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Banks Doing Business In Illinois Beware!

Friday, Feb 23, 2007 --- What are the implications for a branch bank, or the main office of a bank having multiple branches, when a court seizes (e.g., via a restraining order, garnishment, or attachment) a bank depositor's funds on deposit in another branch?

The answer has historically hinged on the relationship between a bank and its branches and is governed by the Separate Entity Rule.

That may not be the case, however, if the branch bank served with a seizure writ or similar devise is in Illinois. Illinois is "a minority perhaps of one" that may not follow the Separate Entity Rule.

Banks which do business in Illinois may want to take heed and beware of the implications of the intermediate Illinois appellate court's apparent renewed rejection of an age-old principle of banking law.

The failure to recognize potential pitfalls could subject a bank to arguments that the bank is responsible for funds withdrawn from a depositors account and that the bank is subject to contempt sanctions for the violation of a court order.

* The Separate Entity Rule *

Under the right conditions, subject to the regulations and dictates of the National Bank Act, 12 U.S.C. § 36, and various state banking acts, banks are permitted to establish and operate branches.

Traditionally, when the branch of a bank was served with a writ of garnishment or other similar seizure notice, the notice was only good against the specific branch served, not other branches of the bank or even the main office.

Under this longstanding "separate entity rule," accounts or deposits may be seized only by serving a writ, such as garnishment, attachment, or injunction, at the branch or main office holding the funds.

Courts have found that branches of banks are generally considered "separate entities" and, as such, they are not concerned with the accounts maintained by depositors in the main office or at other branches.

The Rule has a plain, functional, and oft-cited purpose: "[s]ervice on one branch should not be permitted to accomplish a restraint on accounts and funds in other branches because of the substantial interference with routine

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banking business." E.g., Cronan v. Schilling, 100 N.Y.S.2d 474, 476 (S. Ct. N.Y. 1950).

As a federal District Court sitting in Illinois reasoned, it would be an "intolerable burden upon banking and commerce" to require a branch served with a writ of seizure or similar device to notify every other branch and the main office that such an action occurred. In re Estate of Marcos, No. 97C0477, 1997 WL 428544, *3 (N.D. Ill. Jul. 24, 1997).

The Separate Entity Rule has been a staple at the intersection of banking and seizure law for years and years and years.

* A Problem *

Consider the following fact pattern:

"Wife" deposits money in an account in the Mainz-Kastel, Germany branch of "German Bank." German Bank has a branch in Chicago, Illinois.

"Husband" files for divorce in Chicago and seeks a temporary restraining order against Wife and German Bank, asserting that the Wife absconded with money belonging to Husband and deposited the funds in the Mainz-Kastel branch of German Bank. Husband serves notice of the restraining order on the Chicago branch of German Bank.

Court grants the relief and later, at Husband's urging and against the objections of German Bank, makes the injunctive relief permanent. German Bank appeals arguing, among other things, that service on the Chicago branch is ineffective under the Separate Entity Rule.

What result? Under the Separate Entity Rule, Husband's service of the restraining order on the Chicago branch of German Bank would be ineffective to freeze the Wife's account. German Bank could, pursuant to the Rule, freely allow Wife to withdraw the funds from her account and not expect to incur any liability as a result. What about in Illinois?

Over 100 years ago, in an opinion widely-recognized as an outlier on the Separate Entity Rule landscape, an intermediate Illinois appellate court held that the Bank of Montreal was liable for funds withdrawn by the defendant from the Chicago branch of the bank, which had been served with a garnishment writ.

The defendant had an account at the Toronto branch of the Bank of Montreal, but not at its Chicago branch. Bank of Montreal v. Clark, 108 Ill. App. 163 (Ill. App. 1903).

As later courts trying to make sense of this opinion noted, the Bank of Montreal court was particularly unhappy with the defendant, who had run off to another jurisdiction in an attempt to escape the court's order.

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The Bank of Montreal court did not specifically address the Separate Entity Rule, but commentators speculated for years that the decision suggests that Illinois may not follow the Rule. It would take until 2005 before the Illinois Appellate Courts had the opportunity to address the issue. By then, of course, several things had changed in Illinois.

First, the Illinois legislature adopted Articles 4 and 4A of the Uniform Commercial Code (UCC), both of which endorse the notion of treating separate bank branches as separate entities. Article 4A of the UCC states that a "branch or separate office of a bank is a separate bank for purposes of this Article." 810 ILCS 5/4A-105(a)(2).

Similarly, Section 4-107 of Article 4 of the UCC provides that a "branch or separate office of a bank is a separate bank for the purpose of…determining the place at or to which action may be taken or notice or orders must be given under this Article or Article 3." 810 ILCS 5/4-107.

Indeed, as the comments to Section 4-107 recognize, "[i]n many states and for many purposes a branch or separate office of the bank should be treated as a separate bank." Id. at cmt. 2.

Second, until 1935 when the Illinois Courts Act was amended, Illinois appellate court decisions were non-binding. Thus, the outlying Bank of Montreal decision, issued in 1903, has no precedential value today.

Third, in 1997, a highly regarded federal district court judge in Illinois noted that "numerous courts throughout the country" had adopted the Separate Entity Rule. The court found—based largely on a survey of modern jurisprudence on the issue and the above changes in Illinois law—that the Bank of Montreal decision was a poor indicator of how the Illinois Supreme Court would rule today. In re Estate of Marcos, 1997 WL 428544 at *4.

The door was thus left open for the Illinois courts to expressly align the law of Illinois with that of the rest of the nation's courts which have addressed the Separate Entity Rule.

* In re: Kosmond *

The opportunity to do so presented itself in In re: Kosmond, 357 Ill. App. 3d 972 (Ill. App. 2005).

In Kosmond, the fact pattern outlined above was presented to the First District Illinois Appellate Court. Would the Court join the majority, adopt the Separate Entity Rule, and avoid a potentially "intolerable burden upon banking and commerce?"

No. The Court, in a very succinct ruling, held that "Illinois does not follow that rule," citing Bank of Montreal. Id. at 978.

The Kosmond court noted parenthetically its view of the holding of the Bank

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of Montreal decision: "the commonplace use of the telegraph enables a branch bank readily to inform another branch of the receipt of a garnishment summons." Id.

The implicit reasoning of the Kosmond Court is that technology, even as far back as 1903, eliminates the need for the Separate Entity Rule. Other courts that have addressed this argument, however, have soundly rejected it in favor of a more rational approach.
Specifically, courts employ a three-part test addressing issues related to modern technology. Under this test, courts decline to apply the Separate Entity Rule only where each of the following factors is present: (1) the restraining or seizure notice is served on the main office of the bank; (2) the bank's main office and branches are within the same jurisdiction; and (3) the bank's branches are connected to the main office by high-speed computers. See, e.g., Limonium Mar., S.A. v. Mizushima Marinera, S.A., 961 F. Supp. 600, 608 (S.D.N.Y. 1997) (quoting Cronan, 100 N.Y.S.2d at 476).

None of these factors were present in Kosmond. Regardless, the Kosmond court did not address the test in its opinion.

Ultimately, the appellate court in Kosmond reversed the lower court on grounds unrelated to the Separate Entity Rule.

Specifically, Commerzbank AG, the third-party "German Bank" in the case, successfully argued that the lower court erred by not holding a hearing to determine the international comity implications raised by an order of an Illinois court restraining a bank account in Germany and by failing to consider German law, pursuant to which Commerzbank argued it was restrained from freezing Wife's account held in Mainz-Kastel. Kosmond, 357 Ill. App. 3d at 978-80. The case recently settled and was dismissed, leaving the Kosmond opinion intact.

* Banks With Branches In Illinois Beware *

Any bank with a branch in Illinois should be aware that, until definitively determined by the Illinois Supreme Court, Illinois state courts have shown little indication that they will follow the Separate Entity Rule.

As a federal district court sitting in Illinois recently found, "[b]y rejecting this rule, the Illinois Courts accept the proposition that service upon one branch of a bank is sufficient to bind another branch holding assets subject to garnishment/attachment outside a court's jurisdiction." Hicks v. Midwest Transit, Inc., 03CV4004, 2006 WL 644814, *9 (S.D. Ill. March 9, 2006).

Thus, if a bank has branches in New York and Illinois, and a garnishment writ is served on an Illinois branch regarding an depositor's account held at a New York branch, one could argue that, pursuant to Kosmond, a banker ought to freeze that depositor's account nationwide (indeed, worldwide).

The failure to do so could open the door to arguments that the bank should

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be held responsible for the withdrawal of the funds up to the amount of the garnishment and potentially even contempt sanctions in Illinois for failure to comply with a court order.

Accordingly, banks with branches in Illinois may want to consider placing mechanisms in place to swiftly transmit service of any account seizure writ or similar order directly to the bank's main branch so that the writ or order can then be transmitted bank-wide. If this transmittal is timely accomplished, banks could avoid potential pitfalls the current state of Illinois law presents to the unknowing bank.

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