

Memorandum

To: Commissioners and Life Members

From: Michael B. Getty, Drafting Committee Chair

Subject: Uniform Asset-Freezing Order Act

The Committee created to draft a Uniform Asset-Freezing Order Act is pleased to present its draft for final reading and approval by the states. Two ABA Advisers and two of our colleagues from Canada as well as numerous observers including representatives of the State Department, the Federal Reserve Board, the American Bankers Association, the National Center for State Courts, and the banking industry have assisted us in our work. They have provided invaluable assistance in creating this draft.

### **BACKGROUND**

This uniform act relates to asset-freezing orders, which are in personam orders issued to freeze the assets of a defendant to prevent that defendant from dissipating its assets to defeat satisfaction of an existing or future judgment. English Courts and the courts in other common law countries have been using asset-freezing orders since 1975. Those courts view asset freezing orders as valuable tools, particularly in the modern world of technology, where assets can be transferred with the simple stroke of a computer key.

In the United States, the primary remedy against asset dissipation has traditionally been an in rem order prohibiting the transfer of assets. Nonetheless, some courts in this country have issued in personam asset freezing orders where those orders were necessary to prevent a defendant from dissipating assets where it appeared that no assets would be left to satisfy a potential judgment.

The viability of asset-freezing orders was the subject of the United States Supreme Court opinion in *Grupo Mexicano de Desarrollo v. Alliance Bond Fund, Inc.*, 527 U.S. 308 (1999). The *Grupo Mexicano* case is a classic case demonstrating the need for an asset-freezing order procedure. The plaintiffs were a group of investment funds in the United States which had purchased 75 million dollars in notes issued by a Mexican holding company that operated toll roads in Mexico. The Mexican holding company suffered serious financial setbacks and began transferring the assets securing the notes in order to pay other obligations. The assets were located in Mexico and consequently there was no possible in rem remedy.

The investment funds commenced an action in the United States District Court for the Southern District of New York seeking an asset-freezing order precluding the Mexican holding company from transferring or encumbering the assets. The district court issued an asset-freezing order restraining the Mexican holding company from dissipating the assets which were pledged to satisfy the note. The court found that the investment funds would suffer irreparable injury since the Mexican holding company's financial condition and dissipation of assets would frustrate any judgment recovered. The United States Court of Appeals for the Second Circuit affirmed the district court's issuance of an asset freezing order and the United States Supreme Court granted certiorari.

In this 5-4 opinion authored by Justice Scalia, the Supreme noted that an asset-freezing procedure was a valuable procedural tool but concluded that federal courts lacked the jurisdiction to issue such orders because they were not part of the common law at the time the federal court system was created. Justice Scalia expressed no substantive concern with the asset-freezing order entered by this district court or the overall concept of asset-freezing orders but simply found that the district court lacked the jurisdiction to enter the order. He also remarked that the decision whether federal courts should have the power to issue asset-freezing orders should be left up to the legislature.

Although the *Grupo Mexicano* decision involved the jurisdiction of federal courts, it caused confusion in the state court system over the propriety of asset-freezing orders. Some state supreme courts concluded, in the wake of that decision, that courts in their state lacked the authority to issue asset-freezing orders. At least one other state supreme court concluded the opposite – that courts in their state still had the power to issue asset freezing orders because the *Grupo Mexicano* decision involved federal court jurisdiction.

The Uniform Asset-Freezing Order Act remedies this lack uniformity on the asset-freezing order issue by providing state legislatures with a Uniform Act that authorizes the issuance of asset-freezing orders and provides for the recognition and enforcement of asset-freezing orders issued by sister states and courts outside the United States.

## ISSUES RELATING TO THIS ACT

### A. Procedural Protections

While asset-freezing orders are valuable procedural tools to protect against the dissipation of assets to insure the enforceability of judgments, they can have a significant impact on the debtor whose assets are frozen and on nonparties who hold those assets. The drafting committee was acutely aware of the need to draft a uniform law providing appropriate procedural safeguards to debtors and nonparties.

Section 4 provides a rigorous process for the issuance of an asset-freezing order with notice. It draws heavily on the currently existing American law concerning temporary restraining orders and preliminary injunctions and currently existing English and Canadian law concerning asset-freezing orders. Under the provisions of Section 4, a party can obtain an asset-freezing order only if it establishes that there is a substantial likelihood that the assets of a party against which the order is sought will be dissipated so that the party seeking the asset freezing order will be unable to receive satisfaction of the judgment.

Sections 4(c) and 4(d) provide additional safeguards. Section 4(c) authorizes a court to relieve a party of its obligations under an asset-freezing order by permitting that party to post a bond or other security. Section 4(d) entitles a party against which an asset freezing order is entered to an order from the court allowing the use of assets to meet normal living or business expenses and the cost of defending the action.

Section 5 allows for the issuance of an asset freezing order without notice. In order to obtain such an order, the party must meet the rigorous showing required by Section 4. It must also make the disclosures normally required for the issuance of a Temporary Restraining Order as well as one important additional disclosure. Section 5(b)(1) requires the party seeking the order to conduct a reasonable inquiry and disclose all material facts that weigh against the issuance of the order.

Since asset freezing orders also impact nonparties, it is important that the obligations of nonparties be set out with specificity. Those obligations are contained in Section 6(b). Under the provisions of this section, nonparties served with an asset-freezing order shall promptly freeze the assets held on behalf of the party against which the order is issued. The nonparty is provided significant protection because a court, assessing the promptness of a nonparty's response to an asset-freezing order under this section, must take into account the manner, time of service and other factors that reasonably affect a nonparty's ability to comply. This language is intended to incorporate the spirit of UCC §4-303.

Section 6(b) is a self-executing provision that requires a nonparty in a state that has adopted the uniform act to comply with the asset-freezing order without the need for further action. (If the nonparty is in a state that has not adopted this uniform act, the nonparty is not required to comply with the order unless and until the party on whose behalf the asset-freezing order has been issued has obtained an order in that state recognizing the asset-freezing order from the jurisdiction where the nonparty is located.)

Section 6(b) also provides protection for nonparties whose actions in freezing assets could potentially violate foreign law. Section 6(d) makes clear that a nonparty violates an asset-freezing order only if it knowingly assists in or permits a violation of the order.

Section 7 authorizes a court to require security to protect a party against the wrongful issuance of an asset-freezing order. It also requires a party on whose behalf an asset-freezing order has been entered to indemnify a nonparty for the reasonable costs of compliance.

## B. Recognition and Enforcement of Asset-Freezing Orders

Because asset-freezing orders are not final judgments, there is a lack of uniformity in the approach courts take to the recognition and enforcement of asset-freezing orders issued by other courts. This Act remedies that deficiency. The provisions for recognition and enforcement appear in Sections 8, 9 and 10 and authorize recognition and enforcement of judgments of sister states as well as courts outside the United States. These sections borrow freely from the architecture and language of the Uniform Foreign-Country Money Judgments Recognition Act.