

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

-----X
DEBORAH D. PETERSON,
Personal Representative of the Estate of
James C. Knipple (Dec.), et al.,

Plaintiffs,

v.

ISLAMIC REPUBLIC OF IRAN, et al.,

Defendants.
-----X

Case No. 10 Civ. 4518 (KBF)

REDACTED

CONTAINS CONFIDENTIAL
MATERIAL SUBJECT TO
PROTECTIVE ORDER

**MEMORANDUM OF LAW IN SUPPORT OF DEFENDANT CLEARSTREAM
BANKING, S.A.'s MOTION FOR PARTIAL RECONSIDERATION**

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Defendant Clearstream Banking, S.A. (“Clearstream”) respectfully submits this memorandum of law in support of its motion, pursuant to Local Rule 6.3, seeking partial reconsideration of this Court’s February 28, 2013 opinion and order (the “Order”).

PRELIMINARY STATEMENT

Clearstream is a leading European supplier of post-trading services in the global securities market, playing a role in Europe equivalent to that of the Federal Reserve Bank or DTCC in the United States. Alongside its peers, such as Euroclear, Clearstream provides services indispensable to the functioning of the global capital markets. It plays a systemically important role as an intermediary and is an essential part of the global market infrastructure. This role explains and motivates Clearstream’s support for the well-established legal rules governing the securities industry.

For this reason, Clearstream seeks reconsideration of the Order, which undercuts those established rules. In its Order, the Court concludes that security entitlements held by Clearstream in its omnibus account at Citibank, N.A. were property of Bank Markazi. But Clearstream does not hold customer assets in its account at Citibank in New York. Under Article 8 of the Uniform Commercial Code, Bank Markazi held no rights – legal, equitable, beneficial, or otherwise – in assets or cash credited to Clearstream at Citibank. As a matter of law, only Clearstream held such rights. This structure is essential to the securities custody system in the United States and globally. This system is given legal effect in the United States by Article 8 of the UCC, pursuant to which each intermediary financial institution acts effectively as custodian for its entitlement holders, and each entitlement holder has property interests only with regard to entitlements held by its intermediary.

Under Article 8, Clearstream, and only Clearstream, has ownership rights to the security entitlements held in its name at Citibank. 22 U.S.C. § 8772 does not preempt this ownership determination. Thus, Clearstream contests the Court's interpretation of Section 8772, which effectively transfers to Iran an interest in Clearstream's property, a result at odds not only with Article 8, but also with a sanctions statute intended to hold Iran "accountable."

In addition, certain of the Court's findings of fact are not supported by the record, largely because they relate to litigation that has been stayed by court order. Specifically, there is no evidence, and none is cited, that Clearstream instructed Citibank to transfer funds to [REDACTED] with respect to the [REDACTED] of two securities by UBAE (Order at 8, 10); that Clearstream was aware of Plaintiffs' judgments when [REDACTED] (Order at 34); that any Clearstream account at Citibank was in the name of UBAE (Order at 51); that after the June 2008 hearing, entitlements in two securities were sold (Order at 5); or that restrained and blocked assets are held in Clearstream's omnibus account at Citibank (Order at 12).

LEGAL STANDARD FOR RECONSIDERATION

A motion for reconsideration is governed by Local Rule 6.3 and is committed to the sound discretion of the district court. Grounds for reconsideration include "'the need to correct a clear error.'" *See, e.g., Gucci Am., Inc. v. Guess?, Inc.*, No. 09 Civ. 4373 (SAS), 2011 WL 6326032, at *1 (S.D.N.Y. Dec. 16, 2011) (quoting *RST(2005) Inc. v. Research in Motion Ltd.*, 597 F. Supp. 2d 362, 365 (S.D.N.Y. 2009)).

ARGUMENT

I. BANK MARKAZI HAS NO PROPERTY INTEREST IN THE ASSETS HELD AT CITIBANK

The fundamental underpinning of the Order is the legal conclusion that only Bank Markazi holds an interest in the security entitlements and cash credited by Citibank to Clearstream. As a matter of law Bank Markazi has *no* cognizable interest in those assets.

It is black letter law that property rights are “created and defined by state law.” *Butner v. United States*, 440 U.S. 48, 55 (1979); *see also Calderon-Cardona v. JPMorgan Chase Bank, N.A.*, 867 F. Supp. 2d 389, 400 (S.D.N.Y. 2011) (“[u]nless there is a federal statute or regulation that governs, courts generally apply state law when determining interests in or ownership of property” (citing *Export-Import Bank of U.S. v. Asia Pulp & Paper Co., Ltd.*, 609 F.3d 111, 117 (2d Cir. 2010))). Where a statute ““creates no property rights but merely attaches consequences, federally defined, to rights created under state law,”” the Second Circuit has delineated a “two step method of analysis”:

First, we look initially to state law to determine what rights the judgment debtor has in the property the [petitioner] seeks to reach. Second, we then look to federal law to determine whether the judgment debtor’s state-delineated rights constitute a[n] . . . interest in property sufficient to trigger application of the [relevant statute].

Calderon-Cardona, 867 F. Supp. 2d at 400 (quoting *Export-Import Bank of U.S.*, 609 F.3d at 117).

In this case, the relevant state law is the Uniform Commercial Code, which has been enacted in every state. Revised Article 8 sets out the rules governing creation and ownership of security entitlements within the indirect holding system, a system based upon statutory principles entirely distinct from the common law. “Although this section recognizes that the entitlement holders of a securities intermediary have a property interest in the financial assets held by the

intermediary, the incidents of this property interest are established by the rules of Article 8, *not* by common law property concepts.” UCC § 8-503 cmt. 2 (emphasis added).

Under the UCC, the law of New York applies to the security entitlements established by Citibank, acting in New York as Clearstream’s securities intermediary. *See* UCC § 8-110(b)(2) (“The local law of the securities intermediary’s jurisdiction, as specified in subsection (e), governs: . . . (2) the rights and duties of the securities intermediary and entitlement holder arising out of the security entitlement.”); *see also* Declaration of James S. Rogers, dated January 6, 2011 (“Rogers Decl.”),¹ ¶ 5 (“[T]he local law of a securities intermediary’s jurisdiction governs the rights of a person who holds through a securities intermediary[.]”). Similarly, Luxembourg law governs Bank Markazi’s interests against its securities intermediary, Clearstream, and gave Bank Markazi equivalent interests in security entitlements held in custody by Clearstream in Luxembourg. *See* UCC § 8-110(b)(2); Legal Memorandum of Arendt & Medernach (“Arendt Declaration”), dated January 7, 2011, ¶¶ 4, 6-10.²

When Citibank made book entries in Clearstream’s omnibus account reflecting the establishment of security entitlements, Clearstream acquired the sole property interest in these financial assets. UCC §§ 8-102(7); 8-102(14)(ii); 8-501(b)(1); 8-503; Rogers Decl. ¶ 8. Only Clearstream could assert any claim against Citibank as to those assets. UCC §§ 8-505–8-508; Rogers Decl. ¶ 13 (“There is no circumstance in which customers of an intermediary can assert rights directly against anyone else through whom that intermediary holds a securities position.”).

¹ The Rogers Declaration is Exhibit 4 to the Compendium of Exhibits to Clearstream’s Consolidated Memorandum of Law in Support of its Renewed Motion to Vacate Restraints (“Clearstream’s Consolidated Memorandum”), ECF No. 174.

² The Arendt Declaration is Exhibit 2 to Clearstream’s Consolidated Memorandum, ECF No. 174.

While Clearstream held assets in custody for Bank Markazi in Luxembourg, Bank Markazi obtained no legally cognizable interests in the assets booked at Citibank. Tracing by a customer from its intermediary to an upper tier intermediary is inconsistent with the rules of the indirect holding system, and no concept of beneficial or equitable ownership, or any traditional concept of custody, is cognizable under Article 8 or could be asserted by Bank Markazi against Citibank.

A security entitlement is not a claim to a specific identifiable thing; it is a package of rights and interests that a person has against the person's securities intermediary and the property held by the intermediary. *The idea that discrete objects might be traced through the hands of different persons has no place in the Revised Article 8 rules for the indirect holding system.*

Official Comment to Section 8-503 (emphasis added).³ While under Luxembourg law, as under the UCC, a securities intermediary has an obligation to establish security entitlements that correspond to those established for its customers, *see* UCC §§ 8-503, 8-110(b)(2), 8-110(e), that obligation does not create any tracing right or “beneficial” interest, and did not translate into a property right on the part of Bank Markazi that can be asserted through Clearstream to Citibank, let alone to the securities held at a depository.

The fundamental principles of the indirect holding system rules are that an entitlement holder's own intermediary has the obligation to see to it that the entitlement holder receives all of the economic and corporate rights that comprise the financial asset, and that the entitlement holder can look only to that intermediary for performance of the obligations. The entitlement holder cannot assert rights directly against other persons, such as other intermediaries through whom the intermediary holds the positions.

Official Comment to UCC § 8-503; *see also* Arendt Declaration ¶¶ 9-10.

³ Nor does Bank Markazi have any interests with respect to the cash Clearstream maintains at Citibank. *See, e.g., NML Capital, Ltd. v. Banco Central de la Republica Argentina*, 652 F.3d 172, 192 (2d Cir. 2011) (a bank account “consists of nothing more or less than a promise to pay, from the bank to the depositor.” (quoting *Citizens Bank of Md. v. Strumpf*, 516 U.S. 16, 21 (1995))). Bank Markazi has a right to payment only against its securities intermediary, Clearstream. *See* UCC § 8-503(c).

Finally, no creditor of Bank Markazi has legal recourse, under any theory, against Citibank with respect to Clearstream's assets. "The interest of a debtor in a security entitlement may be reached by a creditor *only* by legal process upon the securities intermediary with whom the debtor's securities account is maintained." UCC § 8-112(c) (emphasis added); *see also* Rogers Decl. ¶ 14. As illustrated by the Official Comment to UCC § 8-112, with relevant names inserted:

If *Bank Markazi* holds securities through *Clearstream*, and *Clearstream* in turn holds through *Citibank*, *Bank Markazi*'s property interest is a security entitlement against *Clearstream*. Accordingly, *Plaintiffs* cannot reach *Bank Markazi*'s interest by legal process directed to *Citibank*.

II. CLEARSTREAM HAS CONSISTENTLY ASSERTED ITS RIGHTS

The Order also erred when it found that "[n]one of the defendants cite authority or facts supporting that any entity other than Bank Markazi has [a constitutional, beneficial or equitable] interest [in the assets at issue]." (Order at 62.) Clearstream has consistently asserted its rights and has denied that Bank Markazi had any rights in the assets at Citibank. *See, e.g.*, Clearstream's Consolidated Memorandum, ECF No. 174, at 26 ("Citibank holds the security entitlements in the Omnibus Account for Clearstream. Those entitlements are not property of Citibank, and Clearstream has 'a pro-rata property interest' in the securities held at Citibank to the extent of its entitlements."), 36 ("Clearstream has *its* entitlements with Citibank in New York, in which, under Luxembourg law and the UCC, Bank Markazi does not have an interest and against which it cannot enforce its property rights." (emphasis in original)); Clearstream's Supplemental Memorandum of Law in Opposition to Plaintiffs' Motion for Partial Summary Judgment Under the Iran Threat Reduction and Syria Human Rights Act of 2012, ECF No. 286, at 11 ("Clearstream has a constitutionally protected interest in the cash restrained at Citibank due

to the rights Clearstream acquired when Citibank established the security entitlements in Clearstream's favor.”⁴

III. ARTICLE 8 GOVERNS THE DETERMINATIONS REQUIRED BY 22 U.S.C. § 8772

Contrary to the Court's Order, Article 8 is not “mooted” by 22 U.S.C. § 8772. (Order at 61 & n.17.) Just the opposite. Section 8772 is plainly intended to permit plaintiffs to execute their judgments *upon the property of Iran and Bank Markazi*. But equally plainly Section 8772 is *not* intended to permit plaintiffs to execute upon property in which another party has a “constitutionally protected interest,” a result that would only help Iran. *See, e.g.*, Brief for the United States as Amicus Curiae, *Calderon-Cardona v. Bank of New York Mellon*, No. 12-75, 2012 WL 4509846, at *20 (Sept. 21, 2012) (“[P]aying judgments from assets that are *not* owned by the terrorist party does not impose a cost on the terrorist party. It does, however, impose a heavy cost on non-terrorist property owners—and not a cost that Congress demonstrably chose to impose.” (emphasis in original)).

Consequently, Section 8772 requires the Court to determine whether Iran or another entity owns the relevant assets. As the statute offers no rules for determining who has a “constitutionally protected interest,” reference to Article 8 is required. *See, e.g.*, *Calderon-Cardona*, 867 F. Supp. 2d at 401 (“[The Terrorism Risk Insurance Act] does not preempt New

⁴ And Clearstream has never conceded that Bank Markazi has a property interest in the assets held by Citibank. In its Motion to Vacate the Restraints, Clearstream was willing to stipulate “solely for purposes of argument” that Bank Markazi was the underlying beneficial owner of the assets in order to avoid a fight with the Plaintiffs on the issue because “beneficial ownership” is irrelevant under Article 8. Clearstream's Reply Memorandum of Law In Support Of Its Renewed Motion To Vacate Restraints, ECF No. 220, at 3-4. This limited stipulation obviated the need for discovery or briefing on whether fraudulent conveyance law trumps the UCC in connection with Clearstream's Motion to Vacate. *Id.* As recognized in the Order, Clearstream did not stipulate that Bank Markazi has any interest in the assets (beneficial, equitable or otherwise) in connection with Clearstream's opposition to Plaintiffs' motion for summary judgment on turnover. (Order at 59.)

York law, however, because it provides no guidance for determining which blocked assets are ‘of that terrorist party.’”).

The structure of Section 8772 confirms that Article 8 is not preempted for purposes of this ownership determination. While Section 8772(a)(1) is to be enforced “notwithstanding any other provision of law . . . and preempting any inconsistent provision of State law,” paragraph 1 is expressly “[s]ubject to paragraph (2).” (emphasis added). Paragraph 2 contains no preemption of the UCC, and Section 8772(c)(2) provides that “[n]othing in this section shall be construed . . . to preempt State law, including the Uniform Commercial Code, *except as expressly provided in subsection (a)(1).*” (emphasis added).

The determinations required under Paragraph (2) can be made *only* by reference to Article 8. Paragraph (2) of Section 8772 states:

In order to ensure that *Iran is held accountable* for paying the judgments described in paragraph (1) and in furtherance of the *broader goals of this Act to sanction Iran*, prior to an award turning over any asset pursuant to execution or attachment in aid of execution with respect to any judgments against Iran described in paragraph (1), *the court shall determine whether Iran holds equitable title to, or the beneficial interest in, the assets described in subsection (b) and that no other person possesses a constitutionally protected interest in the assets described in subsection (b) under the Fifth Amendment to the Constitution of the United States.* To the extent the court determines that a person other than Iran holds—

(A) equitable title to, or a beneficial interest in, the assets described in subsection (b) (excluding a custodial interest of a foreign securities intermediary or a related intermediary that holds the assets abroad for the benefit of Iran); or

(B) a constitutionally protected interest in the assets described in subsection (b),

such assets shall be available only for execution or attachment in aid of execution to the extent of Iran’s equitable title or beneficial interest therein and to the extent such execution or attachment does not infringe upon such constitutionally protected interest.

(emphasis added).

There is no dispute that the security entitlements and cash at Citibank were and are held in an account in Clearstream's name. "[T]he best, if not the only, way in which the possession of a chose in action – such as a bank account – can be shown, is by showing in whose name the account stands, for the person in whose name the account stands has absolute control of it and that is all possession of a chose in action can mean." *Bradford v. Chase Nat'l Bank*, 24 F. Supp. 28, 38 (S.D.N.Y. 1938), *aff'd sub nom., Berger v. Chase Nat'l Bank*, 105 F.2d 1001 (2d Cir. 1939), *aff'd*, 309 U.S. 632 (1939).

As a matter of law, therefore, Clearstream has "a constitutionally protected interest" in the security entitlements and cash held at Citibank. *See* UCC § 8-503. That the triggers for Clearstream's property rights were account entries by Citibank, *see* Order at 68, does not diminish their Fifth Amendment protection. And while Clearstream's interests in the Citibank account were not acquired for proprietary purposes, they are not held or identified as property of Bank Markazi.⁵ The omnibus account is not a segregated account in the name of the ultimate client, such as "Bank Markazi P/O/A Clearstream," to which only securities credited to Bank Markazi are identified. Bank Markazi was not identified in any way on Citibank's books as a beneficial or equitable owner of assets in Clearstream's omnibus account.⁶ Under UCC Article 8

⁵ Compare 12 U.S.C. § 1813(p), 1817(1) (2006) (discussing the general treatment of fiduciary accounts under section 92a in "trust funds" at FDIC-insured depository institutions), with 12 C.F.R. §§ 150.10-150.60 (2012) (containing the OCC's rules for trust accounts at federal saving associations).

⁶ The Order incorrectly states that the omnibus account is the segregated interest bearing account. (Order at 12, 57, 59.) Clearstream's omnibus account is a securities account that holds its global positions in many security entitlements. It does not hold the "Blocked Assets." Citibank established the segregated interest bearing account when it was served with the writ of execution on June 13, 2008, and placed the assets from the omnibus account identified in the writ into that segregated account. *See* Exh. 19 to Plaintiffs' Reply in Support of their Motion for Partial Summary Judgment, ECF No. 270, Affidavit of Mary Fenoglio of Citibank, N.A. ¶ 12 ([REDACTED]); Plaintiffs' Reply in Support of their Motion for Partial Summary Judgment, ECF No. 270, Rule 56.1 Statement ¶ 34.

Bank Markazi had no right to assert a claim to the assets at Citibank, and Citibank had no obligation to Bank Markazi with regard to assets credited to Clearstream.

Finally, nothing in Section 8772 grants Iran an interest in assets to which it otherwise has *no* equitable title or beneficial interest. Section 8772 authorizes execution only “to the extent of Iran’s equitable title or beneficial interest.” To interpret Section 8772 to permit execution upon assets to which neither Iran nor Bank Markazi has an interest, and in which Clearstream has a constitutionally protected right, would violate the stated objective of Section 8772, which is to hold *Iran* accountable for Iran’s terrorist acts – not *Clearstream*. *See, e.g., Calderon-Cardona*, 867 F. Supp. 2d at 396 (“The plain language of the statute is considered in the context in which it is used and the ‘broader context of the statute as a whole.’” (quoting *In re Ames Dept. Stores, Inc.*, 582 F.3d 422, 427 (2d Cir. 2009))). Such an interpretation would either give Clearstream a “takings” claim under the Fifth Amendment, or would breach a key canon of construction by rendering Section 8722 unconstitutional. *See, e.g., Hooper v. California*, 155 U.S. 648, 657 (1895) (“The elementary rule is that every reasonable construction must be resorted to, in order to save a statute from unconstitutionality.”).

IV. FACTUAL ERRORS

Certain of the Court’s findings of fact are not supported by the record because they relate to matters – including in particular Plaintiffs’ direct claims against Clearstream relating to the two securities worth US\$250 million that were [REDACTED] – as to which litigation has been stayed until Clearstream’s motion to vacate the restraints and Bank Markazi’s motion to dismiss were decided. *See Peterson v. Islamic Republic of Iran*, 18 Misc. 302 (BSJ), Order dated October 14, 2010 at 1 (not filed on ECF); *Peterson v. Islamic Republic of Iran*, 10 Civ. 4518 (BSJ), Order Authorizing Third-Party Interpleader Complaints and/or Petitions dated June 27,

2011 ¶ 3 (not filed on ECF); *Peterson v. Islamic Republic of Iran*, 10 Civ. 4518 (BSJ) (GWG), Scheduling Order filed November 29, 2011, ECF No. 157, ¶ 7. Other findings are plainly erroneous.

The Order states that “Clearstream allegedly instructed Citibank to transfer the cash proceeds of the \$250 million from the holding account to Clearstream’s cash account,” and that Clearstream instructed Citibank to make an electronic funds transfer (“EFT”) of the cash from Citibank to UBAE’s correspondent bank in New York, [REDACTED]. (Order at 8, 10 (citing Second Amended Complaint).)

First, this finding rests solely upon Plaintiffs’ allegations regarding the two securities worth US\$250 million that were [REDACTED]. The evidence shows to the contrary that the two securities were sold by UBAE to third party banks [REDACTED], reflected in entries on the books of Clearstream in Luxembourg. *See* Exh. 7 to Clearstream’s Consolidated Memorandum of Law, ECF No. 174, June 27, 2008 Hr’g Tr. at 45:16-21 (Clearstream’s witness stating: “[REDACTED] [REDACTED]”).

Second, Plaintiffs rely on an [REDACTED] bank statement to allege that Clearstream instructed Citibank to transfer sale proceeds from Citibank to [REDACTED]. But that statement shows rather that UBAE, the originating bank (the “ORG”), was directing Clearstream, as the order-giving bank (the “OGB”), to transfer funds from one UBAE account to another by instructing Clearstream’s dollar correspondent bank, JP Morgan Chase, to make a transfer of funds to UBAE’s correspondent account at [REDACTED]. *See* Exh. E to Plaintiffs’ Memorandum of Law in Opposition to UBAE’s Motion to Dismiss, ECF No. 323, at 13 (wire transfer advice: “[REDACTED]”).

[REDACTED].”).

Finally, nineteen of the restrained bonds were never [REDACTED]. (*See* Order at 10.) They remained in UBAE’s account. *See* Plaintiffs’ Supplemental Rule 56.1 Statement in Support of Partial Summary Judgment ¶ 4; Second Amended Complaint ¶ 169.

The Order in two places refers to the “UBAE/Clearstream account” at Citibank in New York and “the account at Citibank [] listed under the Clearstream and UBAE names.” (Order at 8, 51.) The only accounts that Clearstream had at Citibank were its securities omnibus account and a related cash account, neither of which names any customer. *See* Exh. 7 to Clearstream’s Consolidated Memorandum of Law, ECF No. 174, June 27, 2008 Hr’g Tr. at 12:13-18, 22:5-8 (Clearstream’s witness testifying that “individual customer accounts are not reflected” in the omnibus account). Likewise, Clearstream’s cash account at Citibank holds U.S. dollars for Clearstream. *See id.* at 12:23-13:2 (Clearstream’s witness testifying about the nature of the cash account: “Q. And are there corresponding cash accounts for each of those securities? A. No, there are not. The cash accounts that custodians would maintain with each other would be typically identical to normal correspondence Nostr[o] accounts.”).

The Order states that “Plaintiffs have sufficiently alleged, and the facts in the record support, that Bank Markazi and Clearstream were aware of Plaintiffs’ judgments at the time that UBAE was engaged to open an account and engage in a sale transaction on behalf of Bank Markazi. ([Second Amended Complaint] ¶¶ 13, 15, 24, 37, 41.).” (Order at 34-35.) As to Clearstream there is no record support for this allegation.

CONCLUSION

For these reasons, the Court should grant Clearstream's motion for reconsideration and deny Plaintiffs' motion for summary judgment for turnover.

Dated: March 13, 2013
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Respectfully submitted,

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