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Sudan Sanctions and State Divestment Initiatives

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Governmental responses to events in Darfur continue to create new uncertainties for investment and financial companies seeking to comply with federal and state Sudan sanctions measures. New measures announced last week by President Bush make relatively modest changes in the current regime of federal sanctions related to Sudan transactions. Their true importance, ironically, may be to undercut the series of state-level Sudan sanctions and investment restrictions that have begun to proliferate.

THE BUSH SUDAN SANCTIONS ANNOUNCEMENT

On May 29, the White House announced imposition of increased sanctions on the Government of Sudan in response to the failure of Sudan President Bashir to deter violence in Darfur. After a period of delay intended to give the Sudanese government a further chance to make good on its Darfur commitments, the White House concluded that President Bashir has not taken steps to prevent the use of government-sponsored militias to attack civilians, has not disarmed the militias since the Darfur Peace Agreement was signed, and has refused to allow a U.N. peacekeeping force into the Darfur region.

The Bush Administration's new sanctions tighten the restrictions on Sudan dealings that began in 1997. Having seen no improvement in the Bashir government's Darfur response, the Administration escalated the rhetorical attack on Sudan, with the President squarely labeling the events in Darfur as "genocide" in 2005. The escalated rhetoric was accompanied by modest changes in the current federal sanctions program on Sudan, consisting of the following:

- More aggressive enforcement by OFAC of the sanctions regime.
- Addition of 30 companies owned or controlled by the government of Sudan to the list of entities and persons with whom no U.S. person can conduct business (known as the "Specially Designated Nationals and Blocked Persons" List, or "**SDN List**").
- Consultations by Secretary of State Rice with allies to develop a new U.N. resolution to embargo arms sales to the government of Sudan and to prohibit Sudan's government from conducting offensive military flights over Darfur. The resolution would strengthen the international community's ability to monitor and report violations.

Initial response to the new White House sanctions has been lukewarm at best. From the perspective of finance and investment management companies, not much has changed – the new SDN List entities will be added to their automated compliance systems, but few Western companies have been conducting business with the newly added Sudanese parties. Perhaps more significant is the commitment by the White House to engage with allies and multilateral bodies to bring additional pressure on the Bashir regime. But for businesses fine-tuning their systems for complying with OFAC's Sudan rules, little will be different.

EFFECT ON STATE SUDAN RESTRICTIONS PROGRAMS

There is one area in which the White House's new announcement may have broader effects, however, and ironically that effect may be to weaken the Sudan sanctions movement. A number of states have adopted, or are considering, state legislation to restrict dealings within their purview – most prominently, investment by state pension funds – from direct and indirect entanglement with Sudan.

These state measures are always subject to challenge as intruding on foreign policy zones that are reserved to the federal government. State sanctions programs have met with mixed responses from the courts when challenged under federal supremacy and preemption principles. One key factor in the preemption analysis is evidence of careful calibration of sanctions by the President. On that score, the Administration's latest Sudan foray may end up undercutting parallel state efforts to squeeze companies that deal with Sudan.

State and Local Sudan Sanctions

A number of state and municipal governments, colleges and universities, and international and religious organizations have adopted policies requiring funds they control to divest themselves of investments in any company with active business operations in Sudan. Others have required their funds to reevaluate their "indirect investments" in Sudan. Of particular interest are divestment measures proposed or enacted by several American states and municipalities over the course of the last two years, which require divestment by state pension funds of stock in companies that do business with or in Sudan.

These measures share provenance with sanctions adopted in the 1980s to hasten the demise of the apartheid regime in South Africa, and with other state laws from the 1990s targeting companies doing business in an array of countries whose conduct state legislatures or regulators deemed morally objectionable, including Burma (Myanmar), Nigeria, Tibet, Cuba, Indonesia, and Northern Ireland. As of the end of May 2007, thirteen state governments have enacted specific divestment legislation targeting Sudan, and four others have enacted related measures.[1] Additional divestment legislation campaigns are under way in sixteen other states. In four of these, divestment legislation has passed both houses of the legislature and awaits signature by the governor.[2]

Municipal and local bodies have joined the fray as well. Seven major municipalities have enacted Sudan divestment measures.[3] Campaigns have been initiated in five others. Forty-three American colleges and universities have adopted Sudan investment restrictions, often including divestment requirements, and similar campaigns are ongoing at 41 additional institutions. And several national, international and religious organizations – ranging from religious groups like the American Jewish World Service to municipal civic organizations like the Boston Group – have adopted or are considering Sudan divestment policies.

Federal Preemption

These state and municipal measures inevitably run into the teeth of federal preemption doctrine, under which measures that conflict with federal sanctions regimes or that intrude in a field fully occupied by federal regulation are invalidated.

The Supreme Court's latest word on this topic came in 2000, in a decision striking down Massachusetts law barring state entities from buying goods or services from companies doing business with Burma.[4] In *Crosby v. National Foreign Trade Council* ("*Crosby*"), the Court found that "state or local ordinances [that] blunt the consequences of" the federal sanctions imposed by the President are preempted because, when structured in an "unyielding" way, they "undermine[] the President's authority by leaving him with less economic and diplomatic leverage than the federal Act permits."

The Court further found the state Burma sanctions

> interfere[d] with Congress's intention to limit economic pressure against the Burmese Government to a specific range . . . . It prohibits some contracts permitted by the federal Act, affects more investment than the federal Act, and reaches foreign and domestic companies while the federal Act confines its reach to United States persons. It thus conflicts with the federal law by penalizing individuals and conduct that Congress has explicitly exempted or excluded from sanctions. That the two Acts have a common end hardly neutralizes the conflicting means, and the fact that some companies may be able to comply with both sets of sanctions does not mean the state Act is not at odds with achievement of the congressional decision about the right calibration of force.

State Sudan Divestment Statutes

States adopting Sudan sanctions have attempted to design around *Crosby* by avoiding a direct state-enforced boycott of vendors that do business with Sudan. A leading example was the Illinois Sudan Act. Under that law:

- state officials were prohibited from investing state funds in banks that did not require a formal certification from borrowers that they do no business in Sudan or with Sudanese companies; and
- state and municipal pension funds were prohibited from investing in any company that does business in Sudan.

In a February 2007 decision, the federal court in Chicago struck down the Illinois law.[5] It found the ban on depositing state monies in institutions that had not certified Sudan non-involvement to be preempted by the federal Sudan regulations, stressing the lack of waiver authority and flexibility in the Illinois law. On the pension investment ban, however, the court found no evidence that barring investment in companies that do business with Sudan would interfere with the balance of objectives in the federal Sudan restrictions, and accordingly denied the preemption challenge on those grounds. It found, nonetheless, that the Illinois pension law conflicted with the dormant commerce clause of the Constitution, at least as to municipal pension funds, and invalidated it on that ground.

Crosby leaves open the possibility that a carefully crafted state Sudan statute can withstand constitutional challenge, provided its scope is properly limited, it includes flexibility to waive or modify the state sanctions to adjust to changing federal restrictions, it exempts geographic areas that are carved out of the federal sanctions, and it applies only to state pensions. No state has yet crafted such a nuanced sanctions regime, for Sudan or for other countries that have appeared on the bad-actor list (e.g., Libya, Saddam-era Iraq, Syria).

It is at this point that the new Bush Administration changes become pertinent to the state Sudan sanctions movement. The White House's tweaking of the Sudan program reinforces the core message of *Crosby*: sanctions against foreign countries are one tool in the bag of incentives and threats the President and Congress can use to encourage desired overseas behavior, and it is up to the President and Congress to make that calibration and to modify it as events warrant. States that seek to do more than a mere me-too version of federal sanctions will run into concerns that an investment board in Peoria or a treasury officer in Sacramento cannot know what measures other states are considering, or what fine-tuning the State Department and federal agencies are employing, or what mix of carrots and sticks is most likely to produce change by the Sudan authorities.

California: A Key Test?

Should it be tested, California's Sudan Law may prove key in understanding the boundaries of state and federal sanction powers. That statute, adopted in late 2006, shows the efforts to design around Crosby in several forms: the geographic reach of the sanctions is more closely tailored to the federal sanctions' scope; it leaves the state pension administrator with some level of discretion as to which instructions to pass along to fund managers; its reporting requirements contain more flexibility than some comparable programs; and it gives the board power to make exceptions (though it erects a presumption against them).

In other respects, the new California law is subject to the same objections as the stricken Illinois provisions, particularly extension of those state restrictions to overseas subsidiaries and affiliates of U.S. companies – entities that are not covered by the federal Sudan sanctions. Federal sanctions restrictions generally do not apply to overseas subsidiaries,[6] and state legislatures that overreach to extend sanctions to foreign affiliates are likely to find their handiwork invalidated when it reaches the courts.

More importantly, despite the changes aimed at introducing malleability to the California restrictions, the California Sudan statute will remain vulnerable to the objection that it intrudes into a zone that is reserved for uniform, consistent and clear national action under the President's authority. President Bush now has issued directives narrowing the geographic focus of the federal Sudan sanctions (so as to permit aid to southern Sudan) and commencing a new multilateral initiative to restrain Sudanese behavior. Those directives reinforce the point, as emphasized in *Crosby*, that the authority to deal with foreign governments belongs preemptively to federal actors, with only limited range for state legislatures and regulators.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings Washington, D.C. lawyers:

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[1] California, Colorado, Connecticut, Illinois, Indiana, Iowa, Kansas, Maine, Maryland, Minnesota, New Jersey, Oregon and Vermont have adopted Sudan-specific divestment measures. Arizona, Kentucky, Louisiana and Washington have adopted other measures relating to investments in some way connected to Sudan.

[2] These states are Florida, Hawaii, Rhode Island and Texas. Florida's statute also mandates divestment from Iran.

[3] These municipalities are Denver, CO; New Haven, CT; Newton, MA; Philadelphia, PA; Pittsburgh, PA; Providence, RI; and San Francisco, CA.

[4] *Crosby v. National Foreign Trade Council*, 530 U.S. 363 (2000).

[5] *National Foreign Trade Council v. Giannoulias*, 2007 U.S. Dist. LEXIS 13341 (N.D. Ill. February 23, 2007).

[6] Cuba is the most prominent exception: foreign affiliates of U.S. persons are covered by the Cuban embargo rules, whereas sanctions on other countries normally apply only to U.S.-incorporated entities and U.S. nationals.