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Rule B - the latest news

Aftermath of Federal Appeal Court decision in SCI v Jaldhi

Automatic vacation of Rule B attachments

As has been widely publicised over recent days, the United States Federal Court of Appeals for the Second Circuit ruled on Friday 16 October, in *Shipping Corporation of India v Jaldhi*, that electronic fund transfers ("EFT's") being processed by an intermediary bank in New York are no longer subject to Rule B attachments. Following that ruling, some Southern District of New York judges have reacted by automatically vacating (i.e. setting aside without application from an interested party) pre-existing Rule B attachments. The developing situation, and possible options open to those affected by these events, are discussed below.

The position established by the "*Winter Storm*" case in 2002 was as follows. Where the named defendant in Rule B proceedings was either the party transferring US dollar funds via New York, or the named beneficiary, those funds represented property belonging to the defendant and were capable of being attached to secure a maritime claim against the defendant if he was not otherwise present in New York. The effect of this decision was that a Rule B order could effectively be used as a "fishing net" to catch US dollar transfers that were made from anywhere in the world, to or from the party from whom security was being sought, as the funds passed through New York.

The Federal Court judges of the New York Southern District had apparently been growing increasingly frustrated over the past year or so at the huge numbers of Rule B attachment applications. Those applications often seemed speculative and frequently related to disputes which had no obvious connection with the jurisdiction of the Southern District of New York. We understand that apart from the concern that the high volume of applications was causing strain on the judicial resources of the Federal Court for the Southern District of New York, there were also concerns expressed that the disruption caused by Rule B attachments might undermine the status of the US dollar as the pre-eminent currency of international trade.

Although the decision was something of a surprise in its absolute overruling of the "*Winter Storm*" decision, (which had been affirmed as recently as 2008) it follows a progression of recent cases at District Court level which have seen judges taking a more conservative approach to Rule B attachments.

Since Friday's decision, some judges in the Southern District of New York are already giving the decision retrospective effect and are automatically vacating existing Rule B attachments. Such automatic vacations may, in fact, be premature, as there should normally be an automatic 10-day stay to allow the losing party to file an appeal or application for rehearing. We anticipate a number of such applications may be seen over the coming weeks.

Those parties involved in cases where funds previously attached under Rule B have been replaced by bank guarantees or escrow agreements, or some other form of security, may also be affected by the decision. It is unclear whether such security arrangements can be retrospectively challenged and, if so, how far back the court will go to unravel security. At least one Southern District judge has already said that where funds have been transferred into the Court Registry (which, along with a bond, is the only compulsory replacement for attached funds), those funds should also be released in accordance with this decision. Where the funds have been replaced by contractual security, such as an escrow account or bank guarantee, this ought to be outside the Court's jurisdiction. However, there may still be room for these to

be challenged, especially where the underlying agreement refers to the Rule B attachment. New York lawyer Gene O'Connor, who is advising several parties on the implications of the decision, has recommended that escrow arrangements for attached EFT's be established outside the jurisdiction, as far as possible, to avoid risk of attachment orders being re-served on New York escrow agents.

SCI are apparently considering an application for a rehearing to the same Court, or an Appeal to the US Supreme Court. Either application would result in a stay of the decision. Given that this decision is referred to as having the consent of all sitting judges already, the prospects of success seem slim. However, as the basis for the decision included anecdotal facts, such as the judges' irritation with the volume of Rule Bs, which SCI did not have opportunity to address, a rehearing may be appropriate. We understand that the Supreme Court accepts only a tiny number of cases, so it is unclear whether an appeal is even possible at this stage.

Many businesses have registered a corporate presence in New York, particularly over the past year or so, to avoid the threat of Rule B attachments. The benefit of such registrations (unless they include genuine business advantages) must now be open to question and a presence in New York could in fact expose such businesses to an increased risk of enforcement proceedings against them, as enforcement against the New York entity will be possible, whereas no enforcement would have been available prior to registration.

Rule B - what is still possible?

Despite the furore of the past few days, this is not the end of Rule B as a security remedy – it only affects the attachment of EFT's. Rule B attachments will still be available where businesses who cannot be found in the jurisdiction have property within the jurisdiction (whether bank accounts, real property or other assets). As a Federal maritime law remedy, this applies to the whole of the United States. It should still be possible to use Rule B to attach bunkers aboard time-chartered vessels to secure claims against charterers (which has been a security remedy employed quite extensively over recent years, particularly in Gulf and Californian ports). Equally, Rule B attachments of cargoes should also remain possible.

Further, the decision has no bearing on other forms of security, such as ship, bunker or cargo arrests; letters of security or voluntary escrow arrangements, whether in the United States (for instance, under the various applicable state laws, as opposed to Rule B, which is a Federal remedy), or in other jurisdictions. While Rule B EFT attachments had become particularly popular with creditors over recent years, as one of the easiest, cheapest and most effective ways of obtaining security from recalcitrant debtors, it is clear that, subject to any appeal, this remedy has now had its wings clipped. Accordingly, we can expect renewed interest from creditors in the traditional arrest jurisdictions such as South Africa, France and the Netherlands.

For further information on Rule B attachments, please contact Jonathan Webb on jonathan.webb@hfw.com or Sarah Taylor on sarah.taylor@hfw.com, or your usual HFW contact.

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