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Discrimination claims against foreign companies: new developments

By Philip M. Berkowitz

Subsidiaries of foreign companies doing business in the United States often employ “rotating” or “rotational” staff. These are employees of the parent company seconded from the parent company’s headquarters to work in the U.S. for a set period—commonly three to five years—before returning home. American employees of the subsidiary sometimes bring claims of discrimination based on what they perceive as unfairness when comparing their treatment with that received by rotational employees.

A recent Southern District of New York case, Schanfield v. Sojitz Corp., represents something of a breakthrough for foreign companies doing business in the United States, illustrating special defenses sometimes available to those companies. But the case is notable not only for the employer’s successful invocation of these defenses—it also demonstrates the benefit of responding proactively when an employer learns that the employee has improperly removed trade secrets from the workplace when pursuing employment-related claims.

Arnold Schanfield was a U.S. citizen who applied for and was offered a position as chief internal auditor (“CIA”) of Sojitz Corporation of America (“SCA”), the U.S. subsidiary of Sojitz Corporation, a global trading company based in Japan.

Schanfield was hired in June 2006, and the trouble started soon thereafter. He clashed repeatedly with his superiors, who were Japanese rotating staff employees of the parent. Within only a few weeks after his hire, he identified alleged “risks,” which in particular related to the rotational staff system.

1 663 F. Supp. 2d 305 (S.D.N.Y. 2009).
Three months later, he asserted in an internal report to his Japanese boss (who was himself a rotational employee):

- Communication was “quite dismal” in the U.S., and all should be in English, not Japanese.
- Americans should be hired at the U.S. company’s most senior level, which level, he asserted, was occupied only by Japanese rotating staff.
- There existed an “imbalance” between rotating staff and U.S. staff that should be addressed.
- The “cost” of rotating staff should be carefully reviewed.

Schanfield also expressed his view that it was unfair to give rotational employees higher titles (and, he incorrectly believed, higher compensation, excluding overseas assignment allowances) when national employees did “90 percent” of the work.

SCA became concerned that Schanfield was abusing his position by inserting himself into promotion and compensation decisions involving employees he favored but who did not report to him. SCA also found him verbose and discourteous, and complained that he “was quick to point to an impropriety without sufficient investigation of the circumstances.”

In an e-mail Schanfield sent to a colleague not employed by or associated with SCA, he reported that he had “a big fight with CEO—I suggested that he should resign and go home!! Now we are not on speaking terms.” A scant eleven months after his hire, SCA discharged him, and he brought his lawsuit alleging unlawful discrimination based on national origin, in violation of Title VII, as well as other state and federal laws.

SCA counterclaimed for breach of contract, breach of fiduciary duty and duty of loyalty, and misappropriation of trade secrets, based on Schanfield’s allegedly having removed confidential SCA documents and disclosing them to third parties not affiliated with SCA, as well as to his own lawyers, who then “produced” them to SCA in discovery.

The Schanfield court granted SCA’s motion for summary judgment on his discrimination claims (while declining to grant summary judgment on certain retaliation claims), and, sua sponte, granted SCA’s motion for summary judgment on the above-described common law claims.

Special defenses for foreign employers

Of course, foreign companies doing business in the U.S. generally must comply with federal, state, and local laws prohibiting discrimination in employment. However, special defenses may protect foreign companies. The scope of these defenses’ application as to U.S. subsidiaries of foreign companies has been somewhat unsettled.

At least two dozen countries, including Japan, have entered into treaties of Friendship, Commerce, and Navigation (“FCN Treaty” or “Treaty”), most of which were implemented in the aftermath of World War II in an effort to encourage post-war economic growth.
They generally include an “employer choice” provision, similar or identical to that used in the 1953 FCN Treaty between the United States and Japan, which provides:

Companies of either Party shall be permitted to engage, within the territories of the other Party, accountants and other technical experts, executive personnel, attorneys, agents and other specialists of their choice.2

Employer choice provisions were proposed to dodge the severe percentile limitations that foreign governments required on the employment of Americans abroad.3 By allowing businesses to select key personnel from their own country to work in the participating country, governments could encourage international investment.

Relationship between the FCN Treaty and Title VII

Title VII prohibits discrimination in employment against “any individual” on the basis of race, color, religion, sex, and national origin.4 The law covers U.S. citizens and aliens alike. Accordingly, American employees of foreign companies (or their U.S. subsidiaries) who are subjected to adverse employment action—e.g., termination, demotion, or reduction in compensation—may sue their employers under Title VII, alleging that the adverse action was motivated by the employees’ national origin (i.e., American) or their race (i.e., non-Asian).

The employer choice provision provides immunity only insofar as the foreign company discriminates in favor of its own citizens for one of the select employment positions named in the Treaty—thus, it does not immunize covered entities from all manner of otherwise unlawful discrimination, such as age and gender, nor does it necessarily protect discrimination on the basis of national origin (although as far as countries with homogenous cultures like Japan and Korea are concerned, this distinction may be difficult to unravel).5

Parties entitled to FCN Treaty protection

The extent to which U.S. subsidiaries of foreign companies (as opposed to the parent itself) can rely on the Treaty as a defense is not entirely settled. In 1982, the Supreme Court held that a U.S. subsidiary of a foreign company cannot directly invoke the protections of an FCN Treaty. In Sumitomo Shoji America, Inc. v. Avagliano, female employees brought a class action against Sumitomo, a New York subsidiary of a Japanese company, claiming that Sumitomo’s practice of hiring only Japanese males to


4 While discrimination based upon citizenship status does not necessarily violate Title VII, the Supreme Court has held that Title VII prohibits such conduct when it has the purpose or effect of discrimination based upon national origin. Sumitomo Shoji America, Inc. v. Avagliano, 457 U.S. 176 180 n.4 (1982).

fill key managerial positions violated Title VII’s prohibition against gender and race discrimination. The Court held that the subsidiary was not protected by the FCN Treaty. Nevertheless, the Supreme Court expressly left undecided whether a U.S. subsidiary of a Japanese company could vicariously assert the FCN Treaty rights “of its parent” when faced with an employment discrimination claim.

Until Schanfield, no New York federal court appears to have considered this issue. The Seventh Circuit famously did so—famously, because the EEOC has disagreed with it—in Fortino v. Quasar Co. There, American employees of Quasar, an American subsidiary of Matsushita, a Japanese company, brought suit under Title VII after they were terminated and replaced by Japanese nationals. The court held that the employees could assert Matsushita’s rights under the FCN Treaty because Matsushita had dictated the employment decision at issue. The court explained that this decision was warranted “to prevent the treaty from being set at naught.”

The EEOC rejected Fortino, stating it intends to solely regard the country of incorporation as controlling the application of the Treaty, and that if the company is organized under U.S. law, it cannot obtain Treaty protection. This narrower view limits the availability of FCN Treaty rights solely to the parent and/or unincorporated business entities such as branch offices.

Schanfield is in accord with Fortino—indeed, Schanfield noted that “Fortino’s facts are uncannily similar to the facts in this case.” With nary a nod to the EEOC’s view of the matter, the court granted summary judgment to SCA, stating: “Sojitz, a Japanese corporation, has chosen to send its own employees to work in top management positions at its wholly owned subsidiary, SCA. The Treaty allows it to do so. While this may block Schanfield (and other [American] employees) from achieving a higher position in the company …, any discrimination in this regard is entirely a function of citizenship.”

The court also noted that, to the extent the plaintiff complained that he was not the beneficiary of certain compensation practices provided to rotational staff—such as special overseas allowances—he was not similarly situated to those employees. The court pointedly noted that the rotational employees were considered to be jointly employed by SCA and Sojitz—nevertheless, compensation decisions for those employees were made in Japan by Sojitz executives, while compensation for U.S.-based employees was determined by SCA.

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7 950 F.2d 389 (7th Cir. 1991).
8 Accord Papaila v. Uniden America Corp., 51 F.3d 54 (5th Cir. 1995), cert. denied, 516 U.S. 868, 116 S. Ct. 187 (1995) (U.S. subsidiary could invoke Japanese parent’s FCN treaty rights where the decision to fill certain positions with Japanese “expatriates” on rotating staff was imposed upon the company by the Japanese parent).
The court concluded that, “because the alleged pay discrimination results from pay decisions that are
directed by Sojitz, SCA may invoke Sojitz’s rights pursuant to the FCN Treaty, as long as the pay
discrepancy is attributable entirely to citizenship—which it is.”

Finally, the court *sua sponte* granted summary judgment to SCA on its claims that Schanfield had
breached his duty of loyalty to SCA and misappropriated its trade secrets. In granting judgment to
SCA on the duty of loyalty claim, the court made a rare invocation of the Second Circuit’s relatively
recent decision in *Phansalkar v. Andersen Weinroth & Co.*, where that court expanded this claim
significantly, in favor of employers.

**Conclusion**

Foreign companies are highly visible, and remain, for lawyers representing employees, special targets
for discrimination lawsuits. They may, though, invoke unique defenses to these claims—and, as
*Schanfield* demonstrates, they may make use of the same proactive measures that U.S. companies do
to protect their rights when they believe their business practices are improperly threatened.

If you would like more information about the topics covered in this *Alert*, please contact your Nixon
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10 The court also cited *Eschelbach v. CCF Charterhouse/ Credit Commercial de France*, 2006 U.S. Dist. LEXIS
17, 1991).

11 344 F. 3d 184 (2d Cir. 2003)