



LAWYERS' COMMITTEE
FOR CIVIL RIGHTS UNDER LAW

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June 23, 1983

MEMORANDUM

TO: D.C. Divest

FROM: The Southern Africa Project,
Lawyers' Committee for Civil Rights
Under Law*

RE: Authority To Adopt Bill 5-18, The South
African Divestiture Legislation

Executive Summary

The District of Columbia Council has before it legislation that would, among other things, require the District of Columbia Retirement Board to divest its funds from companies making loans to, or doing business with, the Republic of South Africa. Opponents of Bill 5-18 have challenged its legality on two grounds. First, they argue that the District of Columbia Council has no authority to amend, in any way, the Retirement Reform Act, Pub. L. No. 96-122, 93 Stat. 868 (1979) [hereinafter cited as "the Retirement Act"]. Second, they claim that divestiture would constitute a breach of the Retirement Board's fiduciary duty.

Both these contentions are without merit. The Retirement Act contains no provision that prohibits amendment by the Council. Moreover, the Council possesses authority under the District of Columbia Self-Government and Governmental Reorganization Act, Pub. L. No. 93-198, 87 Stat. 774 (1973) [hereinafter cited as "the Home Rule Act"] to amend the Retirement Act. The Home Rule Act only forbids amendments that affect federal interests, which the divestiture bill would not.

* We gratefully acknowledge the assistance of Arnold & Porter in the preparation of this memorandum.

So long as South African divestiture does not adversely affect the fiscal integrity of the retirement fund, the Council may enact Bill 5-18 without causing the Retirement Board to breach its fiduciary duty. The Board's fiduciary duty requires sound financial management: the trustees' primary obligation is to ensure the financial soundness of the fund. The language of the Retirement Act, and of identical provisions of the Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1001 et seq. (1976) [hereinafter cited as "ERISA"], have never been interpreted to prohibit the pursuit of social objectives in investment.

I. THE DISTRICT OF COLUMBIA COUNCIL
POSSESSES THE AUTHORITY TO AMEND
THE RETIREMENT ACT

A. Congress Intended To Allow the Council
To Amend the Retirement Act

Opponents of the divestiture legislation contend that, because Congress passed the Retirement Act subsequent to granting Home Rule to the District of Columbia, it intended to render the Retirement Act unamendable.¹ For two reasons, it is implausible that Congress intended, by its silence, to circumvent the District of Columbia Council's general authority to amend the local Code.

First, Congress expected to have the Retirement Act in place before Home Rule took effect, not after.²

¹ Congress passed the Home Rule Act in 1974 and the Retirement Act in 1979.

² See Home Rule for the District of Columbia 1973-74, Background and Legislative History of District of Columbia Self-Government and Governmental Reorganization Act. 93d Cong., 2d Sess. 1631 (1974) ("the complex retirement [Footnote continued on following page]

A presidential veto and other bottle-necks in the legislative process delayed the passage of a District of Columbia Retirement Act. That delay did not, however, represent a conscious effort on the part of Congress to present the District of Columbia Council with an unamendable retirement package.³

Second, the legislative history of the Retirement Act suggests that Congress contemplated that the District of Columbia Council would have the authority to amend the Act. In floor debate, Congressman Dellums explained that the Retirement Act "still leaves a large part of the job of designing the pension system of the future to the local city officials. . . . Under the Home Rule Act, Congress has delegated to the city the power to conduct its internal affairs."⁴ In addition, Council Chairman Sterling Tucker testified before the Subcommittee on Fiscal Affairs of the House Committee on the District of Columbia that, except in instances "where some benefits are tied to programs of other Federal employees," the Council's authority to amend the Retirement Act benefit program is "full and clear."⁵

[Footnote 2 continued from preceding page]
funding question can best be handled via separate legislation to be enacted prior to the effective dates of the new locally elected government") (emphasis added).

³ See Report of D.C. General Counsel Lawrence H. Mirel to William R. Spaulding, Chairman, D.C. Council Committee on Government Operations at 11 (Dec. 8, 1982) (legal memorandum on Bill 4-420, District of Columbia Retirement Reform Act Amendments Act of 1982).

⁴ 125 Cong. Rec. H-8370 (daily ed. Sept. 24, 1979) (statement of Rep. Dellums).

⁵ Financing Retirement Funds For Police, Firemen, Teachers, and Judges--Hearings and Markup before the Subcomm. on Fiscal Affairs of and the Comm. on the District of Columbia. 94th Cong., 2d Sess. 143 (1976).

The question of the District of Columbia's authority to amend the Retirement Act is not a new one. Last year, the Committee on Government Operations of the District of Columbia Council solicited a legal memorandum from District of Columbia General Counsel Lawrence H. Mirel on this very issue with respect to a different bill.⁶ After examining the language and legislative history of the relevant statutes, General Counsel Mirel concluded that "[t]here is nothing in the Home Rule Act or the Retirement Reform Act which suggests that the Council is precluded from amending the Retirement Reform Act because it was enacted by Congress subsequent to the grant of home rule to the District."

B. The Council Possesses the Authority To Amend the Retirement Act Under the Home Rule Act

Because the Retirement Act is silent on the question of amendment, the provisions of the Home Rule Act control. Congress prohibited amendment of the District of Columbia Code only insofar as particular modifications affect federal property or a federal function. The Council may amend the Retirement Act to require divestiture because divestiture represents a local policy decision that will not affect the federal government's share of the retirement fund.

Faced with the "anomaly that the people of our Nation's Capital have virtually no voice in their own

⁶ General Counsel Mirel discussed Bill 4-420, which had nothing to do with South African divestiture or the Retirement Board's fiduciary duties.

government,"⁷ Congress passed the District of Columbia Home Rule Act to afford the District of Columbia "some measure of self-government." Congress limited its grant of legislative power, however, by retaining its constitutional authority⁸ to legislate for the District of Columbia.⁹

Section 602(a)(3) of the Home Rule Act denies the District of Columbia Council authority to:

enact any act, or enact any act to amend or repeal any Act of Congress, which concerns the functions or property of the United States or which is not restricted in its application exclusively in or to the District¹⁰

The second clause of that section clearly does not prohibit the adoption of Bill 5-18: divestiture would be restricted exclusively to the Board's management of the trust fund.

Opponents of the divestiture legislation contend, however, that the first clause of that section precludes amendment of the Retirement Act, because the Retirement Fund includes some "property of the United States." This argument rests upon the assumption that the Home Rule Act prohibits amendments to any Act of Congress

⁷ H.R. Rep. No. 482, 93d Cong., 1st Sess. 50 (1973); S. Rep. No. 390, 92nd Cong., 1st Sess. 1 (1973).

⁸ Article I, Section 8, cl. 17, of the Constitution provides that: "Congress shall have the power . . . [t]o exercise exclusive Legislation in all Cases whatsoever, over such District"

⁹ See Home Rule Act § 302 (District of Columbia's legislative Power); § 601 (Retention of Constitutional Authority).

¹⁰ D.C. Code § 1-233(a)(3).

that contains even a minimal, unrelated federal component. General Counsel Mirel, however, has rejected this interpretation of the statute as:

an unreasonably rigid interpretation of the Council's legislative authority which is not supported by the plain meaning of Sec. 602(a)(3). . . . There is no basis for distorting Sec. 602(a)(3) to declare certain Acts of Congress off limits when the provision plainly means that federal functions and interests are off limits to the Council. This is the only reasonable interpretation of this provision, and the interpretation which finds support in the legislative history of the Home Rule Act.¹¹

Thus, the language of the Home Rule Act compels the conclusion that the Council may amend provisions that do not directly affect federal interests.

The Retirement Act provides that the federal contribution to the fund is fixed. Therefore, the federal government has no substantial interest in the financial management and investment decisions of the fund: the United States will contribute the same amount irrespective of whether or not the District requires divestiture. The District, on the other hand, has a strong interest in how its funds are invested. The Home Rule Act dictates that the District government should control such local decisions so long as they do not infringe upon federal interests.

¹¹ Report of General Counsel, supra note 3, at 7.

II. SOUTH AFRICAN DIVESTITURE IS CONSISTENT WITH THE RETIREMENT BOARD'S FIDUCIARY DUTY

The primary obligation of the Retirement Board Trustees is to maintain the financial integrity of the Retirement fund. Insofar as divestiture from companies making loans to, or doing business with, South Africa can be achieved without affecting the fiscal soundness of the retirement fund, the Trustees may consider and accommodate this social goal.¹²

A. The Fiduciary's Duties Under the Retirement Act

The Retirement Act provides in relevant part as follows:

A fiduciary shall discharge his duties with respect to a Fund solely in the interest of the participants and beneficiaries and:

(A) For the exclusive purpose of providing benefits to participants and their beneficiaries. . . .

A fiduciary's duty under the Retirement Act is identical to the obligations imposed by Congress for private retirement funds under ERISA.¹³ In both contexts, the obligations ultimately stem from the fiduciary's common-law duty of loyalty.

¹² This memorandum does not address the financial impact of Bill 5-18. In his testimony on March 4, 1983, before the District of Columbia Council Committee on Consumer and Regulatory Affairs, Frank A. Higgins, Chairman of the District of Columbia Retirement Board, indicated that he would present to the Board a study of that issue.

¹³ Congress imposed similar fiduciary obligations in the Internal Revenue Code, with respect to tax exempt status for private pension funds. I.R.C. § 401(a) ("exclusive benefit") and the Labor Management Relations Act of 1947, § 302(c)(5), 29 U.S.C. § 186(c)(5)(1976) ("sole and exclusive benefit").

Opponents of divestiture claim that Bill 5-18 would contravene the Retirement Board's duty to act "solely in the interests" of the pension fund's participants and beneficiaries. In addition, they contend that divestiture would violate the requirement that the Trustees manage the fund for the "exclusive purpose of providing benefits to the fund's participants and beneficiaries." Both contentions are meritless.

1. "Solely in the interests of the participants and beneficiaries"

At first glance, the language of this section might appear to impose a rigid prohibition against considering any factors other than the direct, tangible financial interests of the participants and beneficiaries. In practice, however, this restriction (which has been interpreted by the courts in connection with the identical language in ERISA) has been construed much more narrowly. In no case has a fiduciary ever been held liable for making financially neutral social investments.¹⁴ Instead, courts have relied upon the "solely in the interests" language to reach traditional breaches of fiduciary loyalty. For instance, the "solely in the interests" requirement has been used to prevent self-dealing, attempts to favor one beneficiary or participant over another, and attempts to benefit a third party at the expense of the trust's participants or beneficiaries.¹⁵

¹⁴ See Leibing, "You Can't Do That With My Money" - A Search for Mandatory Social Responsibility in Pension Investments, 6 J. Pension Plan. & Compliance 358, 370 (1980).

¹⁵ See, e.g., Freund v. Marshall & Easley Bank, 485 F. Supp. 629, 639 (W.D. Wis. 1979); Winpisinger v. Aurora Corp. of Ill., 456 F. Supp. 599 (N.D. Ohio, 1978); Eaves v. Penn, 587 F.2d 453 (10th Cir. 1978).

As one commentator has concluded:

Violations of trustee obligations most often involve elements of self-dealing; where there is no connotation of self-seeking it is extremely unlikely that trustees will be held liable for their acts absent extreme negligence or irresponsibility.

This construction -- that the "solely in the interests" language was designed to prevent fiduciary wrongdoing -- is borne out by the legislative history of the clause in ERISA. As Senator Javits explained in floor debate, ERISA obligates every fiduciary "to act solely in the interest of the participants and beneficiaries or the plan; that is, to refrain from involving himself in situations or transactions (especially transactions with known parties in interest) where his personal interests might conflict with the interests of the participants and beneficiaries for whom the fund was established."¹⁶ Congresswoman Schroder explained:

¹⁶ 119 Cong. Rec. 12,076 (1973). As two commentators have observed:.

The 'solely in the interest' provision of ERISA constitutes nothing more than a restatement of the common law duty of loyalty. As such, this provision should have no impact on trustees who promote nontraditional objectives through their investments. The purpose of the duty of loyalty is to require a fiduciary to avoid situations where his or her own interests are at odds with those of the beneficiaries. As long as the fiduciary avoids self-interested transactions, his or her investment decisions should not be subject to attack under this provision."

Fiduciaries of the plans are required to discharge their duties solely in the interests of the participants; they are prohibited from engaging in transactions purely for their own gain. . . .¹⁷

2. "Exclusive Purpose for Providing Benefits"

Like the "solely in the interests" language, the term "exclusive purpose" is deceptively harsh. The Tax Court, in interpreting the similar "exclusive benefit" language that appears in section 401(a) of the Internal Revenue Code, found that the "exclusive benefit" rule was not designed to prohibit all benefits to third parties.¹⁸ In Feroleto Steel Co. v. Commissioner, the court found that the trustees' loan to an insurance company violated their fiduciary duty to the beneficiaries. Because the trustees did not conduct the fund for the "exclusive benefit" of the beneficiaries, the pension fund did not qualify for tax-exempt status. The court qualified its holding by noting:

By our holding here, we do not mean to imply that the exclusive benefit rule is contravened whenever a benefit enures to someone other than the employees or their beneficiaries as the result of an investment of the funds of an employee trust. However, under the facts of this case the benefit to the third party is not merely an incidental side effect of an investment of trust assets, but is rather a major purpose of the investment. In these circumstances, we hold that the exclusive benefit rule has not been followed.

¹⁷ 120 Cong. Rec. 4316 (1974).

¹⁸ 69 T.C. 97, 113 (1977). Accord, Shelby v. U.S. Distributor, Inc., 71 T.C. 874 (1977).

Similarly, in a revenue ruling interpreting the Internal Revenue Code's counterpart to the "exclusive benefit" rule, the Service established that the language is intended to prohibit fiduciary wrong-doing, not consideration of financially neutral social criteria.¹⁹

3. Divestiture Is Consistent With
the Common Law Duty of Loyalty

Because the fiduciary's obligations under the Retirement Act are derived from ERISA, which in turn relies heavily upon common law principles, the interpretation and application of the common law duty of loyalty is instructive with respect to the Retirement Board's fiduciary obligation. Professor Austin W. Scott, the preeminent authority on trusts, has concluded that socially conscious investments are consistent with common law principles:

¹⁹ The Ruling lists four objective financial criteria to apply in judging whether the trustee has acted for the "exclusive benefit" of the employees and, hence, whether the fund is eligible for tax-exempt status. The criteria address the reasonableness of the financial decision; they do not consider possible benefits to third parties. There are two other interpretations of the rule. First, some scholars read the "exclusive benefit" rule to apply only to expenditures, rather than to investments. See Hutchinson & Cole, Legal Statements Governing Investment of Pension Assets for Social and Political Goals, 6 U. Pa. L. Rev. 1340, 1370-71 (1980). This provision has been used by the Department of Labor to attack exorbitant expenditures for administration by trustees. Second, some scholars advocate that the term "benefit" be read broadly to include more than merely tangible, direct financial gains. See Ravikoff & Curzan supra note 16 at 532. One commentator, analyzing divestiture in the public trustfund context, observed "that 'benefit' may be other than financial. In the case of South Africa exclusion, the benefit is not condoning unjust practices." Note, Socially Responsible Investment of Public Pension Funds: The South Africa Issue and State Law, 10 N.Y.U. Rev. L. & Soc. Change 407, 424 (1980-81).

Trustees in deciding whether to invest in, or to retain, the securities of a corporation may properly consider the social performance of the corporation. They may decline to invest in, or to retain, the securities of corporations whose activities or some of them are contrary to fundamental and generally accepted ethical principles. . . .

[A] trustee of funds for others is entitled to consider the welfare of the community, and refrain from allowing the use of the funds in a manner detrimental to society.²⁰

One illustration of that principle is Withers v. Teachers' Retirement System of the City of New York, 447 F. Supp. 1248 (S.D.N.Y. 1978), aff'd, 595 F.2d 1210 (2d Cir. 1979). In Withers, the Teachers' Retirement System sued to prevent the trustees of their pension fund from investing in risky New York City "Big Mac" bonds. The court rejected the teachers' claim that the trustees had breached their fiduciary duty in investing in the bonds. Although it cloaked the decision in terms of the beneficiary's ultimate financial interest, the Court in Withers demonstrated that the fiduciaries were entitled to look beyond strictly financial considerations to the broader social goal of aiding New York City.²¹

²⁰ 3 A. Scott, Scott on Trusts § 227.17 (Supp. 1980). The issue of social investing is not altogether new in the common law. In 1918, a plaintiff-beneficiary sued the fiduciary who invested in World War I "Liberty Bonds" contrary to the instruction of the trust's creator. The Court found that the investment "was in aid of our government in its hour of need, and [the trustees] should be commended rather than condemned therefore." In re London's Estate, 171 N.Y.S. 981, 983 (Sup. Ct. 1918), aff'd, 175 N.Y.S. 910 (Sup. Ct. 1919).

²¹ It was the important social value of aiding New York City that distinguishes Withers from Blankenship v. Boyle, 329 F. Supp. 1098 (D.D.C. 1971). In Blankenship, the court found that the trustees had breached their fiduciary duty by placing pension funds in non-interest bearing accounts owned by the union. The decision was
[Footnote continued on following page]

B. Other Pension Funds Have Lawfully
Engaged in Divestiture

Beneficiaries of public and private pension funds have increasingly begun to demand more than just a good return on financial investments. In collective bargaining with the Chrysler Corporation, the United Auto Workers agreed that up to ten percent of new contributions would be used for "socially desirable projects" and that the Union would possess the right to recommend that pension trustees divest from up to five companies that conduct business in South Africa.²² Because this agreement expressly required that the financial integrity of the fund be maintained, the Department of Labor held that agreement was consistent with the fiduciary principles of ERISA.²³

Moreover, several states (including Massachusetts, Connecticut, Wisconsin, and Nebraska) have adopted laws

[Footnote 21 continued from preceding page]
financially unwise and clearly put the interests of the union ahead of those of the beneficiaries. The trustees attempted to argue that the strength of the union was essential to the beneficiaries and participants -- the same argument made by the trustees in Withers -- but the court rejected it. The distinction is that in Blankenship -- unlike Withers -- the non-economic investment decision did not involve the furtherance of public policy objectives.

²² Collective Bargaining: UNW-Chrysler Agreement Calls for "Socially Desirable" Investment of Contributions [July-Dec. 1979] Pen. Rep. (BNA) No. 263 at A28-29. (Oct. 29, 1979).

²³ Chrysler Corp. (Advisory Opinion) Op. Ian D. Lanoff, Admin. Pen. and Welf. Ben. Pro. Dep't of Lab. 80-33A (June 3, 1980). See, Advisory Opinions: Labor Department Issues Letters on Social Investing, Coverage and Garnishment of Benefits [July-Dec.] Pen. Rep. (BNA) No. 302 at A-2 (Aug. 4, 1980).

restricting investment of state trust funds in South Africa.²⁴ As public pension funds, they are not bound by ERISA or any similar statute. Nonetheless, the state trustee still must fulfill its common law fiduciary duty. In addition, the states possess a strong economic interest in maintaining the soundness of their funds.

Moreover, the federal official primarily responsible for administering ERISA has expressed qualified approval of socially conscious investments by pension funds. In considering the propriety of such investments under ERISA, Ian Lanoff, the Labor Department's Administrator of Pension and Welfare Benefit Programs, stressed the importance of the "overriding social objective" of protecting retirement income.²⁵ He recognized, however, that "there is no one 'best' investment to be made to the exclusion of all others."²⁶ And he concluded that, "if after evaluating other factors, these investments appear to be equally desirable, then social judgments are permissible in determining which to select."²⁷

²⁴ Nebraska passed a legislative resolution calling for divestiture; Massachusetts divested its pension reserve fund; Connecticut divested its pension funds from all companies in South Africa that do not employ the "Sullivan Principles" for advancement of Blacks; and Wisconsin restricted gifts to State Universities. See, Note, supra, note 19 at 413-15.

²⁵ Lanoff, The Social Investment of Private Pension Plan Assets: May Be Done Lawfully Under ERISA, 31 Lab. L. J. 387, 389 (1980).

²⁶ Id. at 390.

²⁷ Id. Lanoff any plan that "excludes investment possibilities without considering their economic and financial merit." Id. at 391. His objection, however, was based on the supposition that such exclusionary funds are inherently financially risky.

Conclusion

The legal objections to Bill S-18 are unpersuasive. The District of Columbia Council must, of course, ascertain whether divestiture would compromise the financial integrity of the retirement system. If the Council concludes that divestiture will not affect that system adversely, then there would be no legal impediments to adoption of this legislation. The Council does have authority to amend the Retirement Act, and it may apply financially neutral social objectives to the fund's investments without infringing upon the Retirement Board's fiduciary duties.