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Revisiting Divestment

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This Note explores whether state and local legislation passed during the anti-apartheid divestment campaign can serve as a model for trustees of public pension funds to divest their holdings in fossil fuels consistent with their fiduciary duties of loyalty and prudence. The primary case to emerge from the anti-apartheid divestment campaign, Board of Trustees of the Employees Retirement System of the City of Baltimore v. Mayor and City Council of Baltimore City *gives some (albeit insufficient) guidance as to whether divestment by trustees of public pension plans of investments in fossil fuels would be a breach of their fiduciary duties. While the duty of loyalty allows for consideration of moral and ethical factors under certain circumstances, the duty of prudence more strictly requires that investors make no sacrifice in plan performance in favor of other considerations. However, the* Baltimore *analysis does not answer the question of whether it is consistent with the fiduciary duties of trustees to consider the risk that investments in fossil fuel companies will become "stranded assets" or that stigmatization will likely affect the share value of fossil fuel companies. This Note concludes that as the risks of climate change become clearer, fiduciary duties do not prohibit divestment.*

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INTRODUCTION

In 2012, 350.org, a nonprofit environmental organization, launched a campaign entitled "Fossil Free" that encourages investors to divest their holdings in the top 200 publically traded fossil fuel companies.[1] The organization argues that fossil fuel companies are the major drivers of climate change; the earth faces extraordinary harm from climate change; shareholders benefit from the success of fossil fuel companies, and therefore benefit from climate change; and such profit is unethical.[2] The campaign's goal is to "force the hand" of fossil fuel companies to leave fossil fuels underground and to transform their businesses to significantly reduce emissions.[3] The campaign also aims to pressure governments to enact legislation, such as drilling bans or carbon taxes.[4] Campaigners

1. ATIF ANSAR ET AL., STRANDED ASSETS AND THE FOSSIL FUEL DIVESTMENT CAMPAIGN: WHAT DOES DIVESTMENT MEAN FOR THE VALUATION OF FOSSIL FUEL ASSETS? 19 (2013) *available at* http://www.smithschool.ox.ac.uk/research/stranded-assets/SAP-divestment-report-final.pdf.

2. *Frequently Asked Questions*, FOSSIL FREE, http://gofossilfree.org/frequently-asked-questions/ (last visited Feb. 2, 2015).

3. ANSAR ET AL., *supra* note 1, at 9.

4. *Id.*

seek commitments from colleges and universities, cities and states, religious institutions, and foundations to divest from fossil fuel companies, signaling public disapproval for business as usual.[5] The movement has gathered considerable support from cities, educational institutions, and religious entities since 2012.[6]

Divestment campaigns have targeted issues as various as tobacco, nuclear power, firearms, genocide in Sudan, apartheid in South Africa, and now, the fossil fuels industry.[7] There are many arguments against targeted divestment from fossil fuel companies. These arguments include concerns that: (1) divestment from such a large component of the U.S. economy may be considered a breach of fiduciary duties; (2) the industry is not easily replaced in investment portfolios; (3) divestment eliminates the possibility of encouraging fossil fuel companies to change their practices; and (4) making such substantial changes to an investment portfolio is too costly.[8] All of these reasons warrant thorough investigation, but this Note examines whether divestment would breach pension plan managers' duties of loyalty and prudence.

Solving climate change requires action from all quarters. In the face of national and international inaction, the divestment campaign could prove one of many tools to bring about a solution. As was the case during the anti-apartheid campaign, divestment supporters do not believe the movement will put fossil fuel companies out of business.[9] Indeed, this is an unsupportable position. The relatively small depressions in share value that would result from public pension fund divestment will not have a permanent effect on fossil fuel companies' bottom line in the short term. Neutral investors will recognize the opportunity to buy up shares if they believe a company's actual value remains unaffected.[10] Furthermore, the full host of divestible assets that the campaign targets is a very small pool of capital within a very large industry. However, divestment can result in stigmatization of target companies and encourage progressive legislation. Fund managers can use the media attention drawn by divestment to signal intolerance for business as usual and sway public opinion towards a more aggressive

5. *Divestments Commitments*, FOSSIL FREE, http://gofossilfree.org/commitments (last visited Feb. 2, 2015).

6. *Id.*

7. ANSAR ET AL., *supra* note 1, at 40 tbl.3 (reviewing past divestment campaigns).

8. Craig Metrick & Jane Ambachtsheer, *Doing the Homework on Fossil Fuel Divestment*, PENSIONS & INVESTMENTS (May 8, 2013, 10:12 AM), http://www.pionline.com/article/20130508/REG/130509918/doing-the-homework-on-fossil-fuel-divestment.

9. *Frequently Asked Questions*, *supra* note 2 ("Divestment isn't primarily an economic strategy, but a moral and political one. At the same time, there are certain economic impacts. Our institutions have enormous amounts of money and getting it out of coal, oil and gas, will create uncertainty about the viability of the fossil fuel industry's business model.").

10. *See* ANSAR ET AL., *supra* note 1, at 30.

approach to addressing climate change.[11] An example of bad media attention spurring corporate change is Exxon's reaction to bad press after the 1989 Valdez oil spill.[12] Shareholders responded to stigmatization by forcing the company to add an environmentalist to the board, opening the door for more socially responsible policies.[13]

Divestment campaigns generally develop in three phases.[14] In the first phase, religious groups and industry-related public organizations begin to take action. In the apartheid context, as early as 1980, the Protestant and Roman Catholic Churches pledged to divest $250 million from banks with ties to South Africa.[15] The second phase ushers in universities, cities, and select public institutions.[16] University divestment, public pension divestment, and the passage of the Comprehensive Anti-Apartheid Act came during this phase.[17] The final phase comes when the wider market recognizes the risk of continued investment in the offending assets.[18] The fossil fuel divestment campaign is currently in the second phase.[19]

This Note does not seek to judge the wisdom of divestment—there are strong arguments disputing its efficacy as a tool of social change. For example, some public pension funds, such as the California Public Employees' Retirement System ("CalPERS"), actively manage their portfolios, vote their proxies, and work to influence company behavior.[20] CalPERS believes this is the most effective strategy for changing company behavior.[21] Rather, this Note specifically examines the argument that trustees of public pension funds may breach their fiduciary duties of loyalty and prudence if they divest their beneficiaries' assets from fossil fuel companies. This Note asks whether the legal framework for the anti-apartheid divestment campaign in the 1980s is a fitting model for divestment from fossil fuels. This Note concludes that though divestment from fossil fuels may not mirror the anti-apartheid divestment model, it does not create a breach of fiduciary duties for public pension plan trustees.[22]

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11. *See id.* at 72.
12. *Id.* at 65.
13. *Id.*
14. *Id.* at 10.
15. *Id.*
16. *Id.*
17. *Id.*
18. *Id.*
19. *Id.* at 11.
20. *See generally* CalPERS, Towards Sustainable Investment: Taking Responsibility (2012), *available at* http://www.calpers.ca.gov/eip-docs/about/press/news/invest-corp/esg-report-2012.pdf (demonstrating CalPERs commitment to and progress toward sustainable investments).
21. Madison Marriage, *U.S. Pension Funds Keep Fossil Fuels Burning*, Fin. Times, July 7, 2014, at 1.
22. The choice of public pension plan managers as subjects for this Note is deliberate. David Hess argues that public pension plans are well suited to be "surrogate regulators" given that they lack the

Part I of this Note explains the historical framework for the anti-apartheid divestment campaign. In Part II, this Note outlines the legal framework for the anti-apartheid divestment campaign, including a discussion of the case *Board of Trustees of the Employees Retirement System of the City of Baltimore v. Mayor and City Council of Baltimore City* ("*Baltimore*"). Part III introduces the climate change divestment campaign, and applies the duties of loyalty and prudence to fossil fuel divestment. In Part IV, this Note argues that the duty of loyalty is unlikely to pose a challenge to trustees, but the duty of prudence may give trustees pause. The analysis of the duty of prudence introduces evidence that fossil fuel-free funds perform similarly to other funds and explains the risks of "stranded assets" and stigmatization. This Part then briefly entertains the idea that the duty of prudence might *require* divestment from fossil fuel companies. Part V brings up another legal consideration from *Baltimore*. Finally, Part VI suggests areas of further exploration.

I. The Anti-Apartheid Divestment Campaign: Historical Framework

In the 1980s, activists used a divestment campaign to influence the United States' response to apartheid in South Africa.[23] Under the apartheid regime, black South Africans, comprising approximately seventy-two percent of South Africa's population in 1984, were subject to a system of institutionalized racism.[24] Black South Africans were unable to change their circumstances because they were all but precluded from participation in the government and lacked political allies and formal organization.[25] In 1985, the system of apartheid was entrenched. Those in the powerful minority of white South Africans benefited from the status quo.[26] For white South Africans, an end to apartheid heralded higher taxes, less political power, marketplace competition, and the possibility of "cultural dilution."[27] Many in the global community held the opinion

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conflict of interest that corporate pension plan managers face; they are committed not only to current, but also future public employees; and their portfolios usually mirror that of the investment market as a whole. David Hess, *Public Pensions and the Promise of Shareholder Activism for the Next Frontier of Corporate Governance: Sustainable Economic Development*, 2 Va. L. & Bus. Rev. 221, 235 (2007).

23. This discussion of apartheid in South Africa is based on writing contemporary to the apartheid divestment movement and represents the perspectives of writers at the time. This is an incomplete picture of the complex history and politics of apartheid.

24. Christine Walsh, *The Constitutionality of State and Local Governments' Response to Apartheid: Divestment Legislation*, 13 Fordham Urb. L.J. 763, 764 n.4, 764–68 (1985).

25. *Id.* at 767.

26. Jonathan Leape et al., *Introduction*, *in* Business in the Shadow of Apartheid: U.S. Firms in South Africa ix, xiii (1985).

27. *Id.*

that change would have to come from outside the country.[28] As anti-apartheid sentiment grew in the United States, groups frustrated with The U.S. government's inaction sought to influence policy through divestment of assets associated with companies doing business in South Africa.

The campaign to divest from companies doing business in South Africa began on college campuses and took some time to grow. As of January 1980, Harvard President Derek Bok had rejected divestiture proposals in favor of shareholder activism.[29] In several states, attorneys general issued opinions cautioning that trustees of state institutions divesting on ideological grounds may breach their fiduciary duty of prudence.[30] The arguments used then are similar to those advanced now in the fossil fuel context: divestment involves significant transactional costs that result in a loss to pension plans, and there are better ways to influence businesses.[31] However, by the end of 1989, twenty-five states, nineteen counties, and eighty-three cities in the United States had passed some sort of binding legislation against firms doing business in South Africa.[32]

Several factors led to divestment during apartheid. The first was a moral one. The fundamentally racist foundation of the apartheid regime struck close to home for Americans. Activists viewed the American capacity to tolerate racial oppression abroad as a barometer for how black interests in the Unites States were weighted against the interests of the country as a whole.[33] Furthermore, the United States profited economically from its business engagement with South Africa. Those profits were indivisible from, and were often the direct product of, the exploitation of black laborers.[34] For example, in 1982, the United States owned twenty-five percent of the South African gold industry while black miners suffered terrible working conditions.[35] The United States was also interested in the continued use of South Africa's geopolitical position.[36]

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28. Walsh, *supra* note 24, at 768.

29. Ben Bradlee, *Apartheid and the Dollar—The Divestiture Dilemma: Should Colleges Use Stock Portfolios to Influence South Africa?*, BOS. GLOBE, Jan. 27, 1980, at 1.

30. *Id.* The fiduciary duty of prudence is also referred to as the duty of care. This Note will use the term "prudence" except in direct quotations.

31. *See* Randy Furst, *Impact of State's Divestiture Policy Disputed*, MINNEAPOLIS STAR & TRIB., Jul. 22, 1986, at 7A.

32. Richard Knight, *Sanctions, Disinvestment, and U.S. Corporations in South Africa*, *in* SANCTIONING APARTHEID 67, 69 (Robert E. Edgar ed., 1990).

33. LEAPE ET AL., *supra* note 26, at xi.

34. *Id.* at xxvi.

35. *Id.* at xii.

36. *Id.*

Second, there were also political arguments for ending apartheid. In introducing a 1985 collection of essays regarding business during apartheid, Jonathan Leape, Bo Baskin, and Stefan Underhill stated:

> Unless the West effectively communicates its political principles and makes clear its fundamental opposition to apartheid, anti-Western and anticapitalist sentiment will surely grow not only in South Africa but throughout the continent: What better example could communist propaganda find to illustrate the alleged decadence and oppression of the Western capitalist system?[37]

Finally, the United States involved itself in ending apartheid because it was in a better position to influence South Africa than other countries. At the time, the United States was less able to exert ideological influence over other regimes all over the world. In contrast to Iran, Libya, or North Korea, the culturally similar white South African regime was simply more susceptible to American influence.[38]

Though many agree that the anti-apartheid campaign had little, if any, impact on the financial markets, it is generally undisputed that the campaign had a social impact.[39] The most tangible outcome was legislation. Congress passed the Comprehensive Anti-Apartheid Act in 1986 over President Regan's veto.[40] In relevant part, the Act prohibited further U.S. investment in South Africa.[41] It banned sales to the South African police and the military, and it banned new loans except for those made for the purpose of trade.[42] The Act's sanctions were not to be lifted until South Africa freed Nelson Mandela, demonstrated significant progress toward dismantling apartheid, and took at least three of four actions—ending the formal sequestration of black South Africans, freeing political prisoners, granting political freedom to all South Africans, and negotiating a settlement with representatives from the black majority.[43] The actual implementation of the Act was at best, inadequate[44] and at worst, insincere.[45] However, for the purposes of this

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37. *Id.*

38. *Id.*

39. *See, e.g.*, ANSAR ET AL., *supra* note 1, at 64 tbl.5 (finding that although direct economic impacts of the divestment campaign were slight, and perhaps even counterproductive, increased global public awareness "deeply undermined the diplomatic standing of the apartheid regime"); Siew Hong Teoh et al., *The Effect of Socially Activist Investment Policies on the Financial Markets: Evidence from the South African Boycott*, 72 J. BUS. 35, 83 (1999) (concluding that, at most, the anti-apartheid divestment campaign "may have been effective in raising the public moral standards of public awareness" but had very little impact on financial markets).

40. Knight, *supra* note 32, at 69.

41. Comprehensive Anti-Apartheid Act of 1986, Pub. L. No. 99-440, § 310, 316, 100 STAT. 1086, 1102, 1104 (repealed 1993).

42. *Id.* §§ 304(1)–(2), 305.

43. *Id.* § 311(a)–(b).

44. Gay MacDougall, *Implementation of the Anti-Apartheid Act of 1986*, *in* SANCTIONING APARTHEID, *supra* note 32, at 19, 22–23.

Note, it is sufficient to note that in the face of significant political resistance, the anti-apartheid movement resulted in comprehensive legislation.

II. The Anti-Apartheid Divestment Campaign: Legal Framework

As is currently occurring in the fossil fuel divestment campaign, plan managers during the apartheid divestment campaign resisted being told to divest. This Part describes the legal framework for requiring plan managers to divest through anti-apartheid divestment legislation. The Part begins with a discussion of the fiduciary duties of loyalty and prudence. Then, the Part provides some examples of anti-apartheid divestment legislation. Finally, the Part introduces the primary case to emerge from challenges to divestment legislation.

A. Fiduciary Duties of Loyalty and Prudence

In 1985, much like today, trustees of pension funds were required to comply with the duties of loyalty and prudence.[46] The Uniform Prudent Investor Act of 1994 ("UPIA") describes the modern duties of loyalty and prudence.[47] Individual state law governs the duty a public pension plan trustee owes her beneficiaries.[48] By way of example, the fiduciary duties of public pension plan managers in California are set forth in the California Constitution.[49] In many cases, these duties mirror those of the UPIA, though some states have adopted their own clarifying laws to expand or contract the trustees' discretion to base investment decisions on factors other than plan performance.[50] For private funds, fiduciary duties are outlined in the Employee Retirement Income Security Act of 1974 ("ERISA").[51] ERISA was the model for many states' public fiduciary duties during the apartheid divestment campaign.[52]

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45. David Hirschmann, *The Impact of Sanctions and Divestment on Black South African Attitudes Toward the United States*, *in* Sanctioning Apartheid, *supra* note 32, at 91, 105.

46. Thomas A. Troyer et al., *Divestment of South Africa Investments: The Legal Implications for Foundations, Other Charitable Institutions, and Pension Funds*, 74 Geo. L.J. 127, 147 (1985).

47. *See Trust Examination Manual: Appendix C—Fiduciary Law: Uniform Prudent Investor Act*, FDIC, https://www.fdic.gov/regulations/examinations/trustmanual/appendix_c/appendix_c.html#_toc497113667 (last visited Feb. 2, 2015); *see also* Restatement (Third) of Trusts § 90(a)–(c) (2007) (introducing the prudent investor rule); Unif. Prudent Mgmt. of Institutional Funds Act § 3 (2006) [hereinafter UPMIFA] (outlining fiduciary duties for charitable institutions). These standards are discussed further in their application to fossil fuel divestment.

48. Troyer et al., *supra* note 46, at 156–57.

49. *See, e.g.*, Cal. Const. art. XVI, § 17.

50. Hess, *supra* note 22, at 247–48.

51. 29 U.S.C. § 1104(a)(1) (2014); Troyer et al., *supra* note 46, at 154.

52. *See* Troyer et al., *supra* note 46, at 155.

UPIA's duty of loyalty states, "[a] trustee shall invest and manage the trust assets solely in the interest of the beneficiaries."[53] Likewise, ERISA's duty of loyalty is that "a fiduciary shall discharge [her] duties with respect to a plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing financial benefits to participants and their beneficiaries."[54] Thomas Troyer, Walter Slocombe, and Robert Boisture, writing about the apartheid divestment movement in 1985, stated that under the fiduciary duty of loyalty, "no social good can justify imposing an increased investment risk or a reduced investment return on the beneficiaries of the fund."[55] On its face, the duty of loyalty does not per se prohibit social or moral factors from entering into the investment calculus, but it does require that such considerations not have a negative impact on plan performance.[56]

Fiduciaries must also exercise a duty of prudence.[57] Under ERISA, this means exercising the "care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."[58] Similarly, under the UPIA, the duty is to "invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution."[59] This duty also requires considering the whole portfolio rather than single assets, balancing risk and return, and considering a wide array of factors, including general economic conditions, rather than taking a narrow view of investment decisions.[60]

B. State and Local Legislation

State and local legislatures, concerned that traditional trust law constrained pension plan managers from divesting their holdings in companies doing business in South Africa, enacted laws prohibiting or restricting the investment of public funds in firms doing business in South Africa.[61] During the anti-apartheid campaign, in many cases, divestment came from such legislation rather than pension plan managers

53. Unif. Prudent Investor Act § 5 (1994) [hereinafter UPIA].
54. 29 U.S.C. § 1104(a)(1)(A)(i).
55. Troyer et al., *supra* note 46, at 155.
56. *Id.*; UPMIFA § 3 cmt. (2006).
57. Troyer et al., *supra* note 46, at 155.
58. *See* 29 U.S.C. § 1104(a)(1)(B) (2013); *see also* Troyer et al., *supra* note 46, at 155.
59. UPIA § 2(a) (1994).
60. *Id.* § 2 cmt.
61. Troyer et al., *supra* note 46, at 157.

themselves.[62] If anti-apartheid divestment legislation was deemed legal under the state constitution, such legislation was a complete defense to challenges brought against managers of public pension funds on fiduciary duties grounds.[63]

Some cities and states placed conditions on pension plan managers' investment decisions. For example, Connecticut required corporate pension plan managers to do the following to retain or attract public funds: (1) "adhere to the Sullivan Principles," a list of business practices that supported equality and fairness in the workplace, and quality of life improvements for nonwhites, such as better "housing, transportation, school, recreation, and health facilities";[64] (2) refrain from supplying "strategic products or services to the South African government, military, or police"; and (3) recognize the rights of South African workers to strike.[65] Other states withdrew public funds entirely. For example, Massachusetts withdrew the entirety of its public pension funds from financial institutions with outstanding loans to the South African government and all corporations doing business in South Africa.[66]

C. The *Baltimore* Case

The primary case to emerge in the anti-apartheid divestment context was a pension plan trustees' challenge to two Baltimore city ordinances. The ordinances required city pension plan trustees to divest their holdings from firms doing business in South Africa.[67] Adopted in July of 1983, the Baltimore ordinances addressed holdings in the city's three public retirement plans.[68] They "provide[d] that no funds . . . shall remain invested in, or in the future be invested in, banks or financial institutions that make loans to South Africa or Namibia or companies 'doing business in or with' those countries."[69]

With respect to the fiduciary duties of the trustees, the Maryland Court of Appeals considered two arguments from the challenging trustees. The first was that the ordinances improperly mandated that the trustees consider social factors where their duty of loyalty required consideration of the fund's beneficiaries alone.[70] The trustees argued that the Baltimore ordinances required them to act in the interest of parties

62. *See id.* at 157 n.111 (collecting examples of anti-apartheid legislation).
63. *Id.* at 157.
64. *The Sullivan Principles*, Marshall Univ., http://www.marshall.edu/revleonsullivan/principles.htm (last visited Feb. 2, 2015).
65. Walsh, *supra* note 24, at 774.
66. *Id.* at 774–75.
67. Bd. of Trs. v. Mayor of Balt. City, 562 A.2d 720, 723 (Md. 1989), *cert. denied*, 493 U.S. 1093 (1990).
68. *Id.* at 724.
69. *Id.* (citation omitted).
70. *Id.* at 736.

other than the beneficiaries, thereby violating the duty of loyalty.[71] In dismissing this argument, the court found that consistent with their duty of loyalty, trustees could conclude that considering the ethical implications of the fund's investment would properly serve the beneficiaries' interests and effectively secure the provision of benefits in the future.[72]

Second, the trustees argued that the ordinances altered the common-law duty of prudence that pension plan managers owed to their beneficiaries by prohibiting certain investments rather than permitting independent decisionmaking.[73] In dismissing this argument, the court agreed with the trial judge's finding that although the ordinances prevented the trustees from investing in some of the market's largest firms, they did not prohibit construction of "an almost perfectly diversified portfolio, one that accurately matches the market as a whole" with smaller, South Africa-free firms.[74]

The court further found that a number of safeguards prevented divestment from being inconsistent with the duty of prudence. These safeguards were a two-year phasing in of the transition to a South Africa-free portfolio, the power of fiduciaries to suspend the program, and permission to make new investments in otherwise impermissible companies while the program was suspended.[75] In the court's interpretation, then, limitations on the ordinance prevented it from violating the trustees' duty of prudence.[76] The court also advanced a public policy argument, that "given the vast power that pension trust funds exert in American society, it would be unwise to bar trustees from considering the social consequences of investment decisions in any case in which it would cost even a penny more to do so."[77] Thus, Maryland's highest court found that legislation requiring public pension plan managers to divest from firms doing business in South Africa would not require pension plan managers to violate their fiduciary duties.[78] Though *Baltimore* is of little precedential value outside of Maryland, the case sets out a framework for analyzing whether divestment legislation or independent decisions by pension plan managers to divest from fossil fuel companies would violate the duties of loyalty or prudence.

71. *Id.* at 738.
72. *Id.* at 738.
73. *Id.* at 734.
74. *Id.* at 735.
75. *Id.* at 724–25, 736.
76. *Id.* at 736.
77. *Id.* at 737.
78. *Id.*

III. Climate Change and the Fossil Fuel Divestment Campaign

As explained above, the fossil fuel divestment campaign targets climate change. This Part first discusses why we must address climate change and then introduces the fossil fuel divestment campaign.

A. Why Solve Climate Change?

In the *Dallas Morning News*, an apartheid divestment challenger, contending that the human condition was much worse in countries less accessible to the media, stated, "[I]t sounds good politically for American politicians to say, 'I'm against apartheid.'"[79] Today, fighting against climate change is politically risky. Though this is changing, climate change denial is a prerequisite for political hopefuls in some circles.[80] For example, Bob Inglis, a conservative Republican and former congressman from South Carolina, may have lost his seat in Congress for expressing his belief in anthropogenic climate change.[81]

However, like apartheid, climate change presents serious human rights challenges. These challenges are global. The 2014 Intergovernmental Panel on Climate Change ("IPCC") report presents evidence that changing patterns of precipitation and snowmelt have affected water quality and quantity worldwide.[82] The report describes a waning food supply in a time of increasing food demand due to rising populations and an increased ability to purchase food worldwide.[83] This will lead to higher food prices that will hurt the world's poorest first.[84] Indeed, climate change-induced heat waves have already impacted food production and driven up costs in some places.[85] Agricultural yields of maize and wheat have decreased.[86] There is increased risk to people and ecosystems from extreme weather events, especially for those living in poverty.[87] Urban areas are more vulnerable to heat stress and harm to

79. Doug J. Swanson, *Apartheid Issue Reborn: Recent Awareness Spawns Rallies, Debates Across U.S.*, Dall. Morning News, Nov. 2, 1985, at 1a.

80. *See generally* Coral Davenport, *The Coming GOP Civil War Over Climate Change*, Nat'l J. (May 9, 2013), http://www.nationaljournal.com/magazine/the-coming-gop-civil-war-over-climate-change-20130509.

81. Jennifer Ludden, *New Groups Make a Conservative Argument on Climate Change*, NPR (Sept. 26, 2012), http://www.npr.org/blogs/itsallpolitics/2012/09/26/161824667/new-groups-argue-a-conservative-take-on-climate-change.

82. Intergovernmental Panel on Climate Change, Climate Change 2014: Summary for Policymakers: Impacts, Adaptation, and Vulnerability: Contribution of Working Group II 6 (Christopher B. Field et al. eds., 2014), *available at* http://ipcc-wg2.gov/AR5/images/uploads/WG2AR5_ SPM_FINAL.pdf [hereinafter IPCC Summary for Policymakers].

83. Justin Gillis, *Climate Change Seen Posing Risk to Food Supplies*, N.Y. Times, Nov. 1, 2013, at A1.

84. IPCC Summary for Policymakers, *supra* note 82, at 6.

85. *Id.*

86. *Id.* at 5.

87. *Id.* at 6.

people and infrastructure from extreme weather events.[88] Small islands face loss of livelihood, economic instability, and threats to low-lying coastal areas.[89]

North America is expected to face drying, flooding, intense weather-related events, shifting patterns of agricultural viability, and intense, localized heat waves.[90] Latin America will likely experience flooding, landslides, decreased food production, spread of vector-borne diseases, and water and food insecurity.[91] Europe will likely experience economic loss due to increased flooding and rising sea levels, and witness intense heat and drought in the arid south.[92] Asia, already strained in many areas by rapid urbanization and industrialization, will likely experience flooding, increased drought, malnutrition, and damage to infrastructure.[93] Australia and New Zealand will likely lose agricultural vitality in some regions, experience biodiversity loss, and see increased coastal erosion and flooding.[94] Finally, Africa will likely experience drought, reduced cereal crop production, threat to food security, and changes in the distribution of vector- and water-borne diseases.[95] By the end of the twenty-first century, flood hazards will likely increase across over half the globe and droughts are expected to be more frequent and longer in dryer areas.[96]

The report also notes that people who are already socially, economically, politically, culturally, institutionally, or otherwise marginalized are at a heightened risk for experiencing the effects of climate change.[97] Like apartheid, climate change presents grave human costs. Unlike apartheid, the physical effects of climate change, though distributed disproportionately, will be experienced worldwide. Addressing climate change, even if only to protect the world's poorest and most vulnerable populations, is a moral imperative.

The reasons advanced for United States involvement in challenging apartheid also apply to climate change, in addition to the physical effects of climate change on the United States. Like profiting from poor labor conditions and low wages in South Africa, American companies and their investors have long profited from inexpensive greenhouse gas

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88. *Id.* at 18.
89. *Id.* at 24 tbl.1.
90. *Id.* at 23 tbl.1.
91. *Id.* at 24 tbl.1.
92. *Id.* at 22 tbl.1.
93. *Id.*
94. *Id.* at 23 tbl.1.
95. *Id.* at 21 tbl.1.
96. Intergovernmental Panel on Climate Change, Climate Change 2014: Impacts, Adaptation, and Vulnerability: Part A: Global and Sectoral Aspects: Contribution of Working Group II 247 (Jimenéz Cisneros et al. eds., 2014), *available at* http://ipcc-wg2.gov/AR5/images/uploads/WGIIAR5-Chap3_FINAL.pdf.
97. IPCC Summary for Policymakers, *supra* note 82, at 6.

emissions. There is also a political argument for taking action to solve climate change. As explained in this Note, many parts of the developing world will experience severe effects of climate change. This could cause the sort of political turmoil, weakened governance, and demographic shifts that strengthen violent non-state groups.[98] In sum, it is both contradictory and unwise for the United States to decline to take a leading role against climate change where the reasons for doing so are similar to those advanced when the United States acted against apartheid.

B. The Fossil Fuel Divestment Campaign

As of mid-September 2014, twenty-eight U.S. cities have committed to divesting from fossil fuels.[99] Most of the city resolutions "urge," "request," or "recommend" that their pension fund managers consider a path towards divestment. As one of many examples, on October 21, 2013, Ann Arbor, Michigan "urged" pension fund managers to reconsider their investments in fossil fuels.[100] Providence, Rhode Island, a coastal city uniquely situated to feel the effects of climate change, also "requested" divestment.[101] The Providence divestment resolution "request[s] that the Board of Investment Commissioners ensure that within five years none of its . . . assets include holdings in fossil fuel public equities and corporate bonds as determined by the Carbon Tracker list."[102] Though this signals solidarity with the divestment movement, the city of Providence (not to be confused with the Rhode Island Public Pension System) is not a public pension plan fiduciary. San Francisco, another vulnerable city, is among the twenty-eight to have made a commitment to fossil fuel divestment.[103] However, despite the San Francisco Board of Supervisors' commitment, San Francisco's

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98. *See* Joshua W. Busby, Council on Foreign Relations, Climate Change and National Security: An Agenda for Action 9 (2007), *available at* http://www.cfr.org/climate-change/climate-change-national-security/p14862.

99. *Divestment Commitments*, *supra* note 5.

100. *Ann Arbor OKs Fossil Fuel Divestment*, Ann Arbor Chron. (Oct. 22, 2013, 1:00 AM), http://annarborchronicle.com/2013/10/22/ann-arbor-oks-fossil-fuel-divestment.

101. *See* Alex Kuffner, *Experts: Climate Change Leaves Rhode Island, Region Vulnerable to Severe Storms*, Providence J. (Sept. 20, 2013, 11:15 PM), http://www.providencejournal.com/breaking-news/content/20130920-experts-climate-change-leaves-rhode-island-region-vulnerable-to-severe-storms.ece.

102. *Resolution of the City Council*, City of Providence (June 20, 2013), *available at* http://350ma.org/wp-content/uploads/2013/08/Providence-RI_resolution-enacted_6-20-2013.pdf.

103. Aaron Sankin, *San Francisco Fossil Fuel Divestment Movement Takes Its First Steps Against Big Oil*, Huffington Post (Apr. 25, 2013, 8:06 PM), http://www.huffingtonpost.com/2013/04/25/san-francisco-fossil-fuel-divestment_n_3158012.html.

Employees' Retirement System Board has refused to take action.[104] The board cited a preference for "slow[ing] down," and voted instead to analyze its proxy voting policy.[105]

As these examples show, the movement is gaining traction and recognition. A bill that was proposed in the Massachusetts Legislature would have made Massachusetts the first to divest from fossil fuel companies. Interestingly, Massachusetts was the first state to divest during the apartheid divestment movement.[106] The fossil fuel divestment bill called for: (1) the identification of fossil fuel companies; (2) a divestment scheme ratcheting up to complete divestment of public funds from publically traded securities in fossil fuel companies within five years of enactment; (3) a prohibition against the acquisition of new fossil fuel assets; and (4) an exception for indirect holdings in actively managed investment funds, provided that the trustees submit a letter to the managers of the fund requesting that they remove fossil fuel companies from the investment fund, or alternatively, to create another fund devoid of the fossil fuel companies and to reinvest the Massachusetts assets in the new fund.[107] Like the Baltimore ordinances upheld in *Baltimore*, the Massachusetts proposal included a clause that allowed the public fund to cease divestment as necessary if the total value of the Public Fund drops in value by more than 0.5 due to the initiative.[108] The legislature did not take action on the bill.[109]

On average, public pension plans in the United States and United Kingdom hold only two to five percent of their assets in fossil fuel companies.[110] However, divestiture is a weighty decision for fiduciaries and may explain why certain cities have failed to take action. Public pension plan managers may cite their fiduciary duties as a reason not to divest or otherwise incorporate social responsibility into their investment decisions.[111] For example, CalPERS states that its fiduciary duties of loyalty and prudence, as defined by the California Constitution, "generally forbid CalPERS from sacrificing investment performance for

104. Joshua Sabatini, *SF Board Decides Not to Divest Pension Money from Fossil Fuel Companies*, S.F. EXAMINER (Oct. 11, 2013), http://www.sfexaminer.com/sanfrancisco/sf-board-decides-not-to-divest-pension-money-from-fossil-fuel-companies/Content?oid=2602319.

105. *Id.*

106. Shira Schoenberg, *Pension Politics: The History of Divestment in Massachusetts*, MASSLIVE (May 8, 2014, 7:00 AM), http://www.masslive.com/politics/index.ssf/2014/05/the_history_of_divestment_in_m.html.

107. S. 1225, 188th Gen. Ct., Reg. Sess. § 3 (Mass. 2013).

108. *Id.* § 5.

109. Shira Schoenberg, *Fossil Fuel Divestment Bill Fails to Pass in Massachusetts Legislature*, MASSLIVE (Aug. 1, 2014, 9:45 AM), http://www.masslive.com/politics/index.ssf/2014/08/fossil_fuel_divestment_bill_fa.html.

110. ANSAR ET AL., *supra* note 1, at 11.

111. *See* Hess, *supra* note 22, at 247.

the purpose of achieving goals that do not directly relate to CalPERS operations and benefits."[112] Pension plan managers may also challenge divestment legislation as inconsistent with their fiduciary duties.

IV. Under the *Baltimore* Framework, May Public Pension Plans Divest from Fossil Fuel Companies?

Using *Baltimore* and the UPIA as a framework, this Part assesses whether pension plan managers can divest from fossil fuels consistent with their duties of loyalty and prudence. Because there is evidence that fossil fuel-free portfolios perform similarly to other portfolios, plan managers may divest from fossil fuels without breaching their duty of loyalty. Those performance outcomes, the risk that fossil fuels will become stranded assets, and the risk that fossil fuel companies will become stigmatized are all factors properly considered in deciding to divest consistent with the duty of prudence.

A. Duty of Loyalty

Under the *Baltimore* framework, localities that choose to divest their public pension plan holdings are unlikely to face successful legal challenges based on their duty of loyalty. Again, UPIA's duty of loyalty states, "[a] trustee shall invest and manage the trust assets solely in the interest of the beneficiaries."[113] On its face, administering a plan to alleviate the suffering of those living under apartheid or affected by climate change is not "solely in the interest of the beneficiaries." However, fiduciaries do not necessarily violate their duty of loyalty by considering the social impact of their investment decisions. So long as the costs of those considerations are de minimis, a pension plan manager is not likely to breach her duty of loyalty.[114] The court in *Baltimore* reached this conclusion by finding that investing in "businesses with 'a proper sense of social obligation'" will serve the long-term interests of plan beneficiaries.[115] Thus, under the UPIA and *Baltimore* frameworks, the duty of loyalty permits divestment if: (1) plan managers believe that it will help then invest in "companies with a proper sense of social obligation"; and (2) divestment does not have more than a de minimis impact on plan performance.

First, judging whether top fossil fuel companies have a "proper sense of social obligation" is beyond the scope of this Note. However,

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112. CalPERS, California Public Employees' Retirement System Statement of Investment Policy Regarding Divestment 2 (May 29, 2014), *available at* http://www.calpers.ca.gov/eipdocs/investments/policies/invo-risk-mang/divestment.pdf.

113. UPIA § 5 (1994).

114. Bd. of Trs. v. Mayor of Balt. City, 562 A.2d 720, 738 (Md. 1989), *cert. denied*, 493 U.S. 1093 (1990).

115. *Id.* (citation omitted).

given the risks of climate change, divestment from fossil fuel companies would certainly not prohibit plan managers from investing in companies with a "proper sense of social obligation." Second, divestment from fossil fuel companies for the benefit of those living in regions vulnerable to climate change will likely have no more than a de minimis impact on the performance of pension plans. Studies demonstrate that fossil-free portfolios closely track the performance of the major stock indices. For example, the Aperio Group, an investment management firm, produced a report on how two different portfolios (coal-free and fossil fuel-free) would perform compared to an average portfolio.[116] For comparison, they used the funds' tracking error, or, their deviation from a trusted index of stock performance, such as the Russell 3000.[117] Deviation could indicate either better or poorer performance. Passively managed investments are expected to closely track the market indices, meaning that they have a tracking error close to zero percent.[118] Actively managed pension funds bear an average tracking error of five percent.[119]

The report finds that excluding fifteen of the most harmful coal companies from an otherwise optimized portfolio returns a minute deviation from the Russell 3000 benchmark, meaning that plan managers could have been almost completely passive in their investment management and achieved the same results.[120] Next, the report found that a portfolio excluding all oil, gas, and consumable fuels returned a tracking error of 0.60 .[121] This means that portfolios excluding fossil fuels track the market indices more closely than those actively managed by plan administrators. The Aperio Group concluded that although there are financial arguments for both advocates and skeptics of divestment, the difference in performance is minimal.[122] The fact that there *is* tracking error implicit in fossil fuel-free portfolios demonstrates some risk. A second analysis uses the difference in returns between the Russell 3000 and a hypothetical fossil-free fund to measure the historical tracking error. The analysis shows that the fossil-free fund delivered slightly better returns over the past twenty-five years, but that historical tracking error is slightly higher than the predictive model at 0.78 .[123] On the other hand, the difference in performance is minute, much smaller even than the risk of allowing a professional investment manager to actively

116. *See generally* PATRICK GEDDES, APERIO GRP., DO THE INVESTMENT MATH: BUILDING A CARBON-FREE PORTFOLIO (2013), *available at* http://www.aperiogroup.com/system/files/documents/building_a_carbon_free_portfolio.pdf.

117. *Id.* at 2.

118. *Id.* at 3.

119. *Id.*

120. *Id.*

121. *Id.* at 4.

122. *Id.* at 6.

123. *Id.* at 5.

manage funds.[124] This sort of negligible volatility is similar to that predicted under the Baltimore ordinances, which were found not to breach the fiduciary duty of loyalty. Another investment support firm, MSCI, conducted a study that showed similarly minute deviations from market performance for fossil fuel-free funds.[125] Because fossil fuel-free portfolios perform similarly to portfolios that include fossil fuel companies, divestment does not breach the fiduciary duty of loyalty, even if undertaken for social benefit.

B. Duty of Prudence

The duty of prudence is a higher hurdle for trustees than the duty of loyalty. First, as stated above, the duty of prudence generally requires "invest[ing] and manag[ing] trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution."[126] This duty may vary by state. For example, Section 17 of Article 16 of the California Constitution, states, in part:

> The members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims. . . . The members of the retirement board of a public pension or retirement system shall diversify the investments of the system so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly not prudent to do so.[127]

In light of the modern "prudent investor rule," set forth in the UPIA, analysis of the duty of prudence in the fossil fuel divestment context differs in some ways from the Maryland Court of Appeal's analysis in *Baltimore*. For example, the court in *Baltimore* noted the importance of the trustees' ability to construct a "perfectly diversified portfolio" that matched the makeup of the market at large. Diversification is the investment practice of holding multiple stocks whose performance is negatively correlated.[128] Diversification reduces "diversifiable risk" by ensuring that as the value of one stock declines, the value of another will rise.[129] The duty to diversify could present a

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124. *Id.* at 6.

125. *See* MSCI, Responding to the Call for Fossil-Fuel Free Portfolios 4–8 (2013), *available at* http://www.msci.com/resources/factsheets/MSCI_ESG_Research_FAQ_on_Fossil-Free_Investing.pdf.

126. UPIA § 2 (1994).

127. Cal. Const. art. XVI, § 17(c)–(d).

128. UPIA § 3 cmt.

129. *See id.*

hurdle for plan managers wishing to divest from fossil fuels, or for state or local legislatures wishing to require divestment. Fossil fuel-related companies offer a distinct diversification benefit because they possess strong negative correlation to other sectors.[130] However, this duty does not constitute a significant barrier. The UPIA does not specify what constitutes a diversified portfolio. Rather, the only explicit requirement of the duty to diversify is that trustees not retain a concentration in one particular asset.[131] Indeed, "there is no automatic rule for identifying how much diversification is enough."[132] Studies have concluded that as few as ten to fifteen and as many as 150 stocks are required to properly diversify.[133] Furthermore, the *most* beneficial sector for purposes of diversification is utilities,[134] suggesting that reinvestment of fossil fuels in other forms of energy could provide an equal, if not better, diversification opportunity. Finally, the duty has an escape hatch. A plan manager need not diversify if, "the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying."[135] By exercising prudence in minimizing diversifiable risk through other assets, a plan manager will not breach her duty to diversify.

In addition, the *Baltimore* court based its decision in part on the availability of exceptions to divestment in case of poor plan performance.[136] Indeed, the court noted that a divestment scheme may not cause more than a de minimis effect on the performance of a public pension fund.[137] The court noted if "social investment yields economically competitive returns at a comparable level of risk, the investment should not be deemed imprudent."[138] Thus, "social" investments must yield returns at comparable risk to investments that do not consider social or moral concerns. The studies addressed above show that real and hypothetical fossil fuel-free funds perform similarly to the market as a whole. These studies provide sufficient support for the decision to divest in accordance with the duty of prudence.

Even absent these results, there is evidence that the viability of the fossil fuel industry is questionable. The following Subparts present the risks that investment in fossil fuels pose to pension plans. These risks are

130. *See Sector Correlation Matrix*, ASSETCORRELATION, http://www.assetcorrelation.com/sectors (last visited Feb. 2, 2015).

131. Trent S. Kiziah, *The Trustee's Duty to Diversify: An Examination of the Developing Case Law*, 36 ACTEC L.J. 357, 361 (2010).

132. UPIA § 3 cmt.

133. Kiziah, *supra* note 131, at 362–63.

134. *See Sector Correlation Matrix*, *supra* note 130.

135. *See* UPIA § 3.

136. Bd. of Trs. v. Mayor of Balt. City, 562 A.2d 720, 736 (Md. 1989), *cert. denied*, 493 U.S. 1093 (1990).

137. *Id.* at 737.

138. *Id.*

(1) that fossil fuels will become "stranded assets" and (2) that fossil fuel companies will become stigmatized as a result of the divestment campaign itself. These risks should indicate to trustees that they do not breach their fiduciary duty of prudence by divesting. Whether a trustee has fulfilled her duty of prudence concerns the trustee's actions in investigating and evaluating an investment.[139] Under the UPIA, each investment decision is evaluated as part of an entire portfolio, rather than as a single investment.[140] Trustees who want to protect the decision to divest must develop and adhere to a well-documented investment plan that contains clear and convincing procedural safeguards.[141]

1. The Risk of Stranded Assets

Fossil fuels are at risk of becoming "stranded assets." The Stranded Asset Program at the Smith School of Energy and the Environment at Oxford defines "stranded assets" as "environmentally unsustainable assets [that] suffer from unanticipated or premature write-offs, downward revaluations or are converted to liabilities."[142] In the fossil fuel context, this refers to investments in fossil fuels that will either never be extracted, or when they are, will be worth less than anticipated. Because the risk of assets becoming stranded is largely underappreciated, they are priced higher than their actual value, posing a risk to investors.[143]

There are a number of commonly cited risks in the fossil fuel industry that may result in assets becoming stranded: (1) physical environmental challenges to resource-intensive industries, including the rising costs of new methods of extraction; (2) international greenhouse gas emissions regulation, extraction limits, or carbon taxes that may cap the amount of fossil fuel extracted; (3) the decreasing cost of competitive clean technology; (4) evolving social norms and consumer behavior that preference cleaner energy; and (5) the growing litigation risk faced by fossil fuel companies.[144]

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139. *See generally* United States v. Mason Tenders Dist. Council of Greater N.Y., 909 F. Supp. 891 (S.D.N.Y. 1995) (finding that defendant trustees acted in delinquencies rather than mistake and had a duty to invest in a way that would earn compound interest).

140. UPIA § 2(b).

141. Troyer et al., *supra* note 46 , at 156.

142. ANSAR ET AL., *supra* note 1, at 2.

143. *Id.* at 16.

144. *Id.* at 2. Plaintiffs have sued private corporations under theories such as negligence and nuisance. *See generally* Vill. of Kivalina v. ExxonMobil Corp., 696 F.3d 849 (9th Cir. 2012); Comer v. Murphy Oil U.S.A., 585 F.3d 855, 859 (5th Cir. 2009); Conn. v. Am. Elec. Power Co. Inc., 582 F.3d 309, 314 (2d Cir. 2009); People v. Gen. Motors Corp., No. C06-05755 MJJ, 2007 WL 2726871, at *1 (N.D. Cal. 2007). A U.K. commentator suggested that in addition to encouraging divestment, pension plan beneficiaries should release a "barrage of lawsuits" against pension plan trustees for violating the right to life and subsistence of many millions worldwide by maintaining investments in, and therefore

Particularly worth noting here is the risk of regulation. Many scientists agree that to avoid the most catastrophic effects of climate change, the earth must not increase in mean temperature more than two degrees.[145] To remain short of this threshold, between sixty and eighty percent of the world's current fossil fuel reserves must remain unconsumed.[146] Meaningful legislation to meet this goal could reduce the value of fossil fuels by requiring that most of the reserves that comprise the fossil fuel industry's value remain in the ground. Legislation affecting share price could come in the form of carbon taxation, restrictions on the net permitted amount of fossil fuel extracted, renewable energy portfolio standards, or non-fossil fuel energy subsidies.[147] Any one or combination of these regulations could cause a devaluation of the entire industry, and therefore pose a risk to share value and pension plan performance for those plans that remain invested. Without widespread international cooperation, a drilling ban is unlikely.[148] The companies with the most significant fossil fuel reserves operate in other countries and would not be impacted by U.S. legislation.[149] However, the United States is a large consumer of fossil fuels and a carbon tax, if enacted, would significantly depress demand.[150] Renewable energy portfolio standards are a common feature of state and local law.[151]

The Securities and Exchange Commission provided what should be a useful tool for pension plan managers trying to take a measured look at whether divestment from fossil fuel companies is prudent. In 2010, the SEC issued an interpretation of its disclosure rules as they relate to climate change.[152] This interpretation suggests that the rules require disclosure of the material business impacts of the following: (1) pending legislation, regulation, or international accords; (2) possible consequences of developing market trends; (3) possible adverse reputational impacts; and (4) physical impact of climate change on productivity.[153] If

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funding, fossil fuel companies. Assad W. Razzouk, *A Barrage of Lawsuits Is Needed to Curb Climate Change*, INDEP. (Apr. 22, 2014), http://www.independent.co.uk/voices/comment/a-barrage-of-lawsuits-is-needed-to-curb-climate-change-9274922.html.

145. CARBON TRACKER INITIATIVE, UNBURNABLE CARBON 2013: WASTED CAPITAL AND STRANDED ASSETS 3 (2013), *available at* http://carbontracker.live.kiln.it/Unburnable-Carbon-2-Web-Version.pdf.

146. *Id.* at 4.

147. ANSAR ET AL., *supra* note 1, at 66.

148. *Id.*

149. *Id.* at 67.

150. *Id.*

151. *See, e.g.*, *Renewables Portfolio Standard (RPS)*, CAL. ENERGY COMM'N, http://www.energy.ca.gov/
portfolio (last updated Sept. 16, 2014); *Most States Have Renewable Portfolio Standards*, U.S. ENERGY INFO. ADMIN. (Feb. 3, 2012), http://www.eia.gov/todayinenergy/detail.cfm?id=4850.

152. *See generally* Commission Guidance Regarding Disclosure Related to Climate Change, 75 Fed. Reg. 6290 (Feb. 8, 2010) (to be codified at 17 C.F.R. pts. 211, 231, 241).

153. *Id.* at 6295–97.

companies are in fact making the required disclosures, trustees have at their fingertips the information required to decide on behalf of their beneficiaries whether the assets they hold in fossil fuel companies are at risk of becoming stranded. However, a private study indicates that companies are not meaningfully reporting their climate change risk.[154] British Petroleum, for example, reports its belief that by 2035, oil, coal, and gas will make up eighty-one percent total of the global energy mix, down only five percent from 2012.[155] They also predict a forty-one percent increase in energy consumption in that time period.[156] This outlook presents a very different future than one that avoids the most devastating effects of climate change. To avoid these effects, global emissions would have to become negative starting in 2020.[157]

2. *The Risk of Stigmatization from the Divestment Campaign Itself*

The divestment campaign itself could pose a risk to share value and, consequently, to pension plans holding stocks in fossil fuel companies. This would not be due to a direct impact on fossil fuel companies' bottom lines, but rather due to the indirect impact of stigmatization.[158] A typical but erroneous understanding of divestment is that it causes the company from which investment is withdrawn financial hardship, which in turn causes the company to change its behavior.[159] However, divestment is unlikely to have a direct effect on a fossil fuel company's bottom line. As explained above, neutral investors will purchase the divested shares, which will hold the price stable.[160]

However, the likelihood of an indirect impact caused by stigmatization does support divestment. Divestment skeptics focus on the fact that unlike declining to purchase a product, which depresses demand and, ultimately, the company's share value, selling stocks does not depress value.[161] That is true, "[u]nless the sale of stock conveys

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154. Leon Kaye, *Amazon, Apple Ignoring SEC Climate Change Risk Disclosure Rules*, TRIPLE PUNDIT (Sept. 23, 2013), http://www.triplepundit.com/2013/09/amazon-apple-sec-climate-change-disclosure-rules.

155. BRITISH PETROLEUM, B.P. ENERGY OUTLOOK 2035, at 17 (2014), *available at* http://www.bp.com/en/global/corporate/about-bp/energy-economics/energy-outlook/outlook-to-2035.html.

156. *Id.* at 4.

157. Andrew Freedman, *IPCC Report Contains "Grave" Carbon Budget Message*, CLIMATE CENT. (Oct. 4, 2013), http://www.climatecentral.org/news/ipcc-climate-change-report-contains-grave-carbon-budget-message-16569.

158. ANSAR ET AL., *supra* note 1, at 14.

159. *See id.* at 29.

160. *See id.* at 30; *see also supra* notes 1–22 and accompanying text.

161. M. Todd Henderson, *Divestment and Financial Illiteracy*, HUFFINGTON POST BUS. (May 21, 2013, 8:20 AM), http://www.huffingtonpost.com/m-todd-henderson/divestment-and-financial-_b_3308747.html.

information to the market about the future cash flows."[162] The Stranded Assets Program report finds that stigmatization due to the fossil fuel divestment campaign could convey such information.[163] Stigma "evokes a collective perception from a social audience that a target organisation 'possesses a fundamental, deep-seated flaw that deindividuates and discredits the organisation.'"[164] Stigmatization can scare "away suppliers, subcontractors, potential employees, and customers."[165]

Governments prefer to do business with firms perceived as responsible to avoid tainting their own reputation.[166] Firms that experience stigmatization may be unable to compete for projects, be barred from permits or licenses, and have weakened bargaining power with other companies. For example, Ashland Oil Company sold its South African operations when, in mid-1986, it stood to lose a $12-million contract with the City of Los Angeles.[167] Stigmatization can depress the value of stock by making the company appear risky, even where the actual value of the company remains unchanged.[168]

Stigmatization can also foreshadow legislation. This is one of the most consistent results of divestment campaigns, and is a likely and desirable outcome of the fossil fuel divestment campaign.[169] If the campaign spreads the belief that legislation restricting the extraction or use of fossil fuels (such as a drilling ban or a carbon tax) is imminent, it increases the uncertainty of the future profitability of fossil fuel companies.[170] The threat of such legislation is sufficient to create uncertainty around future cash flows and provoke even morally uninterested investors to sell their shares.[171]

Stigmatization is likely to be the most tangible effect on fossil fuel companies.[172] Because people increasingly believe that doing nothing in the face of climate change is unethical and financially unwise, fossil fuel companies are beginning to experience negative stigmatization. Norway's Storebrand, a large private pension and insurance firm, sold its shares of nineteen fossil fuel companies.[173] The firm does not have an ethical mission; rather, they determined that investment in fossil fuels no longer

162. *Id.*
163. ANSAR ET AL., *supra* note 1, at 71.
164. *Id.* at 36.
165. *Id.* at 14.
166. *Id.*
167. Knight, *supra* note 32, at 75.
168. ANSAR ET AL., *supra* note 1, at 14.
169. *Id.*
170. *Id.*
171. *Id.* at 67.
172. *Id.* at 71.
173. *Rabobank, Storebrand Dump Fossil Fuel Companies*, ENVTL. LEADER (July 8, 2013), http://www.environmentalleader.com/2013/07/08/rabobank-storebrand-dump-fossil-fuel-companies.

served the long-term financial goals of its clients.[174] More recently, the heirs to the Rockefeller oil fortune cleared the Rockefeller Brothers Fund of its fossil fuel assets.[175] Stanford University emptied its endowment of investments in coal.[176] Financial institutions may begin to find fossil fuel stocks undesirable for purely economic reasons, in addition to moral reasons.[177]

Adherents to the efficient market hypothesis would argue that all available knowledge about the risk that climate change poses to the viability of the fossil fuel industry (including stranded assets and stigmatization) is already reflected in fossil fuel share prices. However, since the 1987 Supreme Court decision that announced the presumption of an efficient market, *Basic v. Levinson*,[178] the efficient market theory has been challenged as "a theory in search of objective proof."[179] Moreover, recent calls for fossil fuel companies to disclose their climate change risk and carbon fuel holdings suggest mounting concern that information relevant to investors, while available through other media, is not part of regular disclosures and thus not reflected in investment decisions.[180]

3. Changes in Market Norms and Debt Financing

Explained below are two other possible, though unlikely, direct impacts that the fossil fuel divestment campaign may have on fossil fuel companies: changes in market norms and debt financing.[181]

If the campaign signals a shift in market norms, a relatively small removal of assets could cause a lasting depression of share value. This is because money managers manage money uniformly according to market conventions to avoid the risk of accusations of mismanagement.

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174. Gabe McHugh, *The Sun Sets on Fossil Fuels: Norwegian Pension Fund Divests from Financially Worthless Assets*, ALTERNET (Oct. 15, 2013), http://www.alternet.org/environment/sun-sets-fossil-fuels-norwegian-pension-fund-divests-financially-worthless-assets.

175. Suzanne Goldenberg, *Heirs to Rockefeller Oil Fortune Divest from Fossil Fuels over Climate Change*, GUARDIAN (Sept. 22, 2014), http://www.theguardian.com/environment/2014/sep/22/rockefeller-heirs-divest-fossil-fuels-climate-change.

176. *Stanford to Divest from Coal Companies*, STANFORD NEWS (May 6, 2014), http://news.stanford.edu/news/2014/may/divest-coal-trustees-050714.html.

177. Jamie Arbib, *Organisations Controlling £30bn Are Divesting from Fossil Fuels*, GUARDIAN (Sept. 22, 2014), http://www.theguardian.com/sustainable-business/2014/sep/22/divestment-campiagn-fossil-fuels-dirty-energy-stanford.

178. 485 U.S. 224 (1987).

179. Daniel Fisher, *Supreme Court Takes Halliburton's Frontal Assault on Securities Class Action*, FORBES (Nov. 16, 2013, 10:29 AM), http://www.forbes.com/sites/danielfisher/2013/11/16/supreme-court-takes-halliburtons-frontal-assault-on-securities-class-actions.

180. *See*, *e.g.*, Steve Burkholder, *FASB to Weigh Writing of Rules Calling for Companies to Disclose Carbon Holdings*, 46 SEC. REG. & L. REP., no. 17, at 845 (2014).

181. ANSAR ET AL., *supra* note 1, at 12–13.

Demonstrating a herd mentality, money managers may act irrationally when it appears that their peer institutions are all following a pattern of behavior.[182] A change in market norms could occur if divestment triggers a snowball effect, where influential investors begin to move capital away from fossil fuel companies, and it quickly becomes unacceptable for others not to follow suit.[183] Studies show that divestment campaigns can result in shifts in market norms.[184] This is unlikely to happen solely due to public pension fund divestment because the amount of capital that the divestment campaign targets is relatively small and unlikely to trigger such a snowball effect.[185] However, divestment by institutions like Stanford and the Rockefeller Brothers Fund could signal a change in market norms.

Furthermore, debt financing becomes less available when banks consider a venture too risky to be worth extending credit.[186] This happened in South Africa during apartheid. U.S. banks denied loans to South Africa in response to uncertainty created by the divestment campaign.[187] This is unlikely to happen with the fossil fuel industry. There are many sources of capital, and the industry's high liquidity largely shields it from defaulting on debt.[188] However, this may impact financing of riskier projects, such as those that are located in remote geographical locations or are politically contentious.[189] Though there is a chance that the divestment campaign will cause a shift in market norms or debt financing, these impacts are unlikely and do not support divestment on those grounds.

Because there is evidence that fossil fuel company stocks are at risk of stigmatization and of becoming "stranded assets," pension plan managers divesting from fossil fuel companies do not breach their fiduciary duty of prudence. Indeed, pension plan managers who choose not to divest should take a close look at the risk fossil fuel assets pose to their portfolios. In light of the research presented above, pension plan managers who do not stay informed of these political and economic developments may find themselves in breach of their duty of prudence for failure to consider the extent of the risk of climate change.

182. *Id.* at 31.
183. *Id.* at 32.
184. *Id.* at 62.
185. *Id.*
186. *Id.*
187. *Id.* at 63.
188. *Id.* at 62.
189. *Id.* at 63.

V. Another Legal Consideration: The Nondelegation Doctrine

Proponents of divestment encourage removing assets from the "Carbon Tracker 200", a list of the top 200 contributors to climate change.[190] For example, a resolution in Providence, Rhode Island calls for divestment of "assets includ[ing] holdings in fossil fuel public equities and corporate bonds as determined by the Carbon Tracker list."[191] This is low-hanging fruit for those seeking to challenge legislation. The Maryland Court of Appeals considered whether the Baltimore Legislature had impermissibly delegated its lawmaking authority when it instructed pension fund directors to divest from the Africa Fund's "Unified List of United States Companies with Investments or Loans in South Africa and Namibia."[192] The court noted that it would strictly scrutinize delegation to a private entity (as opposed to an agency) because such entities are "wholly unaccountable to the general public."[193]

Also troubling to the court was the fact that the Baltimore ordinances did not merely accept a fixed list of companies promulgated by the Africa Fund; rather, the ordinance directed trustees to refer to the most recent annual report.[194] If the ordinance delegated to the Africa Fund the power to identify companies subject to divestment, reasoned the court, there would have been serious concerns about the validity of the ordinance.[195] However, in a feat of constitutional avoidance, the Court of Appeals interpreted the language of the ordinance to require the pension plan managers to use the Unified List as "merely as an advisory reference."[196] Noting that the descriptor "'doing business' in a particular area" lends itself to multiple interpretations, the court proposed its own standard: doing "a 'substantial amount of business' or engaging 'in significant business activity' in that area."[197] In drafting divestment legislation, lawmakers should consider including methods for determining from which companies' pension plan managers should be required to divest to avoid nondelegation challenges.

VI. Areas for Further Research

This Note leaves open the question of whether divestment would actually achieve a desirable social outcome. The results of the anti-

190. Joshua Humphreys, Institutional Pathways to Fossil-Free Investing 6 (2013), *available at* http://gofossilfree.org/se/wp-content/uploads/sites/13/2014/07/Rapport-Institutional-Pathways-toFossil-Free-Investing.pdf.

191. *Resolution of the City Council*, *supra* note 102.

192. Bd. of Trs. v. Mayor of Balt. City, 562 A.2d 720, 730–33 (Md. 1989), *cert. denied*, 493 U.S. 1093 (1990).

193. *Id.* at 730.

194. *Id.* at 731.

195. *Id.* at 732.

196. *Id.*

197. *Id.* at 732–33.

apartheid divestment campaign were decidedly mixed, and critics proposed many other actions that may have had a more direct and lasting impact on the well being of black South Africans. Likewise, there may be more desirable alternatives to divestment, such as shareholder engagement. Divestment also involves transactional and other costs, an economic consideration beyond the scope of this Note.

Finally, this Note also leaves for another time the question of when liability for *continued* investment in fossil fuels will attach. Assuming that the economic predictions supporting this Note's conclusion ultimately occur, the question arises: Are pension plan managers continuing to invest in fossil fuel companies currently in breach of their fiduciary duties? For the same reasons, fiduciary duties may ultimately require trustees to divest. As described above, there is evidence that current stock prices reflect the value of unburnable carbon reserves. Indeed, a recent IPCC report found that companies and governments worldwide have identified four times more fossil fuel in reserve than the earth can safely burn without experiencing the most drastic effects of climate change.[198] When stock prices adjust, they will depress permanently, causing a loss to shareholders and beneficiaries. Evidence from past divestment campaigns shows that the campaign itself, through stigmatization of the fossil fuel industry and the ultimate achievement of industry regulation, could lead to decreased share value.[199] However, because the duty of prudence requires measured decisionmaking, and not a specific outcome, this question warrants further exploration.

Conclusion

Though divestment from fossil fuels may be more financially complex than anti-apartheid divestment, it does not require pension plan managers to breach their fiduciary duties. Reversing climate change will take a global, cohesive effort that the U.S. government has so far resisted. However, as the strength of the fossil fuel divestment movement indicates, the public's motivation for change could prove an alternative catalyst. Because fossil fuel-free portfolios perform similarly to other portfolios, divestment from fossil fuels does not breach a plan manager's duty of loyalty, even if divestment is socially motivated. Furthermore, divestment does not require a breach of the duty of prudence. That fossil fuels are at risk of becoming stranded assets, and fossil fuel companies are at risk of being stigmatized, conveys valuable information about the future value of these stocks. Thus, divestment based on an evaluation of these risks is consistent with the duty of prudence. Consistent with their

198. Justin Gillis, *U.N. Draft Report Lists Unchecked Emissions Risks*, N.Y. Times, Aug. 27, 2014, at A3.

199. *See supra* Part IV.

fiduciary duties, public pension plan managers may divest from fossil fuel companies, whether motivated by economic considerations, moral duty, or to signal their commitment to reversing climate change.

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