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Spiess v. C. Itoh & (and) Co. (America), Inc.: Another Chapter in the Continuing Conflict between FCN Treaties and Title VII

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decision was motivated by political expediency will certainly not be denied. The full impact of the decision will rest upon the decisions of the Claims Tribunal and resulting future litigation.

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Spiess v. C. Itoh & Co. (America), Inc.: Another Chapter in the Continuing Conflict between FCN Treaties and Title VII

The Fifth Circuit, in *Spiess v. C. Itoh & Co. (America), Inc.*,[1] recently held that the 1953 Treaty of Friendship, Commerce and Navigation (FCN) between the United States and Japan[2] grants wholly owned American subsidiaries of Japanese corporations "the limited right to discriminate in favor of Japanese nationals" in filling managerial and technical positions.[3] By contrast, the Second Circuit in *Avigliano v. Sumitomo Shoji America, Inc.*[4] held that the Japanese Treaty does not exempt wholly owned American subsidiaries of Japanese corporations from laws prohibiting discrimination in employment.[5] *Spiess* is unique because it thrusts the Second and Fifth Circuits into discord regarding the applicability of domestic employment discrimination laws to wholly owned Japanese subsidiaries incorporated in the United States. Unlike *Avigliano*, *Spiess* holds that "Article VIII [of the Japanese Treaty] does exempt C. Itoh-America from domestic employment to the extent of permitting discrimination in favor of Japanese citizens in employment for executive and technical positions."[6]

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1. 643 F.2d 353 (5th Cir. 1981).

2. Treaty of Friendship, Commerce and Navigation, Apr. 2, 1953, United States-Japan, 4 U.S.T. 2063, T.I.A.S. No. 2863 [hereinafter cited as Japanese Treaty].

3. 643 F.2d at 355.

4. 638 F.2d 552 (2d Cir. 1981).

5. In *Avigliano*, female secretarial employees of Sumitomo Shoji America, Inc., a wholly owned subsidiary of a Japanese commercial firm, appealed from an order entered by the district court dismissing their claim of discrimination on the basis of sex and national origin in violation of Title VII of the Civil Rights Act of 1964 as amended, 42 U.S.C. §§ 2000e *et seq.*, the Civil Rights Act of 1966, 42 U.S.C. § 1981 *et seq.*, and the Thirteenth Amendment of the U.S. Constitution. 638 F.2d at 553. The Second Circuit held that the Treaty did not exempt Japanese companies operating in the United States "whether or not they are incorporated in the United States, from American laws prohibiting discrimination in employment." *Id.* at 554. The present note should be read in conjunction with that published in volume 10, number 2 of this journal on the *Avigliano* case. Development, *The Impact of Title VII Protection on FCN Treaties: Conflict and Interpretation*, 10 DEN J. INT'L L. & POL'Y 373 (1981).

6. 643 F.2d at 359.

While *Spiess* and *Avigliano* reach opposing conclusions regarding the applicability of domestic employment discrimination laws to wholly owned American subsidiaries of Japanese corporations, the Second and Fifth Circuits leave two major issues unresolved. First, may a less-than-wholly owned American subsidiary of a foreign corporation seek exemption from domestic employment discrimination laws by raising FCN treaty provisions as a shield? Second, does Title VII supersede inconsistent FCN treaty provisions? These are the questions left open in the wake of *Avigliano* and *Spiess*.

In *Spiess*, American male employees of C. Itoh-America filed a class action under Title VII of the Civil Rights Act of 1964[7] and section 1981 of the Civil Rights Act of 1866.[8] The employees charged nationality discrimination, alleging that the company made "managerial promotions and other benefits available only to Japanese citizens."[9] In response, C. Itoh-America filed a rule 12(b) motion to dismiss for failure to state a claim upon which relief may be granted.[10] C. Itoh-America argued that the language of article VIII(1) of the 1953 FCN Treaty, which permitted companies to "engage . . . executive personnel . . . and other specialists of their choice,"[11] granted absolute immunity to C. Itoh-America from American employment discrimination laws.[12]

As with *Avigliano*, the court of appeals in *Spiess* faced two difficult issues. First, could a wholly owned Japanese subsidiary incorporated in the United States take advantage of the provisions of the Japanese Treaty? Second, if so, did the Treaty provisions exempt the Japanese company from American employment discrimination laws?

The *Spiess* court began its discussion with a brief analysis of the history of friendship, commerce and navigation treaties.[13] The court noted

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7. 42 U.S.C. §§ 2000e *et seq.* (1976).

8. 42 U.S.C. § 1981 *et seq.* (1976).

9. 643 F.2d at 355.

10. *Id.; see* Spiess v. C. Itoh & Co. (America), Inc., 469 F.Supp. 1 (S.D. Texas 1979). For a discussion of the background of the district court's holding, see Note, *Commercial Treaties and the American Civil Rights Laws: The Case of Japanese Employers*, 31 STAN. L. REV. 947 (1979) [hereinafter cited as Note].

11. 643 F.2d at 355.

12. *Id.*

13. FCN treaties are commercial agreements "designed to create a legal environment that encourages mutually beneficial trade and investment." Note, *supra* note 10, at 949. The Japanese Treaty is one of many FCN treaties negotiated between the United States and other countries on a bilateral basis beginning with the first FCN treaty with France in 1778. *See* Walker, *Modern Treaties of Friendship, Commerce and Navigation*, 42 MINN. L. REV. 805, 806 (1958) [hereinafter cited as Walker, *Modern Treaties*]; Walker, *Provisions on Companies in United States Commercial Treaties*, 50 AM. J. INT'L L. 373, 374 (1956) [hereinafter cited as Walker, *Provisions on Companies*]. In one of his articles, Walker outlined the purpose and nature of FCN treaties:

> These treaties . . . are 'commercial' in the broadest sense of that term; and they are above all treaties of 'establishment,' concerned with the protection of persons, natural and juridical, and of the property and interests of such per-

that FCN treaties are self-executing,[14] "the Supreme law of the land," and supersede inconsistent state law.[15] The court also noted that federal statutes should not be construed to "violate the law of nations if any other possible construction remains," for "only when Congress clearly intends to depart from the obligations of a treaty will inconsistent federal legislation govern."[16] The court reasoned that article VIII(1)[17] of the Treaty was not subsequently repudiated by Title VII, for Congress did not expressly repudiate the "of their choice" language of FCN treaties when it enacted Title VII. Accordingly, the court was reluctant to act in the absence of congressional mandate, for "[i]n the absence of Congressional guidance, we decline to abrogate the American government's solemn undertaking with respect to a foreign nation."[18]

The U.S. District Court for the Southern District of Texas, relying primarily on article XXII(3) of the Treaty,[19] denied C. Itoh-America's motion to dismiss.[20] The district court reasoned that since C. Itoh-America was a New York corporation, it was a "company of the United States"[21] and did not have standing to assert the provisions of the Japanese Treaty. In the district court's view, "[a]rticle XXII(3) unequivocally states that for the purpose of the Treaty the nationality of the corporation is determined by the place of incorporation."[22] On appeal, the Fifth Circuit rejected the district court's construction of article XXII(3) of the treaty, noting that treaties, unlike domestic legislation, "must create a common ground between differing cultures before the rights of the parties can be defined."[23] The court reasoned that the negotiating history of the

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> sons. They define the treatment each country owes the nationals of the other; their rights to engage in business and other activities within the boundaries of the former and the respect due them, their property and their enterprises.

Walker, *Modern Treaties, id.*, at 805-06.

14. 643 F.2d at 356. *See* Zenith Radio Corp. v. Matsushita Electric Indus. Co., Ltd., 494 F. Supp 1263, 1266 (E.D. Pa. 1980).

15. U.S. CONST. art. VI, cl. II.

16. 643 F.2d at 356, *citing* The Charming Betsy, 6 U.S. (2 Cranch) 64, 118 (1804), *quoted in* McCulloch v. Sociedad Nacional de Marineros de Honduras, 372 U.S. 10, 21 (1963). Since the Japanese Treaty was ratified after the enactment of section 1981, "it supersedes the Federal Statute." 643 F.2d at 362 n.2. *See* Hijo v. United States, 194 U.S. 315, 324 (1904).

17. Article VIII(1) of the Japanese Treaty provides: "[N]ationals and companies of either party shall be permitted to engage, within the territories of the other party, accountants and other technical experts, executive personnel, attorneys, agents and other specialists *of their choice.*" Japanese Treaty, *supra* note 2, art. VIII para. 1 (emphasis added).

18. 643 F.2d at 362.

19. Article XXII(3) of the Japanese Treaty provides: "[C]ompanies constituted under the applicable laws and regulations within the territories of either party shall be deemed companies thereof and shall have their juridical status recognized within the territories of the other party." Japanese Treaty, *supra* note 2, art. XXII para. 3.

20. Spiess v. C. Itoh & Co. (America), Inc., 469 F. Supp. 1, 6 (S.D. Texas 1979).

21. *Id.* at 6.

22. *Id.*

23. 643 F.2d at 356.

Treaty indicated an attempt to create a common ground between Japan and the United States, as "the provision was intended, not to determine which forms of corporate organization were entitled to assert Treaty rights, but to ensure that unfamiliar organizations would be recognized as 'companies' by the legal institutions of the respective countries."[24] The court relied on various articles written by Mr. Herman Walker, a leading authority on FCN treaties and former Advisor on Commercial Treaties to the State Department.[25] The court cited Walker for the proposition that the term "companies" in the FCN treaties had to be broadly interpreted to encompass the "varied purposes of an FCN treaty."[26] The court noted that the State Department has consistently recognized the right of American subsidiaries of Japanese corporations to enjoy full protection of the provisions of the Japanese Treaty.[27] C. Itoh-America concurred in this view, maintaining that various Treaty provisions, when read together, create a right of "companies of Japan" to employ Japanese citizens "of their choice."[28] The Fifth Circuit noted that the issue of corporate nationality need not be considered, as it determined that C. Itoh-America could assert Treaty rights on other grounds.[29]

Both *Spiess* and *Avigliano* hold that a wholly owned American subsidiary of a Japanese corporation has standing to raise the Japanese Treaty provisions. Like *Avigliano*, the *Spiess* court recognized that the lower court's interpretation of article XXII(3), which denied standing to

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24. *Id.* This intent was demonstrated in a memorandum prepared by State Department negotiators. *See* Dispatch No. 13, Office of the United States Political Advisor for Japan, at 5 (Apr. 8, 1952).

25. According to a State Department cable, Mr. Walker formulated the modern concept of FCN treaties. Walker also negotiated many such treaties on behalf of the United States. *See* Airgram from Secretary of State Kissinger to American Embassy in Tokyo, No. 1-105 (Jan. 9, 1976), *cited in* 643 F.2d at 357 n.2. Walker is a former Foreign Service Officer and former Advisor on Commercial Treaties, Office of International Trade and Resources, Department of State. *See* Walker, *Treaties for the Encouragement and Protection of Foreign Investment: Present United States Practice*, 5 AM. J. COMP. L. 229 (1956) [hereinafter cited as Walker, *United States Practice*].

26. According to Walker,

> A 'company' is defined simply and broadly to mean any corporation, partnership, company or association which has been duly formed under the laws of one of the contracting parties; that is, any 'artificial personal acknowledged by its creator, as distinguished from a natural person, whether or not for pecuniary profit.' Every association meeting this simple test of valid existence must be accounted by the other party a company of the party of its creation, and have its juridical status recognized without any reservation for the laws of the forum.

Walker, *Provisions on Companies*, *supra* note 13, at 380-81.

27. 643 F.2d at 357-58. *See* Letter from Lee R. Marks to Herbert J. Hansell (Oct. 17, 1978), *reprinted in* 73 AM. J. INT'L L. 281 (1979). *But cf.* Letter of James R. Atwood to Lutz Alexander Prager (Sept. 11, 1979), *reprinted in* 74 AM. J. INT'L L. 158 (1980). The *Spiess* court viewed the latter letter as "an aberration in State Department policy." 643 F.2d at 358 n.3.

28. 643 F.2d at 358 n.4.

29. *Id.*

C. Itoh-America, "would create an unreasonable distinction between treatment of American subsidiaries of Japanese corporations on the one hand, and branches of Japanese corporations on the other."[30] Citing *Avigliano, Spiess* noted that such an interpretation of the Treaty provision would create a "crazy quilt" pattern allowing Japanese corporations to enjoy Treaty protection while wholly owned Japanese subsidiaries incorporated in the United States would only be able to secure minimum protection under the Treaty.[31]

The *Spiess* court differed from *Avigliano* on the issue as to whether C. Itoh-America was bound by American employment discrimination laws. While the plaintiff (Spiess) argued and *Avigliano* held that article VIII(1) of the Treaty only provides for national treatment to Japanese corporations, the *Spiess* court held that this provision did in fact exempt C. Itoh-America "to the extent of permitting discrimination in favor of Japanese citizens in employment for executive and technical positions."[32]

Citing Walker, the court noted that rights of foreign nationals under these FCN treaties were measured by so called "contingent standards."[33] The first—the "national treatment" standard—guaranteed foreign nationals "the same treatment afforded to native citizens."[34] Article VII(1) of the Japanese Treaty reflects this standard, for it provides that "nationals and companies of either Party shall be accorded national treatment with respect to engaging in all types of commercial, industrial, financial and other business activities."[35] The second—the "most favored nation" standard—grew out of the nationalistic post-war period which "prevented universal application of the national treatment rule."[36] The court suggested that this standard is found in several of the Japanese Treaty provisions.[37] The court also noted that there were "absolute rules" which were created "to protect vital rights and privileges of foreign nationals in any situation, whether or not a host government provided the same rights to the indigenous population."[38] The court quoted Walker for the proposition that, under these absolute rules, "foreign nationals were to receive not only equal protection, but also a certain minimum degree of protection, as under international law, regardless of a Government's pos-

30. 643 F.2d at 358.

31. *Id., citing* Avigliano v. Sumitomo Shoji America, Inc., 683 F.2d 552, 556 (2d Cir. 1981).

32. 343 F.2d at 359.

33. *Id., citing* Walker, *Modern Treaties, supra* note 13, at 810-11.

34. 643 F.2d at 359.

35. Japanese Treaty, *supra* note 2, art. VII, para. 1.

36. 643 F.2d at 359, 360. *See* Walker, *United States Practice, supra* note 25, at 236.

37. The court cites the following Japanese Treaty articles as illustrative of the "most favored nation" standard: art. VII(2) (granting most favored nation treatment for foreigners who seek to operate a public utility in the host country, or who engage in shipbuilding and other designated areas); art. XIII (granting this treatment to foreign travelers entering and leaving the country); art. XIV(5) (granting this treatment in export and import matters). 643 F.2d at 360.

38. 643 F.2d at 360, *citing* Walker, *Modern Treaties, supra* note 13, at 811, 823.

sible lapses with respect to its own citizens."[39] The court added that absolute rules could also be found in various provisions of the Japanese Treaty.[40]

While *Avigliano* held that the "of their choice" provision of article VIII(1) must be read as granting national treatment to companies of either party, the *Spiess* court reached the opposite conclusion:

> National treatment was not the Treaty's exclusive measure of the rights to be accorded to foreign nationals. It is apparent that article VIII(1)'s 'of their choice' provision was intended, not to guarantee national treatment, but to create an absolute rule permitting foreign nationals to control their overseas investments. . . . The language of article VIII(1) makes clear that the of their choice provision was designed to establish such a rule. Use of the phrase 'of their choice' does not express the requirement that the parties are limited to national treatment. . . . Considering the Treaty as a whole, the only reasonable interpretation is that article VIII(1) means exactly what it says: companies have a right to decide which executives and technicians will manage their investment in the host country, without regard to host country laws."[41]

The *Avigliano* court had reasoned that the Japanese Treaty could be construed in accordance with American employment discrimination laws, for the "bona fide occupational qualification" (bfoq) Title VII exemption is "broad enough to encompass any rights that Japanese corporations legitimately could assert under the Treaty."[42] The Fifth Circuit disagreed, noting that "[this] argument misapprehends the nature of a right created in the course of international bargaining,"[43] since the purpose of the Treaty, from the American perspective, was to "facilitate American private-sector investment in foreign nations."[44] The court further reasoned that Japanese companies also have a right under article VIII(1) to pick and choose their essential personnel in order to manage their own affairs.[45]

The plaintiff in *Spiess* had also argued that article VIII(1) would conflict with article 55 of the Charter of the United Nations,[46] which ar-

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39. Walker, *United States Practice*, *supra* note 13, at 232.

40. The court cites the following Japanese Treaty provisions to illustrate the prevalence of "absolute rules" in the Treaty: art. I (permitting foreign nations to enter and leave the host country freely); art. II(2) (providing for notification of an alien's consulate in the event of his arrest); art. VI(3) (guaranteeing just compensation for expropriated property); art. XX(a) (guaranteeing freedom of transit through the host country for each party's nationals). 643 F.2d at 360.

41. *Id.* at 360-61.

42. 638 F.2d 552, 559. For further elaboration of the use of the "bfoq" Title VII exception in *Avigliano*, see Note, note 5 *supra*.

43. 643 F.2d at 361.

44. The *Spiess* court noted that the "of their choice" provision of the Japanese Treaty sought to ensure domestic control of American businesses in host countries. 643 F.2d at 361.

45. *Id.* at 362.

46. Article 55 of the United Nations Charter provides, in part, that "the United Nations shall promote . . . universal respect for, and observance of, human rights and funda-

guably prohibited employment discrimination. The court disagreed, noting that the "national origin distinction" at issue in the case did not fall within the enumerated categories of "race, sex, language, or religion." Second, the Charter, though ratified by the United States, "is not self-executing."[47] Article 55 of the Charter was found to be inapplicable in this case. Accordingly, the Fifth Circuit permitted C. Itoh-America to assert the Treaty in its favor and the court reversed the district court holding and remanded the case with directions to dismiss.[48]

The Second and Fifth Circuit holdings leave two major unresolved issues in their wake. First, may a less-than-wholly owned American subsidiary of a foreign corporation seek exemption from domestic employment discrimination laws by raising FCN treaty provisions as a shield? Second, does Title VII supersede inconsistent FCN Treaty provisions?

The notes to treaty trader regulations[49] may provide an answer to the first question. According to the regulations, corporate nationality is determined by the nationality of the majority (more than fifty percent) stockholders, "regardless of the place of incorporation."[50] It is not clear whether or not these regulations resolve the issue after *Spiess*.[51] Thus, whether or not a less-than-wholly owned American subsidiary of a foreign company may assert FCN treaty protection is still an open question.

The Second and Fifth Circuits came to opposite conclusions on the question of whether or not Title VII supersedes inconsistent FCN treaty provisions. Yet, the United States District Court for the Eastern District of New York recently faced the same issue and reached a conclusion which supports the Second Circuit's position. In *Linskey v. Heidelberg Easter, Inc.*,[52] a disgruntled employee brought a Title VII action against an American subsidiary and its Danish parent. The defendants moved to dismiss under Rule 12(b), arguing in part that the Danish FCN Treaty[53] exempts Danish corporations from the provisions of Title VII. Article VII(4) of the Danish Treaty provides: "Nationals and companies of either Party shall be permitted to engage, within the territory of the other Party, accountants and other technical experts, executive personnel, at-

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mental freedoms for all without distinction as to race, sex, language, or religion." U.N. CHARTER art. 55(c).

47. 643 F.2d at 363.

48. *Id.*

49. "Treaty traders" are aliens permitted by section 101(a)(15)(E)(i) of the Immigration and Nationality Act of 1952 to enter the United States in a supervisory capacity pursuant to a commercial treaty. 8 U.S.C. § 1101(a)(15)(E)(i) (1976). The regulations cited to are found in § 22 C.F.R. § 41.40 *et seq.* (1980).

50. 22 C.F.R. § 41.40(8) (1980).

51. The court stated in a footnote that "we do not reach or decide whether a corporate subsidiary in which a Japanese trader owns less than a 100% interest should be considered a company of Japan under the Treaty." 643 F.2d at 359 n.5.

52. 470 F. Supp. 1181 (E.D.N.Y. 1981).

53. Treaty of Friendship, Commerce and Navigation, with Protocol, Oct. 1, 1951, Uniied States-Denmark, 12 U.S.T. 908, T.I.A.S. No. 4797, 421 U.N.T.S. 105.

torneys, agents and specialized employees of their choice, regardless of nationality."[54]

The parent company claimed exemption from Title VII restrictions as plaintiff's job fell within the "executive personnel" category.[55] Yet, the district court denied the defendants' motion to dismiss, holding that the Danish Treaty did not exempt a Danish corporation from the provisions of Title VII.[56] According to the court, "while this defense to a Title VII action is a novel one, the history of the provision belies any claim that a foreign corporation has an absolute privilege to hire professional and other specialized employees of their choice irrespective of the American laws prohibiting employment discrimination."[57] The court added that the purpose of the Danish Treaty's provision was to "exempt specialized employees of foreign countries and companies"[58] from the admission requirements of the host country in special areas of employment. "It was not intended to immunize foreigners from claims under the host country's employment discrimination laws."[59] Thus, the district court's interpretation in *Linskey* of the legislative history of Title VII directly conflicts with that of the Fifth Circuit. According to *Linskey,* since Title VII was enacted without reference to the "of their choice" provision, "the only inference to be drawn is that such a provision was not intended to exempt foreign countries and companies from the requirements of Title VII."[60]

Consequently, the Fifth Circuit's interpretation of the legislative history of the Treaty and Title VII and their subsequent analysis of the interrelationship between treaty law and domestic employment discrimination laws is not widely ascribed to, as evidenced by the *Avigliano* and *Linskey* decisions.

The *Linskey* decision further complicates the *Avigliano-Spiess* dispute because it strongly argues in support of the proposition that the "of their choice" provision was not intended to supersede Title VII restrictions on employment discrimination. Although the *Spiess* court reached a different conclusion, the *Avigliano* and *Linskey* holdings weaken its effect. As a result, the questions whether or not Title VII supersedes inconsistent FCN treaty provisions and whether a less-than-wholly owned American subsidiary of a foreign corporation may seek exemption from domestic employment discrimination laws have yet to be conclusively resolved.

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54. *Id.* art. VII para. 4.
55. 470 F. Supp. at 1185.
56. *Id.*
57. *Id.*
58. *Id.*
59. *Id.* at 1186.
60. *Id.* at 1187.