

## Second Circuit Rules that International Comity and New York’s “Separate Entity” Rule May Prevent Asset Restraint Orders From Reaching Assets Held At Bank’s Foreign Branches

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On August 30, 2021, the U.S. Court of Appeals for the Second Circuit affirmed a district court ruling in *Next Investments, LLC v. Bank of China, et al.*, that six Chinese banks could not be held in contempt for, *inter alia*, failing to implement asset restraints that purported to reach assets held at the banks’ non-New York branches.<sup>1</sup>

The Second Circuit reasoned that the district court appropriately exercised its discretion in denying contempt because there were “colorable” international comity concerns, in light of Chinese banking laws that could be read to prohibit Chinese banks from freezing assets at the request of non-Chinese courts. Moreover, the New York state law “separate entity rule”—which provides that a bank’s branches in different jurisdictions are treated as “separate entities” for various purposes—made it doubtful whether asset restraints issued by a New York court could reach the banks’ Chinese branches.

The Second Circuit’s ruling fortifies the protections that may be available to non-U.S. banks regarding activity in their branches outside of New York, even where the bank at issue has a New York branch subject to the jurisdiction of a New York court.

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<sup>1</sup> *Next Investments, LLC v. Bank of China, et al.*, No. 20-602, 2021 WL 3851922 (2d Cir. Aug. 30, 2021) (“*Next Investments*”).



## Background

In 2013, Nike, Inc. and its subsidiary Converse, Inc., sued several participants in Chinese counterfeiting networks that advertised and sold products bearing their marks and brand names. The district court issued a temporary restraining order, a preliminary injunction, and ultimately a default judgment against the defendants. These orders enjoined the defendants and persons acting in concert with them from “transferring, withdrawing or disposing of any money or other assets” in or out of defendants’ bank accounts “regardless of whether such money or assets are held in the U.S. or abroad.”<sup>2</sup>

After Nike assigned its interest in the judgment to Next Investments, LLC in 2017, Next Investments sought and obtained a contempt order in light of defendants’ failure to make reasonable efforts to comply with the default judgment (the “Order”). Unlike the district court’s previous orders, this Order explicitly bound all third parties with actual notice of it. The district court also allowed Next Investments to seek discovery from banks servicing the defendants.

Next Investments served the Order and subpoenas on various Chinese banks that held defendants’ assets in overseas branches. The banks complied with the subpoenas on behalf of their New York branches, stating that none of defendants’ accounts were held in New York. But the banks objected that neither the subpoenas nor the Order’s asset restraints could reach accounts held at branches outside of New York.

The district court “found that it had specific personal jurisdiction sufficient to compel production abroad based on the Banks’ maintenance of correspondent and settlement accounts in New York, some of which had been used to facilitate transfers for Defendants.”<sup>3</sup> The district court made certain modifications to accommodate Chinese banking laws and held that the factors in an international comity analysis weighed in favor of compelling compliance with the subpoenas. But Next Investments represented

that it did not currently seek to enforce the Order against the banks, so the district court did not decide whether the asset restraints applied extraterritorially.

After the banks made their productions and filed a motion to shift discovery costs, Next Investments moved to hold the banks in contempt based on their purported failure to freeze assets under the Order and allegations that the banks produced only a fraction of relevant documents in response to the subpoenas.

The district court denied the motion. Regarding the asset restraints, the district court held they did not bind the banks *inter alia* because (i) “New York’s separate entity rule required the court to treat the Banks’ foreign branches as entities separate from their New York branches” for post-judgment enforcement purposes and (ii) Next Investments failed to show the banks’ activities amounted to aiding and abetting defendants, rather than routine account management.<sup>4</sup>

The district court also noted that the Order’s “geographic scope” was ambiguous, and criticized Next Investments’ request for contempt sanctions against the banks as a “gotcha” tactic in light of its previous assertions that it was “not seeking enforcement against the Banks.”<sup>5</sup> Finally, the district court found that the banks had made reasonable efforts to comply with the subpoenas.

## The Second Circuit’s Decision

On appeal, the Second Circuit held that the district court’s decision to deny Next Investments’ motion for contempt sanctions against the banks “was an appropriate exercise of its discretion.”<sup>6</sup>

*First*, it was appropriate to consider Next Investments’ “dilatatory conduct,” *i.e.*, its “delay of nearly six years” before “taking any steps to compel the Banks’ compliance” and its “specific[] aver[ments]” that it was not seeking enforcement against the banks.<sup>7</sup>

*Second*, Next Investments “failed to carry its burden to demonstrate that the asset restraints clearly

<sup>2</sup> *Next Investments* at \*2 (emphasis omitted).

<sup>3</sup> *Id.* at \*4.

<sup>4</sup> *Id.* at \*5.

<sup>5</sup> *Id.*

<sup>6</sup> *Id.* at \*6.

<sup>7</sup> *Id.* at \*6-\*7 (citation omitted).

and unambiguously forbade the Banks' conduct" since there was a "fair ground of doubt" as to whether they could bind the banks extraterritorially in light of international comity and the separate entity rule.<sup>8</sup>

Regarding international comity, the banks argued that Chinese law prohibited them from freezing customer accounts. Noting that the district court had not engaged in a comity analysis regarding the asset restraints, the Second Circuit held there were "colorable" comity concerns in ordering a nonparty foreign bank to freeze assets held abroad, especially in light of the possibility that China's banking laws could be read to prohibit Chinese banks from freezing assets at the request of foreign courts.<sup>9</sup> Accordingly, the banks had a reasonable basis to doubt whether the asset restraints applied to their foreign branches.

The Court reasoned that New York's separate entity rule, "itself a rule of comity," also raised doubts as to whether the asset restraints could apply to the banks' Chinese branches.<sup>10</sup> The separate entity rule provides that "even when a bank garnishee with a New York branch is subject to personal jurisdiction, its other branches are treated as separate entities for certain purposes," such as judgment enforcement.<sup>11</sup> Although a state law rule, it applies where a federal rule points to the procedure of the state where the court is located (here, Federal Rule of Civil Procedure 69).

The Second Circuit found that it "need not decide whether the separate entity rule bars enforcement of the postjudgment asset restraints."<sup>12</sup> The district court's order could be affirmed on the basis that Next Investments had not "identif[ied] a legal principle that clearly subjects the Chinese branches to the asset restraints, whether by blocking application of the separate entity rule or by reaching the Chinese branches notwithstanding the separate entity rule."<sup>13</sup>

The Second Circuit rejected Next Investments' argument that application of the separate entity rule

conflicted with Federal Rule of Civil Procedure 65(d)'s provisions binding nonparties with actual notice, finding that Federal Rule 69 applied more specifically and therefore its incorporation of the separate entity rule controlled. It also rejected Next Investments' argument "that the separate entity rule applies only if personal jurisdiction is based entirely on the presence of a New York branch"<sup>14</sup> since Next Investments adduced no New York authority in support of this position and the district court in any event had not ruled on specific personal jurisdiction over the banks regarding the asset restraints.

*Third*, the Second Circuit held there was "a fair ground of doubt" as to whether the banks' provision of "routine financial services" constituted "active concert or participation" with respect to defendants' violations of the district court's orders.<sup>15</sup>

*Finally*, the Second Circuit affirmed the district court's denial of discovery sanctions, since Next Investments had not met its burden of showing that the district court's factual findings regarding the banks compliance were "clearly erroneous."<sup>16</sup>

## Conclusion

Since its *Next Investments* decision was rendered in the context of a request for contempt sanctions, the Second Circuit did not need to squarely decide whether international comity concerns and the separate entity rule applied to the facts at issue—it was sufficient that they reasonably *could* apply and thus the banks were not clearly and unambiguously in violation of the district court's Order. Nevertheless, the decision suggests that litigants may find it difficult to enforce judgments and other orders against the foreign branches of banks, even those with a New York presence, in light of international comity principles and New York's separate entity rule.

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<sup>8</sup> *Id.* at \*8 (citation omitted).

<sup>9</sup> *Id.* at \*9.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.* (citing *Motorola Credit Corp. v. Standard Chartered Bank*, 24 N.Y.3d 149 (2014)).

<sup>12</sup> *Id.* at \*10.

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

<sup>15</sup> *Id.* at \*11 (citation omitted).

<sup>16</sup> *Id.*