



STATE OF KANSAS

OFFICE OF THE ATTORNEY GENERAL

2ND FLOOR, KANSAS JUDICIAL CENTER, TOPEKA 66612

ROBERT T. STEPHAN
ATTORNEY GENERAL

November 12, 1985

MAIN PHONE: (913) 296-2215
CONSUMER PROTECTION: 296-3751

ATTORNEY GENERAL OPINION NO. 85- 153

The Honorable Jessie M. Branson
Representative, Forty-Fourth District
800 Broadview Drive
Lawrence, Kansas 66044-2423

The Honorable Betty Jo Charlton
Representative, Forty-Sixth District
1624 Indiana Street
Lawrence, Kansas 66044

The Honorable Henry Helgersen
Representative, Eighty-Sixth District
4009 Hammond Drive
Wichita, Kansas 67218

Re: Corporations -- Loans or Investments -- Standards
for Investment; Prudent Person Rule

Personal and Real Property -- Uniform Management of
Institutional Funds -- Standard of Conduct;
Business Care Rule

Synopsis: Kansas law contains two different standards, the "prudent person" rule and the "business care" rule, which are relevant to any question concerning the divestment by a trust fund of assets linked to investments in the Republic of South Africa. The identity of the holder of the assets determines the applicable standard. In administering the investments which are subject to their control, cities and counties are subject to the "prudent person" rule of K.S.A. 17-5004, which requires them to exercise the same care in the management of trust funds that prudent persons would use in managing their own affairs. Universities and

The Honorable Jessie M. Branson
The Honorable Betty Jo Charlton
The Honorable Henry Helgerson
Page 2

charitable corporations such as endowment funds are subject to the "business care" rule found at K.S.A. 58-3606, which requires the exercise of ordinary business care and prudence, based on the facts available at the time. While neither standard permits divestment decisions to be made on moral grounds alone, the "prudent person" standard does permit divestment upon a finding by the trustees that economic conditions in South Africa make continued investment in a particular asset less than prudent. Under the "business care" standard, notice may be taken of both the political and economic situations existing in the country as they affect the security of the investment. Cited herein: K.S.A. 17-5004; 58-3606; 74-4921; L. 1983, ch. 374; Kan. Const., Art. 2, §20.

* * *

Dear Representatives Branson, Charlton and Helgerson:

As members of the Kansas House of Representatives, you have each submitted requests to this office asking for our opinion concerning the "prudent person rule" as it applies to universities, endowment funds, cities and counties. Specifically, you ask whether the "prudent person rule" precludes universities, endowment funds, cities and counties from divesting of stocks and other interests in corporations which do business in South Africa. As your separate inquiries are similar in nature, we address your questions in one opinion.

The central issue presented by each of your requests concerns whether governmental entities or charitable corporations may legally "divest" themselves of stocks and other assets in corporations with financial ties to the Republic of South Africa. As noted in Attorney General Opinion No. 83-135, that country

"currently is undergoing substantial public criticism in the United States for its policy of apartheid. From an Afrikaner word meaning 'separateness,' its historical antecedents go back to the 17th century, when the area was first settled by colonists from the Netherlands. These settlers, or Boers, as they called themselves, based their

The Honorable Jessie M. Branson
The Honorable Betty Jo Charlton
The Honorable Henry Helgerson
Page 3

domination of the native Hottentots and the Bantu to the north on principles they believed to be found in the Bible. Although restrained by the British during the period from 1815 to 1908, the Boers gradually extended their beliefs into government policy from that time on, with the definitive break coming in 1948 with the Nationalist Party's electoral victory over the more moderate and pro-British elements. Since that time, apartheid has been criticized by the nations and peoples of the world."

Our research has not disclosed any Kansas statutes or cases which specifically address divestiture of investments in corporations doing business in the Republic of South Africa. 1983 House Resolution No. 6056 (L. 1983, ch. 374) declares it to be the policy of the Kansas House of Representatives that such investment practices are against public policy. However, such a resolution does not have the force and effect of law. See Kansas Constitution, Article 2, Section 20.

The standard of care to be exercised by the trustees of a university, an endowment fund, or a city or county pension fund is generally derived from the law of trusts. The standard is commonly referred to as the "prudent person" rule and generally requires trustees to exercise the same care in the management of trust funds that prudent persons of intelligence and discretion would use in managing their own affairs. (See K.S.A. 17-5004, cited below.) Until recently, universities have relied on such traditional trust law to determine the fiduciary duties of their trustees, because little statutory or case law existed regarding the trustees or the governing boards of charitable or non-profit corporations. However, the emerging standard applicable to universities and endowment funds is derived from corporate, rather than trust, law. That standard, contained in K.S.A. 58-3606, directs trustees to make their investment decisions subject to "ordinary business care and prudence under the facts and circumstances prevailing at the time of action or decision." While similar, these standards are not identical. Accordingly, the standard of care for universities and endowment associations will be discussed under the traditional "prudent person" standard (which is applicable to the state and its political subdivisions), and also under the emerging "business care" standard.

The Honorable Jessie M. Branson
The Honorable Betty Jo Charlton
The Honorable Henry Helgerson
Page 4

The "prudent person" rule is codified at K.S.A. 17-5004 and states in part as follows:

"In acquiring, investing, reinvesting, exchanging, retaining, selling and managing property for the benefit of another, a fiduciary shall exercise the judgment and care under the circumstances then prevailing, which men of prudence, discretion and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of their capital. Within the limitations of the foregoing standard, a fiduciary is authorized to acquire and retain every kind of property, real, personal or mixed, and every kind of investment, specifically but not by way of limitation, bonds, debentures and other corporate obligations, and stocks, preferred or common, and securities of any open-end or closed-end management type investment company or investment trust registered under the federal investment company act of 1940, as from time to time amended, which men of prudence, discretion and intelligence acquire or retain for their own account, and within the limitations of the foregoing standard, a fiduciary may retain property properly acquired, without limitation as to time and without regard to its suitability for original purchase." (Emphasis added.)

"Prudent person" is defined in K.S.A. 58-1201(c) as follows:

"'prudent person' means a trustee whose exercise of trust powers is reasonable and equitable in view of the interests of income or principal beneficiaries, or both, and in view of the manner in which persons of prudence, discretion and intelligence would act in the management of their own affairs." (Emphasis added.)

The "prudent person" rule establishes a high fiduciary standard of care in managing trust assets. In re Estate of Rothko, 43 N.Y.2d 305, 372 N.E.2d 291 (1977); In re Bank of New York, 35 N.Y.2d 512, 323 N.E.2d 700 (1974). Hence, traditional notions of prudent investment would not enable trustees to make a decision to divest based solely on moral beliefs without violating their fiduciary responsibilities.

However, K.S.A. 17-5004 allows a trustee to consider the "probable income" of the investment as well as the "probable safety" of the capital. Pursuant to such language, in our opinion a trustee could legitimately consider the present economic climate of South Africa in making a divestment decision, i.e., investments which are in danger of being expropriated or destroyed may be imprudent. A decision by trustees to divest could be based on the theory that any immediate loss from selling stock of corporations doing business in the Republic of South Africa would be less than the potential loss if the growing political crisis leads to nationalization or even destruction of the corporation's property, with a decline in the value of the particular stock. Therefore, the prevailing fiduciary standard of care does not prohibit trustees from divesting on the grounds of potential economic loss if the trustees believe divestiture is in the best interests of all trust beneficiaries, both present and future.

A case which illustrates the merging of economic factors with political ones is Chase National Bank of New York City v. Runicke, 10 N.Y.S.2d 420 (1938). There, a trustee was requested by the settlor of a trust to loan the settlor 80% of the corpus, as provided for in the trust instrument. Repayment was to be made by the settlor (a resident of Germany) subject to existing laws of the Third Reich which limited such repayment of interest to a fraction of what was actually owed. The court found that the trustee properly refused to make a loan under such conditions, where there was little hope of repayment.

In noting that this economic fact was related to prevailing political conditions in Germany, the court found as follows:

"Judicial notice of the condition now existing under the presently controlled government of Germany, is inescapable. Some of its citizens are deprived of their homes, of the right of free speech, of their liberties, or of any privileges

The Honorable Jessie M. Branson
The Honorable Betty Jo Charlton
The Honorable Henry Helgerson
Page 6

usually accorded to citizens and inhabitants of a civilized country, and this without even a pretext of law, order, or of justice. Rigid, abnormal and cruel restrictions affecting their human and property rights are enacted and enforced without reason and without warning. Power and Force has supplanted Right and Justice. All of it is revolting to the mind and sickening to the heart.

"Phrases, impregnated with a wealth of meaning in our Courts, such as 'Justice under the Law', 'Due regard for human rights or property rights', 'Due process of Law' and many others, too numerous to mention, are preciousy regarded, and safeguarded by us. These are foreign terms in the Third Reich, and for the present, there seems to be neither the ability nor the willingness to understand them." 10 N.Y.S.2d at 430.

As earlier noted, the standard of care governing the trustees of a university or an endowment fund was initially derived from corporation law and the law of trusts, as is K.S.A. 17-5004. However, the Uniform Management of Institutional funds Act (UMIFA), codified in Kansas at K.S.A. 58-3601 et seq., was adopted in 1973 as an attempt to respond to the needs of trustees of universities and charitable corporations in carrying out their responsibilities. In part, the "business care" standard was adopted in order to alleviate the debilitating effect that fear of liability may have upon members of a governing board. K.S.A. 58-3606 describes the standard of conduct required of trustees when making investment decisions:

"In the administration of the powers to appropriate appreciation, to make and retain investments, and to delegate investment management of institutional funds, members of a governing board shall exercise ordinary business care and prudence under the facts and circumstances prevailing at the time of the action or decision, and in so doing they shall

consider long and short term needs of the institution in carrying out its educational, religious, charitable, or other eleemosynary purposes, its present and anticipated financial requirements, expected total return on its investments, price level trends, and general economic conditions." (Emphasis added.)

A number of commentators have observed that the "business care" standard is somewhat more flexible than is the "prudent person" standard, for the "business care" standard requires proof of bad faith or gross or willful neglect before personal liability for an investment (or divestment) decision can be imposed on trustees or directors. Comment, Divestiture Resolutions: University Director Liability Under the Emerging Corporate Standard, 15 U.S.F.L.Rev. 261 (1981); Comment, University Investments in South Africa, 11 Journal of Law and Politics 543 (1979). See also Stern v. Lucy Webb Hayes National Training School, 381 F.Supp. 1003 (Dist. of Col. 1974), which is in accord with the UMIFA, of which K.S.A. 58-3606 is a part.

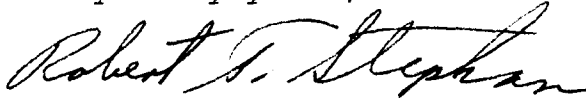
Further, the more liberal investment discretion allowed charitable corporations under the "business care" standard enables trust administrators to exercise greater discretion in their investment decisions than is enforced by the traditional trust standards of the "prudent person" rule. As a result, if held to the "business care" standard, directors or trustees may legitimately consider both the political and the economic climate of the Republic of South Africa, especially if the present unrest there constitutes a change in circumstances threatening to defeat or substantially impair the accomplishment of the trust purpose. If such a showing could be made, under UMIFA the trustees of a university or the directors of an endowment association could defend themselves from a legal challenge arising out of their decision to divest, even if some economic loss resulted from the decision.

In conclusion, Kansas law contains two different standards, the "prudent person" rule and the "business care" rule, which are relevant to any question concerning the divestment by a trust fund of assets linked to investments in the Republic of South Africa. The identity of the holder of the assets determines the applicable standard. In administering the investments which are subject to their control, cities and counties are subject to the "prudent person" rule of K.S.A. 17-5004, which requires them to exercise the same care in the

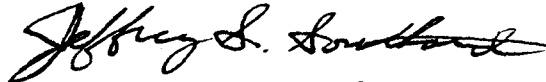
The Honorable Jessie M. Branson
The Honorable Betty Jo Charlton
The Honorable Henry Helgerson
Page 8

management of trust funds that prudent persons would use in managing their own affairs. Universities and charitable corporations such as endowment funds are subject to the "business care" rule found at K.S.A. 58-3606, which requires the exercise of ordinary business care and prudence, based on the facts available at the time. While neither standard permits divestment decisions to be made on moral grounds alone, the "prudent person" standard does permit divestment upon a finding by the trustees that economic conditions in South Africa make continued investment in a particular asset less than prudent. Under the "business care" standard, notice may be taken of both the political and economic situations existing in the country as they affect the security of the investment.

Very truly yours,



ROBERT T. STEPHAN
ATTORNEY GENERAL OF KANSAS



Jeffrey S. Southard
Deputy Attorney General

RTS:JSS:BGH:crw