Arguments in Favor of Fiduciary Divestment of "South African" Securities

Joel C. Dobris
University of California at Davis School of Law, jcdobris@ucdavis.edu

Follow this and additional works at: https://digitalcommons.unl.edu/nlr

Recommended Citation
Available at: https://digitalcommons.unl.edu/nlr/vol65/iss2/2

This Article is brought to you for free and open access by the Law, College of at DigitalCommons@University of Nebraska - Lincoln. It has been accepted for inclusion in Nebraska Law Review by an authorized administrator of DigitalCommons@University of Nebraska - Lincoln.
Arguments in Favor of Fiduciary Divestment of “South African” Securities

TABLE OF CONTENTS

I. Introduction ................................................ 210
II. Initial Considerations .................................... 211
   A. Divestment Defined ................................... 211
   B. Why Divestment? ...................................... 212
   C. Basic Trust Law ....................................... 215
      1. Pension Trusts ..................................... 216
      2. Charities .......................................... 218
      3. Universities ....................................... 219
III. Arguments that Transcend the Law ...................... 221
   A. Moral Considerations in Trust Law ................... 221
   B. Moral Considerations in South African Investment ... 222
IV. Legal Arguments .......................................... 224
   A. The Analogy of Real Property Law .................. 224
      1. Changing Public Values ............................ 225
      2. Why We Recognize Trusts ......................... 225
      3. Redefining Property Rights for Social Purposes .. 226
      4. Property Rights, Especially Pension Rights, As A Function of the Political Process ............. 228
   B. Pension Trusts As Quasi-Public Entities .............. 228
   C. The Ability of a Trustee to Sell South African Securities ............................................. 230
      1. The Attorney’s Problem with Divestment ........ 230
      2. No Investment Duty to Maximize Profit ........... 232
   D. Problem: The Costs of Divestment ................. 233
      1. Minimizing and Accepting Divestment Costs .... 233
      2. Divestment in Pursuit of Trust Purposes ....... 234

* Professor of Law, University of California, Davis. B.A., Yale College, 1963; LL.B., University of Minnesota, 1966. I want to thank Anthony W. Pierotti and James C. Wolf, class of 1987, University of California, Davis, School of Law, for their aid in the preparation of this Article.

© Copyright Joel C. Dobris, 1985. All rights reserved.
I. INTRODUCTION

Pressure to divest is sweeping the country. Some commentators maintain that divestment is futile, puts portfolios at risk, and comes close to stealing from beneficiaries of pensions and private trusts. Recent legal and financial analysis indicates that trustees may be able to divest without breaching any fiduciary duties.

The purpose of this Article is to present the arguments in favor of divestment. Among other things I have not limited myself to commenting on the current state of the law, nor have I confined myself to traditional trust principles. In writing this “brief,” I am going to allow myself two luxuries: I intend to make my clients’ case, not my opponents; and I shall make incredible arguments as well as credible ones, for the argument that might not persuade me or you might persuade the judge. I, of course, have no client in this matter. I have just given myself the hypothetical job of writing a brief for divestment, because it seemed like a useful thing to do.


2. See generally Langbein, supra note 1.


5. Cf. T. Troyer & R. Boisture, supra note 3, at 31 (suggesting that Scott has gone beyond traditional social investing doctrine).

6. I practiced as a trust and estates and charitable corporations specialist for ten years, and have now taught and written in the trusts and estates area almost as long. I am well acquainted with fiduciary duty, know more about investment theory than a lot of people, and a little more about South Africa than a lot of people. I am well aware of the enormous complexity of the South African situation and believe that most Americans cannot even begin to understand the...
SOUTH AFRICAN DIVESTMENT

II. INITIAL CONSIDERATIONS

A. Divestment Defined

Divestment is the sale by investors of the securities of businesses with South African contacts. There exists a broad spectrum of possible divestment plans. These range from (1) immediate sale of all holdings that have anything to do with South Africa, to (2) the slow sale of the securities of Standard and Poor's 500 corporations that have a business presence in South Africa, to (3) active shareholding of corporations that do business in South Africa, with periodic culling of the shares of corporations that do not actively pursue social justice in that country.

All divestment plans must deal with at least two questions: what gets sold, and when it gets sold. As to what gets sold, this Article adheres to the second definition above: the sale of all stock of any Standard and Poor's 500 company with a business presence in South Africa. It is this type of company that has generated the most controversy. As to when the sale takes place, this Article assumes orderly sales over a period of time long enough not to depress the market. Instant divestment of large stock portfolios is generally con-

---

8. Id. at 52.
9. Standard and Poor's is a financial rating service. One of its many services is to publish a list of the so-called Standard and Poor's 500 corporations. Standard and Poor's 500 corporations are companies from various sectors of the economy chosen for their ability, as a whole, to emulate the movement of the market. L. GITMAN & M. JOHNSON, THE FUNDAMENTALS OF INVESTING 82, 84 (1981). For our purposes, the S & P 500 is a convenient symbol of the larger companies with publicly traded securities, that operate in the public view.
11. See J. SIMON, C. POWERS & J. GUNNERMANN, supra note 7, at 52.
12. The statement in the text is a useful simplification. A divesting investor should apply her definition of divestment to all stocks in her portfolio.
13. We must remember that divestment is really not about selling the stock of companies that sell police hardware to the South African government. It is not even about selling the shares of companies that mine gold in South Africa. It is about selling the shares of major American corporations that do some business in South Africa.
considered imprudent and therefore is not addressed in this Article.14

B. Why Divestment?

I assume that people seek to divest to get justice in South Africa, either through evolution or revolution in that society. Some assume that divestment will lead to corporate disengagement,15 which will yield change.16 Others see divestment as the first step to denying South Africa access to capital and/or technology, which again will presumably lead to change.17 Still others treat the question as one of morality.18

How might divestment make South Africa a more just society? Sales of the shares of corporations doing business in South Africa may be meaningless if the shares are simply bought by other investors.19 Divestment, however, can be an act of communication to others considering divestment: to corporate management, to American and South African politicians, and to the people of both countries.20 The various messages sent can hopefully change the conduct of management, politicians, and citizens. Stock sales can possibly yield a change in the actions of management through a temporary drop in stock prices,21 or through a deterioration in public image that interferes with doing business.22 The problem with forcing the prices of shares down through sales is that it is bad for the seller—you have to get into the cage with the lion to hit it over the head with the two-by-four. At this writing, the message is reaching American politicians. To this extent the divestment movement is not futile.23

14. See, e.g., N.Y. Times, Apr. 21, 1985, § 3, at 10, col. 1, which notes that Wall Street professionals assume any divestment will take place over an extended period of time.
15. To avoid confusion, I am using the term “disengagement” instead of the term “disinvestment” to describe a company leaving South Africa.
18. See infra notes 112-42 and accompanying text.
19. See Langbein, supra note 1, at 12.
21. The drop in price discussed in the text would come from the mass sales of stock by individuals and/or institutional holders. One imagines the drop would be temporary, but it is obvious that if institutions became generally disenchanted with a corporation’s South Africa policy to the point of dumping the stock then that corporation’s South Africa policy would change very quickly.
23. See L.A. Times, July 12, 1985, § 1, at 1, col. 5.
Divestment can be seen as the first step in an attempt to deny South Africa access to American capital, the goals being, perhaps, forcing those who govern South Africa to come to their senses, and to change their policy, or to make conditions so bad as to hasten a revolution.\textsuperscript{24} Obviously, the United States is not the only source of capital, but it is a very important one.\textsuperscript{25}

Similarly, divestment can be seen as the first step in an attempt to deny South Africa access to American technology.\textsuperscript{26} Again, the United States is not the only source of technology. But, to the extent that any of its technology is unique or preferable, and to the extent that divestment can cause people to stop doing business in South Africa, then there is a purpose to divestment.\textsuperscript{27}

Divestment is just one issue on the general agenda of social investing.\textsuperscript{28} This Article presents only one side of that one issue.\textsuperscript{29} Social investing is a funny business. I believe that a small but meaningful number of trusts will be amended or drafted to forbid social investing because of the apparent success of the divestment movement. It must be remembered, too, that reforms often bring results opposite from the ones intended.\textsuperscript{30} There are at least two such risks here. The first is that the noble desire to reform apartheid in South Africa via the investment policies of American fiduciaries may lead to unexpected and unfortunate results.\textsuperscript{31} For instance, divestment may harm trust portfolios while accomplishing no change in South Africa.\textsuperscript{32} A second, and lesser, reform risk is that more trusts may forbid social investing as people press for it.\textsuperscript{33}

Certain threshold arguments have been advanced against divest-

\begin{itemize}
\item \textsuperscript{24} See D. HAUCK, M. VOORHES \& C. GOLDBERG, supra note 20, at 127-28.
\item \textsuperscript{25} S. BALDWIN, J. TOWER, L. LITWAK \& J. KARPEN, supra note 3, at 17; A. NEWMAN \& C. BOWERS, FOREIGN INVESTMENT IN SOUTH AFRICA AND NAMIBIA 111 (1984).
\item \textsuperscript{26} B. BALDWIN \& T. BROWN, ECONOMIC ACTION AGAINST Apartheid: An Overview of the Divestment Campaign \& Financial Implications for Traditional Investors 7-8 (1985); House Hearings, supra note 17, at 373.
\item \textsuperscript{27} See House Hearings, supra note 17, at 373.
\item \textsuperscript{29} For the other side of the issue see Langbein, supra note 1.
\item \textsuperscript{30} See Univ. of CAL., OFFICE OF THE TREASURER, 1 TREASURER'S REPORT ON SOUTH AFRICA INVESTMENTS 21 (1985) (limited circulation report) [hereinafter cited as U. CAL. REP.].
\item \textsuperscript{31} See The Not-Quite Revolution, ECONOMIST, July 27, 1985, at 11.
\item \textsuperscript{32} F. Cheru, supra note 4, at 8.
\item \textsuperscript{33} See, e.g., Dobris, A Brief for the Abolition of All Transfer Taxes, 35 SYRACUSE L. REV. 1215 (1984).
\end{itemize}
Most important, divestment opponents contend that the Sullivan Principles are effecting meaningful social change. In response to this argument, it can be said that continued United States presence in South Africa, even with full corporate compliance with the Sullivan Principles, can never be a meaningful force for social change. Not that many black people work for United States companies, and not many more are likely to be hired, since the typical American company's presence in the country is capital intensive, not labor intensive. Furthermore, the blacks who do work for United States companies are in low level jobs, for the most part, with little chance for advancement due to inadequate education and training.

The real benefit of investment in South Africa, it can be said, accrues to the white minority, and a few nonwhites, and not to the black majority. The economy is in reality a dual economy, with the whites and some nonwhites obtaining the benefit of United States investment, not the black majority. This means two things: such investment is morally wrong because it supports an undesirable oligarchy, and such investment is wrongly labeled as being good for blacks.

Next, it is argued that United States disinvestment from South Africa would have no effect on social reform in that country. Even if

34. See generally Langbein, supra note 1 (a negative discussion of all social investing).
35. The Sullivan Principles is a voluntary code of corporate behavior that a number of U.S. companies operating in South Africa have ratified. One of the goals of the Principles is to gradually integrate the workplace and promote social harmony. For instance, the Principles call for integration of bathrooms and eating areas. For the text of the current Principles see Schotland, Divergent Investing of Pension Funds and University Endowments: Key Points About Pragmatics, and Two Current Case Studies, in DIVESTMENT 31 & 71-73 (1985).
36. See id. at 63-64. See also Murray, U.S. Investment in South Africa - the $2.5 billion question, FORTUNE, Oct. 1, 1984, at 151-60 (advertisement).
37. See D. HAUCK, M. VOORHES & G. GOLDBERG, supra note 20, at 94, 98. Rev. Sullivan has called for U.S. companies to withdraw if apartheid has not ended by 1987. This seems to indicate that the promulgator of the Principles himself has some doubts about the efficacy of the Principles. See Sullivan Calls for Economic Sanctions if Apartheid Not Ended in Two Years, 3(2) S. AFR. REV. SERVICE REP. 33 (June 1985). The Sullivan Principles now call for signatories to lobby against apartheid. See Schotland, supra note 35, at 73. This may be against South African law. See The Africa Fund, South Africa Fact Sheet, 1 S. AFR. PERSP. 3 (Mar. 1984) [hereinafter cited as Fact Sheet].
38. About 65,000 people of all colors work for American corporations that have signed the Sullivan Principles. See Schotland, supra note 35, at 81. Of those, 40,000, or about 1.5 percent of the total workforce, are nonwhites.
40. See D. MYERS, supra note 16, at 20 & 24-25.
41. See Fact Sheet, supra note 37, at 2.
42. See S. BALDWIN, J. TOWER, L. LITWAK & J. KARPEN, supra note 3, at 13.
43. See D. MYERS, supra note 16, at 78.
this is true, which it probably is not, we might as well do the moral thing at that point and leave.

C. Basic Trust Law

To deal adequately with the legal issues that divestment presents, one must first have an understanding of basic principles of trust law. This includes knowledge of the various fiduciary standards and duties under which a typical trustee, pension trustee, or charitable director must operate.

There are three types of trusts that we need to consider: those that are silent on the question of divestment; those that allow divestment; and those that forbid divestment. At this writing, the vast bulk of the trusts in existence are surely silent on the question.

In dealing with a silent trust there are three logical possibilities, assuming the law is clear on the question: (1) the body of law governing that trust requires divestment, a most unlikely possibility; (2) the body of law governing that trust forbids divestment; or (3) the body of law governing that trust allows divestment. When all is said and done this Article is a brief for the third position.

Every trustee is a fiduciary. Simply stated, a fiduciary relationship exists as to property when its legal owner has duties to another regarding that property. Those duties to the beneficiary transcend mere private ownership by the fiduciary. Thus, during the existence of the fiduciary relationship, the fiduciary must always act in the best interests of the beneficiary. This dedication to the beneficiary, the duty of loyalty, seems to stand in the way of divestment. That is, the

45. It is interesting to note that apartheid has only been in place in South Africa since 1948. See D. Myers, supra note 16, at 5-9; 1 U. Cal. Rep., supra note 30, at 8. While the social problems of South Africa are much older, the immediate problem is relatively new, and therefore perhaps more solvable than might be imagined.
47. I imagine that in the future a modest number of trusts will specifically allow divestment or other forms of social investment, and that a moderate number of trusts will in the future forbid divestment and perhaps other forms of social investing. ERISA will limit the statements in the preceding sentence. See Langbein, supra note 1, at 21.
49. See generally Langbein, supra note 1.
51. See 1 A. Scott, supra note 50, at §§ 2.6 to 2.7.
52. See id. at § 2.5; Dobris, supra note 46, at 2.
53. See Restatement (Second) of Trusts §§ 170 & 206 (1959).
ordinary understanding of an ordinary rule of fiduciary conduct can easily be understood as forbidding any investment activities that would primarily benefit someone other than the beneficiary.\textsuperscript{54}

If a fiduciary is a trustee then she is held to the highest standard of trust investment—the prudent person rule.\textsuperscript{55} In a sentence, that rule provides that “[t]he trustee is under a duty to the beneficiary in administering the trust to exercise such care and skill as a man of ordinary prudence would exercise in dealing with his own property; and if the trustee has or procures his appointment as trustee by representing that he has greater skill than that of a man of ordinary prudence, he is under a duty to exercise such skill.”\textsuperscript{56}

\textbf{1. Pension Trusts}

The typical pension trustee is a trustee in the classic sense and must, in the usual circumstances, invest as a prudent person.\textsuperscript{57} The pension trustee is being asked to divest because pension funds are so financially important in today’s society.\textsuperscript{58} Public pension trustees are being asked to divest because they are subject to public scrutiny and political pressure,\textsuperscript{59} and because they are not subject to the stricter ERISA prudent person rule.\textsuperscript{60} Private pension trustees, generally, have been subject to less organized pressure to divest because their actions are confined by the stricter ERISA standard.\textsuperscript{61}

A crucial distinction exists between those trusts that are governed by ERISA and those that are not.\textsuperscript{62} Briefly, ERISA, the Employment Retirement Income Security Act of 1974,\textsuperscript{63} was designed to improve the pension status of many American workers.\textsuperscript{64} ERISA contains a codified prudent person rule.\textsuperscript{65} Much has been written about the dif-

\textsuperscript{54} It has been said that “[c]onsistent with this fundamental standard, divestment may—and must—be justified on either of two grounds: that it will not impair the financial performance of the organization’s investment portfolio, or that it contributes sufficiently to the accomplishment of the organization’s purposes to justify its cost.” T. Troyer & R. Boisture, supra note 3, at i.

\textsuperscript{55} See 1 A. Scott, supra note 50, at § 174.

\textsuperscript{56} See RESTATEMENT, supra note 53, at § 174.


\textsuperscript{58} See H. Gray, supra note 28, at 20-25; Schotland, supra note 35, at 31.

\textsuperscript{59} See H. Gray, supra note 28, at 23-47; Langbein, supra note 1, at 9; 1 U. Cal. Rep., supra note 30, at 2.

\textsuperscript{60} See Langbein, supra note 1, at 7.

\textsuperscript{61} See T. Troyer & R. Boisture, supra note 3, at 42-44.

\textsuperscript{62} See Hutchinson & Cole, supra note 57, at 1346-52; Langbein, supra note 1, at 6.

\textsuperscript{63} 29 U.S.C. §§ 1001 to 1381 (1982).


\textsuperscript{65} 29 U.S.C. § 1104(a)(1)(B) (1982). See generally Note, Fiduciary Standards and
ference between the common law prudent person rule and the ERISA version. For our purposes, it is sufficient to say that the statutory version of the rule is the same or somewhat stricter than the common law rule. Let us assume that the codified rule is actually more demanding, either because of its meaning, or because concern about the existence and/or the enforcement of a federal rule will lead to more fastidious trustee conduct.

One can imagine ERISA trusts that either allow or forbid divestment. If an ERISA trust were to allow divestment, it would only be effective if there were sufficient play in the ERISA prudent person standard. ERISA pension trusts are, however, much less subject to change than other trusts because the prudent person rule cannot be set aside as to them. For all practical purposes then, the question of whether the ERISA prudent person rule allows divestment is one of great moment.

Since public employee pensions are outside ERISA, the question there is whether the relevant investment rule allows divestment. The relevant rule is often the common law prudent person rule, although statutory standards may have been enacted regulating the investments of such pension trustees. At one time, most states required trustees to invest only in specified securities from a so-called legal list. Since the Depression, legal lists have largely been repealed, leaving the more flexible common law standard of prudence to guide fiduciary conduct. Recently, however, a new form of legal list has emerged that bans the investment of public pension funds in se-


69. See Lanoff, supra note 64, at 390.
71. See generally Ravikoff & Curzan, supra note 67 (favoring social investing).
72. See Langbein, supra note 1, at 7.
74. See Ravikoff & Curzan, supra note 67, at 536.
75. 3 A. SCOTT, supra note 50, at § 227.13.
76. See G. BOGERT & G. BOGERT, HANDBOOK OF THE LAW OF TRUSTS § 103 (1973). State legislatures have recently begun to expand the common law rule to accommodate some aspects of Modern Portfolio Theory.
securities of corporations that do business in South Africa and Northern Ireland.\textsuperscript{77}

Fiduciary conduct must also meet the requirements of the trust instrument.\textsuperscript{78} Within public policy and statutory limits, a non-ERISA pension trust may be amended or initially drafted to allow or forbid a particular investment policy.\textsuperscript{79} That is, the prudent person rule is not obligatory,\textsuperscript{80} and can be set aside in the instrument.\textsuperscript{81} Thus public pension trustees have been required by some local governments to divest.\textsuperscript{82}

2. Charities

Charities, for the most part, are organized as nonprofit corporations.\textsuperscript{83} Some are trusts.\textsuperscript{84} Charities are targeted for divestment for several reasons, including the discordance between the South African investment policies of some multinationals and the eleemosynary goals of some charities.\textsuperscript{85}

If the conduct of a director of a profit-making enterprise is being questioned, then the so-called business judgment rule applies.\textsuperscript{86} That rule provides that "[a] director or officer has a duty to his corporation to perform his functions in good faith in a manner that he reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances."\textsuperscript{87}

The investment conduct of directors of business corporations is


\textsuperscript{78} See \textit{3 A. Scott, supra note 50, at § 227.14.}

\textsuperscript{79} See \textit{id. at § 227.14.}

\textsuperscript{80} See \textit{id. at § 174.}

\textsuperscript{81} See \textit{Restatement, supra note 53, at § 227(b) comment p & § 227(c) comments q, r & s. The prudent person rule cannot be set aside when ERISA pension trusts are involved, or in the case of charitable trusts if the Internal Revenue Code practically speaking prohibits it, or the state attorney general, acting on behalf of all charitable beneficiaries, successfully opposes it. \textit{See Langbein, supra note 1, at 21; T. Troyer & R. Boisture, supra note 3, at i.}


\textsuperscript{83} See T. Troyer & R. Boisture, \textit{supra note 3, at i.}

\textsuperscript{84} See \textit{M. FREMONT-SMITH, FOUNDATIONS AND GOVERNMENT 82-111 (1965); 4 A. Scott, supra note 50, at § 348.3. A charity could also be an unincorporated association or even facially a business corporation in a state without a nonprofit corporations statute.}

\textsuperscript{85} See D. HAUCK, M. VOORHES & G. GOLDBERG, \textit{supra note 20, at 74, 80; T. Troyer & R. Boisture, supra note 3, at 15-19.}

\textsuperscript{86} See \textit{Arsht, The Business Judgment Rule Revisited, 8 Hofstra L. Rev. 93 (1979).}

\textsuperscript{87} \textit{Principles of Corporate Governance: Analysis and Recommendations} § 4.01(a) (Tent. Draft No. 4, Apr. 12, 1985).
outside the scope of this Article. The directors of some nonprofit organizations may, however, be subject to this business judgment rule. In other jurisdictions, directors of charitable organizations are subject to what I would call the charitable business judgment rule. This rule is somewhat more demanding than the business judgment rule, but less demanding than the prudent person rule. And, in some jurisdictions, the directors of charitable corporations are understood to be subject to the prudent person rule, as if they were trustees.

3. Universities

The university trustee is being asked to divest for a number of reasons. First, students and faculty are typically the kind of people who demand action. Second, the university trustee is subject to scrutiny and pressure. Third, persons involved with colleges and universities tend to take a proprietary attitude towards them. Fourth, the public university trustee is exempt from the strict ERISA prudence standard and, at the same time, subject to substantial political pressure. Finally, perhaps the university trustee is being asked to divest because our society has a higher expectation of the university and its trustees. As was once said, in another context, "[i]t is the University's bounden duty... to inspire, to cultivate, to edify."

Oversimplifying, the university trustee likely oversees the management of one or more distinct funds. Let us assume she is responsible for three distinct funds: employee pension funds, endowments, and operating funds. The standard of fiduciary conduct for a university trustee may depend on the particular fund involved.

The operating funds of the school are typically not held with a goal of preserving the corpus, but are, instead, likely to be exhausted within a short period of time—let us say by the end of a fiscal year. The money is likely put into short-term, liquid investments, relatively

88. The Internal Revenue Code aspects of these questions are also outside the scope of this Article. For such a discussion see T. Troyer & R. Boisture, supra note 3, at 35-40.
93. See Langbein, supra note 1, at 7.
94. U. of Cal. (Berkeley), Campus Historical Resources Study 1 (1978).
free of South Africa taint. The decisions of the university trustee regarding the investment and disbursement of these funds are similar to those of a director of a business corporation. Fiduciary duties apply during the period the operating funds are held, but they will be different than those applied to other funds, no matter what the standard of duty is. Those fiduciary duties, depending on the jurisdiction, may be set forth in the business judgment rule, the charitable business judgment rule, or the prudent person rule.

Endowment funds are typically made up of gifts from private donors. This money is to be held long-term, and perhaps even preserved, with the income and/or the principal being transferred to the operating fund or being spent for certain specific educational projects. The endowment is, then, similar in some ways to a charitable trust and in some ways to the capital of a business corporation. Thus, the university fiduciary who manages an endowment fund may be seen as a trustee who must follow the prudent person rule, or as the director of a charitable corporation, who must follow either the charitable business judgment rule or the business judgment rule depending on the jurisdiction.

Employee pension funds are often the largest component of university funds, especially in public universities. If the university is a private institution, the pension funds are protected by the relatively strict prudent person standard of ERISA. If the university is operated by a government, the fiduciary management of the pension funds is most likely governed by the common law prudent person rule, perhaps as amended by state statute. As explained above, this rule can be altered by statute or by amendment of the trust instrument.

98. The decisions regarding the investment and disbursement of operating funds are really going to be made by staff, not trustees.
99. See id. at 118 n.3.
101. See FORD FOUND., supra note 96, at 11.
103. See 1 U. CAL. REP., supra note 30, at 116.
105. W. CARY & C. BRIGHT, supra note 91, at 60.
106. Id. at 14-15.
108. See T. Troyer & R. Boisture, supra note 3, at 42-44.
110. See supra notes 67-82 and accompanying text.
111. 3 A. SCOTT, supra note 50, at § 227.14.
With this background in mind, let us then turn to our discussion of the legal and policy issues involved.

III. ARGUMENTS THAT TRANSCEND THE LAW

A. Moral Considerations in Trust Law

Generally speaking, we have grown used to trust investment law taking no account of morality in investment.\textsuperscript{112} It is, however, appropriate to consider moral factors when dealing with fiduciary matters.\textsuperscript{113} It is not written in stone that there is no place for morality in trust investing. Trusts are creatures of equity and should be subject to equitable and perhaps moral directives.\textsuperscript{114}

The current anti-apartheid movement is heartfelt and intuitive.\textsuperscript{115} Many of the arguments against divestment are intellectualized and cerebral. There are times when the law's response must be heartfelt.\textsuperscript{116} A legal system that seems, or is, arrayed against justice is in danger of disrespect and decay.\textsuperscript{117} There are times when the law's response must be first and foremost moral.\textsuperscript{118}

The legal system, or more specifically the trust investment system, has enough strength and flexibility to absorb and accommodate a morally based response to apartheid.\textsuperscript{119} It is appropriate, if not necessary, to have a trust investment system that incorporates justice. The fear that fiduciary investment cannot adjust to divestment is reminiscent of Andrew Mellon's fear that transfer taxation would destroy capital.
over time. Just as the estate tax did not destroy capital, so it can be argued that divestment will not destroy large trusts. Is it not better to lose a little trust revenue, if that does in fact occur, than to suffer grotesque injustice? Indeed, it is quite possible that divested portfolios will heal themselves in our dynamic economy. Society can impose burdens on property in trust for wholesome social purposes.

There are ways of earning money for trusts that are so improper, low, and immoral that the question of whether to make or retain the investment transcends law. One would not invest in the Third Reich. Once you accept this argument, then the only question is whether doing business in South Africa constitutes such conduct. This does not take a great deal of jurisprudential analysis, or great complication of the relatively mundane question of trust investment.

Law, even technical questions of trust investment, embodies a moral consensus about how our society is to be run. If a social consensus is reached about an issue then the law is expected to respond. If such consensus is reached that investment in corporations that operate in South Africa is wrong, then trust investment law can reflect that consensus. Once the consensus is clear, then we just are involved in the relatively simple job of conforming the law to the consensus. While the matter is not free from doubt, it is not unreasonable to argue that there is a consensus on the question of divestment. There is arguably widespread political support for the essentially moral proposition that United States capital should not be used to support apartheid. And there is surely consensus on the question of apartheid.

B. Moral Considerations in South African Investment

Assuming that morality has a role in the fiduciary's investment decision then the following can be said. Apartheid is immoral. We know

120. Pedrick, supra note 113, at §§ 1900, 1903.1.
121. See S. BALDWIN, J. TOWER, L. LITWAK & J. KARPEN, supra note 3, at 95.
122. See House Hearings, supra note 17, at 373 (statement of Stephen K. Moody, Vice President of United States Trust Co. of Boston).
124. See 3 A. SCOTT, supra note 50, at § 227.17 (Supp. 1984); 1 U. CAL. REP., supra note 50, at 114.
127. See F. COHEN, supra note 116, at 22 & 240-41.
128. See L.A. TIMES, Aug. 2, 1985, § 1, at 1, col. 5.
that from many things, including our own national experience. It is immoral to profit from apartheid, and investments in apartheid should be sold. The presence of United States firms in South Africa supports the government of South Africa.\textsuperscript{130} Those firms pay taxes, invest capital, and indirectly preserve the status quo.\textsuperscript{131} To do so is immoral and should be stopped as soon as possible. Investment in South Africa does not significantly benefit blacks, nor does it work to improve conditions there.\textsuperscript{132} It can be said that blacks would be better off free than they are now, even if freedom requires a revolution or a fall in their standard of living.\textsuperscript{133} Those who oppose this argument seem to be saying “Better Fed Than Dead.” That argument should be rejected, and on moral grounds trustees should divest and be done with the place.

The relationship between United States investment in South Africa and apartheid is symbiotic.\textsuperscript{134} Profits are higher because apartheid encourages foreign investment. Foreign investment is very good for the South African economy and this encourages apartheid.\textsuperscript{135} The circle must be broken.

It is immoral to do nothing. Passivity in the face of injustice is corrosive.\textsuperscript{136} Investment has led to increased injustice, and aggressive shareholding, which is offered as the next best step,\textsuperscript{137} will likely lead nowhere.\textsuperscript{138} The American corporation is not the engine of social justice in South Africa.\textsuperscript{139} The corporation is ill-suited for the job. The number of blacks working for American corporations is small.\textsuperscript{140} The advantages of doing business in South Africa are too attractive. The time has come to divest.

The argument is made that other places around the globe are as bad or worse than South Africa and therefore that nothing should be done about South Africa.\textsuperscript{141} South Africa is arguably the worst coun-

\begin{itemize}
  \item[\textsuperscript{130}] See S. Baldwin, J. Tower, L. Litwak & J. Karp, supra note 3, at 17-18.
  \item[\textsuperscript{131}] American businesses may be said to prosper in South Africa because of government policies that keep black wages artificially low and the incomes of white consumers artificially high. See Black Rage, White Fist, Time, Aug. 5, 1985, at 24 & 29.
  \item[\textsuperscript{132}] See D. Myers, supra note 16, at 146.
  \item[\textsuperscript{133}] See 1 U. Cal. Rep., supra note 30, at 19.
  \item[\textsuperscript{134}] See S. Baldwin, J. Tower, L. Litwak & J. Karp, supra note 3, at 18-19.
  \item[\textsuperscript{135}] America and South Africa, The Economist, Mar. 30, 1985, at 17 & 30.
  \item[\textsuperscript{136}] Let me make a far fetched argument. The worst sin in the world of trust litigation is passivity. For instance, it is the passive trustee who gets surcharged. And, going back 350 years, it is the passive use that gets executed. Can it not be argued that it is the trustee who sits passively by in the face of injustice who should be taken to task by the law?
  \item[\textsuperscript{137}] See Bok, supra note 10, at 99.
  \item[\textsuperscript{138}] See D. Hauck, M. Voorhes & G. Goldberg, supra note 20, at 61-64, 68, 72.
  \item[\textsuperscript{139}] See id. at 119-20.
  \item[\textsuperscript{140}] See D. Myers, supra note 16, at 46.
  \item[\textsuperscript{141}] See Langbein, supra note 1, at 10.
\end{itemize}
try on the globe in which United States firms do substantial business. Progress, in any event, must begin somewhere, and there is no compelling reason to start with a different country. Injustice elsewhere is no reason to tolerate injustice in South Africa, or to refuse to begin with South Africa, or to require a more comprehensive program of social investing before beginning.

In setting a social agenda there is no obligation to be all inclusive. If I have a bad knee and a bad back it is absurd to say that since I will not fix the back, there is no purpose to fixing the knee. Similarly, it would be absurd to say I must fix them both at once or not at all.

IV. LEGAL ARGUMENTS

A good part of the legal business of the 20th century has involved the allocation of society's resources and the redefinition of property rights. Interestingly enough, beneficiary interests under trusts have escaped this ferment. It may well be that the time has come to subject trust investment rules to a reevaluation insofar as they create property rights in beneficiaries. It is useful, in seeking to accomplish that task, to look to analyses that have emerged in other areas of the law.

A. The Analogy of Real Property Law

We are in a transition period, one might argue, when trust investment law is metamorphosizing from a body of law focused inwardly on portfolios and beneficiaries, to a body of law that is focused more outwardly on other values as well. New values and new notions of trust portfolio productivity may well be emerging as part of the divestment movement. If notions of community and shared values are included in the trust investment mix, then it is easier to conclude that divestment is in order.

To some commentators, social investing may seem stupid or purposeless. If, however, one steps back and looks at 20th century property law, it seems arguable that social investing, or more specifically divestment, is an idea that comes to us not from outer space, but out of the evolving law of real property.

142. See Fact Sheet, supra note 37, at 3.
143. See generally Sax, supra note 123.
144. I am certainly open to the argument that this is one of the primary jobs of the law in any time period. See C. Auerbach, W. Hurst, L. Garrison & S. Mermin, The Legal Process 85-86 (1961).
145. See 3 A. Scott, supra note 50, at § 227.17.
146. See Ravikoff & Curzan, supra note 67, at 519.
147. See Sax, supra note 123, at 492.
148. See generally Langbein, supra note 1.
1. Changing Public Values

It is expectable, appropriate, and indeed inevitable that changing public values will be reflected in property law, including trust investment law.\textsuperscript{149} The continued recognition of equitable property rights created under trusts assumes that such recognition produces socially desirable results.\textsuperscript{150} It may be that a beneficiary's property interest in seeing trust assets invested in a social and economic vacuum, in order to obtain a high return, is not as absolute as it once was. Such has been the case in real property law.

Once one recognizes the changes that have taken place in real property law, it is a small step to say that we can, and perhaps even should, bring the changes over into trust law. As Professor Sax said in an analogous context: “However shocking such results may be to conventional legal sensibilities, they reveal a trend that is equally obvious in a range of other areas.”\textsuperscript{151}

It is now understood in property law that there is a tension between efficiency and equity, between productivity and humaneness.\textsuperscript{152} As the 20th century comes to a close, it is no longer satisfactory to simply assume that the great resource of capital held in trust, especially capital in pension trusts, is subject only to the efficiency standard of being productive but not to the equity standard of humane use.\textsuperscript{153}

2. Why We Recognize Trusts

We recognize the trust system for a variety of reasons. Most relevant here, we recognize the separation of legal ownership from equitable ownership,\textsuperscript{154} and we recognize the passive ownership of shares in giant corporations by trustees because we assume that this system will allocate and reallocate property to socially desirable uses. Can we not say that if the system “fails to allocate property to ‘correct’ uses, we begin to lose faith in the system itself? Just as older systems of property, like feudal tenures, declined as they became nonfunctional,”\textsuperscript{155} so it can be argued that the trust system is declining to the extent it is misallocating property to incorrect uses. If such failures become increasingly common, the property rights and rules that lead to such failures should be subject to revision.

\textsuperscript{149} See Sax, supra note 123, at 486.
\textsuperscript{150} Id. at 487.
\textsuperscript{151} Id. at 488.
\textsuperscript{152} See P. Goldstein, Real Property xxi (1984).
\textsuperscript{153} See B. Longstreth & H. Rosenbloom, supra note 28, at 42 (57.4 percent of institutional investors polled already take social considerations into account in investment decisions).
\textsuperscript{154} Restatement, supra note 53, at § 2 comment f.
\textsuperscript{155} See Sax, supra note 123, at 484.
One can imagine a time when general principles of trust investment law will fail to satisfy society's needs to such an extent that reform will occur. The trustee is traditionally obligated to manage the fund in a sensible fashion, to the best of the trustee's ability, conserving it and making it productive. This obligation may no longer be adequate. Currently, the trustee invests as she sees fit, inside a straightjacket (or at least a girdle) of investment rules, and accepts the consequences of misconduct. Perhaps this method of fiduciary operation, which takes no account of social responsibility, no longer effectively allocates and uses that portion of society's capital assigned to the management of trustees.

3. Redefining Property Rights for Social Purposes

In property law realty is subject to use for the public good. It is narrow-minded and ostrich-like to assume that equitable interests in intangible property are to be forever free of such constraints. As Professor Sax put it in discussing the rights of an owner of real property, "we are in the midst of a major transformation in which property rights are being fundamentally redefined to the disadvantage of property owners." It is not at all clear that the equitable property interests of trust beneficiaries will continue to escape this transformation. Indeed, it may well be that the transformation has begun; if it has not, then divestment may mark the beginning.

The law has no problem requiring that real property be used so as not to injure persons. That is one understanding of the law of nuisance. One can foresee a rule requiring that capital in trust be invested so as not to injure persons.

Peeling off another layer of the real property "onion," it may soon be that trust beneficiaries will be expected to confer benefits on their

---

157. G. BOGERT & G. BOGERT, supra note 76, at §§ 2-5. The inadvertent result of the Statute of Uses was the modern trust, which is itself now, arguably, getting in the way of the functioning of our society.
158. 2 A. SCOTT, supra note 50, at §§ 176 & 181.
161. See generally Sax, supra note 123.
162. See B. LONGSTRETH & H. ROSENBLOOM, supra note 28, at 42.
neighbors, and sometimes on their communities, just as real property owners are now expected to do.165 Perhaps having trustees of giant trusts (essentially responsible to no one, and distant from management) passively holding stocks in giant corporations managed by persons (who have no stake in the business and who are responsible to no one) is more than our system of property allocation can accept.166

When the use of capital in trust becomes noxious, then the law surely has the power to regulate that use.167 We are not required to win the battle of trust investment but lose the war to achieve a just and wholesome society.168 Simply put, society can require the use of its resources, including capital held in trust, for its own benefit.169 Trusts, the corporations they invest in, indeed private property itself, are allowed to exist in society because they serve a wholesome social purpose.170 It really is not that dramatic to say that trust funds must, or may be, invested for a broader social purpose than the financial well-being of the beneficiaries.

We must also remember that we have a history of making trust law conform to notions of what is good for the greater society.171 For proof, one need look no further than the Rule against Perpetuities,172 or the general rule forbidding direct restraints on the alienation of equitable future interests.173 This holds true in the area of trust administration as well. Thus, in Colonial Trust Co. v. Brown,174 the court set aside administrative provisions of a trust that were interfering with the rational development of the downtown area of a Connecticut city.

It is appropriate for society to expect that a portion of capital will be devoted, in part, to nonprofit producing uses.175 If a trust were invested in real estate we would accept automatically that the real estate was subject to a regime of property law that required reduced profits, and the direct or indirect dedication of some of the value of the land to the public.176 Indeed, if the United States corporations in South Africa are required by our society to act in a certain fashion as to South Africa, no one will seriously complain about abuse of power. What is wrong if shareholders who are fiduciaries are allowed under trust law

165. See Sax, supra note 123, at 483.
166. See Malkiel & Quandt, supra note 160, at 40.
167. See Sax, supra note 123, at 491.
168. See Malkiel & Quandt, supra note 160, at 39.
169. See 1 A. Scott, supra note 50, at § 62.13.
170. See 1 A. Scott, supra note 50, at § 62.12.
171. See id. at § 62.10.
172. See id. at § 62.10.
173. See id. at § 62.12.
174. 105 Conn. 261, 135 A. 555 (1926).
175. See Sax, supra note 123, at 495.
to act in a way that may reduce profits, but realizes a social good? For better or worse, if the concern is unfairness to trust beneficiaries there is ample precedent in modern property law for allocating social costs to a limited group of property owners. For proof one need look no further than modern landlord-tenant law or the law of land use.\textsuperscript{177}

It is within the realm of human conjecture that we will someday conclude that there is no equitable private property right in a trust beneficiary to prevent the fiduciary, acting on behalf of society, from making a fair, equitable, or humane use of trust assets.\textsuperscript{178} What seems remarkable today may seem commonplace tomorrow.\textsuperscript{179} If one grants that this could be so, then what better occasion to require, or at least deem acceptable, the use of trust funds to free the blacks of South Africa?\textsuperscript{180}

4. \textit{Property Rights, Especially Pension Rights, As A Function of the Political Process}

Just as land use is a political process, it is well within the realm of possibility that the use of capital resources in trust will be, or is in the process of becoming, a political process.\textsuperscript{181} It may be that the divestment movement we are looking at is not to be characterized as some kind of dreary politicization of a neutral process. Rather, it may be part of the continuing evolution and refinement of our property system. Thus these events are more inevitable than unfortunate. Pension funds, then, are not mere targets of opportunity, but are major parts of our property system that are undergoing necessary reform. Moreover, it is entirely believable that trust law has fallen behind and that a "political" expression of the need to modernize is in order.

The diction of the preceding few paragraphs suggests the future. But, arguably the time is now. We cannot allow for the usual evolutionary period between the time the needs of society change and the time the law changes. The problems of South Africa's nonwhite population are too pressing.

B. \textit{Pension Trusts As Quasi-Public Entities}

In addition to real property, other forms of private property have been harnessed for social purposes.\textsuperscript{182} For an example one need look no further than our attitude towards the large publicly held corpora-


\textsuperscript{178} See B. Longstreth & H. Rosenbloom, \textit{supra} note 28, at 40-70.

\textsuperscript{179} See Sax, \textit{supra} note 123, at 488.

\textsuperscript{180} See id. at 482.

\textsuperscript{181} See Langbein, \textit{supra} note 1, at 9-12.

\textsuperscript{182} See J. Simon, C. Powers & J. Gunnermann, \textit{supra} note 7, at 27.
tion and a passage from a speech by Harold M. Williams, then the chair of the Securities and Exchange Commission:

The fact of the breadth of the corporation’s constituency is almost universally recognized today, but the consequences are seldom perceived. What I believe this expanded constituency necessarily means is that the large corporation has ceased to be private property—even though theoretically still owned by its shareholders—and has become, in essence, a quasi-public institution. As a society, we depend on private enterprise to serve as the instrument through which to accomplish a wide variety of goals—full employment, equal economic opportunity, environmental protection, energy independence, and others. When viewed in light of these social implications, corporations must be seen as, to a degree, more than purely private institutions, and corporate profits as not entirely an end in themselves, but also as one of the resources which corporations require in order to discharge their responsibilities.183

Cannot the same be said of pension trusts? Has not the time come to set aside the rule that trust investment takes place inside a social and economic vacuum? Pension trusts are so much creatures of society that it is appropriate to harness them for the job of producing socially desirable results.184

Indeed, if the pension beneficiaries have a defined benefit—a promise of so many dollars a month185—and if the promise will be made good by the corporate or government employer, or by the pension guarantee fund established by ERISA,186 then the imposition on the trust beneficiary or the incursion on hundreds of years of trust law is much less than it seems.187 The real nature of the fiduciary obligation is much less clear at that point, because the real nature of the pension fund in our society is not clear.188

Pension trusts, especially large ones, are very much quasi-public entities, tightly woven into the fabric of society.189 It is hardly dramatic to suggest that they should be invested to obtain, in part, a benefit for persons other than the direct trust beneficiaries.190 It is entirely appropriate to impose quasi-public functions on them.191

Divestment and new emerging social values may be anti-productive.192 Trust investment law is designed to obtain production from


185. See H. GRAY, supra note 28, at 15.

186. See Langbein, supra note 1, at 5-6.

187. See id. at 23.

188. See id. at 20-25.

189. One must consider if the fiduciary has an obligation to the entity that ultimately sponsors the plan and focus on that obligation as much as the obligation to the beneficiaries. See, e.g., H. GRAY, supra note 28, at 25, 29-35.

190. See id. at 20-25.

191. See S. BALDWIN, J. TOWER, L. LITWAK & J. KARPEN, supra note 3, at 144.


assets held in trust.\textsuperscript{193} Divestment at a cost to productivity may, however, be acceptable because we are in pursuit of social gain: the abolition of apartheid in South Africa. There is value in living in a just society and knowing that one's trust is invested in a divested portfolio. This alternative benefit arguably should be part of the investment decision mix.\textsuperscript{194} Trust law should now allow recognition of social gain obtained at a financial cost,\textsuperscript{195} all as part of a modern, socially responsible investment decision.\textsuperscript{196}

The point is simple: it is not written in stone that capital held in trust will automatically and always have to, by law, be devoted to a higher and more productive profit producing use. It is entirely rational and appropriate to bring acceptable criteria, in addition to gain, into the fiduciary investment decision-making process in an effort to improve society.\textsuperscript{197}

Trustees should be required or allowed to take social impact into account because society can always require a higher use of its resources.\textsuperscript{198} The fact that it has not been done before simply means that the past may be prologue to the future, not that the past is the future.

C. The Ability of a Trustee to Sell South African Securities

1. The Attorney's Problem with Divestment

There are two, or perhaps three, legal constraints on divestment: the prudent person rule;\textsuperscript{199} the duty of loyalty;\textsuperscript{200} and, in the case of

\textsuperscript{193} 2 A. SCOTT, supra note 50, at § 181.
\textsuperscript{194} See Presbyterian Church (U.S.A.), Divestment For South Africa: An Investment in Hope § 27.206 (July 1985) (unpublished report to the 197th General Assembly of the Presbyterian Church (U.S.A.).)
\textsuperscript{195} See S. BALDWIN, J. TOWER, L. LITWAK & J. KARPEN, supra note 3, at 93-95.
\textsuperscript{196} Indeed, the best single argument for setting aside the idea that trust investment takes place inside a social and economic vacuum, with the focus of proper conduct being the beneficiary's welfare, has nothing to do with South Africa. The argument goes like this. Trustees invest conservatively. Indeed, they invest too conservatively. Money invested conservatively does not contribute sufficiently to economic growth. See generally Langbein & Posner, supra note 73. It is lazy money from society's viewpoint. Therefore, the law governing the investment of trust funds should be changed to either require or clearly allow riskier investments and thus economic growth. The power of the vast funds held in trust should be harnessed for the economic good of society. See Dobris, supra note 33, at 1223 n.76. This is arguably clearer and easier to take than the idea that trusts should be harnessed for social good. Curiously, this also may knock out some of the MPT arguments against divestment. MPT practitioners would say divestment is too risky. Yet risk, if compensated, is good for society and perhaps should be forced on trustee investors to make our economy grow.
\textsuperscript{197} See 3 A. SCOTT, supra note 50, at § 227.17 (Supp. 1984).
\textsuperscript{199} 2 A. SCOTT, supra note 50, at § 174.
operating charities, the duty to use funds exclusively for the purpose of the charity. It may well be that the law is not clear. If so, then it is hard for a lawyer to assure a client that it is safe to divest, and easy for a lawyer to say not to divest. Even if, in the law’s current state of development, divestment is forbidden, the law may still change. The lawyer for a trustee is in a bind. The lawyer probably cannot opine that divestment is acceptable. At most, she could say that she thinks the law will come to allow divestment. The trustee must take the risk of being wrong. Or, she must wait for a case to come up, perhaps one where a trustee acted without counsel, or took the risk of divesting, and got sued. Indeed, one wonders where the case approving of divestment will come from.

Let us turn to the specific question of interest: “Can a trustee sell ‘South African’ securities?” More specifically, let us consider the sale of stock, the duty of loyalty, the duties of the prudent person, and the duty to properly expend charitable funds. Since the preceding

200. Generally speaking, the duty of loyalty requires that the fiduciary “administer the trust solely in the interest of the beneficiary.” Restatement, supra note 53, at § 170. This means the fiduciary may not profit from the investment and must not “be guided by the interest of any third person.” Id. at § 170 comment q. If it is assumed that the investment that is prudent is now being tested under the loyalty standard, then it seems the following can be said. The primary focus of the duty of loyalty, when it comes to investments, is on the trustee who breaches the duty for personal gain. 2 A. Scott, supra note 50, at § 170. As such it is not particularly relevant. While it simply has to be that the duty could be breached by the selfless act favoring strangers, the nonwhite people of South Africa, the basic body of law does not seem to be particularly relevant. This is all the more the case if: (1) there is understood to be an investment purpose to the divestment, see 3 id. at § 227.12; or (2) arguments of defacto beneficiary approval are given weight, see Restatement, supra note 53, at § 216; or (3) one accepts the argument that the role of capital in trust in our society is changing. See generally Sax, supra note 123. Troyer and Boisture state that “ERISA imposes a clear and uncompromising duty of loyalty. A fiduciary must ‘discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries . . . .’” T. Troyer & R. Boisture, supra note 3, at 42 (quoting 29 U.S.C. § 1104(a)(1) (1974)).

201. I am using charity as a broad general term.


203. I feel that it would be a mistake to bring on a declaratory judgment because the court will not then be faced with a trustee who is going to get hurt if the court finds liability. This I believe would make it easier to say divestment is a breach of fiduciary duty. See House Hearings, supra note 7, at 54-61 (reprint of a Complaint for Declaratory Judgment by the Regents of the Univ. of Mich. against the State of Mich. concerning a Mich. investment practices law).

204. 2 A. Scott, supra note 50, at § 170.

205. Id. at § 174.

206. See id. at § 379. Note that the duty to properly expend charitable funds could be called a duty to be loyal to indefinite charitable beneficiaries if one wanted to, although this does not seem to be an unavoidable category. See id. at § 364.
arguments about the humane use of capital in trust probably do not describe the current law as viewed by conservative lawyers for conservative trustees, we had best consider if divestment is prudent and loyal, and in appropriate circumstances, if it is within a charity's purposes. I would think that before divesting a pension trustee, more than another trustee, would want to be able to conclude that divestment was solely in the interests of participants and beneficiaries, or required by general notions of investing. If so, then as to pension funds a congressional change in ERISA, or definitive judicial interpretation of the prudent person rule, which would be deemed to affect the ERISA standard, would be necessary before divestment could take place.

2. No Investment Duty to Maximize Profit

There is clearly no affirmative duty to invest in companies doing business in South Africa, at least not in those terms. Even if these are the most profitable corporations in the marketplace there is no investment duty to maximize profit. A fiduciary is merely obliged to invest in accordance with the various rules governing the fiduciary investor, chief among them being the prudent person rule. The law does not require a minimum level of investment performance. There is, however, such a thing as actionable inferior investment performance. It results from breaching the applicable conduct standard. In other words, it is not whether you win or lose, but how you play the game.

Morality alone cannot justify actionable inferior investment performance. But there is no affirmative duty to invest in highly profitable activities that are unattractive or morally repugnant. A trustee is under no duty to open a brothel in Nevada, where prostitution is legal, in order to maximize return to beneficiaries. It may be, however, that other trust investment duties, such as the duty to diversify, will point the trustee towards investments with South African connections. Thus, the duty to diversify, or the prudent person's duty to act with skill, may cause the trustee to invest in major companies with South African connections.

Obviously, there is no currently recognized legal duty to sell mor-

207. G. BOGERT & G. BOGERT, supra note 76, at §§ 57-65.
208. But see Lanoff, supra note 64, at 392.
209. 3 A. SCOTT, supra note 50, at §§ 227 to 227.3.
210. Id. at § 174.
211. Id. at § 204.
212. Id. at §§ 201-12.
213. 1 U. CAL. REP., supra note 30, at 127.
214. See RESTATEMENT, supra note 53, at §§ 228 & 230 comment j.
215. See id. at § 174.
ally offensive investments either. The question quickly becomes whether the fiduciary is allowed to sell. And, if she is, what is the legal analysis of the direct costs of the sale—e.g., commissions?

D. Problem: The Costs of Divestment

It seems clear there is no prohibition against costless social investing.216 If a trustee wants to follow a “South Africa free” investment policy, and can do so without incurring losses or extra transaction costs, then there is nothing much the law has to say.217 There is, however, no doubt that there can be real investment costs to divestment.218 They include: the transaction costs of sale; the lost value, if any, caused by mass liquidation of assets; the transaction costs of reinvesting; the likely increased costs of monitoring a portfolio of increased, smaller holdings; reduced liquidity caused by holding stocks of less interest to investors; and the added risks of various kinds occasioned by giving up the shares of many major American companies and replacing them with the shares of smaller and less prominent corporations.219

So what can be said in response to these arguments, and when can costs be incurred in pursuit of social good?

1. Minimizing and Accepting Divestment Costs

One might argue with some comfort that South Africa free investing at low cost should be allowed. There arguably is enough benefit in such a divestment policy to justify the cost, which is low by hypothesis.220 Moreover, there is enough play in the system to justify accepting modest losses in order to obtain a social gain.221 We willingly accept losses everyday inevitably incurred in pursuit of monetary gain. Why not accept some loss in pursuit of social gain? This does not, however, say very much because there may be high costs in avoiding broad market portfolios that approximate the market as a whole or portfolios that contain the giant corporations likely to have South African contacts.222

It can also be said that equity often comes at a price of efficiency. There are many efficient acts we forgo as members of society, and as

216. See Ravikoff & Curzan, supra note 67, at 519. See also Langbein, supra note 1, at 20.
217. T. Troyer & R. Boisture, supra note 3, at i.
218. Universities and charities may also incur losses in the form of foregone gifts. See Ad Hoc Comm. on South African Investments, supra note 192, at 38-45.
222. See Langbein, supra note 1, at 14-15.
As to the transaction costs of the sale and purchase, it has been suggested that orderly sales over an extended period of time will occasion no additional transaction costs because extensive sales would have taken place anyway in an actively managed portfolio. It has also been suggested that divestment sales, as sales made for noninvestment reasons, generate a lower spread between bid and ask prices. Thus it is said that divestment sales can take place more cheaply than ordinary institutional sales.

2. Divestment in Pursuit of Trust Purposes

Next, one might argue that divestment fulfills some purpose of the trust. Costs incurred in pursuit of trust purposes are acceptable. This one might assert that a church endowment can be divested because one of the church’s purposes is to provide moral and spiritual guidance, and to divest is to provide such.

Similarly, universities have a duty to lead, to experiment, and to teach, and they must be given a reasonable margin in the discharge of their mission. One might seek to apply this analysis to university endowments and unrestricted funds, and conclude that divestment fulfills the fund’s purpose. When one is considering the endowment fund of a major American university with an international constituency, it is not at all unreasonable to argue that the duty to educate extends well beyond the current students on campus.

One might also stretch to include black South Africans, or all South Africans, as intended beneficiaries of a charitable or educational trust, and find that divestment provides them with an intended ben-

223. The prudent conservatism of many pension trustees may be inefficient. One survey reported that 90 percent of the funds underperformed the S & P 500. Langbein & Posner, supra note 73, at 887.
225. Bid and ask prices, in this context, are simply the price asked by the seller and bid by the buyer. In the ordinary institutional sale, the bidder underbids by an amount designed to insure against the theoretical possibility that the seller is selling for a good investment reason that the buyer does not know about. This costs the seller money. Divestment sales are made for nonmarket reasons and so the spread between bid and ask can be smaller. This cost of the sale is thus lower than it might seem. See S. BALDWIN, J. TOWER, L. LITWAK & J. KARPEN, supra note 3, at 114.
226. See id. at 115-16.
228. Id. at 1.
231. Id. at 4-5. See also T. Troyer & R. Boisture, supra note 3, at 18.
232. See 4 A. SCOTT, supra note 50, at § 364.
effit of the trust.\textsuperscript{233} Thus, a foundation devoted to the realization of human potential might divest in order to help nonwhite South Africans achieve their potential in a society free of apartheid.\textsuperscript{234}

Another argument is that the act of divestment provides other tangible benefits to the trust beneficiaries that can substitute for investment benefits.\textsuperscript{235} That is, there are nonfinancial returns or "other benefits" to obtain for trust beneficiaries.\textsuperscript{236} A homely example of this idea might be the trust for the widow and children that contains the family home. It seems absurd to require the trustee to sell the house to buy stocks to generate income to be used to buy a house. The failure to make the house productive of income is not a breach of trust—it is merely obtaining another benefit for the trust beneficiaries.\textsuperscript{237}

Similarly, it might be argued that under appropriate circumstances divestment of South African securities might procure other benefits, the classic example being peace and quiet on a campus bedeviled by demonstrations.\textsuperscript{238}

Another thing to be said is that there is a fair amount of flex in the system. All investment expenditures and activity do not translate into profit. We are always ready to accept costs in operating trusts.\textsuperscript{239} Are not the costs of justice as entitled to recognition as other costs, especially when they are not large? It can be argued that the direct transaction costs of divestment sales and purchases are, relative to the size of the portfolios typically under discussion, fairly small.\textsuperscript{240} Might it not be said that "Equity does not stoop to pick up pins?" Indeed, we may already be accepting costs that generate "incidental" or "collateral" social benefits.\textsuperscript{241} Expansion of this doctrine would be sensible and expectable.

3. \textit{Implied Consent of Beneficiary}

One might argue that the current spate of pro-divestment activity

\begin{thebibliography}{99}
\bibitem{233} See 1 U. Cal. Rep., \textit{supra} note 30, at 19.
\bibitem{234} T. Troyer & R. Boisture, \textit{supra} note 3, at 16-17.
\bibitem{235} See Lanoff, \textit{supra} note 64, at 392.
\bibitem{236} See Ravikoff & Curzan, \textit{supra} note 67, at 523.
\bibitem{237} 2 A. Scott, \textit{supra} note 50, at § 181.
\bibitem{238} T. Troyer & R. Boisture, \textit{supra} note 3, at 18. Of course, the hypothetical in the text assumes a direct economic benefit to the widow, while the university seeking peace on campus is seeking the benefit of being able to efficiently perform its nonprofit purpose and only the indirect economic benefit of having to spend less on crowd control and the like.
\bibitem{239} See S. Baldwin, J. Tower, L. Litwak & J. Karpfen, \textit{supra} note 3, at 118-19; 3 A. Scott, \textit{supra} note 50, at § 204.
\bibitem{241} T. Troyer & R. Boisture, \textit{supra} note 3, at 48-53.
\end{thebibliography}
is to be read as the functional equivalent of beneficiary permission to divest. The beneficiaries of a trust can, by agreement with the trustee, change the investment policy of the trust after it is drafted, even if it is irrevocable.\textsuperscript{242} Arguably, the political manifestations of a sentiment in favor of divestment can be understood by the courts as the equivalent of the agreement of all of the beneficiaries to a change in investment policy to accomplish divestment.\textsuperscript{243}

While this argument should not be considered as determinative, given the imprecision of measurement,\textsuperscript{244} and the inevitability of disagreement among beneficiaries, it might be worthy of some weight in a court's decision. This argument has the greatest appeal in special situations where it might be said with something approaching a straight face that the vast bulk of the beneficiaries do want divestment. This is imaginable with funds held by a religious entity, or with university funds, if the overwhelming majority of members of the university community support divestment.\textsuperscript{245}

To restate what has been said, one can argue that the nature of the trust or its beneficiaries, or the conduct of the beneficiaries, can be read as constituting an implied setting aside of the prudent person rule as it applies to divestment. Obviously, the same argument can be made to the extent that divestment is disloyal.\textsuperscript{246}

While the above arguments may not be enough to induce action by conservative trustees, one can easily imagine them as factors in a court decision not to punish a trustee for divesting. Furthermore, these arguments in favor of divestment need not open the door to social investing generally. As we all know, we can cross that bridge when we come to it. There are certainly arguments that the South African situation is unique and thus in need of special attention.\textsuperscript{247}

V. THE FINANCIAL ASPECTS OF DIVESTMENT

A. Introduction

Financially, the basic concerns of trustees are whether divestment

\begin{footnotesize}
\begin{enumerate}
\item[242.] \textit{See Restatement, supra} note 53, at §§ 216 & 256.
\item[243.] Perhaps it can be said that equitable claims of beneficiaries against pension trusts are much more proprietary than we have recognized in our law to date and so we should consider heeding the beneficiaries who want divestment. \textit{See H. Gray, supra} note 28, at 25-27. Thus some professors on my campus are wont to ask "It's my money, why can't I tell the Regents what to do with it?" Of course, both pro-divestment and anti-divestment employees want to tell the Regents what to do.
\item[244.] In a giant trust how many beneficiaries would be allowed to stop divestment?
\item[245.] If settlor consent is required, or persuasive, when a court is asked to change a trust's investment policy after the fact, then the same argument might perhaps be made as to the argued political manifestation of the settlor's intent.
\item[246.] It is interesting to contemplate what role polling might play in determining beneficiary attitude towards divestment.
\item[247.] Ad Hoc Comm. on South African Investments, \textit{supra} note 192, at 3-4.
\end{enumerate}
\end{footnotesize}
SOUTH AFRICAN DIVESTMENT will increase investment risks, reduce diversification, or increase investment costs. Such concerns, if they materialize, could lead to a breach of fiduciary duty.

Many of the investment-based arguments against divestment, especially in the case of large portfolios, are based on Modern Portfolio Theory. Oversimplifying, Modern Portfolio Theory, or MPT, is an umbrella term used to describe a number of loosely related, academically derived theories that analyze the investment and performance of stock portfolios.

MPT suggests several things, including the importance of: broad diversification; investment in a broad market portfolio; close analysis of the amount and types of risk in a portfolio; inclusion of risky stocks in a balanced portfolio; management of risk in a portfolio through diversification; management of the portfolio as a single entity, not a collection of individual securities; and the efficiency of the market in valuing securities of closely watched corporations. MPT has greatly informed modern investing and is worthy of the closest consideration. At the same time, it must be noted that MPT is not perfect. It is constantly being refined, and while it is usually accurate at the center, it loses some of its power and definition at its outer rings.

It is easy to read the work of MPT theorists and conclude there is no room for divestment, especially in large portfolios. Several studies, however, suggest that MPT does not require that divestment be abandoned. Moreover, it would be a serious error to make a decision of the magnitude of whether to divest or not solely by reference to a less than perfect body of doctrine, one still not in its final state of development and still seemingly not accepted as controlling in trust.

---

249. See S. BALDWIN, J. TOWER, L. LITWAK & J. KARPEN, supra note 3, at 93-94.
250. For example, the costs of buying and selling and research costs. See id. at 114-15.
251. See generally R. HAGIN, supra note 248 (a book-length treatment of the subject).
252. See also Langbein, supra note 1, at 14-15.
254. See id. at 183-86.
255. See id. at 179-80.
256. See id. at 161-65.
257. See id. at 132-33 & 186.
258. See Langbein & Posner, supra note 73, at 889-90.
259. See R. HAGIN, supra note 248, at 89-91.
261. See House Hearings, supra note 17, at 181-83 (statement of Stephen K. Moody, Vice-President, Investments, and Lawrence Litwak, Investment Officer, U.S. Trust Co. of Boston); S. BALDWIN, J. TOWER, L. LITWAK & J. KARPEN, supra note 3, at 93-95; F. Cheru, supra note 4, at 10 (a brief study of the question).
B. Financial Arguments in Favor of Divestment

There are investment or financial arguments in favor of divestment. First, it can be argued that South Africa free portfolios perform well. Second, it can be argued that the risks of investing in South Africa may be unreasonably high. Third, it can be argued that only a poorly managed corporation would do business in South Africa in the first place. Finally, it is arguable that divestment would not cause adverse financial consequences to either small or large trusts.

The first possibility is that South Africa free portfolios perform well. Well can be defined in various ways, including well enough, as well as the market, and better than South Africa tainted portfolios. Most of the studies backing up these arguments, however, leave room to conclude that large portfolios, let us say over $50 million, may fall down in performance over time if they are South Africa free. This negative conclusion seems to conform with MPT.

Next, divestment proponents argue that the political risk in South Africa is such that it is unwise to invest in corporations doing business in South Africa, or with banks that have loans outstanding in South Africa. This argument may be easier to accept when talking about banks since their exposure seems greater than that of most corporations that do a relatively small amount of business in South Africa. However, accepting the political risk argument requires one to reject the MPT doctrine that the market price of closely followed securities already takes into account the political risk. It also requires assuming that those who would divest have greater knowledge about South Africa's future than stock investors generally. This, of course, may be correct, but it would offend the MPT theorists who would say that the

261. See Langbein & Posner, supra note 73, at 890-91.
263. See TRINITY INV. MGMT. CORP., supra note 259, at 2; Langbein, supra note 1, at 21-22.
267. See R. HAGIN, supra note 248, at 90-91; Langbein, supra note 1, at 15-16.
market is “perfect” or nearly perfect in valuing securities.268

In addition, it can be asserted that corporate management that chooses to stay in South Africa is either so foolish or so wicked that it is going to get the company in trouble somewhere; therefore the stock should be sold before disaster strikes.269 The argument is that the company’s position on doing business in South Africa is a good touchstone for answering the general question of whether the company is well managed. Again, some MPT theorists would argue that this is already reflected in the price of the stock because of the market’s capacity to accurately value securities.270

There seems to be something approaching general agreement that portfolios under $50 million dollars can be divested without meaningful effect.271 It is the larger portfolios that create problems. Why? Well, to use a homely explanation, it is a lot harder to drive a supertanker than it is to drive a speed boat.

One of the more attractive and sensible investment policies a large investment fund can follow is to invest in a passive, low transaction cost portfolio that seeks to emulate the movements of the stock market as a whole.272 This is usually done by investing in a portfolio that is made up of the Standard and Poor’s 500.273 Such a portfolio is likely to outperform about 80% of the professionally managed portfolios in the country.274

It has been suggested “that it is possible to construct passive portfolios that exclude South Africa related securities and that track the S&P 500 reasonably well . . .” but at a higher nonmarket risk.275 Nonmarket risk is, simplifying, risk that is “uncompensated”; i.e., not likely to lead to reward.276 So, the passive investor might survive reasonably well.277 The report further suggests that investments made on the basis of mechanical rules may be accomplished sensibly in a

268. It may be that the market is less efficient in measuring foreign political risk than it is in measuring other risks. As to risk generally, see R. HAGIN, supra note 248, at 95-103 & 179-89.
270. See R. HAGIN, supra note 248, at 91.
273. See R. HAGIN, supra note 248, at 140.
274. See Langbein & Posner, supra note 73, at 887.
275. See D. HAUCK, supra note 271, at 3.
276. See R. HAGIN, supra note 248, at 183-84.
277. See D. HAUCK, supra note 271, at 3. And, it makes sense to be a passive investor with a large portfolio. The report, moreover, holds out the hope that mathematical modeling of portfolios may allow for sensible investing, even given the possibility of higher nonmarket risk.
South Africa free investment world. It also suggests that the most vulnerable investor is the active manager who trades a great deal on the basis of company specific research. The point is, without overlong involvement with the world of investment, that there may be rational and appropriate investment approaches to South Africa free investing of large portfolios.

It may be that the investment of large trust portfolios could do with a good shakeup. There is a real sameness to how trustees invest, and it could be that divestment is a needed breath of fresh air in portfolio management. The great truth is that most trustees do a lousy job of investing trust funds. We tolerate that poor performance all the time. We accept it because the trustees are trying to do a good job, and because we realize two things that are never discussed in the cases: there aren’t enough good trustees to go around, and, relatively speaking, 50 percent of the trustee investors are going to be in the bottom 50 percent of the class. Since we accept lack-luster investment performance in the name of profit, why not accept lack-luster investment performance in the name of justice? And while we are at it, why not admit that a lot of our attempts to invest for the sake of social gain are not going to work, just as a lot of our attempts to invest for profit do not work?

Whether investment in South Africa free securities is possible at the same level of quality and risk is something as to which the experts are in disagreement. The better side of the argument may well belong to the anti-divestment side. Still, there is hope of successful investing in a South Africa free portfolio, and that hope is sufficient to sustain further thought and, arguably, action as well.

278. See id. at 3.
279. See id.
280. See Langbein & Posner, supra note 73, at 887 (90 percent of pension fund managers failed to perform as well as the S & P 500 for the five year period ended Dec. 31, 1974).
281. The law says this is irrelevant, but I tend not to believe it.
282. TRINITY INV. MGMT. CORP., supra note 259, at 3.
283. See R. HAGIN, supra note 248, at 225. Of course, the bottom 50 percent could still have adequate performance.
284. See B. BALDWIN & T. BROWN, supra note 26, at 35; S. BALDWIN, J. TOWER, L. LITWAK & J. KARPEN, supra note 3, at 93-95; F. Cheru, supra note 4, at i. But see Trinity Inv. Mgmt. Corp., supra note 259, at 2; Langbein, supra note 1, at 21-22.
285. I have presented the arguments that suggest that divestment will yield only a modest loss, if any. I must say, however, (perhaps because it is my pension we are talking about) that I am very concerned for the stability and growth of a giant fund invested in a South Africa free portfolio that is managed by reference to company-specific research. It would be appropriate for a consortium of universities to sponsor research on this question.
VI. CONCLUSION

Divestment is a question of great moral, legal, and economic import. It is complicated by politics, the anchor of trust law, and the burdens of running large pension trusts and institutions. The current discussion of divestment is uncertain because the effect of divestment on South Africa and on portfolios is uncertain. All concerned seek to act morally and, hopefully, within the bounds of law.

Perhaps the time has come to declare that the minimum duty of the trustee, at least the institutional trustee dealing with a large institutional fund, should be understood as including a duty to take the social impact of investments into account, at least to the extent of divestment of South African securities. If that is too strong, perhaps such trustees should be allowed to take South African matters into account if they wish to do so.

Much that is said about divestment is speculative. Surely, we do not wish to have our law stand as an obstacle to justice. We expect that our law will respond to changing social attitudes, especially when those changes are bottomed on ideas of morality and fairness. This is so even in the face of complexity and possible financial diminution. Hopefully, in the near future, we can derive and put into place a body of law and financial theory designed to reach the goal of political, social, racial, and economic justice for all South Africa. Any lawyer can say "no." It takes a good lawyer to say "yes." 286

---

286. I would like to briefly describe, without analysis, some ideas that trustees might wish to consider in appropriate circumstances. Some of them may raise significant legal issues and involve significant expense. I can imagine several possibilities, in the abstract, including: establishing an experimental South Africa free equity portfolio to get some “hands on” experience; commissioning, perhaps with other institutions, the definitive study of large, South Africa free portfolios; establishing a South Africa free fund that beneficiaries could elect for defined contribution plans; and establishing the same for salary reduction plans. I can even imagine trustees, in essence, going out of the pension business and letting each employee manage his or her own account.