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A legal update from Dechert's Financial Services Group

Sudan Accountability and Divestment Act of 2007 Signed into Law

On December 31, 2007, President Bush signed into law the Sudan Accountability and Divestment Act of 2007 ("Act")[1] to allow fund managers and other investment advisers, as well as states and local governments, to adopt measures to facilitate divestment from companies involved in four key business sectors in Sudan: oil, power production, mineral extraction, and military equipment. The Act also affirms the rights of fiduciaries of employee benefit plans to engage in such divestitures, and it directs the U.S. federal government to require that all U.S. government contractors certify that they are not involved in business in the key business sectors of Sudan. A provision of the Act invites foreign countries to adopt similar measures.

The purpose of the Act is to codify the rights of investors and their fiduciaries to hold and relinquish assets in accordance with their responsibilities to guard against economic and reputational risks associated with investments in companies that conduct business operations in Sudan while the political and humanitarian crisis continues in the Darfur region of Sudan, as long as in doing so, fund managers continue to adhere to their fiduciary duties, and state and local governments adhere to the limited authorization provided by the Act.

Investment Company Act Amendment

Section 4 of the Act adds a new subsection (c) to Section 13 of the Investment Company Act of 1940 ("Investment Company Act") to protect registered investment companies and their employees, officers, directors, and investment advisers from any civil, criminal, or administrative action "based solely upon the investment company divesting from, or avoiding investing in, securities issued by persons that the investment company determines, using credible information that is available to the public, conduct or have direct investments in business operations in Sudan described in Section 3(d) of the [Act]."[2] In its report accompanying the Act, the Senate Committee on Banking, Housing, and Urban Affairs explained that this provision was in response to a "major concern" on the part of fund managers regarding "the possibility of a breach of fiduciary responsibility" in connection with decisions to divest Sudan-related investments.[3] The Act makes clear, however, that fund managers will still be required to observe their other fiduciary responsibilities.

1 Pub. L. No. 110-174. Available at http://www.govtrack.us/congress/bill.xpd?bill=s110-2271.

2 Section 3(d) includes the list of the key business sectors in Sudan targeted by the Act indicated above. However, Section 3(d)(2) of the Act specifically excludes business operations that:

> (A) are conducted under contract directly and exclusively with the regional government of southern Sudan; (B) are conducted under a license from the Office of Foreign Assets Control, or are expressly exempted under Federal law from the requirement to be conducted under such a license; (C) consist of providing goods or services to marginalized populations of Sudan; (D) consist of providing goods or services to an internationally recognized peacekeeping force or humanitarian organization; (E) consist of providing goods or services that are used only to promote health or education; or (F) have been voluntarily suspended.

3 S. Rep. No. 110-213, at 7 (2007). The Committee further noted that fund managers may have legitimate "financial or reputational concerns as reasons to divest from companies that accept the business risk of operating in countries subject to international economic sanctions."

The Act also requires the U.S. Securities and Exchange Commission ("SEC") to adopt, no later than 120 days after the enactment of the Act (April 29, 2008), rules requiring disclosure by any investment company that divests itself of securities in reliance on the Act in the investment company's first periodic report filed with the SEC following the divestiture. Importantly, the Act states that the protection of the Act will *not* apply to divesting investment companies if they do not make the required disclosures.

It is unclear how many fund managers will choose to divest Sudan-related assets as a result of the adoption of the Investment Company Act amendment. Some fund managers and fund investors may take the position that continued ownership is the best way to influence issuers to change their practices (through proxy votes and other measures). Others may determine that the potential for high returns from issuers doing business in Sudan outweighs the risks resulting from the investments. Without doubt, shareholder activists interested in the Sudanese crisis will scrutinize fund investments closely.

Affirmation of ERISA Fiduciaries' Rights to Divest

Section 5 of Act affirms the rights of fiduciaries of employee benefit plans to divest plan assets from, or avoid investing plan assets in, companies conducting business operations in the key business sectors of Sudan without breaching their fiduciary duties under Section 404 of the Employee Retirement Income Security Act of 1974 ("ERISA") if such divestment or avoidance of investment is in accordance with the Department of Labor ("DOL") regulation at 29 C.F.R. 2509.94–1.

Under ERISA, a fiduciary must act solely in the interest of the plan's participants and beneficiaries and for the exclusive purpose of providing benefits to their participants and beneficiaries. The DOL regulation interprets these requirements as prohibiting a fiduciary from subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives. With regard to the duty of prudence imposed on fiduciaries by ERISA, a fiduciary, when making investment decisions, must give appropriate consideration to the role that an investment or investment course of action plays (in terms of such factors as diversification, liquidity, and risk/return characteristics) with respect to that portion of the plan's investment portfolio within the scope of the fiduciary's responsibility. When deciding among various investments or investment courses of action, a fiduciary must also give consideration to the expected return on alternative investments with similar risks that may be available to the plan. Therefore, the Act explicitly permits plan fiduciaries to divest plan assets from, or avoid investing plan assets in, companies conducting business operations in the key business sectors of Sudan, so long as, in doing so, the fiduciary does not subordinate the interests of participants and beneficiaries in their retirement income to this objective, and is otherwise prudent in making such decisions (including by giving consideration to the expected return on alternative investments with similar risks).

Other Relevant Provision

Most prominent among the other provisions of the Act is Section 3, which grants state and local governments the right to adopt and enforce measures to divest governmental funds from Sudan-related investments under certain conditions. This provision is intended to validate state and local government measures that require divestment by government plans (including government pension plans) and thus may impact the investment management programs of the plans.[4]

The Act requires the state or local governments to provide notice to the U.S. Attorney General of the enactment of any such measures, and provide notice and the opportunity to comment to any person from

4 Several states have enacted Sudan-related measures in recent years. Notable among these measures is an Illinois statute that, in part, required mutual fund managers, to be eligible to accept investments of state pension fund assets, to certify that the fund they advise was not invested in companies doing business in Sudan. The enforcement of the Illinois statute was enjoined by a federal district court, which found the law unconstitutional because it interfered with the national government's conduct of foreign affairs and it was in large part preempted by federal law. The Act is intended to balance the authority of the federal government to conduct foreign policy with the ability of the state and local governments to invest and divest their funds as they see fit (see S. Rep. No. 110-213, at 3). When he signed the Act, President Bush issued the following statement: "[as] the Constitution vests the exclusive authority to conduct foreign relations with the Federal Government, the executive branch shall construe and enforce this legislation in a manner that does not conflict with that authority" (statement available at http://www.whitehouse.gov/news/releases/2007/12/20071231.html).

which a state or local government proposes to divest investments in reliance on such measures. Section 3(e)(3) of the Act provides that a state or local government measure cannot apply to a person who can demonstrate to the governmental authority issuing the notice that the person "does not conduct or have direct investments" in business operations in the key business sectors in Sudan.

Sunset Provision

Section 12 of the Act provides that key provisions of the Act (including the provisions discussed above) will terminate 30 days after the date the President certifies to Congress that the Government of Sudan has honored its commitments to:

- abide by UN Security Council Resolution 1769;
- cease attacks on civilians;
- demobilize and demilitarize the Janjaweed and associated militias;
- permit free and unfettered access for delivery of humanitarian assistance; and
- allow for the safe and voluntary return of refugees and internally displaced persons.

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