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# **Expropriation of Offshore Branches of American Banks Located in Foreign Tax Havens**

## **Introduction**

In recent years, many American banks have opened branches in Caribbean and other tax havens, such as Nassau in the Bahamas, the Cayman Islands, and Curaçao. These branches have certain advantages:

1. Deposits in a foreign branch are not domiciled in the United States, resulting in favorable United States tax consequences for the depositor,<sup>1</sup> interest rates which are not subject to regulation by the banking authorities in the United States, and no reserve requirements;<sup>2</sup>
2. Since the countries in which these branches are located have minimal or no requirements regarding the staffing or operation of the branch, the American bank commonly operates its Caribbean branch from the United States, avoiding the expense and personnel difficulties associated with the operation of a full-scale foreign branch; and
3. The American bank receives favorable tax treatment from the foreign country.

As an example of the type of operation required by an American bank in a foreign tax haven, the Bahamas requires only that the American bank appoint an agent there and publish an annual financial statement in a Bahamian newspaper. The bank need maintain no employees and no account records in the Bahamas. The operations and records of the Nassau branch may be located in the United States.

Although the physical presence of an American bank operating an offshore branch in a foreign tax haven is minimal, these offshore branches transact billions of dollars worth of business. Federal Reserve figures show that assets of American bank branches in the Caribbean in 1976 totalled \$67.4 billion.<sup>3</sup> Therefore, the question as to whether a foreign expropriation decree would reach any of the funds domiciled in branches of American banks located in the expropriating country bears serious consideration.

An effective expropriation of any of these offshore assets would require possession of the offshore branch's records. The expropriating government must find out how much money is deposited in the branch and who the branch's borrowers are. Records containing this information are located in the United States. Therefore, the expropriating government would have to enlist the aid of courts in the United States to obtain these records.

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<sup>1</sup>I.R.C. § 861(a)(1)(F).

<sup>2</sup>12 C.F.R. § 204.112 (1978).

<sup>3</sup>L.A. Times, July 24, 1977, § 4, at 9, col. 4.

Would a court in the United States enforce a foreign expropriation decree? The expropriating government would argue that all assets of the branch, located in the expropriating country, including its records, now belong to the government pursuant to its expropriation decree. Possession of the branch records should therefore be turned over to the expropriating government, as their rightful owner. This argument will succeed to the extent that the courts recognize the validity of the expropriation decree.

Recognition of an expropriation decree by the courts is governed by the act of state doctrine. As discussed below,<sup>4</sup> there is no accepted formulation of the act of state doctrine. It cannot therefore be predicted whether an expropriation of an offshore branch of an American bank will be recognized by a court in the United States.

However, the act of state doctrine applies only to assets located within the expropriating state. If the American bank can successfully argue that the branch is located in the United States for purposes of this doctrine, the act of state doctrine will not protect the expropriating state, and the expropriation must satisfy American due process standards to be enforced. Many offshore branches of American banks are operated in such a manner that an argument can be made that for purposes of expropriation, these offshore branches are located in the United States.

In New York, recognition of an expropriation decree is also affected by New York law, which gives New York banks some additional protection from the effects of expropriation.

## I. Act of State Doctrine

The act of state doctrine appears in many early decisions of the United States Supreme Court.<sup>5</sup> But the early formulation of the doctrine most often cited by the courts and commentators is that found in *Underhill v. Hernandez*:<sup>6</sup> "Every sovereign State is bound to respect the independence of every other sovereign State, and the courts of one country will not sit in judgment on the acts of the government of another, done within its own territory."

The Supreme Court has had occasion to reexamine and reformulate the act of state doctrine in recent years in a series of cases resulting from the Cuban

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<sup>4</sup>See notes 5 to 18 and related text *infra*.

<sup>5</sup>See, e.g., *Ware v. Hylton*, 3 U.S. (3 Dall.) 199, 231 (1796); *Hudson v. Guestier*, 8 U.S. (4 Cranch) 293, 294 (1808); *The Schooner Exchange v. M'Faddon*, 11 U.S. (7 Cranch) 116, 135-36 (1812); *L'Invincible*, 14 U.S. (1 Wheat.) 237, 253 (1816); *The Santissima Trinidad*, 20 U.S. (7 Wheat.) 283, 336 (1822).

<sup>6</sup>168 U.S. 250 (1897). See also *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 416 (1964); *First National City Bank v. Banco Nacional de Cuba*, 406 U.S. 759, 763 (1972); Delson, *The Act of State Doctrine — Judicial Deference or Abstention?* 66 AM. J. INT. LAW 82, 87 (1972); Note, *A New Approach to the Act of State Doctrine: Turning Exceptions Into The Rule*, 8 CORNELL INT'L. L.J. 273, 274 (1975).

<sup>7</sup>168 U.S. at 252.

expropriation decree of 1960.<sup>8</sup> The result has been confusion, with no majority support for any statement of the act of state doctrine appearing in the last two Supreme Court cases discussing it. In order to understand the present confused status of the doctrine, a brief review of recent cases is necessary.

A. *Bernstein v. N. V. Nederlandsche-Amerikaansche Stoomvaart-Maatschappij*

Although not a Supreme Court case, *Bernstein v. N. V. Nederlandsche-Amerikaansche Stoomvaart-Maatschappij*<sup>9</sup> has influenced all subsequent cases. During World War II, officials of the Nazi German government forced Bernstein to transfer ownership of a steamship line, which was then sold to the defendant. Bernstein sued for recovery of the vessels. The court held that it would not pass on the validity of the acts of the officials of another state unless the executive branch allowed the court to exercise jurisdiction. The reasoning behind this holding was that normally the judging of the acts of another country would interfere with the conduct of foreign policy by the executive branch. But, if the executive branch would specifically state that exercise of jurisdiction by the court would not interfere with the conduct of foreign policy, the reason for the rule would disappear and the court would exercise jurisdiction.

B. *Banco Nacional de Cuba v. Sabbatino*

*Banco Nacional de Cuba v. Sabbatino*<sup>10</sup> dealt with the expropriation by the Cuban government of a boatload of sugar in Cuban territorial waters. The Court held that

the Judicial Branch will not examine the validity of a taking of property within its own territory by a foreign sovereign government, extant and recognized by this country at the time of suit, in the absence of a treaty or other unambiguous agreement regarding controlling legal principles, even if the complaint alleges that the taking violates customary international law.<sup>11</sup>

No “*Bernstein* letter,” stating that exercise of jurisdiction by the Court would not interfere with the conduct of foreign policy by the executive branch, existed in this case.<sup>12</sup> As in *Bernstein*, the Court’s refusal to rule on the validity of the expropriation, invoking the act of state doctrine, was based on reluctance to interfere with the conduct of foreign policy by the executive branch.<sup>13</sup>

In response to *Sabbatino*, Congress passed the Hickenlooper Amendment to the Foreign Assistance Act, also known as the Sabbatino Amendment.<sup>14</sup>

<sup>8</sup>See, e.g., *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398 (1964).

<sup>9</sup>210 F.2d 375 (2d Cir. 1954).

<sup>10</sup>376 U.S. 398 (1964).

<sup>11</sup>*Id.* at 428.

<sup>12</sup>*Id.* at 420.

<sup>13</sup>*Id.* at 425-26.

<sup>14</sup>22 U.S.C. § 2370(e)(2) (1977).

The Sabbatino Amendment states that the act of state doctrine does not apply in cases in which a claim of title or other right to property is asserted based upon a confiscation or other taking in violation of international law, in the absence of presidential determination that the act of state doctrine should apply. But, the Sabbatino Amendment can only be invoked by American firms when another entity attempts to market the American firms' expropriated property and some aspect of the attempted transaction takes place in the United States.<sup>15</sup> The application of the Sabbatino Amendment is, therefore, limited.

C. *First National City Bank v. Banco Nacional de Cuba*

The Supreme Court again considered the act of state doctrine in *First National City Bank v. Banco Nacional de Cuba*.<sup>16</sup> In this case, First National City Bank offset Cuban government funds in its possession against losses incurred by the bank as the result of expropriation of its Cuban branches by the Cuban government. The state bank of Cuba sued to recover the offset funds. The Court split drastically, with Justice Rehnquist writing for a plurality of three, two Justices concurring in the two separate opinions, and four Justices dissenting. The executive branch wrote a "*Bernstein* letter" in this case, stating that the interests of American foreign policy did not require application of the act of state doctrine to this case. Justice Rehnquist allowed the bank's counterclaim for losses caused by the Cuban expropriation, stating that when the executive branch has written a "*Bernstein* letter," the act of state doctrine need not be applied. Justice Douglas concurred in the result on the theory that since the foreign government had originally invoked the aid of the United States courts in recovering the offset funds, it submitted itself to adjudication of counterclaims against it regarding those funds. Justice Powell concurred, stating that the counterclaim should be heard unless it is affirmatively shown that the Court's exercise of jurisdiction would interfere with the conduct of foreign relations by the executive branch. The dissenting Justices held that Cuba should be entitled to invoke the act of state doctrine in spite of the "*Bernstein* letter." There was thus no agreement on the Court as to the circumstances under which the act of state doctrine should apply.

D. *Alfred Dunhill of London, Inc. v. Republic of Cuba*

The Supreme Court most recently considered the act of state doctrine in *Alfred Dunhill of London, Inc. v. Republic of Cuba*.<sup>17</sup> The case dealt with

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<sup>15</sup>*Banco Nacional de Cuba v. First National City Bank of New York*, 431 F.2d 394, 402 (2d Cir. 1970), *rev'd on other grounds*, 406 U.S. 759 (1972).

<sup>16</sup>406 U.S. 759 (1972).

<sup>17</sup>425 U.S. 682 (1976).

payment of accounts by American importers to companies expropriated by Cuba. Lower courts had held that payments made on shipments by the Cuban companies prior to expropriation were payable to the former owners of the companies, and not the expropriators. The Cuban expropriators refused to return the payments, and claimed that the refusal was an act of state. A majority opinion of five members of the Court held that the refusal was not an act of state, on the narrow ground that the persons in control of the expropriated companies did not have the authority to exercise sovereign power. Four of the majority were additionally of the opinion that the act of state doctrine should not include the purely commercial conduct of a foreign government. Four dissenting Justices felt that the refusal was an act of state, and that any commercial exception to the act of state doctrine would not apply to this case. The refusal was part of the process of nationalizing the Cuban companies and was not a commercial act. Even though there was a majority opinion in *Dunhill*, it dealt only with the question of what ministerial acts are necessary to constitute an act of state. The Court still failed to reach a consensus on the formulation of the act of state doctrine.

Thus, at this point, a comprehensive statement of the act of state doctrine cannot be made. There is general agreement that the doctrine exists as set forth in *Underhill v. Hernandez*,<sup>18</sup> but there is disagreement as to the exceptions for its application. Possible exceptions are the existence of a “*Bernstein* letter,” a treaty or agreement with the expropriating state regarding rules by which its actions are to be judged, situations in which property was expropriated and then imported into the United States, cases initiated by the expropriating state, and commercial acts of the state. The availability of any of the above exceptions cannot be predicted in evaluating the potential effect of a future expropriation decree on the offshore activities of American banks. The extent to which any of the exceptions is available is in the control of the expropriating government.

## **II. Act of State Doctrine Applicable Only to Acts Within the Sovereign's Territory**

Although American banks cannot do anything to ensure that in the event of expropriation they will be able to utilize one of the exceptions listed in the preceding section to escape the act of state doctrine, they can structure their offshore operations in some countries so that they can argue in the event of an expropriation decree that the act of state doctrine does not apply at all. If the act of state doctrine does not apply, the courts will be free to adjudicate on the acts of the expropriating government. Referring back to the basic formulation of the act of state doctrine, *Underhill* states that the act of state doctrine applies to acts of the sovereign done *within its own territory*.<sup>19</sup>

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<sup>18</sup>168 U.S. 250 (1897).

<sup>19</sup>*Id.* at 252.

When the effect of a foreign sovereign's act is at issue, the court must make a determination that the sovereign's act was done within its own territory before the act of state doctrine will be applied. When the subject of the litigation is an intangible, such as accounts receivable or a bank account, the court has certain latitude in determining its situs. It may hold that the property is situated outside the sovereign's territory in order to avoid applying the act of state doctrine where the result would be distasteful. If property which is the subject of the litigation can be situated in the United States, the Court will not only avoid the act of state doctrine, but will decide the case according to the policy and law of the United States.<sup>20</sup> And under United States policy and law, acts of expropriation which do not afford compensation to persons adversely affected will not be recognized.<sup>21</sup>

United States courts have often avoided the act of state doctrine by holding that the property at issue was in the United States. *Carl Zeiss Stiftung v. V.E.B. Carl Zeiss, Jena*<sup>22</sup> and *Maltina Corp. v. Cawy Bottling Co.*<sup>23</sup> held that a United States trademark, owned by a foreign corporation, was located in the United States so that the foreign expropriation decree did not reach it. *United Bank Ltd. v. Cosmic International, Inc.*<sup>24</sup> held that accounts owed by American importers to foreign corporations were in the United States and unaffected by a foreign expropriation decree. *Rupali Bank v. Provident National Bank*<sup>25</sup> held that the bank account of an expropriated foreign bank with an American bank was in the United States and was not reached by the foreign expropriation decree.

In reaching these results, the courts indicated that some latitude existed in the determination of situs. *Tabacalera Severiano Jorge, S.A. v. Standard Cigar Co.*,<sup>26</sup> stated that "the situs of intangible property is about as intangible a concept as is known to the law."<sup>27</sup> Demonstrating a judicial bias against expropriation, the *Tabacalera* court stated that the foreign sovereign's acts are to be recognized under the act of state doctrine only insofar as they are able to come to *complete* fruition within the dominion of the foreign sovereign.<sup>28</sup> The court held that the act at issue was attempting to reach property within the United States because the property could only be reached with the assistance of a United States court. Regarding the rules for determining situs, the court stated: "... we find no compelling requirement that we accept the

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<sup>20</sup>F. Palicio y Compania, S.A. v. Brush 256 F. Supp. 481, 487 (S.D.N.Y. 1966).

<sup>21</sup>*Id.* at 488.

<sup>22</sup>293 F. Supp. 892 (S.D.N.Y. 1968).

<sup>23</sup>462 F.2d 1021 (5th Cir. 1972).

<sup>24</sup>542 F.2d 868 (2d Cir. 1968).

<sup>25</sup>403 F. Supp. 1285 (E.D. Pa. 1975).

<sup>26</sup>*Tabacalera Severiano Jorge, S.A. v. Standard Cigar Co.*, 392 F.2d 706 (5th Cir. 1968), *cert. denied*, 393 U.S. 924 (1968).

<sup>27</sup>*Id.* at 714.

<sup>28</sup>*Id.* at 715-16.

fiction that the situs is irrevocably at the domicile of the creditor, a fiction sometimes used for other commercial purposes. For the purpose of our inquiry we find this debt was not property in Cuba."<sup>29</sup>

The courts have decided several cases<sup>30</sup> involving the foreign expropriation of funds in bank accounts in bank branches located in the United States. They have held that the funds are located in the branch, not at the foreign domicile of the depositor. *Rupali Bank v. Provident National Bank*<sup>31</sup> refused to recognize a Bangladesh expropriation decree purporting to reach funds in a Philadelphia bank account. No Bangladesh court had jurisdiction over the Philadelphia bank so Bangladesh could not compel the bank to pay over the funds in the account. *Republic of Iraq v. Ist National City Bank*<sup>32</sup> refused to recognize an Iraqi expropriation decree as applied to the account of an Iraqi citizen in a New York bank because there was no showing that the New York bank was answerable to the courts of Iraq. *McGrath v. Agency of Chartered Bank of India, Australia, and China*<sup>33</sup> held that funds of a German entity in a New York bank account were located in the United States because the New York courts had jurisdiction over the branch in which they were deposited.

### **III. The Act of State Doctrine and Expropriation of Offshore Branches Located in Foreign Tax Havens**

The courts have never decided the issue of whether property of an offshore branch of an American bank, nominally located in a foreign country but in fact operated entirely in the United States, is in the United States. The courts have demonstrated a bias against expropriation decrees which violate the policy and law of the United States, and have avoided the act of state doctrine and applied United States policy and law several times.

If the expropriating government sues to enforce its decree in the United States, it will invoke the act of state doctrine. The American bank will argue that the situs of property of the offshore branch is in the United States because its operations and account records are located there. The decisions cited above indicate that the courts will be receptive to that argument.

### **IV. The New York Expropriation Laws**

New York State has passed certain statutes relevant to the expropriation of a foreign branch. These statutes give New York banks additional protection against expropriation.

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<sup>29</sup>*Id.* at 716. See also *United Bank Ltd. v. Cosmic International, Inc.*, 542 F.2d 868, 874 (2d Cir. 1976); *Maltina Corp. v. Cawy Bottling Co.*, 462 F.2d 1021, 1027-28 (5th Cir. 1972).

<sup>30</sup>See notes 31-33 and accompanying text *infra*.

<sup>31</sup>403 F. Supp. 1285 (E.D. Pa. 1975).

<sup>32</sup>353 F.2d 47 (2d Cir. 1965).

<sup>33</sup>104 F. Supp. 964 (S.D.N.Y. 1952), *aff'd*, 201 F.2d 368 (2d Cir. 1953).



One statute provides that a bank need not recognize a claim to a deposit of a person in territory occupied by a government not recognized by the United States or any statute purporting to cancel the authority of a depositor in such territory unless required to do so by a United States court or an indemnity bond is furnished, where the claim is sent from such territory or the statute emanates from the territory's government.<sup>34</sup> A second statute reduces the bank's liability for assets of a foreign branch that are seized by a government not recognized by the United States.<sup>35</sup>

Where an expropriation has occurred, and the expropriating government is not recognized by the United States, these statutes relieve the New York bank from liability to the expropriator of its customers' deposits, and reduce its liability for its own expropriated assets. The bank's risk of operating in a foreign country is therefore reduced.

## **V. Conclusion**

It is unclear whether an expropriation decree issued by the government of a foreign tax haven would reach the property of branches of American banks nominally located there. There is no clearly formulated law applicable. However, the courts have demonstrated an understandable bias against expropriation decrees that do not adequately compensate the former owners for the property expropriated. American banks, by limiting their activities in these tax havens to the minimum required by local law, may place themselves in a position to argue in the event of an expropriation that the expropriation does not apply to their branches nominally located in the expropriating country. The courts have demonstrated that they may be receptive to such an argument.

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<sup>34</sup>N.Y. BANKING LAW § 134(7) (McKinney 1958).

<sup>35</sup>*Id.*, § 138(2).

