manager or . . . . . (800) 223-1940
Outside the United States and Canada, please call . . . . . (518) 487-3000

Library of Congress Card Number: 80-68780

ISBN: 978-0-7698-7816-4 (print)
ISBN: 978-0-7698-7958-1 (eBook)

Cite this publication as:

Financial Fraud Law Report § [sec. no.] (LexisNexis A.S. Pratt);
Financial Fraud Law Report § 1.01 (LexisNexis A.S. Pratt)

Because the section you are citing may be revised in a later release, you may wish to photocopy or print out the section for convenient future reference.



*An A.S. Pratt™ Publication*

Editorial Offices
630 Central Ave., New Providence, NJ 07974 (908) 464-6800
201 Mission St., San Francisco, CA 94105-1831 (415) 908-3200
www.lexisnexis.com

MATTHEW BENDER

(2015–Pub.4759)

# *Editor-in-Chief & Board of Editors*

POSTMASTER: Send address changes to the *Financial Fraud Law Report*, LexisNexis Matthew Bender, 121 Chanlon Road, North Building, New Providence, NJ 07974. Direct inquiries for editorial department to catherine. dillon@lexisnexis.com. *ISBN: 978-0-76987-816-4*

# U.S. Second Circuit Eases Banks' Garnishment Burdens in Recent TRIA and FSIA Decisions

***Mark G. Hanchet and Christopher J. Houpt****

*Banks have found themselves named as parties in their capacities as garnishees in enforcement litigation brought by judgment creditors of governments or entities that have been designated as terrorist parties. Two recent decisions from the U.S. Court of Appeals for the Second Circuit limit the number of assets subject to attachment by deferring to New York state law to define property interests. The authors of this article explain the law in this area and discuss the significance of the decisions.*

In recent years, banks have found themselves named as parties in their capacities as garnishees in enforcement litigation brought by judgment creditors of governments or entities that have been designated as terrorist parties. Two decisions from the U.S. Court of Appeals for the Second Circuit spell good news for banks. The decisions in *Calderon-Cardona, et. al v. Bank of New York Mellon*[1] and *Hausler v. JPMorgan Chase Bank, N.A.*,[2] limit the number of assets subject to attachment by deferring to New York state law to define property interests.

The Foreign Sovereign Immunities Act ("FSIA") provides foreign states with immunity from suits and also makes foreign government property immune from attachment and execution in U.S. courts. The FSIA has exceptions, however, for state-sponsored terrorism. For example, Section 1605A overrides immunity for suits based on acts of terrorism. In addition, FSIA Sections 1610(f)(1)(A) and 1610(g), and Section 201 of the Terrorism Risk Insurance Act ("TRIA"), permit creditors who hold terrorism judgments to garnish certain types of sovereign property. Each of these exceptions has a slightly different scope, and *Calderon-Cardona* and *Hausler* clarify their applicability.

**FSIA SECTION 1610(f)(1)**

FSIA Section 1610(f)(1)(A) permits the garnishment of property "claim[ed]" by a foreign state, which is blocked or regulated under the Trading With the Enemy Act ("TWEA") or the International Emergency Economic Powers Act.

---

* Mark G. Hanchet is a partner at Mayer Brown LLP, where he serves as one of the firm's co-leaders of the Banking & Finance Litigation group. Christopher J. Houpt is a partner at the firm and a member of the Banking & Finance Litigation group. The authors may be reached at mhanchet@mayerbrown.com and choupt@mayerbrown.com, respectively.

1 No. 12-0075 (2d Cir. Oct. 23, 2014).

2 No. 12-1264 (2d Cir. Oct. 27, 2014).

The remedy is limited to the enforcement of terrorism-related judgments, for which states are not immune under Section 1605A of the FSIA. The exception to immunity is further subject to a presidential waiver,[3] and in 2000, President Clinton did completely waive the garnishment remedy. Accordingly, *Calderon-Cardona* held that Section 1610(f)(1)(A) cannot be used to execute on blocked funds.

**TRIA**

In 2002, Congress passed the Terrorism Risk Insurance Act,[4] which permits execution on "blocked assets" of a "terrorist party," to satisfy judgments for acts of terrorism. TRIA differs from Section 1610(f) in several ways. It is not subject to a blanket presidential waiver, but the President may waive it "on an asset-by-asset basis" as to assets that are subject to the Vienna Conventions on Diplomatic Relations or Consular Relations.[5] TRIA is limited to judgments for compensatory damages only. Like Section 1610(f), it extends not only to state actors, but also to their agencies and instrumentalities.

One provision in TRIA that has been particularly contested is the meaning of the phrase "the blocked assets *of* that terrorist party," especially as applied to blocked wire transfers. Specifically, some banks have argued that the phrase permits execution only on property that *belongs* to the judgment debtor, as would be the case under ordinary state-law procedures. Judgment creditors, however, have argued that the phrase covers all assets that are blocked because of a "nexus" with the judgment debtor. Because federal asset control regulations require blocking many assets that would not be considered property of the terrorist under state property law—for example, the Cuban sanctions require blocking all transactions with Cuban nationals, not just property of the Cuban government—the creditors' interpretation subjected many more assets to execution.

The two Southern District of New York decisions on appeal in *Calderon-Cardona* and *Hausler* (as well as other district court decisions) came to divergent conclusions. The Second Circuit reversed *Hausler*, holding that Congress had not defined the property interests that were subject to attachment under TRIA. Because the statute did not create new property rights, but merely attached consequences to rights created under state law, the Second Circuit held that state law governs whether the creditor can reach the frozen assets. As neither the

---

[3] 28 U.S.C. § 1610(f)(3).

[4] Codified as a note to 28 U.S.C. § 1610.

[5] The waiver authority does not extend to proceeds from the sale of diplomatic or consular property, or to such property that has been used for non-diplomatic purposes.

terrorist party judgment debtor nor any of its agencies or instrumentalities had transmitted any of the EFTs directly to the blocking bank, they were not attachable under TRIA.

The court did not reach that question in *Calderon-Cardona* because, addressing another aspect of TRIA, it found that the plaintiffs did not even have a judgment against a "terrorist party." As applied to foreign states, that term is limited to those that are designated by the State Department as state sponsors of terrorism. North Korea, the defendant in the underlying case, had once been so designated, but that designation was revoked before the plaintiffs won their judgment. The Second Circuit held that the revocation made the judgment ineligible for TRIA.

**SECTION 1610(g)**

Because TRIA did not apply, *Calderon-Cardona* went on to consider another exception to sovereign immunity under Section 1610(g) of the FSIA. That section permits execution on "the property of a foreign state" by the holder of a judgment based on the terrorism exception in Section 1605A. The court explained that "the fact that North Korea no longer has that [state sponsor of terrorism] designation does not bar attachment of North Korea's property, or that of its agents and instrumentalities, under § 1610(g)."

What did bar attachment was the phrase "property of a foreign state." Just as it would interpret TRIA a few days later in *Hausler*, the court held "that FSIA § 1610(g) does not preempt state law applicable to the execution of judgments."

**NEW YORK UNIFORM COMMERCIAL CODE**

According to the Second Circuit, the New York UCC provides that usually neither the originator nor the beneficiary of a midstream wire owns the funds; the claim is limited to the bank or other entity immediately preceding the bank that blocked the wire. That conclusion follows from the UCC Article 4A's treatment of wire transfers as essentially a series of bilateral transactions from a sender to a receiver: "Because [wire transfers] function as a chained series of debits and credits between the originator, the originator's bank, any intermediary banks, the beneficiary's bank, and the beneficiary, the only party with a claim against an intermediary bank is the sender to that bank, which is typically the originator's bank."[6] And state law determines whether the property belongs to the judgment debtor.

Thus, under both TRIA (as interpreted in *Hausler*) and Section 1610(g) (as

---

[6] *Calderon-Cardona, supra.*

interpreted in *Calderon-Cardona*), judgment creditors of a foreign state may seize blocked wires "only where either the state itself or an agency or instrumentality thereof (such as a state-owned financial institution) transmitted the [wire] directly to the bank where the [wire] is held pursuant to the block."

**SIGNIFICANCE OF THESE DECISIONS**

These decisions should sharply curtail litigation over blocked assets. Since the assets subject to execution have varied from courtroom to courtroom in the Southern District, creditors typically have sought turnover of every blocked account. This has led to costly litigation for intermediary banks, especially on wire transfers that have numerous potential claimants. Now that the only blocked wire transfers available under the FSIA are those in which a terrorist state or its agency sent the money directly to the U.S. bank, fewer assets should be at issue.

In fact, it is possible that few, if any, wire transfers will be subject to turnover. That is because a wire transfer requires privity (usually maintenance of an account) at each step of the chain, but U.S. banks are prohibited from maintaining accounts for sanctioned parties. That makes it unlikely that the party immediately upstream from a U.S. bank in a blocked wire transfer will be a party that is subject to sanctions. A wire might still be blocked because a party two or more steps removed from the U.S. bank is on a sanctions list, but under the new Second Circuit rule, that asset is not "property" of the sanctioned party subject to turnover. Judge Castel denied an unopposed motion for turnover in *Harrison v. The Republic of Sudan*, ruling in part that plaintiffs "may not execute on blocked accounts for which a Sudanese agency is on the beneficiary side."[7]

Some doubt remains as to how these rulings will be received outside of the Second Circuit. In *Gates v. Syrian Arab Republic*,[8] a Northern District of Illinois judge found that *Hausler* and *Calderon-Cardona* did not prevent turnover of a wire for which a Syrian state-owned bank was both originator and beneficiary and where the intermediary bank immediately preceding the blocking bank had disclaimed any interest in the account. *Gates* raises the broader question of whether assets to which a judgment debtor does not have a claim under the UCC could still be deemed an asset "of" that party where competing claimants waive their rights or simply fail to appear.

Yet another twist appears in the Eleventh Circuit's 2013 decision in *Stansell*

---

[7] No. 13-cv-3127 (S.D.N.Y. Nov. 13, 2014).

[8] No. 11 C 8715 (N.D. Ill. Nov. 6, 2014).

*v. FARC*.[9] There, the court denied turnover to judgment creditors of the Colombian rebel group, as to a blocked wire on which a federally designated narcotics trafficker was the intended beneficiary. It focused on the cancellation provisions of UCC Article 4A, holding that the wire's blocking under the narcotics sanctions led to an automatic cancellation of the wire five business days later. That negated any interest of the beneficiary in the blocked funds—upon release of the block, the funds would be returned to the originator, not forwarded to the beneficiary. But the court also pointed out that under Section 4A-402(d), the originator is subrogated to the right of the originating bank to receive any refund. That point was immaterial in *Stansell* itself, where none of the originator-side parties were judgment debtors, but it suggests that plaintiffs could seek turnover where the originator (but not the originator's bank) is a judgment debtor. That fact pattern is not uncommon.

Rehearing petitions have been filed in both Second Circuit cases, and several district court cases have been stayed pending final resolution on appeal.

---

[9] *Stansell v. Revolutionary Armed Forces of Columbia*, No. 13-11339 (11th Cir. Oct. 16, 2014).