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***PAPAILA V. UNIDEN*: FURTHER SUPPORT FOR THE RIGHT OF U.S.
SUBSIDIARIES TO INVOKE FCN TREATIES AS A DEFENSE AGAINST
CLAIMS OF NATIONAL ORIGIN DISCRIMINATION**

June 1995

SUMMARY PAGE

White Paper

PAPAILA V. UNIDEN AMERICA CORPORATION:

**FURTHER SUPPORT FOR THE RIGHT OF U.S. SUBSIDIARIES
TO INVOKE FCN TREATIES AS A DEFENSE AGAINST
CLAIMS OF NATIONAL ORIGIN DISCRIMINATION**

On April 28, the Fifth Circuit Court of Appeals in *Papaila v. Uniden America Corporation*, affirmed a lower court determination that Uniden, a U.S.-based subsidiary of a Japanese parent corporation, had standing to assert the rights of its parent under the 1953 United States-Japan Treaty of Friendship, Commerce and Navigation (FCN). This decision is significant because it provides additional support for the proposition that in certain circumstances a U.S.-incorporated subsidiary may invoke FCN treaty protections of its parent as a defense against national origin and race discrimination claims, a right first recognized by the Seventh Circuit in *Fortino v. Quasar Company*, 950 F.2d 389 (1991). This White Paper discusses *Uniden* and its meaning when considered together with *Fortino v. Quasar Company*.

PAPAILA V. UNIDEN: FURTHER SUPPORT FOR THE RIGHT OF U.S. SUBSIDIARIES TO INVOKE FCN TREATIES AS A DEFENSE AGAINST CLAIMS OF NATIONAL ORIGIN DISCRIMINATION

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In *Papaila v. Uniden America Corporation*, 1995 WL217330, ___ F.3d ___ (5th Cir. 1995), the Fifth Circuit Court of Appeals affirmed the summary dismissal of an action alleging race and national origin discrimination, holding that the defendant-employer, a U.S.-incorporated subsidiary of a Japanese parent corporation, could assert the parent company's rights under the 1953 United States-Japan Treaty of Friendship, Commerce and Navigation (FCN). The decision marks the second time a U.S. Circuit Court of Appeals has effectively found an exception or limitation to the U.S. Supreme Court's decision in *Sumitomo Shoji America, Inc. v. Avagliano*, 457 U.S. 176 (1981), which held that an American subsidiary of a Japanese parent has no treaty rights or defenses of its own. The decision in *Uniden* thereby provides additional authority for a U.S. subsidiary to defend against discrimination suits by asserting rights of its Japanese parent corporation under the FCN Treaty.

The FCN Treaty

The Japanese FCN Treaty is one of approximately 12 bilateral commercial treaties entered into by the United States following World War II. The general purpose of these treaties is to promote and protect both foreign investment in the United States and overseas investment by U.S. corporations, by recognizing foreign companies' right to exercise some control over the businesses they establish abroad. To that end, Article VIII(1) of the Japanese FCN Treaty provides:

Nationals 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. 4 U.S.T. 2064, 2070.

It has been argued that the quoted, so called "employer choice" language of Article VIII(1) gives any Japanese company the unfettered right to hire executives of its choice in its U.S. operations, effectively exempting them from U.S. equal employment opportunity laws. However, this interpretation was rejected by the Supreme Court's decision in *Sumitomo Shoji America, Inc. v. Avagliano*.

In *Avagliano*, the Supreme Court was presented with the question of whether the operations of a U.S.-incorporated subsidiary of a Japanese company could assert rights on its own behalf under Article VIII(1) of the Japanese FCN Treaty. In ruling that it could not, the Court relied upon a definitional section of the Treaty, Article XXII(3), which

provides:

... Companies constituted under the applicable laws and regulations within the territories of either Party shall be deemed companies thereof and shall have the juridical status recognized within the territories of the other Party.

457 U.S. at 182 (emphasis in original). Reading this language literally, the Supreme Court held that because Sumitomo Shoji America, Inc. was incorporated under New York law, it was a company of the United States rather than of Japan. Therefore, the Supreme Court held that Sumitomo had no rights under Article VIII(1) and that it was barred from raising the Japanese FCN Treaty on its behalf as a defense to claims of employment discrimination under U.S. law. However, the Court introduced considerable uncertainty into the arena by commenting in a footnote in the last sentence of the opinion, "We . . . express no view as to whether [a U.S.-incorporated subsidiary] may assert any Article VIII(1) rights of its Parent." 457 U.S. at 189-190, n.19 (emphasis added). Through this open door, the Seventh Circuit entered and expressed its view in the affirmative.

Fortino v. Quasar Company

In *Fortino v. Quasar Company*, 950 F.2d 389 (1991), three former executives of Quasar, a division of a U.S. subsidiary of Matsushita Electric Industrial Company Ltd. of Japan, brought suit under Title VII alleging that Quasar unlawfully discriminated against them on the basis of their American national origin when it selected them to be laid off as part of a reduction in force. While 66 of Quasar's 80 American managers lost their jobs, not one of Quasar's nine Japanese managers lost theirs.

In its argument before the Seventh Circuit, Quasar argued that the case did not fall within the scope of Title VII because the Japanese managers were selected by Quasar's parent company based on their citizenship, not national origin, in accordance with the parent's rights under the Japanese FCN Treaty. The Court framed as "the most important question . . . whether a claim of discrimination on the basis of national origin is tenable when . . . the discrimination is in favor of foreign citizens employed temporarily in the United States in accordance with [the Japanese FCN Treaty]" (emphasis in original).

In a unanimous decision, a three-judge panel of the Seventh Circuit held that the Japanese FCN Treaty could be invoked by Quasar. In so ruling, the court distinguished the Quasar situation by explaining that in *Avagliano*, "there was no contention that the Parent had dictated the subsidiary's discriminatory conduct, and the [Supreme] Court left open the question whether the subsidiary might in such a case assert any of its Parent's Treaty rights." In contrast to the situation in *Avagliano*, the court found that in *Fortino*, the Japanese managers were assigned to Quasar by the parent company. They retained their status as employees of the parent and were "designated" as parent company personnel on Quasar's books. The parent evaluated the Japanese executives' performance, kept their personnel

records, fixed their salaries, and assisted with the relocation of their families to the U.S. Moreover, the executives were in the U.S. under "E-1" or "E-2" temporary visas, which permit a visa holder to work in the U.S. on the condition that, among other things, he or she is "doing work authorized by the Japanese FCN Treaty." Under these circumstances, the Seventh Circuit concluded that to forbid Quasar to give preferential treatment to the executives that its parent sends would have the same effect on the parent as it would have if the court's decision ran directly against the parent.

Fortino was the first decision to recognize a limitation, if not an outright exception, to the Supreme Court's holding in *Avagliano*. Therefore it was uncertain what the decision's full effect would be and whether it would be adopted or viewed critically by the courts in other circuits. In *Papaila v. Uniden America Corporation* the Fifth Circuit expressly endorsed the decision in *Fortino* and continued a trend allowing U.S.-incorporated subsidiaries to assert the FCN Treaty rights of parent companies in certain situations.

Papaila v. Uniden America Corporation

Since *Fortino*, two district courts have adopted the Seventh Circuit's analysis concerning whether and under what circumstances, the FCN treaty rights of a parent company may "pass through" to a U.S. subsidiary. See *Papaila v. Uniden America Corp.*, 840 F. Supp. 440 (N.D. Tex. 1994) (granting summary judgment to defendant on race and national origin claims under Title VII); *Kierans v. Samsung Semiconductor*, 1993 WL 262454 (N.D. Cal. 1993) (denying defendant's motion to dismiss in the absence of *Fortino*-type factual allegations as to parent's degree of control over subsidiary).

In affirming the lower court's decision in *Uniden*, the Fifth Circuit followed the lead of its sister circuit in *Fortino*. In *Uniden*, the plaintiff, a male caucasian employee of Uniden America Corporation (UAC), a wholly owned subsidiary of Uniden Corporation of Tokyo, Japan, brought suit under Title VII alleging race and national origin discrimination. The plaintiff alleged that employees of UAC who were also Japanese citizens received higher base salaries and greater fringe benefits in the form of housing and tuition allowances. The plaintiff also alleged that the Japanese citizens received enhanced job protection in that they were transferred rather than discharged in cases of poor job performance. *Id.* at *1.

The Fifth Circuit first held that the FCN Treaty, by virtue of its language permitting parties to engage certain types of professional personnel "of their choice," allows Japanese companies to discriminate in favor of their fellow citizens because of their citizenship. *Id.* at *1-2. That conclusion is not a new one. In *Espinoza v. Farah Manufacturing Company, Inc.*, 414 U.S. 86 (1973), a case alleging national origin discrimination, the Supreme Court held that nothing in Title VII makes it illegal to discriminate on the basis of citizenship or alienage. Likewise in *Fortino v. Quasar Company* the court noted that the FCN Treaty and Title VII are not in direct conflict because the treaty permits discrimination on the basis of citizenship, not national original, while Title VII forbids discrimination on the basis of

national origin, not citizenship. Accordingly, citizenship requirements imposed by an employer are unlawful under Title VII only when they are used as a pretext for what is really national origin discrimination, a sometimes elusive distinction.^{1/}

The Fifth Circuit then went on to address the issue of whether UAC, a U.S.-incorporated subsidiary of a Japanese corporation, could assert the FCN Treaty defense of its parent. The court explicitly adopted the reasoning of the Seventh Circuit in *Fortino* and held that a subsidiary may assert the FCN Treaty rights of its parent, at least to the extent necessary to prevent the FCN Treaty from being effectively nullified. *Id.* at *2. As in *Fortino*, the court held:

A judgement that forbids [UAC] to give preferential treatment to the expatriate executive that its Parent sends would have the same effect on the Parent as it would have if it ran directly against the Parent: it would prevent [Uniden Japan] from sending its own executives to manage [UAC] in preference to employing American citizens in these posts.

Id. at *2, citing, *Fortino*, 950 F.2d at 293.

The court in *Uniden* based its decision, in part, on the fact that UAC had not caused the discriminatory conduct at issue. The Court noted specifically that Uniden's Japanese employees were hired in Japan by the parent and were assigned by the parent to the United States (so-called "expatriate" employees). Further, the expatriates all held managerial positions and were responsible for managing the parent company's shareholder interests, and were subject to transfer at the request of the parent. The court also referred to the facts that salaries were set in Japan and that the parent directed the U.S. subsidiary to maintain a separate payroll account for the expatriates. Finally, the court mentioned that the parent set benefits and hours and evaluated the job performance of the expatriates.

The decision in *Uniden* is important for two reasons. First, when coupled with *Fortino*, the decision continues a trend within the federal courts to recognize an exception to *Avagliano*, which allows the rights of a parent corporation to pass through to a subsidiary at least as to employees relative to whom the parent company exercises a significant amount of control. Second, the *Uniden* decision provides a further exposition of the factors considered by the courts in determining whether a parent corporation does in fact exert

^{1/} For a detailed explanation of the *Avagliano* and *Fortino* precedents, as well as a full discussion of the distinction between citizenship and national origin discrimination, please refer to Morgan, Lewis & Bockius' March 1992 White Paper titled "*Fortino v. Quasar Company* and the FCN Treaties: A Possible Defense to Claims of National Origin Discrimination Against U.S. Subsidiaries of Foreign Companies."

enough control over a subsidiary so as to allow the subsidiary to claim the protections of the FCN Treaty. Again, in *Uniden* the factors considered included the fact that the employees at issue were assigned to the subsidiary by the parent, the visa status under which expatriates were in the United States (in *Uniden* the expatriates were on temporary work assignments), the fact that they were kept on the books of the parent company, the parent fixed their salaries and benefits and conducted performance appraisals.

In practice, the *Uniden* decision lends further support for the advice that a U.S.-incorporated subsidiary of a Japanese parent corporation may in certain circumstances favor Japanese citizens in terms and conditions of employment without violating Title VII and, possibly, other employment-based anti-discrimination laws.

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