EDITORIAL

Divestment Upheld in First Full Legal Challenge
by Beatte Klein

Beatte Klein is a portfolio manager at U.S. Trust Company of Boston. She has been a consultant to the U.N. Centre Against Apartheid and the World Council of Churches.

On July 17, 1987 supporters of divestment celebrated a landmark legal victory in Baltimore. In the first major court challenge to divestment, Maryland Circuit Court Judge Martin Greenfeld upheld the legality and constitutionality of a law that required the sale of $400 million of the city's $1.2 billion in pension assets over the course of two years.

The trustees of Baltimore's three public retirement funds sued the Mayor and City Council seeking nullification of a 1986 ordinance mandating the complete divestment from city pension funds of companies doing business in South Africa. Because the Baltimore decision ruled on all of the major issues surrounding the divestment debate, including such controversial points as the financial performance of South Africa-free portfolios and the pre-emptive powers of the federal 1986 Comprehensive Anti-Apartheid Act, the decision establishes important legal support for both existing and pending divestment legislation.

Finance and Foreign Policy

The case pitted Baltimore's mayor and city council, which passed the legislation, against the pension trustees, who claimed that the law forced them to violate their fiduciary obligation to invest retirement funds in a prudent manner. The situation was complicated by Baltimore's unusual employee benefit system under which retirees receive bonus payments based on portfolio earnings over 7.5 percent. The plaintiffs asserted that divestment would lower the returns on the portfolios, thereby reducing pensioners' benefits in violation of U.S. and Maryland contract laws which prohibit impairment of employee benefits unless the lost benefits are "reasonable and necessary to serve an important public purpose." In addition to the financial and fiduciary issues, trustees sought to invalidate the ordinance on constitutional grounds, claiming that it infringed on the federal government's jurisdiction in matters of interstate and foreign trade and foreign policy.

The Financial Debate

Judge Greenfeld heard expert witnesses present "massive financial investment data" establishing the financial impact of divestment on the city's portfolios. At U.S. Trust Company in Boston, we had a particular interest in the debate. Our extensive experience in managing socially sensitive portfolios convinced us that investors need not be penalized by taking social considerations into account in their investment decisions. Drawing on numerous studies and twenty years of experience in managing South Africa-free portfolios, U.S. Trust economist Robert Zevin testified that divestment would have no practical impact on the risk, return or cost characteristics of the Baltimore portfolios. He was supported by Adrian Anderson, assistant executive director of Washington, D.C.'s pension fund, who said that divestment had not had an adverse impact on his city's pension fund.

Judge Greenfeld rejected the trustees' claims that the ordinance constitutes and impairment of contract on the grounds that Baltimore has no contractual obligation to guarantee the bonus portion of the retirees' funds. He estimated the one-time cost of divestment at one-thirty-second of one percent of the market value of the portfolios with annual costs of one-twentieth of one percent of the portfolios' value. In a decision with important ramifications for the divestment movement, the judge ruled that initial and ongoing costs of divestment were of such a minimal nature as to not even approach federal constitutional or state legal dimensions of "impairment."

Infringement On Federal Jurisdiction

The Baltimore pension trustees also claimed the city's divestment ordinance was superseded by the less stringent terms of the federal Comprehensive Anti-Apartheid Act of 1986. In dismissing the plaintiffs' preemption argument, Judge Greenfeld cited Congressional debate on this topic in support of his conclusion that the conspicuous absence of any pre-emptive language in the Anti-Apartheid Act proved the lack of any Congressional intent to invalidate state or local antiapartheid initiatives. In other rulings regarding the city's authority to enact divestment legislation, the court ruled that:

- The ordinance does not violate the Interstate Commerce Clause because Baltimore is a market participant which, like any private investor, may decide with whom it will or will not do business.
- The ordinance has indisputable "foreign resonances" but does not intrude on the power of the federal government to establish foreign policy.
- The ordinance does not violate the federal Foreign Commerce Act because divestment applies to domestically-owned corporations engaged in foreign commerce rather than foreign companies doing business in the U.S.

An Important Reminder

The Baltimore case was an important test of the legality of divestment legislation that has already been passed by twenty-one states, fourteen counties and seventy-two cities in the United States. Its rulings remove obstacles to the passage of many other divestment statutes currently under consideration. Judge Greenfeld reminded us that divestment is not, in essence, a financial debate when he concluded that "even if the [financial] impairment were more significant, it would be insubstantial when compared to the salutary moral principle which generated the Ordinance."