

The Sudan Accountability and Divestment Act of 2007

While the Sudan Accountability and Divestment Act of 2007 (P.L. 110-174), signed into law on December 31, 2007, provides for the “authority of State and local governments to divest from certain companies directly invested in certain Sudanese sectors,” (among other things) it does not simply bless anything States and localities have done or wish to do in the area of divestment. In fact, some believe it could be argued the methods outlined in the Act are the exclusive means by which States can divest. As noted in the summary below, the legislation is complex, leaves many questions unanswered, and State and local governments seeking to take advantage of the protection of the Act will need to carefully consider what will be entailed in satisfying its many requirements. They will also need to contemplate to what extent doing so affects or regulates investment decisions made in the normal course.

In his signing statement with regard to the Act, President Bush noted:

“This Act purports to authorize State and local governments to divest from companies doing business in named sectors in Sudan and thus risks being interpreted as insulating from Federal oversight State and local divestment actions that could interfere with implementation of national foreign policy. However, as the Constitution vests the exclusive authority to conduct foreign relations with the Federal Government, the executive branch shall construe and enforce this legislation in a manner that does not conflict with that authority.”

Many thanks to Wayne Schneider, General Counsel, New York State Teachers’ Retirement System and Cornelia Chebinou, Washington Director, National Association of State Auditors Comptrollers and Treasurers, for the following analysis:

On December 31st the President signed the Sudan Accountability and Divestment Act of 2007 into law noting that in enforcing the law the administration would “take into consideration” the authority held by the federal government in implementing foreign policy.

Among other provisions, the new law would permit (though not require) states and localities to adopt and enforce measures requiring divesting from companies having business operations in Sudan that include operations in four sectors (oil, power production, mineral extraction and military equipment) and provides a safe harbor from federal preemption. It would also allow registered investment companies, such as mutual funds and investment manager pooled investment funds, to divest from such companies and provide them a safe harbor from lawsuits, including lawsuits brought by state and local governments.

The legislation is complex and bristles with uncertainties which require considerable study. State and local governments seeking to take advantage of the protection of the Act will need to review and consider what will be entailed in satisfying the Act's many requirements.

Presumably, the Act is only intended to address the current spate of Sudan divestment legislation and is not intended to affect those States and local governments which do not enact Sudan divestment legislation or measures. Accordingly, it should not affect or regulate investment decisions made in the normal course by public pension funds in the latter such jurisdictions nor should it immunize registered investment companies with which they deal from the adverse consequences of bad investment decisions taken in the normal course. On other hand, in the case of those jurisdictions which wish to enact Sudan divestment legislation or measures, they will have to consider whether and, if so, how legislation enacted in accordance with the requirements of the Act might thereafter constrain the ability of their public funds to take investment actions in the normal course with respect to companies doing business in Sudan.

The specifics with respect to permitted state and local divestment initiatives are contained in Section 3 of the Act. Section 3 appears to have been drafted in response to the federal district court decision¹ which, among other things, struck down the public pension divestment provisions of an Illinois divestment act as an unconstitutional violation of the Foreign Commerce Clause of the United States Constitution.² The Foreign Commerce Clause gives Congress the authority to regulate commerce with foreign nations.

Section 3 allows state and local governments to adopt and enforce divestment measures without creating a conflict with the United States Constitution or federal law but only where a number of complicated requirements are met:

¹ National Foreign Trade Council, Inc. v. Giannoulas, 2007 U.S. Dist. LEXIS 12241 (N.D. Ill. February 23, 2007). Of interest to this discussion is the fact that the district court seemed to hint the Illinois act insofar as it directed state pension funds to divest might have survived scrutiny, had it not also directed municipal pension funds to divest as well. Presumably the Act now pre-empts any and all alternative theories supporting the constitutionality of a divestment law and makes compliance with the Act the exclusive route through which Sudan divestment measures can be made constitutional.

² Section 3 might appear to address only state and local government investment in or divestment from companies with operations in Sudan. However, by virtue of the way "investment" is defined in Subsection 3(f)(1), Section 3 would appear to also address portions of the district court's decision insofar as they struck down other portions of the Illinois act relating to public contracting with companies doing business in Sudan.

1. Subsection 3(a) states that “[i]t is the sense of Congress that the United States Government should support the decision of any State or local government” to divest from or prohibit investment in any “person” which “the State or local government determines poses a financial or reputational risk.”³ Financial and reputational risk are not specifically defined. This provision would presumably require the State or local government to make specific findings in its Sudan divestment legislation in order to qualify for the protection of Section 3. Subsection 3(e)(4), however, contains another “sense of Congress” provision, saying that a State or local government should not adopt any measure “unless the State or local government has made every effort to avoid erroneously targeting [a] person and has verified that the person conducts or has direct investments in business operations” covered by Section 3(b). Thus, even where a State or local government has made findings with respect to financial and reputational risk, it must accord a form of due process to each targeted company before it implements a divestment decision with respect to that company.
2. Under Subsection 3(b), a state or local government may, “[n]otwithstanding any other provision of law”, adopt and enforce divestment legislation, provided it complies with the complex requirements of Section 3. Presumably, the “notwithstanding” provision is only intended to refer to the United States Constitution and federal statutory and administrative law and does not override state constitutional and statutory provisions which might otherwise bar or limit implementation of divestment legislation or measures by a public pension fund.⁴
3. Subsection 3(b) further provides a state or local government can only consider divestment (if they want the protection and safe harbor provided by the Act) when the state or local government determines “**using credible information available to the public**” (credible information is not defined) that such person is conducting or has direct investments in “business operations” (commerce of any form) in Sudan that include power production, mineral extraction, oil related activities or the production of military equipment.⁵ **Note**

³ Person is defined by Subsection 2(9) of the Act as: (A) a natural person, corporation, company, business association, partnership, society, trust, any other nongovernmental entity, organization, or group;(B) any governmental entity or instrumentality of a government, including a multilateral development institution (as defined in section 1701(c)(3) of the International Financial Institutions Act (22 U.S.C. 262r(c)(3))); and (C) any successor, subunit, parent company or subsidiary of any entity described in (A) or (B).

⁴ For example, the New York constitution bars legislation which directs public pension plan trustees to take certain investment actions. Sgaglione v. Levitt 37 NY2d 507 (1975)

⁵ These are all defined terms under Section 2 of the Act. Power production activities are defined as: any business operation that involves a project commissioned by the National Electricity Corporation of Sudan or other similar entity of the Government of Sudan whose purpose is to facilitate power generation and delivery, including establishing power-generating plants or

that this is not a blanket authorization of Sudan divestment. Persons with business operations in Sudan, if any, which do not “include” any of the four specified types of businesses are presumably not covered by Subsection 3(b) and, therefore, outside its scope.⁶ If the company is not within the scope of Subsection 3(b), one might assume that the public fund may buy and sell their shares in the normal course without complying with the requirements of Section 3 but it is uncertain as to whether that is what is intended. Investment decisions taken pursuant to a state or local law requiring divestment in the case of companies which are not covered by the Act could be subject to challenge as unauthorized by the Act.

Subsection 3(d)(2) expressly excludes from covered “business operations” those “business operations” that a “person” conducting the business operations can demonstrate (A) are conducted directly with the regional government of **southern Sudan**; (B) are conducted under a license from the Office of Foreign Assets Control, or are expressly exempted under Federal law from the requirement to be conducted under such a license; (C) consist of providing goods or services to marginalized populations of Sudan (as defined as adversely affected groups in regions authorized to receive assistance under

hydroelectric dams, selling or installing components for the project, or providing service contracts related to the installation or maintenance of the project. Mineral extraction activities are defined as exploring, extracting, processing, transporting, or wholesale selling or trading of elemental minerals or associated metal alloys or oxides (ore), including gold, copper, chromium, chromite, diamonds, iron, iron ore, silver, tungsten, uranium, and zinc. Oil related activities are defined as exporting, extracting, producing, refining, processing, exploring for, transporting, selling, or trading oil; and constructing, maintaining, or operating a pipeline, refinery, or other oilfield infrastructure. A person shall not be considered to be involved in an oil-related activity if the person is involved in the retail sale of gasoline or related consumer products in Sudan but is not involved in any other activity defined as oil related; or the person is involved in leasing, or owns, rights to an oil block in Sudan but is not involved in any other activity described as oil related. Finally, military equipment is defined as weapons, arms, military supplies, and equipment that readily may be used for military purposes including radar systems or military-grade transport vehicles **OR** supplies and services sold or provided directly or indirectly to any force actively participating in a armed conflict in Sudan.

⁶ There is no express substantiality requirement in Section 3 so it is unclear whether a “person” whose business operations only marginally or incidentally “include” any of the four enumerated activities would be covered by Section 3 and not exempt. The repeated references to “business operations in Sudan” may suggest that the “person”, either directly or through an affiliate, must have operations on the ground inside Sudan in order to come under Section 3 but it is uncertain whether the courts might construe the phrase more broadly and require a public fund implementing a Sudan divestment program to give the required notices, observe the required waiting periods, etc. in the case of a broader range of companies than might first appear from a reading of the Act.

section 8(c) of the Darfur Peace and Accountability Act (Public Law 109-344; 50 U.S.C. 1701 note); and (B) marginalized areas in Northern Sudan described in section 4(9) of such Act; or consist of providing goods or services to an internationally recognized peacekeeping force or humanitarian organization; (E) consist of providing goods or services that are used only to promote health or education; or (F) have been voluntarily suspended.

4. Subsection 3(b) speaks of the divestment or investment of “the assets of the State or local government.” Assets are defined in Subsection 3(f) as public monies and includes any pension, retirement, annuity, or endowment fund, or similar instrument, that is controlled by a State or local government (except employee benefit plans covered by title I of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1001 et seq.)
5. A state or local government must provide specific notice when prohibiting the investment in or divesting of assets in a “person” with business operations in Sudan that include power production, mineral extraction, oil related activities or the production of military equipment as defined in the Act. A state or local government:
 1. **must** provide written notice and an opportunity to comment in writing to each person to whom a measure is to be applied;
 2. will not divest until 90 days after the date on which written notice is provided to the person
 3. cannot apply covered measures against a “person” that demonstrates to the State or local government that the person does not conduct or have direct investments in business operations in Sudan that include power production, mineral extraction, oil related activities or the production of military equipment described.

In other words, a permitted divestment action may not even take place until the State or local government has given plenty of notice to the target company of its proposed action. Where the public fund owns shares in the target company, this could create a danger that a public pension fund acting pursuant to a divestment mandate could sustain substantial losses in its position while it waits out the notice period. Furthermore, that public pension fund could be barred from acting at the end of the 90 day period if the target company elects to challenge the fund’s proposed action. Thus, the adoption of a divestment law or measure complying with the Act may prevent a public fund from taking actions which it would otherwise have taken, had it been acting in the normal course.⁷

⁷ Compliance with the Act may create a potential field day for other investors seeking to benefit from advance knowledge of the public fund’s proposed actions if they should become public knowledge.

Under Subsection 3(f) the term “investment” as used in Section 3 includes not only investments as commonly understood but also loans or extensions of credit and the entry into and renewal of contracts for goods and services. The term “assets” includes “any pension, retirement, annuity, or endowment fund...that is controlled by a State or local government.”

Any State or local government enacting a divestment law subject to subsection 3(b) must give notice of the action to the Justice Department no later than 30 days after adoption.

Strict compliance with the requirements of Section 3 appears necessary to obtain the benefit of the Act. Subsection 3(g) expressly provides that an action of a State or local government authorized under Subsection 3(b) is not pre-empted by any Federal law or regulation. Presumably, any failure to comply with any of the requirements of Section 3 will cause Federal law and regulation pre-emption to attach.

Section 3 is applicable to all divestment actions even those undertaken prior to the Act; however, the notice requirements only apply to actions taken after enactment of the Act.

Section 4 of the Act also requires study by public pension plans. Section 4 provides a “safe harbor” for changes in investment policy by asset managers. Specifically, Subsection 4(a)(1) amends the Investment Company Act of 1940 (“1940 Act”) to bar the commencement any action against an investment company or any employee, officer, director or investment advisor thereof, based solely upon a Sudan divestment action by the investment company. This exemption from suit, however, does not apply to decisions not covered by Section 4(a)(1) or where disclosures are not made as prescribed by the regulations of the Securities Exchange Commission. Subsection 4(a)(3) specifically includes State and local governments within the bar of parties which may not sue an investment company. Thus, Section 4 would appear to allow an investment company to decide unilaterally to divest from companies having operations in Sudan, provided it complies with the complex requirements of Section 3.

Sections 3 and 4 of the Act will terminate 30 days after the date the President certifies to Congress that the “Government of Sudan” as defined in the Act has honored its commitment to:

- (1) abide by United Nations Security Council Resolution 1769 (2007);
- (2) cease attacks on civilians;
- (3) demobilize and demilitarize the Janjaweed and associated militias;
- (4) grant free and unfettered access for delivery of humanitarian assistance; and
- (5) allow for the safe and voluntary return of refugees and internally displaced persons.