"Ringfencing" U.S. Bank Foreign Branch Deposits: Working Toward A Clearer Understanding Of Where Deposits Are Payable In The Midst Of Chaos

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ARTICLES

"RINGFENCING" U.S. BANK FOREIGN BRANCH DEPOSITS: WORKING TOWARD A CLEARER UNDERSTANDING OF WHERE DEPOSITS ARE PAYABLE IN THE MIDST OF CHAOS

BY V. GERARD COMIZIO* AND RYAN CHIACHIERE**

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I. BANKING ABROAD—WHY AND HOW?

In the second half of the Twentieth Century, the investment of U.S. companies abroad grew dramatically as the United States emerged as a world economic power. The number of foreign offices of U.S. banks skyrocketed commensurate with new U.S. investment, and new challenges to the understanding and regulation of banking deposits abroad accompanied this growth.1

In 1960, eight U.S. banks maintained offices abroad; in 1984, there were 163; and by 1987, 902 U.S. banks had offices abroad.2 In 1985, there were over 2,000 foreign offices of American banks, with Citibank and Chase Manhattan together accounting for nearly 1,200 offices at the end of 1983.3 At that time, more than half of the total assets of both banks were foreign.4 As of 2013, Citibank claims to operate over 4,000 branches overseas,5 including offices in 160 countries across North and South America, Europe, the Middle East, and the Asia-Pacific region.6 According to the Federal Deposit Insurance Corporation (FDIC), foreign branch deposits have doubled since 2001 alone, totaling approximately $1 trillion.7

4. Id.
A U.S. bank may establish a foreign presence in a number of ways, including through representative offices, shell branches, correspondent banking relationships, affiliates, subsidiaries, or branches. The Federal Reserve Act of 1913 grants banks the authority to open foreign branches, and the branch office is the most common form of foreign involvement. Nationally chartered banks operate the majority of foreign branches. A foreign branch is subject to both American law and the laws and regulations of the country in which it is located. Host country law may apply to capital requirements, reserves, submission to local courts and laws, and assurances from the parent bank.

As with U.S. banks, foreign banks can accept two broad types of deposits: special deposits and general deposits. In a special deposit, the deposited funds are kept separate from the bank’s funds, and the same bills deposited must be returned. They are, however, less common than the general deposit, in which the funds deposited become the property of the bank and the depositor can demand payment for general assets of the bank.

The U.S. bank regulatory environment has generally been favorable for foreign branches. For instance, Regulation D, which pertains to reserves that depository institutions are required to maintain for “the purpose of facilitating the implementation of monetary policy,” does not apply to any deposit that is payable only at an office located outside the United States. The rule’s impact is significant—U.S. banks do not have to hold reserves against the large amount of deposits at foreign branches of their banks.

Further, the overwhelming majority of foreign deposits are not dually payable; that is, they are not payable at the U.S. home office in addition to being payable at the foreign branch. Significantly, recent events have
made it less costly for banks to hold dually payable deposits. The Dodd-Frank Act, as one such event, altered the deposit insurance assessment such that all liabilities are included, so dual-payability no longer increases the assessment base. 

Additionally, the Federal Reserve now pays interest on reserves. Nonetheless, banks have been hesitant to make deposits in foreign branches dually payable because they have concerns that dual-payability would mean they would no longer be protected from sovereign risk under Section 25(c) of the Federal Reserve Act.

While domestic branches of U.S. banks are not considered separate legal entities, foreign branches of U.S. banks have been treated by courts as separate entities, and accordingly banks have traditionally not been compelled to incorporate as a subsidiary abroad to shield the parent from liability. This is known as the "Separate Entity Doctrine," but courts have not treated it as an ironclad principle, resulting in a great deal of uncertainty regarding liability for foreign branch deposits.

Foreign branches provide many of the same kinds of services that a domestic branch would provide to its customers, including investment of funds brought in from outside the host country and the lending of local funds received as deposits. Foreign offices of U.S. banks may also finance the importation of U.S. goods or the exportation of goods to the U.S. U.S. banks often operate these branches "to provide banking, foreign currency, and payment services to multinational corporations." Often, foreign branches of U.S. banks do not offer retail deposit or retail banking services, but rather accept deposits from large businesses seeking the convenience of the bank’s international branch network.

In general, foreign branch banking is beneficial to all parties involved, as foreign countries obtain investment capital and U.S. financial services and U.S. companies reap the profitable rewards of foreign operations. Further, corporations may use foreign bank deposits as a means of minimizing U.S. tax consequences. Problems can arise, however, when tumultuous social

20. Id.
22. Id.
23. Id.
24. See Hannigan, supra note 1, at 739.
25. Johnson, supra note 3, at 205.
26. Id.
27. FDIC Deposit Insurance Regulations; Definition of Insured Deposit, 78 Fed. Reg. at 11605.
28. See id. (explaining how banks take advantage of transferring from branch to branch in different countries based on deposit agreements not governed by U.S. law).
and political events in countries where U.S. bank branches are located result in questions as to whether risk of political upheaval ("political risk") is borne by depositors or by the U.S. offices of the branch. Accordingly, banks have attempted to "ringfence" foreign deposits; to wall them off so that they are not payable in the U.S. The U.S. government and state governments have sought, in various ways, to "ringfence" foreign deposits as well, either by attempting to ensure that banks are not liable for the deposits or by mandating that deposits payable outside the U.S. are not, unlike deposits payable exclusively in the U.S., backed by the full faith and credit of the U.S. government. Part II of this Article will review the cases that examine political risk and U.S. bank foreign branch deposits. Part III will review various solutions offered to this problem in the last three decades, including a rule issued by the FDIC in late 2013 aimed at addressing aspects of this very issue. Part IV will offer some conclusions regarding the allocation of political risk in foreign bank deposits.

II. CASES AND CONFLICTS: THE ROOT OF THE PROBLEM

The Russian Revolution, the Cuban Revolution, and the Vietnam War posed complex issues related to foreign deposits in U.S. banks, and resulted in case law that sought to develop an overarching theory of liability for foreign bank deposits. In general, the cases surrounding these political upheavals involve emerging regimes nationalizing the assets of private banks without expressly declaring their intentions regarding the banks' liabilities, leaving the banks with all of their obligations and none of their assets.29 Upon analysis, the relevant cases do not reflect a clear and consistent approach by courts, and developing more consistent outcomes is indispensable to creating certainty for U.S. investors and those seeking funding for ventures abroad.

A. The Russian Revolution Cases

Boris N. Sokoloff was a Russian citizen residing in New York City following the overthrow of the Imperial Government in Russia in March 1917 and preceding the Bolshevik Revolution later that year.30 In June of that year, Sokoloff deposited $31,108.50 in the New York branch of National City Bank to be transferred to the branch in Petrograd; in September, he departed New York and arrived in Petrograd.31 Just prior to the Bolshevik Revolution, Sokoloff instructed the Petrograd branch to

29. See Johnson, supra note 3, at 213.
31. Id. at 68–69.
transfer the bulk of his account, now denominated in rubles, to a bank in Kharkoff via the Russian State Bank. Upon discovering that the new bank did not receive his funds, he instructed the Petrograd branch to cancel the transfer and hold his funds, which the branch told him it could not do, as it had already acted upon his transfer request. The Petrograd branch inquired with the State Bank as to the status of the funds, and the State Bank replied that it was unsure of the status because of a failure of communication, presumably due to the revolution. Ultimately, the State Bank confirmed that no transfer had been made to Kharkoff, and the Petrograd branch asked to be re-credited with the transfer amount.

In December 1917, the Soviet Government issued a decree merging all existing banks into the State Bank, and on the same day soldiers occupied the Petrograd branch and took possession of it. The State Bank limited the amount of rubles that the Petrograd branch could disperse in a given day, but during the spring of 1918 the branch sent two letters to depositors encouraging them to withdraw any balance held at the branch. In December 1918, the bank was nationalized and all assets were confiscated.

Sokoloff sued the National City Bank branch in New York. In denial of a motion for re-argument before the New York Court of Appeals in 1924, Judge Cardozo noted the defendant’s claim that the plaintiff "was fully aware of the probability of future political and governmental changes," and had therefore, in essence, assumed the risk of revolution. Cardozo, and the court, held that neither the bank’s attempt to terminate its existence nor the seizure of the bank’s assets affected its” liability ”because the Russian government “could not terminate [the bank’s] existence ... for it was a corporation formed under [U.S.] laws." By simply “depriv[ing] it of the privilege of doing business upon Russian soil,” the Russian government did not “end[] its duty to make restitution for benefits received without

32. Id. at 69.
33. See id. at 69–70 (having already debited Sokoloff the 120,000 rubles and credited that amount to the record of its account with the State Bank, the Petrograd branch claimed that it no longer possessed the funds Sokoloff now wished it to hold).
34. See id. at 70.
35. Id. (noting that the Petrograd branch chose not to inform Sokoloff of its receipt of this news from the State Bank).
36. Id. at 71.
37. Americans were permitted to withdraw 500 rubles per day; all others were permitted to withdraw 150 rubles per week. See id.
38. See id.
39. See id. at 72.
41. Id. at 919.
Most importantly, Cardozo explicitly tied the Petrograd branch to the assets of the home office in the U.S., asserting that Sokoloff “did not pay his money to the defendant, and become the owner of this chose in action, upon the security of the Russian assets,” but rather “[h]e paid his money to a corporation organized under our laws upon the security of all its assets, here as well as elsewhere.” Indeed, Cardozo held that “[e]verything in Russia might have been destroyed by fire or flood, by war or revolution, and still the defendant would have remained bound by its engagement.”

The Supreme Court of New York County, hearing the case again in 1927, held that a contract was entered into between Sokoloff and National City, whereby the latter was to pay on demand in Petrograd. Because payment could not be made elsewhere, the court asserted, there was an “implied obligation on the part of the defendant that it would maintain its branch in Petrograd.” The branches were separate entities, the court asserted, “as distinct from one another as any other bank.” However, it asserted:

[W]hen considered with relation to the parent bank, [branches] are not independent agencies; they are, what their name imports, merely branches, and are subject to the supervision and control of the parent bank, and are instrumentalities whereby the parent bank carries on its business, and are established for its own particular purposes, and their business conduct and policies are controlled by the parent bank, and their property and assets belong to the parent bank, although nominally held in the names of the particular branches . . . . Ultimate liability for a debt of a branch would rest upon the parent bank.

The court emphasized that it was not “concerned with questions of liability for transactions originating in Russia and wholly to be performed in Russia, but with a debt incurred in this State which the defendant agreed to pay on demand at its own branch in Petrograd.” The court also noted that the bank’s loss was somewhat of a fiction: after all, the transfer was

42. Id.
43. Id. (emphasis added).
44. Id.
46. Id.
47. Id.
48. Id.
49. Id. at 73–74.
merely a "bookkeeping entry" that was not a loss until cash was paid.\textsuperscript{50} National City Bank's Petrograd branch "parted with nothing" and the rubles it had promised through its bookkeeping entry "were [still] in its possession."\textsuperscript{51} "To constitute payment of a debt payable in money," the court asserted, "there must be a delivery by the debtor or his representative to the creditor or his representative of money or some other valuable thing for the purpose of extinguishing the debt and which is received by the creditor for the same purpose."\textsuperscript{52} 

Addressing force majeure, the court asserted that the nationalization of the Petrograd branch and seizure of its assets "have no force and effects as acts of sovereignty," because the U.S. did not recognize the Soviet Republic as a legitimate government of Russia.\textsuperscript{53} The confiscation by such a government "has no other effect, in law, than seizure by bandits or by other lawless bodies."\textsuperscript{54}

\textbf{B. The Vietnam War Cases: Fall of Saigon}

Six days before the fall of the South Vietnamese government in Saigon in 1975, Chase Manhattan bank closed the doors of its Saigon branch without any prior notice to depositors.\textsuperscript{55} Staffers "balanced the day's books, shut the vaults and the building itself, and delivered keys and financial records needed to operate the branch to personnel at the French Embassy in Saigon."\textsuperscript{56} Shortly thereafter, the North Vietnamese government issued a confiscation decree that applied to established banks, and the French embassy turned over records from Chase to the new government.\textsuperscript{57} Two plaintiffs—one a shareholder in ten corporations with deposits at Chase in Saigon and the other an individual depositor—fled South Vietnam for the United States just prior to the communist takeover, and upon arrival there, demanded payment from Chase on their Saigon accounts.\textsuperscript{58} Chase refused to pay, and the depositors brought a breach of contract claim in the United States District Court for the Southern District of New York.\textsuperscript{59}

\begin{itemize}
\item 50. See \textsuperscript{id.} at 75.
\item 51. Id.
\item 52. Id. at 78.
\item 53. Id. at 82–83.
\item 54. Id. at 83.
\item 56. Id.
\item 57. Id.
\item 58. Id.
\item 59. Id.
\end{itemize}
The court noted that "for purposes of the act of state doctrine, a debt is not 'located' within a foreign state unless that state has the power to enforce or collect it." The court further elaborated that a state's jurisdiction over the debtor determines whether the state has "the power to enforce payment of a debt." Chase departed from Vietnam a week before the North Vietnamese issued the confiscation decree, and, when Chase left, the court held that the deposits no longer had their situs in Saigon. Here, the court endorsed the "springing situs" theory, which it credited to Patrick Heininger:

The situs of a bank's debt on a deposit is considered to be at the branch where the deposit is carried, but if the branch is closed, ... the depositor has a claim against the home office; thus, the situs of the debt represented by the deposit would spring back and cling to the home office. If the situs of the debt ceased to be within the territorial jurisdiction of (the confiscating state) from the time the branch was closed, then at the time the confiscatory decree was promulgated, (the confiscating state would) no longer (have) sufficient jurisdiction over it to affect it.

"[I]mpossibility of performance in Vietnam," the court went on to hold, "did not relieve Chase of its obligation to perform elsewhere," because operating abroad "through a branch instead of a separate corporate entity" meant that Chase had "accepted the risk of liability in other jurisdictions for obligations sustained by its branch." The court cited Sokoloff for the proposition that a branch's "ultimate liability for a debt rests with the parent bank." A bank accepting deposits at a foreign branch is "a debtor, not a bailee," the court held, before offering very specific instructions to banks doing business abroad:

In the event that unsettled local conditions require it to cease operations, it should inform its depositors of the date when its branch will close and give them the opportunity to withdraw their deposits or, if conditions prevent such steps, enable them to obtain payment at an alternative location. In the rare event that such measures are either impossible or only partially successful, fairness dictates that the parent bank be liable
for those deposits which it was unable to return abroad. To hold otherwise would be to undermine the seriousness of its obligations to its depositors and under some circumstances (not necessarily present here) to gain a windfall.66

Citibank’s Saigon office suffered a similar fate when the South Vietnamese government fell. In 1974, Quang Quy Trinh, a former South Vietnamese government official, opened a joint bank account at Citibank’s Saigon office in his name and his son’s name, paying an annual interest rate of 19%.67 Per the deposit agreement, withdrawals were only permitted at Citibank’s Saigon branch and only in Vietnamese currency—piasters—and the agreement further included a provision attempting to insulate the bank from political risk: “Citibank does not accept responsibility for any loss or damage suffered or incurred by any depositor resulting from government orders, laws . . . or from any other cause beyond its control.”68

On April 24, 1975, in conjunction with the U.S. embassy’s plan to evacuate American citizens,69 Citibank closed its branch, leaving all branch documents, files, records and books inside, and entrusting the cash, branch keys, vault combination, and official documents to U.S. embassy officials.70 Trinh was sent to a reeducation camp, from which he did not emerge until 1980, at which time he inquired about his deposit with Citibank in New York and was told that the National Bank of Vietnam was responsible for it.71

The United States District Court for the the Eastern District of Michigan, in which Trinh filed suit for the deposit, found in his favor, relying heavily on Vishipco and the “springing situs” theory.72 It also held that force majeure was not implicated, because Citibank closed its branch voluntarily and “not an act of God, act of government, or fortuitous cause beyond its control.”73 Additionally, the court held that Citibank failed to prove that the confiscation included an assumption of the liabilities as well as the assets of Citibank Saigon.74

On its review, the United States Court of Appeals for the Sixth Circuit

66.  Id. at 864.
68.  Id.
69.  Id.
70.  It is not coincidence, then, that this was the same date on which Chase Manhattan vacated its Saigon office, as noted in the above discussion of Vishipco.
71.  See Trinh, 850 F.2d at 1166.
72.  See id.
73.  Id. (quotations omitted).
74.  Id.
noted the Sokoloff court’s assertion that the home office is liable on a deposit placed at a branch if the branch closes or wrongfully returns it.\(^{75}\)

Citibank’s liability in this circumstance was consistent with the separate entity doctrine, the court asserted, because closure of a branch is one of the special circumstances triggering home office liability.\(^{76}\)

The court also addressed the assumption of political risk, asserting that, simply by the fact of the bank’s operating a branch in Vietnam:

> Citibank indicated to its foreign depositors that it accepted the risk that, in at least some circumstances, it would be liable elsewhere for obligations incurred by its branch. In so doing, it reassured those depositors that their deposits would be safer with them than they would be in a locally incorporated bank. With the volatile situation in Vietnam in the early 1970’s, this assurance of safety was undoubtedly one of the primary factors motivating Vietnamese depositors, like Trinh, to place their money in Citibank. Certainly, these depositors expected that Citibank, with its worldwide assets and international reputation, would be “good” for the deposits if, for whatever reason – whether it be financial mismanagement, insolvency, or political events – Citibank Saigon could not return them.\(^{77}\)

In support of this proposition, the Trinh court cited to Vishipco’s assertion that “U.S. banks, by operating abroad through branches rather than through subsidiaries, reassure foreign depositors that their deposits will be safer with them than they would be in a locally incorporated bank.”\(^{78}\)

The Trinh court did not believe that Citibank had effectively dispelled Trinh’s expectation that its worldwide assets would back the Saigon deposit.\(^{79}\) The agreement absolved the branch office of political risk, but not the home office.\(^{80}\) In order to effectively limit their exposure to such liability in deposit agreements, the court asserted, “limitation provisions must be explicit and must clearly and unmistakably inform depositors that

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\(^{75}\) See id. at 1168 (pointing to the Sokoloff court’s holding that the ultimate liability for a debt incurred by a branch rests with a parent bank).

\(^{76}\) See id. at 1168–69 (citing Sokoloff and similar cases dealing with home office liability when a bank closes a branch).

\(^{77}\) Id. at 1169 (citations omitted).


\(^{79}\) See Trinh, 850 F.2d at 1169 (pointing to the fact that Citibank’s decision to open a Saigon branch indicated to foreign depositors that Citibank was willing to accept the risk of potential liabilities for debts incurred by its branch).

\(^{80}\) Id. at 1169–70.
they have no right to proceed against the home office."  

C. The Cuban Revolution

Rosa Manas y Pineiro, the wife of a former cabinet minister in the pre-revolutionary Cuban government lead by Fulgencio Batista, deposited almost a quarter million dollars in a Cuban branch of Chase Manhattan Bank in 1958. On January 1, 1959, Fidel Castro assumed control of Cuba, and the couple subsequently fled to the United States. The newly formed Ministry of Recovery of Misappropriated Property ordered Chase to close the accounts of former government officials and their families, including Manas' accounts, and to hand the cash over to the new Castro government, which it did. All of Chase's Cuban branches were nationalized in September 1960. When Manas sought to draw the funds in 1974 and was denied, she filed suit.

The trial court noted favorably the plaintiff's citation to Sokoloff for the proposition that the parent bank is ultimately liable for the obligations of the branch. However, it asserted, the "liability does not alter the situs of the debt," and when the branch's liability is extinguished, the parent is relieved of liability as well. The court held that its ruling on the validity of the confiscation would violate the Act of State Doctrine, "which precludes the courts of [the U.S.] from adjudicating the legality of acts of foreign governments."

The first appellate court disagreed, asserting that the doctrine would only apply if the obligation was payable solely in Cuba, and that the doctrine had never been applied "to relieve an American bank of obligations owed by its branches to depositors." Citing Vishipco, the court held that the nationalization of its branch office did not extinguish Chase's liability for the deposit.

The New York Court of Appeals disagreed, holding that the lower court had misapplied the Act of State Doctrine and distinguishing the Vishipco

81. Id. at 1170.
83. Id. at 6.
84. Id. at 7.
85. Id.
87. Perez, 463 N.E.2d at 8.
88. See id. at 8, 11.
89. Id.
90. See id. (reaching this result regardless of the fact that the Cuban government, through Banco Nacional de Cuba, assumed Chase's liabilities for its Cuban branches).
line of cases on the grounds that the government had specifically confiscated Manas' funds in advance of nationalization of the branches.  

For purposes of the Act of State Doctrine, the court asserted, "a debt is located within a foreign State when that State has the power to enforce or collect it," and the power to enforce a debt, in turn, depends on the presence of the debtor. At the time of confiscation, Chase was present in Cuba and the debt was payable at any Chase bank in the world. But the debt was nonetheless only a single obligation to pay, and once Cuba exercised its jurisdiction to collect and enforce that debt—through its confiscation—Chase's debt to Manas was satisfied. The confiscation was an Act of State and, as such, was unreviewable by the Court of Appeals.

In Perez, unlike the above cases, the court found for the debtor-Bank and against the creditor-depositor. Yet the court rather convincingly argued that its holding is consistent with both Vishipco and Sokoloff, because the "springing situs" theory espoused in those cases did not apply to Manas' deposit. In the earlier cases, the courts asserted that confiscation orders directed at depositors had no effect because, where the bank's foreign branches had ceased operations before the confiscation orders, the situs of the debt was no longer in the foreign state—it had sprung back. In Manas' case, the debt was "extinguished before the bank was nationalized, [so] there [was] no occasion to apply the rationale" of those earlier cases.

A provocative dissent in Perez argued that the most appropriate way for judges to defer to the acts of foreign governments would be to ignore legal fictions such as "situs" regarding debt, which is an intangible, and focus on the actual bank assets seized. The bank should not be permitted, the dissent asserted, to shift its loss to the depositor by refusing to pay an account. The dissent then addressed political risk, making a point to emphasize the fact that Chase was not ignorant as to the identity of the people from whom it was accepting deposits:

The essence of the relationship between the parties is that the bank agreed

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91. See id. (going on to explain that the Act of State Doctrine would only be inapplicable if Manas' funds were not payable in Cuba at the time of confiscation).
92. Id.
93. Id. at 9.
94. Id.
95. See id.
96. Id. at 10.
97. See id.
98. Id. at 11.
99. Id. at 11–15.
100. Id. at 14–15.
to safeguard the depositor’s money. It did so in the midst of a revolution by accepting deposits from a person whose husband was an official in the government under attack. The bank specifically agreed that the certificates would be redeemed at any of its branches, most of which are in this country, and further agreed to pay in United States currency. Even after the revolution had succeeded, the bank remained in Cuba and maintained assets all of which could have been, and in fact ultimately were, confiscated by the Cuban government. Under these circumstances it could be said that the bank was fully aware of and accepted the risk of confiscation of its assets, and should not be permitted to refuse to honor its commitment to this depositor after her arrival in this country.101

Interestingly, in a case decided the same year, the United States Court of Appeals for the Second Circuit agreed with some of the reasoning in the dissent in Perez and held in favor of a depositor in a case with strikingly similar facts.102 Juanita Gonzalez Garcia and her husband, Lorenzo Perez Dominguez, made two deposits totaling half a million pesos in a Cuban branch of Chase in 1958.103 Dominguez, who had served in the Cuban Senate for the previous four years and, prior to that as a colonel in the Cuban Army, expressed to bank officers at the time of deposit that he was concerned about the safety of his money.104 The officers expressed to him that depositing with Chase represented “insurance” and “security” for his funds, and that the home office guaranteed his deposit, which was redeemable at any Chase branch.105 As in Perez, Dominguez’s accounts were frozen and then seized by the Ministry of Recovery of Misappropriated Property, before Chase was later nationalized.106 After failing to recover the funds from Chase, Garcia filed suit.107

The court did not focus on intangibles or legal fictions in its Act of State Doctrine analysis. It asserted that the “monies paid over to the Cuban government did not come from funds specifically earmarked to Dominguez’s and Garcia’s ‘account,’” “but rather “from Chase’s general funds in the branch bank.”108 The bank’s debt to its depositors “was not extinguished merely because it was forced to pay an equivalent sum of its own money to a third party,” the court said starkly, before comparing the

101. Id.
103. Id. at 646.
104. Id.
105. Id.
106. Id. at 647.
107. Id. at 647–48.
108. Id. at 649.
confiscation rather bluntly to a bank robbery:

Chase would not argue that its debt was extinguished if an armed gunman had entered its Vedado branch and demanded payment of a sum equal to the amount of its debt to Dominguez and Garcia. Yet in effect, this is what transpired. The Cuban government did nothing more than "enter" Chase’s Vedado branch armed with [the confiscation law] and demand depositors’ money. Chase turned over funds without requiring the surrender of the CDs, without notice to the holder of the CDs and without a fight. As in the case of a bank robbery, the bank itself must bear the consequences.109

The court took pains to play up the depositors’ emphasis on the safety of their funds, and if there is any way to distinguish Garcia from Perez, perhaps that is it. “The purpose of the agreement between Chase and Dominguez and Garcia,” the court held, “was to ensure that, no matter what happened in Cuba, including seizure of the debt, Chase would still have a contractual obligation to pay the depositors upon presentation of their CDs.”110 Chase’s international reputation was integral in the couple’s decision to deposit there, the court asserted, and the deposits would not have been made absent such security.111

The Act of State Doctrine, the court held, is not implicated in such a case.112 The court’s decision did not challenge the validity of a foreign government’s actions and had “no international repercussions.”113 The decision was “simply resolving a private dispute between an American bank and one of its depositors.”114

D. The Philippines Cases

In 1983, Wells Fargo Asia Limited ("WFAL") paid $2 million to Citibank’s New York office with the understanding that the money would be deposited in Citibank’s branch in Manila.115 Two months before the deposits matured, the Philippine government issued an order asserting that "[a]ny remittance of foreign exchange for repayment of principal on all foreign obligations due to foreign banks and/or financial institutions,

109. Id.
110. Id. at 650.
111. See id. (explaining that Chase failed to notify the couple that it would not accept the risk of liability for obligations of its Cuban branch).
112. Id. at 651.
113. Id.
114. Id.
irrespective of maturity, shall be submitted to the Central Bank [of the Philippines] thru the Management of External Debt and Investment Accounts Department (MEDIAD) for prior approval" ("the Order"). The Central Bank of the Philippines interpreted this as preventing Citibank's Manila branch from repaying the WFAL deposits with Philippine assets. WFAL sued, and the Central Bank of the Philippines gave Citibank permission to repay foreign depositors with non-Philippine assets, after which Citibank repaid just under half of the $2 million deposit.

The Southern District of New York held for WFAL, rejecting Citibank's impossibility defense and noting that the Order allowed repayment where permission was obtained and that Citibank had not made a good faith effort to obtain it. Under New York Law, the court held that "Citibank's worldwide assets were available" to satisfy WFAL. The United States Court of Appeals for the Second Circuit affirmed, noting that a debt may be collected wherever repayable unless the parties have agreed otherwise. Because there was no such restriction in this case, WFAL was entitled to collect in New York. Reviewing that decision, the United States Supreme Court asserted that the question was whether, absent an agreement respecting collection from Citibank's New York assets, WFAL could collect based on "rights and duties implied by law." It vacated and remanded the case to the Second Circuit to clarify whether New York or Philippine law applied and to determine the outcome accordingly.

The Second Circuit quoted at length from the district court's analysis of choice of law issues:

Jurisdiction in this action is asserted both on the basis of diversity and federal question involving 12 U.S.C. § 632. In diversity cases, of course,
we must apply the conflict of law doctrine of the forum state. In federal question cases, we are directed to apply a federal common law choice of law rule to determine which jurisdiction’s substantive law should apply. The rule in New York is that “the law of the jurisdiction having the greatest interest in the litigation will be applied and that the facts or contacts which obtain significance in defining State interests are those which relate to the purpose of the particular law in conflict.” Federal law invokes similar considerations and the place of performance is considered an important factor.

Under either test, the district court held, New York law should be used to evaluate the claim. Because the transaction was in U.S. dollars, settled through New York offices, and Citibank is headquartered in New York, both parties would be justified in an expectation that New York law applied. The goal of promoting certainty in financial markets is achieved by applying New York law uniformly. The “most recent pronouncement” from the New York Court of Appeals was, at that time, Perez, which the district court cited for the proposition that “the parent bank is ultimately liable for the obligations of the foreign branch.”

The district court acknowledged that it was “aware of no persuasive authority to tell us to what extent, if any, a New York court would defer to local law in the situation here presented, where the foreign sovereign did not extinguish the branch’s debt either in whole or in part but merely conditioned repayment on the obtaining of approval from a government agency.” However, it asserted that this question need not be answered, as Citibank had not “satisfied its good faith obligation to seek the [Philippine] government’s consent to use the assets booked at Citibank’s non-Philippine office.”

The Second Circuit agreed, holding that Citibank was not excused from payment despite its reliance on federal regulations asserting that a “customer who makes a deposit that is payable solely at a foreign branch of the depository institution assumes whatever risk may exist that the foreign country in which a branch is located might impose restrictions on

125. Id. at 726.
126. Id.
127. See id.
128. Id.
129. Id.
130. Id. at 727.
withdrawals.”132 The court noted that federal law “defines a deposit that is ‘payable only at an office outside the United States’ as ‘a deposit . . . as to which the depositor is entitled, under the agreement with the institution, to demand payment only outside the United States.’”133 Accordingly, there is no “policy allocating the risk to depositors as a matter of law where there is no such agreement.”134

The Second Circuit concluded that, “unless the parties agree to the contrary, a creditor may collect a debt at a place where the parties have agreed that it is repayable,” and, in the “absence of any agreement forbidding the collection in New York,” it may be collected there.135

III. GOVERNMENTS REACT: RINGFENCING LAWS AND RULES

Various federal and state laws will have an impact on an analysis of the appropriate political risk calculation regarding foreign bank deposits. Typically, these laws and rules are a reaction to issues presented to legislators and regulators by the U.S. banking industry. A new rule finalized by the FDIC in late 2013, in reaction to a proposal by a foreign bank regulator, would make clear that deposits in foreign branches of U.S. banks are not FDIC insured but may be deposits for the purposes of so-called depositor preference regimes. All constitute attempts to ringfence foreign deposits.

A. Federal Banking Laws

Federal law contains a sweeping provision regarding payment on deposits in cases of emergency closure. 12 U.S.C. § 633 asserts that Federal Reserve member banks are not liable for deposits made at a foreign branch of a bank if they are unable to repay them as a result of either “an act of war, insurrection, or civil strife” or “an action by a foreign government or instrumentality (whether de jure or de facto) in the country in which the branch is located.”136 An exception is made if “the member bank has expressly agreed in writing to repay the deposit under those circumstances,” leaving banks the option of explicitly insuring customer accounts against political risk, but taking from the courts the power to impose an insurance requirement upon them.137

The federal statute did not exist prior to its adoption as part of the Riege
Community Development and Regulatory Improvement Act of 1994. After *Vishipco*, the banking community sought an addition to 12 U.S.C. § 1828 that would have added a subsection (m) to read as follows:

(m) In any action or proceeding brought in a state or Federal court in the United States or the District of Columbia, the terms and conditions adopted or made applicable by the parties to any deposit or other obligation of a foreign branch of an insured bank shall be conclusive to establish the place, currency and manner of performance of such deposit or other obligations and the law or custom governing such performance. Notwithstanding any other rules of law, where action or threats on the part of any authority at the place where a foreign branch of an insured bank is located prevents performance at the foreign branch of a deposit or other obligations, in accordance with its terms and conditions establishing the place, currency, and manner of such performance because of:

(i) seizure, destruction, cancellation, or confiscation by governmental authorities of the branch’s assets or business, or assumption of its liabilities;
(ii) other similar governmental decrees or actions, or
(iii) closure of the branch in order to prevent, in the reasonable judgment of the insured bank, harm to the bank’s employees or property
the deposit or other obligation of the foreign branch will not transfer to and may not be enforce against any other office of the insured bank located outside the country in which the foreign branch is located.

The proposed subsection was never introduced in Congress, despite some evidence that regulators at the staff level favored it.

**B. State Banking Laws**

Several states have passed legislation aimed at protecting the interests of domestic banks abroad. These might be quickly dismissed as giveaways to banking interests that are seeking to protect themselves from double liability arising as a result of political risk. There is some evidence, however, that these laws were drafted, in part, to protect local banks’ capital from flowing out of the state to the aid of non-residents injured by

140. Id.
actions undertaken by their very own governments.\textsuperscript{141}

For example, New York banking law asserts that banks— including national banks—located in New York and operating a branch abroad “shall be liable for contracts to be performed at such branch office or offices and for deposits to be repaid at such branch office or offices to no greater extent than a bank... organized and existing under the laws” of the host country.\textsuperscript{142} It also holds that if an authority that is not the de jure government of a foreign territory seizes assets of a bank operating in that territory, the liability of that bank “for any deposit theretofore received and thereafter to be repaid by it... shall be reduced pro tanto by the proportion” the seized assets bear to the bank’s total deposit liabilities.\textsuperscript{143} Finally, it asserts that a bank located in New York:

shall not be required to repay any deposit made at a foreign branch of any such bank if the branch cannot repay the deposit due to (i) an act of war, insurrection, or civil strife; or (ii) an action by a foreign government or instrumentality, whether de jure or de facto, in the country in which the branch is located preventing such repayment, unless such bank has expressly agreed in writing to repay the deposit under such circumstances.\textsuperscript{144}

New York’s law did not cover national banks until the 1984 amendments; prior to that, it applied only to banks with state charters, which greatly limited its usefulness, as most banks operating abroad are nationally chartered.\textsuperscript{145}

A portion of Nevada’s banking law is dedicated to the emergency closure of banks. It defines “emergency” as “any condition or occurrence which may interfere physically with the conduct of normal business operations at one or more or all of the offices of a bank, or which poses an imminent or existing threat to the safety or security of persons or property.”\textsuperscript{146} According to the law, any day on which an office of a bank is closed for all or part of the day is treated as a bank holiday, and “[n]o liability or loss of rights of any kind on the part of any bank, or director, officer or employee thereof, shall accrue or result by virtue of any” such

\textsuperscript{141} See Johnson, supra note 3, at 234.
\textsuperscript{142} N.Y. BANKING LAW § 138 (McKinney 2013).
\textsuperscript{143} Id.
\textsuperscript{144} Id. Michigan has a similar statute. See MICH. COMP. LAWS ANN. § 487.13714 (West 2013).
\textsuperscript{145} Smedresman & Lowenfeld, supra note 139, at 795–96.
\textsuperscript{146} NEV. REV. STAT. ANN. § 662.265 (West 2013).
C. FDIC Foreign Deposit Rules

One thing is certain, the FDIC, in its primary role as the U.S. deposit insurer, wants to make very clear that it is not responsible for the U.S. banks’ foreign branch deposits. Earlier this year, the FDIC issued a notice of proposed rulemaking in which it proposed a new regulation to explicitly state that deposits payable in branches of U.S. insured depository institutions outside the U.S. are not FDIC insured.\(^\text{148}\) This would apply to deposits even if they were considered dually payable, or payable in both the U.S. and the foreign country.\(^\text{149}\) Under the rule, foreign deposits would still be considered deposit liabilities even though they are not insured, and would be on equal footing with domestic deposits under the depositor preference regime of the Federal Deposit Insurance Act.\(^\text{150}\) Accordingly, these deposits would receive preferred status over general creditors in the event of a bank failure and FDIC receivership.\(^\text{151}\)

The rule is not intended to stop U.S. banks from drafting deposit agreements in such a way as to protect themselves from sovereign risk liability.\(^\text{152}\) Rather, it is designed to ensure that the FDIC does not take on the role of a worldwide insurer of deposits.\(^\text{153}\)

The notice of proposed rulemaking comes in response to a Consultation paper issued by the United Kingdom’s Financial Services Authority (“UK FSA”). This proposed to prohibit banks that are not based in the European Economic Area (“EEA”) from operating deposit-taking branches in the UK unless UK depositors are put on an equal footing in the depositor preference regime with depositors from the bank’s home country in the event of a resolution.\(^\text{154}\) The UK FSA offered several options for the non-EEA banks that wish to continue deposit-taking: (1) use a UK-incorporated subsidiary instead of a branch, so that UK resolution and insolvency laws apply and UK depositors are not subordinated to home-country depositors; (2) segregate assets in the UK through a trust

\(^{147}\) NEV. REV. STAT. ANN. § 662.305.


\(^{149}\) Id. at 11604.

\(^{150}\) Id.

\(^{151}\) Id.

\(^{152}\) Indeed, the proposal makes clear that it is “not intended to preclude a United States bank from protecting itself against sovereign risk by excluding from its deposit agreements with foreign branch depositors liability for sovereign risk.” Id. at 11605.

\(^{153}\) Id.

\(^{154}\) Id. at 11605–06.
arrangement and provide a legal opinion explaining how the arrangement prevents subordination of UK depositors; (3) make the deposits dually payable, such that under U.S. law, UK deposits would occupy the same priority as uninsured home country deposits.\textsuperscript{155}

The FDIC, predicting that most U.S. banks will prefer the third option offered by the UK FSA, sought through this rulemaking to protect the Deposit Insurance Fund ("DIF") by clarifying that a foreign branch deposit, though it may be dually payable and on the same footing as a domestic deposit in terms of the depositor preference regime, is not insured by the DIF.\textsuperscript{156} The FDIC believed that this rule will preserve confidence in the DIF by protecting it against the possibility of becoming a global deposit insurer.\textsuperscript{157}

On September 13, 2013, the FDIC adopted a final rule to clarify that deposits in foreign branches of U.S. banks are not FDIC insured though they may be deposits for purposes of the depositor preference regime.\textsuperscript{158} The comment period ended on April 22, 2013, and the FDIC received comments from only three industry groups and two individuals.\textsuperscript{159} Commenters generally did not object to the concept that the DIF should not insure deposits in foreign branches, but suggested an alternative approach whereby the FDIC interpret "deposit liability" to include all deposits of a U.S. bank no matter where payable for the purposes of the depositor preference regime in Section 11(d)(11) of the Federal Deposit Insurance Act.\textsuperscript{160} Such an approach, commenters argued, would "bolster[] international cooperation" and "eliminate[] the potential for inconsistent treatment of deposits in different foreign jurisdictions," in addition to saving the FDIC the expense of continued efforts at guidance to banks, foreign depositors, and foreign regulators regarding dual payability.\textsuperscript{161} The FDIC rejected this approach as "inconsistent with current statutory language," and did so explicitly "[w]ithout expressing an opinion as to the merits" of the policy arguments commenters made in support of their approach.\textsuperscript{162} Accordingly, the rule was ultimately adopted as proposed, with minor changes that did not impact the substance of the proposal.\textsuperscript{163}

\textsuperscript{155} Id. at 11606.
\textsuperscript{156} Id.
\textsuperscript{157} Id. at 11604.
\textsuperscript{159} Id. at 56585.
\textsuperscript{160} Id. at 56585–86.
\textsuperscript{161} Id. at 56586.
\textsuperscript{162} Id. at 56586–87.
\textsuperscript{163} Id. at 56587–89.
IV. SOLUTIONS FOR BANKS

There have been various proposed solutions to the uncertainty faced by banks attempting to protect themselves against the political risk of operating branching abroad. Organizational practices have not been successful in containing branch liabilities. Several other proposed solutions are examined below.

A. "Partial Suspension of Operations" Theory

One author has suggested that the Federal Reserve Board adopt a regulation permitting U.S. banks to "partially suspend the operations of a foreign branch during periods of unrest in the host country." This proposal was primarily a response to Vishipco, in which the closure of the branch resulted in the debts "springing back" to the home office, where courts held they were payable. As long as the branch stayed open, the debt would presumably remain at the branch office and the home office would not be liable. If the political situation were to become untenable and result in expropriation, the author argued, the home office would not be liable because the debtor branch remained within the jurisdiction of the expropriating power. Given the court's sweeping ruling in Garcia, it is not clear that such a regulation would protect banks from liability following expropriation. After all, if courts have made a policy decision that banks are offering political risk insurance to foreign branch deposits and the legal decision that Act of State Doctrine does not apply to adjudications of contract disputes between private parties, keeping the branch partially open will not save the bank.

To prevent the banks from obtaining a windfall if it is "relieved of liability yet permitted to retain assets that branch officials somehow removed from the host country" or if it is insured against expropriation, this author suggested that courts "require the home office to pass on to the foreign branch depositors the value of any branch assets that the home office recovers or any insurance payments received." How this would work in practice is unclear; if courts follow Vishipco to the letter and determine that the home office is not liable for expropriated deposits under a partial suspension scenario, how would they have the authority to force

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164. For example, banks creating subsidiaries rather than branches.
165. Johnson, supra note 3, at 212.
167. Id. at 134.
168. Id. at 135.
169. Id.
an accounting of bank losses and ensure that the depositors share them equally?

However, while courts would be ill suited to such an accounting, it is not entirely out of the realm of possibility that the FDIC would be able to undertake one. After all, the FDIC has the capabilities associated with taking banks into receivership and accounting for their assets and liabilities. Perhaps the appropriate regulation for the federal government to undertake is one that allows the FDIC or the Federal Reserve to demand an accounting from U.S. banks of the exact losses incurred as a result of nationalization or expropriation.

In some cases, the funds lost will simply be bookkeeping entries that never existed as cash reserves in the bank or were quickly moved to other foreign branches or to the U.S. upon deposit. In some cases, the bank will have made loans to locals that it is no longer able to enforce and collect upon and will need to write off its books. There will be hard assets lost, including real estate holdings, the bank office itself, certain repossessed collateral, and whatever cash reserves the bank held in the host country. But while the cases reviewed do not provide a dollar amount representing what the affected branch had actually lost, that amount should not be a mystery. Once this information is available, the FDIC or Federal Reserve—or whatever body is placed in charge of winding down expropriated foreign banks—could allocate the losses according to any number of algorithms. One could envision a scenario in which the regulator would simply divide them equally between the debtor-bank and creditor-depositors. Or perhaps each depositor’s funds would be reduced pro rata according to the amount of its assets the bank lost, as envisioned by the New York statute.170 In that case, for example, a deposit of 50,000 bolivars at a Citibank branch in Venezuela that demonstrated losses amounting to 20% of its assets would be reduced commensurately by 10,000 bolivars.

V. CONTRACT LANGUAGE

As discussed below, it is possible that risk can be appropriately distributed between banks and their depositors via the language in deposit agreements. There are legitimate questions to be raised, however, about the fairness of this approach given (1) the disparity in bargaining power between some depositors and the depository institutions; and (2) the expectations of depositors—particularly less sophisticated depositors—that their deposits are protected notwithstanding language in an agreement they may or may not have read.

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170. See supra, notes 141–42.
A. Achieving Clearer Understandings of Risk through Contract Language

Whether banks can limit their liability and depositors can clarify their risk through the language of deposit agreements is an open question. Some courts have been unwilling to side against plaintiffs even where it means ignoring the language of the deposit agreement.

Banks may use deposit agreements to create various covenants and clauses spelling out which countries laws would govern disputes, a forum for litigation or restricting payment on the deposit to the issuing branch.\textsuperscript{171} Courts have upheld such clauses in insurance policies and shipping contracts, and might be willing to do the same in deposit agreements assuming the bank could show that the limitation in the depositor’s rights had been freely bargained for.\textsuperscript{172}

One author has argued that the explicit terms of the agreement and the reasonable expectations of the parties ought to be the “fundamental issue” in determining whether a bank is required to pay on a deposit that is exposed to political risk.\textsuperscript{173} She asserted that the \textit{Trinh} court “rewrote the deposit agreement and awarded the plaintiffs something they never had under its terms – a deposit payable in the United States in the event of expropriation.”\textsuperscript{174} In \textit{Vishipco}, too, it has been argued, the courts went out of their way to produce a recovery of some kind for the plaintiff.\textsuperscript{175}

B. The Fairness Issue in Distribution of Political Risk through Contract

Perhaps the ultimate issue to resolve is the fairness of the ultimate distribution of political risk. Where contract language is used to determine that allocation, the parties with the greatest bargaining power will be allocated less risk and those with lesser bargaining power will be allocated more. That could mean that large, multinational corporations holding their money abroad are able to demand payment of their accounts at a bank’s home office while the individual depositor is not. Perhaps this is as it should be; after all, large corporate investors are providing the bank with substantially more investment capital and, with that larger investment, they receive greater benefits. On the other hand, individual depositors at a commercial bank—when taken together—make up a sizable portion of total deposits, and should not be left unprotected merely because they cannot bargain collectively over deposit agreement language.

There is some disagreement about the appropriate distribution of political risk.

\textsuperscript{171} Johnson, \textit{supra} note 3, at 210.
\textsuperscript{172} \textit{Id}.
\textsuperscript{173} Hannigan, \textit{supra} note 1, at 753.
\textsuperscript{174} \textit{Id.} at 754.
\textsuperscript{175} Johnson, \textit{supra} note 3, at 232.
risk. In an article published several years before Trinh, for example, the authors asserted, "the parties to a deposit contract logically would expect the holder of an account at an overseas branch to accept the local legal and political risks which may affect the deposit in the location of the branch." A U.S. bank operating overseas does not intend, they assert, "to offer the customers of that branch any greater or different protection against local legal, regulatory, or political risks than that afforded by a locally incorporated bank." The authors cite to the Citibank's Amicus Curiae brief in Vishipco for the proposition that banks operating international branches have never understood their operations to provide political risk insurance to their customers. They explain that the risk to the banks is two-fold: (1) there is the risk that the brick and mortar premises, cash-on-hand, deposits with other banks, investments, and right to repayment of loans will be confiscated without adequate compensation; and (2) there is a double-liability risk when "the host country expropriates a depositor's right to repayment of a deposit" while the depositor demands payment elsewhere.

Another author, by contrast, agrees with the courts' thinking in Vishipco and Trinh, asserting that a foreign national would have no reason to bank with a local branch of an U.S. bank were it not for political risk protection. But he goes even further, asserting that U.S. banks should be happy to take this tradeoff: "foreign branch banks like those of Bank of America may make more money providing de facto insurance against revolution than they ever will lose in double payments following expropriations."

VI. CONCLUSIONS

It may seem as if this is a problem of the past; that the end of the spread of communism means that expropriation of bank assets is a worry relegated to the second half of the Twentieth Century. However, there is no reason to believe that asset seizure by a foreign country will not happen in the future. In resolving this complex problem, certainty on a going-forward basis is paramount. The current state of disarray is bad for investors seeking returns abroad and for those seeking U.S. funding for overseas ventures. Accordingly, the time to prepare a coherent theory of bank liability is not

176. Logan & Kantor, supra note 13, at 336.
177. Id.
178. Id. at 337.
179. Id.
180. Johnson, supra note 3, at 245.
181. Id.
after assets are seized, but right now.

Perhaps the best practical advice for banks regarding foreign deposits comes down to the analysis of an author mentioned above, who points out that maintaining foreign deposits and investment is, at the end of the day, a profitable endeavor. Even if it means insuring a few unstable countries against political risks, banks will ultimately profit. It is almost certainly the case that a system in which banks guarantee foreign deposits at the home office would result in additional foreign deposits, driving up investment and profits. In exchange for that, banks would have to agree to be on the hook for the few cases in which funds are expropriated or frozen.

In light of the FDIC's recent notice of proposed rulemaking regarding foreign deposits and 12 U.S.C. § 633(a), banks should carefully and narrowly draft deposit agreements with depositors in foreign branches, such that there can be no confusion as to whether the home branch is liable for foreign deposits. This includes not only explicit instructions as to where deposits are payable, but perhaps also explicit instructions, in light of the Wells Fargo case, as to where deposits are not payable. In the past, as the cases summarized in Part II make clear, courts have not been inclined towards sympathy with banks that have accepted deposits without the most rigorous and express provisions regarding allocation of risk.

By the same token, depositors should keep in mind that, in spite of bank-friendly regulations, laws, and proposals to limit bank liability absent a deposit agreement to the contrary, there is still the possibility of allocating political risk to the bank by demanding that such allocation be included in the deposit agreement. This caveat may not be helpful to small individual depositors, but, as noted above, most depositors in foreign branches of U.S. banks are, in fact, corporations, and such large organizations should have the bargaining power to insist on certain terms in agreements in which they provide foreign branches the capital to invest in places where investment capital often sees far higher returns.

182. See supra notes 178–79 and accompanying text.