Are Foreign Companies Doing Business in the United States Required to Comply With American Employment Discrimination Laws?

by Carol A. Docan

INTRODUCTION

In June 1982 the United States Supreme Court decided that a New York incorporated subsidiary of a Japanese company could not invoke the terms of a 1953 U.S.-Japan Treaty, to defend an action filed against it by female employees who alleged discrimination on the basis of sex and national origin in violation of Title VII of the Civil Rights Act of 1964. The decision is an important one because it not only affects the over 1.6 million workers in the U.S. who are employed by U.S. affiliates of foreign corporations, it may also affect future foreign investment in the United States generally.

Foreign investment has grown rapidly in the United States in recent years. In 1981 foreign direct investment in the U.S. increased 58% from that of 1980, with a total of $19.29 billion spent to acquire or establish business in America.[1] Those investments were found in manufacturing, mining, wholesale and retail trades, finance, banking, insurance, real estate, oil and gas extraction, and chemical and allied products. The major foreign investors in 1980 were from Canada, France, Japan, the Netherlands, Switzerland, United Kingdom, and West Germany. The decision in this case is important because approximately 47 nations have entered into Friendship, Commerce and Navigation Treaties (hereinafter referred to as "FCN treaties") with the United States which contain language similar to that of the Japanese Treaty.[2]

This article will review the facts and issues raised by recent cases which have interpreted the Japanese Treaty in light of Title VII, discuss unresolved issues and raise questions to consider.

The United States Supreme Court recently reviewed two similar cases concerned with the possible conflict between the FCN Japanese Treaty and Title VII. Those cases are *Avigliano v. Sumitomo Shoji America, Inc.*,[3] (hereinafter referred to as *Avigliano*) and *Spiess v. C. Itoh & Co. (America)*,[4] (hereinafter referred to as *Spiess*). The Court, through Chief Justice Burger, rendered an opinion in *Avigliano* case and thereafter vacated the judgment in *Spiess* case and remanded it for further consideration in light of *Avigliano*.

The plaintiffs in the *Avigliano* case were past and present female secretaries of the defendant, an import and export trading company. The plaintiffs alleged that they were not trained or promoted beyond clerical jobs, and that the defendant filled executive, managerial and sales positions with male citizens of Japan.

The defendant in *Avigliano*, Sumitomo, case argued at trial that the discrimination claim should be dismissed because it had the privilege to hire non-immigrant Japanese nationals pursuant to the terms of FCN Treaty entered into between the U.S. and Japan in 1953. Sumitomo argued that the U.S.-Japan Treaty eliminated its employment practices from federal review by relying on Article VIII(1) of the Treaty which states in part:

> ". . . 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*."[5] (Emphasis added.)

Sumitomo considered itself a "company" within the clause and interpreted it literally to mean that it had complete freedom to choose its employees without the necessity of complying with Title VII,[6] which prohibits employment discrimination on the basis of national origin or sex. Sumitomo also argued in the alternative that if its enterprise did not fit within the terms of the Treaty, that it was still exempt from Title VII under the Bona Fide Occupational Qualified Exception rule.

The defendant in *Spiess*, C. Itho & Co., (America), also a U.S. incorporated subsidiary of a Japanese owned company, asserted the same argument when it was sued by its American male employees in a class action. The employees charged that C. Itoh had made managerial promotions and other benefits available only to Japanese citizens. It is important to note that *Spiess* is distinguishable from *Avigliano* in that it was limited to an allegation of discrimination on the basis of national origin not sex.

The legal issues raised by these two cases were numerous. The court was faced with such questions as: What are the goals and purposes of the Treaty; why did the Treaty include such a "choice" clause and what was its effect; do Title VII and the Treaty conflict; what types of Japanese business companies are included in the "of their choice" clause and whether the Bona Fide Occupational Qualification Exception (hereinafter referred to as BFOQ)could be interpreted to allow Japanese companies to continue to hire on a discriminatory basis.

In order to determine whether the defendants in these cases were included within the terms of the U.S.-Japan Treaty and to decide if the Treaty did conflict with Title VII, the courts reviewing these cases began with a general analysis of the Treaty overall. To accomplish this task the courts examined the history of international commercial treaties in general, referred to articles written by Herman Walker, Jr., who at the time of drafting the Japanese Treaty served as an advisor on commercial treaties at the State Department, and considered recent correspondence and statements from the governments of the United States and Japan.

Chief Justice Burger pointed out, in the Supreme Court's opinion, that these treaties were intended to promote cooperative investment activities with foreign countries. In the 19th and early 20th century, U.S. commercial treaties with foreign countries were primarily entered into to protect trade and shipping rights of

individuals but in the 20th century, international trade became more of a corporate activity.[7] Since corporations had no legal existence outside their country of incorporation, it became necessary to negotiate new treaties granting foreign corporations legal status.[8] Burger noted that it was not until the post-World War II FCN treaties that U.S. corporations gained the right to actively conduct business abroad. These treaties gave foreign corporations the same rights as individuals and domestic corporations to do business, to be taxed in a nondiscriminatory manner and to acquire real and personal property. The preface of the Treaty itself made it clear that:

> "The purpose of the treaty is to . . . [strengthen] the bonds of peace and friendship . . . [encourage] closer economic and cultural relations . . . by promoting . . . commercial intercourse, encourag[ing] investment and establish[ing] mutual rights and privileges."

Although all the courts involved in reviewing *Avigliano* and *Spiess* agreed on the overall purpose of the Japanese Treaty, there was great disagreement with respect to whether all types of Japanese business enterprises would be covered by the "choice" clause. The courts also disagreed on the meaning of Article VIII(1)'s "of their choice" language.

The Second Circuit in *Avigliano*[9] and the Fifth Circuit in *Spiess*[10] found that all Japanese companies, whether incorporated in the United States or not, were covered by the Japanese Treaty. These opinions concluded that the purpose of the Treaty was not to protect foreign investment made only through branches (unincorporated enterprises), but to protect foreign investment generally. The Fifth Circuit stated that to hold otherwise would make an unreasonable distinction between branches and incorporated subsidiaries. The courts argued that it would be unlikely that nations would allow the formation of corporate subsidiaries through these treaties and then go on to bar them from substantive provisions of the Treaty (like the "choice" clause). To support its conclusion, the Second Circuit made reference to statements made during the negotiations of the United States FCN Treaty with the Netherlands in 1955, which took place three years after the U.S.-Japan Treaty was signed. Apparently, the Dutch were concerned that the same term, "of their choice," would exclude locally incorporated subsidiaries from all the substantive benefits accorded to their branches. State Department officials, at that time, made it clear that was not the case and were willing to insert an extra clause to clear up the matter. After this assurance, the Dutch were convinced the extra clause was not necessary and no additional terms were included in the Treaty.[11]

The Supreme Court strongly disagreed with the Circuit Court's interpretation that all Japanese owned companies could invoke the terms of the Treaty. The Court concluded that the Treaty covered only branches of Japanese companies not U.S. incorporated subsidiaries. This conclusion was based on the definition of "company" found within the Treaty itself. The Treaty defined the legal status of a company (foreign or domestic) based on where the company was "constituted" or incorporated.[12] The Supreme Court used that definition to conclude that Sumitomo was "constituted" or incorporated under the laws of New York and was therefore a "company" of the U.S. not Japan (a Japanese company would be a company of the "Other Party" according to the Treaty language). Since the "choice"

clause was clearly applicable to companies of the Other Party, i.e., a branch of a Japanese company operating in America, a U.S. incorporated subsidiary could not take advantage of the clause.

Traditional rules of corporate law, which state that a corporation's citizenship is based on its place of incorporation, support this finding. The Supreme Court also cited a 1957 district court ruling in *U.S. v. R. P. Oldham*[13] which interpreted the same Japanese Treaty. The court in *Oldham* stated that if a foreign parent company operated as a branch, the branch would retain its foreign identity and would receive the benefits of the Treaty, but that if it chose to incorporate in the U.S., it lost Japanese identity. Additionally, the court relied on recent statements from the Japanese Ministry of Foreign Affairs and the U.S. Department of State which interpreted the "choice" clause not to include U.S. incorporated subsidiaries.[14]

Since the Supreme Court concluded that Sumitomo was a U.S. corporation and therefore did not have standing to invoke the "of their choice" clause, it did not analyze the meaning or effect of that clause in detail, particularly whether it conflicted with Title VII. However, in a footnote, the Court did refer to an analysis of the clause by Herman Walker, Jr., a State Department advisor. According to Walker, Article VIII(1) and comparable provisions in other treaties were intended to avoid foreign laws which set a strict percentile limitation on the employment of Americans abroad. The avoidance of these laws was thought to be particularly necessary with respect to essential executive and technical personnel in a foreign country.[15] At the time the Treaty was signed, some states within the U.S. also had laws restricting the employment of foreigners. Under Walker's analysis, this clause would allow Japanese companies to avoid those state laws when hiring specialized personnel, but would not exempt them from other employment laws.

It should be noted that legislative history indicates that at the time Title VII was enacted, Congress did not consider or discuss whether this statute would be applicable to foreign employers operating in the United States or what effect this statute would have on the U.S. Japanese Treaty or other similar international commercial treaties[16]. Perhaps if Congress had considered the issue, it would have found no conflict between Title VII and the "choice" clause. This appears to be the conclusion the Supreme Court made in its brief discussion of the issue. The Court indicates that it would not construe the clause as immunizing foreign employers, in particular branches of foreign companies, from the restrictions of Title VII but would allow those employers to hire specialized personnel irrespective of local laws restricting the admission of foreign employees. On the basis of this analysis, branches would be held to the same standards of nondiscriminatory employment practices as U.S. incorporated subsidiaries.

The next issue raised by these cases was whether foreign business enterprises which were required to comply with Title VII could take advantage of the BFOQ exception and therefore continue to discriminate on the basis of national origin and sex in certain situations.

The Second Circuit in *Avigliano* agreed with the Supreme Court that the "choice" clause did not exempt any Japanese-owned company, U.S. incorporated or otherwise, from complying with Title VII. But, it then went on to qualify this conclusion to find that the BFOQ exception would apply in the unique case of a

Japanese company doing business in the United States.

The BFOQ exception states that it shall not be unlawful for an employer to discriminate on the basis of sex or national origin in those instances where it is "reasonably necessary for the normal operation" of a partucular business.[17] The Second Circuit found that discriminatory hiring and promotional practices were reasonable, necessary and therefore permissible under the BFOQ exception because executive personnel in these Japanese companies would need to possess:

> "1. Japanese linguistic and cultural skills, 2, knowledge of Japanese products, markets, customs and business practices, 3. familiarity with personnel . . . (of these) parent enterprises in Japan and, 4. acceptability of those persons with whom the company or branch does business."[18]

It appears from the fourth criterion cited by the court that if "persons with whom the company does business," i.e., customers, would prefer not to do business with a female, that the foreign subsidiary could successfully argue the BFOQ exception and hire only males for positions with customer contact.

Japanese employers would be eager to argue that the BFOQ exception should apply to their businesses based on the employment structure and system of Japan. Japanese employers would argue that it is quite reasonable for its customers to prefer to deal with males since women in Japan are generally restricted to a narrow range of low paying occupations; that they are promoted more slowly than men and are rarely found in executive positions.[19]

As convincing as the Japanese employer's argument may be in terms of working conditions in Japan, this interpretation of customer preference by the Second Circuit is very controversial because the BFOQ exception as applied to sex discrimination has been very narrowly defined and construed. The Equal Opportunity Employment Commission guidelines specifically state that the refusal to hire an individual because of the preferences of clients or customers does not fall within the BFOQ exception.[20]

The courts have placed stringent limits on the customer preference arguments of employers, stating that "essence of the business operation must be undermined" by hiring of members of the other sex; that employers must show that applicants of one sex are unable to perform their duties safely and efficiently and that there must be significant compelling business purposes with no acceptable alternative to hire on a sexually discriminating basis.[21] In *Diaz v. Pan American World Airways, Inc.*, a leading case on the issue of customer preference, a lower court stated that Title VII was enacted to overcome the preferences and prejudice of customers, even foreign customers. Pursuant to these cases , it would appear that Japanese employers could not legally discriminate on the basis of sex even if their customers did prefer males of Japanese citizenship.

The only discussion the Supreme Court had regarding the issue of whether a Japanese company could assert the BFOQ exception or business necessity defense in a Title VII case was in a brief footnote at the end of the opinion. In that footnote, the Court states that it was expressing no view as to whether Japanese citizenship or an employee's sex may be a BFOQ for certain positions of a foreign subsidiary. The note then went on to give a hint as to what the Court's opinion would be on the matter:

"There can be little doubt that some positions in a Japanese controlled company doing business in the United States call for *great familiarity* with not only the language of Japan, but also the *culture, customs* and *business practices* of that country." (Emphasis added.)

Notably missing from this list was the Second Circuit's fourth factor of "acceptability to those with whom the company or branch does business," i.e., customer preference. The Supreme Court chose not to answer an important question regarding the extent of the BFOQ exception for foreign employers. But it appears from the Court's brief statement that it would not extend the exception to include sexual preferences of customers as the Second Circuit had concluded. This may be viewed as a positive decision for women and a continuation of a strict interpretation of the BFOQ exception.

It is interesting to note another recent lower court decision which dealt with the limits of the BFOQ exception as applied to sex discrimination in an employment setting outside the U.S. That case is *Fernandez v. Wynn Oil Co.*,[24] a Ninth Circuit case dealing with an allegation of sex discrimination against an American company doing business in South America. The defendant company argued that its South America clients would refuse to deal with a female Director of International Operations and it therefore refused to hire a female for the position. The defendant argued that being male was necessary under the BFOQ exception for this position. The Ninth Circuit strongly disagreed, stating that even if there was evidence to support the trial court's findings, that decision would be rejected because it was an erroneous interpretation of Title VII. The court went on to state that stereotypical impressions of male or female roles and stereotypical customer preferences do not justify sex discrimination in employment practices. The court concluded that:

"Though the U.S. cannot impose standards of non discriminatory conduct on other nations through its legal system . . . other nations (may not) dictate discrimination in this country. No foreign nation can compel the nonenforcement of Title VII here."[25]

Although the *Fernandez* case admittedly does not deal with the same fact situation as either *Avigliano* or *Spiess*, it does make a clear statement that foreign culture, customs or preferences cannot be used to support a legitimate BFOQ exception which would allow employment discrimination on the basis of sex.

The issue of whether a person's sex or national origin can be a legitimate BFOQ exception in an international setting has been left unanswered by the Supreme Court. If in the future, foreign companies are not permitted to extend the BFOQ exception to their employment practices, that decision may detrimentally affect foreign investment in the U.S. On the other hand, if foreign companies are successful in creating this specialized exception, the U.S. commitment to civil rights and equal employment opportunity will be undermined within its own territory.

The Supreme Court left several other issues unanswered in the *Avigliano* opinion. The court specifically pointed out that it was not expressing any opinion as to whether Sumitomo may assert any Article VIII(1) ("of their choice") rights of its parents.[26] It is puzzling why the Court did not make a statement regarding this "parents' rights" issue since the Court took great lengths to distinguish branches

from U.S. incorporated subsidiaries which "lost their Japanese identity." It seems that the Court could have simply concluded that U.S. incorporated subsidiaries could not assert the rights of their foreign parents since they were completely separate legal entities.

The Supreme Court pointed out, in a footnote, that it took no view as to whether Japanese citizenship is a BFOQ for "certain positions."[27] It did not go any further to describe those "certain positions." Did the Court intend to include those positions listed in Article VIII(1) of the Treaty—technical personnel, attorneys, agents, specialists—or did it have another category of positions in mind? The issue remains unanswered.

Another unresolved issue is whether this decision would apply only to a 100% Japanese-owned U.S. incorporated subsidiary. The issue was not before the court in either *Avigliano* or *Spiess* since both defendants were owned solely by Japanese parents. Should there be a distinction between subsidiaries based on the foreign and domestic ownership of the company?

Furthermore, the Supreme Court pointed out that it was expressing no view as to the interpretation of other FCN Treaties, although they may contain similar wording, because they may have different negotiating histories.[28] As pointed out earlier, over 47 other countries have entered into similar treaties. It appears that each of these treaties will require individual interpretation.

CONCLUSION

The Supreme Court in the *Avigliano* case was faced with a novel set of questions. It was asked to interpret a post-World War II commercial treaty in order to determine whether foreign companies doing business in the U.S. were required to comply with American civil rights and equal employment opportunity laws which were enacted years later. The court was required to study the history and purpose of commercial treaties generally and then to determine the effect federal legislation would have on interpreting the terms of those treaties. In its conclusion, the Court read the Treaty literally and supported American concepts of civil rights and equal employment opportunity. It found that if a Japanese company incorporated a subsidiary in the U.S., that the subsidiary was a U.S. corporation and was therefore prohibited from discriminating on the basis of national origin or sex in hiring or promoting employees. Although some issues remain unanswered, the decision is an important one which will undoubtedly affect the employment practices and decisions of foreign business enterprises in the U.S. in the future.

FOOTNOTES

[1]U.S. Dept. of Commerce, International Trade Administration, "Foreign Direct Investment in the U.S.," Oct. 1981, 1.

[2]Note, *Discriminatory Hiring Practices by Foreign Corporations in the United States - A Limited Right*, 5 Fordham Int'l. L. Rev., 509, 510, 513 n. 25 (1982).

[3]102 S. Ct. 2374 (1982).

[4]102 S. Ct. 2951 (1982).

[5]1953 Treaty of Friendship, Commerce and Navigation between the United States and Japan [1953] 4 U.S.T. 2063, 2070.

[6]42 U.S.C. § 2300e-2(a) (1967).

[7]102 S.Ct. at 2380 n. 15 (citing Walker, *Provisions on Companies in the United States Commercial Treaties*, 50 Am. J. Int'l. L. 373, 374-378)(1956).

[8]*Id.* at 2380 n. 16 (citing *Bank of Augusta v. Earle*, 13 Peters)(1839).

[9]638 F.2d 552 (2d Cir.) (1981).

[10]643 F.2d 353 (5th Cir.) (1981).

[11]638 F.2d. at 557 (citing Letter from Herman Walker, Jr., Department of State, to The Hague, Netherlands, October 28, 1955.)

[12]1953 Treaty, *supra* note 5, 4 U.S.T. 2079-80.

[13]152 F.Supp. 818 (1957).

[14]102 S.Ct. at 2379.

[15]*Id.* at 2378 n. 6.

[16]Note, *Discriminatory Hiring Practices by Foreign Corporations in the United States—A Limited Right, supra* note 2, at 256 and n.n. 97 and 99.

[17]42 U.S.C. § 2000e-2(a) (1967).

[18]638 F.2d. at 559.

[19]Alice Cook and Hiroko Hayashi, *Working Women in Japan, Discrimination, Resistance and Reform*, Cornell Univ., 1980, Women's and Minors' Bureau, Ministry of Labor, Japan, The Status of Women in Japan 15 (1977). *Sumitomo in America: Women Scorned*, ECONOMIST, April 24, 1982, pp. 95-96, J. Lebra, J. Paulson and E. Powers, *Women in Changing Japan* (1976).

[20]29 CFR 1604.2(a)(1)(iii).

[21]*Weeks v. Southern Bell Telephone & Telegraph Co.*, 408 F.2d 228, 235 (1969), *Robinson v. Lorillard Corp.*, 444 P. 2d 791 (1971), *cert. denied.* 404 U.S. 1006 (1971).

[22]442 F.2d 385, 388 (1971), *cert. denied*, 404 U.S. 950 (1971).

[23]102 S.Ct. at 2382 n. 19.

[24]653 F.2d 1273 (1981).

[25]*Id.* at 1277.

[26]102 S.Ct. at 2382 n. 19.

[27]*Id.* n. 19.

[28]*Id.* at 2380 n. 12.

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