State Notes

TOPICS OF LEGISLATIVE INTEREST

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Divestiture of State Funds from Businesses Associated with State Sponsors of Terror
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Divestment Legislation

Throughout the United States, various states have enacted or are considering legislation to require the divestment of state funds from various countries, most notably Sudan. In Michigan, proposed legislation would require the divestment of State funds from all "state sponsors of terror" as identified by the U.S. Department of State. Currently, that list includes Sudan, Iran, North Korea, Syria, and Cuba. There are several proposals before the Michigan Legislature that target different countries and vary in breadth, timeline, and strictness.

Senate Joint Resolution J (SJR J) would amend the State Constitution to prohibit any public body, including public universities, from investing in any company doing business in or with state sponsors of terror. Senate Bills 846 through 856 would prohibit the investment of State funds in companies engaging in business with known state sponsors of terror. The bills also would establish a gradual divestment schedule, requiring that all funds be divested from such investments within 15 months. Funds affected would include the four major State pension funds (the Michigan State Employees' Retirement System (MSERS), Michigan Public School Employees' Retirement System (MPSERS), Michigan State Police Retirement System (MSPRS), and Michigan Judges' Retirement System (MJRS)) as well as the Michigan Education Trust Fund, State surplus funds, and community colleges' funds.

Senate Bill 555 as introduced addresses divestment from companies with active business operations in Sudan. That bill would require divestment within nine months, following an investigation and written notices to the companies involved. Several other states are considering similar proposals, although the scope of those proposals varies greatly. Florida recently enacted legislation requiring divestment from Sudan and any company with investments of more than $20.0 million in Iran's energy sector. Ohio recently came to a compromise for state pension funds voluntarily to divest themselves of Iran energy-related holdings without legislation. California enacted a bill requiring the state pension funds to eliminate any Iran-related investments.

The Michigan Department of Treasury has indicated that there are considerably more State investments in Iran than in Sudan, and broadening the divestment requirement to additional countries would increase the costs of implementation. The current legislation is summarized in Table 1.

South Africa

In the late 1980s, a similar movement swept through state legislatures in regard to South Africa. Michigan passed divestiture legislation with a five-year implementation program. The program was abandoned after the third year, as apartheid had ended and investment in that country was once again encouraged. However, some would argue that this movement, which included both public and private investments, contributed to the end of apartheid.

Table 1

Pending Michigan Legislation on Divestment		
Bill Number	**Content**	**Status**
SJR J	Would amend the State Constitution to prohibit investment in companies doing business with state sponsors of terror	Pending before the whole Senate
SB 555	Would require the State to divest State funds in any Sudanese business or interest	Referred to Senate Appropriations Committee
SB 846	Would require various State funds to divest from certain companies with business operations in state sponsors of terror	Pending before the whole Senate; tie-barred to H.B. 4854 and 4903
SB 847-856	Would require various State funds (pensions, trust funds, community colleges, et al.) to comply with the terms of S.B. 846	Pending before the whole Senate; tie-barred to H.B. 4854 and 4903
HB 4854	Would require the various State retirement systems to divest from certain companies invested in Sudan	Passed the House, referred to Senate Appropriations Committee
HB 4903	Would require the various State retirement systems to divest from certain companies invested in Iran	Passed the House, referred to Senate Appropriations Committee
HB 4904	Would prohibit the State Treasurer from depositing surplus funds in certain financial institutions that knowingly make or maintain loans to Iran, North Korea, Sudan, or the Syrian Arab Republic, its national corporations, or subsidiaries or affiliates of U.S. firms operating in those countries	Referred to House Committee on Government Operations
HB 4969	Would prohibit the Department of Management and Budget and State agencies from entering into contracts with a vendor or supplier who conducts business in or with the Republic of Sudan	Referred to House Committee on Government Operations
HB 5095	Would prohibit the State Treasurer from depositing surplus funds in certain financial institutions that knowingly make or maintain loans to oppressive regimes, national corporations of oppressive regimes or subsidiaries or affiliates of U.S. firms operating in those countries	Referred to House Committee on Government Operations

Sudan Divestment Legislation

There are a number of states that either have enacted or are considering legislation requiring divestment from state sponsors of terror, most notably Sudan. As of December 2007, 12 states had passed laws requiring divestment from Sudan, four states had legislation pending, four states had voluntarily divested certain holdings, and three states had failed to pass proposed measures. The U.S. Congress also has passed legislation that allows states to divest from Sudan, but President Bush has not signed it. There are some concerns at both the state and Federal levels that these proposals blur the lines between state and Federal jurisdiction. The Bush administration has stated publicly that it does not support these types of proposals. In Michigan, the Department of Treasury has voiced concern about states' engaging in foreign policy decisions. An additional concern is the process for identifying state sponsors of terror.

While the U.S. Department of State identifies certain countries as being involved in terror activity, the list is subject to change, and creating a clear-cut definition of which countries were permissible investments would be difficult. Table 2 below from the Sudan Divestment Task Force summarizes initiatives across the United States.

Table 2

Targeted Sudan Divestment Legislative Chart

State	Bill	Status	Notes
California	AB 2941	Signed by Governor Arnold Schwarzenegger (9/25/06)	Passed
Colorado	HB 1184	Signed by Governor Bill Ritter (4/19/07)	Passed Endorsed by Public Employees' Retirement Association of Colorado (PERA)
Florida	SB 2142	Signed by Governor Charlie Crist (6/8/07)	Passed
Hawaii	HB 34	Signed by Lt. Governor Duke Aiona (6/18/07)	Passed
Indiana	HB 1484	Signed by Governor Mitch Daniels (5/3/07)	Passed
Iowa	SF 361	Signed by Governor Chet Culver (4/5/07)	Passed
Kansas	SB 2457	Signed by Governor Kathleen Sebelius (5/11/07)	Passed
Maryland	SB 344	Withdrawn	Alternative legislation passed; prohibits future investments and recommends divestment
Massachusetts	S2255	Signed by Governor Deval Patrick (11/2/07)	Passed
Michigan	SB 0555, HB 4854	SB 0555: Assigned to Senate Appropriations Committee HB 4854: Passed House Chamber; Assigned to Senate Appropriations	
Minnesota	SF1075	Signed by Governor Tim Pawlenty (5/23/07)	Passed
Nevada	*No Legislation Filed*		Governor Jim Gibbons and legislative leadership have urged the state pension fund (PERS) to voluntarily adopt a targeted Sudan divestment policy

New Mexico	*No Legislation Filed*	State Investment Officer Gary Bland, at the behest of Governor Bill Richardson, ordered the State Investment Council to divest the New Mexico Permanent Fund (11/9/07) New Mexico Educational Retirement has also divested (12/8/07)	Follows Sudan Divestment Task Force model of targeted Sudan divestment The Public Employees Retirement Association of New Mexico has not adopted a Sudan divestment policy.
New York	*Legislation Not Needed; Session Ended*	New York State Comptroller, Thomas P. DiNapoli, adopted a targeted Sudan divestment policy for the New York State Common Retirement Fund (6/11/07)	Follows Sudan Divestment Task Force model of targeted Sudan divestment
North Carolina	HB 291	Signed by Governor Mike Easley (8/31/07)	Passed
Ohio	SB 161	Assigned to Senate Committee on Finance	
Pennsylvania	HB 1140	Passed House Chamber; now heads to Senate Chamber	
Rhode Island	H 5142, S 87	Signed by Governor Donald Carcieri (6/22/07)	Passed
South Carolina	SB 241	Failed to Pass	Based off California divestment statute
Texas	SB 247	Signed by Governor Rick Perry (6/15/07)	Passed
Vermont	*Legislation Not Needed*	Vermont State Treasurer, Jeb Spaulding, adopted a targeted Sudan divestment policy (2/26/07)	Follows Sudan Divestment Task Force model of targeted Sudan divestment
Virginia	SB 1331, HB 1828	SB 1331: Failed to Pass HB 1828: Failed to Pass	
Wisconsin	AB 124, SB 57	AB 124: Assigned to House Committee on Financial Institutions SB 57: Assigned to Senate Committee on Veterans and Military Affairs, Biotechnology and Financial Institutions	
Federal	S 2271	Passed Congress; now heads to President	Authorizes and encourages state level Sudan divestment, places restrictions on Federal contracts for offending companies operating in Sudan

Source: http://sudandivestment.org/home.asp

National Foreign Trade Council* v *Giannoulias

At different times, states have proposed divesting from certain countries, including South Africa and Burma, for political reasons. However, those restrictions have come under scrutiny from the courts, questioning whether such measures encroach on the jurisdiction of the Federal government. In the case of divestment from Sudan, legislation passed in January 2006 in Illinois has been the target of a lawsuit brought by the National Foreign Trade Council (NFTC). In *National Foreign Trade Council* v *Giannoulias*, the NFTC claimed that the law violated the U.S. Constitution and interfered with the Federal government's foreign affairs power, specifically Article VI, Clause 2 of the U.S. Constitution, which reads:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

The U.S. District Court sided with the NFTC in the case in February 2007, and the state of Illinois may appeal or alter the law to address the concerns of the court.

Michigan Senate Bill 846 (S-1) states that if any provision of the legislation is found to be unconstitutional or otherwise illegal, the provision is severable from the remainder of the act. Also, fiduciaries that complied with the legislation would be immune from liability. Michigan House Bill 4903 contains language stating that if the Congress or President of the U.S. finds that the legislation "interferes with the conduct of United States foreign policy", the legislation is no longer valid.

Fiscal Impact

The various measures proposed in Michigan would have an indeterminate fiscal impact on the State and local units of government. Senate Joint Resolution J would amend the State Constitution to prohibit any public body, including public universities, from investing in any company doing business in or with state sponsors of terror, as determined by the U.S. Secretary of State. Senate Bill 846 (S-1) would prohibit the fiduciaries for various State entities from maintaining investments in or investing in companies with business operations or direct or indirect investments in state sponsors of terror, subject to certain threshold amounts an exemption for companies providing humanitarian aid. These entities include the retirement systems of the Michigan Legislature, the State Police, judges, State employees and public school employees, as well as the fiduciaries for the 21st Century Jobs Trust Fund, the Veterans' Trust Fund, the Children's Trust Fund, surplus funds in Treasury, the State Lottery, community colleges, the Environmental Protection Fund, the Michigan Education Trust, and the Michigan Strategic Fund. The remaining bills simply would update the individual acts pertaining to these entities to require compliance with Senate Bill 846.

While it is difficult to quantify the precise fiscal impact of these bills on State government, it could be substantial. The Department of Treasury has indicated that not only would there be immediate transaction costs involved in the divestiture, there would be compliance costs going forward as well. Currently, the Bureau of Investments does not have employees dedicated to compliance with legislative restrictions, but several would be necessary under these bills. Transaction costs are typically paid out of the funds, and are not subject to the appropriations process, but the cost of additional staff would need to be included in the Treasury Department's budget. According to the Department, transaction costs could be considerable, particularly because these funds often invest in indices and mutual funds that contain many companies, which would make singling out individual companies difficult. In addition to these more measurable costs, the Department predicts that the opportunity costs of prohibited investments could be high, thereby affecting the overall value of State funds; however, these potential costs or gains can only be determined retrospectively. The Department also is concerned that injecting political motives into the investment process could hinder that process; and restricting permissible investments would undermine the mission of the Bureau of Investments, which is to maximize the value of its investments in a fiscally responsible way.

The Department of Treasury has focused on the impact of these bills with respect to the Department's investments, which would not include all of the entities in the resolution and bills. For the Department's investments alone, Treasury has estimated that it would cost approximately $30,000 per year per country to ensure compliance with the proposed restrictions. That amount would cover the cost of hiring a private company to monitor compliance, and would be ongoing. That number could be slightly lower for countries where the State has smaller investments.

The potential fiscal impact on universities, community colleges, local units of government, and other public bodies is difficult to determine, as it depends on the amount each entity has invested in relevant companies. Senate Joint Resolution J would require that each public body report to the Department annually. While the resolution does not specify the Department's responsibility, if the Department of Treasury were charged with compiling a list of companies for each country and assisting public bodies with compliance, the Department would incur significant additional costs.

As of September 30, 2006, MSERS, MPSERS, MSPRS, and MJRS had combined total assets of approximately $64.0 billion.