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Abstract

Part I of this Note examines the case law that addresses the issue of U.S. bank home office liability. Part II analyzes U.S. monetary policy provisions that affect deposits held in foreign branches of U.S. banks and the conditions under which a U.S. bank may become a guarantor. Part III argues that the case law holding the U.S. bank home office liable implies a guaranty term into the deposit account contract and frustrates efforts to regulate U.S. monetary policy. This Note concludes that unless appropriate arragements are made between the foreign depositor and the U.S. bank home office, the home office should not be liable for the return of deposits held in its foreign branches.

HOLDING U.S. BANK HOME OFFICES LIABLE FOR DEPOSITS IN THEIR FOREIGN BRANCHES

INTRODUCTION

It is currently the practice of U.S. courts to hold the home office of a U.S. bank liable for the return of the deposits in its foreign branch office if the foreign branch assets are confiscated or disposition of its assets are restricted. This practice, most recently followed by the United States District Court for the Southern District of New York in *Wells Fargo Asia Ltd. v. Citibank, N.A.*,[1] conflicts with the goal of U.S. monetary policy as understood by U.S. monetary policymakers[2] by making the home office the guarantor of deposits in the foreign branch.

Part I of this Note examines the case law that addresses the issue of U.S. bank home office liability. Part II analyzes U.S. monetary policy provisions that affect deposits held in foreign branches of U.S. banks and the conditions under which a U.S. bank may become a guarantor. Part III argues that the case law holding the U.S. bank home office liable implies a guaranty term into the deposit account contract and frustrates efforts to regulate U.S. monetary policy. This Note concludes that unless appropriate arrangements are made between the foreign depositor and the U.S. bank home office, the home office should not be liable for the return of deposits held in its foreign branches.

I. *TREATMENT OF FOREIGN DEPOSITS BY U.S. COURTS*

A. *Nature of the Claim*

The relationship between a bank and a depositor is that of debtor and creditor.[3] The depositor, in effect, lends money to

1. 660 F. Supp. 946 (S.D.N.Y. 1987), *remanded*, No. 87-7685 (2d Cir. Mar. 25, 1988) (order directing limited remand), *previous judgment reaffirmed*, No. 84 Civ. 996 (WK), slip op., 1988 U.S. Dist. LEXIS 3604 (S.D.N.Y. Apr. 22, 1988) (supplemental findings of fact and conclusions of law).

2. For the purpose of this Note, the phrase "U.S. monetary policymakers" means the Board of Governors for the Federal Reserve System, the United States Department of the Treasury, and Congress.

3. Sokoloff v. National City Bank of N.Y., 130 Misc. 66, 73, 224 N.Y.S. 102, 113-14 (Sup. Ct. 1927), *aff'd without opinion*, 223 A.D. 754, 227 N.Y.S. 907, *aff'd*, 250 N.Y. 69, 164 N.E. 745 (1928). *Sokoloff* is a complicated case that produced six opinions

the bank in return for the bank's promise to return the deposit and pay for the use of the deposit, usually in the form of interest. The depositor does not own a right to the exact dollars he deposited; instead, he has a right to demand payment from the bank for the amount deposited.[4] When the deposit is not returned upon the depositor's demand, the bank has breached the deposit contract[5] and the depositor may then sue for the return of money that the bank owes the depositor.

In the typical case leading to U.S. bank home office liability, a citizen of a host country ("foreign depositor") opens a deposit account at a foreign branch of a U.S. bank.[6] Political turmoil leads to the overthrow of the host government and the installation of a new government.[7] The new government places restrictions on the actions of the foreign branch[8] and eventually confiscates the foreign branch's assets and assumes its liabilities.[9] The foreign depositor then approaches the U.S.

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from the New York court system from 1923 through 1928. The first group of cases addressed Sokoloff's motion to strike National City Bank's defenses of impossibility and frustration. *See* Sokoloff v. National City Bank of N.Y., 120 Misc. 252, 199 N.Y.S. 355 (Sup. Ct. 1922) (denying the motion), *rev'd*, 208 A.D. 627, 204 N.Y.S. 69, *aff'd*, 239 N.Y. 158, 145 N.E. 917, *reh'g denied*, 239 N.Y. 171, 145 N.E. 921 (1924). Judge Cardozo's opinion established the practice that the action should be pursued on the theory of breach of contract and not, as Sokoloff had originally claimed, on a theory of rescission. *See Sokoloff*, 239 N.Y. at 171, 145 N.E. at 921. The second group of cases, which addressed National City Bank's defenses of payment and improper demand, were dismissed as insufficient. *See* Sokoloff v. National City Bank of N.Y., 130 Misc. 66, 224 N.Y.S. 102 (Sup. Ct. 1927), *aff'd without opinion*, 223 A.D. 754, 227 N.Y.S. 907, *aff'd*, 250 N.Y. 69, 164 N.E. 745 (1928). The report of Referee Alfred Page, 130 Misc. 66, 224 N.Y.S. 102 (Sup. Ct. 1927), was relied upon by the Second Circuit for the proposition that ultimate liability lies with the home office. *See* Vishipco Line v. Chase Manhattan Bank, 660 F.2d 854, 863 (2d Cir. 1981), *cert. denied*, 459 U.S. 976 (1982).

4. *See* Scammon v. Kimball, 96 U.S. 362 (1876).

5. *Sokoloff*, 250 N.Y. at 81, 164 N.E. at 749.

6. *See, e.g.*, *Garcia*, 735 F.2d at 646-47; *Vishipco Line*, 660 F.2d at 857; Perez v. Chase Manhattan Bank, 61 N.Y.2d 460, 465-66, 463 N.E.2d 5, 6, 474 N.Y.S.2d 689, 690, *cert. denied*, 469 U.S. 966 (1984); *Sokoloff*, 130 Misc. at 68, 224 N.Y.S. at 108-10.

7. *See, e.g.*, *Garcia*, 735 F.2d at 647; *Vishipco Line*, 660 F.2d at 857; *Perez*, 61 N.Y.2d at 466, 463 N.E.2d at 6, 474 N.Y.S.2d at 690-91; *Sokoloff*, 130 Misc. at 70-72, 224 N.Y.S. at 111-13.

8. *See, e.g.*, *Garcia*, 735 F.2d at 647; *Vishipco Line*, 660 F.2d at 857; *Perez*, 61 N.Y.2d at 466, 463 N.E.2d at 6-7, 474 N.Y.S.2d at 690-91; *Sokoloff*, 130 Misc. at 71-72, 224 N.Y.S. at 112-13.

9. *See, e.g.*, *Garcia*, 735 F.2d at 647; *Vishipco Line*, 660 F.2d at 857; *Perez*, 61 N.Y.2d at 466, 463 N.E.2d at 6-7, 474 N.Y.S.2d at 690-91; *Sokoloff*, 130 Misc. at 71-72, 224 N.Y.S. at 112-13.

bank home office and demands the return of his deposit.[10] The first U.S. case to address the question whether the foreign depositor could recover his deposit from a U.S. bank home office was *Sokoloff v. National City Bank of New York.*[11]

B. Sokoloff: *What To Do with a Deposit Caught in a Revolution*

Sokoloff arranged with the head office of National City Bank of New York ("National City Bank") to open a Russian ruble deposit account in his name at National City Bank's branch in Petrograd.[12] After the fall of the Kerensky government in November 1917, the new Soviet government issued decrees merging all banks into the State Bank.[13] Later, it nationalized all private banks, resulting in the confiscation of the assets of the Petrograd branch.[14] Subsequently, when Sokoloff approached National City Bank in New York to withdraw his deposit, National City Bank refused payment on the grounds that the deposit was held by the Soviet government.[15]

In a subsequent suit for breach of contract, National City Bank claimed that the actions of the Soviet Government relieved the bank of its obligations to Sokoloff. The referee, in his report to the Supreme Court in New York, noted that the foreign branch was a "separate business entity"[16] and, as such, the depositor could not demand payment at another branch office.[17] But this fact did not alter the relationship between the foreign branch and the home office, stated the referee. The foreign branch was an instrument through which the home office "carries on its business."[18] The referee reasoned that the branch may normally hold assets and liabilities in its own name, but its conduct and operating policies emanate from the home office.[19] Thus, "[u]ltimate liability for a debt of a branch

10. *See, e.g., Garcia,* 735 F.2d at 647-48; *Vishipco Line,* 660 F.2d at 857; *Perez,* 61 N.Y.2d at 466-67, 463 N.E.2d at 7, 474 N.Y.S.2d at 691.

11. 130 Misc. 66, 224 N.Y.S. 102 (Sup. Ct. 1927), *aff'd without opinion,* 223 A.D. 754, 227 N.Y.S. 907, *aff'd,* 250 N.Y. 69, 164 N.E. 745 (1928).

12. *Sokoloff,* 130 Misc. at 68-69, 224 N.Y.S. at 109-10.

13. *Id.* at 71, 224 N.Y.S. at 111-12.

14. *Id.* at 72, 224 N.Y.S. at 112-13.

15. *Id.* at 74, 224 N.Y.S. at 115.

16. *Id.* at 73, 224 N.Y.S. at 114.

17. *Id.*

18. *Id.*

19. *Id.*

would rest upon the parent bank."[20] Judgment was entered for Sokoloff based on this report.[21]

C. *The Rules of Disengagement*

U.S. bank home office liability was reaffirmed and expanded by the U.S. Court of Appeals for the Second Circuit in *Vishipco Line v. Chase Manhattan Bank*.[22] On April 24, 1975, near the end of the Vietnam War, Chase officials in New York ordered its Saigon office to shut down.[23] The Saigon office closed its books, locked the vault and front door, and handed over the keys and records to the French Embassy.[24] They left instructions that the French officials were to hand these items over when the new government asked for them.[25] The Chase officials in Saigon then left Vietnam,[26] and on April 30, 1975, Saigon fell.[27]

The new government issued a communiqué on May 1, 1975, that professed, *inter alia*, to confiscate all assets of banks and corporations in Vietnam.[28] The French Embassy subsequently handed over the Saigon branch's records to the new government.[29]

Chase claimed that the corporate plaintiff, Vishipco Line, should be denied recovery because the new government had confiscated the corporations'[30] tangible and intangible assets,

20. *Id.*

21. *See Sokoloff*, 250 N.Y. at 70, 164 N.E. at 745-46.

22. 660 F.2d 854 (2d Cir. 1981), *cert. denied*, 459 U.S. 976 (1982).

23. *Id.* at 857.

24. *Id.* The opinion in Trinh v. Citibank, N.A., 623 F. Supp. 1526 (E.D. Mich. 1985), noted the reaction of the South Vietnamese government:

> "[T]he Chase Manhattan Bank, the First National City Bank, and the Bank of America had closed temporarily without asking permission from our government. . . . The Finance Ministry and the National Bank will apply sanctions against these banks according to law." Clearly, the government of South Vietnam did not close the bank[s]. And, of course, the revolutionary forces had not yet gained control and thus did not close Citibank. Citibank closed itself.

Id. at 1533-34.

25. *Vishipco Line*, 660 F.2d at 857.

26. *Id.*

27. *Id.*

28. *Id.*

29. *Id.*

30. Tran Dinh Truong represented ten corporate plaintiffs, including Vishipco Line, in this action. 660 F.2d at 857.

the latter being the deposits held in the Saigon office.[31] The obligation to pay the individual plaintiff, Chase claimed, was assumed by the new government, thus relieving the Saigon office of liability.[32]

The Second Circuit found that the key to Chase's liability was that the Saigon office closed prior to the fall of the South Vietnamese Government. When the Saigon office shut its doors and fled, the debt to the plaintiffs had the effect of "spring[ing] back" to the home office.[33] The May 1, 1975, communiqué did not affect the Saigon office's obligations because as of that date there were no longer any assets or liabilities of the Saigon office in Vietnam for the new government to seize.

The Second Circuit also noted that by operating in Saigon through a branch rather than a subsidiary, Chase "accepted the risk that it would be held liable elsewhere for obligations incurred by its branch."[34] The court contended that such an operation "reassure[s] foreign depositors that their deposits will be safer with them than they would be in a locally incorporated bank."[35] The court then cited *Sokoloff*, noting that "*[u]ltimate liability for a debt of a branch would rest upon the parent bank.*"[36]

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31. *Id.*

32. *Id.*

33. *Id.* at 862-63 (quoting Heininger, *Liability of U.S. Banks for Deposits Placed in Their Foreign Branches*, 11 LAW & POL'Y INT'L BUS. 903, 975 (1979)).

34. *Vishipco Line*, 660 F.2d at 863.

35. *Id.*

36. *Id.* (emphasis in original) (citing Sokoloff v. National City Bank, 130 Misc. at 73, 224 N.Y.S. at 114). The Second Circuit, however, incorrectly attributes this quote to "Harrison Tweed, of the Milbank Tweed firm." *Id.* Chase Manhattan was represented in this suit by Milbank, Tweed, Hadley & McCloy. The quote was in fact written by Referee Alfred Page. *See* 130 Misc. 66, 224 N.Y.S. 102. Referee Tweed is noted for calling for a reassessment of *Sokoloff* in Dougherty v. National City Bank of New York, 157 Misc. 849, 285 N.Y.S. 491 (Sup. Ct. 1935).

Dougherty involved four claims arising out of the closing of the Petrograd and Moscow branch of National City Bank by the Soviet government in 1918. *Id.* at 850, 285 N.Y.S. at 494. Three of the claims involved deposits made at the foreign branch office. *Id.* at 851, 285 N.Y.S. at 494-95. The fourth claim involved a deposit arrangement made with the home office. *Id.* Referee Tweed noted that National City Bank was excused from performance as to the three direct depositors, since the deposit was payable only in the Soviet Union. *Id.* at 863-64, 285 N.Y.S. at 506-08. The merger and confiscation decrees relieved the home office of any obligations its branch offices may have had to the three depositors. *Id.* at 864, 285 N.Y.S. at 508. National City Bank was not excused from performance to the indirect depositor, The Second Circuit then expanded on *Sokoloff* by establishing what could be labeled "rules of disengagement" for foreign branch offices. First, if conditions exist that require the foreign branch to "cease operations,"[37] the branch should: (i) inform the depositors of the date the branch will close;[38] (ii) allow enough time for the depositors to withdraw their deposits;[39] and (iii) if time is not available, inform the depositors of an alternative place of payment.[40] The court added that in the "rare event" such steps were impossible, "fairness dictates" that the home office is "liable for those deposits which it was unable to return abroad."[41]

Sokoloff and *Vishipco* hold that when the assets of the foreign branch are confiscated, the U.S. bank home office is liable for the return of the foreign branch's deposits.[42] *Vishipco* took the next step and established rules of disengagement for foreign branches faced with political unrest. But what obligation, if any, does the U.S. bank home office have when the foreign branch's assets are merely frozen because of economic unrest? This issue was addressed by the District Court for the Southern District of New York in *Wells Fargo Asia Ltd. v. Citibank,*

however, since under *Sokoloff* the deposit was governed by New York law. *Id.* at 864, 285 N.Y.S. at 507-08. Performance was limited but not excused. Referee Tweed, however, urged the New York Court of Appeals to reassess this view to determine whether the "mere fact" that the deposit arrangement was made in New York was sufficient grounds for not giving effect to the Soviet decrees. *Id.*

37. *Vishipco Line*, 660 F.2d at 864.

38. *Id.*

39. *Id.*

40. *Id.*

41. *Id.*

42. *See also* Garcia v. Chase Manhattan Bank, 735 F.2d 645 (2d Cir. 1984) (home office held liable where Cuban branch officers stated that the CD purchased by the plaintiff was guaranteed by the home office and could be presented for payment at any branch of the bank); Trinh v. Citibank, 623 F. Supp. 1526 (E.D. Mich. 1985) (home office held liable, based on *Vishipco*, for deposit account opened at Saigon branch of Citibank for the benefit of a child, and payment was later demanded when father was released from re-education camp); Perez v. Chase Manhattan Bank, 61 N.Y.2d 460, 463 N.E.2d 5, 474 N.Y.S.2d 689, *cert. denied*, 469 U.S. 966 (1984) (home office was ultimately liable, but was under no obligation to pay on the deposit a second time after paying the deposit to Cuban authorities). For a discussion of the *Garcia* and *Perez* holdings, see Note, *Debt Situs and the Act of State Doctrine: A Proposal for a More Flexible Standard*, 49 ALBANY L. REV. 647 (1985). For a critical discussion of *Vishipco Line*, see Vishipco Line v. The Chase Manhattan Bank: *Bank Liability for Foreign Branch Seizures*, 2 ANN. REV. BANKING L. 393 (1983). *See generally* Heininger, *Liability of U.S. Banks for Deposits Placed in Their Foreign Branches*, 11 LAW & POL'Y INT'L BUS. 903 (1979).

N.A.[43]

D. Wells Fargo: *What to Do with a Deposit Caught in a Debt Restructuring*

On October 17, 1983, the Philippine Government, in furtherance of an external debt restructuring plan, issued a decree that forbade repayment of principal to foreign banks without prior approval by the Philippine central bank.[44] The Citibank office in Manila informed Wells Fargo Asia Limited ("WFAL"), the Singapore branch of Wells Fargo Bank, N.A., that it was unable to deliver payment on WFAL's certificates of deposit because of the decree.[45] The Citibank office in Manila eventually obtained Philippine approval to make a partial payment by using its non-Philippine assets, that is, money generated by loans and investments made by the Manila branch outside of the Philippines.[46]

WFAL claimed that the Manila branch should also use assets located at the home office to satisfy the debt owed to WFAL.[47] WFAL's reasons were that: (i) Philippine law states that debt obligations of a branch are the obligations of the bank as a whole;[48] and (ii) Citibank otherwise assumed the risk that the host government would place payment restrictions on the foreign branch.[49]

Citibank claimed that it was not required to use home office assets since: (i) the act of state doctrine precluded the court from ruling on the validity of the actions of the Philip-

43. 660 F. Supp. 946 (S.D.N.Y. 1987), *remanded*, No. 87-7685 (2d Cir. Mar. 25, 1988) (order directing limited remand), *previous judgment reaffirmed*, No. 84 Civ. 996 (WK), slip op., 1988 U.S. Dist. LEXIS 3604 (S.D.N.Y. Apr. 22, 1988) (supplemental findings of fact and conclusions of law).

44. Wells Fargo Asia Ltd. v. Citibank, N.A., 612 F. Supp. 351, 354-55 (S.D.N.Y. 1985). The facts relied upon in the district court's opinion in 660 F. Supp. 946 are contained in this opinion denying Wells Fargo Asia Limited's motion for summary judgment. *See Wells Fargo*, 612 F. Supp. at 352-55.

45. 612 F. Supp. at 355.

46. *Id.*

47. *Wells Fargo*, 660 F. Supp. at 947.

48. *Id.*

49. *Id.* at 950. The Act of State doctrine is a principle of judicial restraint that prevents U.S. courts from passing on the validity of a sovereign's actions with respect to property within its jurisdiction. *See generally* Heininger, *supra* note 42, at 950-87; Note, *The Act of State Doctrine: Resolving Debt Situs Confusion*, 86 COLUM. L. REV. 594 (1986).

pine government;[50] (ii) there existed an understanding in the banking community that a foreign depositor assumed the risk that a host government would restrict the withdrawal of funds from a foreign branch;[51] and (iii) Treasury Regulation D[52] evidenced an understanding in the banking community that the repayment of the deposit was subject to the laws of the host country[53] because the deposit was payable only through the

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50. 660 F. Supp. at 947.

51. Reserve Requirements of Depository Institutions, 12 C.F.R. §§ 204.1-.124 (1988). The provisions effecting deposits in foreign branch offices are as follows:

> 204.1 Authority, Purpose and Scope.
>
> . . . .
>
> (b) *Purpose.* This part relates to reserves that depository institutions are required to maintain for the purpose of facilitating the implementation of monetary policy by the Federal Reserve System.
>
> (c) *Scope.* (1) The following depository institutions are required to maintain reserves in accordance with this part: . . . .
>
> (5) The provisions of this part do not apply to any deposit that is payable only at an office located outside the United States.
>
> 204.2 Definitions. . . . .
>
> (t) "Any deposit that is payable only at an office located outside the United States" means (1) a deposit of a United States resident that is in a denomination of $100,000 or more, and as to which the depositor is entitled, under the agreement with the institution, to demand payment only outside the United States or (2) a deposit of a person who is not a United States resident as to which the depositor is entitled, under the agreement with the institution, to demand payment only outside the United States.

12 C.F.R. §§ 204.1-.2 (1988) (footnotes omitted).

52. *Wells Fargo,* 660 F. Supp. at 947.

53. WFAL instructed Wells Fargo International ("WFI"), the New York branch of Wells Fargo Bank, N.A., to transfer funds from its account with WFI to Citibank/Manila's account at Citibank, N.A., in New York. *Wells Fargo,* 612 F. Supp. at 354. Citibank/Manila, in turn, agreed to reverse the process, including the interest payment, on the maturity date. *Id.* The Federal Reserve Bank of New York, in an amicus curiae brief filed in this case, noted that this fact did not have any bearing on whether the deposit was payable outside of the United States for the purpose of Regulation D reserve requirements:

> The location where the depositor has legal right to demand payment is a distinct concept from the location where the deposit is settled. The fact that settlement of United States dollar deposit liabilities takes place in the United States between United States domiciliaries is not determinative of where the deposit is legally payable. Virtually all United States large-dollar transactions between parties located outside the United States must be settled in the United States. The Clearing House Interbank Payments System, or CHIPS, operated by the New York Clearing House Association for some 140 banks, handles at least $400 billion in transfers each day, and it is assumed that perhaps 90 percent of these payments are in settlement of offshore transactions.

Memorandum of Law of the Federal Reserve Bank of New York as Amicus Curiae at foreign branch.[54] Citibank argued that the decree thus excused the Manila office from further performance under its contract with WFAL until it received approval from the Philippine central bank.

The district court, citing an affidavit presented by WFAL, concluded that under Philippine law "an obligation incurred by a branch is an obligation of the bank as a whole"[55] and that the decree did not prevent Citibank from using its "worldwide assets" for satisfaction of WFAL's claim.[56]

The district court did not resolve the issue of who assumed the risk of non-payment because the evidence presented was not persuasive of either party's argument.[57] Nor did it rule upon the impact of Treasury Regulation D, which it viewed as a moot question given the fact that its holding was based on Philippine law.[58]

II. *TREATMENT OF FOREIGN DEPOSITS BY U.S. MONETARY POLICYMAKERS*

The treatment accorded a foreign deposit by U.S. courts is different from the treatment it is accorded by U.S. monetary policymakers. While U.S. courts have held that the home office is always liable for the payment of the foreign deposit, U.S. monetary policymakers, on the other hand, consider the home office liable only when the foreign deposit is payable in the United States.[59] The view held by U.S. monetary policymakers is based on the function of the reserve requirement, certain exemptions from the reserve requirement, and the conditions under which a bank is allowed to issue a guaranty.

A. *Federal Reserve Regulations*

Section 19 of the Federal Reserve Act of 1913 (the "Act")

12-13, Wells Fargo Asia Ltd. v. Citibank, N.A., 660 F. Supp. 946 (S.D.N.Y. 1987) (No. 84 Civ. 996 (WK)), *remanded*, No. 87-7685 (2d Cir. Mar. 25, 1988) (order directing limited remand), *previous judgment reaffirmed*, No. 84 Civ. 996 (WK), slip op., 1988 U.S. Dist. LEXIS 3604 (S.D.N.Y. Apr. 22, 1988) (supplemental findings of fact and conclusions of law) [hereinafter N.Y. Fed. Brief in WFAL].

54. *Wells Fargo*, 660 F. Supp. at 949.

55. *Id.* at 950.

56. *Id.*

57. *Id.*

58. *Id.*

59. *See infra* notes 60-81 and accompanying text.

requires member banks to set aside vault cash to provide for unseasonable withdrawals by depositors.[60] Although this requirement was originally intended to serve as a liquidity function to the whole banking system,[61] the reserve requirement today, by law, is used solely for the purpose of implementing monetary policy.[62]

The Federal Reserve has three major tools to regulate the U.S. money supply and thereby to regulate economic growth in the United States: the reserve requirement, the discount rate on loans made to financial institutions,[63] and purchases or sales on the open market by the Federal Open Market Committee of the Federal Reserve System ("FOMC").[64] An increase in the reserve requirement, or an increase in the discount rate, or sales by the FOMC, causes a contraction in the pool of money available to the member banks for purposes of making loans or investments.[65] On the other hand, a decrease in the reserve requirement, or in the discount rate, or purchases by the FOMC, has the opposite effect.[66] These tools allow the Federal Reserve to pursue its primary function: to ensure a stable

60. Federal Reserve Act, ch. 6, § 19, 38 Stat. 251, 270-71 (1913) (codified as amended at 12 U.S.C. § 461 (1982 & Supp. IV 1986)).

61. The Federal Reserve Bank of New York has noted that in 1918 "reserve requirements on domestic deposits were intended primarily to protect domestic deposits by promoting liquidity of member banks. The [12 regional] Reserve Banks made the reserves available to supply the member banks demand for currency, especially when withdrawals by domestic depositors were abnormally high." N.Y. Fed. Brief in WFAL, *supra* note 53, at 6-7; *see also* W. MELTON, INSIDE THE FED: MAKING MONETARY POLICY 16-17 n.1 (1985).

62. Section 19 of the Federal Reserve Act states in part: "Each depository institution shall maintain reserves against its transaction accounts as the Board [of Governors of the Federal Reserve System] may prescribe by regulation solely for the purpose of implementing monetary policy . . . ." 12 U.S.C. § 461(b)(2)(A) (1982).

63. The Discount Rate is the interest rate the Federal Reserve charges on short-term loans to financial institutions. W. MELTON, *supra* note 61, at 17 n.2.

64. The Supreme Court has noted:

> The Federal Open Market Committee . . . by statute has exclusive control over the open market operations of the entire Federal Reserve System. The FOMC is charged with conducting open market operations "with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country."

Federal Open Market Comm. v. Merrill, 343 U.S. 340, 344 (1979) (citation and footnote omitted); *see also* N.Y. Fed. Brief in WFAL, *supra* note 53, at 4-5; W. MELTON, *supra* note 61, at 202-15.

65. *See* N.Y. Fed. Brief in WFAL, *supra* note 53, at 4-5; W. MELTON, *supra* note 61, at 114.

66. *Id.*

money supply to promote orderly growth and to curb inflation.[67]

B. *Exemption for Deposits in Foreign Branches*

A 1918 opinion of the Counsel to the Federal Reserve Chairman[68] noted that although the Federal Reserve was authorized to require foreign branch offices of U.S. banks to set aside reserves against their deposits under section 25 of the Act,[69] the policy underlying section 19 indicated that the reserve requirement was clearly intended to protect domestic creditors.[70] Therefore, "[r]eserve[s] should [not] be carried against foreign deposits in a place where such reserve[s] could not perform the functions it is intented to perform."[71]

In 1970, the Federal Reserve issued an opinion[72] regarding reports that member banks were "in effect guarantee[ing] payment of . . . deposits in the United States if the foreign branch is precluded from making payment."[73] The opinion stated that foreign branch offices were not subject to reserve requirements so long as the deposits were payable only outside of the United States.[74]

The exemption, the opinion noted, primarily enabled U.S. foreign branch offices to compete on equal footing with the local banks.[75] The opinion also noted that the foreign depositor "assumes whatever risk may exist that the foreign country might impose restrictions on withdrawals."[76] When the foreign deposit is guaranteed, however, the depositor "no longer assumes such risk, but enjoys substantially the same right[s] [as a domestic depositor]" as if the foreign deposit had been made

67. BOARD OF GOVERNORS OF THE FED. RESERVE SYS., THE FEDERAL RESERVE SYSTEM: PURPOSES AND FUNCTIONS 13 (1984).

68. Reserves of Foreign Branches, 4 Fed. Res. Bull. 1123 (1918).

69. Ch. 6, § 25, 38 Stat. 251, 273-74 (1913) (codified as amended at 12 U.S.C. §§ 601-604 (1982)).

70. Reserves of Foreign Branches, 4 Fed. Res. Bull. 1123 (1918).

71. *Id.*

72. Interpretation of Regulations D and Q: Deposits in Foreign Branches Guaranteed by Domestic Offices of Member Banks, 56 Fed. Res. Bull. 140 (1970) [hereinafter Interpretations of Regulations D and Q].

73. *Id.*

74. *Id.*

75. *Id.*

76. *Id.*

in the United States.[77] Thus, the opinion concluded that to assure effectiveness of and to prevent evasions from reserve requirements, such guaranteed foreign deposits are subject to reserve regulations "the same as if the deposit had been made in the domestic office."[78] This position was reaffirmed in 1983.[79]

Congress codifed the foreign branch reserve exemption into the Act in 1980[80] and in 1981 excluded deposits at foreign branches from coverage by the Federal Deposit Insurance Corporation.[81] When these exemptions are read with section 19 of the Act, which states that reserves are to be used solely for the purpose of implementing monetary policy, it can be inferred that Congress believed that deposits in foreign branch offices were not important to the implementation of U.S. monetary policy.

C. *To Guaranty or Not To Guaranty*

Since the opinions and rulings of U.S. monetary policymakers generally exclude deposits held in foreign branches unless such deposits are guaranteed by the U.S. office,[82] it is important to review the rules governing guarantees of foreign branch deposits.

A guaranty has been defined by case law as a promise to answer for the debt or default of another.[83] It is a contract between a third party and a party to whom performance is due on the primary contract. Current Treasury Regulations allow a member bank to become a guarantor[84] if the bank: (i) has a

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77. *Id.*

78. *Id.*

79. Deposits Payable Outside United States—Guarantee by U.S. Bank, 1 Fed. Reserve Reg. Serv. ¶ 2-330.1 (Staff Op. July 29, 1983); Deposits Payable Outside the United States—CD Issued in United States, 1 Fed. Reserve Reg. Serv. ¶ 2-521.1 (Staff Op. Mar. 21, 1983).

80. Monetary Control Act of 1980, Pub. L. No. 96-221, sec. 103, § 19(b)(6), 94 Stat. 132, 136 (codified at 12 U.S.C. 461(b)(6) (1982)).

81. International Banking Facility Deposit Insurance Act, Pub. L. No. 97-110, sec. 102, § 3(*l*)(5), 95 Stat. 1513, 1513 (1981) (codified at 12 U.S.C. 1813(*l*)(5)(A) (1982)).

82. *See supra* notes 71-81 and accompanying text.

83. United States v. Frisk, 675 F.2d 1079, 1082 n.6 (9th Cir. 1982).

84. 12 C.F.R. § 7.7010 provides that:

> (a) A national bank may lend its credit, bind itself as a surety to indemnify another, or otherwise become a guarantor if it has a substantial

"substantial interest" in the performance of the transaction involved;[85] or (ii) has a segregated deposit sufficient in amount to cover the bank's total potential liability.[86]

The decision to guaranty the deposit held in the foreign branch office is a complicated one involving a host of business decisions. The home office must decide whether it is willing to make its asset base available to settle the guaranty. It must also decide whether it will be required to establish a fund equal to the amount of the guaranteed deposit. Such a fund may be required since payment to the depositor of a foreign branch might not be labeled a "substantial interest" of the home office.[87]

If repayment of the deposit is viewed as a "substantial interest" a separate fund will not be required.[88] But, since the deposit is no longer payable only outside the United States it would be considered a domestic deposit leading to the imposition of the reserve requirement.[89] This requirement, however, would reduce the pool of funds available to the foreign branch and place it at a competitive disadvantage with local banks.

III. *THE CONFLICTING TREATMENT ACCORDED TO FOREIGN DEPOSITS*

The key distinction between the conflicting views of United States courts and U.S. monetary policymakers lies in the way each side views the relationship among the key parties:

> interest in the performance of the transaction involved or has a segregated deposit sufficient in amount to cover the bank's total liability. For example, a bank, as a fiduciary, has a sufficient interest in the faithful performance by its cofiduciary of his duties to act as surety on the bond of such cofiduciary.
>
> (b) Under appropriate circumstances, foreign branches may exercise additional powers pursuant to [the Act].

12 C.F.R. § 7.7010 (1988). 12 C.F.R. § 7.7012 provides that: "A national bank may guarantee the deposits and other liabilities of its Edge Act and agreement corporations and its corporate instrumentalities in foreign countries." *Id.* § 7.7012 (1988).

85. *Id.* § 7.7010(a) (1988).

86. *Id.*

87. Since 12 C.F.R. § 7.7012 specifically allows a national bank to guaranty the deposits in its foreign branches, it could be viewed that such a move is not within 12 C.F.R. § 7.7010(a), see *supra* note 84 for text (substantial interest provision thus requiring a special fund equal to the guaranty). *See supra* note 84.

88. 12 C.F.R. § 7.7010(a), provides for either the presence of a substantial interest or the use of a special fund equal to the amount of the guaranty, but not both. *See supra* note 84.

89. Interpretations of Regulations D and Q, *supra* note 72.

the U.S. bank home office, the foreign branch, and the foreign depositor.

A. *Relationship Among the Parties*

U.S. case law holding the home office liable for the return of confiscated or frozen deposits places the home office as the debtor to the foreign depositor and makes the foreign branch a mere teller's window.[90] These decisions make the home office the guarantor to the foreign depositor, since the home office is called upon to answer for the debt of another person. In contrast, the position consistent with U.S. monetary policy is that the home office is a third party to the deposit contract between the foreign depositor and foreign branch office.

Support for this latter view can be found in the 1970 Federal Reserve opinion.[91] In that opinion the Federal Reserve specifically disapproved of the guaranteeing of deposits in foreign branch offices. It stated that it was important for U.S. monetary policy that the foreign depositor, and not the home office, assume the risk of non-payment.[92] This position was reaffirmed in two 1983 Federal Reserve staff opinions,[93] as well as in the amicus curiae brief filed by the Federal Reserve Bank of New York in *Wells Fargo Asia Ltd. v. Citibank, N.A.*[94]

Further support is contained in Congressional actions regarding the implementation of U.S monetary policy. In 1980, Congress amended the Act with the Depository Institutions Deregulation and Monetary Control Act of 1980[95] (the "Monetary Control Act"). The Monetary Control Act addressed new deposit instruments used by U.S. banks that were not covered by the reserve requirement provisions of the Act.[96] The banks

90. The phrase "teller's window" in the context of U.S. bank home office liability was coined by Referee Harrison Tweed in Dougherty v. National City Bank of New York, 157 Misc. 849, 285 N.Y.S. 491 (Sup. Ct. 1935), where he noted, "The branches were not, of course, corporate entities separate and distinct from the [home office], but they were something more than . . . 'teller's windows.' " *Id.* at 858, 285 N.Y.S. at 502.

91. *Id.*

92. *Id.*

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

94. *See* N.Y. Fed. Brief in WFAL, *supra* note 53, at 7-9.

95. Pub. L. No. 96-221, secs. 101-108, 94 Stat. 132, 132-41 (codified at scattered sections of 12 U.S.C.).

96. S. REP. No. 368, 96th Cong., 2d Sess. 14-15, *reprinted in* 1980 U.S. CODE CONG. & ADMIN. NEWS 236, 249-51.

were incurring debt for which the system had no safeguard. The Monetary Control Act authorized the Federal Reserve to impose the reserve requirement on these new deposit instruments.[97]

The Senate Report on the Monetary Control Act noted that reserves were required to allow the Federal Reserve to pursue "[s]ound management of [U.S.] monetary policy" in the wake of the use of these new deposit instruments.[98] Congress characterized the inclusion of these deposits as important to the Federal Reserve's management of U.S. monetary policy.[99] But Congress did not mention that deposits in foreign branches should be included. In fact, Congress specifically incorporated the exemption that the Federal Reserve had recognized for so long.[100] If Congress believed that foreign deposits were important to the implementation of U.S. monetary policy, it would have listed foreign deposits with the other deposit instruments. Instead, Congress reaffirmed the longstanding regulatory treatment of foreign branch deposits by specifically excluding foreign deposits from consideration.[101]

B. *The Current Problem*

By treating U.S. bank home offices as guarantors of foreign branch deposits, U.S. courts have now exposed U.S. bank home offices to an unreserved liability—the very risk that U.S. monetary policymakers have specifically tried to protect them from.

Arguably, holding U.S. bank home offices liable for the deposits held in their foreign branches would do little harm to their asset base, their stockholders, or their ability to make money in the future. And, as the *Vishipco* court noted, "fairness" dictates that U.S. bank home offices should pay when their foreign branch office can not.[102] But such a practice ignores the impact that liability has on U.S. monetary policy.

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97. *Id.* at 14, *reprinted in* 1980 U.S. CODE CONG. & ADMIN. NEWS at 249.

98. *Id.*

99. *See id.* at 14-15, *reprinted in* 1980 U.S. CODE CONG. & ADMIN. NEWS at 249-51.

100. *See* Monetary Control Act of 1980, sec. 103, § 19(b)(6), 94 Stat. 132, 136 (codified at 12 U.S.C. § 461(b)(6) (1982)).

101. *See id.*

102. Vishipco Line v. Chase Manhattan Bank, 660 F.2d 854, 864 (2d Cir. 1981), *cert. denied*, 459 U.S. 976 (1982).

As of December 31, 1986, nine of the largest U.S. banks collectively held US$208 billion in domestic deposits and US$184 billion in foreign deposits.[103] Under current federal law and regulations, these banks must set aside reserves on the US$208 billion in domestic deposits.[104] This figure is also used by the Federal Reserve in making decisions to regulate the growth of the money supply.[105] If any one of these banks failed, regulators would be called in to figure out a way of returning this debt to the depositors.[106]

Unless the U.S. bank home office guarantees that a foreign deposit can be collected at the U.S. bank home office, the US$184 billion in foreign deposits are not accorded similar treatment.[107] This situation is exactly what the Federal Reserve[108] and Congress[109] found desirable for the implementation of U.S. monetary policy. But the court decisions holding the U.S. bank home office liable have the effect of adding US$184 billion in debt to these home offices. This is debt that neither the Federal Reserve nor Congress took into account when establishing the guidelines for regulating U.S. monetary policy.

Foreign depositors now enjoy the security of a U.S. domestic deposit with a higher interest rate,[110] while the U.S.

103.

	Domestic Deposits (in millions of US$)	Foreign Deposits (in millions of US$)
Bank of America	56,674	21,324
Bankers Trust Company	12,398	21,487
Chemical Bank	26,726	12,347
Citibank	39,956	59,952
Continental Illinois	8,987	9,691
First Nat'l Bank of Chicago	11,674	13,235
Manufacturers Hanover	24,521	20,680
Morgan Guaranty	15,297	29,484
Security Pacific	27,918	6,656

See RAND MCNALLY BANKERS DIRECTORY 780, 2866, 2888, 2892, 1310, 1316, 2914, 2926, 712 (1987).

104. *See supra* notes 62-64 and accompanying text.

105. *See supra* notes 67-68 and accompanying text.

106. For a discussion of the rescue of the Franklin National Bank, see W. MELTON, *supra* note 61, at 158-60.

107. *See supra* notes 72-81 and accompanying text.

108. *See id.*

109. *See supra* notes 80-81 and accompanying text.

110. The district court's summary judgment opinion in *Wells Fargo* noted:

monetary system is now liable for debt that it is not designed to handle. The courts have made the U.S. monetary system the guarantor of every foreign depositor of a U.S. bank without creating a corresponding safeguard to ensure a stable money supply.

C. *Resolution*

The resolution of this problem must proceed on the following three premises. First, the foreign depositor assumes the risk that its country may restrict the disposition of its deposit.[111] Second, the operation of a foreign branch office does not assure the foreign depositor that it can go to any office of the bank and demand the return of its deposit.[112] The foreign

> [WFAL] makes a cogent argument that the theory propounded by Citibank to explain the higher rate of interest borne by a Eurodollar deposit—that the depositer [sic] assumes a sovereign risk—is considerably undercut by the fact that the higher rate of interest is uniform among countries whose governments might be regarded as more or less "risky" than others. Thus, the Manila deposits here at issue bore the same rate of interest as those placed in London, Frankfurt and Singapore on the same day. Suggestive as the circumstance might be, we believe whether the validity of Citibank's position is thereby undermined is a question for the trier of fact.

Wells Fargo Asia Ltd. v. Citibank, N.A., 612 F. Supp. 351, 356 n.2 (S.D.N.Y. 1985).

The district court adopted WFAL's view in the subsequent trial. Wells Fargo Asia Ltd. v. Citibank, N.A., 660 F. Supp. 946, 950 (S.D.N.Y. 1987), *remanded*, No. 87-7685 (2d Cir. Mar. 25, 1988) (order directing limited remand), *previous judgment reaffirmed*, No. 84 Civ. 996 (WK), slip op., 1988 U.S. Dist. LEXIS 3604 (S.D.N.Y. Apr. 22, 1988) (supplemental findings of fact and conclusions of law).

The district court, however, failed to recognize that the distinction is not between different offshore markets but between the U.S. market and the offshore market as a whole. The New York Federal Reserve Bank noted:

> The effect of the exemption [from the reserve requirement] was to promote competitive equality between offshore offices of United States banks and their foreign counterparts. In part because foreign branches of United States depository institutions are not required to hold reserve against deposits payable only outside the United States, they are able to pay the higher rates of interest on deposits found in the offshore banking market. Thus, they are better able to compete with local banks which generally are not subject to any reserve requirements.

N.Y. Fed. Brief in WFAL, *supra* note 53, at 7.

Thus, the key to the higher interest rate as an indicator of additional risk does not lie in the interest rate offered in different offshore deposit markets, but in the difference in interest rate offered between the U.S. deposit market and the offshore deposit market as a whole. The foreign depositor receives a higher interest rate for the less regulated and less secure offshore market.

111. *See supra* notes 72-81 and accompanying text.

112. *See supra* notes 89-94 and accompanying text. *But see* Heininger, *supra* note

branch office merely offers the foreign depositor services that a local branch may not be able to provide. Finally, there is no contractual relationship between the U.S. bank home office and the foreign depositor when the deposit contract is made with the foreign branch office. The only existing contractual relationship is between the foreign depositor and the foreign branch office. It is incumbent upon the foreign depositor to alter this relationship to provide security for its deposit.[113] It is the responsibility of the foreign depositor to bring the U.S. bank home office into its contract with the foreign branch office. There are three options that could be used to remedy the current conflict.

1. Guaranty Payment in the United States

The foreign depositor could sign a guaranty agreement with the U.S. bank home office providing for payment of his deposit at the U.S. bank home office. This agreement would provide the foreign depositor with the security it requires. The foreign branch, however, would be required to set aside reserves against the deposit.[114] This requirement would cause a reduction in the pool of funds available to it to make loans and investments. The foreign branch would be placed at a competitive disadvantage when compared to the local banks since the foreign branch might not be able to offer competitive local interest rates. Also the U.S. bank home office is required to use its assets as security for the deposit since the foreign branch office reserves would be confiscated along with its other assets. Unless the U.S. bank home office is required to set aside a special fund equal to its liability under the guaranty,[115] the U.S. bank home office asset base, and thereby U.S. monetary policy, will be adversely affected.

42, at 911 n.20 (bank may not be able to operate abroad if liability was limited by incorporating the foreign office as a subsidiary as opposed to operating it as a branch).

113. Since the foreign depositor is assuming the risk of non-payment because of local restrictions, *see supra* notes 72-79 and accompanying text, it is his responsibility to shift this risk to another party, namely the home office.

114. *See supra* notes 72-79 and accompanying text.

115. *See supra* note 86-89 and accompanying text.

2. Teller's Window

The foreign branch office could act as an agent for the U.S. bank home office. In this situation, the deposit is "opened" in the U.S. bank home office with the provision that the foreign depositor can draw on the account at the foreign branch office.[116] The foreign depositor would accept the lower interest rate offered by the U.S. bank home office but he would receive the security he desires. There are, however, two major problems with this option.

First, by acting as an agent the foreign branch does not have the use of the funds to make loans or other investments. Second, this option encourages capital flight, since many depositors would no doubt prefer the added security offered to a deposit located in the United States. Laws could be enacted to ensure that only a certain amount is available for this treatment, but it is unlikely that any nation would encourage the exodus of currency upon which the local economy is dependent for economic growth.

3. No Guaranty

Finally, the foreign depositor could be held to the bargain it struck with the foreign branch office. The foreign depositor is aware that the return of its deposit is dependent upon the local laws governing its contract with the foreign branch and that U.S. law prohibits payment in the United States unless the deposit is guaranteed by the U.S. home office. The foreign depositor accepts the higher interest rate in exchange for this risk.[117] Its deposit is in no better or worse position than the deposit in a locally incorporated bank. It is the foreign depositor's responsibility to withdraw its deposit if confiscation or other limitations seem imminent.

CONCLUSION

The U.S. courts' practice of holding the U.S. bank home office liable for foreign branch office deposits, and the establishment of rules of disengagement for foreign branch offices

116. *See, e.g.*, Sokoloff v. National City Bank of N.Y., 130 Misc. 66, 224 N.Y.S. 102 (Sup. Ct. 1927), *aff'd without opinion*, 223 A.D. 754, 227 N.Y.S. 907, *aff'd*, 250 N.Y. 69, 164 N.E. 745 (1928).

117. *See supra* note 110 and accompanying text.

faced with political unrest appear to provide a workable solution to the problem. But this practice places the U.S. bank home office as the guarantor of the foreign depositor and adds debt that the U.S. monetary system is not designed to handle. The U.S. courts should recognize the clear intention of U.S. monetary policymakers to isolate foreign deposits from U.S. monetary policy consideration hold that the risk of non-payment is upon the foreign depositor and not the U.S. bank home office. The U.S. bank home office should be held liable only when the foreign depositor has taken steps to provide for payment in the United States and the U.S. bank home office has taken steps to bring the deposit within the U.S. monetary system. Fairness dictates that the foreign depositor of a U.S. bank should not be allowed to gain a more favorable position than other local depositors simply because his bank has an office in the United States.

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