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American Parent Bank Liability for Foreign Branch Deposits: Which Party Bears Sovereign Risk?

I. INTRODUCTION[1]

Assume that you are a director on the board of Very Large American Bank. Very Large maintains offices throughout the world. Assume further that Very Large has branch offices in, inter alia, Kuwait and Sri Lanka. On July 20, 1990, the Kuwait City branch of Very Large accepts a one million dollar deposit from a mid-level Kuwaiti official, while in Sri Lanka, the local Very Large branch borrows one million dollars from Big Bank.

Contrary to expectations, on August 1, 1990, Iraq invades Kuwait.[2] Very Large's Kuwait City branch is similarly overrun, and all assets are confiscated by the Iraqi government.[3] In response to the Iraqi invasion, the United Nations imposes economic sanctions on Iraq.[4]

As a result of the sanctions, Sri Lanka loses a large portion of its tea market.[5] Over one hundred thousand migrant workers flee the Iraqi invasion of Kuwait by returning to Sri Lanka. However, upon their return few jobs are available to them.[6] In addition, the war with the Tamil Tigers[7] is going poorly.[8] On October 25, the Sri

1. At the time that this comment was initially written, the Iraqi military had occupied Kuwait and the future of Kuwait was uncertain. This provided an excellent factual background upon which to base a hypothetical scenario which would aid in illustrating the issues presented in this comment.

Now that the Iraqi forces have been expelled from Kuwait, the lines between fact and hypothetical may blur with time. For the convenience of the reader, the factual basis of the hypothetical will be emphasized here.

The text accompanying footnotes 1,3,4,5,6,7 are all actual occurrences. The text accompanying footnote 2 (Iraqi seizure of assets of foreign bank branches, herein referring to intangible assets such as bank accounts) and 8 (moratorium on payment of foreign currency debts by Sri Lanka) are hypothetical. Of course, Very Large and Big Banks are hypothetical, as are any transactions in which they are involved. The factual background is incorporated into the hypothetical to bring this academic comment more in touch with the "real world."

2. L.A. Times, Aug. 2, 1990, at A1, col. 5.

3. Such expropriation did not occur and it is only for hypothetical purposes that such a statement is made.

4. L.A. Times, Aug. 7, 1990, at A1, col. 3.

5. *If They Get Bored With The War*, ECONOMIST, Nov. 3, 1990, at 42.

6. *Id.*

7. *Id.*

8. The nation of Sri Lanka, formerly Ceylon, is an island off the coast of India's

Lankan military announces an upcoming "full-scale operation" against the Tigers.[9] Such an operation requires arms. These arms must be purchased on the world markets, using a hard currency - such as the United States dollar. Consequently, the Sri Lankan government imposes a moratorium on all outflows of foreign currency.[10]

Very Large American Bank now has two distinct problems. In Kuwait, the Iraqis have seized all assets of the Kuwait City branch. However, the depositor has managed to escape the country, and files a lawsuit in New York demanding access to his deposit. In addition, the first payment from the Sri Lankan branch is due to Big Bank, but the currency restrictions imposed by the Sri Lankan government forbid that branch from repaying its debt. Big Bank also files suit in New York demanding payment from the head office of Very Large American Bank.

Is the home office of Very Large obliged to honor the debts of its overseas branches? In both cases the money received by the branches is inaccessible to the home office of Very Large. These two cases involve an aggregate liability of over two million dollars (including interest), from which Very Large has received no benefit. All of the parties involved are innocent, but Saddam Hussein[11] is not likely to show up and accept liability.[12] Someone must pay; the ques-

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Southeast coast. The population is composed of two main ethnic groups, a Sinhalese majority and a Tamil minority. The Tamil Tigers are a separitist insurgency which is seeking to establish an independant Tamil state on the island of Sri Lanka. *See, e.g.*, *Bad Behaviour*, ECONOMIST, Feb. 23, 1991, at 34-35.

9. *Id.*

10. While the text accompanying *supra* notes 4-7 is a report of actual occurences, the imposition of "a moratorium on all outflows of foreign currency" is purely hypothetical. *But see infra* notes 173-210 and accompanying text for real examples of countries imposing currency restrictions.

11. Saddam Hussein was, and as of the publication of this article, still is, the political leader of Iraq. On July 18, 1990, Iraq accused Kuwait of stealing its oil. It soon moved troops to the Iraq-Kuwait border. On August 2, 1990, Iraqi troops invaded Kuwait, formally annexing Kuwait on August 8, 1990. On August 28, Kuwait was declared to be the 19th province of Iraq.

On November 29, 1990, the United Nations Security Counsel authorized "all necessary means" to free Kuwait after January 15, 1991. On January 12, 1991, Congress empowered President Bush with the authority to go to war with Iraq. War began on January 16, 1991 with numerous bombing sorties against Iraq. *Stepping-stones*, ECONOMIST, January 19, 1991, at 20.

Saddam Hussein came to represent all that was bad in Iraq, to the extent that the war seemed to be waged not against Iraq but against Saddam Hussein himself. *See e.g.*, *His War, His Peace*, ECONOMIST, February 23, 1991, at 15. It is therefore ironic that although the war resulted in the withdrawl of Iraqi forces from Kuwait, Saddam Hussein retained his power in Iraq, despite revolt in both the north and south of Iraq. *See generally Guess Who's Still Running Iraq*, ECONOMIST April 6, 1991, at 39.

12. This is not presented facetiously. Saddam Hussein's hypothetical refusal to accept liability would be in keeping with the Act of State Doctrine. The Act of State Doctrine will generally respect the ability of a sovereign, in this case Iraq, to act with impunity within its own territorial boundaries. *See infra* notes 109-116 and accompanying text. The liberation of Kuwait may produce some technical problems for this

tion is who - the home office of the bank or the branch's creditors?

Along with the potential rewards of conducting business outside the United States come the potential risks of operating outside its protection. International business requires placing oneself under the control of a foreign sovereign.[13] A sovereign has the power to make the rules and to change them at any time.

Consequently, conducting business abroad involves the risk that the actions of a foreign sovereign will impair the ability of an American bank's foreign branch to repay its debts. This risk is called "sovereign risk."[14] As raised in the hypothetical scenario presented above, there is a question as to which party must bear sovereign risk.[15]

This comment is comprised of two basic parts. Part I of this comment provides background as to the realm in which questions of allocation of sovereign risk arise. Part II of this comment addresses the

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comment. Since the occupation is merely used here to bolster a hypothetical, this comment will assume that the Act of State Doctrine applies. Outside of this comment, Saddam Hussein would be better advised to invoke Sovereign Immunity, a concept which is beyond the scope of this comment.

13. *See infra* note 61.

14. Sovereign risk has been defined as "the risk that actions by the foreign government having legal control over the foreign branch and its assets would render the branch unable to repay the deposit." Citibank, N.A. v. Wells Fargo Asia, Ltd., 110 S. Ct. 2034, 2041 (1990).

In addition to sovereign risk, there exists what is known as "country risk." Country risk has been defined as "the possibility that sovereign borrowers of a particular country may be unable or unwilling to fulfill their foreign obligations." E. SYMONS & J. WHITE, BANKING LAW 719 (2d ed. 1984). While country risk is beyond the scope of this comment, many of the same factors that lead to country risk may eventually lead to sovereign risk, as states attempt to alleviate debt problems by retaining a hold on "hard currency" through currency restrictions. *See infra* notes 173-210 and accompanying text (review of currency restriction cases).

The implications of country risk are real. In 1982, Mexico, Brazil, Venezuela and Argentina each declared that it was going to limit debt repayments to interest only and renegotiate payments of principal. Each year several countries renegotiate or reschedule their debts. During the period of 1982-1984, over thirty-five countries sought to renegotiate or reschedule their foreign debts. In 1986, the number of countries following a similar course was twenty-four, and in 1988, fifteen countries followed suit. Kassa, *A Safety Net for the Eurodollar Market?: Wells Fargo Asia, Ltd. v. Citibank*, 65 N.Y.U. L. REV. 126, 127 n.6 (1990).

15. The United States itself has been a source of realized sovereign risk in the past. This has occurred most recently in the cases of the Iranian and Libyan asset freezes. For discussions of these cases and their international banking repercussions, *see* Leigh, *Libyan Arab Foreign Bank v. Bankers Trust Co.* 1986 L. Nos. 1567, 4048; 82 AM. J. INT'L. L. 132 (1988); Edwards, Jr., *Extraterritorial Application of the U.S. Iranian Assets Control Regulations*, 75 AM. J. INT'L. L. 870 (1981). *See also* Smedresman & Lowenfeld, *Eurodollars, Multinational Banks, and National Laws*, 64 N.Y.U. L. REV. 733, 746-61 (1989).

approaches adopted by courts in resolving questions of allocation of sovereign risk. Part I of this comment is divided into three sections. The first section provides a brief introduction to the concept of the "Eurodollar" and the Eurocurrency markets. The second section traces the development of international branch banking, and the American banking regulatory scheme. This section addresses the Separate Entity Doctrine, a legal construction which treats branches as independent from their home offices, and the concept of Debt Situs, or where a debt is located. The final section of Part I introduces the concept of interbank lending.

Part II of this comment addresses the substantive issue of allocation of sovereign risk. This is accomplished by analyzing cases involving bank expropriation arising out of Communist revolutions in Russia, Cuba and Vietnam. These expropriations may be analogized to the hypothetical seizure of Very Large's Kuwait City branch by the conquering Iraqis. Additionally, a newer aspect of sovereign risk, currency restrictions, is analyzed. The actions of the Sri Lankan government in the hypothetical situation introduced above represent the currency restriction aspect of sovereign risk.

II. BACKGROUND

A. *Eurocurrency Markets*

Eurocurrency is any money outside the territorial control of the nation which issues it.[16] For example, a United States dollar in England is a Eurodollar, and a Japanese Yen in the United States is likewise a Euroyen. Currency out of the territorial control of the country which issues it is no longer considered "coin of the realm."[17] It is merely another commodity which may be bought, sold or bartered.[18] Regulations on the use of Eurocurrency are based on those of the country in which the Eurocurrency is found, not upon those of the issuing country.[19] Eurocurrency accounts generally are held for three purposes: (1) to allow banks to loan money to borrowers at lower interest rates than are available within the country which issued the currency; (2) to enable banks to pay depositors higher rates of interest on their deposits; and (3) to facilitate international transactions.[20]

Suppose a Japanese manufacturer builds cars in a factory in Thai-

16. KIDWELL & PETERSON, FINANCIAL INSTITUTIONS, MARKETS, AND MONEY 666 (3d ed. 1987).

17. SYMONS & WHITE, *supra* note 14, at 750.

18. *See generally* Deutsche Bank Filiale Nurnberg v. Humphrey, 272 U.S. 517 (1926) (obligations in terms of a country's currency assume the risk of fluctuation of that currency).

19. Smedresman & Lowenfeld, *supra* note 15, at 743.

20. KIDWELL & PETERSON, *supra* note 16, at 668. On May 22, 1991, the U.S. Treas-

land, and ships them via a Korean shipping line to an American end user. The American pays in United States dollars to the American branch of Very Large Bank. The Japanese manufacturer wishes to receive Thai Baht to pay factory employees, Korean Won to pay the shipping company, and Yen for the home office in Japan. Rather than purchase the various currencies on the open market, Very Large Bank maintains accounts in all currencies at its American branch and pays at once. This procedure helps to eliminate the risk of currency fluctuations.[21]

Many American banks maintain United States dollar accounts abroad. In addition to facilitating inter-currency transactions, Eurodollar accounts are a means of avoiding United States banking regulations.[22] All banks which operate in the United States are required to maintain a certain percentage of their assets in reserve. These funds may not be loaned, and consequently are a liability for the bank.[23] Since the bank may not loan this money and is simultaneously required to pay interest to its depositors, the funds to cover this cost must come from profit gleaned from other loans. This is coupled with further federal restrictions on interest rates.[24] When a bank operates outside the United States, it is not subject to United States reserve and interest rate requirements.[25] Accordingly, it may reap greater profit while paying its depositors a higher rate of

ury Bill Market Rate, one year rate was 5.80 - 5.78, while the one year Eurodollar rate was 6.50 - 6.625. L.A. Times, May 22, 1991, at D7, col. 6.

21. In the realm of international banking and finance, money is a commodity. Different currencies may be more or less attractive to investors at a particular point in time. The amount of one currency required to purchase a unit of another currency is the "currency exchange rate."

For example, on or about May 10, 1991, one hundred thirty-eight Japanese Yen would be required to purchase one United States Dollar. The Yen to Dollar exchange rate would be 138. *Trade, Exchange Rates and Reserves*, ECONOMIST, May 11, 1991, at 100.

Exchange Rates are not static, but move according to market forces. SYMONS & WHITE, *supra* note 14, at 721. The change in the exchange rate can be called a "currency fluctuation." Again, for illustrative purposes, the Yen to Dollar exchange rate on about May 10, 1990 was 158. As such, the value of the Dollar dropped twenty Yen between May 10, 1990 and May 10, 1991. This is a decrease of almost thirteen percent, a real loss to the holder of United States Dollars. This is a real life demonstration of the risk involved due to currency fluctuations to any international business.

22. Smedresman & Lowenfeld, *supra* note 15, at 744. *See also* 12 U.S.C. § 461(b)(6) (1989); 12 U.S.C. § 1813(e)(5) (1989).

23. 12 C.F.R. § 204.1-.124 (1990). *See also* Hannigan, *United States Home Bank Liability for Foreign Branch Deposits*, 1989 U. ILL. L. REV. 735, 738 n.21.

24. 12 C.F.R. § 217 (1990).

25. Hannigan, *supra* note 23, at 738.

interest.[26]

The Eurodollar market began to emerge after the end of World War II. While the sun still shone on the English Empire, the pound was the dominant currency of international trade, with England the "center of international finance."[27] In 1957, England faced a "sterling crisis." This led to the prohibition of the foreign use of the pound by non-U.K. residents.[28] By the 1950's, English banks found themselves in the position of no longer being able to make international sterling loans, while holding large amounts of United States dollars.[29]

These dollar holdings were largely the result of the Marshall Plan.[30] This money was kept in English banks because of their prior experience with international transactions, America's close alliance with the United Kingdom, and the fact that few American banks were established in Europe.[31] American businesses seeking to establish themselves in the new overseas markets also made use of English banks by adding to the Marshall Plan funds.[32]

Meanwhile, Eastern bloc nations removed their funds from the United States. This effort was led by the Soviet Union, which withdrew its dollar deposits to avoid possible expropriation by the United States.[33] The Soviet government had repudiated bonds issued by the former Czarist government, many of which were held by American investors.[34] In 1963, President Kennedy called for the imposition of an "Interest Equalization Tax."[35] The tax, approved by Congress, was designed to raise interest rates in the United States to the level of then current European interest rates. The tax remained in effect until 1974,[36] by which time it had "discourage[d] U.S. investors from buying certain foreign securities and thus forced the reopening of capital markets in Europe . . . [and] had the effect of creating the

26. 12 C.F.R. § 204.128 (1990). *See also infra* notes 59-60 and accompanying text.

27. KIDWELL & PETERSON, *supra* note 16, at 613.

28. REVEL, THE BRITISH FINANCIAL SYSTEM 295 (1982).

29. *See infra* notes 30-38, and accompanying text.

30. On June 5, 1947, Secretary of State George C. Marshall, Jr. proposed an aid plan for rebuilding post-World War II Europe. This plan has since been referred to as the Marshall Plan. *See* 52 Fed. Reg. § 20695 (1987).

31. *See* KIDWELL & PETERSON, *supra* note 16, at 614 (the strong ties between America and England can be demonstrated by their alliance during the Second World War).

32. *Id.*

33. KIDWELL & PETERSON, *supra* note 16, at 669.

34. *Id.*

35. The Interest Equalization Tax, as well as the Foreign Credit Restraint Program and the Foreign Direct Investment Regulations (which were similarly designed to provide disincentives to American domination of the post-war European capital markets), were all repealed on January 1, 1974. *See* Kassa, *supra* note 14, at 132 n.43.

36. *Id.*

largest international capital market the world has known."[37] Largely through United States action, the raw materials (dollars) and the mechanism (international capital markets) created what began as the Eurodollar, and became the Eurocurrency capital markets.[38]

The United States dollar, the successor currency to the sterling, was soon found throughout the world as the result of U.S. aid and investment. Currently, the Deutchemark and the Yen are widely used on the international market. However, the dollar retains its place as the most widely used Eurocurrency.[39]

B. International Branch Banking

1. The Regulatory System

The American banking system is a dual system. Both state governments and the federal government may charter a bank.[40] The current regulatory scheme is an amalgamation of competing state and federal regulations coupled with the New Deal's efforts to reform the failing banking system of the 1930s.[41] The primary regulatory body for nationally chartered banks is the Office of the Comptroller of the Currency (OCC).[42] The Board of Governors of the Federal Reserve System also exerts regulatory power over national banks, and is similarly responsible for monitoring state banks which are members of the Federal Reserve System.[43] State regulations, of course, also control the actions of domestic banks.[44]

The Federal Reserve System was created by the Federal Reserve Act of 1913.[45] All national banks are required to become members of the Federal Reserve System, and state banks are allowed to join.[46] The Federal Reserve System is divided into twelve districts across

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37. R. TENNEKOON, LECTURE (1989) (citing J. WATKINS, CURRENT ISSUES OF INTERNATIONAL FINANCIAL LAW 19 (1985)).

38. *See* Kassa, *supra* note 14, at 1288 n.17, 18, 131 n.40.

39. Kassa, *supra* note 14, at 131-33.

40. SYMONS & WHITE, *supra* note 14, at 46. For early cases dealing with the United States banking system, *see* McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819); Osborn v. Bank of the United States, 22 U.S. (9 Wheat.) 738 (1824).

41. For the history of the current banking regulatory scheme, *see generally* SYMONS & WHITE, *supra* note 14, at 1-67.

42. 12 U.S.C. §§ 1-14 (1989).

43. SYMONS & WHITE, *supra* note 14, at 42.

44. SYMONS & WHITE, *supra* note 14, at 36.

45. Federal Reserve Act of 1913, ch. 6, 38 Stat. 251 (1913) (codified as amended at 12 U.S.C. §§ 221-530 (Supp. 1990).

46. For national banks, see 12 U.S.C. § 222 (1989); for state banks, see 12 U.S.C. § 321 (1989).

the United States, and is headed by a seven-member Board of Governors.[47] Today the Federal Reserve is primarily used like a central bank to control U.S. money supply, set interest rates, and act as a general clearing house for checks.[48]

The pervasive and widespread bank failures of the 1920s revealed drastic inadequacies in the then current banking regulatory scheme.[49] In response, the Banking Act of 1933 was passed.[50] Perhaps the most important provision of this act was the creation of the Federal Deposit Insurance Corporation (FDIC).[51] The FDIC provides deposit insurance for the accounts of member banks.[52] As a result, the FDIC is in a position to provide "the most pervasive regulation of the banking industry since its ranks include virtually all of the nation's . . . commercial banks."[53] Indeed, all banks, national or state, which are members of the Federal Reserve System are automatically qualified for FDIC protection and consequently, FDIC regulation. Nonmember banks may also qualify for FDIC protection.[54]

National banks may open branches within a state to the same extent that state law allows state banks to branch.[55] A provision of the Federal Reserve Act of 1913 allowed national banks to establish branches overseas.[56] These international branches, however, require the prior approval of the Federal Reserve Board.[57]

American banks did not begin to take advantage of their ability to establish overseas branches until well after the United States had become the major post-World War II power.[58] The number of United States banks maintaining foreign offices grew from just eight in 1960, to one hundred and sixty-three in 1984.[59] By 1987, nine hundred and two foreign offices were being operated by United States banks.[60]

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47. 12 U.S.C. § 241 (1989).

48. SYMONS & WHITE, *supra* note 14, at 35-40. The turmoil caused by the inordinate number of bank failures coupled with the risk of forced closure affecting even sound banks due to national panic led President Roosevelt to declare a "bank holiday," during which all banks suspended activities to prevent "runs" from occurring. *Id.* at 37-40, for a transcript of President Roosevelt's subsequent radio address to the nation describing the reasons behind the bank holiday. *See also* Exec. Order No. 6073 (1933) (regulations for lifting of emergency bank holiday).

49. *See* Glass-Steagall Act, ch. 89, 48 Stat. 162 (1933) (codified as amended at 12 U.S.C. § 227 (1989)).

50. 12 U.S.C. § 1811 (1989).

51. *Id.*

52. SYMONS & WHITE, *supra* note 14, at 41.

53. *Id.* at 42. *See* 12 U.S.C. §§ 1811-1831 (1989).

54. 12 U.S.C. § 1815 (1989) (application process).

55. The modern articulation of this rule is found at 12 U.S.C. § 36 (1989).

56. 12 C.F.R. § 211.3 (1990); 12 U.S.C. § 601 (1989).

57. 12 U.S.C. § 1815 (1989).

58. SYMONS & WHITE, *supra* note 14, at 744.

59. KIDWELL & PETERSON, *supra* note 16, at 615.

60. Kassa, *supra* note 14, at 126 & n.2.

This growth is due in large part to a sympathetic legal environment, as foreign branches are excluded from U.S. reserve maintenance requirements[61] and interest rate limitations.[62]

2. International Activities

A bank may maintain a presence in a foreign country in a variety of ways, depending on the extent of a presence it wishes to maintain, and the type of presence the host country allows.[63] There are five basic methods by which an American bank may establish a foreign presence. A lower level presence may be maintained through representative offices,[64] shell branches[65] and/or the development of correspondent banking relationships.[66] A higher level presence may be maintained through a foreign subsidiary[67] or branch.[68]

A representative office may not engage in banking activity. Instead, it enables an American bank to familiarize itself with a foreign market, and to introduce itself to the local banking and business communities.[69] Another function of a representative office is to act as a

61. 12 C.F.R. § 204.1 (1990), which provides in pertinent part: "(b) *Purpose.* This part relates to reserves that depository institutions are required to maintain. . . . (c)(5) The provisions of this part do not apply to any deposit that is payable only at an office located outside the United States." (Regulation D).

62. 12 C.F.R. § 217.1 (1990), which provides in pertinent part: "(c)(2) For deposits held by a member bank or a foreign bank, this regulation [establishing interest rate ceilings for deposits] does not apply to 'any deposit that is payable only at an office located outside the United States' . . . ." (citing 12 C.F.R. § 204.2(t) (1990). (Regulation Q).

> Any deposit that is payable only at an office located outside the United States "means (1) a deposit of a United States resident that is in a denomination of $100,000 or more, and as to which the depositor is entitled, under the agreement with the institution, to demand payment only outside the United States or (2) a deposit of a person who is not a United States resident as to which the depositor is entitled . . . to demand payment only outside the United States."

12 C.F.R. § 204.2(t) (1990).

63. For example, Canada requires foreign banks to operate only through locally incorporated subsidiaries. Smedresman & Lowenfeld, *supra* note 15, at 741 n.19 (citing Canada Bank Act, 1 CAN., REV. STAT. ch. B-1, § 302(1)(b) (1985)). In contrast, South Vietnam required foreign banks to operate only through branches. *See* Trinh v. Citibank, N.A., 850 F.2d 1164 (6th Cir. 1988), *cert. denied*, 110 S. Ct. 2602 (1990). Most "major host countries," such as the United States, the United Kingdom, Germany, Switzerland, France and Japan, allow foreign banks to operate either through branches or subsidiaries. Smedresman & Lowenfeld, *supra* note 15, at 741.

64. 12 C.F.R. § 211.5(d)(6) (1990).

65. KIDWELL & PETERSON, *supra* note 16, at 620.

66. *Id.* at 622.

67. 12 C.F.R. § 211.5(b)(i) (1990).

68. 12 U.S.C. §§ 601, 615(b) (1989).

69. KIDWELL & PETERSON, *supra* note 16, at 620.

liaison between American customers and local banks.[70] Similarly, a shell branch seldom interacts with the public. A shell branch is primarily concerned with interbank money market transactions.[71] The main purpose of a shell branch is to provide an American bank with a branch in a tax haven, such as the Bahamas or the Cayman Islands.[72] This is the most common form of "international presence" banks maintain.[73] When an American bank is precluded from establishing a presence of its own in a foreign country, it may establish a correspondent relationship with a foreign bank to facilitate international transactions.[74]

An American bank may also establish itself abroad in the form of a locally incorporated bank. In this case, the foreign office is truly a separate entity from the home office, although such subsidiaries are generally wholly owned by an American institution.[75] As such, this is the easiest means of insulating the home office from liability for the failure of a foreign branch to pay its debts.[76] Banks however, unlike most other international businesses, have generally not opted to venture abroad through subsidiaries.[77]

The most common form of foreign involvement for banks is through the establishment of a branch office.[78] A branch is a "legal and operational part of the parent bank."[79] Foreign branches are subject to both American law and the law of their host country.[80] Foreign branches benefit from the name recognition and reputation of their parent and the belief that the assets of the parent will back the liabilities of the branch.[81] As this comment will demonstrate, however, such a belief is not always well founded.

3. The Separate Entity Doctrine

In the early part of the twentieth century, as a domestic branch banking system was developing, courts developed the concept of the branch as a separate entity from the home office.[82] One of the first

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70. *Id.*

71. *Id.*

72. *Id.* at 620-21.

73. *Id. See also* Comment, *Reducing Liability of American Banks for Expropriated Foreign Branch Deposits*, 34 EMORY L.J. 201, 205 (1985).

74. KIDWELL & PETERSON, *supra* note 16, at 622.

75. KIDWELL & PETERSON, *supra* note 16, at 624; Comment, *supra* note 73, at 208.

76. *Id.*

77. Comment, *supra* note 73, at 207.

78. SYMONS & WHITE, *supra* note 14, at 746.

79. KIDWELL & PETERSON, *supra* note 16, at 622-23.

80. *Id.*

81. *Id. See also* Comment, *supra* note 73, at 207-08.

82. Pan-American Bank & Trust Co. v. National City Bank, 6 F.2d 762, 767 (2d Cir.), *cert. denied*, 269 U.S. 554 (1925) ("[B]ranches and a parent bank are to be considered as separate entities."); Bluebird Undergarment Corp. v. Gomez, 139 Misc. 742, 744,

articulations of the separate entity doctrine is found in the 1916 case of *Chrzanowska v. Corn Exchange Bank*,[83] where the court stated that "different branches [are] as separate and distinct from one another as from any other bank."[84] The separate entity doctrine has been maintained in situations where the bank's assets are being attached,[85] as well as when attachment of a depositor's account is sought.[86]

The initial rationale for the doctrine stems from the very real problems posed by the inefficient means of communications extant at the time.[87] Branches generally operated as independent cost and profit centers, with little commingling of assets and liabilities between the branch and home office.[88] Modernly, federal statute requires that the accounts of foreign branches be kept separate from one another and from the home office. At year end, the branch's profit or loss is then transferred to the home office's books as a separate ledger item.[89] In addition, the Freedom from Federal Reserve requirements and interest rate limitations are dependent on maintaining this distinction.[90]

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249 N.Y.S. 319, 321-22 (1931) ("Not only are branch banks separate entities, but deposits made in a branch bank are payable there only . . . . A branch bank being separately indebted to its depositor, the existing obligation lies primarily between such branch bank and its depositor.").

83. 173 A.D. 285, 159 N.Y.S. 385 (1916), *aff'd per curiam*, 225 N.Y. 728, 122 N.E. 877 (1919).

84. *Id.* at 291, 159 N.Y.S. at 388.

85. *See, e.g.*, Bluebird Undergarment Corp. v. Gomez, 139 Misc. 742, 249 N.Y.S. 319 (1931); Chrzanowska v. Corn Exch. Bank, 173 A.D. 285, 159 N.Y.S. 385 (1916), *aff'd per curiam*, 225 N.Y. 728, 122 N.E. 877 (1919); Cronan v. Schilling, 100 N.Y.S.2d 474 (N.Y. Sup. Ct. 1950).

86. *See, e.g.*, McCloskey v. Chase Manhattan Bank, 11 N.Y.2d 936, 183 N.E.2d 227, 228 N.Y.S.2d 825 (1962). In *McCloskey*, Chase Manhattan's New York home office sought attachment of the account of a customer of a Chase branch office in Germany. The court found that "[b]alances maintained by the individual in the German branch were payable only in Germany at that branch and . . . the funds were not subject to attachment in New York." *Id. But see* United States v. First Nat'l City Bank, 379 U.S. 378, 384 (1965) (The branch bank's affairs are . . . as much within the reach of the *in personam* order entered by the District Court as are those of the home office).

87. *See, e.g.*, Cronan v. Schilling, 100 N.Y.S.2d 474 (N.Y. Sup. Ct. 1950).

> Unless each branch of a bank is treated as a separate entity . . . no branch could safely pay a check drawn by its depositor without checking with all other branches and the main office to make sure that no warrant of attachment had been served upon any of them . . . . This would place an intolerable burden upon banking and commerce, particularly where the branches are numerous, as is often the case.

Id. at 476.

88. Comment, *supra* note 73, at 216.

89. 12 U.S.C. § 604 (1989).

90. 12 C.F.R. §§ 204.1(b), 204.1(c)(5), 204.2(t) (1989) (setting forth Regulation D re-

Modern communications abilities have decreased the necessity of maintaining a strict legal separation between branch and home office. The separate entity doctrine has eroded, and is sometimes even ignored in the post-1960 era.[91] A somewhat nebulous restriction of the separate entity doctrine occurs when a foreign branch and a home office fail to maintain an arms-length relationship.[92] Further, the separate entity doctrine may be waived by contract. In the case of contractual time deposits,[93] courts may hold that the terms of the instrument make it the debt of every office a bank operates if payment of the foreign deposit is guaranteed by a domestic banking office.[94]

C. *Debt Situs*

Returning to the hypothetical of Very Large Bank, one may observe that in both of Very Large's invasion related trials, Kuwait citizen v. Very Large and Citybank Bombay v. Very Large, the plaintiffs are attempting to place liability on the home office for deposits accepted at Very Large's branches. Very Large's first line of defense against these claims is to invoke the separate entity doctrine. Since the deposits are the debt of the branches, and the branches are legally separate entities from the American parent bank, the plaintiffs' only cause of action is against the branches themselves. If the separate entity doctrine is still viable, the plaintiffs will have to circumvent the doctrine. Perhaps the simplest and most effective means to accomplish this task is to state that the debt is not located at the branch, but rather at the parent, in which case the separate entity doctrine will not apply.

Therefore, the concept of the situs of a debt is an important issue in cases seeking to place liability on the home office for debts incurred at foreign branch offices.

In order for the separate entity doctrine to have effect, a court must determine that the debt in question is located solely in the branch office.[95] If a debt were to have its situs in the home office of a bank, despite the fact that the debt was first created at a branch,

quiring separation of foreign and domestic accounts to allow foreign deposit exemption from U.S. reserve requirements). *See also* 12 U.S.C. § 604 (1989) (foreign branch accounts must be operated independently of accounts in the domestic home office); 12 U.S.C. § 461(b)(6); 12 U.S.C. § 1813(1)(5) (1982) (lack of Federal Deposit Insurance Corporation coverage for foreign branches). *See also* SYMONS AND WHITE, *supra* note 14 at 752.

91. Hannigan, *supra* note 23, at 745.

92. *See* First Nat'l City Bank v. Internal Revenue Service, 271 F.2d 616, 618-19 (2d Cir. 1959), *cert. denied*, 361 U.S. 948 (1960).

93. A time deposit is a deposit made with a bank which cannot be withdrawn before a prescribed date without a penalty. KIDWELL & PETERSON, *supra* note 16, at 164.

94. Hannigan, *supra* note 23, at 744.

95. *Id.* at 742-45.

the separate entity doctrine would be inapplicable.[96] The issue is not a simple one, for "[t]he situs of intangible property is about as intangible a concept as is known to the law."[97] Debt situs issues are also of primary importance in determining the applicability of the act of state doctrine.[98]

Early cases resolved questions of debt situs under conflict of laws procedures.[99] These cases rely on the presumption that a debt has a sole situs at the branch of deposit.[100] However, courts are not always apt to adopt such a position. Justice Cardozo first introduced the concept of a debt having a situs simultaneously in several distant locations, notably, at both the branch and home office of a bank.[101]

D. Interbank Lending

Very Large bank is in trouble. Its London branch has a shortage of sterling, and an important customer wants to draw out a large sum against his line of credit. Fortunately, Small English Bank happens to have a surplus of sterling on hand. Very Large borrows the sterling it needs from Small English, and lends the money to its customer. This is an example of interbank lending at its simplest form.

Given the large number of banks in operation throughout the world and the similarly large diversity of available currencies, there are always some banks with a surplus of one currency and a deficit of another. To facilitate the process of getting currencies to where they are needed, banks have developed their own system of interbank lending. Due to the speed with which such transactions must now occur, "[d]eposit taking and making is often conducted by telephone

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96. *Id.*

97. Tabacalera Severiano Jorge, S.A. v. Standard Cigar Co., 392 F.2d 706, 714 (5th Cir.), *cert. denied*, 393 U.S. 924 (1968).

98. *See infra* notes 109-116 and accompanying text.

99. *See* Zimmerman v. Sutherland, 274 U.S. 253 (1927) (debt created by deposit in Austria-Hungary held to be discharged under the law of Austria-Hungary and therefore not collectible in the United States); Die Deutsche Bank Filiale Nurnberg v. Humphrey, 272 U.S. 517 (1926) (deposit made in Germany is subject to currency fluctuations in Germany and to German law); Dunn v. Bank of Nova Scotia, 374 F.2d 876 (5th Cir. 1967) (Canadian government could tax United States dollar account, established in Canada through contract with Texas citizens).

100. *See, e.g.*, Edwards, Jr., *supra* note 15, at 877 n.34. ("The choice-of-law rule applied by most courts is that the law governing the contractual relationship of a bank and its depositor when a deposit is placed with a branch, in the absence of an explicit statement by the parties, is the law of the place where the branch is sited."). *See also* Citibank, N.A. v. Wells Fargo Asia, Ltd., 110 S. Ct. 2034 (1990).

101. Sokoloff v. National City Bank, 231 N.Y. 158, 145 N.E. 917 (1924). *See infra* notes 120-27, 231 N.Y. 158, 145 N.E. 917 (1924) and accompanying text.

and evidenced merely by terse telex messages containing the bare essential terms."[102]

The primary interbank lending market is found in London, England. The interest rate at which such loans are made is LIBOR, the London InterBank Offering Rate.[103] LIBOR therefore represents the rate at which banks can "buy" money. Similarly, the Federal Reserve facilitates interbank transfers of funds in the United States. The Federal Reserve also sets the rate, the United States Prime Rate, at which banks located in America may "buy" money.[104] Consequently, most international loans are calculated using either LIBOR or the U.S. Prime Rate.[105]

II. Treatment by the Courts

A. *Inability of a Foreign Office to Pay its Debts*

American parent bank (home office) liability for foreign branch deposits reflects the patchwork system of regulation extant in the rest of the banking regulatory scheme. While the rationale behind the separate entity doctrine has weakened, treatment of branches as separate entities must still be addressed.[106] Concomitant with this doctrine is the concept of debt situs.[107] Once the situs of a debt is determined, the court must determine which legal doctrines are applicable.[108] Since the actions of a foreign sovereign are involved, a court will have to take into account the extent to which political action and separation of powers are involved. This is determined under the penumbra of the act of state doctrine.[109] Underlying all of the doctrines, procedures and rules, simple contract law and allocation of risk exist.[110]

1. The Act of State Doctrine

In the hypothetical scenario which introduced this comment, the

102. Smedresman & Lowenfeld, *supra* note 15, at 740.

103. KIDWELL & PETERSON, *supra* note 16, at 670. It is interesting to note that Eurodollar interbank transactions are also cleared in the United States. Such transactions occur via the Society for Worldwide Interbank Financial Transfers (SWIFT). For an illustration of the procedures involved, see Smedresman & Lowenfeld, *supra* note 15, at 745. For an example of the legal effects that this procedure may have in the event of realized sovereign risk, see Leigh, *supra* note 15, at 132-36.

104. KIDWELL & PETERSON, *supra* note 14, at 177-79.

105. *Id.* at 670. As of May 21, 1991, the U.S. prime rate was 8.50, while the six month LIBOR rate was 6.25. L.A. Times, May 22, 1991, at D7, col. 5.

106. *See* Hannigan, *supra* note 23, at 744-45.

107. *See supra* notes 93-99 and accompanying text.

108. This will be illustrated by the analysis of cases presented in this section.

109. *See infra* notes 111-16 and accompanying text.

110. "The deposit relationship is, in fact, mainly a matter of contract between bank and depositor." Smedresman & Lowenfeld, *supra* note 15, at 739.

Kuwait City branch of Very Large American Bank was overrun by invading Iraqi armies. This was followed by a hypothetical Iraqi proclamation that the assets of the seized branch were now the property of Iraq. This is an example of sovereign expropriation of a foreign branch of a United States bank.

American jurisprudence has long held that the acts of a foreign sovereign which come to fruition within that sovereign's territorial control are outside the purview of American courts.[111] While the rationale for the rule has shifted from one of comity between nations[112] to one of separation of powers,[113] the end result remains the same; the acts of a foreign sovereign within its own territory will generally be held beyond the powers of American courts to review.[114] This rule of judicial restraint is called the act of state doctrine.

Territorial limitations are a major aspect of the act of state doctrine.[115] This has led to some confusion when the property affected is intangible, such as in the case of a debt.[116] The major question in deciding whether to apply the act of state doctrine in the case of

111. *See* 45 AM. JUR. 2D *International Law* §§ 83-87 (1969).

112. The first articulation of the act of state doctrine is found in Underhill v. Hernandez, 168 U.S. 250 (1897).

> Every sovereign State is bound to respect the independence of every other sovereign State, and the courts of one country will not sit in judgement on the acts of the government of another done within its own territory. Redress of grievances by reason of such acts must be obtained through the means open to be availed of by sovereign powers as between themselves.

Id. at 252.

113. Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 423 (1964). *Cf.* Alfred Dunhill of London, Inc. v. Republic of Cuba, 425 U.S. 682, 697 (1976) (purely commercial, rather than political, conduct of Cuba is not an act of state implicating separation of powers).

The separation of powers rationale led to the so-called Bernstein exception, which allowed for the abrogation of the act of state doctrine when the Executive branch informed the court that the act of state doctrine was not applicable. Bernstein v. N. V. Nederlandsche-Amerikaansche, Stoomvaart-Maatschappij, 210 F.2d 375 (2d Cir. 1954). This exception was repudiated by six Justices in a plurality of opinions in First Nat'l City Bank v. Banco Nacional de Cuba, 406 U.S. 759 (1972), *reh'g denied*, 409 U.S. 897 (1972). The second circuit, however, was unconvinced that the Bernstein exception was overruled and decided to reinstate it, albeit in a more restricted version, in Banco Nacional de Cuba v. Chase Manhattan Bank, 658 F.2d 875, 882-84 (2d Cir. 1981) (In addition to Executive branch waiver of the act of state doctrine, there must be no interference with foreign relations and the claim against the foreign sovereign must be asserted by counterclaim not exceeding the value of the sovereign's claim).

114. 45 AM. JUR. 2D *International Law* § 83 (1989).

115. *See Sabbatino*, 376 U.S. at 428 ("[T]he Judicial Branch will not examine the validity of a taking of property within its own territory by a foreign sovereign government.").

116. Heininger, *Liability of U.S. Banks for Deposits Placed in Their Foreign Branches*, 11 LAW & POL'Y INT'L BUS. 903, 963 (1979).

bank expropriations is deciding the location, or situs of the debt.[117] If the debt situs can be shown to be outside the territorial control of the foreign sovereign, the act of state doctrine need not be applied.[118]

2. Sovereign Expropriation

The disputes brought before the courts are generally between the bank and its depositors.[119] It is the bank, which has suffered the seizure of its foreign branch, that will argue for the applicability of the act of state doctrine to avoid payment to its depositors at the expropriated branch. These are cases where generally "both . . . are innocent parties and, to a great extent, victims of circumstances beyond their control. However, . . . it is [the] job [of the] court to determine which of [the] parties is to suffer the loss."[120] Courts have approached the issue of the applicability of the act of state doctrine on a case-by-case basis.[121] The incidence of sovereign expropriations of American foreign branch banks is actually quite limited. It is generally in the wake of successful communist revolutions that these cases have arisen. Consequently, the law has developed from the Russian revolution through the rise of Castro and the fall of Vietnam.

a. Russia

The leading case law from the Russian revolution can be found in the New York Sokoloff cases.[122] Between the fall of Czarist Russia and the birth of the Soviet Union, Boris Sokoloff deposited United States dollars with National City Bank (National) in New York to be converted to rubles and made available in Petrograd.[123] Sokoloff

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117. *See, e.g.*, Garcia v. Chase Manhattan Bank, N.A., 735 F.2d 645, 650 (2d Cir. 1984) ("[I]f the situs of Chase's debt to Garcia were in Cuba, the Cuban government could validly seize it."). *See also*, Note, *The Act of State Doctrine: Resolving Debt Situs Confusion*, 86 COLUM. L. REV. 594 (1986).

118. Hannigan, *supra* note 23, at 749.

119. *See, e.g.*, *Garcia*, 735 F.2d at 651 ("We are simply resolving a private dispute between an American bank and one of its depositors.").

120. Trinh v. Citibank, N.A., 850 F.2d 1164, 1172 (6th Cir. 1988), *cert. denied*, 110 S. Ct. 2602 (1990).

121. Texas Trading & Milling Corp. v. Federal Republic of Nigeria, 647 F.2d 300, 316 n.38 (2d Cir. 1981), *cert. denied*, 454 U.S. 1148 (1982) ("Act of state analysis depends upon a careful case-by-case analysis of the extent to which the separation of powers concerns on which the doctrine is based are implicated by the action before the court.").

122. Sokoloff v. National City Bank, 250 N.Y. 69, 164 N.E. 745 (1928) (ruling on the appropriate remedy); Sokoloff v. National City Bank, 239 N.Y. 158, 145 N.E. 917 (1924) (ruling on propriety of claim against home office).

123. On June 27, 1917, Sokoloff deposited funds with the New York home office of National City Bank. *Sokoloff*, 250 N.Y. at 73. In September of 1917, Sokoloff received a passbook from the Petrograd branch of National City Bank. *Id.* at 74. The Communists eventually took power and subsequently issued decrees nationalizing Russian banks and later confiscating the accounts of depositors as a "revolutionary tax." *Sokoloff*, 239 N.Y. at 167.

then sought to transfer a portion of the funds from Petrograd to Kharkoff. During the transfer, the funds became lost as a result of the communication difficulties of the Russian State Bank, through which such transfers were accomplished.[124] Thereafter, while the transfer of monies from the Petrograd branch of National was still in an executory stage, the then successful Bolsheviks nationalized all banks in Russia and seized all individual accounts.[125]

Sokoloff sued National City Bank in New York in an attempt to recover the balance of his Petrograd account. Justice Cardozo, then with the New York Court of Appeals, propounded what could be considered the multiple situs and springing situs theories.[126] The court found the situs of National's debt to Sokoloff to be wherever the bank maintained a presence. "The intangible chose in action, at least when it is the result of a deposit in a bank, has for some purposes a situs at the residence or place of business of the debtor."[127] Locating the situs of National's debt in the United States was predicated on the expectations of the creditor. "Plaintiff did not pay his money to the defendant . . . upon the security of the Russian assets. He paid his money to a corporation organized under our laws upon the security of all its assets, here as well as elsewhere."[128] The situs of the debt could further be considered to "spring back" to the United States home office upon closure of a branch. "[A] decree of confiscation directed against depositors does not reduce the liabilities of a bank which has already yielded up its assets in virtue of a decree of

124. *See Sokoloff*, 250 N.Y. at 77.

125. *Sokoloff*, 239 N.Y. at 167.

126. Multiple situs theory holds that the debt is located both at the branch and at the home office. Springing situs theory holds the site of the debt to be the branch, yet "springing back" to the home office upon closure of the branch. "Everything in Russia might have been destroyed by fire or flood, by war or revolution, and still the defendant would have remained bound by its engagement." *Sokoloff*, 239 N.Y. at 167. *See* Vishipco Line v. Chase Manhattan Bank, N.A., 660 F.2d 854, 862-63 (2d Cir. 1981), *cert. denied*, 459 U.S. 976 (1982), for an articulation of the springing situs doctrine.

127. *Sokoloff*, 239 N.Y. at 169.

128. *Id.* at 167. *Cf.* Dougherty v. Equitable Life Assurance Soc'y, 266 N.Y. 71, 193 N.E. 897 (1934); Dougherty v. National City Bank, 157 Misc. 849, 285 N.Y.S. 491 (N.Y. Sup. Ct. 1935). *Dougherty* was distinguished from *Sokoloff* based on the site of the initial deposit. While Sokoloff made his initial deposit in the United States, Dougherty made his initial deposit in Russia. The New York Court of Appeals in *Dougherty* found that in cases where the initial deposit taking was in Russia, Russian law applied. The Soviet government was held to have assumed liability for the branch's debts. These cases involved the application of Russian law as opposed to American law, demonstrating the importance of conflict of laws, and of the ability of parties to contract for their choice of law.

confiscation directed against itself."[129]

b. Cuba

In the wake of Castro's victory, American banks found their Cuban branches expropriated.[130] The twin cases of *Garcia*[131] and *Perez*[132] demonstrate the degree of latitude given to courts in examining depositors' rights in the wake of a branch expropriation. In *Garcia*, the plaintiff and her husband were concerned with securing their money in the face of the Cuban Revolution. Garcia approached the Vedado (Cuban) branch of Chase Manhattan Bank (Chase). Accounts were opened under the expressly stated desire to secure the money in the midst of a revolution.[133] Chase agreed to payment in U.S. dollars in New York, or at any other Chase branch. In return for their deposits, Garcia and her husband received two non-negotiable certificates of deposit (CDs).[134]

Chase's Cuban branches were subsequently nationalized, with the National Bank of Cuba, Banco Nacional de Cuba, assuming the assets and liabilities of the expropriated branches. Banco Nacional de Cuba notified Chase that the Garcia "account" was closed and demanded payment of monies equal to the value of the CDs. Chase paid the requested monies. Garcia's husband subsequently sought to redeem the matured CDs, to which Chase responded that all inquiries should be tendered to the Banco Nacional de Cuba.[135]

Chase's argument was based on the language in the CDs which allowed repayment at any Chase office. Chase argued that the debt to Garcia consequently had its situs at every Chase office, including Cuba. As such, the Cuban decree demanding payment of Garcia's account affected monies which had their situs in Cuba. Thus, the act of state doctrine was applicable and the monies could be seized by the Cuban government.[136]

This argument was dismissed by the court for a variety of reasons. The payment to the Cuban government was analogized to a "run of the mill" bank robbery which was insufficient to extinguish Chase's

129. *Id.* at 168-69.

130. *See* Hannigan, *supra* note 23, at 747.

131. Garcia v. Chase Manhattan Bank, N.A., 735 F.2d 645 (2d Cir. 1984).

132. Perez v. Chase Manhattan Bank, N.A., 61 N.Y.2d 460, 463 N.E.2d 5, 474 N.Y.S.2d 689 (1984).

133. *Garcia*, 735 F.2d at 646.

134. *Id.* A certificate of deposit (CD) is "an acknowledgment by a bank of receipt of money with an engagement to repay it." U.C.C. § 3-104(2)(c) (1987). For a discussion of the role of the CD in international banking, see Smedresman & Lowenfeld, *supra* note 15, at 739-41.

135. *Garcia*, 735 F.2d at 646-48.

136. *Id.* at 648-49.

debt to Garcia.[137] "Chase's debt . . . was not extinguished merely because it was forced to pay an equivalent sum of its own money to a third party."[138] Chase's payment to the Cuban government was a voluntary "loss," for which the bank must accept liability.[139] Further support for treating Chase's payment as voluntary arises from standard banking law. "[A] bank cannot be compelled to pay a certificate of deposit issued by it, without the production and surrender of the certificate. . . . A bank acts at its peril in paying a certificate without surrender thereof and endorsement . . . ."[140]

The court further noted that it would have held Chase liable to Garcia based solely on the terms of the CD. "The purpose of the agreement between Chase and . . . Garcia was to ensure that, no matter what happened in Cuba, including seizure of the debt, Chase would still have a contractual obligation to pay the depositors upon presentation of their CDs."[141] Consequently, the terms of the contract (CD) were interpreted to remove the situs of Chase's debt to Garcia out of Cuba, thus rendering the debt immune from the actions of the Cuban government.[142]

In contrast, *Perez*, a case with nearly identical facts to *Garcia*, and decided by the New York Court of Appeals within two days of *Garcia*, reached the opposite conclusion.[143] The *Perez* court held, as did the *Garcia* court, that the CD was redeemable at any Chase branch.[144] The *Perez* court differed, however, in its view of the consequences of this fact:

> While the debt contemplated alternate places of payment and thus had multiple situs, because it constituted but a single obligation to pay, payment at one of the places chosen for performance extinguished the debt at all of its situses. . . . Chase's debt to [Perez] was satisfied by payment to the Cuban government in response to its confiscation of [Perez's] accounts, and at that point the debt, wherever else it had been payable, was extinguished.[145]

Perez is factually distinguishable from *Sokoloff*[146] and *Vishipco*.[147]

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137. *Id.* at 649.

138. *Id.*

139. *See* Trinh v. Citibank, N.A., 850 F.2d 1164, 1172 (6th Cir. 1988), *cert. denied*, 110 S. Ct. 2602 (1990).

140. *Garcia*, 735 F.2d at 649 (quoting 5B MICHIE ON BANKS AND BANKING, § 326a, at 317-18 (1983)).

141. *Id.* at 650.

142. *Id.* at 651.

143. Smedresman & Lowenfeld, *supra* note 15, at 776-78.

144. *Perez*, 61 N.Y.2d at 469-70, 463 N.E.2d at 9, 474 N.Y.S.2d at 693. *Cf.* *Garcia*, 735 F.2d at 649.

145. *Perez*, 61 N.Y.2d at 470, 463 N.E.2d at 9, 474 N.Y.S.2d at 693.

146. Sokoloff v. National City Bank, 250 N.Y. 69, 164 N.E. 745 (1928); Sokoloff v.

In both *Sokoloff* and *Vishipco*, the revolutionary government had nationalized the foreign branch before confiscating the accounts in question. In *Perez*, the order confiscating the account preceded the nationalization of Chase's Cuban branches.[148] This distinction was crucial in the court's decision. "For purposes of the Act of State doctrine, a debt is located within a foreign State when that State has the power to enforce or collect it."[149] This rule of law, coupled with the holding in *Harris v. Balk*,[150] that "the power to enforce or collect a debt has been dependent on the presence of the debtor,"[151] led the *Perez* court to the conclusion that a taking had been affected by the government of Cuba. The requirements of the act of state doctrine were satisfied because the taking occurred within the territory of Cuba. Accordingly, the taking was immune to American judicial review.[152]

Perez may reflect the effort by states to limit the liability of American parent banks since the federal courts do not provide a similar shield.[153] Although the New York Court of Appeals acknowledged the contemporaneous *Garcia* decision, it failed to adequately rebut the rationale of the *Garcia* court.[154] The *Perez* court also failed to address the implicit contractual terms utilized in *Garcia*, which were designed to protect depositors by allowing payment in New York.

The scheme for determining the applicability of the act of state doctrine with regard to debt situs rules proffered by the *Perez* court would create a regime ready to wreak havoc. By focusing solely on the presence of the debtor to determine debt situs, any bank account could be seized wherever a bank maintains a branch.

> This is apparently the first case in which the rule has been applied to the Act of State doctrine in such a way as to expose deposits made in an American bank, payable in United States currency at any of its branches worldwide, to confiscation by any country in which the bank maintains a branch office.[155]

The dissent in *Perez* advanced the use of a "jurisdiction over the

National City Bank, 239 N.Y. 158, 145 N.E. 917 (1924). *See supra* notes 120-27 and accompanying text.

147. Vishipco Line v. Chase Manhattan Bank, N.A., 660 F.2d 854 (2d Cir. 1981), *cert. denied*, 459 U.S. 976 (1982).

148. *Perez*, 61 N.Y.2d at 472, 463 N.E.2d at 10, 474 N.Y.S.2d at 692.

149. *Id.* at 469, 463 N.E.2d at 8, 474 N.Y.S.2d at 692.

150. 198 U.S. 215 (1905), *rev'd on other grounds*, *Shaffer v. Heitner*, 433 U.S. 186 (1977).

151. *Id.* at 222-23.

152. *Perez*, 61 N.Y.2d at 469, 463 N.E.2d at 8, 474 N.Y.S.2d at 692.

153. New York and Michigan have both enacted statutes which attempt to limit the liability of American parent banks for foreign branch deposits. Hannigan, *supra* note 23, at 751-52 (citing MICH. COMP. LAWS § 487.466 (1979); N.Y. BANKING LAW § 138 (McKinney 1971)).

154. *Perez*, 61 N.Y.2d at 477, 463 N.E.2d at 13, 474 N.Y.S.2d at 697 (Wachtler, J., dissenting).

155. *Id.* at 478, 463 N.E.2d at 13, 474 N.Y.S.2d at 697 (Wachtler, J., dissenting).

creditor" approach to resolving the question of debt situs.[156] The dissent viewed the seizure of assets by Cuba as the bank's loss "which it now seeks to shift to the depositor by refusing to pay the account."[157] This approach is quite similar to the "bank robber" analogy used in *Garcia*.[158] In the view of the dissent, the bank was the party which assumed the risk of revolution.

> The essence of the relationship between the parties is that the bank agreed to safeguard the depositor's money. It did so in the midst of a revolution .... The bank specifically agreed that the certificates would be redeemed at any of its branches . . . and further agreed to pay in United States currency. Even after the revolution had succeeded, the bank remained in Cuba. . . . Under these circumstances it could be said that the bank was fully aware of and accepted the risk of confiscation of its assets, and should not be permitted to refuse to honor its commitment to this depositor after her arrival in this country.[159]

c. *Vietnam*

The fall of Vietnam helped to further define the law regarding bank expropriations.[160] The two major cases arising out of Vietnamese expropriations are *Vishipco Line v. Chase Manhattan Bank, N.A.*[161] and *Trinh v. Citibank, N.A.*.[162] In both cases the Saigon branch of an American bank closed its doors when North Vietnamese occupation became imminent. The rationale by which the courts found the home office liable was likewise parallel. Both courts found the closing of the branch to be a voluntary action on the part of the bank, and thus circumvented both the separate entity doctrine and the act of state doctrine by removing the situs of the debt from Vietnam.[163] The closures were held to be voluntary despite the fact that the offices were in fact seized by the conquering North Vietnamese army within days of the closures.[164]

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156. *Id.* at 479, 463 N.E.2d at 14, 474 N.Y.S.2d at 698 (Wachtler, J., dissenting).

157. *Id.*

158. *See supra* note 137 and accompanying text.

159. *Perez*, 61 N.Y.2d at 479-80, 463 N.E.2d at 14-15, 474 N.Y.S.2d at 698-99 (Wachtler, J., dissenting).

160. Pursuant to the Paris Accords of 1973, the United States withdrew all of its forces from South Vietnam, culminating with the closure and evacuation of the United States Embassy on April 24, 1975. On April 30, 1975, the North Vietnamese Army conquered South Vietnam. *See* Smedresman & Lowenfeld, *supra* note 15, at 779.

161. 660 F.2d 854 (2d Cir. 1981), *cert. denied*, 459 U.S. 976 (1982).

162. 850 F.2d 1164 (6th Cir. 1988), *cert. denied*, 110 S. Ct. 2602 (1990).

163. *Trinh*, 850 F.2d at 1167; *Vishipco*, 660 F.2d at 862.

164. On May 1, 1975, the new government issued a directive which stated: "All . . . banks . . . together with documents, files, property and technical means of U.S. imperialism and the Saigon administration—will be confiscated and, from now on, managed by the revolutionary administration." *Vishipco*, 660 F.2d at 857. The North

Force majeure and impossibility of performance arguments were held insufficient because of the close relationship between the home and branch offices of a bank.[165] As the court in *Trinh* stated, "[T]he closing of a bank by revolutionary forces is the type of fortuitous cause contemplated by the law of *force majeure*, we do not agree that, where a parent/branch relationship is involved, application of that doctrine requires the conclusion that the depositor is to bear the risk of loss."[166] In the view of the *Vishipco* court, the proposition that the home office would be liable for the debts of the branch was further supported by Vietnamese law which barred the creation of a locally incorporated subsidiary.[167] The *Trinh* court noted that by limiting foreign involvement to branches, "Vietnamese law sought to remove any ambiguity as to where the responsibility would ultimately lie for the liabilities of branch banks."[168]

Following a similar rationale, the *Vishipco* court held that

> [a] bank which accepts deposits at a foreign branch becomes a debtor, not a bailee, with respect to its depositors. In the event that unsettled local conditions require it to cease operations, it should [provide depositors] . . . the opportunity to withdraw their deposits or, if conditions prevent such steps, enable them to obtain payment at an alternative location.[169]

Force majeure and impossibility of performance defenses must fail because an inability to satisfy a debt at a branch office is not a bar to performance at other offices.[170]

A bank may seek to contractually limit its liability for losses resulting from branch bank expropriation. The *Vishipco* court stated that, "if the deposit contract had included an explicit waiver on the part of the depositor of any right to proceed against the home office,"[171] such a clause may be upheld. However, "to be effective, such limitation provisions must be explicit and must clearly and unmistakably inform depositors that they have no right to proceed against the home office."[172] Thus, where a contractual provision absolved the branch office from liability in the event of "government orders and 'any other cause beyond its control,' " it did not serve to absolve the

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Vietnamese even went so far as to declare that "[T]he Vietnam National Bank . . . is ready to recover former debts incurred by banks through lending and to conduct settlement of debts, deposits, savings and all other sources of capital in the economy." *Trinh*, 850 F.2d at 1166. Despite this apparent novation, the court still found liability at Citibank's home office for reasons described *infra*.

165. *Trinh*, 850 F.2d at 1170 (force majeure); *Vishipco*, 660 F.2d at 863-64 (impossibility of performance).

166. *Trinh*, 850 F.2d at 1170 (emphasis in original).

167. *Vishipco*, 660 F.2d at 863.

168. *Trinh*, 850 F.2d at 1169.

169. *Vishipco*, 660 F.2d at 864.

170. *Trinh*, 850 F.2d at 1169-70; *Vishipco*, 660 F.2d at 863-64. *See* Hannigan, *supra* note 23, at 750-51.

171. *Vishipco*, 660 F.2d at 863-64.

172. *Trinh*, 850 F.2d at 1170.

home office of liability.[173]

3. Currency Restrictions

In the hypothetical which began this comment, the Sri Lankan government prohibited the outflow of all foreign currency from the country. This represents an aspect of sovereign risk, which is different from the case of outright expropriation. In the case of expropriation, all the assets of the seized branch are taken through the exercise of sovereign action. The bank in such a case no longer maintains control over the assets to any degree. When a sovereign opts to merely restrict the outflow of currency, the foreign branch maintains the deposits but is no longer able to repay the depositor. For the depositor, the outcome is the same; the bank states that the depositor no longer has access to his deposits.

The cases examined in this section deal with sovereign restriction on repayment of a debt owed by a foreign branch. Nations faced with a weak economy have sought to maintain possession of "hard" currencies, such as the United States dollar. In order to retain local control, Eurodollar debt payments were either restricted[174] or converted at an artificial rate to the local currency.[175]

The first of these cases is *Allied Bank Int'l v. Banco Credito Agricola De Cartago*.[176] Allied was the agent bank for a syndicate of thirty-nine banks. The syndicate lent money to three Costa Rican banks "wholly owned by the Republic of Costa Rica and subject to the direct control of the Central Bank of Costa Rica."[177] Prior to the lawsuit, the Central Bank of Costa Rica issued orders suspending all external debt payments. This was followed by a Costa Rican executive decree conditioning all such payments on the express approval of the Central Bank. Such approval was again denied. The notes, which were payable in the United States, were then accelerated and Allied sued for the remaining principal and interest.[178]

The case was originally decided in favor of the defendant banks. Then, the court held that Costa Rica's actions "were fully consistent

173. *Id.* at 1169-70.

174. *See* Citibank, N.A. v. Wells Fargo Asia, Ltd., 110 S. Ct. 2034 (1990); Allied Bank Int'l v. Banco Credito Agricola De Cartago, 757 F.2d 516 (2d Cir. 1985).

175. Braka v. Bancomer, S.N.C., 762 F.2d 222 (2d Cir. 1985).

176. 757 F.2d 516 (2d Cir. 1985).

177. *Id.* at 518.

178. *Id.* at 518-19.

with the law and policy of the United States."[179] However, subsequent intervention by the United States government which argued against such construction caused the court to vacate its prior opinion.[180] The court then determined that the applicability of the act of state doctrine was the deciding factor.[181] The decision hinged on the "situs of the property at the time of the purported taking."[182] The court found that since the Costa Rican banks agreed to pay in United States dollars by the terms of the promissory note, they had acceded to the jurisdiction of a United States court. Accordingly, "Costa Rica could not wholly extinguish the Costa Rican banks' obligation to timely pay . . . in New York. Thus the situs of the debt was not Costa Rica."[183] Since the situs of the debt was contracted out of Costa Rica, the act of state doctrine was not applicable and no sovereign action by Costa Rica could affect it.[184]

The 1985 case *Braka v. Bancomer*[185] also illustrates the use of currency restrictions. The plaintiffs in *Braka* were United States citizens who purchased certificates of deposit (CDs) from the defendant bank, Bancomer. Prior to the date of maturation of the CDs, the Mexican government "banned the use of foreign currency as legal tender" and "requir[ed] that all domestic obligations be performed by delivery of an equivalent amount in pesos."[186] Subsequent decrees nationalized Bancomer bank and established a proscribed exchange rate at approximately half the actual market rate. The plaintiffs consequently sued to recover damages based on breach of contract.[187]

In *Braka*, the court held the act of state doctrine applicable.[188] In contrast to *Allied*, the situs of the debt in this case was found to be in Mexico. "The CDs named Mexico City as the place of deposit and of payment of interest and principal. Although some of the CDs were dollar-denominated, [Bancomer] never agreed to pay them in any location other than Mexico."[189] The fact that Bancomer had on occasion accepted deposits through its New York agency had no bearing

179. *Id.* at 519.

180. *Id.* at 519-20.

181. *Id.* at 520.

182. *Id.* at 521.

183. *Id.*

184. *Id.* at 522.

185. 762 F.2d 222 (2d Cir. 1985).

186. *Id.* at 223.

187. *Id.*

188. *Id.*

189. *Id.* at 224. *See also* Callejo v. Bancomer, S.A, 764 F.2d 1101 (5th Cir. 1985). Deposits were made through an account held in Laredo, Texas, by Bancomer. The court held the situs to be in Mexico, however, and therefore, the act of state doctrine applied to bar liability. *Id.* at 1125.

on the determination of debt situs.[190]

Despite the court's determination that the act of state doctrine applied in this case, plaintiffs sought to place liability with Bancomer. Plaintiffs' argument was based on an exception to the act of state doctrine, which provides that when a foreign government is engaged in a purely commercial activity, its actions may not fall within the purview of the act of state doctrine.[191] The court rejected this contention on the basis of the facts and theory. "This action, taken by the Mexican government for the purpose of saving its national economy from the brink of monetary disaster, surely represents the 'exercise [of] powers peculiar to sovereigns.' "[192] In addition, "Bancomer ha[d] already paid plaintiffs all that it may under Mexican law."[193]

In *Allied* and *Braka*, the determining factor was court interpretation of the terms of a contract, whether implied or express. In the case of a CD, there is generally a physical contract. The parties may negotiate terms and banks may include the language necessary to protect them from "sovereign risk."[194] The same is generally true of a demand account, although the depositor may be in a weaker negotiating position. The difficulty arises in the case of interbank transfers. Such transactions have historically been accomplished by telex. Thus, the contractual terms are typically minimal.[195] It is in this situation, with two sophisticated innocent parties, that the court must determine which party bears "sovereign risk."

In the 1990 case of *Citibank, N.A. v. Wells Fargo Asia, Ltd.*[196] (WFAL), this question of who bears sovereign risk was posed to the United States Supreme Court. A Wells Fargo Bank subsidiary in Singapore made two term loans to Citibank's Manila branch office.[197] The deposit contract was oral with minimal written acknowledgment.[198] Subsequently, prior to the maturation of the loans, the Phil-

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190. Bancomer's New York office could be likened to the American shell or representative office. *Id.* at 225 (quoting *Dunhill*, 425 U.S. at 704).

191. *Braka*, 762 F.2d at 225. *See also Dunhill*, 425 U.S. 696-706.

192. *Braka*, 762 F.2d at 225.

193. *Id.*

194. *See supra* note 12 (definition of sovereign risk).

195. *See supra* note 100 and accompanying text.

196. 110 S. Ct. 2034 (1990).

197. Of the approximately fifty institutions which had lent money to Citibank Manila only WFAL opted to litigate Citibank's inability to repay the principle due on its debt. Smedresman & Lowenfeld, *supra* note 15, at 763-64.

198. The written terms of the contract between WFAL and Citibank Manila were essentially as follows:

From the broker to both WFAL and Citibank:

ippine government issued a decree prohibiting the repayment of principal on all foreign loans without prior approval from the Philippine central bank.[199] Citibank Manila consequently did not repay its debt to WFAL upon maturation. After WFAL filed suit, Citibank Manila received permission to use non-Philippine based assets to repay its loan and repaid almost half of its debt.[200] Both the district court and the court of appeals found in favor of WFAL, however, the United States Supreme Court vacated the decision of the Seventh Circuit Court of Appeals and remanded the case to that court.[201]

The question presented in *Citibank* was "whether the home office of a United States bank is obligated to use its general assets to repay a Eurodollar deposit made at one of its foreign branches, after the foreign country's government has prohibited the branch from making repayment out of its own assets."[202] The Court noted a two-tier approach to this issue. First, a court must look for explicit contractual terms allocating sovereign risk.[203] This task was made simpler by the Supreme Court's apparent approval of the district court's definition of "repayment" and "collection." Repayment was defined as "referring to the location where the . . . [actual] repayment at maturity [is] to occur."[204] Collection was defined as "refer[ring] to the place or places where [the depositor is] entitled to look for satisfaction of its deposits in the event that [the debtor branch] should fail to make the required [payment] at the place of repayment."[205] Second, in the ab-

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" 'Pay: Citibank, N.A. New York Account Manila' "

" 'Repay: Wells Fargo International, New York Account Wells Fargo Asia Ltd., Singapore Account #003-023645.' " *Citibank*, 110 S. Ct. at 2037.

From the broker to WFAL:

" 'Settlement - Citibank NA NYC AC Manila' "

" 'Repayment - Wells Fargo Bk Intl NYC Ac Wells Fargo Asia Ltd Sgp No 003-023645.' " *Id.*

From WFAL to Citibank Manila:

" 'We shall instruct Wells Fargo Bk Int'l New York our correspondent please pay to our a/c with Wells Fargo Bk Int'l New York to pay to Citibank NA customer's correspondent USD 1,000,000.' " *Id.*

From Citibank Manila to WFAL:

" 'Please remit US Dlr 1,000,000 to our account with Citibank New York. At maturity we remit US Dlr 1,049,444.44 to your account with Wells Fargo Bank Intl Corp NY through Citibank New York.' " *Id.*

199. *Id.* at 2038. The Philippine government's Memorandum to Authorized Agent Banks (MAAB 47) provided:

"Any remittance of foreign exchange for repayment of principal on all foreign obligations due to foreign banks and/or financial institutions, irrespective of maturity, shall be submitted to the Central Bank . . . for prior approval."

Id.

200. *Citibank*, 110 S. Ct. at 2038.

201. *Id.* at 2042.

202. *Id.* at 2036.

203. *Id.* at 2041.

204. *Id.* at 2038.

205. *Id.*

sence of an explicit allocation of sovereign risk, the court must imply such a term and impute liability to one of the parties.[206] Since the terms of the loan agreement in *Citibank* only covered repayment, the implied collection site was at issue.

This question provided the Supreme Court with the opportunity to decide where sovereign risk would lie, absent an express allocation by contract. It declined to do so. Instead, the Court found the law to be unsettled.[207] Philippine law was not proved, and the law of New York, based largely on the divergence of the *Garcia*[208] and *Perez*[209] holdings, was found to be undecided.[210] As to establishing a federal common law standard, the Court found "it premature to consider . . . the necessity for any rule of federal common law, or the preemptive effect of federal statutes and regulations on bank deposits and reserves."[211]

III. CONCLUSION

The issue of allocation of sovereign risk is undecided. Courts generally find the home office is liable for the debts of its branches, although no generally applicable rule has been established. This result is accomplished despite the apparent legislative intent to maintain a distinction between assets which are payable domestically and abroad.[212]

Courts have adopted several theories to establish the liability of the home office. All seem to be based on a conception of the bank as the guardian of its deposits. From Justice Cardozo's first articulation in *Sokoloff*: "He paid his money . . . on the security of all its assets, here as well as elsewhere,"[213] through *Garcia*[214] and the Vietnamese cases,[215] the courts have placed the role of protector upon the bank. While the case of interbank lending may alter the scenario, the main policy concern is that debts be repaid.[216] The burden is not a great

206. *Id.* at 2041.
207. *Id.*
208. Garcia v. Chase Manhattan Bank, N.A., 735 F.2d 645 (2d Cir. 1984).
209. Perez v. Chase Manhattan, N.A., 61 N.Y.2d 460, 463 N.E.2d 5, 474 N.Y.S.2d 689 (1984).
210. *Citibank*, 110 U.S. at 2042.
211. *Id.*
212. *See supra* notes 95-118.
213. Sokoloff v. National City Bank, 239 N.Y. 158, 167 (1924).
214. Garcia v. Chase Manhattan Bank, N.A., 735 F.2d 645 (2d Cir. 1984).
215. *See supra* notes 159-72 and accompanying text.
216. *See* Allied Bank Int'l v. Banco Credito Agricola De Cartago, 757 F.2d 516, 519 (2d Cir. 1985).

one to place on American banks. Despite the possibility of future debt repayment moratoriums, as were found in *Allied*,[217] *Braka*,[218] and *Citibank*,[219] banks may protect themselves. While the Supreme Court has avoided deciding the basic issue of assumption of sovereign risk, it has provided for a possible means of allocating such risk contractually.[220] Due to the deference given to a party's right to contract, the simple inclusion of a contractual term such as, "collection is limited solely to the borrowing branch office, collection may not be obtained through any other office of this bank, including the home office," may serve to protect the home office from liability. Such terms are brief enough to be included in a telex without much difficulty. In addition, banks may utilize the more modern convenience of a telefax machine to allow for the inclusion of more contractual terms in interbank transactions. Banks may further protect themselves by operating through locally incorporated subsidiaries, where allowed, as opposed to branches. The American bank is viewed as the protector of its depositors. If a bank does not wish to live up to this heritage, it should clearly warn its potential depositors.

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217. *Id.*
218. Braka v. Bancomer, S.N.C., 762 F.2d 222 (2d Cir. 1985).
219. Citibank, N.A. v. Wells Fargo Asia, Ltd., 110 S. Ct. 2034 (1990).
220. *See supra* notes 172-74 and accompanying text.