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December 4, 1986

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Law and Legislation Committee
Sacramento, California 95814

Re: South African Divestiture Policy

Dear Committee Members:

On September 2, 1986, the City Council asked the City Attorney to prepare a legal opinion on a divestiture policy relating to business organizations which engage in business in or with South Africa.

A copy of the legal opinion on this subject prepared by our office is attached for your information. The opinion was prepared primarily by William Carnazzo, Deputy City Attorney. Deputy City Attorneys Samuel Jackson and Diane Balter also assisted in its preparation. Mr. Carnazzo will be present at your Committee meeting to explain the opinion in more detail and to answer any questions you may have.

A city staff committee composed of Deputy City Manager Jack Crist, City Treasurer Tom Friery, General Services Director Frank Mugartegui and myself met on several occasions. These staff members will be present to discuss other aspects of this subject.

Sincerely,

JAMES P. JACKSON
City Attorney

JPJ:rmm

Attachment

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November 12, 1986

MEMORANDUM

TO: City Council
City of Sacramento
City Hall
Sacramento, CA 95814

FROM: James P. Jackson, City Attorney
William P. Carnazzo, Deputy City Attorney

Subject: South African Divestiture Policy

Honorable Members in Session:

I. SUMMARY

The City Attorney was directed to prepare a comprehensive legal opinion on a divestiture policy relating to business organizations which engage in business in or with South Africa.

This opinion is organized by division into two broad functional areas: divestiture policies, and purchasing restrictions. The first broad area is further subdivided into three subcategories of assets, each of which presents issues common to all categories, and separate issues peculiar to the category in question. This division was selected solely for convenience of presentation only. The three subcategories are: (i) funds held in the city general fund; (ii) funds of the Sacramento City Employees Retirement System; and (iii) funds held by the city under trust agreements, bond covenants, or other external governing documents.

The conclusions reached vary, but can be summarized as follows:

(1) The City may choose not to purchase goods manufactured or produced in South Africa or to contract for goods or services with companies which have substantial business operations in South Africa. However, it appears that the City is barred by a provision in the Cartwright Act (Business and Professions Code §16721.5) from refusing to enter into contracts for goods and services with any person on the ground that such person does business with the Government of South Africa or with private business interests within South Africa.

(2) Although it is not entirely free of doubt, unrestricted funds held in the city general fund and invested or deposited by the City Treasurer may be subjected to a "South Africa free" investment/deposit restriction, and a reasonable "South Africa free" divestiture policy.

(3) Investment decisions regarding funds of the Sacramento City Employees Retirement System are the exclusive province of the Administration, Investment and Fiscal Management Board (hereafter "Board") and:

(a) The City Council is prohibited from mandating investment policy to the Board;

(b) The Board is precluded by both fiduciary standards and prudent expert rules from establishing investment decision criteria other than those which focus upon economic factors furthering the primary purpose of the pension system, which is to provide funds when required to pay the promised benefits.

(4) Other funds held and invested by the City under various external documents and legal criteria must be evaluated individually and separately to determine:

(a) Which of those funds can be treated in the same fashion as the City's general fund; and

(b) Which of these funds are subject to restrictions which would preclude application of a divestiture policy.

II. ISSUES

The issues which this opinion will explore may, in a very general sense, be stated as follows:

1. May the City Council adopt an ordinance or a resolution which prohibits further investment in, and which concomitantly requires divestiture of any interest in business organizations which engage in business or trade in or with the Republic of South Africa, and which imposes restrictions on purchases of goods and services by the City based upon whether the vendor does business with or within the Republic of South Africa?

2. If so, does the City Charter or external law limit the breadth and scope of the controls which may be imposed by the City Council?

Subsumed within these two very broadly-formulated issues are numerous specific legal questions, which will be identified, analyzed and resolved in as logical and orderly fashion as is possible considering the magnitude of the topic.

III. BACKGROUND

The enormity of the social evil of the caste system practiced by the Republic of South Africa, known as "apartheid", cannot be overemphasized. The invidious oppression imposed upon that country's black population through subjugation of their economic, social, spiritual and human needs is repugnant to all notions of justice and fairness in a civilized society. Despite nearly universal international condemnation of these policies, no real progress has been made by the government of South Africa to accomplish their eradication.

That government's stubbornness has spawned not only public indignation, and proclamations of censure, but a firm resolve on the part of national governments, as well as state or local governments, to adopt measures designed to bring economic pressure upon South Africa in order to force the required social changes. While it has been subject to widespread debate as to wisdom and efficacy, the most popular sanction which has been developed and adopted is the policy known as "divestiture".(1)

We have examined numerous divestiture policies(2) adopted by the State and some of its agencies, and by local governments within the state. These policies are so diverse in their definitions, limitations, criteria and operative language, that they defy any systematic categorization. Rather, each entity appears to have engaged in a two-step process. In the first step, the agency has made its own policy determinations regarding the parameters of the restrictions to be adopted and has directed drafting in accordance with those parameters. In the second step, the written policy so drafted is adopted and implemented. The City Council, approaching the first step,(3) has asked for this legal analysis and for a fiscal analysis, the latter to be prepared by city staff members having fiscal and investment authority over city-administered funds.

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(1) While various other terms, including "divestment", have been used to describe this policy, the most appropriate generic term appears to be "divestiture". We will use this term to include a policy which not only requires disposal of investments, but also contains restrictions on future investments and similar restrictions.

(2) We have not examined all adopted policies. A recent list of agencies having a divestiture policy is attached as Appendix "A" to this opinion.

(3) The City Council has not adopted policy parameters, although Councilmember Johnson has submitted a comprehensive draft ordinance based upon one adopted by the City of Oakland.

IV. ANALYSIS - THE CITY GENERAL FUND

The following analysis deals with that portion of the City's general fund which, except for budgetary allocations, is not otherwise restricted by external documents or relationships.[4] Money in the general fund is invested by the City Treasurer as part of "City Investment Pool A". A profile of the various general fund investment vehicles utilized by the Treasurer is attached as Appendix "B", and his separate staff report will elaborate on those vehicles.

A. THE STANDARD OF CARE APPLICABLE TO THE CITY COUNCIL IN ADOPTING A DIVESTITURE POLICY

This analysis must commence with an identification of the legal standards against which a court would measure the action of the City Council in adopting a general fund divestiture policy. Clarification of this point ab initio is imperative, since differing conclusions flow from application of one set of criteria as opposed to another. For example, if the City Council acts as "trustee" of money in the general fund, the conclusion would likely differ from that which would be reached if the Council's status is determined to be something less than a trustee.

1. The City Charter

We begin the search for the applicable standards with the City Charter. Article IX, Sections 110-119 deal with "fiscal administration". The only language in this article which comes close to an asset management/investment standard are the words found in §115 "Accounting System", which state that the adopted system must "...conform to generally accepted principles of accounting...." In fact, this is not an investment policy since it merely dictates monetary accounting practice. No other provision of the charter deals with investment policy, or assigns investment responsibility to the City Council.

On the other hand, Charter §73 delegates to the City Treasurer the responsibility for "deposit and investment" of city funds, and requires that he or she "shall keep the City Council fully advised as to the deposit and investment of funds." No investment criteria are set forth for the guidance of Treasurer or for the City Council in its supervision of the Treasurer. Hence, the City Charter is silent on the question of the applicable standard of care.

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[4] References to the "general fund" in this portion of the opinion will mean the otherwise unrestricted assets of City Investment Pool A. Appendix "B" concludes that as of June 30, 1986, approximately eighty percent (80%) of the Pool A could be so characterized.

2. The State Constitution

Article XI, §11(b) of the State Constitution authorizes the State Legislature to control the deposit and investment of "public moneys". This provision has been held to control over the "home rule" provisions of the Constitution, so that any state law on this subject binds charter cities. McGuire v. Wentworth, (1932) 120 Cal.App. 340, 344.

This provision of the Constitution is, however, silent on the standard of care regarding deposit and investment of city funds.

3. The California Government Code

Sections 53600, et seq., of the Government Code[5] contain the restrictions adopted by the Legislature in its implementation of Article XI, §11(b). Section 53601 states that the "legislative body of a local agency[6]...may invest such portion of the money as it deems wise or expedient in:..." (emphasis added) ten listed categories of investments. With respect to deposits, there are some rather specific restrictions listed:

> As far as possible, all money belonging to, or in the custody of, a local aency...shall be deposited for safekeeping in state or national banks or state or federal savings and loan associations in the state selected by the treasurer or other official having the legal custody of the money, or may be invested in the following unless otherwise directed by the legislative body pursuant to Section 53601.... (§53635)
>
> The money shall be deposited in any depository selected from those banks and those associations agreeing to pay the highest rate of interest. (Emphasis added) (§53637)

In our opinion, these various sections establish the standards to be applied. In the case of deposits, the standard is simple: "the highst rate of interest" (§53637). In the case of investments, the standard is somewhat more vague: "wise and

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[5] All references to code sections are to the Government Code unless otherwise stated.

[6] "Local agency" is defined to include charter cities. Section 53600.

expedient"[7] (§53601). Such language strongly suggests a degree of latitude and discretion.[8] The limits of that discretion are best expressed by a direct quote from the California Supreme Court's opinion in Stanson v. Mott, (1976) 17 Cal.3d 206, at p. 225:

> We recognize, of course, that public officials who either retain custody of public funds or are authorized to direct the expenditure of such funds bear a peculiar and very grave public responsibility, and that the courts and legislatures, mindful of the need to protect the public treasury, have traditionally imposed stringent standards upon such officials.

In authorizing public expenditures the court in Stanson held that public officials must "use 'due care', i.e., reasonable diligence," or else be subject to personal liability. Id., at 226-27. "Numerous considerations may be relevant to the determination of whether a public official has acted with due care or not. For example, a court may consider whether the expenditure's impropriety was obvious or not..., whether the official was alerted to the possible invalidity of the expenditure..., or whether the official relied upon legal advice or on the presumed validity of an existing legislative enactment or judicial decision in making the expenditure...." Id., at 227.

Thus, in making its investment decisions within the ten specified categories, the City Council is held to a "due care" standard, and not to the much higher fiduciary standards which are applied to a trustee.

B. APPLICATION OF THE STANDARDS TO SOCIALLY RESPONSIVE DEPOSIT AND INVESTMENT POLICIES

1. Deposits

If there is but one institution which offers the highest available interest rate, it must be used. Presumably, however, more than one depository will offer the highest available interest rate. The question, then, is whether under those circumstances the City Council can prescribe that socially

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[7] Section 53635, which allows the Treasurer to make investments in the same 10 categories, does not contain the words "wise or expedient", possibly indicating less discretion for the Treasurer.

[8] See Juliard v. Greenman, (1883) 110 U.S. 421, 450, where the words "wise and expedient" were so interpreted.

responsive concerns dictate the choice of a depository. Although there is no pertinent case authority, it is our opinion that so long as the money is kept in depositories offering the highest rate of interest, socially responsive criteria can be used in making the selection.(9)

This conclusion is analogous to that reached by the California Legislative Counsel on June 1, 1978, in an opinion issued to then State Senator Dunlap. That opinion concerned whether deposits could be made on the basis of whether the institution's "practice of making loans are considered to be beneficial to the community, such as loans for small business, agriculture, cooperatives, and students, and taking into account the interest charged on such loans?" Opinion, p. 1. The Legislative Counsel opined that §53637 requires selection of the institution offering the highest interest rate. If more than one such institution so qualifies, however, such "other factors" can be considered in choosing between or among them. Opinion, p. 3. Among the available "other factors", of course, are the type of social concerns--apartheid--dealt with here.

2. **Investments**

Similar considerations apply to investment decisions. So long as the investments are made in the ten categories set forth in §§53601 and 53635, we see no legal impediment to socially responsive decisions in making those investments (e.g., avoiding entities that do business in the Republic of South Africa). Even if some economic price were paid, in effect, by virtue of such socially responsive decisions, we think that a public purpose would be served.

The paying of such a "price" can be viewed as an expenditure and, as such, it must serve a public purpose. In City of Roseville v. Tulley, 55 Cal.App.2d 601, 607-609, 131 P.2d 395 (3d Dist., 1942), the Court of Appeal held that a chartered city's expenditures must serve a public purpose, the existence of which is a subject of legislative discretion that will be disturbed only upon a showing of unquestionable abuse. The leading treatise on municipal law states:

> What is a public municipal purpose is not susceptible of precise definition, since it changes to meet new developments and conditions of the times. Indeed, it has been

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(9) Other public agencies have also taken this view. See Opinion of Los Angeles City Attorney, Nos 84-56 and 85-1, May 21, 1985.

> recognized that 'public purpose' should be broadly construed to comport with the changing conditions of modern life.

15 S. Flanagan, McQuillin on Municipal Corporations §39.19, at 39 (3d ed., 1985 rev. vol.) (footnotes omitted). We can only speculate now, of course, as to whether an investment policy that avoids banking institutions that do business in South Africa would require payment of an economic price. But if it did, we anticipate that it could be defended against the charge that its payment would not serve a public purpose. While the policy by definition would not be intended to be of economic benefit to the City and its citizens, it would be of moral benefit. The apparent purposes behind the proposed anti-apartheid program are both to make a moral statement against the abhorrent racial policy that is apartheid, and to bring about a social change in the Republic of South Africa, where it is practiced. Both purposes doubtless reflect the ideals of at least most citizens of the City; hence, we believe that a public purpose would be served by the hypothetical expenditure here being discussed.

C. INDEMNITY FOR CITY EMPLOYEES AND MEMBERS OF THE CITY COUNCIL

A lawsuit to recover perceived losses caused by enactment and implementation of a divestiture policy would be brought under Code of Civil Procedure ("CCP") 526a, which reads in part as follows:

> An action to obtain a judgment, restraining and preventing any illegal expenditure of, waste of, or injury to, the estate, funds, or other property of a county, town, city or city and county of the state, may be maintained against any officer thereof, or any agent, or other person, acting in its behalf, either by a citizen resident therein, or by a corporation, who is assessed for and is liable to pay, or, within one year before the commencement of the action, has paid, a tax therein.

This section does not operate so as to preclude a taxpayer's suit to recover allegedly illegally expended funds (Cf. Stanson v. Mott, supra).

The "indemnity" question cannot, in reality or in logic, be separated from the question of whether liability exists in the first instance. To explain this point, the reasoning must be broken down into its several steps:

(i) Under the rule announced in Stanson v. Mott, supra, city officials are held "personally" liable only if they violate the "due care" standard adopted by the court.

(ii) If that standard is violated, and the liability is consequently "personal", necessarily there can be no indemnity; i.e., personal liability and indemnity are antithetical concepts.

(iii) If that standard is not violated, the expense of public funds is lawful and there is no liability, personal or otherwise. If there is no liability, there is no need to consider indemnity.

Some further elaboration will serve to clarify these points. Government Code §825 reads in relevant part as follows:

> If an employee or former employee of a public entity requests the public entity to defend him against any claim or action against him for an injury arising out of an act or omission occurring within the scope of his employment as an employee of the public entity and such request is made in writing not less than 10 days before the day of the trial, and the employee or former employee reasonably cooperates in good faith in the defense of the claim or action, the public entity shall pay any judgment based thereon or any compromise or settlement of the claim or action to which the public entity has agreed.

This section provides for indemnification of public employees regardless of whether or not a claim arises under state or federal law. See Williams v. Horvath, 16 Cal.3d 834, 548 P.2d 1125, 129 Cal.Rptr. 453 (1976). The public entity, who pays such a judgment, may not seek recovery of the payment from the public employee. See Government Code Section 825.4; Johnson v. California, 69 Cal.2d 782, 447 P.2d 352, 73 Cal.Rptr. 240 (1968). While council members are not included within the language of this section, the common law result is the same.

There are several exceptions to the general rule requiring indemnity, as set out in §825. For example, the city need not pay for punitive damages assessed against an employee. Pertinent here, however, is the Stanson v. Mott exception, whereunder "personal liability is imposed where the due care standard is employed."

In our view, if the City Council adopts a reasonable divestiture policy as to unrestricted portions of the general fund, which policy comports with the principles set out in this opinion, the Stanson v. Mott standard would not be violated. Since the City Council will have acted based upon legal advice, the "due care" standard is satisfied.

D. OTHER LEGAL ISSUES

The above analysis disposes of issues arising under state law. However, there are significant concerns relating to federal constitutional and statutory law[10] which must be analyzed and resolved. These issues are three in number, and may be stated as follows: (i) whether a divestiture policy violates the Commerce Clause of the U.S. Constitution; (ii) whether a divestiture policy would impermissibly intrude into Presidential or Congressional authority over foreign affairs; and (iii) whether the recently-adopted federal sanctions (after the President's veto was overriden) expressly or impliedly preempt any local legislation on this subject.

1. Compliance with the Commerce Clause[11]

The Constitution gives Congress the power "to regulate commerce with foreign nations, and among the several States...." U.S. Const., Article 1, §8, cl. 3 (the "Commerce Clause"). A question arises as to whether a divestiture program might encroach upon such powers. The United States Supreme Court has stated:

> Although the Commerce Clause is by its text an affirmative grant of power to regulate interstate and foreign commerce, the Clause has long been recognized as a self-executing limitation on the power of the States to enact laws imposing substantial burdens on such commerce.

South-Central Timber Development, Inc. v. Wunnicke, ____ U.S. ___, 104 S.Ct. 2237, 2240, 81 L.Ed.2d 71 (1984). But the Court has long recognized that States have "broad power" to legislate in matters of local concern and has held that "not every exercise of local power is invalid merely because it affects in some way the flow of commerce between the States." A & P Tea Co. v. Cottrell, 424 U.S. 366, 371, 96 S.Ct. 923, 47 L.Ed.2d 55 (1976). Modern Commerce Clause doctrine entails a balancing of national and local concerns. Id.; Arkansas Elec. Coop. v. Ark. Public Service Comm'n, 461 U.S. 375, 390, 103 S.Ct. 1905, 76 L.Ed.2d 1 (1983). Where foreign commerce is involved, the exercise of local power bears a greater burden of justification. Japan Line,

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[10] Litigation on these questions has occurred in the State of Michigan.

[11] Much of the material contained in this and the succeeding sections has been taken from an opinion issued by the Los Angeles City Attorney.

Ltd. v. County of Los Angeles, 441 U.S. 434, 446, 448, 99 S.Ct. 1813, 60 L.Ed.2d 336 (1979) ("a more extensive constitutional scrutiny is required"; Congressional power is "greater").

Whether or not a burden might be imposed by a divestiture program upon either interstate or foreign commerce, we believe that it probably would be sheltered under the market participant doctrine. In a series of decisions in recent years, the United States Supreme Court has distinguished for Commerce Clause purposes between State and local government acting in a proprietary, as opposed to a regulatory, capacity. As a proprietor (e.g., buyer or seller) the State or local government is a market participant and, as such, has been given latitude otherwise impermissible under the Commerce Clause.

The market participant doctrine is a product of three cases decided by the Court. The first involved a state program to reduce junked automobiles that involved imposing more stringent documentation requirements on out-of-state processors than in-state ones in the administration of a state program under which the state paid a bounty for each junked automobile. The Court held that "[n]othing in the purposes animating the Commerce Clause prohibits a State, in the absence of Congressional action, from participating in the market and exercising the right to favor its own citizens over others." Hughes v. Alexandria Scrap Corp., 426 U.S. 794, 810, 96 S.Ct. 2488, 49 L.Ed.2d 220 (1976). The Court treated the State not as a market regulator, but rather, as a market participant, because by offering the bounty it had "entered into the market itself to bid up" the price of junked automobiles. Id., at 806. In the second case, a State policy to restrict the sale of cement from a State-owned plant to State residents was approved under the doctrine. Reeves, Inc. v. State, 447 U.S. 429, 436, 100 S.Ct. 2271, 65 L.Ed.2d 244 (1980). The Court noted "the long recognized right of trader or manufacturer, engaged in an entirely private business freely to exercise his own independent discretion as to parties with whom he will deal." Id., at 438-39. The third case concerned a municipality's requirement that all construction projects funded in whole or in part by city or city-administered funds be performed by a work force of at least 50% city residents. The Court held that "[i]nsofar as the city expended its own funds in entering into construction contracts for public projects, it was a market participant and entitled to be treated as such [under the Alexandria Scrap doctrine]." White v. Mass. Council of Constr. Employers, 460 U.S. 204, 214-15 103 S.Ct. 1042, 75 L.Ed.2d 1 (1983).

A more recent decision of the Court signals a word of caution about the reach of the market participant doctrine. That case concerned a State requirement that purchasers of State timber provide "primary manufacture" in the State. The requirement effectively meant partial processing in the State prior to shipment outside the State. South-Central Timber Development, Inc. v. Wunnicke, ____ U.S. ____, 104 S.Ct. 2237, 2238-39, 81 L.Ed.2d

71 (1984). A plurality of four Justices refused to apply the market participant doctrine where the State's actions would "have a substantial regulatory effect outside of" the market in which the State is a participant. Id., at 2246.

Unlike South-Central, a divestiture program would not have a downstream regulatory impact. The City would simply limit the kinds of securities it would keep and purchase. No effort would be made to regulate other transactions. So viewed, a divestiture program bears a closer resemblance to Alexandria Scrap (preference to in-state junk processors), Reeves (preference for in-state buyers of cement), and White (preference for city residents) than to the timber processing requirements in South-Central. We believe, therefore, that it is likely that a divestiture program would be sustained against a challenge that it violated the Commerce Clause.

2. The Need to Avoid Challenging Federal Authority in Foreign Affairs

The Constitution entrusts to the President and Congress the authority to conduct the foreign affairs of the nation. These powers include the power to make treaties with foreign nations (a power expressly denied to the States), see Article II, §2; Article I, §10, the power to define and punish crimes on the high seas and against international law, Article II, §2; and the power to appoint and receive ambassadors, Article II, §2. The Supreme Court has consistently held in favor of "the supremacy of the national power" in foreign affairs. Hines v. Davidowitz, 312 U.S. 52, 62, 61 S.Ct. 399, 85 L.Ed. 581 (1941).

Two cases decided by the Supreme Court illuminate the extent to which this "national power" tolerates activities in the States that may impact foreign affairs: Clark v. Allen, 331 U.S. 503, 67 S.Ct. 1431, 91 L.Ed. 1633, 170 A.L.R. 953 (1947) and Zschernig v. Miller, 389 U.S. 429, 88 S.Ct. 664, 19 L.Ed.2d 683 (1968). Both cases concerned State laws of descent and distribution to nonresident aliens. In Clark the Court sustained a reciprocity statute under which a reading of the laws of the foreign nation was to be made to determine if reciprocity existed. 331 U.S., at 517. Zschernig, however, concerned a State law under which nonresident aliens could inherit only if the law of the foreign nation provided that (1) United States citizens could take property on the same terms as citizens or inhabitants of the foreign nation, (2) United States citizens could receive payment here of funds from estates in the foreign nation, and (3) foreign citizens could receive proceeds under State law "without confiscation" at home. 389 U.S, at 431. The Court in Zschernig distinguished the law in Clark, which "seemed to involve no more than a routine reading of foreign laws," id., at 433, from the statute at bar, which required judicial inquiry "into the types of governments that obtain in particular foreign nations--whether

aliens under their law have enforceable rights, whether the so-called 'rights' are merely dispensation turning upon the whim or caprice of government officials, whether the representation of consuls, ambassadors, and other representatives of foreign nations is credible or made in good faith, whether there is in the actual administration in the particular foreign system of law any element of confiscation." Id., at 434. The Zschernig Court was clearly bothered by the searching inquiry required of the laws and policies of foreign nations. Such a State law "affects international relations in a persistent and subtle way," id., at 440, and "has a direct impact upon foreign relations and may well adversely affect the power of the central government to deal with those problems." Id., at 441.

A divestiture plan resembles Clark more than Zschernig. The Zschernig Court was evidently concerned about the activity of State courts in examining in some depth the laws and policies of foreign nations. No study of South African policies or laws (or of apartheid for that matter) is envisioned here. The apartheid policy is already known, and the only question remaining is what can be done to bring about its demise.

Nor can one say at this time that a divestiture plan is incompatible with or would "adversely affect" American foreign policy, which itself is antagonistic toward apartheid. We conclude that under these circumstances a divestiture program is likely to survive a challenge on the ground that it permissibly intrudes upon the authority of the federal government in foreign affairs.

3. Preemption

Beyond the Commerce Clause and foreign policy issues, there remains the difficult problem of whether, by adoption of the federal sanctions which recently became law, the federal government has preempted state and local legislation. While the preemption theory and concept is inherent in the discussion above regarding the Commerce Clause and foreign policy, the recent action taken by Congress posits the following new, independent and transcendent preemption question: may Congress expressly preempt local sanction legislation and, if so, did Congress do so in the recent sanctions legislation?

The first half of this question is easily answered. Since Congress is constitutionally vested with exclusive power over foreign policy, if Congress expressly declares that local divestiture policies infringe upon that power and on that basis declares local policies preempted, a court would likely not "second guess" Congress' judgement. The test in such matters is whether, under any conceivable analysis, Congress could have reached its conclusion regarding infringement. As thus posed, the question is rhetorical.

The more significant issue is whether Congress has manifested an intention to preempt or occupy the field of sanctions. The theory of preemption is that when Congress enacts a law that "occupies the field", states and local governments are precluded from legislating on the same subject. However, the Supreme Court has stated that for express preemption to occur, Congress must "manifest its intention clearly"; unless it does so, local legislation is valid. Commonwealth Edison Co. v. Montana, (1981) 453 U.S. 609, 69 L.Ed.2d 884, 101 S.Ct. 2946.

Examining the federal law, there appears to be no clear indication of intent to occupy the sanctions field. Opponents of this view would, however, point to several things. First, the law's title does include the word "comprehensive". However, such titles are prefatory only and ambiguous at best, and would not be dispositive. Secondly, there are some events in the rather extensive legislative history which could form the basis for an inference that Congress intended to preempt. One such event was the failed amendment introduced by Senator D'Amato which would have expressly protected state and local sanctions legislation. Another was the inclusion in the law of a requirement that gives state and local governments 90 days to comply with the law or lose federal funds. Finally, there were extensive arguments made in the record that the new law indeed does preempt local legislation.

While those points are interesting, the immutable fact remains that having full opportunity to do so, and having debated the preemption issue fully, the law simply does not say that local legislation is preempted. The mentioned events at most create a slight ambiguity, and do not meet the test which requires Congress to "manifest its intention clearly." For that reason, it is our opinion that a preemption challenge will almost surely be rejected in favor of a ruling that absent a clear manifestation of contrary intent, local legislation is not overridden.

V. ANALYSIS - THE SACRAMENTO CITY EMPLOYEES RETIREMENT SYSTEM

A. BACKGROUND AND DESCRIPTION OF THE CITY'S RETIREMENT SYSTEM

The City of Sacramento has, over the years, embodied in its charter a number of retirement systems. These systems are collectively known and administered as the "Sacramento City Employees Retirement System" (hereafter "SCERS"). SCERS is a closed-end system, in that it is closed to new membership after January 29, 1977; i.e., any person employed by the City after that date is a member of the Public Employees Retirement System ("PERS"). City Charter §372; City Code §34.103(a)(7).

SCERS is administered by two separate bodies: (i) the Retirement Hearing Commission, which hears and determines contested benefit decisions made by the retirement system manager (see City Charter §388); and (ii) the Administration Investment and Fiscal Management Board ("AIFM Board"), which is assigned the duty of fiscal management of the system and its assets. Currently, the AIFM Board is entrusted with the management and investment of approximately 253 million dollars. The AIFM Board and its responsibilities are examined in this portion of our opinion; the Retirement Hearing Commission, having no jurisdiction over assets of the system, is excluded from the analysis.

The AIFM Board is established as a five-member independent body under City Charter §381. Two seats are reserved for private citizens; the remaining three are held by the City Manager, the City Finance Director and the City Treasurer. The Board is given broad fiscal management powers under §382, which reads in part as follows:

> Subject to the provisions of sections 388 and 391, the board shall have full authority under the Charter and such general ordinances as may be lawfully adopted by the city council to maintain and manage retirement plans of this system, including but not limited to the adoption of investment standards, the fixing of contribution rates, the administration and investment of funds, the selection of investment advisors, the crediting of interest, any action required of it by the Charter and any action relating to the fiscal management of the system except those matters directly pertaining to claims for benefits, and claims for refunds under Charter section 436, filed with the retirement system manager.

The Board's control over investment of SCERS funds is "exclusive" by virtue of City Charter §383:

> The board shall have <u>exclusive</u> control of the administration of such fund or funds as may come into the possession of the system, provided that all investments shall be investments permissible by law for investment of trust funds (as provided in section 2261 of the Civil Code) and shall conform to general investment standards approved by the city council. The board shall adopt general investment standards which the city council shall either approve or disapprove. The board shall employ and obtain advice and services from professional financial advisors, expert in their respective fields, such as investment counsel, trust companies or trust

departments of banks, in regard to the management and investment of the funds in the system. Nothing contained in this article shall be construed to prevent the board from administering, managing and investing the funds of the system as a single fund. (Emphasis added.)

Except for its power to approve the general investment standards adopted by the AIFM Board,[12] the City Council has no authority over SCERS asset investment decisions under §383.

The 253 million dollars in SCERS funds consists of contributions of employee/members, regular and supplemental[13] contributions of the City of Sacramento (primarily from its general fund), and return on investments. The return on investments made under the Board's authority is significant to the fiscal integrity of SCERS, for several reasons: (i) the proper investment of SCERS funds helps to assure members that the promised benefits will be provided when due; (ii) members' contribution accounts accrue interest at a rate based primarily upon investment performance (City Charter §387); and (iii) investment performance affects the City's contribution rates, and thus the extent to which the citizens of the City of Sacramento must support SCERS[14].

As set out in City Charter §383, the Board's asset investment decisions are governed by the "prudent expert" rule specified in §2261 of the California Civil Code. To aid it in its investment decisions, the Board has employed various investment advisors,[15] to whom it has delegated investment authority over

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[12] The latest set of such standards was approved by the City Council on April 13, 1982 (Resolution No. 82-253).

[13] The City has been required, commencing with 1976, to make supplemental contributions in order to eliminate the SCERS unfunded liability. See City Charter §385.

[14] Returns also affect the contribution rate of members under certain earlier SCERS plans.

[15] For example, the Board is presently under contract with four separate common stock managers and a real estate advisor. The City Treasurer has been appointed as investment manager for the SCERS bond and other fixed income asset portfolio as well as the gold/silver portfolio.

defined portions of the asset portfolio, as more specifically depicted in Appendix C. In furtherance of its duties, the Board has also adopted investment standards, extensive guidelines to implement those standards, and asset allocation and diversification standards and procedures.

B. PREVIOUS BOARD ACTIONS REGARDING INVESTMENTS IN COMPANIES ASSOCIATED WITH SOUTH AFRICA

During 1979 and 1980, a proposal was made to the AIFM Board which, in effect in very broad terms would have required disinvestment in any company doing business in or with South Africa. In the ensuing hearings before the Board, the City Treasurer by written report[16] stated:

> It is my opinion that the magnitude for loss must be expressed objectively and subjectively in ranges. I would define these ranges of loss as $5.8 million to $66.5 million respectively over the next 12 years, and $33.9 million to $126.9 million respectively over the next 25 years if the proposal were implemented.

In those same proceedings, the City Attorney was asked for an opinion on the following limited question:

> May the Administration, Investment and Fiscal Management Board invest funds of the Sacramento City Employees' Retirement System for the purpose of advancing the social or moral goals of the Board or its members?

The limited nature of the question was recognized and made specific in the body of the opinion:

> The scope of the question presented is significant and requires some clarification. In many instances, if not all, social or moral considerations affecting an investment decision can be rephrased as economic considerations. For example, an argument can be made that, by virtue of its policy of apartheid, investments in South Africa present greater risks than other investments. It requires no analysis to realize that the probable safety of an investment is not only a proper matter

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[16] Reports of City Treasurer to AIFM Board dated August 27 and August 29, 1979.

> for the Board's consideration, but a mandatory one (Civil Code §2261). Under the prudent investor rule, any matter, whether social, political or otherwise, which bears on the financial risk or return of a possible investment may properly be considered by the Board. This opinion, therefore, addresses only the propriety of investment decisions based solely or primarily upon social or moral considerations. (Emphasis added.)

The conclusion reached on the issue as limited was as follows:[17]

> In our opinion, the fiduciary duty owed by the Board to SCERS members prohibits the Board from engaging in financial transactions which are intended to advance the personal social or moral goals of Board members. A policy of making investment decisions on such social or moral criteria also presents potential violations of the Board's duty to exercise the judgment and care of a prudent investor, and its duty to diversify investments.

The Board on October 15, 1979, which was prior to the above City Attorney's opinion, declined to adopt a divestment policy and adopted its resolution dated October 15, 1979, which reads in pertinent part as follows:

> 2. It is the intent of the Board to generally limit security buy/sell/hold investment discussions to purely financial considerations such as financial statements, bond ratings, etc. (Emphasis added.)
>
> 3. Notwithstanding paragraphs 1 and 2, such matters as social or public concerns, corporate compliance with Government policies or regulations, or other subjects not related to the administration, investment, or fiscal policy of the Sacramento City Employees' Retirement System can be agendized by request of any two members, or by request of a simple majority of the City Council.[18]

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[17] This opinion was dated August 12, 1980.

[18] AIFM Board Resolution No. 79-004.

C. THE CITY CHARTER PRECLUDES THE CITY COUNCIL FROM ADOPTING AN INVESTMENT PROHIBITION OR MANDATORY DIVESTMENT PLAN REGARDING SCERS ASSETS

City Charter §383 vests exclusive[19] jurisdiction and governance of the assets of SCERS in the AIFM Board. Under the City Charter, the Council's only function relative to SCERS investments is to "approve" standards which have been "adopted" by the AIFM Board.

Therefore, if an investment prohibition or a mandatory divestment plan is to be adopted for SCERS assets, that decision rests solely with the AIFM Board. The balance of this opinion, then, is based upon that principle, and deals with the contours of the Board's power to adopt such policies.

D. "PRUDENCE" STANDARDS APPLICABLE TO THE ASSET INVESTMENT DECISIONS OF THE AIFM BOARD

There are two separate but interrelated general sets of criteria against which asset investment decisions of the AIFM Board must be measured. The first criterion to be discussed in this opinion is the "prudence" standard; the second criterion is the much broader concept of fiduciary responsibility.

1. The "Prudent Expert" Rule of City Charter §383 and Civil Code §2261.

City Charter §383 expressly incorporates Civil Code §2261 as the applicable standard. That section, as amended in 1984, sets up a relatively high level of required performance, employing a "prudent expert" standard:

> **(a) Degree of care, skill, prudence and diligence.**
> (1) Subject to paragraph (2), when investing, reinvesting, purchasing, acquiring, exchanging, selling and managing property for the benefit of another, a trustee shall act with the care, skill, prudence, and diligence under the circumstances then prevailing, specifically including, but not by way of limitation, the general economic conditions and the anticipated needs of the trust and its beneficiaries, that

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[19] The City Attorney of San Diego has reached the same conclusion on virtually identical wording embodied in that City's charter. Memorandum Opinion dated September 9, 1985, San Diego City Attorney.

> a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, to attain the goals of the trustor as determined from the trust instrument. Within the limitations of the foregoing and considering individual investments as part of an overall investment strategy, a trustee is authorized to acquire every kind of property, real, personal or mixed, and every kind of investment. (Emphasis added.)

The prior version of this section provided for a standard attuned to a theoretical "prudent man" dealing with his/her own funds.

2. California Constitution Article XVI, §17.

In 1984, the same year that §2261 was amended to set out the "prudent expert" criterion, Proposition 21 (on the June 5, 1984 ballot) amended Article XVI, §17, so that the relevant portion now reads as follows:

> Notwithstanding provisions to the contrary in this section and Section 6 of Article XVI, the Legislature may authorize the investment of monies of any public pension or retirement system, subject to all of the following:
>
> (a) The assets of a public pension or retirement system are trsut funds and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system.
>
> (b) The fiduciary of the public pension or retirement system shall discharge his or her duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system.
>
> (c) The fiduciary of the public pension or retirement system shall discharge his or her duties with respect to the system with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these

matters would use in the conduct of an enterprise of a like character and with like aims.

(d) The fiduciary of the public pension or retirement system shall diversify the investments of the system so as to minimize the risk of loss, and to maximize the rate of return, unless under the circumstances it is clearly prudent not to do so. (Emphasis added.)

In September, 1984, the Legislature enacted Government Code §53216.6. The provisions of this section embody the same standards set out in the amendment to the Constitution quoted above.

While it is not entirely free of doubt, it appears that Article XVI, §17 of the California Constitution does not apply to the City of Sacramento as a charter city. This conclusion is based upon an extensive analysis of the history and background of Article XVI, §17 and its predecessor provisions, together with pertinent judicial precedents.(20) However, for purposes of this opinion, it is unnecessary to address that issue directly, since Proposition 21 would probably have an impact upon any SCERS investment decisions under challenge as imprudent. Both Proposition 21 and California Civil Code §2261 employ the "prudent expert" standard. Both revisions came into California law at approximately the same time, and it is quite likely that a court would be guided by the provisions of the Constitution in interpreting and applying the Civil Code §2261 standard to asset investment decisions of the AIFM Board.

3. Are Socially Responsive Investment Decisions Consonant with the "Prudent Expert" Rule?

Having set out the applicable standards, the next issue is whether divestiture of investments in companies which do business in South Africa comports with the "prudent expert" standard. In examining this question, as pointed out above, a court would likely look to Proposition 21 for guidance. In its text, there are two pivotal principles. The first of these is found at Article XVI, §17(a), where it is provided that the system assets are to be "held for the exclusive purposes of providing benefits to system members and their beneficiaries." Secondly, at §17(b), it states that system fiduciaries are required to discharge their

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(20) While the lengthy analysis required to evaluate this question is beyond the required scope of this opinion, we are currently drafting a separate opinion on this subject for the AIFM Board.

duties "solely in the interest of, and for the exclusive purposes of providing benefits to" members and their beneficiaries. The "benefits" in question are retirement benefits. The argument in favor of passage makes the point clear beyond cavil:

> [Proposition 21] [d]eclares all assets of a public pension or retirement plan to be trust funds. It provides that, apart from reasonable administrative costs, the only purpose for which these trust assets can be used is the delivery of retirement benefits. (Emphasis original.)

In the only decided case on this issue of which we are aware, Assoc. Students of the Univ. of Oregon, et al. v. Oregon Investment Council, etc., et al., Lane County Circuit Court, State of Oregon, No. 78-7502, a divestment program was held to be violative of the Oregon statutory "prudent investor" rule. That ruling is now on appeal. The Oregon Attorney General had earlier (May 2, 1978) rendered an opinion reaching the same conclusion.

We reach a similar conclusion. Retirement systems such as SCERS are created primarily for the economic benefit of members and their beneficiaries. Investment decisions concerning system assets, therefore, must serve the economic interests of the members and their beneficiaries. Nevertheless, we also conclude that so long as the prudent investor rule's requirements are met, discretion can be exercised, where possible, to fulfill socially responsive goals (e.g., the divestiture under discussion here). In practical application, this would mean that so long as the fiscal well-being of the system would not be impaired, then socially responsive investment or divestiture decisions may be made. Whether such is the case in any instance depends largely on the view of investment experts, and upon the facts and circumstances pertinent to the particular company whose securities are held by the system. The question in each case must be: would the prudent expert, in making the investment decision under scrutiny, sell (or buy) this particular security at this particular time?

E. FIDUCIARY STANDARDS APPLICABLE TO THE AIFM BOARD

1. SCERS is, in Effect, a Trust Fund Administered by the AIFM Board as Trustees.

The City Charter does not expressly declare that SCERS is a "trust". However, unquestionably a court would construe it to be a trust in any litigation challenging an investment decision as imprudent. Additionally, for the reasons set forth below, we believe that AIFM Board members bear a fiduciary relationship to system members and their beneficiaries, which relationship spawns: (i) a special obligation to exercise care, skill,

prudence, and diligence in the management of SCERS assets; and (ii) a duty of strict loyalty to SCERS members. While these concepts interrelate with the previous discussion regarding prudency, still they reach beyond that concept and therefore merit separate treatment and discussion.

The notion of "fiduciary relationship" was developed by the courts to protect those relationships in which a high degree of trust and confidence is placed by one person in another. (Bogert, The Law of Trusts & Trustees, §481 [2d ed. revised 1978]). In many business relationships, of course, there is no such degree of trust and confidence. On other occasions, however, a person may, by desire or necessity, enter into a relationship with a representative who acquires a great deal of knowledge and control over that person's affairs. For such representative relationships to succeed, the person must be able to deal with the representative openly and without reservation. To insure that persons may enter into confidential relationships without fear or special precautions, the courts have given special protection to such relationships, deeming them "fiduciary relationships." The notion of fiduciary relationship is found in every area of law where confidential relationships are employed to conduct business. Examples of the fiduciary relationship, however, are the relationship between business partners; between trustee and beneficiary; between an attorney and client; and, as will be shown below, between the managing board of a retirement system and retirement system members. Such fiduciary relationships are protected by the courts and by the legislature by imposing unusually high ethical standards on the person in whom confidence is placed (Bogert, §1).

A "trust" is one type of fiduciary relationship, although it may well be the most important type. A trust can be defined broadly as a fiduciary relationship in which one person holds an interest in property, subject to an equitable obligation to keep or use that interest for the benefit of another (Bogert, §1). California's statutory definition of a trust is to the same effect:

> A voluntary trust is an obligation arising out of a personal confidence reposed in, and voluntarily accepted by, one for the benefit of another. (Civil Code §2216)

Turning now to the relationship between the Board and SCERS members, the fiduciary character of the relationship between a pension administrator and pension members was noted by the California Supreme Court in Symington v. City of Albany, 5 Cal.3d 23, 33 (1971):

> ...[W]e deal here with a relationship that begins as that of employee and employer but which now has matured into that of pensioner and administrator. In the vast development of pensions in today's complex society, the numbers of pension funds and pensioners have multiplied, and most employees, upon retirement, now become entitled to pensions earned by years of service. We believe that courts must be vigilant in protecting the rights of the pensioner against powerful and distant administrators; the relationship should be one in which the administrator exercises toward the pensioner a fiduciary duty of good faith and fair dealing. (see also Lix v. Edward, 82 Cal.App.3d 573, 578-579 (1978)

The trust relationship between the managing board of a pension system and the pension system members was also recognized in Lix v. Edward, supra:

> [Pension plans] create a trust relationship between pensioner-beneficiaries and the trustees of pension plans who administer retirement benefits. The trustees must exercise their fiduciary trust in good faith and must deal fairly with the pensioner-beneficiaries (82 Cal.App.3d at 578).

The Board, therefore, is not merely an investor of funds. It is a trustee of SCERS funds, with the responsibility to act in accordance with the terms of the trust for the benefit of SCERS members who are the beneficiaries of the trust.

In addition to the above analysis, there are other signposts which dictate these conclusions. The wording of Proposition 21, now set out in Article XVI, §17(a), specifically states that "the assets of a public pension or retirement system are trust funds." Correspondingly, City Charter §383 contains the same words, viz: "trust funds". Furthermore, the two most important elements of a voluntary trust exist: (1) the intention on the part of the trustor (here, the City and its employees through the Charter) to create a trust by assuming the obligation to fund (actuarily) the retirement system, and (2) entrusting control over the trust corpus (system funds) to trustees (the AIFM Board) with benefits flowing to beneficiaries (system members and their beneficiaries). See California Civil Code §§2215, 2216, 2221. Since the system members also make contributions to the system funds through salary deductions, they enjoy the benefits of a tentative (Totten) trust by being able to designate beneficiaries and withdraw contributions upon termination of employment for reasons other than retirement. See Lyles v. Teachers Retirement Board,

219 Cal.App.2d 523, 526, 33 Cal.Rptr. 328 (5th Dist. 1963). Members and their beneficiaries have a "vested right" in pension benefits. Kern v. Long Beach, 29 Cal.2d 848, 851, 179 P.2d 799 (1947); Dryden v. Board of Pension Commrs., 6 Cal.2d 575, 579, 59 P.2d 104 (1936). Finally, SCERS has applied to the Internal Revenue Service for a determination that it is a qualified trust for purposes of Internal Revenue Code §401(a), 26 U.S.C. §401(a). Such qualification results in favorable tax treatment for certain contributions. All things considered, we think it likely that a court would apply trust principles in evaluating investment decisions involving City retirement system assets.

2. **As a Trustee, the Board Must Meet a Duty of Strict Loyalty to SCERS Members.**

As a trustee, the law imposes strict duties upon the Board which governs its management of the trust property and its relationship with the beneficiaries. Paramount among the duties owed by the Board to SCERS members is the duty of strict and complete loyalty to the interests of the beneficiary, excluding all selfish interests and all consideration of the interests of third persons. (Bogert, §543; Scott, The Law of Trusts, §170 [3d ed. 1970]). The classic statement of the duty of loyalty is by Justice Cardozo:

> Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to be something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. Meinhard v. Salmon, 164 N.E. 545, 546 (1928).

The duty has been codified in California as Civil Code §2229, which reads as follows:

> A trustee may not use or deal with the trust property for his own profit, or for any other purpose unconnected with the trust, in any manner.

The loyalty rule is based upon the recognition that it is generally, if not always, impossible for a person to act fairly as a representative when self-interest is also at stake:

> It has always been against public policy for a trustee to occupy any position in which his actions affect his individual interests. "When one undertakes to deal with himself in different capacities -- individual and representative -- there is a manifest hostility in the position he occupies. His duty calls upon him to act for the best interests of his principal; his self-interest prompts him to make the best bargain for himself. Humanity is so constituted that when these conflicting interests arise the temptation is usually too great to overcome; and duty is sacrificed to interest." Estate of McClellan, 8 Cal.2d 49, 54 (1936).

It is, of course, difficult to prove in a given transaction whether a trustee has acted fairly toward the beneficiaries. Therefore, in order to protect the integrity of the fiduciary relationship and discourage disloyal acts, the courts forbid all such acts without regard to the fairness or unfairness of the particular transaction. (Howard Estate, (1955) 133 Cal.App.2d 535.) A broad variety of remedies is available to beneficiaries for disloyal acts: if the beneficiaries learn that a disloyal act is about to be committed, it may be enjoined [Bogert, §543(v)]; the trustee may be held liable for damages if a loss is suffered by the trust (Id.); the trustee may be removed (Id.); and the transaction resulting from the disloyal act may be set aside (Id.). Although a single beneficiary may consent to a disloyal transaction and thereafter be prohibited from attacking it, there is significant doubt as to whether consent by even a majority of beneficiaries can bind a non-consenting minority (see Bogert, §941).

The scope of the duty of loyalty cannot be stated precisely. It unquestionably prohibits a trustee from engaging in any transaction with trust property in which the trustee has a personal financial interest; such a transaction violates the duty regardless of whether the trustee acts in good faith, and regardless of whether he or she realizes a financial gain (Estate of Howard, supra; Estate of McClellan, supra). The question presented here, however, does not involve in any way the personal financial interests of Board members. We assume, with good reason, that no Board member would have a financial interest in any investment which might be made (or avoided) for social or moral purposes. Thus, the issue is whether the duty of loyalty prohibits a trustee from engaging in transactions in which the trustee has a personal social or moral interest, or whether the

duty prohibits only those transactions which present the possibility of financial gain.

In our opinion, the duty of loyalty is, and must be, broad enough to prohibit a trustee from engaging in any transaction in which a significant personal interest--whether financial or non-financial--conflicts with the interest of the beneficiaries. The purpose of the duty is to eliminate those situations in which, because of a conflict of interest, the trustee might pursue his or her own interest over that of the beneficiary. If the duty is to achieve its purpose, it cannot prohibit only those transactions in which a trustee has a personal financial interest. Other interests, including family, friendship, religion, and various social, political or moral causes may just as easily lead a trustee to sacrifice the interests of the beneficiary if they conflict with his or her own. Indeed, a strong argument can be made that as between financial interests and the non-financial interests just mentioned, the non-financial ones are (or should be) the more compelling. California's statutory statement of the duty of loyalty also suggests that a particular transaction may be disloyal even if it is not done for the trustee's profit:

> A trustee may not use or deal with the trust property for his own profit, or for any other purpose unconnected with the trust, in any manner. Civil Code §2229. (Emphasis added.)

The emphasized clause indicates a residual category of acts which may be disloyal even where the trustee's financial interest is not involved. The recent change in Article XVI, §17 of the California Constitution buttresses this conclusion, in its unequivocal declarations that the plan administrator must act solely in the interest of the members and beneficiaries.

In light of the analysis just offered, it is our opinion that the common law duty of loyalty, together with the statutory duty stated in Civil Code §2229 and the principles specified in the Constitution, prohibit the Board from engaging in transactions intended to promote the social or moral interests of the Board or its members. Although every member of SCERS undoubtedly has personal social and moral beliefs of his or her own, the interest of each member with respect to the retirement system is, and can be, financial only. Every member certainly has the right to expect that the promised retirement benefits will be paid when they become due. It is equally certain, however, that SCERS members cannot reasonably expect SCERS to do more than that: nothing in the charter, for example, could lead a member to believe or expect that SCERS funds would be used as an instrument of social policy. The social or moral interests of the Board are irrelevant at best, and hostile at worst, to the purely financial interest of SCERS members. Such interests are irrelevant because they have nothing to do with insuring the financial well-being

of SCERS. An actual conflict of interest would arise, however, if the Board were to use SCERS funds for the purpose of promoting its social or moral interests. The conflict stems from the fact that the Board, in pursuit of its own interests, would be tempted to make investment decisions to promote its social or moral concerns rather than the financial interest of SCERS members. Under such circumstances, investment decisions intended to satisfy the Board's interests would be disloyal to the financial interest of the beneficiaries, even if no harm to the trust resulted. In addition, investments for social or moral purposes violate Civil Code §2229, which prohibits a trustee from using trust property "...for any other purpose unconnected with the trust...." The sole purpose of SCERS is to provide certain financial benefits for SCERS members and their qualified beneficiaries, not to advance the social or moral interests of the Board or its members. Although in theory a policy of social or moral investments could be cured by the unanimous consent of SCERS members, it is highly unlikely that unanimous consent would be given. Therefore, it is our opinion that the duty of loyalty prohibits the Board from making investment decisions which have as their sole or primary purpose the advancement of social or moral interests or beliefs of the Board or its members, rather than the financial interest of SCERS members.

F. "IMPAIRMENT OF CONTRACT" CONCERNS

Beyond the thorny "prudence" and fiduciary responsibility issues discussed ante, there remain for analysis the difficult "impairment of contract" issue, together with labor relations concepts (to be discussed later). In general, it is clear that public pension benefits are vested contractual rights which cannot be impaired. Those vested rights include assurance of an actuarally sound funding system so designed that the promised benefits will indeed be paid when due. Unilateral changes in funding principles or mechanisms, which changes bear no relationship to the theory and purpose of a retirement system (provision of benefits) and which changes potentially jeopardize the integrity of the system's funding, would no doubt be found to impair the vested rights of the members and their beneficiaries.

The court in Lyon v. Flournoy, (1969) 271 Cal.App.2d 774 stated that there exists in California a body of decisional law placing earned retirement rights within the shelter of the constitutional prohibition against contract impairment. The United States Constitution prohibits any state from passing a law impairing the obligation of contracts (Sec. 10, Art. I, U.S. Const.); a parallel proscription is contained in Section 9 of Article I of the California Constitution. The federal provision has been held to apply to any enactment upon which a state confers the force of law, including its own constitution (Allen v. Board of Administration, (1983) 34 Cal.3d 114, 119). The court decisions hold that: (i) a public employee's pension constitutes an element of compensation; (ii) a vested contractual

right to pension benefits accrues upon acceptance of employment; and (iii) such a pension right may not be destroyed, once vested, without impairing a contractual obligation of the employing entity. Betts v. Board of Administration, (1978) 21 Cal.3d 859, 863. Nevertheless, the constitutional bar against the destruction of vested contractual pension rights does not absolutely prohibit their modification. In respect to active employees, any modification of vested pension rights must be reasonable, must bear a material relation to the theory and successful operation of a pension system, and when resulting in disadvantage to employees, must be accompanied by comparable new advantages (Allen v. City of Long Beach, (1955) 45 Cal.2d 128, 131). As to retired employees, the scope of continuing governmental power is more restricted and the retiree is entitled to the fulfillment without detrimental modification of the contract which he or she has already performed (Lyon, supra, at p. 783).

Practically all California reported cases have dealt with the right to receive benefits, and only three cases dealt with the method of funding pension liabilities until the decision of Valdes v. Cory, (1983) 139 Cal.App.3d 773. The court in Valdes held that a statute withholding three months' state and school employer contributions from the Public Employees' Retirement System constituted an impairment of contractual relationships between the members and their public employers in violation of the state and federal constitutions. The court, after examining the origin and statutory structure of the PERS system, and the vested interest of pension beneficiaries in the integrity and security of the source of funding for the payment of benefits, concluded that the state had a statutorily-created contractual obligation to make systematic, substantial monthly contributions to the PERS fund in order to fund pension benefits as the liability incurred. The contractual rights of public retirement system members, retirees, and beneficiaries in the integrity and security of the funding of their systems was also the subject in California Teachers Association v. Cory, (1984) 155 Cal.Ap.3d 494. The court in California Teachers Association ordered the State Controller to transfer funds from the General Fund to the Teachers' Retirement Fund and upheld the petitioners' contention that the transfer was compelled by continuing appropriation statutes in the Education Code notwithstanding the appropriations for payments of lesser amounts in annual budget bills enacted subsequently. After noting that the case in question was a close relative of Valdes v. Cory, supra, the court reaffirmed that the right to reserve funding of the state retirement system was a contractual pension right within the ambit of the constitutional contract clauses (pp. 503, 506). The court determined that: (i) the statutory provisions establishing the funding for the State Teachers' Retirement System implied a legislative intent to grant private rights of contract; (ii) a contract was established when the promise to permanently fund the retirement system embodied in the statutory scheme was accepted by teachers by initial or continued employment; (iii) the state's failure to fund the

Teachers' Retirement Fund in accordance with the statutory terms constituted an impairment of contract; and (iv) that the state failed to demonstrate a compelling interest which justified the impairment.

Thus, the courts have affirmed the contractual rights of the members, retirees, and beneficiaries of public retirement systems in California in the integrity and security of the funding of those systems and it is clear that any legislation affecting such rights will be closely examined. To the extent that an investment prohibition/mandatory divestiture plan would (i) direct investment decisions for reasons unrelated to provision of benefits; (ii) narrow the universe of available investments; or (iii) force loss or reduction of income or principal without regard to sound economic principles, those restrictions would likely be found to adversely impact the integrity and security of the system's funding. Absent evidence that the restrictions bear any material relation to the theory of a pension system and its successful operation or that they carry out the beneficient policy of the pension laws, and without any demonstration that impairment is warranted by an existing emergency or compelling interest serving to protect a basic interest of society (see Valdes v. Cory, supra, p. 791; California Teachers Association v. Cory, supra, pp. 511, 512), the restrictions would clearly be unlawful as an unconstitutional impairment of the contractual rights of the members, retirees, and beneficiaries of the retirement system.

G. LABOR RELATIONS CONCERNS

As set forth above, the policy of the AIFM Board is that its investments are to be made based upon "purely financial considerations". Any substantial change in that policy could, of course, create an impact upon the retirement system and therefore implicate the vested rights of members, as set forth above.

Characterizing the effect of a policy change in that manner raises the issue of whether it can be accomplished unilaterally; or, put differently, is there a bargaining obligation which must be satisfied prior to making the change? The resolution of that issue turns upon fundamental public sector labor law concepts, the most basic of which is the "scope of bargaining" principle; i.e., if the decision in question (investment policy which has a potential effect upon vested rights of members) is within the "scope", then no change can be made without satisfaction of the duty to bargain with the members' bargaining representative.

In California, as in the federal sector, the scope of bargaining is quite broad. Building Materials Contractors v. Farrell, (1986) 41 Cal.3d 651; Sullivan v. State Board, (1986) 176 Cal.App.3d 1059. The general rule is set out in Government Code §3504, which reads as follows:

§3504. Scope of representation.

> The scope of representation shall include all matters relating to employment conditions and employer-employee relations, including, but not limited to, wages, hours, and other terms and conditions of employment, except, however, that the scope of representation shall not include consideration of the merits, necessity, or organization of any service or activity provided by law or executive order.

In interpreting this provision, which is part of the "Meyers-Milias-Brown Act" ("MMBA"), the courts look to federal decisional precedent under the National Labor Relations Act. Firefighters Union, Local 1186 v. City of Vallejo, (1974) 12 Cal.3d 608. To the extent that any local rule conflicts with MMBA, the local rule is preempted. Professional Firefighters v. City of Los Angeles, (1963) 23 Cal.2d 276; People of the State of Calif., ex rel Seal Beach P.O.A. v. City of Seal Beach, (1984) 36 Cal.3d 591. If, therefore, the decision whether to adopt the SCERS policy in question here is a matter within the scope, employee bargaining representatives must be given notice and have the right to engage in good faith bargaining over the issue despite local rules or charter provisions which dictate otherwise.

In the private sector, retirement benefits and the qualifications for those benefits are clearly mandatory subjects of bargaining. Inland Steel Co. v. NLRB, (1948) 170 F.2d 247; Pacific Assn. of Pulp & Paper Mfrs. v. NLRB, (1962) 304 F.2d 760. In fact, if those benefits are "vested", they can only be increased by bargaining, and cannot ever be diminished by the act of the union in negotiation. Shatto v. Evans Products, (1984) 728 F.2d 1224. Since the right to adequate and secure funding policy is, as pointed out above, one of the members' vested rights, no unilateral change can be made which would affect those rights without satisfaction of the bargaining obligation. Under California law, any such unilateral is void (Vernon Firefighters v. City of Vernon, (1978) 107 Cal.App.3d 802) and per se an unfair labor practice (Moreno Valley U.S.D v. PERS, (1983) 142 Cal.App.3d 191).

It can be argued, however, that since SCERS is a defined benefit plan[21] in which employee contributions are

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[21] A defined benefit plan is one in which the employee, upon retirement, is guaranteed a specified amount which is a mathematical function of only three factors: length of service; age at retirement; and "final compensation", which is an average of the three highest consecutive salary years.

fixed[22] and the city's obligation is to "contribute such sums of money as may be required to fund this plan" (City Charter §405), members are in effect guaranteed the integrity of the system's funding by the city itself. If so, there is no actual impairment of members' vested right to adequate and secure funding by virtue of the obligation of the City itself to fund any deficit, and thus there is nothing to bargain over. While the internal logic of this argument cannot be disputed, it presumes the ready availability of city general fund money, a premise which employee organizations may not be entirely willing to accept. Thus, as a practical matter, bargaining may be necessary in any event.

VI. ANALYSIS: PURCHASE OF GOODS AND SERVICES

Among the measures which have been suggested or adopted by other jurisdictions in connection with a "South Africa free" purchasing policy are:

1. Prohibit the purchase of commodities or goods produced or manufactured in South Africa.

2. Prohibit the purchase of goods or services from the Government of South Africa, from businesses organized under the laws of South Africa, or from companies which own property or business assets in South Africa.

3. Prohibit the purchase of goods or services from anyone who is "doing business in South Africa."

4. Give a preference when determining the lowest responsible bidder to vendors who certify that they do not and will not "do business in South Africa."

In 1976, the California Legislature enacted Chapter 1247/76, which contains amendments to the Cartwright Act (Business and Professions Code §§16700, et seq.). The amendments provide in part that it is unlawful for any person to enter into any contract for goods or services which "requires any person to discriminate against or to certify that he, she, or it has not dealt with any other person on the basis of sex, race, color, religion, ancestry, or national origin, or on the basis of a person's lawful business associations." (Business and Professions Code §16721.5) The full text of Business and Professions Code §16721.5 is set forth in Appendix F. By its terms, §16721.5 applies to "governmental agencies," a category that would almost certainly be construed to include the City of Sacramento. Violations of this section can lead to civil and criminal penalties.

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[22] In the earlier plans, contributions varied; however, at this time, there as so few active employee members in the earlier plans that this variable can be ignored.

The apparent legislative intent of the 1976 amendments was to outlaw the Arab League's boycott of Israel with respect to any business conducted in California (8 Pacific Law Journal 203). However, the law is not on its face so limited in application, and it would appear to reach other secondary and tertiary boycotts with respect to business conducted in California.

There is little authority discussing the application and construction of this section. It is discussed by the California Attorney General in one opinion found at 59 Ops.Atty.Gen. 592 (1976). That opinion, which discusses the applicability of the statute to letters of credit, contains this example at page 602:

> . . . [A]ssume that after January 1, 1977 a California bank confirms a letter of credit which requires the California beneficiary to certify he has not dealt either with Israel or with a California company which was on any blacklist used to enforce an international boycott. This activity would have a direct effect on commercial relations between California citizens. It would be covered by the literal language of Chapter 1247 and would prima facie expose the bank to liability.

This fact situation, which in the opinion of the Attorney General constitutes a prima facie violation of Section 16721.5, is not unlike the City's requiring its vendor of professional services to certify that it does not do business with South Africa.(23)

In Warden v. Younger, 428 F.Supp. 64 (N.D. Cal. 1977), plaintiffs sought a preliminary injunction to restrain enforcement of Business and Professions Code Sections 16721 and 16721.5, pending consideration of their constitutionality. The primary constitutional challenge was that these sections impermissibly regulated in the areas of interstate and foreign commerce which are reserved to the plenary authority of the federal government. The federal district court abstained, declining to reach the constitutional issues raised by the plaintiffs because the California state courts had not yet had an opportunity to construe the sections challenged. Nonetheless, the court's discussion is instructive:

> . . . not all state regulation of interstate or foreign commerce is forbidden in every instance (citation omitted). In at least one instance, a state's interest in protecting the civil rights of

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(23) "Doing business with South Africa" would include doing business with the Government of South Africa or with private business interests within South Africa.

> its citizens has been deemed so important that enforcement of the statute involved was permitted despite its effect on foreign commerce (citation omitted). The point is that even under a very broad construction there may be a certain set of facts under which the California courts could find the Act to be constitutional.
>
> In lieu of a broad interpretation, California courts could determine that the statute is limited in scope to situations involving a California nexus for a questioned business activity, or that it applies only to intrastate transactions. It seems fair to say that if the Act is interpreted in such a manner it would be constitutional. Certainly, interpreting the Act in accord with the coverage of the Cartwright Act and the Unruh Civil Rights Act, it would take on a presumptively constitutional meaning.

So long as doing business with South Africa is lawful (and that is surely a matter solely within the purview of the federal government), it appears that Section 16721.5 bars the City from requiring anyone it contracts with to certify that they do not do business with South Africa. Further, discriminating against a vendor by way of bidding preferences because of the vendor's lawful business associations with South Africa would also be prohibited. However, nothing in Section 16721.5 bars the City from setting other criteria to determine with whom it wishes to do business or what type of goods it wishes to buy, if those criteria do not constitute a secondary or tertiary boycott. Therefore, the City may decide it does not wish to purchase goods manufactured or produced in South Africa, or to purchase goods and services from the Government of South Africa, from businesses organized under the laws of South Africa, or from businesses which have substantial business operations in South Africa.[24]

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[24] The business operations within South Africa must be substantial to avoid crossing the line from a lawful primary boycott to an illegal secondary boycott. Assets such as inventory in a South African distribution warehouse simply for the purpose of allowing a business located in California to service its South African customers or licensing agreements with South African concerns could not be the basis of disqualifying a business from contracts with the City, because this would be refusing to contract with a company because of its lawful business connections, a secondary boycott and a violation of the Cartwright Act as previously detailed.

Thus, the Cartwright Act permits the City to refuse to contract for:

1. Goods manufactured in South Africa;

2. Goods or services from the Government of South Africa;

3. Goods or services from businesses organized under the laws of South Africa;

4. Goods or services from businesses with substantial business operations in South Africa.

Another issue remains, however: would bidders in these four categories, or a bidding preference for bidders outside these four categories, violate City Charter Section 202 (requires that contracts for purchase of goods in the amount of $10,000 or more be awarded to the lowest responsible bidder after competitive bidding)?

The Charter's mandate that contracts be awarded to the lowest responsible bidder is not an insurmountable obstacle. Section 203 of the Charter authorizes the Council to suspend competitive bidding upon a finding by a two-thirds vote that such action is in the best interests of the City. Alternatively, at least one court has held that because of its broad home rule authority, a charter city has some flexibility in determining the criteria which may be considered in determining the lowest responsible bidder. Although no foolproof prediction is possible, it is likely that a court would permit exclusions and preferences as described if approved by the Council.

Sections 201 and 202 of the City Charter require that contracts for public projects of $5,000 or more and purchases of goods, equipment, materials or supplies of $10,000 or more be awarded to the lowest responsible bidder.

This requirement is not absolute, however. Section 203 permits the Council to "provide for the suspension of competitive bidding for any contract or purchase upon a finding by a two-thirds (2/3) vote that such action is in the best interests of the City." The importance of placing the City squarely in opposition to apartheid and businesses which profit therefrom is an interest which the Council could take into account in determining to suspend competitive bidding.

More likely, however, the Council would want to retain competitive bidding while disqualifying bidders with the prohibited South African connections. Could they be considered not responsible?

One federal court has held that a local ordinance providing for minority business enterprises/women-owned business enterprises (MBE/WBE) set-asides and for bidding preferences for MBEs, WBEs and local business enterprises is consistent with a charter requirement that bids be awarded to the lowest responsible bidder. Associated General Contractors of California, Inc. v. City and County of San Francisco, 619 F.Supp. 334 (N.D. Cal. 1985) (hereinafter "the San Francisco case")[25] Reviewing pertinent California law, the court reasoned that a "home-rule" charter is not a grant of power, but rather acts as a limitation, and should be construed in favor of the exercise of a power when no express limitation is indicated. The court also considered the term "responsible" sufficiently flexible to embody concerns beyond price and quality of work, such as the remedying of past discrimination. The court found the leading California Supreme Court case, which holds that a contract must be awarded to the lowest bidder based on price alone, unless the lowest bidder is found not qualified to perform the particular work under consideration, City of Inglewood-Los Angeles County Civic Center Authority v. Superior Court, (1972) 7 Cal.3d 861, not to be controlling because:

1. It involved interpretation of a state statute, not a local charter;

2. A home rule city has broader power than does a joint powers authority to exercise full sovereign authority over its municipal affairs; and

3. It was not decided in the context of affirmative action efforts.

Again, remembering the limited value of such predictions, it seems likely that a court, in the context of anti-apartheid sanctions, would conclude that the role of a vendor in maintaining and profiting from the immoral apartheid system and the City's desire not to economically enrich such a vendor is a factor which can be considered in determining whether a bidder is "responsible". If the Council were to adopt a strategy which interprets the term "responsible" to encompass not only quality of work and fitness of the contractor but also matters of public interest and concern such as anti-apartheid efforts, the Council's interpretation and implementation of its Charter is likely to be upheld.[26]

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[25] This case is on appeal to the Ninth Circuit.

[26] The City of Los Angeles has reached a different conclusion, but that City's charter is more explicit than Sacramento's in requiring that the determination be made solely on the basis of "lowest ultimate cost" and "previously delinquent or unfaithful" performance of a City contract by the bidder.

VII. CONCLUSIONS

Our conclusions are as follows:

(1) The City may choose not to purchase goods manufactured or produced in South Africa or to contract for goods or services with companies which have substantial business operations in South Africa. However, it appears that the City is barred by a provision in the Cartwright Act (Business and Professions Code §16721.5) from refusing to enter into contracts for goods and services with any person on the ground that such person does business with the Government of South Africa or with private business interests within South Africa.

(2) Although it is not entirely free of doubt, unrestricted funds held in the city general fund and invested or deposited by the City Treasurer may be subjected to a "South Africa free" investment/deposit restriction, and a reasonable "South Africa free" divestiture policy.

(3) Investment decisions regarding funds of the Sacramento City Employees Retirement System are the exclusive province of the Administration, Investment and Fiscal Management Board (hereafter "Board") and:

(a) The City Council is prohibited from mandating investment policy to the Board;

(b) The Board is precluded by both fiduciary standards and prudent expert rules from establishing investment decision criteria other than those which focus upon economic factors furthering the primary purpose of the pension system, which is to provide funds when required to pay the promised benefits.

(4) Other funds held and invested by the City under various external documents and legal criteria must be evaluated individually and separately to determine:

(a) Which of those funds can be treated in the same fashion as the City's general fund; and

(b) Which of these funds are subject to restrictions which would preclude application of a divestiture policy.

VIII. RECOMMENDATIONS

As stated in this opinion, we have reviewed a large number of divestiture plans, including the plan submitted by Councilman Johnson. The latter plan, in the form of an ordinance, is identical to that adopted by the City of Oakland.

Of all of the plans reviewed, the state law (AB 134, Maxine Waters)[27] appears to be the clearest, most concise, and simple in function. If the City Council decides to adopt a divestiture plan, the following are our recommendations:

1. The plan should be embodied in a resolution, and not an ordinance. Resolutions are a more flexible tool should the need for change arise.

2. The Council should make the necessary policy decisions regarding the scope of the plan, considering the limitations expressed in this opinion. Some of these policy issues are as follows:

(a) Will the policy cover deposits of money with banks and other financial institutions?

(b) Regarding investments:

(i) Will the policy cover future investments?

(ii) Will the policy require divestiture of existing investments?

(c) Will the City Treasurer be given a period of time to carry out divestiture? If so, then:

(i) How long?

(ii) Will there be a phasing requirement to allow for orderly divestiture?

(d) What standards will be imposed for determining whether or not a particular company or financial institution has sufficient contact with South Africa to render it an offending entity?

(e) Should a purchasing restriction be included and, if so, what types of criteria should be used?

The plan should not cover the retirement system; should not cover trust funds or those funds within the General Fund which are restricted; and should not include a prohibition against contracts for goods and services with a person solely on the ground that such person does business with South Africa.

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[27] A copy of AB 134, and an analysis of its provisions, is attached as Appendix E.

3. Upon making the policy decisions, the City Council should direct the City Attorney to draft a resolution to implement its decisions.

JAMES P. JACKSON, City Attorney

By _____
WILLIAM P. CARNAZZO
Deputy City Attorney

STATES THAT HAVE DIVESTED

California
Colorado
Connecticut
Iowa
Kansas
Louisiana
Maine
Maryland
Massachusetts
Michigan
Minnesota
Nebraska
New Jersey
New Mexico
North Dakota
Rhode Island
Vermont
West Virginia
Wisconsin
Virgin Islands

CITIES/COUNTIES THAT HAVE DIVESTED

Berkeley,CA
Cotati, CA
Davis, CA
Fresno, CA
Los Angeles, CA
Oakland, CA
Richmond, CA
San Diego, CA
San Francisco, CA
San Jose, CA
Santa Cruz, CA
Stockton, CA
West Hollywood, CA

Tucson, Arizona
Boulder, Colorado
Fort Collins, Colorado
Hartford, Connecticut
Middletown, Connecticut
New Haven, Connecticut
Washington, D.C.
Wilmington, Delaware
Gainesville, Florida
Miami, Florida

Atlanta, Georgia
Gary, Indiana
Topeka, Kansas
New Orleans, Louisiana
Balitmore, Maryland
College Park, Maryland
Montgomery County, Maryland
Amherst, Massachusetts
Boston, Massachusetts
Brookline, Massachusetts
Cambridge, Massachusetts
Detroit, Michigan
East Lansing, Michigan
Flint, Michigan
Grand Rapids, Michigan
St. Louis, Missouri
Atlantic City, N.J.
Camden, N.J.
Jersey City, N.J.
Newark, N.J.
Rahway, N.J.
New York, N.Y.
Rochester, N.Y.
Rockland County, N.Y.
Westchester County, N.Y.
Raleigh, North Carolina
Cincinnati, Ohio
Cleveland, Ohio
Columbus, Ohio
Cuyahoga County, Ohio
Youngstown, Ohio
Pittsburgh, PA
Philadelphia, PA
Burlington, Vermont
Alexandria, VA
Charlottesville, VA
Richmond, VA
Seattle, WA
Madison, Wisconsin

BOARDS, COMMISSIONS, AND OTHERS THAT HAVE DIVESTED

Los Angeles Board of Harbor Commissioners
East Bay Municipal Utility District
Los Angeles Community College Distict
California Federation of Teachers
Lutheran Church in America
American Lutheran Church
Presbyterian Church in America

ANALYSIS OF INVESTMENTS

AS OF 6/30/86

POOL A

Pool A contains 84 separate funds or accounts. Some of the 85 are clearly trust fund accounts, subject to the prudent expert rule that the only factor one may consider in making investment decisions is the obligation to obtain the highest return available consistent with prudence. However, most of these 84 funds are general fund accounts, not subject to the prudent expert rule applicable to funds held in trust. A few accounts are deposited with the City primarily to obtain the benefits of Pool A investment return. It seems likely that these depositors would consent to applying general fund investment policies to these accounts.

I. General Fund (and Similar)

Fund	Name	Dollar Days 2nd Q 1986* (In millions)
1-01	General Fund	3,124.5
1-01	General Fund 2-09	625.7
1-01	General Fund 2-43	17.8
1-01	General Fund 4-34	2.4
1-01	General Fund 5-60	.9
1-01	General Fund 5-61	4.1
1-01	General Fund 5-64	.2

*To determine average daily balance, divide dollar days by 94.

I. General Fund (and Similar)
(Continued)

Fund	Name	Dollar Days 2nd Q 1986* (In millions)
1-01	General Fund 5-71	2.7
1-01	General Fund 5-74	5.8
1-01	General Fund 5-75	2.0
1-01	General Fund 5-87	1.7
1-01	General Fund 5-89	18.2
1-01	General Fund 6-38	430.2
1-01	General Fund 6-39	21.7
1-01	General Fund 9-27	95.0
2-02	Gas Tax 2106	239.0
2-03	Gas Tax 2107	127.7
2-08	Traffic Safety	93.7
2-15	Disaster Relief Act	.2
2-29	Maint. Assmt. Dist.	5.8
2-32	Assmt. Bond Registration	9.1
2-35	Transp. Dev. Act-Bikeway	51.2
2-40	Pocket Area-Trunk Sewer	117.3
2-42	Metro Arts Fund	.6
2-47	Gas Tax 2107.5	159.2
2-49	Bridge Construction	28.2
2-51	Animal Acquisition	.9
2-52	Cablevision Franchise	6.1
3-26	Debt Service	42.2

4-12	Parking	207.5
4-15	Waste Removal	25.5
4-17	Boat Harbor	57.6
4-18	Golf Fund	164.8
4-19	Community Center	161.8
4-20	Fleet Management	356.4
4-21	Risk Management	1,289.1
4-24	Camp Sacramento	3.9
4-25	Storm Drainage	96.7
5-90	Art in Public Places Pro	53.4
6-36	Muni. Impr. Act-1913	134.7
6-40	Florin Rd. Storm & San	5.5
6-41	Morrison Creek Sewer/Water	145.8
6-42	Pocket Road Storm & San	121.7
638A	Florin Road Ad-Reserve	21.4
638B	Sunset Meadows-Reserve	16.7
638C	Washington Ad-Reserve	.3
638D	Alpine Aven St.	5.7
638E	East Del Paso 1A	.5
638F	Main Aven Sewer	2.7
638G	William Land School St. Light	.1
638H	Amador Aven Sewer Water	.5
638I	Woodbine #3A	.8
638J	H & I - 27th & 28th	.1
638K	Pocket Road Sewer #2	93.1
638L	Del Paso Ad #7	.8

638M	Del Paso Hts A/D #6A	1.3
638N	Morrison Creek	54.2
7-10	Quimby Act	392.4
7-94	Citation I-5 Impr.	11.8
7-95	So. Natomas Dev. Fund	77.7
7-96	So. Natomas Fac Ben Assn	8.0
7-98	So. Natomas Develop Im	10.2

II. Trust Funds

Fund	Name	Dollar Days (Millions)
5-51	Retirement Trust	1,304.4
5-52	A. Land Indigent	7.3
5-54	Fratt Fund	.7
5-55	B. Henschel Indigent	3.6
5-59	Moore Memorial	5.6
5-63	Alice Miller	1.1
5-65	Citation I-5 Maint.	12.2
5-66	Crocker Tr-Catalog	1.2
5-67	Crocker Tr-Special Events	2.5
5-68	Crocker Tr-Library	.8
5-72	Sac Hist. Center-Endow	1.5
5-77	Crocker Master Tr-Gene	13.8
5-78	Crocker Trust-Capital	3.6
5-79	Narcotics Task Force Trust	10.4

5-85	Sutter Park Sites	12.4
5-93	Community Services Gift	3.1
7-97	Sacto History, Inc.-Const. (Contains endowment from Nat'l Endowment for Humanities)	27.7

III. With Consent of Depositor, May Be Treated According to General Fund Policy

Fund	Name	Dollar Days (Millions)
101A	LRT/RACS Acct.	355.0
2-46	Mountain Valley Lib System	14.0
5-33	CADA	112.8
5-35	CADA 5-35	20.8
5-82	CAMA-Building	132.2

Summary

	Dollar Days (Millions)	Avg. Daily Deposit (Millions)	Percentage
Gen'l	8,756.8	93.2	81%
Trust	1,411.9	15.0	13%
Consent	634.8	6.8	6%
	10,803.5	115.0	100%

Thus, as of June 30, 1986, 87% (81% + 6%) of Pool A moneys could have been restricted by Council investment policies based on factors beyond those which may be considered by the "prudent expert." Percentages change as the moneys in each account change, but it may be

concluded generally that the bulk of Pool A moneys may be invested on a "South Africa free" basis.

POOL B

Pool B contains Water, Sewer and Parking Authority Funds. The average daily balance in 2nd quarter 1986 was approximately $21.5 million dollars. These investments are subject to bond covenants and the prudent expert rule, and may not be restricted by Council policy on South Africa-related investments.

POOLS C & D

Investment Pool C contains funds of the Sacramento Housing and Redevelopment Agency which are received from federal sources and which must be invested in government securities or authorized federal agency securities as well as public fund deposits.

Investment Pool D consists of SHRA local monies. Monies may be invested in a broader range of securities than may Pool D's monies.

It appears that these pools may be treated comparably to City general funds, except to the extent that investment in approved federal government or agency securities is required.

The average daily balance of Pool C & D funds during 2nd quarter 1986 was approximately $40 million.

The City Treasurer handles investments of County redevelopment and housing money as well as City redevelopment and housing money for SHRA. Terry Wolford, SHRA's Director of Finance, estimates that

the proportion of county money in Pools C & D at any one time is 10% to 20%. He states that it would be very difficult to segregate County money from City money.

It would be appropriate to obtain authorization from the Board of Supervisors to invest their SHRA money according to any general fund investment policies adopted by the Council.

POOL E

Pool E is Ann Land/Bertha Henschel trust fund moneys, subject to the prudent expert rule. They may not be subjected to additional special restrictions.

ATTACHMENT A-1

SCERS - STATEMENT OF ASSETS AVAILABLE FOR INVESTMENT
AS OF JULY 31, 1986

	CASH		SCERS INVESTMENT POOLS	INVESTMENTS - @ COST	AMOUNT 1/ AVAILABLE FOR INVESTMENT
	POOL A	PAC MOR			
EXTERNAL CONTRIBUTIONS	1,023,302	0	0	0	1,023,302
FIXED:					
BONDS, 2ND TD'S, & MTG. BK. CERTS	(105,982)	1,346,262	0	125,683,211	126,923,491
REAL ESTATE MORTGAGE	1,681,097	0	0	4,561,344	6,242,441
TOTAL FIXED	1,575,115	1,346,262	0	130,244,555	133,165,932
EQUITY:					
ALLIANCE	0	2,321,876	0	20,589,108	22,910,98
BATTERYMARCH	0	182,731	0	21,446,443	21,629,174
EMERGING GROWTH	0	6,756	0	0	6,756
DELAWARE	0	368,219		22,151,632	22,519,851
NEWBOLD'S	0	2,302,656		20,243,863	22,546,519
UTILITY STOCK	0	17,457		11,415,487	11,432,944
IN-HOUSE EQUITY	0	10,190	0	0	10,190
GOLD & SILVER	1,829,290	0	0	537,258	2,366,548
REAL ESTATE EQUITY	382,059	0	10,215,768	4,690,207	15,288,034
TOTAL EQUITY	2,211,349	5,209,885	10,215,768	101,073,998	118,711,000
TOTAL	4,809,766	6,556,147	10,215,768	231,318,553	252,900,234

1/ This colusn represents the amount available for investsent for each category derived by adding to or subtracting from the previous period's balance all invested incose (interest, dividend, gains, losses, etc.) and all contribution transfers.

APPENDIX C

Sections 16721 and 16721.5, effective January 1, 1977, are additions to the Cartwright Act, California's antitrust law. California Business and Professions Code §§ 16700 et seq. Section 16721 provides that:

> Recognizing that the California Constitution prohibits a person from being disqualified from entering or pursuing a business, profession, vocation, or employment because of sex, race, creed, color, or national or ethnic origin, and guarantees the free exercise and enjoyment of religion without discrimination or preference; and recognizing that these and other basic, fundamental constitutional principles are directly affected and denigrated by certain on-going practices in the business and commercial world, it is necessary that provisions protecting and enhancing a person's right to enter or pursue business and to freely exercise and enjoy religion, consistent with law, be established.
>
> (a) No person within the jurisdiction of this state shall be excluded from a business transaction on the basis of a policy expressed in any document or writing and imposed by a third party where such policy requires discrimination against that person on the basis of the person's sex, race, color, religion, ancestry or national origin or on the basis that the person conducts or has conducted business in a particular location.
>
> (b) No person within the jurisdiction of this state shall require another person to be excluded, or be required to exclude another person, from a business transaction on the basis of a policy expressed in any document or writing which requires discrimination against such other person on the basis of that person's sex, race, color, religion, ancestry or national origin or on the basis that the person conducts or has conducted business in a particular location.
>
> (c) Any violation of any provision of this section is a conspiracy against trade.
>
> (d) Nothing in this section shall be construed to prohibit any person, on this basis of his or her individual ideology or preferences, from doing business or refusing to do business with any other person consistent with law.

Section 16721.5 provides that:

> It is an unlawful trust and an unlawful restraint of trade for any person to do the following:
>
> (a) Grant or accept any letter of credit, or other document which evidences the transfer of funds or credit, or enter into any contract for the exchange of goods or services, where the letter of credit, contract, or other document contains any provision which requires any person to discriminate against or to certify that he, she, or it has not dealt with any other person on the basis of sex, race, color, religion, ancestry, or national origin, or on the basis of a person's lawful business associations.
>
> (b) To refuse to grant or accept any letter of credit, or other document which evidences the transfer of funds or credit, or to refuse to enter into any contract for the exchange of goods or services, on the ground that it does not contain such a discriminatory provision or certification.
>
> The provisions of this section shall not apply to any letter of credit, contract, or other document which contains any provision pertaining to a labor dispute or an unfair labor practice if the other provisions of such letter of credit, contract, or other document do not otherwise violate the provisions of this section.
>
> For the purposes of this section, the prohibition against discrimination on the basis of a person's business associations shall be deemed not to include the requiring of association with particular employment or a particular group as a prerequisite to obtaining group rates or discounts on insurance, recreational activities, or other similar benefits.
>
> For purposes of this section, "person" shall include, but not be limited to, individuals, firms, partnerships, associations, corporations, and governmental agencies.

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September 15, 1986

MEMORANDUM

TO: Tom Friery, City Treasurer

FROM: William P. Carnazzo, Deputy City Attorney

RE: A.B. 134

This memorandum is intended to supplement my September 9, 1985 response to you. I had assumed that your memorandum concerned the broader "divestment" issue as to which we have undertaken in-depth analysis.

I have attached two documents we received from Senator Watson's office which provide some interpretive guidance on A.B. 134. I have also attached several lists we have obtained, which appear to set out companies which are divestment candidates.

For your assistance in reviewing A.B. 134, the following is the manner in which I interpret its provisions:

A. DEFINITIONS. The following are the key definitions which govern the applicability of A.B. 134:

1. "Investment" - includes loans or other commitment of money to a business firm; or an interest in such a firm; or ownership of a stock, bond or other security issued by it.

2. Business Firm - virtually any form of business which exists for profit or economic gain is covered by this law.

3. Financial Institution - this definition appears to be a standard one, inclusive of all types of banks and related organizations.

4. Business Operations - this definition covers a "business firm" which maintains some situs actually within South Africa itself, in the form of equipment, personnel or property.

5. Business Arrangements - this definition would include virtually any type of business arrangement. However, it is limited by the phrase "requiring ongoing or periodic performance by both sides." Thus, apparently a single transaction which is self-limited would not be a "business arrangement".

6. South Africa and Government of South Africa - these words are given a broad definition which would, for example, include Namibia.

7. South African Corporation - a "business firm" which is, or whose parent is, headquartered in South Africa.

8. State Trust Moneys - this definition includes funds administered by the various entities expressly named. In short, it covers retirement funds.

9. State Trust Fund - this definition refers to the fund itself, rather than the funds administered by it. The affected trust funds are expressly named.

10. State Moneys - this definition includes all state-owned money, bonds and securities.

B. EFFECT ON "STATE TRUST MONEYS"

1. New/Renewed Investments in Business Firms (§16641)

a. Effective Date: from and after 1/1/87.

b. Prohibition: no additional or new or renewed investments in business firms which:

(i) have business operations in South Africa; or

(ii) have business arrangements with the government of South Africa [NOTE: the business arrangement must be with the government itself].

c. Exception: the prohibition is inapplicable to any business firm which adopts a resolution containing a policy meeting the requirements of §16641.5, which resolution is properly filed under §16643(a) with the certification of compliance called for by §16643(b).

2. New/Renewed Investments in Financial Institutions (§16642)

a. Effective Date: from and after 1/1/87.

b. Prohibition: no additional or new or renewed investments in financial institutions that make loans to:

(i) South African corporations;

(ii) or with the government of South Africa.

c. Exceptions:

(i) the prohibition is inapplicable to a financial institution which adopts a resolution containing the policy called for by §16642.5 and which is filed with the necessary certification, as specified above.

(ii) the prohibition is also inapplicable to a financial institution which renews otherwise covered existing loans or makes otherwise covered new loans designed to facilitate repayment of "loans or other credits" committed prior to 1/1/87 (see §16642.7).

(iii) the prohibition is also inapplicable to a financial institution which makes an otherwise covered loan after 1/1/87 for which an agreement was entered into before enactment of this bill. The "enactment" date is 8/27/86. This means that the commitment must have been made prior to 8/27/86 (see §16647).

C. EFFECT ON "STATE TRUST FUNDS"

1. Divestment Requirements (§16644)

a. Effective Date: beginning 1/1/88 and continuing through 1/1/91.

b. Requirement: annually reduce by one-third the value of their respective investments in:

(i) business operations in South Africa; and

(ii) business firms and business arrangements with the government of South Africa; and

(iii) financial institutions making or increasing loans/extensions of credit to any South African corporation or to the government of South Africa.

c. Exception: (§16647) the divestment requirement as to financial institutions is inapplicable to any otherwise covered loan/extension of credit for which an agreement was entered into before enactment of this bill (see above for explanation of this exception). [NOTE: there is no exception for a business firm or financial institution having the resolution/policy described in §§16641.5 and 16642.5.]

d. Reporting Requirement: state trust funds must file with the Governor and the Legislature on January 31 of each year a report on investments still held in business firms and financial institutions covered by the divestment requirement. The contents of this report are listed in §16648.

2. Further Investment Prohibitions (§16645)

a. Effective Date: 1/1/91.

b. Prohibition: after that date, state trust funds are prohibited from making or holding any investment in:

(i) business firms with business operations in South Africa;

(ii) business firms with business arrangements in South Africa; and

(iii) financial institutions making or increasing loans/extensions of credit to any South African corporation or the government of South Africa.

c. Exception: (§16647) this prohibition does not extend to any financial institution making a loan/extension of credit as to which an agreement was entered into prior to enactment of this bill (see above for explanation of this exception). [NOTE: there is no exception, after 1/1/91, for a business firm or financial institution having the resolution/ policy described in §§16641.5 and 16642.5.]

D. EFFECT ON STATE MONEYS (§16646)

a. Effective Date: following 1/1/87.

b. Prohibition: state moneys cannot be deposited with financial institutions which:

(i) make or increase loans/extensions of credit to the government of South Africa; or

(ii) provide funds for the purpose of making or increasing loans or other extensions of credit to the government of South Africa.

c. Exception: (§16647) the same exception applies here as in C.2.c. above.

E. INDEMNIFICATION

In Sections 16649 and 16650, the Legislature has provided indemnity for fund board members, employees, officers, contract investment managers and others who make investment decisions in an attempt to comply with the requirements of this bill.

I trust that this breakdown will be useful to you and to the members of the Board in your deliberations.

WILLIAM P. CARNAZZO
Deputy City Attorney

WPC:je
Att.

cc: Members, Administration Investment and
Fiscal Management Board
Dick Snyder

Sections 16721 and 16721.5, effective January 1, 1977, are additions to the Cartwright Act, California's antitrust law. California Business and Professions Code §§ 16700 et seq. Section 16721 provides that:

> Recognizing that the California Constitution prohibits a person from being disqualified from entering or pursuing a business, profession, vocation, or employment because of sex, race, creed, color, or national or ethnic origin, and guarantees the free exercise and enjoyment of religion without discrimination or preference; and recognizing that these and other basic, fundamental constitutional principles are directly affected and denigrated by certain on-going practices in the business and commercial world, it is necessary that provisions protecting and enhancing a person's right to enter or pursue business and to freely exercise and enjoy religion, consistent with law, be established.
>
> (a) No person within the jurisdiction of this state shall be excluded from a business transaction on the basis of a policy expressed in any document or writing and imposed by a third party where such policy requires discrimination against that person on the basis of the person's sex, race, color, religion, ancestry or national origin or on the basis that the person conducts or has conducted business in a particular location.
>
> (b) No person within the jurisdiction of this state shall require another person to be excluded, or be required to exclude another person, from a business transaction on the basis of a policy expressed in any document or writing which requires discrimination against such other person on the basis of that person's sex, race, color, religion, ancestry or national origin or on the basis that the person conducts or has conducted business in a particular location.
>
> (c) Any violation of any provision of this section is a conspiracy against trade.
>
> (d) Nothing in this section shall be construed to prohibit any person, on this basis of his or her individual ideology or preferences, from doing business or refusing to do business with any other person consistent with law.

Section 16721.5 provides that:

> It is an unlawful trust and an unlawful restraint of trade for any person to do the following:
>
> (a) Grant or accept any letter of credit, or other document which evidences the transfer of funds or credit, or enter into any contract for the exchange of goods or services, where the letter of credit, contract, or other document contains any provision which requires any person to discriminate against or to certify that he, she, or it has not dealt with any other person on the basis of sex, race, color, religion, ancestry, or national origin, or on the basis of a person's lawful business associations.
>
> (b) To refuse to grant or accept any letter of credit, or other document which evidences the transfer of funds or credit, or to refuse to enter into any contract for the exchange of goods or services, on the ground that it does not contain such a discriminatory provision or certification.
>
> The provisions of this section shall not apply to any letter of credit, contract, or other document which contains any provision pertaining to a labor dispute or an unfair labor practice if the other provisions of such letter of credit, contract, or other document do not otherwise violate the provisions of this section.
>
> For the purposes of this section, the prohibition against discrimination on the basis of a person's business associations shall be deemed not to include the requiring of association with particular employment or a particular group as a prerequisite to obtaining group rates or discounts on insurance, recreational activities, or other similar benefits.
>
> For purposes of this section, "person" shall include, but not be limited to, individuals, firms, partnerships, associations, corporations, and governmental agencies.