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New York — The Creditor's Playground

Law360, New York (June 29, 2009) -- The New York Court of Appeals, which is the highest court in the state, has just issued a holding that may effectively make the courts in New York the collection agency against almost any debtor that does not have all its assets hidden under its mattress.

The court has held that the assets of a judgment debtor which are in the possession of an entity, such as a bank or a brokerage house, that does business in New York, can be executed against through a special type of enforcement proceeding brought in a New York court, whether or not the creditor, the debtor or the asset itself, has anything to do with the state of New York. *Koehler v. The Bank of Bermuda Limited*, 2009 WL 1543698, decided June 4, 2009.

As long as the bank or other entity in possession of the asset does business in New York — and almost all the major banks in the world do — such a “garnishee,” as the entity holding the asset is called, can be ordered to bring the asset to New York where it can be seized by the creditor.

The impact is revolutionary. Whenever a creditor with a judgment thinks the debtor may have an account at a bank that has an office in New York, or has investments through a brokerage house that does business in New York, it is simple and inexpensive to start a “turnover proceeding,” as the devise is called, against the New York office of the bank or brokerage, and see what assets are turned up.

We anticipate a flurry of filings of out-of-state and foreign judgments in New York, followed promptly by actions to compel the transfer of assets to New York for seizure by judgment creditors.

The Facts of the Case

Lee Koehler, a citizen of Pennsylvania, sued David Dodwell, a resident of Bermuda, in a federal court in Maryland. In June of 1993 he obtained a default judgment for just over \$2 million. Koehler then registered the judgment in the federal court in Manhattan.

As it happened, Dodwell had placed stock certificates representing shares in a Bermuda corporation with the Bank of Bermuda in Hamilton, Bermuda, as security for a loan.

In October of 1993, Koehler filed a “turnover petition” in the New York federal court, seeking an order under New York’s Civil Practice Law and Rules (“CPLR”) Section 5225 requiring the bank to bring the shares to New York and turn them over to Koehler.[1]

The bank contested the jurisdiction of the Federal court in New York over it, claiming that although it had a subsidiary in New York it was not doing business “regularly and systematically” (the magic words for a state’s jurisdiction over a foreign entity) in New York.

In 2003, after a decade of litigation, the bank conceded that it could be forced to litigate in a court located in New York.

It then transpired that in 1994, after the bank had been served with the turnover petition and the turnover order, it had released the shares to a Bermuda company controlled by Dodwell, who had paid off his loan. Now that the jurisdiction of the court in New York had been established, Koehler sought to have the bank pay him the value of the shares that the bank had released.

The trial court judge denied the application, holding that New York cannot attach, that is make orders concerning, property that is not within the state.

Koehler appealed to the U.S. Court of Appeals for the Second Circuit, which “certified” to the New York State Court of Appeals the question: Under New York law, does a turnover proceeding reach property held outside the state?

In a 4–3 opinion, which breaks new legal ground, the New York Court of Appeals said yes.

The Court’s Reasoning

The majority held that a court’s power over the property of a defendant which has not yet become a judgment debtor, called an “attachment,” always has been limited to property that is within the state. Such an “attachment” can be sought in two types of circumstances:

1) where there is reason to believe a defendant is trying to hide or remove assets from the state, or

2) where the defendant, not having any personal connection to the state, has assets here.

In the latter situation, if a plaintiff is willing to limit its claim to the assets in New York, or to the value of such assets if plaintiff wins and gets possession of them, a plaintiff can base its lawsuit on “in rem” jurisdiction, a Latin phrase referring to the court’s power over the “thing” that is in the state.[2]

But once a defendant becomes a judgment debtor, it generally has been the view of the courts that if the defendant lost in New York, the defendant could be compelled to bring all of its property to New York to be used to satisfy the judgment.

If you can be forced to play in New York’s playground, and you lose, you can’t leave town and take your marbles with you.

What the Court of Appeals held in Koehler, however, is that even if the defendant had nothing whatsoever to do with New York, had no assets here, and had never litigated here, any assets it had in any entity that was itself subject to the jurisdiction of the New York courts would have to be shipped by that entity to New York so that they can be seized by the creditor.

The Court of Appeals held that since a turnover proceeding acts against the person who is subject to New York’s judicial power, such a person, holding the assets of a judgment debtor, has to follow New York’s orders and, as between the judgment creditor and the judgment debtor, the creditor wins.

The Dissent

As one would expect, the dissenting judges pointed out that subjecting any entity holding a creditor’s assets to the New York garnishment statute is overreaching that is not required by any New York statutory or case precedent or in fact any precedent anywhere in the United States.

The dissenters predicted that the holding will be a “recipe for trouble” and will have a disruptive effect on the banking industry, especially if other states adopt the same rule and banks become subject to conflicting orders over the same property.

They also suggested that the holding may be unconstitutional, in that it violates “traditional notions of fair play and substantial justice” that are imposed by the due process clause of the U.S. Constitution.

Where Are We Now?

Under the New York judgment enforcement statutes, there are various methods to deal with such situations as battles between the judgment debtor and the “garnishee” over who has the better right to the assets in question, or battles between various judgment creditors or secured parties.

Since the Bank of Bermuda did not claim that it owned the Dodwell shares, and no other claimant turned up, these other procedures are not discussed in Koehler.

But the effect of the Koehler decision is likely to be that such battles are fought in New York, and not elsewhere, regardless of where the creditor, the debtor, or the assets are located.

In multiple claimant cases, the litigation over the assets, which can be extremely complex, extensive, and costly, may well be in New York and not where the assets were located throughout the underlying dispute.

What are the immediate effects of Koehler likely to be? For creditors, consultation with New York counsel regarding judgments that may have gone unsatisfied for years may be worthwhile; New York generally has a 20-year statute of limitations for judgments and judgments from other states with shorter limitations periods may under some circumstances still be enforceable in either state or Federal courts in New York.

Also, creditors who had trouble locating their debtors may find it simpler to start a turnover proceeding in New York and not worry about personal service; the New York statute permits service on the judgment debtor by registered or certified mail, return receipt requested. NYCPLR § 5225(b).

Debtors, especially soon-to-be judgment debtors, now have to worry that their assets may be shipped to New York if they are in banks or other financial institutions that do business here. Prudence may dictate that foreign debtors consult New York counsel for asset protection planning of a type previously not a concern.

For out of state and foreign banks and institutional investment entities, it may be time to re-think how they participate in the New York economy. Is doing business in New York worth the bevy of litigation that one can anticipate simply because in one’s home office some depositor has an account?

More specifically, foreign institutions of all types may be well advised to consult New York counsel to try to establish a presence in New York without subjecting the institution to the jurisdiction of the New York courts, for now it is the presence of the “garnishee” in New York, and not that of the debtor, that will control the enforcement of judgments.

--By Jeffrey E. Glen, Anderson Kill & Olick PC

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The opinions expressed are those of the author and do not necessarily reflect the views of Portfolio Media, publisher of Law360.

[1] Under federal law, a federal court applies the judgment enforcement law of the state in which the court sits.

[2] Specifically, the court made the distinction between “turnover proceedings” under Article 52 of the CPLR and an attachment proceeding under Article 62. Unlike in a prejudgment attachment proceeding where jurisdiction over the property (“in rem”) to be attached is necessary, in a turnover proceeding, all the court needs is personal jurisdiction over the holder of the assets sought.