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Recent Decisions

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RECENT DECISIONS

ARBITRATION—TRANSNATIONAL ANTITRUST CLAIMS ARE NONARBITRABLE UNDER THE FEDERAL ARBITRATION ACT AND ARTICLE II(1) OF THE CONVENTION ON THE RECOGNITION AND ENFORCEMENT OF FOREIGN ARBITRAL AWARDS— *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 723 F.2d 155 (1st Cir. 1983), *cert. granted,* 105 S. Ct. 291 (1984).

I. FACTS AND HOLDING

Plaintiff, a Japanese automaker,[1] brought suit in federal court[2] against one of its Puerto Rican distributors[3] to recover damages for alleged breaches of a sales contract.[4] Plaintiff petitioned to

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1. Mitsubishi Motors Corp. (Mitsubishi), a Japanese corporation with its principal place of business in Japan, was formed in 1970 when Mitsubishi Heavy Industries, Inc. and Chrysler International, S.A., a Swiss corporation and wholly owned subsidiary of the United States Chrysler Corporation, entered into a joint venture. Pursuant to the joint venture agreement, Chrysler dealers such as Soler sold Mitsubishi vehicles in certain territories outside the continental United States. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 723 F.2d 155, 157 (1st Cir. 1983), *cert. granted,* 105 S. Ct. 291 (1984).

2. Plaintiff originally had filed suit in the United States District Court for the District of Puerto Rico. *Id.* at 155.

3. The defendant is Soler Chrysler-Plymouth, Inc. (Soler), a Puerto Rican corporation with its principal place of business in Puerto Rico. Soler became a franchised Chrysler-Mitsubishi dealer in 1979, when it entered into a distribution agreement with Chrysler. Soler had also signed a separate "sales procedure agreement" with both Chrysler and Mitsubishi that contained the disputed arbitration clause. *Id.*

4. In 1981 Soler's inability to meet its minimum sales commitments caused its inventory to accumulate and threatened its finances. *Id.* Chrysler and Mitsubishi refused to allow Soler to alleviate the problem by "transshipping" automobiles to Central and South America and the continental United States. *Id.* Mitsubishi discontinued further automobile shipments to Soler because of Soler's financial condition. The decision forced Mitsubishi to store in Japan 966 vehicles for which Soler denied liability. *Id.* Mitsubishi's claims in federal district court included nonpayment for the stored vehicles, nonpayment of contractual storage penalties, damage to its warranties and goodwill, expiration of

compel arbitration[5] of its claims pursuant to a clause in the sales contract that provided for arbitration of all disputes arising out of certain paragraphs in the agreement.[6] Defendant denied any breach of contract and counterclaimed, alleging violations of the Puerto Rican Dealers Act,[7] the Sherman Act,[8] the Federal Dealers Day in Court Act,[9] and the Puerto Rican Antitrust Law.[10] The district court ruled that these issues fell within the scope of a valid arbitration clause and ordered arbitration of all claims and counterclaims.[11] The court relied on *Scherk v. Alberto-Culver*[12] as authority for compelling arbitration of disputed terms of an international contract when the issues might be nonarbitrable for reasons of public policy under United States case law. On appeal to the United States Court of Appeals for the First Circuit, *reversed in part and remanded. Held:* Neither United States accession to a treaty encouraging arbitration nor the Supreme Court's holding in *Scherk* precludes extending the United States policy prohibiting arbitration of antitrust issues to claims subject to a valid transnational arbitration agreement.[13]

Soler's distributorship, and other breaches of the sales contract. *Id.*

5. Mitsubishi contended that its claims were arbitrable under the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, Dec. 29, 1970, 21 U.S.T. 2517, T.I.A.S. No. 6997, 330 U.N.T.S. 38 [hereinafter cited as Convention], and its implementing legislation, Chapter 2 of the Federal Arbitration Act, 9 U.S.C. §§ 201-208 (1982). 723 F.2d at 157.

6. The arbitration clause at issue appeared in paragraph VI of the sales procedure agreements signed with both Chrysler and Mitsubishi. It provided that "[a]ll disputes, controversies or differences which may arise between [Mitsubishi and Soler] out of or in relation to Articles I-B through V of [the sales procedure agreement] or for any breach thereof, shall be finally settled by arbitration in Japan in accordance with the rules and regulations of the Japan Commercial Arbitration Association." 723 F.2d at 157 (alterations in original).

7. P.R. LAWS ANN. tit. 10, §§ 278-278d (1976 & 1982 Supp.).

8. 15 U.S.C. §§ 1-31 (1982).

9. 15 U.S.C. §§ 1221-1225 (1982).

10. P.R. LAWS ANN. tit. 10 §§ 257-276 (1976 & 1982 Supp.).

11. The court entered partial final judgment under FED. R. CIV. P. 54(b), but retained jurisdiction over certain other counterclaims that it considered to lie outside the scope of the arbitration clause. 723 F.2d at 158.

12. 417 U.S. 506 (1974).

13. Both parties filed petitions for certiorari with the United States Supreme Court, 52 U.S.L.W. 3737 (U.S. April 10, 1984) (No. 83-1569) (petition by Mitsubishi); 52 U.S.L.W. 3829 (U.S. May 15, 1984) (No. 83-1733) (cross petition by Soler), and the Court has agreed to hear arguments in the case. 105 S. Ct. at 291. The Solicitor General also has filed a brief as amicus curiae. *See* Brief for

II. Legal Background

A. Policy of the Convention

Since Congress enacted the Federal Arbitration Act in 1925,[14] United States courts have endorsed a domestic policy encouraging arbitration of commercial disputes as an alternative to litigation. Arbitration provides litigants with a more flexible method to resolve commercial disputes. It can be informal, quick, private, comparatively inexpensive, and can be held in a location convenient to both parties.[15] When contracting internationally, businesses can utilize arbitration to minimize some of the problems inherent in transnational litigation: forum shopping, concurrent jurisdiction, limited access to pretrial discovery, difficulty obtaining enforcement of foreign judgments, and the obstacles presented by the act of state and sovereign immunity defenses.[16] Although initially the United States was reluctant to support transnational arbitration,[17] in 1970 it responded to the increased use of arbitration clauses in transnational commercial agreements[18] by acceding to the United Nations Convention on the

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the United States as Amicus Curiae, Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc. (July 1984) (U.S. Nos. 83-1569, 83-1733). On January 7, 1985, the Court granted permission to the International Chamber of Commerce and the American Arbitration Association to file briefs as amici curiae. 105 S. Ct. at 772.

14. Act of Feb. 12, 1925, ch. 213, 4 Stat. 883 (codified as amended at 9 U.S.C. §§ 1-14 (1982)). The statute grants to United States courts the power to enforce specifically domestic arbitral agreements, to stay litigation pending the outcome of arbitration, and to confirm arbitral awards.

15. P. Ehrenhaft, *Effective International Commercial Arbitration,* 9 Law & Pol'y in Int'l Bus. 1191, 1194 (1977).

16. Perlman & Nelson, *New Approaches to the Resolution of International Commercial Disputes,* 17 Int'l Law. 215, 218-25 (1983). The authors also point out the disadvantages of arbitration, *id.* at 225-29, and suggest alternate methods for resolving transnational commercial disputes, *id.* at 231-36.

17. United States courts previously upheld the English common law rule established in Kill v. Hollister, 1 Wils. 129, 95 Eng. Rep. 532 (K.B. 1746), that an extrajudicial attempt to solve disputes "ousts" the courts of jurisdiction, and therefore is irrevocable anytime before determination of the arbitral award. The Fifth Circuit followed the common law rule in Carbon Black Export, Inc. v. The S.S. Monrosa, 254 F.2d 297, 300-01 (5th Cir. 1958), *cert. dismissed,* 359 U.S. 180 (1959), but the Supreme Court subsequently rejected the common law in The Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 15 (1972) (a contractual choice-of-forum clause would be enforced specifically unless enforcement would contravene a strong public policy of the forum).

18. For example, the number of cases registered for arbitration before the

Recognition and Enforcement of Foreign Arbitral Awards (Convention).[19] The accession established the current United States policy encouraging the use of transnational arbitration agreements and prohibiting restrictive judicial interpretations that might undermine the goals of the treaty.[20]

The Convention contains two particularly significant exceptions to its central tenet encouraging the recognition and enforcement of transnational arbitration agreements. Article II(1) requires the courts of a contracting state to recognize an arbitration agreement that "concern[s] a subject matter capable of settlement by arbitration."[21] Article II(3) requires a court to refer to arbitration any dispute subject to a recognized arbitration agreement unless the court determines that the agreement is "null and void, inoperative or incapable of being performed."[22] The battle over the scope

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International Chamber of Commerce (ICC) in Paris grew from approximately 50 cases in 1958 to approximately 400 cases in 1982. Glossner, *International Commercial Arbitration,* INT'L BUS. LAW., Nov. 1983, at 9, 10.

19. *See* Convention, *supra* note 5. The Convention provides for the recognition of transnational arbitration agreements and the recognition and enforcement of foreign arbitral awards. It was adopted by the United Nations Conference on International Commercial Arbitration, which convened in New York between May 20 and June 10, 1958, at the request of the ICC. The United States acceded to the Convention in 1970 with the implementation of Chapter 2 of the Federal Arbitration Act, Act of July 31, 1970. Pub. L. 91-368, 84 Stat. 692 (codified at 9 U.S.C. §§ 201-208 (1982)). To date, more than sixty nations have signed the treaty. The United States also is a party to a number of bilateral Treaties of Friendship, Commerce and Navigation (FCN) that provide for arbitration of transnational claims. *See, e.g.,* Treaty of Friendship, Commerce and Navigation, Aug. 3, 1951, United States-Greece, 5 U.S.T. 1829, T.I.A.S. No. 3057.

20. Harnik, *Recognition and Enforcement of Foreign Arbitral Awards,* 31 AM. J. COMP. L. 703, 704 (1983).

21. Convention, *supra* note 5, art. II, para. 1. Article II(1) states in full:

> Each Contracting State shall recognize an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration.

Id. The United States has limited the scope of article II(1) by adopting the reservation in article I that the Convention applies only to arbitration agreements "arising out of legal relationships . . . which are considered as commercial." *See id.* art. I, para. 3.

22. *Id.* art. II, para. 3. Article II(3) states in full:

> The court of the Contracting State, when seized of an action in a matter in respect of which the parties have made an agreement within the meaning

of claims recognized as nonarbitrable by the Convention has been fought with reference to the language in article II(3), the so-called public policy exception.[23] Traditionally, the exception has been construed narrowly to preserve and promote the policy considerations underlying the treaty.[24] One oft-quoted standard for an article II(3) defense, as set forth in *Parsons & Whittemore Overseas Co. v. Societe Generale de L'Industrie du Papier*,[25] requires a party seeking to escape arbitration to prove that "enforcement [of the agreement or award] would violate the forum state's most basic notions of morality and justice."[26] Other United States courts have construed the public policy defense even more narrowly to apply only to those agreements in which the underlying performance is illegal[27] or voidable under internationally recognized con-

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of this article, shall, at the request of one of the parties, refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed.

Id. art. II, para. 3. Similarly, article V(2) allows a court of any signatory nation to refuse recognition and enforcement of an arbitral award if: "(a) [t]he subject matter of the difference is not capable of settlement by arbitration under the law of that country; or (b) [t]he recognition or enforcement of the award would be contrary to the public policy of that country." *Id.* art. V, para. 2(a)-(b).

23. *See supra* note 22.

24. Of approximately 100 internationally reported cases governed by the Convention, courts have refused enforcement for public policy reasons only three or four times. Harnik, *supra* note 20, at 704.

25. 508 F.2d 969 (2d Cir. 1974).

26. *Id.* at 974. In *Parsons & Whittemore*, a United States construction company had terminated the contracted work upon a break in United States-Egyptian diplomatic relations. The company argued that the court should not enforce an arbitration award assessed against it because performance of the contract would defy national policy. The court rejected the argument, stating that "national policy" is not synonymous with "public policy" and does not lie within the narrow scope of the defense. *Id.*

The Second Circuit subsequently repeated the language in Fotochrome, Inc. v. Copal Co., 517 F.2d 512, 516 (2d Cir. 1975), emphasizing that an expansive construction of the public policy defense would undermine the ultimate goal of the Convention—to encourage arbitration. *Id.*

27. In Antco Shipping Co. v. Sidermar S.p.A., 417 F. Supp. 207 (S.D.N.Y. 1976), *aff'd in open court*, 553 F.2d 93 (2d Cir. 1977), the court required proof that "the essence of the obligation or remedy is prohibited by a pertinent statute or other declaration of public policy." 417 F. Supp. at 215. Because the plaintiff had not met this burden by arguing that the affreightment contract between the two parties merely contravened United States and New York State public policy, the court enforced the disputed arbitration agreement. *Id.* at 217.

tract principles.[28] Case law recognizes that local public interest, however strong, may not be the measure for interpreting the Convention. Instead, courts have circumscribed the public policy defense to affirm United States support for a supranational construction of the Convention's terms, as was contemplated by its framers, and to ensure that the defense will not be used as a parochial device to discourage transnational arbitration.[29]

Judicial attempts to limit the scope of the public policy defense seem to have overshadowed any attempt to analyze the "capable of settlement" requirement in article II(1).[30] United States courts have limited their inquiry regarding the arbitrability of a claim to determining whether that claim falls within the scope of a valid

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28. In Ledee v. Ceramiche Ragno, 684 F.2d 184 (1st Cir. 1982), the court held that the public policy defense applied only to "those situations—such as fraud, mistake, duress, and waiver—that can be applied neutrally on an international scale." *Id.* at 187; *see also* I.T.A.D. Assoc., v. Podar Bros., 636 F.2d 75, 77 (4th Cir. 1981) ("our interpretation of the Article II(3) proviso must not only observe the strong policy favoring arbitration, but must also foster the adoption of standards which can be uniformly applied on an international scale"). In *Ledee*, the First Circuit not only defined the limits of a public policy defense, it also presented a method of analysis that a court should use to determine whether to refer a dispute to arbitration. Under its test, a court must ask four preliminary questions:

> (1) Is there an agreement in writing to arbitrate the subject of the dispute?
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> (2) Does the agreement provide for arbitration in the territory of a signatory of the Convention?
>
> (3) Does the agreement arise out of a legal relationship, whether contractual or not, which is considered as commercial?
>
> (4) Is a party to the agreement not an American citizen, or does the commercial relationship have some reasonable relation with one or more foreign states?

684 F.2d at 186-87. If a court answers these questions in the affirmative, it must order arbitration, subject only to the presentation of a valid public policy defense. *Id.* at 187.

29. *Parsons & Whittemore*, 508 F.2d at 974; *see also Podar Bros.*, 636 F.2d at 77.

30. *See supra* note 21. Although United States courts have refrained from interpreting article II(1), the Department of State did set forth its interpretation of the provision in a memorandum written at the time the treaty was submitted to the Senate: "[T]he requirement that the agreement apply to a matter capable of settlement by arbitration is necessary in order to take proper account of laws in force in many countries which prohibit the submission of certain questions to arbitration." S. EXEC. DOC. E., 90th Cong., 2d Sess. 19 (1968).

arbitration clause.[31] The reluctance to rely on article II(1) may stem from its ambiguity.[32] The drafters hesitated to include article II(1) in the text of the treaty for fear that the language could be manipulated by a court of a contracting state to nullify an arbitration clause, thereby controverting the goal of the Convention.[33] At least two European courts, however, have held that a

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31. *See, e.g.,* Siderius, Inc. v. Compania de Acero del Pacifico, 453 F. Supp. 22, 24 (S.D.N.Y. 1978); *see also supra* note 28 (discussing *Ledee,* 684 F.2d 184).

32. *See, e.g.,* Aksen, *American Arbitration Accession Arrives in the Age of Aquarius: United States Implements United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards,* 3 SW. U.L. REV. 1, 8 (1971) (article II(1) is "one of the most troublesome provisions of the entire Convention"); McMahon, *Implementation of the United Nations Convention on Foreign Arbitral Awards in the United States,* 2 J. MAR. L. & COM. 735, 753 n.83 (1971) (the language of article II(1) is so ambiguous that it raises doubts about the provision's effectiveness); Mirabito, *The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards: The First Four Years,* 5 GA. J. INT'L & COMP. L. 471, 489 (1975) (article II(1) is "somewhat weak" in achieving its purpose); Quigley, *Accession by the United States to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards,* 70 YALE L. J. 1049, 1064 (1961) (article II(1) diminishes predictable results under the Convention). One of the major ambiguities apparent in article II(1) is that it fails to state what law governs the issue of arbitrability. A number of commentators have examined the problem. Quigley, for example, suggests:

> Presumably, this determination is to be made upon the basis of the law to which the parties have subjected their agreement [the law applied by the arbitral tribunal]. Failing such a designation, arbitrability might be decided by the law of the State where the agreement was signed, where the dispute arose or where the agreement is sought to be enforced.

Id. at 1064. Quigley predicts, however, that "courts of the State where recognition of the agreement is sought will adopt a similar standard [to that set forth in art. V(2)(a) governing arbitral awards] of judging the arbitrability of the dispute under the law of the forum." *Id.* at 1064 n.70; *see also* McMahon, *supra,* at 757. Application of the law of the forum has gained judicial support as well. *See, e.g.,* Becker Autoradio U.S.A., Inc., v. Becker Autoradiowerk GmbH, 585 F.2d 39, 43 (3d Cir. 1978); Rhone Mediterranee Compagnia Francese v. Lauro, 555 F. Supp. 481, 485 (D.V.I. 1982), *aff'd* 712 F.2d 50 (3d Cir. 1983). One commentator, however, argues that arbitrability should be governed by the law chosen by the contracting parties. *See* van Roven Springer, *The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards,* 3 INT'L LAW. 320, 324 (1969). Another commentator suggests that arbitrability should be decided by the arbitrator. *See* Aksen, *supra,* at 9.

33. Sweden introduced article II(1) at the Conference to ensure that the treaty covered the recognition of arbitration agreements as well as that of arbitral awards. In discussing the article, many delegates expressed concern that local tribunals could allow parochial interests to override the larger goals of the

claim falling within the scope of a valid arbitration agreement should not be referred to arbitration if the issue is legally nonarbitrable under the domestic laws of the contracting nation.[34] The instant decision marks the first time a United States court has applied the same analysis of article II(1) to preclude arbitration because the disputed claim was nonarbitrable under a judicially created domestic policy.

B. Domestic Antitrust Policy Prohibiting Arbitration

Concurrent with the policy to encourage arbitration of commercial disputes, United States courts observe a domestic policy established in *American Safety Equipment Corp. v. J.P. Maguire & Co.*[35] that requires judicial determination of all antitrust issues.[36] In *American Safety* the Second Circuit announced that the complex and diverse nature of antitrust claims[37] and the great public interest in proper enforcement of the antitrust laws require judicial determination of antitrust claims.[38] The antitrust laws are

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Convention and might use the provision to invalidate desirable arbitration clauses. *See* G. HAIGHT, CONVENTION ON THE RECOGNITION AND ENFORCEMENT OF FOREIGN ARBITRAL AWARDS: SUMMARY ANALYSIS OF THE RECORD OF THE UNITED NATIONS CONFERENCE, MAY/JUNE 1958, at 24-28 (1958).

34. *See* Judgment of June 28, 1979, Cour de cassation (1st Chamber), Belgium, *extract translated in* 5 Y.B. COM. ARB. 257 (1980) (Belgian law precludes arbitration of disputes arising under a Belgian law on unilateral termination of exclusive dealerships); Judgment of April 27, 1979, Corte cass., Italy, 1980 Foro It. I 190, *extract translated in* 6 Y.B. COM. ARB. 229 (1981) (Italian law precludes arbitration of labor disputes).

35. 391 F.2d 821 (2d Cir. 1968).

36. Including the Second Circuit in *American Safety* and the First Circuit in the instant decision, six circuit courts of appeals follow the policy. *See* Applied Digital Technology, Inc. v. Continental Casualty Co., 576 F.2d 116, 117 (7th Cir. 1978); Cobb v. Lewis, 488 F.2d 41, 47 (5th Cir. 1974); Helfenbein v. International Indus., Inc., 438 F.2d 1068, 1070 (8th Cir.), *cert. denied*, 404 U.S. 872 (1971); Power Replacements, Inc. v. Air Preheater Co., 426 F.2d 980, 983-84 (9th Cir. 1970). In its petition for certiorari, Mitsubishi argued that this policy constitutes an unwarranted exception to the strong national policy in favor of arbitration. *See* Mitsubishi Motors Corp., Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit, at 8-12 (U.S. No. 83-1569).

37. The Second Circuit felt that courts are better suited than commercial arbitrators to handle complicated antitrust issues because of the massive amounts of evidentiary proof generally offered. 391 F.2d at 827.

38. The court was concerned that an alternative forum might deprive a claimant of the sympathetic consideration given antitrust claims by United States courts. *Id.*

designed to protect the public by promoting a competitive economy. In *United States v. Topco Associates*[39] the Supreme Court called the Sherman Act "the Magna Carta of free enterprise" and described the antitrust laws as being "as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to our fundamental personal freedoms."[40] Antitrust violations generally affect large numbers of people; therefore, a private plaintiff claiming antitrust violations functions as a private attorney general by ensuring redress for violations that probably have affected a large segment of the market.[41] In *American Safety* the Second Circuit also identified a potential conflict of interest when businessmen, acting as arbitrators, interpret the antitrust laws. This conflict may be important because the choice of forum is often imposed upon the party with less bargaining power through the use of an adhesion contract containing an arbitration clause.[42] In 1974 *Overseas Motors, Inc. v. Import Motors Ltd.*[43] extended the policy established in *American Safety* by prohibiting collateral estoppel[44] of an arbitral tribunal's findings of fact relating to the antitrust issues before the court.[45] Although

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39. 405 U.S. 596 (1972).

40. *Id.* at 610.

41. *American Safety*, 391 F.2d at 826-27. The antitrust laws also provide successful plaintiffs with treble damages as an incentive to perform the enforcement function. Comment, *Antitrust and Arbitration in International Commerce*, 17 HARV. INT'L L.J. 110, 117 (1976).

42. 391 F.2d at 827.

43. 375 F. Supp. 499 (E.D. Mich. 1974), *aff'd*, 519 F.2d 119 (6th Cir.), *cert. denied*, 423 U.S. 987 (1975). The plaintiff, an American automobile dealer, asserted antitrust claims based generally on the allegation that its distributor was gradually "pinching off" the supply of automobiles in order to drive the plaintiff out of business. *Id.* at 507.

44. The doctrine of collateral estoppel prohibits litigation between the same parties of issues of ultimate fact already determined by a valid judgment. BLACK'S LAW DICTIONARY 237 (5th ed. 1979).

45. The plaintiff charged the defendant with restraint of trade through breach of an import contract that provided for arbitration in Swiss Court under German law. The arbitral tribunal had ruled in favor of the defendant, who argued that the court was estopped from litigating these issues. 375 F. Supp. at 507. The court noted that the existence of a conspiracy was an ultimate fact at issue in the case. Whether defendant breached the contract, on the other hand, was a mediate fact. *Id.* at 519. Ultimate facts are those essential to a right of action or matter of defense, BLACK'S LAW DICTIONARY 1365 (5th ed. 1979); mediate facts provide a point from which ultimate facts may be rationally inferred. *Id.* at 885. The court limited the effects of collateral estoppel in this case to

Overseas Motors implied that United States courts might be willing to extend *American Safety* to antitrust claims subject to transnational arbitration agreements,[46] later that year, in *Scherk v. Alberto-Culver Co.*,[47] the Supreme Court suggested otherwise.

In *Scherk*, the Court refused to extend to a transnational contract dispute a domestic policy, established twenty-one years earlier in *Wilko v. Swan*,[48] that excluded from arbitration all claims based on violations of the United States securities laws.[49] The Court did not analyze the language of the Convention to justify arbitration of the securities claims at issue.[50] Instead, it distinguished *Wilko* by noting that an arbitration provision is an "almost indispensable precondition"[51] in "truly international"[52] contracts, such as the one in *Scherk*,[53] because international contracts involve considerations and policies significantly different from those that might control in domestic cases.[54] Moreover, invalidation of a transnational arbitration agreement would con-

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mediate rather than ultimate data; it held that plaintiff was not estopped from asserting its antitrust claims. 375 F. Supp. at 521.

46. Review on appeal to the Sixth Circuit was limited to whether the lower court properly had directed a verdict in favor of the defendant. The Sixth Circuit stated, however, that the limited application of collateral estoppel did not affect its decision. *See* 519 F.2d at 123.

47. 417 U.S. 506 (1974).

48. 346 U.S. 427 (1953).

49. In *Scherk* the Court reversed the Seventh Circuit's holding that the securities claims of Alberto-Culver, a United States manufacturer, against Scherk, a German citizen, should not be dismissed even though the disputed sales contract was governed by a valid arbitration clause. The court of appeals had relied on *Wilko* as authority rendering *any* arbitration clause unenforceable against a claim based on the United States securities laws. 417 U.S. at 510.

50. A footnote added that United States accession to the Convention provided additional support for the decision. *Id.* at 520 n.15. In dissent, however, Justice Douglas applied the language of the Convention to the facts before the Court and concluded that the securities claims were nonarbitrable under article II(3) as "null and void, inoperative or incapable of being performed," and article V(2)(b) as "contrary to public policy." *Id.* at 527 & n.5 (Douglas, J., dissenting).

51. *Id.* at 516.

52. *Id.* at 515.

53. The Court emphasized that the contract at issue was more international in character than the contract in *Wilko*. *Id. Scherk* involved a United States plaintiff; a German defendant; and a contract to sell enterprises organized under the laws of Germany and Liechtenstein that was signed in Austria, but closed in Switzerland, which compelled arbitration in Paris subject to the application of Illinois law. *Id.* at 508-09.

54. *See id.* at 515-16.

stitute a parochial imposition[55] of United States laws on an international forum.[56] The Court balanced the need for certainty and predictability in international commerce against the need to protect potential investors in the securities market, and concluded that the domestic policy established in *Wilko* should not be extended to transnational securities claims.[57] The same year, the Second Circuit addressed *Scherk*'s uncertain precedential value regarding the enforcement of arbitration clauses covering antitrust claims governed by the Convention:

> Under . . . [Article II(1)], a court sitting in the United States might, for example, be expected to decline enforcement of an award involving arbitration of an antitrust claim in view of domestic arbitration cases which have held that antitrust matters are entrusted to the exclusive competence of the judiciary. . . . On the other hand, it may well be that the special considerations and policies underlying a "truly international agreement" . . . call for a narrower view of non-arbitrability in the international than the domestic context.[58]

Scherk, therefore, introduced a balancing test to apply in those unique situations in which international policy conflicts with domestic policy. It did not delineate the circumstances, however, that would compel a domestic policy to override an international policy. The instant decision is the first case to identify the appropriate circumstances by extending the domestic policy of nonarbitrability established in *American Safety* to antitrust claims subject to transnational arbitration agreements.

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55. The opinion quoted an admonition from The Bremen v. Zapata Off-Shore Co., 407 U.S. 1 (1971), warning that courts could thwart international expansion of United States business by insisting on a "parochial concept that all disputes must be resolved under our laws and in our courts. . . . We cannot have trade and commerce in world markets and international waters exclusively on our terms, governed by our laws, and resolved in our courts." 417 U.S. at 519 (quoting *Zapata*, 407 U.S. at 9).

56. The Court also distinguished *Wilko* by noting that the special standing and jurisdictional rights incorporated into the securities provision addressed in *Wilko* were not at issue under the section of the securities laws before the Court in *Scherk*, 417 U.S. at 513-14, and that *Wilko*'s proclaimed protection of a securities buyer's broad jurisdictional choices became merely "chimerical" in international situations because an opposing party can preclude access to United States courts by filing suit in a foreign jurisdiction, *id.* at 517-18.

57. *Id.* at 519-20.

58. *Parsons & Whittemore,* 508 F.2d 969, 974 (citations omitted).

III. THE INSTANT DECISION

The court of appeals initially observed that Soler's counterclaims fell clearly within the scope of a valid and enforceable arbitration agreement.[59] The court noted, however, that Soler's antitrust claims were subject both to the statutory policy favoring arbitration of international commercial disputes[60] and to the *American Safety* doctrine,[61] which excludes antitrust issues from domestic arbitration.[62] The court admitted that its conclusion would be a jurisprudential rarity, but held that under the circumstances, the judicially created domestic policy must override the strong legislative international policy.[63] The court did not consider its application of *American Safety* to an international contract to be "parochial"[64] because many nations in the international community both recognize and support the United States antitrust ethic.[65] Moreover, in light of the increasing number of transnational commercial transactions, United States antitrust law and policy would be frustrated if limited to purely domestic

59. The court rejected Soler's argument that a Puerto Rican law prohibited arbitration, holding that under these circumstances the Federal Arbitration Act preempted the Puerto Rican law. 723 F.2d at 158-59.

60. Although the agreement called for the application of Swiss law, the court determined the scope of the arbitration clause to be a matter of United States federal law, *id.* at 159 n.3, and it exercised independent judgment in reviewing defendant's individual allegations. *Id.* at 159. Any doubt concerning the scope of the clause would be settled in favor of arbitration. *Id.*

61. It reviewed the rationale set forth in *American Safety*, *see supra* notes 37-40 and accompanying text, and noted that the policy had been widely accepted among the circuits. 723 F.2d at 162-63; *see supra* note 36.

62. *Id.* at 162.

63. The court acknowledged that the question was one of first impression. At the court's request, the Department of Justice and the Legal Advisor of the Department of State filed an amicus curiae brief. In the brief, the United States argued in support of the nonarbitrability of the international antitrust claims. *Id.*

64. *See Scherk*, 407 U.S. at 515-16; *see also* notes 53-54 and accompanying text.

65. The court observed that the laws of the Federal Republic of Germany and the policies of the European Economic Community also accord significant importance to antitrust issues. 723 F.2d at 163. *But see* Johnson, *International Antitrust Litigation and Arbitration Clauses*, 3 J.L. & COM. 91, 103-04 & n.69 (1983) (citing blocking and clawback statutes limiting the extraterritorial reach of United States antitrust laws as evidence that the international community does not endorse the scope of United States antitrust policy).

commerce.[66]

The court of appeals contended that the language of the Convention[67] supported its conclusion by noting that the treaty expressly exempts from arbitration certain issues that are nonarbitrable under the law of the forum state.[68] Based on its prior holding that the public policy defense should be construed narrowly, the court summarily rejected Soler's argument that the antitrust issues were nonarbitrable under article II(3) of the Convention.[69] On the other hand, because *American Safety* suggested that antitrust issues were not legally "capable of settlement by arbitration"[70] under United States law,[71] they were held nonarbitrable under article II(1). The court reasoned that because article II(1) must have some meaning apart from that of article II(3), the drafters included article II(1) to allow contracting states to avoid recognizing arbitration agreements covering issues uniquely preserved for judicial determination under domestic law.[72]

Last, the court of appeals employed *Scherk*'s balancing test,[73] but explained the different result by distinguishing *Scherk* on two grounds. It first observed that the *Scherk* Court had not analyzed

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66. The court believed that restricting *American Safety* would limit the antitrust exception to "the most minor and insignificant of business dealings," 723 F.2d at 163, and would allow suppliers and sellers to avoid United States antitrust law altogether "by the simple expedient of co-opting some foreign or international entity into the arrangement," *id. But see* Comment, *supra* note 39, at 120 (forbidding arbitration of transnational antitrust issues would result in only a narrow exception to the general rule).

67. The court divided the provisions of the Convention into three groups: those defining which arbitration agreements shall be recognized; those defining which recognized agreements must be referred to arbitration; and those defining which arbitral awards will be enforced. 723 F.2d at 164. Only the first two categories were relevant to the instant case because no arbitral award had been granted.

68. *Id.* at 164-66.

69. *Id.* at 164 (citing Ledee v. Ceramiche Ragno, 684 F.2d 184 (1st Cir. 1982)); *see supra* note 28 and accompanying text.

70. The court interpreted "capable" to mean "legally capable" because "any matter can theoretically be arbitrated or compromised." 723 F.2d at 164.

71. *See supra* notes 37-38 and accompanying text.

72. *See* 723 F.2d at 164-65.

73. The court balanced the private party's interest in the certainty of arbitral agreements against the public's interest "in the preservation of economic order in the United States," and concluded that enforcement of the arbitration clause would be "unreasonable." *Id.* at 168.

the language of the Convention.[74] Second, it noted the essential difference between the securities laws, which protect prospective investors, and the antitrust laws, which protect the general public.[75] The court concluded that if, when applying *Scherk,* a domestic policy falls within the scope of the article II(1) defense, the balance must favor the policy over enforcement of the Convention.[76] The domestic policy established in *American Safety* extends, therefore, to antitrust claims arising from transnational commercial disputes.

IV. COMMENT

The instant decision marks the first time a court has considered whether to apply the United States domestic policy of preserving antitrust issues for judicial determination to an international contract containing a mandatory arbitration clause. The First Circuit's decision to apply domestic policy undermines the preeminent goal of the Convention,[77] which is to encourage arbitration of international commercial disputes, and diminishes the advantages traditionally associated with arbitration.[78] A policy encouraging litigants to raise minor and possibly fabricated antitrust claims will encumber an already overloaded judicial system. The party who perceives a disadvantage in prompt and certain

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74. The court also noted that the agreement in *Scherk* was more "international" than the one currently before the court. *Id.* at 167.

75. Most commentators who contend that *Scherk*'s analysis does not apply equally to antitrust claims distinguish the intended role of the private plaintiff in the two bodies of law. They argue that Congress intended the private cause of action to be the primary mechanism for enforcing the antitrust laws and maintaining competition in the national marketplace. Given the fundamental principle at stake and the magnitude of the market, the role of the private plaintiff is more crucial in antitrust enforcement. By contrast, the private cause of action in 10b-5 securities cases was judicially created, reducing the private plaintiff's enforcement function to secondary significance. *See,* Comment, *supra* note 39, at 110, 115-17 (1976); *see also* Brief for the United States as Amicus Curiae at 12 n.17, Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc. (July 1981) (U.S. Nos. 83-1569, 83-1733). *But see* Delaume, *What Is an International Contract? An American and Gallic Dilemma,* 28 INT'L & COMP. L. Q. 258, 274 (1979); Johnson, *supra* note 63, at 96.

76. The court remanded the case to the district court for a determination of whether the antitrust claims were separable from the arbitrable claims, and which, if either, should be stayed pending the outcome of the other. *Id.* at 169.

77. *See supra* note 26.

78. *See supra* text accompanying notes 15-16.

arbitration before a predetermined forum can now opt to delay the proceeding by raising a collateral antitrust claim. The court reached its conclusion by applying a dormant provision of the Convention[79] and distinguishing the precedent established by the Supreme Court in *Scherk*.[80] Its reasoning on both counts is not persuasive.

First, the court manipulated the ambiguous language in article II(1)[81] to escape the narrow judicial construction of the article II(3) public policy defense.[82] Apparently, the court felt that the antitrust claims could not pass the rigorous test for exclusion under article II(3) that was set forth in *Parsons & Whittemore* and adopted by the instant circuit in *Ledee v. Ceramiche Ragno*.[83] Instead, the court reverted to the ambiguous and seldom considered language of article II(1).[84] It presumed to apply United States law to determine the arbitrability of the claim even though the contract by its own terms was governed by Swiss law and provided for arbitration in Japan in accordance with Japanese law. Furthermore, the court subordinated the fundamental principle of a treaty to which the United States has formally acceded to a judicially created domestic policy with no statutory basis and little international support.[85]

Second, the court's distinction between *Scherk* and the circumstances of the instant decision is not of preponderate significance. Both the *Scherk* Court and the instant court faced the same basic issue—whether competing policy considerations require overriding a purely domestic rule in order to enforce the policy that governs transnational commercial agreements. To distinguish *Scherk*, the court of appeals overemphasized the difference between the antitrust laws and the securities laws. The domestic policies that exclude antitrust and securities claims from arbitration recognize the intent of *both* sets of laws to protect the United States public. Private actions under the securities laws serve to maintain the

79. *See supra* notes 30-31, 68-70 and accompanying text.

80. *See supra* notes 71-74 and accompanying text.

81. *See supra* note 32 and accompanying text.

82. *See supra* note 24-29 and accompanying text.

83. *See supra* note 28.

84. *See supra* note 32 and accompanying text. The First Circuit previously had construed article II(1) merely to require the existence of a written arbitration agreement covering the subject of dispute. *See Ledee*, 684 F.2d at 186-87.

85. *See* Johnson, *supra* note 63, at 103-04.

integrity of the securities market[86] and to protect potential investors by deterring unlawful conduct and increasing public confidence in the market. Although one might argue that private actions were intended to contribute more directly to the enforcement of antitrust laws, the distinction is not sufficiently consequential to justify a judicial rule preventing the enforcement of treaties in force in the United States. As the use of transnational arbitration agreements has grown increasingly common,[87] the particular need for their recognition and enforcement has been consistently supported by United States courts.[88] The decisions emphasize that considerations of international comity warrant overriding the domestic policies in order to preserve the integrity of treaties entered into by the United States and should outweigh any concern for the nature or content of the dispute.[89] In the absence of clear congressional guidance, it is not sound judicial practice to read parochial policies into transnational contracts,[90] especially when those policies conflict with a treaty in force and the decision relies upon a novel reading of ambiguous treaty provisions. The analysis of the instant court provides no practical limit to the number of situations in which a court of a contracting nation could preempt enforcement of the Convention through application of its own domestic policy. Rather, judicial precedent suggests that if an arbitration agreement conflicts with a well-established domestic policy, the conflict may be effectively resolved by applying the narrowly defined public policy defense.[91] Only in these rare circumstances should a United States court refuse to enforce a transnational arbitration agreement, and the instant court admits that enforcing arbitration of a transnational antitrust claim does not present such a situation.[92] If the First Circuit had employed the *Scherk* balancing test to resolve the conflict of policies in the instant case the weight would have fallen, as it did in *Scherk*, on the other end of the scale; a judi-

86. *See* 15 U.S.C. § 78b (1982) ("transactions in securities . . . are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions . . . to insure the maintenance of fair and honest markets in such transactions.").

87. *See supra* note 18.

88. *See supra* note 24 and accompanying text.

89. *See* Johnson, *supra* note 63, at 103.

90. *See supra* notes 53-54 and accompanying text.

91. *See* Aksen, *supra* note 32, at 13.

92. 723 F.2d at 164.

cially created domestic policy should not be imposed on a transnational arbitration agreement subject to a binding international convention.

Lucy C. Gratz

INTERNATIONAL BANKING—THE INTERNATIONAL BANKING ACT OF 1978 LIMITS THE STATES' ABILITY TO REGULATE FOREIGN BANK ENTRY, *Conference of State Bank Supervisors v. Conover*, 715 F.2d 604 (D.C. Cir. 1983), *cert. denied*, 104 S. Ct. 1708 (1984).

I. FACTS AND HOLDING

Plaintiffs, a conference of state officials responsible for the regulation of state-licensed banking institutions,[1] filed suit in the District Court for the District of Columbia against the Comptroller of the Currency[2] seeking declaratory and injunctive relief in a challenge to certain regulations[3] adopted by the Comptroller pursuant to the International Banking Act of 1978 (IBA).[4] Plaintiffs contended that the Comptroller had incorrectly interpreted certain provisions of the IBA to permit foreign banks to establish and operate federal branches and agencies where prohibited by state law.[5] In particular, plaintiffs alleged that the Comptroller's regulations violated the IBA in three ways: (1) by authorizing foreign banks to establish federal branches or agencies in any state unless state law prohibits *all* foreign banks from establishing state-chartered branches or agencies;[6] (2) by permitting foreign banks to establish federal interstate branches or agencies in any state unless state law prohibits *all* foreign banks from establishing state-chartered interstate branches or agencies;[7] and (3) by

1. Plaintiffs in the case were the Conference of State Bank Supervisors; Robert Abrams, Attorney General of the State of New York; Washington *ex rel.* Michael D. Edwards, State Supervisor of Banking; Illinois *ex rel.* William C. Harris, Commissioner of Banks and Trust Companies. Conference of State Bank Supervisors v. Conover, 715 F.2d 604, 605 n.1 (D.C. Cir. 1983), *cert. denied*, 104 S. Ct. 1708 (1984).

2. Defendant C. Todd Conover is the Comptroller of the Currency of the United States.

3. Plaintiffs challenged 12 C.F.R. §§ 28.2(b)-(d), 28.3-.4 (1980), and a portion of an accompanying interpretative statement, 44 Fed. Reg. 65,381-87 (1979). 715 F.2d at 605.

4. 12 U.S.C. §§ 3101-3108 (1982).

5. 715 F.2d at 605.

6. *Id.* at 607-08.

7. *Id.* at 619.

allowing federal agencies to accept foreign-source deposits.[8] Addressing the three issues of first impression, the district court dismissed plaintiffs' objections and granted summary judgment for the Comptroller.[9] The district court reasoned that because Congress passed the IBA to accord full "national treatment" to foreign banks seeking the benefits and burdens of federal control, it was proper for the Comptroller to allow the states to permit or veto the entry of foreign banks' federally chartered offices, but not to condition their entry.[10] The district court also held that the operation of a dual entry system available to foreign banks entering the United States market attested to a clear Congressional intent not to subject federal interstate offices of foreign banks to the particular entry requirements of state law.[11] Last, in light of the ambiguity of the statute prohibiting federal agencies from accepting deposits and its "confused and scant" legislative history, the district court held that the Comptroller's interpretation allowing federal agencies to accept foreign-source deposits was not unreasonable.[12] On appeal to the United States Court of Appeals for the District of Columbia Circuit, *affirmed* in part, *reversed* in part. *Held:* (1) The Comptroller may authorize the establishment of a federal branch or agency, or a federal interstate branch or agency, in a particular state unless that state prohibits all foreign banks from establishing an equivalent office pursuant to state law; but (2) a foreign bank's federally chartered agency may not accept deposits from any source.

II. LEGAL BACKGROUND

United States domestic banking operates under a system of dual regulation in which any bank may choose to be regulated by either state or federal authorities.[13] National banks are federally chartered by the Comptroller of the Currency and are largely exempt from state legislation.[14] Alternatively, a bank may operate

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8. *Id.* at 624.

9. *See* Conference of State Bank Supervisors v. Heimann, No. 80-3284, mem. op. at 15 (D.D.C. Sept. 30, 1981).

10. 715 F.2d at 611.

11. *Id.* at 622.

12. *Id.* at 625-26.

13. *See generally* Redford, *Dual Banking: A Case Study in Federalism,* 31 LAW & CONTEMP. PROBS. 749, 754-55 (1966).

14. National banks are governed primarily by the National Bank Act of

pursuant to a state charter and thus choose regulation primarily by appropriate state law. As automatic members of the Federal Reserve System,[15] national banks must comply with certain reserve requirements[16] and are required to purchase insurance from the Federal Deposit Insurance Corporation (FDIC).[17] On the other hand, state banks may choose whether to become members of the Federal Reserve and to purchase insurance from the FDIC.[18] Most state banks do purchase federal deposit insurance because the lack of the insurance is viewed as a competitive disadvantage.[19]

Prior to the enactment of the IBA there existed no comprehensive regulation of foreign banking at the federal level; therefore, foreign banks operating in the United States were forced to submit to the inconsistent regulatory systems of the individual states.[20] State regulations vary widely with respect to both the privilege and the extent of foreign bank entry.[21] Several states completely prohibit foreign bank operations within their borders. Some permit foreign banks only to establish agencies, while others permit the establishment of both branches and agencies.[22] A few states have reciprocity restrictions that condition entry on proof that the foreign bank's home country permits United States

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1874, ch. 343, 18 Stat. 123 (codified in scattered sections of titles 5, 12, 18, 19, 28 & 31 U.S.C.).

15. *See* 12 U.S.C. § 222 (1982).

16. All banks that are members of the Federal Reserve System must maintain certain reserves either as deposits at a Federal Reserve Bank or in the bank's own vaults. These reserves may not draw interest. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, THE FEDERAL RESERVE SYSTEM: PURPOSES AND FUNCTIONS 14-16 (1954).

17. 12 U.S.C. § 222. The FDIC is a creation of Congress. *See* 12 U.S.C. §§ 1811-1832.

18. 12 U.S.C. § 1815(a).

19. Scott, *The Dual Banking System: A Model of Competition in Regulation,* 30 STAN. L. REV. 1, 3 (1977).

20. Hablutzel and Lutz, *Foreign Banks in the United States After the International Banking Act of 1978: The New Dual System,* 96 BANKING L.J. 133, 133 (1979).

21. *See* Note, *The Regulation of Foreign Banking in the United States After the International Banking Act of 1978,* 65 VA. L. REV. 993, 999-1005 (1979); *see also* Rooney, *Regulation of Foreign Banking Activity in the United States,* 10 ST. MARY'S L.J. 483, 493-94 (1979).

22. One major distinction between branches and agencies is that the former are permitted to receive deposits while the latter are not. *See* Hablutzel and Lutz, *supra* note 20, at 135-36.

banks to conduct banking activities in that country.[23]

Many advocates of the IBA felt that the dual regulatory system unfairly accorded foreign banks competitive advantages unavailable to domestic banks.[24] First, foreign banks could operate across state lines[25] even though the McFadden Act[26] effectively prohibits national banks from conducting interstate operations. Second, state restrictions on interstate branching—the entry of a bank chartered in one state into another state's domestic market—did not apply to foreign banks.[27] Third, foreign banks could conduct securities operations[28] even though the Glass-Steagall Act[29] prohibits domestic banks from engaging in the securities business. Last, foreign banks were not subject to the reserve requirements of the Federal Reserve System, nor were they required to purchase FDIC insurance.[30]

The perceived regulatory inequality became increasingly important to domestic bankers as foreign bank operations in the United States increased significantly during the 1970s.[31] By early 1978, foreign banks controlled more than eight percent of United States banking assets and were processing more than twenty percent of all business loans.[32] The increase in foreign bank operations also alarmed the Federal Reserve Board, which believed that legislation affecting federal control over foreign banks was needed to ensure its ability to function effectively as the nation's central bank.[33] Congress responded to these concerns with the enactment

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23. *See* Note, *supra* note 21, at 999-1005.

24. *See generally* Hablutzel and Lutz, *supra* note 20, at 145-49; Rooney, *supra* note 21, at 494-97; Note, *The International Banking Act of 1978: Federal Regulation of Foreign Banks in the United States,* 8 GA. J. INT'L & COMP. L. 145, 156-57 (1978); Note, *supra* note 21, at 994-95.

25. *See* Hablutzel and Lutz, *supra* note 20, at 145; Comment, *The Regulation of Interstate Bank Branching Under the International Banking Act of 1978: The Stevenson Compromise,* 1 NW. J. INT'L L. & BUS. 284, 286 (1979).

26. 12 U.S.C. § 36 (1982).

27. *See* Rooney, *supra* note 21, at 495.

28. *See id.*

29. 12 U.S.C. §§ 24, 78, 377, 378a (1982).

30. *See* Hablutzel and Lutz, *supra* note 20, at 145; Comment, *supra* note 25, at 285; Note, *supra* note 21, at 995.

31. *See* S. REP. No. 1073, 95th Cong., 2d Sess. 2, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 1421, 1422; *see also* Rooney, *supra* note 21, at 483-86; Comment, *supra* note 25, at 284; Note, *supra* note 21, at 996-97.

32. Note, *supra* note 21, at 997.

33. Hablutzel and Lutz, *supra* note 20, at 145.

of the IBA,[34] which was designed to achieve a uniform national policy on foreign bank operations in the United States.[35] The dual system of regulation established by the IBA is based on "the principle of parity of treatment between foreign and domestic banks in like circumstances."[36]

Section 4 of the IBA[37] permits foreign banks to establish federal branches and agencies in any state unless: (1) the foreign bank is operating a branch or agency under license from the state; or (2) state law prohibits foreign banks from establishing branches or agencies.[38] Thus, both foreign and domestic banks now may choose their primary regulator. Section 4 also extends to federally chartered branches and agencies of foreign banks the same rights and privileges enjoyed by national banks in the same location.[39]

Section 5 of the IBA[40] was designed to eliminate the competitive advantage enjoyed by foreign banks as a result of their ability to operate across state lines.[41] Section 5 has been referred to as "the cornerstone" of the IBA[42] because it addresses what was believed to be the most controversial aspect of foreign bank operations in the United States—the ability to branch into out-of-state markets.[43] A foreign bank now is required to designate a home state[44] in which it may engage in the full range of banking activities. It then is permitted to establish branches or agencies outside of its home state in any state allowing interstate branching. The federal branches, however, are limited in the type of deposits that

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34. According to the Senate Report accompanying the bill that later became the IBA, "[t]he growth in number and size of foreign bank operations . . . has created the need for both Federal monetary policy controls and for a Federal presence in the regulation and supervision of their activities in the United States." S. REP. No. 1073, *supra* note 31, at 2, *reprinted* at 1422.

35. *Id.*

36. *Id.*

37. 12 U.S.C. § 3102 (1982).

38. *Id.* § 3102(a).

39. *Id.* § 3102(b).

40. *Id.* § 3105.

41. *See supra* notes 24-27 and accompanying text.

42. Rooney, *supra* note 21, at 504.

43. *See* Comment, *supra* note 25, at 286.

44. The home state of a foreign bank "generally is the first state in which the foreign bank establishes a branch that accepts deposits from domestic customers." *Conover*, 715 F.2d at 606 n.3.

they may receive.[45]

The IBA contains several other provisions designed to promote competitive equality between foreign and domestic banks. For instance, section 6 requires any foreign bank that accepts retail deposits[46] to obtain FDIC insurance.[47] In addition, section 7 imposes the same reserve requirements upon federal branches and agencies that earlier had been required of FDIC member banks.[48] These provisions represent an attempt by Congress to establish a comprehensive system of dual regulation on foreign banks operating in the United States. The instant case is the first to examine the effect of the IBA on the power of the states to restrict the entry of federally chartered branches and agencies of foreign banks.

III. THE INSTANT OPINION

The court of appeals first addressed the plaintiffs' argument that section 4(a)[49] of the IBA does not authorize the Comptroller to permit a foreign bank to establish a federal bank or agency[50] in

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45. They may receive only those deposits that Edge Act corporations may receive. 12 U.S.C. § 3103(a). The Edge Act, *id.* §§ 611-631, authorizes the formation of corporations "for the purpose of engaging in international or foreign banking." *Id.* § 611. Section 615 places restrictions on the types of deposits that Edge Act corporations are permitted to receive.

46. A retail deposit is a deposit in an amount less than $100,000. *Id.* § 3104.

47. *Id.*

48. Federal branches and agencies of a foreign bank are subject to reserve requirements if the bank's worldwide consolidated bank assets are in excess of $1 billion. *Id.* § 3105(a)(2).

49. Section 4(a) provides:

> Except as provided in section 3103 of this title, a foreign bank which engages directly in a banking business outside the United States may, with the approval of the Comptroller, establish one or more Federal branches or agencies in any State in which (1) it is not operating a branch or agency pursuant to State law and (2) the establishment of a branch or agency, as the case may be, by a foreign bank is not prohibited by state law.

12 U.S.C. § 3102(a) (1982); *see Conover,* 715 F.2d at 607.

50. Section 1(b) of the IBA defines these terms as used in the statute. An agency is defined as an "office . . . of a foreign bank . . . at which deposits may not be accepted from citizens or residents of the United States." A branch is defined as an "office . . . of a foreign bank . . . at which deposits are received." A federal branch or agency is one which has been established and is operating pursuant to section 4 of the IBA. 12 U.S.C. § 3101(1),(3),(5),(6) (1982); *see* 715 F.2d at 607.

any state in which state law would prohibit it.[51] The court initially determined that although the language of section 4(a) did not preclude either party's interpretation,[52] the legislative history of the IBA, including the House and Senate committee reports on the bill,[53] did not particularly support either of the proffered interpretations.[54] The instant court concluded, therefore, that section 4(a) should be interpreted to give effect to Congress' overriding objective in enacting the IBA[55]—to treat foreign banks the same as domestic banks.[56] To effectuate this goal, it held that the establishment of a foreign bank's federally chartered home state office should parallel that of a domestic national bank's principal office.[57] The court recognized, however, that section 4(a) expressly

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51. The plaintiffs specifically challenged the Comptroller's approval of five Australian banks' applications to convert their New York State-licensed agencies to home state federal branches even though New York law prohibits such banks from opening branches. 715 F.2d at 607. The plaintiffs essentially were defending a state's right to impose reciprocity restrictions on a foreign bank's entry within its borders. State reciprocity laws condition entry of a foreign bank on proof that the country under whose laws the bank is organized permits access to United States banks. *Id.*

52. *Id.* at 614. The plaintiffs argued that Congress did not intend passage of the IBA to preclude states from exercising their reciprocity requirements to prohibit the establishment of federally chartered offices. *Id.* at 608 n.5. The Comptroller, on the other hand, argued that state reciprocity requirements reflect more a condition or limitation on entry rather than a "prohibition" within the meaning of section 4(a). *Id.* at 607. The Comptroller also contended that the words "a foreign bank" in section 4(a) should be construed as synonymous with "any foreign bank" to preclude federal licensing of foreign bank branches or agencies only in those states prohibiting any foreign bank to establish state-chartered branches or agencies. *Id.* at 607-08.

53. *See id.* at 608-14.

54. *Id.* at 614-15. The court also rejected the plaintiffs' attempt to equate the policy underlying section 4(a) with that underlying the Douglas Amendment to the Bank Holding Company Act of 1956, 12 U.S.C. § 1842(d), which has been construed to allow states to discriminate among out-of-state bank holding companies when deciding which may conduct banking operations within their borders. *See* Iowa Indep. Bankers v. Board of Governors of the Fed. Reserve Sys., 511 F.2d 1288, 1297 (D.C. Cir.), *cert. denied*, 423 U.S. 875 (1975). The court distinguished the scope of these two policies by noting that subsection 2 of section 4(a), as opposed to subsection 1 of the same section, does not limit its focus to any particular bank, but instead refers to all foreign banks. 715 F.2d at 615.

55. 715 F.2d at 615.

56. *See id.* at 615-16.

57. *Id.* at 616. The court found support for this conclusion in section 4(h) of the IBA which states in relevant part:

> A foreign bank with a Federal branch or agency operating in any State

allows a state to exercise some control over the entry of federally chartered foreign banks even though the state does not have the power to prohibit establishment of a domestic bank's principal office.[58] In order to minimize any departure from the statute's goal of parity of treatment of foreign and domestic banks, the court adopted the Comptroller's interpretation of section 4(a),[59] holding that the Comptroller may license a federal branch or agency of a foreign bank in any state that does not prohibit all foreign banks from establishing state-chartered branches or agencies.[60]

The court then turned to the plaintiffs' argument that section 5(a)[61] of the IBA does not permit the Comptroller to license a federal interstate branch or agency in any state that would prohibit the bank from establishing a state-licensed interstate branch

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may . . . establish and operate additional branches or agencies in the State in which such branch or agency is located on the same terms and conditions . . . as are applicable to the establishment of branches by a national bank if the principal office of such national bank were located at the same place as the initial branch or agency in such State of such foreign bank . . . .

12 U.S.C. § 3102(h) (1982). The court found additional support in the House report accompanying the bill that eventually became the IBA. The report states that "[f]or purposes of the McFadden Act and Federal banking law in general, the branches [established under section 4] would be treated as if they are national banks *or* branches thereof." H.R. REP. No. 910, 95 Cong., 2d Sess. 12 (1978), *quoted in Conover*, 715 F.2d at 616 (emphasis by the court).

58. 715 F.2d at 617.

59. *Id.*; *see also supra* note 36 and accompanying text.

60. 715 F.2d at 617.

61. Section 5(a) provides in part:

Except as provided by subsection (b) of this section, (1) no foreign bank may directly or indirectly establish and operate a Federal branch outside of its home State unless . . . its operation is expressly permitted by the State in which it is to be operated . . . ; (2) no foreign bank may directly or indirectly establish and operate a State branch outside of its home State unless . . . it is approved by the bank regulatory authority of the State in which such branch is to be operated . . . ; (3) no foreign bank may directly or indirectly establish and operate a Federal agency outside of its home State unless its operation is expressly permitted by the State in which it is to be operated; (4) no foreign bank may directly or indirectly establish and operate a State agency or commercial lending company subsidiary outside of its home State, unless its establishment and operation is approved by the bank regulatory authority of the State in which it is to be operated . . . .

12 U.S.C. § 3103(a) (1982).

or agency.[62] It initially noted the Comptroller's argument that state reciprocity laws do not apply to the federal chartering of interstate branches or agencies of a foreign bank.[63] In support of his argument, the Comptroller had emphasized that the language in the sections of the IBA pertaining to the establishment of federally chartered interstate offices differed from the language in sections concerning the establishment of state-chartered interstate offices.[64] The court believed that neither the different language nor the legislative history of section 5(a) cited by the parties[65] conclusively supported one interpretation over the other.[66] It held, however, that because the Comptroller's interpretation is presumed to be correct[67] absent "compelling indications" to the

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62. The plaintiffs specifically complained that the Comptroller had approved two applications submitted by Australian banks to establish a federal interstate branch in Illinois in violation of the state's banking reciprocity law, and had approved an application submitted by a British bank to establish a federal interstate branch in Washington in violation of the state's law requiring the branch to comply with lending restrictions and other operational limitations. 715 F.2d at 619.

63. The Comptroller essentially argued that states have the same power to veto the entry of federal interstate offices as they do to veto the entry of federal home state offices under section 4(a)—basically an all-or-nothing approach. *Id.* at 619.

64. The Comptroller posited that the use in sections 5(a)(1) and 5(a)(3) of the words "expressly permitted" instead of the word "approved," as used in sections 5(a)(2) and 5(a)(4), confirmed the legislative intent to require only general state authorization of federally chartered interstate branches or agencies, as opposed to the individual approval of each application, as required before the establishment of a state-chartered office. *Id.* The Comptroller also contended that the word "operation" in sections 5(a)(1) and 5(a)(3) refers to the fact of operation rather than to the particular activities of a federal interstate office. He argued that section 5(a) was not intended to limit the ability of a federal interstate office to conduct its operations in a manner similar to that of a national bank in the same location. *Id.* at 620. The plaintiffs, on the other hand, posited that the distinction between "expressly permitted" and "approved" was intended solely to acknowledge that federal and state interstate offices are chartered by separate authorities. *Id.* In addition, the plaintiffs argued that the inclusion of the term "operation" in section 5(a) but not section 4(a) demonstrates Congressional intent to require a federal interstate office to receive express permission to conduct bank operations from the state in which the branch will be located. *Id.* at 621.

65. For a discussion of the legislative history presented by the plaintiffs, see *id.* at 621.

66. *Id.* at 623.

67. " '[T]he interpretation of an agency charged with the administration of a statute is entitled to substantial deference.' " *Id.* at 622 (quoting Blum v. Bacar,

contrary,[68] and the interpretation in this case was sufficiently reasonable to be accepted by a reviewing court, it was obliged to affirm the decision below.[69] Thus, the court of appeals held that the Comptroller can license a federal interstate branch or agency in any state that does not prohibit *all* foreign banks from establishing state-chartered interstate branches or agencies,[70] and that a federal interstate branch or agency is not subject to the operational limitations imposed by the state in which it is located.[71]

The court then considered the final issue: whether a federal agency can accept deposits from foreign sources. The court reversed that portion of the district court's decision,[72] holding that the Comptroller's interpretation of section 4(d)[73] to allow such deposits was incorrect. The court concluded that in light of the IBA's legislative history,[74] the language of section 4(d) is not ambiguous and its prohibition clearly applies to federal agencies by virtue of section 1(b)(1).[75] The court held that a foreign bank's federally chartered agency may not accept deposits from any source.[76]

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457 U.S. 132, 141 (1982)).

68. *Id.* (citing Red Lion Broadcasting Co. v. FCC, 395 U.S. 367, 381 (1969)).

69. *Id.* at 623.

70. *Id.*

71. *Id.*

72. *Id.* at 627.

73. Section 4(d) states that "[n]otwithstanding any other provision of this section, a foreign bank shall not receive deposits . . . at any Federal agency." 12 U.S.C. § 3102(d) (1982).

74. For a discussion of the legislative history relied on by the parties, see 715 F.2d at 624-25.

75. *Id.* at 626. The plaintiffs argued that section 1(b)(5), which defines "federal agency," *see supra* note 50, subjects a federal agency to the additional limitations of section 4(d) and therefore precludes federal agencies from accepting deposits. 715 F.2d at 626.

The Comptroller responded that section 4(d) must be interpreted in the context of the entire IBA. He argued that section 4(d) was not intended to place additional limitations on section 1(b)(1) and that the key distinction that applies throughout the IBA is that branches may accept deposits, but agencies may accept them only from foreign sources. He contended that a reading of section 4(a) in light of these other provisions supported his interpretation. *Id.* at 624-25.

76. *Id.* at 627.

IV. COMMENT

The instant decision is the first to address whether the IBA permits states to exercise their reciprocity laws to prohibit the entry of foreign banks operating pursuant to federal charter. In determining whether section 4(a) enables states to prohibit foreign bank entry on a discretionary basis, the court of appeals prudently declined to rely on either the language or the legislative history of that section because neither offers a clear indication of Congressional intent.[77] Instead, the court based its decision on the overriding objective of Congress to accord foreign banks national treatment through the IBA.[78] The legislative history of the IBA clearly indicates Congressional intent to treat foreign banks essentially the same as similarly situated domestic banks.[79] Accordingly, consideration of the broad legislative policy was a sound basis for the court's decision. If Congress had wanted to enable states to exercise their reciprocity laws to prohibit the entry of federally chartered branches or agencies, it could have made that purpose explicit in the statute. Without an unequivocal mandate, a policy that would allow individual states to discriminate in regulating foreign bank entry would be inconsistent with the IBA's goal of national treatment. The instant decision supports the general United States policy to treat foreign enterprises doing business in the United States as the competitive equals of their domestic counterparts.[80]

Section 5(a) governs federally chartered interstate branches and agencies of foreign banks. Unlike section 4(a), it has no domestic counterpart. Thus, the court of appeals could not rely on the IBA's theme of national treatment in determining the correct interpretation of section 5.[81] Instead, the court based its decision to affirm the Comptroller's interpretation on the well-established principle that an agency's interpretation of a statute is entitled to "substantial deference."[82]

The court was correct in stating that the legislative history of

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77. *See supra* notes 52-54 and accompanying text. The ambiguity of this provision was noted by various commentators prior to the instant decision. *See, e.g.*, Hablutzel and Lutz, *supra* note 20, at 148; Note, *supra* note 21, at 1006.

78. *See supra* notes 55-56 and accompanying text.

79. *See supra* note 57 and accompanying text.

80. *See* S. REP. No. 1073, *supra* note 31, at 2, *reprinted* at 1422.

81. *See Conover*, 715 F.2d at 623 n.18.

82. *See supra* notes 66-67 and accompanying text.

section 5 does not favor either interpretation offered by the parties.[83] Its holding, however, was based upon the questionable conclusion that the language of section 5(a) is as ambiguous as that of section 4(a). Section 4(a) states that branches or agencies must not be "prohibited," but section 5(a) states that interstate branches or agencies must be "expressly permitted."[84] Its choice of discrepant terms would seem to indicate that Congress intended the states to have more power over the entry of interstate branches and agencies than over the establishment of a foreign bank's initial branch or agency. Indeed, prior to the instant decision, many commentators assumed that section 5(a) permitted states to discriminate among foreign banks seeking to establish federally chartered interstate branches and agencies.[85] As a result, the instant decision probably will have a significant effect on the future of state reciprocity laws. Although the legislative history of section 5 does not elucidate the meaning of "expressly permitted," it is clear that Congress intended to establish a "uniform national policy concerning foreign banking in [the United States]"[86] through the enactment of the IBA. Thus, the instant decision appears to be consistent with the intent of the IBA's authors if not with the language of the statute itself.

In addition, the instant decision wisely precludes individual states from determining United States international policies. If the states were permitted to discriminate among foreign banks seeking entry into their markets, they would wield undue power to determine the extent both of foreign bank entry into the United States market and United States entry into foreign banking markets. Such a practice would not further a uniform national policy concerning foreign bank operations in the United States. Congress has recognized that "[f]ederal banking law should, to the greatest extent possible, be limited to matters of national interest and concern, that either are not the province of the States or are beyond their ability to cognize and regulate."[87] Clearly, state reciprocity laws focus on state policies. They are designed to

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83. *See supra* notes 65-66 and accompanying text.

84. Compare the language of section 4(a), *supra* note 49, with the language of section 5(a), *supra* note 61.

85. *See, e.g.*, Shay, *Interstate Banking Restrictions of the International Banking and Bank Holding Company Acts*, 97 BANKING L.J. 524, 527 (1980); Note, *supra* note 21, at 1021.

86. S. REP. No. 1073, *supra* note 31, at 2, *reprinted* at 1422.

87. *Id.* at 12, *reprinted* at 1432.

promote opportunities for an individual state's banks in foreign countries rather than to promote the development of international banking centers in the United States.[88] The instant decision, therefore, promotes the Congressional intention to encourage international banking in the United States and greater access for United States banks to foreign markets.

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88. *See* Note, *supra* note 21, at 1007.