NOTES

APPLICABILITY OF U.S. EMPLOYMENT DISCRIMINATION LAWS TO FOREIGN CORPORATIONS IN THE UNITED STATES

—The Circuit Court Decisions in *Spiess v. C. Itoh and Company (America), Inc.*, and *Avigliano v. Sumitomo Shoji America, Inc.*.

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The United States Circuit Courts of Appeal for the Second and Fifth Circuits have handed down differing rulings as to the degree to which the 1953 Treaty of Friendship, Commerce and Navigation between the United States and Japan exempts Japanese corporations and their wholly-owned subsidiaries incorporated in the United States from the anti-discrimination provisions of Title VII of the Civil Rights Act of 1964. The Second Circuit decision has been appealed to the United States Supreme Court, which has agreed to hear the case, while the Fifth Circuit has ordered a rehearing in order to reconsider its decision. The ultimate significance of these decisions therefore remains unclear, but they will undoubtedly affect numerous other commercial treaties and may require changes in the employment practices of Japanese and other foreign companies and their American subsidiaries in the United States.

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SUMMARY

In the *Sumitomo* case[1] the Second Circuit held that under the 1953 Treaty of Friendship, Commerce and Navigation between the United States and Japan (the "Treaty")[2], standing to assert the protections of the Treaty extended not only to Japanese companies, but also to their wholly-owned subsidiaries incorporated in the United States.[3] However, the Second Circuit further held that Article VIII(1) of the Treaty, giving Japanese companies the right to hire, in the United States, executive personnel of their choice, did not displace United States law on employment discrimination, as embodied in Title VII of the Civil Rights Act of 1964 ("Title VII").[4] The Court instead modified the application of Title VII in the light of the Treaty by recognizing certain Japanese employment preferences to be legitimate employment criteria under Title VII.[5] In the *C. Itoh* case,[6] the Fifth Circuit agreed with the Second Circuit that United States subsidiaries of Japanese companies had standing to assert the Treaty,[7] but disagreed with the Second Circuit's position on employment discrimination, holding instead that Title VII did not apply at all to those positions in a Japanese company which were protected by the Treaty.[8]

These apparently divergent positions taken by the Fifth and Second Circuits, when carefully analyzed, indicate that both Circuit Courts are willing to recognize the legitimate staffing needs of Japanese companies at the higher executive levels, but appear un-

1. Avigliano v. Sumitomo Shoji America, Inc., 638 F.2d 552 (2d Cir. 1981), *cert. granted*, 50 U.S.L.W. 3351 (1981).
2. Treaty of Friendship, Commerce and Navigation, April 2, 1952, United States—Japan, 4 U.S.T. 2063, T.I.A.S. No. 2863 [hereinafter cited as "Treaty"].
3. *See* Avigliano v. Sumitomo Shoji American, Inc., 638 F.2d 552, 558 (2d Cir. 1981).
4. The Civil Rights Act of 1964, tit. VII, 42 U.S.C. §§ 2000e to 2000e-17 (1976) [hereinafter cited as "Title VII"]. Title VII prohibits the hiring and firing of any individual or the discrimination against an individual with respect to the terms of his or her employment (including opportunities for promotion) on the basis of race, color, sex, religion or national origin. All employers with fifteen or more employees are covered by this provision. However, Title VII expressly provides that employment practices based on religion, sex or nation origin are not illegal "where religion, sex, or national origin is a bona fide occupational qualification reasonably necessary to the normal operation of that particular business or enterprise." *See* 42 U.S.C. § 2000e-2(e)(1). Title VII also created the Equal Employment Opportunity Commission, empowering it to investigate charges of employment discrimination and to use informal means (*i.e.*, negotiation, conciliation, persuasion) to remedy or eliminate such discrimination, as well as to resort to legal action in a court of law if such informal means turn out to be insufficient.
5. *See* Avigliano v. Sumitomo Shoji American, Inc. 638 F. 2d 552, 559 (2d Cir. 1981).
6. Spiess v. C. Itoh and Company (America), Inc., 643 F.2d 353, *rehearing granted*, 654 F.2d 302 (5th Cir. 1981).
7. *Id.* at 358, 359.
8. *Id.* at 359.

willing to extend the scope of this Treaty protection down to the junior executive levels. Where the Circuits differ is in their fomulation of criteria for determining how the Treaty protection should be applied to these executive positions. The Fifth Circuit's standard allows Japanese citizens to be employed in positions in the United States subsidiary which are essential to maintain *control*,[9] whereas the Second Circuit's standard allows Japanese citizens to fill positions necessary to the successful *operation* of the business.[10] Although these differing criteria may not yield the same result with respect to every executive position, it is clear that both Circuit Court decisions will protect high executives (i.e., *buchō* and higher) from Title VII, while junior executives (i.e., lower than *kachō*) may be fully subject to Title VII.

The *Sumitomo* case is pending in the United States Supreme Court and the *C. Itoh* case is awaiting rehearing in the Fifth Circuit. In the light of a very well-reasoned dissent in the Fifth Circuit,[11] it is possible that the U.S. Supreme Court could reverse both Circuits on the standing issue and hold that United States subsidiaries of Japanese companies have no standing under the Treaty, and are fully subject to Title VII.

THE *C. ITOH* CASE

The *C. Itoh* case involves a class action brought in the U.S. District Court for the Southern District of Texas by employees of C. Itoh and Company (America), Inc. ("C. Itoh"), who claimed that C. Itoh's practice of hiring only Japanese nationals for management level positions constitutes discrimination on the basis of national origin in violation of Title VII.[12]

C. Itoh moved to dismiss the suit on the grounds that the Treaty exempts both Japanese companies and their wholly-owned subsidiaries incorporated in the United States from the provisions of Title VII. In particular, C. Itoh based its motion to dismiss on Article VIII (1) of the Treaty, which states that "companies of either Party shall be permitted to engage, within the territories of the other Party, . . . executive personnel . . . of their choice."[13] C. Itoh argued that this provision gave it the absolute right to hire managerial, professional, and other specialized personnel of its choice, irrespective of Title VII and other United States laws

9. *Id.* at 361, 362.

10. Avigliano v. Sumitomo Shoji America, Inc. 638 F.2d 552, 559 (2d Cir. 1981).

11. *See* Spiess v. C. Itoh and Company (America), Inc. 643 F.2d 353, 353 (5th Cir. 1981) (Reavley, J., dissenting).

12. *See* Spiess v. C. Itoh and Company (America), Inc., 469 F. Supp. 1 (S.D. Tex. 1979).

13. *Id.* at 4.

prohibiting discrimination in employment.[14] The District Court denied C. Itoh's motion to dismiss, holding that the Treaty does not protect the employment practices of wholly-owned United States subsidiaries of Japanese companies, because such subsidiaries are not "companies of Japan" but domestic corporations, and therefore are not entitled to claim the protection of the Treaty.[15]

The Court of Appeals for the Fifth Circuit reversed the decision of the lower court and remanded with directions to dismiss the case.[16] A majority of two judges of the Fifth Circuit, with one judge strongly dissenting, held that a wholly-owned United States subsidiary of a Japanese corporation could claim the protection of Article VIII(1) of the Treaty.[17] Moreover, as to the scope of application of Article VIII(1) of the Treaty, the Fifth Circuit opinion held, after analysis of the legislative history of the Treaty,[18] that the provision of Article VIII(1) allowing companies of Japan to hire executive personnel "of their choice" was intended to permit Japanese companies ". . . to hire only Japanese personnel for *executive* and *technical* positions," [emphasis supplied] and that for such positions Article VIII(1) of the Treaty displaced Title VII.[19] The Court rejected the argument that title VII's enactment after the Treaty constituted an implicit legislative overruling of Article VIII(1), holding instead that without an express indication of congressional intent to overrule the Treaty, Title VII would not alter the rights granted by Article VIII(1) of the Treaty.[20] Thus, as to *executive* and *technical* positions, a majority of the three judge panel in the Fifth Circuit held that neither the Japanese company nor its U.S. subsidiary are subject to Title VII.

In dissenting from the majority opinion of Judges Coleman and Clark, Judge Reavley took issue with the majority's (and Sec-

14. *Id.* at 3, 4.

15. *Id.* at 9.

16. Spiess v. C. Itoh and Company (America), Inc., 643 F.2d 353, 363 (5th Cir. 1981).

17. *Id.*

18. The court relied primarily on the Senate hearings prior to ratification of the Treaty. *See* Spiess v. C. Itoh and Company (America) Inc., 643 F.2d 353, 362 (5th Cir. 1981), *citing Commercial Treaties—Treaties of Friendship, Commerce and Navigation, with Israel, Ethiopia, Italy, Denmark, Greece, Finland, Germany, and Japan: Hearing before the Subcom. of the Senate Comm. on Foreign Relations*, 83d Cong., 1st Sess. 2, 3, 6-9 (1953). In addition, the court relied on the secondary authority of three articles by commercial treaty expert Herman Walker. *See* Spiess v. C. Itoh and Company (America), Inc., 643 F.2d 353, 355, 356, 357 (5th Cir. 1981) *citing* Walker, *Provisions on Companies in United States Commercial Treaties*, 50 AM. J. INTL. L. 373, 380 (1956); Walker, *Treaties for the Encouragement and Protection of Foreign Investment: Present United States Practice*, 5 AM. J. COMP. L. 229, 230-31 (1956); Walker, *Modern Treaties of Friendship, Commerce and Navigation*, 42 MINN. L. REV. 805, 806 (1958).

19. Spiess v. C. Itoh and Company (America), Inc., 643 F.2d 353, 363 (5th Cir. 1981).

20. *Id.* at 362.

ond Circuit's) holding that a wholly owned U.S. subsidiary of a Japanese company had standing to assert the Treaty. Instead, he argued that both the plain language of the Treaty[21] and the apparent intent of the drafters (as indicated in certain U.S. State Department memoranda and telexes[22] as well as other secondary sources[23]) are to the effect that United States subsidiaries of Japanese companies are not "companies of Japan," and therefore, that such subsidiaries have no standing to assert Article VIII(1) of the Treaty.[24] On August 7, 1981 the Fifth Circuit granted the plaintiff's petition for a rehearing of the case, but execution of the rehearing order has been stayed pending the parties' planned petitions for *certiorari*. On rehearing, the Fifth Circuit might adopt the reasoning of Judge Reavley's dissent, reaffirm the Fifth Circuit majority, or take a position similar to that taken by the Second Circuit in the *Sumitomo* case, discussed below.

THE *SUMITOMO* CASE

The holding of the Fifth Circuit, discussed above, followed the Second Circuit's opinion in the *Sumitomo* case, issued on January 9, 1981, in permitting a wholly-owned subsidiary to invoke the protection of Article VIII(1) of the Treaty. However, the *C. Itoh* holding differed from *Sumitomo* in its analysis of the application of the employment discrimination laws in the face of the Treaty protection. Unlike the Fifth Circuit, the Second Circuit in *Sumitomo* had held that Article VIII(1) did not completely displace the effect of Title VII, but merely modified its impact.

In *Sumitomo*, female secretarial employees of a wholly-owned United States subsidiary of a Japanese corporation filed a Title VII class action alleging national origin and sex discrimination.[25] The defendant moved to dismiss on the basis of the

21. In particular, Judge Reavley refered to Article XXII(3) of the Treaty, which provides, "Companies constituted under the applicable laws and regulations within the territory of either Party shall be deemed companies thereof and shall have their juridical status recognized within the territory of the other party." *See* Spiess v. C. Itoh and Company (America), Inc., 643 F.2d 353, 364 (Reavley, J., dissenting).

22. These include a dispatch by Secretary of State Dean Acheson, sent at the height of the Treaty negotiations, entitled "FCN Treaty. Interpretation of Certain Provisions," and an Airgram sent by Secretary of State Henry Kissinger to the American Embassy in Tokyo dated January 9, 1976. *See* Spiess v. C. Itoh and Company (America), Inc., 643 F.2d 353, 369, 370, 371 (5th Cir. 1981) (Reavley, J., dissenting).

23. Sources cited include the three articles by Herman Walker cited at note 18, *supra*, as well as several interpretive letters sent by the State Department Legal Advisor to the EEOC in 1979. *See* Spiess v. C. Itoh and Company (America) Inc., 643 F.2d 353, 371 (5th Cir. 1981) (Reavley, J., dissenting).

24. Spiess J. C. Itoh and Company, (America), Inc., 643 F.2d 353, 372 (5th Cir. 1981) (Reavley, J., dissenting).

25. Avigliano v. Sumitomo Shoji America, Inc., 473 F. Supp. 506, 508 (S.D.N.Y. 1979).

Treaty.[26] The U.S. District Court for the Southern District of New York denied the defendant's motion to dismiss, holding that a wholly-owned subsidiary of a Japanese corporation was not a company of Japan but a domestic corporation, "with neither standing nor need to invoke the aegis of the Treaty."[27] Last January, the Court of Appeals for the Second Circuit disagreed with the New York District Court, holding that a wholly-owned United States subsidiary of a Japanese company *is* entitled to invoke the protection of the Treaty.[28] However, the Second Circuit went on to note that: "the right of Japanese firms operating in the United States under the Treaty to hire executives of their own choice does not give them license to violate American laws prohibiting discrimination in employment."[29] Thus, according to the Second Circuit, if Sumitomo's broad interpretation of the Treaty exemption to Title VII were carried to its logical conclusion, Japanese companies would be exempt not only from Title VII but also from laws prohibiting the employment of children, the Fair Labor Standards Act, and laws providing for the right to form unions, among others.[30] Instead, the Second Circuit held that Article VIII(1), while permitting Japanese companies to hire its own nationals for "bona fide occupational reasons", did not allow the blanket exemption from Title VII that Sumitomo sought.[31]

Thus, the Second Circuit noted in its conclusion that even Title VII, "construed in the light of the Treaty, would not preclude the company from employing Japanese nationals in *positions where such employment is reasonably necessary to the successful operation of its business*."[32] This was based on section 703(e) of Title VII, which provides "It shall not be an unlawful employment practice for an employer to hire and employ employees . . . on the basis of . . . national origin in those certain instances where . . . national origin is a bona fide occupational qualification reasonably necessary to the operation of [the employer's] business or enterprise."[33] Consequently, the court concluded that

> . . . [a]lthough the "bona fide occupational qualification" ("bfoq") exception of Title VII is to be construed narrowly *in the normal context*, . . . we believe that as applied to a Japanese company enjoying rights under Article VIII of the Treaty it must be construed in a manner that *will give due weight to the*

26. *Id.*
27. *Id.* at 513.
28. Avigliano v. Sumitomo Shoji America, Inc. 638 F. 2d 552, 558 (2d Cir. 1981).
29. *Id.*
30. *Id.* at 559.
31. *Id.*
32. *Id.* (emphasis supplied).
33. The Civil Rights Act of 1964, tit. VII, § 703(e), 42 U.S.C. § 2000e-2(e)(1) (1976).

Treaty rights and unique requirements of a Japanese company doing business in the United States, including such factors as a person's (1) Japanese linguistic and cultural skills, (2) knowledge of Japanese products, markets, customs, and business practices, (3) familiarity with the personnel and workings of the principal or parent enterprise in Japan, and (4) acceptability to those persons with whom the company or branch does business.[34]

Accordingly, the Second Circuit affirmed the District Court order denying Sumitomo's motion to dismiss the case, and remanded the case to the District Court for trial. There, Sumitomo would probably be required ". . . to go forward with some evidence of bfoq [bona fide occupational qualification"] status . . ." so that the District Court can determine whether all or some portion of the defendant's executive positions qualify for "bona fide occupational qualification" status.[35] Both parties petitioned the United States Supreme Court for certiorari review of the decision. The Plaintiffs requested the Court to review both the question of whether the treaty is applicable to a domestic corporation which is a wholly owned subsidiary of a Japanese corporation, and the question of whether the "bona fide occupational qualification" exception should be relaxed when applied to an American subsidiary of a Japanese corporation, in deference to the Treaty. Sumitomo asked the Supreme Court to review the issue of whether Title VII limits the right provided under Article VIII(1) of the Treaty to fill management level positions with Japanese nationals. The Supreme Court granted both petitions on November 2, 1981 and review of the case is pending.

ANALYSIS OF CIRCUIT COURT DECISIONS

Although the Fifth Circuit majority opinion in *C. Itoh* cited the *Sumitomo* decision,[36] the Fifth Circuit declined to follow the Second Circuit's holding, stating:

Clearly, article VIII(1) provides some right to Japanese companies to *manage* their own affairs. . . The right of Japanese companies to choose *essential* personnel is a right *to maintain Japanese control* of the overseas investment. To make this right subject to Title VII's bfoq requirements, or to interpret it to override only state law, would render its inclusion in the Treaty virtually meaningless. Thus, we hold that the article VIII(1) "of their choice" provision permits Japanese companies

34. Avigliano v. Sumitomo Shoji America, Inc., 638 F.2d 552, 559 (5th Cir. 1981) (emphasis supplied).

35. *Id.*

36. *See* Spiess v. C. Itoh and Company (America), Inc. 643 F.2d 353, 360, 362 (5th Cir. 1981).

to discriminate in favor of their fellow citizens.[37]

Thus, although both courts agreed that a subsidiary is protected by the Treaty, they differed as to the scope of protection the Treaty affords. Under *Sumitomo*, "bona fide occupational qualification" review will be applied to "positions where such employment is reasonably necessary to the successful *operation* of [Sumitomo's] business . . . ," giving ". . . due weight to the Treaty rights and unique requirements of a Japanese company doing business in the United States. . ."[38] Although the "positions" in question are sometimes referred to in *Sumitomo* as "executive positions," the Second Circuit's emphasis clearly is on the *operational* significance of those positions in the application of Title VII's "bona fide occupational qualification" standards.

Conversely, under the *C. Itoh* formulation, Article VIII(1) permits Japanese companies freely to hire Japanese personnel for "executive and technical positions." The emphasis is to assure Japanese *management* and *control*. The *C. Itoh* majority stated that "[i]t 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," and that "[c]ompanies have a right to decide which executives and technicians will manage their investment in the host country, without regard to host country laws."[39] The Fifth Circuit majority cited with approval an article by Herman Walker in its characterization of the privileged group of personnel as "*essential* executive and technical personnel."[40]

In other words, under the *Sumitomo* "bona fide occupational qualification" standards the emphasis is on *operational* utility to Sumitomo. Under the *C. Itoh* standard the emphasis is on how *essential* the Japanese personnel are for the *management* or *control* of C. Itoh.

As an example, one can imagine that under all or most of *Sumitomo's* four "bona fide occupational qualification" standards, the employment of persons possessing the requisite knowledge of Japanese language and business practice at various levels above the clerical level could be justified as being necessary to the successful operation of a company's business. Indeed, it is likely that under the *Sumitomo* formulation, positions in a typical administrative department of a United States subsidiary of a Japanese company possibly even below the *kachō* level could be

37. *Id.* (emphasis supplied).

38. Avigliano v. Sumitomo Shoji America, Inc., 638 F.2d 552, 559 (2d Cir. 1981).

39. Spiess v. C. Itoh and Company (America), Inc. 643 F.2d 353, 360, 361 (5th Cir. 1981).

40. *Id.* at 361, *citing* Walker, *Treaties for the Encouragement and Protection of Foreign Investment, Present United States Practice*, *supra* note 18, at 234.

justified as necessary, and in some of these positions Japanese nationality may be properly required. On the other hand, under *C. Itoh's* "essential executive and technical personnel" standard, it is not clear that even the *kachō* level, or any level under *buchō*, would be protected by Article VIII(1)'s "limited right to discriminate," because these positions may not be deemed necessary for "control." Under this standard, it is likely that such positions not protected by the Treaty would be subject to the full application of Title VII, while positions deemed "essential" would be fully exempt, and as to them there would be no need to demonstrate the operational utility of requiring Japanese nationality.

Thus, although C. Itoh initially won dismissal of its suit in the Fifth Circuit, while Sumitomo's motion to dismiss was denied and its case remanded for trial, it is by no means clear which statement of the law provides a more beneficial climate for the operations of Japanese companies in the United States. This would depend, in each instance, on which positions enjoy the protection of the Treaty and, in the case of the Second Circuit formulation in *Sumitomo*, on how the "bona fide occupational qualification" standards are applied.[41]

In granting the parties' petitions for certiorari in the Sumitomo case, the Supreme Court agreed to review this issue. It also agreed to review the issue (on which the Circuit Courts did not disagree) of the standing of a wholly owned United States subsidiary of a Japanese corporation to invoke the Treaty protections.

It is difficult to predict what course the Supreme Court will follow. On the one hand, the Supreme Court is usually reluctant to reverse the holdings of two Circuit Courts as to issues on which they agree. On the other hand, there is a chance that the Supreme Court will reverse both Circuits in this instance. As a matter of legal scholarship, Judge Reavley's dissent in *C. Itoh* appears to be the most carefully reasoned. If the Supreme Court does a scholarly and thorough job, it could well decide to render a judgment along the lines of Judge Reavely's dissent and hold that United States subsidiaries of Japanese companies have no standing to assert the protections of Article VIII(1) of the Treaty.

41. One way to reconcile the *C. Itoh* and *Sumitomo* cases may be to focus on their underlying facts. In *C. Itoh*, the plaintiffs were high-level executives, while in *Sumitomo*, they were non-executive secretaries. Thus, it is likely that under *either* standard, *C. Itoh* would have been dismissed while *Sumitomo* would not.