

July 7, 2008

The Honorable Condoleezza Rice
Secretary of State
United States Department of State
Harry S. Truman Building
2201 C Street, N.W., Room 7226
Washington, D.C. 20520

Re: State and Local Sanctions

Dear Madam Secretary:

The Advisory Committee on International Economic Policy has examined the increasing reliance by U.S. state governments on sub-federal foreign policy measures as well as pending and enacted federal legislation to encourage such actions. Many members of the Committee are deeply concerned about this proliferation of foreign policy measures at the state level.

The majority of Committee members believe it would be helpful for the State Department to write to state attorneys general to highlight the potential complications for the conduct of U.S. foreign policy and American economic interests abroad of state sanctions and divestment statutes, and to provide clear limiting guidance based on recent court decisions and enacted legislation like the Sudan Accountability and Divestment Act. We also strongly encourage the State Department to communicate publicly and to Members of Congress the constitutional concerns and practical difficulties this type of legislation poses for the conduct of U.S. foreign policy and the furtherance of U.S. economic interests.

In particular, we recommend that you raise the following concerns publicly, in speeches and meetings, and in writing to state attorneys general and federal legislators:

- **State action on foreign policy issues detracts from the ability of the United States to speak with one voice to the world and complicates the President's conduct of American foreign policy.** Statutes aimed at affecting foreign policy at the state and local levels threaten to create a complex web of restrictions and regulations that interfere with the Constitutional rights given to the President to conduct foreign policy. These statutes send mixed messages to the world about the genesis and intent of American policy. Historically, many of these statutes remain on the books long after federal policy has changed. Massachusetts' sanctions on South Africa, for example, are still officially on the books. In addition, some of them explicitly contradict U.S. government policy. The original Illinois Sudan divestment law, for example, did not acknowledge any difference between southern Sudan and the Khartoum government and would have penalized companies doing business with the former, even when it was pursuant to a U.S. government license. Several members of the Committee – in particular, representatives of labor and Consumers Union – wish to emphasize that while state legislation should be up-to-date and carefully crafted, in certain

egregious cases, state action can serve to bring much-needed attention and focus to urgent human rights concerns.

- **There are serious constitutional concerns with state foreign policy legislation.** A number of court cases suggest serious constitutional concerns with the kind of foreign policy legislation that is gaining ground in state legislatures.

NFTC v. Giannoulis: In February 2007, the Federal District Court for the Northern District of Illinois overturned that state's Sudan sanctions law which required pension funds to divest Sudan-related assets. In *NFTC v. Giannoulis* the Court found that the law was in conflict with the Foreign Commerce Clause of the Constitution, adding to the Federal jurisprudence on constitutional limitations on the ability of states to impose foreign policy sanctions.

Crosby v. NFTC: In 2000, the U.S. Supreme Court unanimously struck down a Massachusetts law that prohibited the state from purchasing goods and services from companies that had commercial ties to Burma. The Court found that the state was preempted from imposing sanctions under the Supremacy Clause of the Constitution since Congress had previously imposed sanctions on Burma. The Court held that "even without an express preemption provision, state law must yield to a congressional act if Congress intends to occupy the field." The Court went on to say "it is implausible to think that Congress would have gone to such lengths to empower the President had it been willing to compromise his effectiveness by allowing state or local ordinances to blunt the consequences of his actions. Yet that is exactly what the state Act does...The state Act undermines the President's capacity for effective diplomacy."

As in the case of Burma, U.S. companies are prohibited by federal law from doing business in the countries referenced by current state bills. Commerce with these and other countries is further restricted by virtue of the fact that most of the countries targeted by state legislatures are on the State Department's terrorist list. The Federal Government has clearly occupied the field by enacting comprehensive sanctions on countries such as Sudan, Iran and Cuba; yet states continue to act, often in ways inconsistent with federal policy.

- **State sanctions and divestment legislation is extraterritorial and may violate U.S. international obligations.** Japan and the European Community initiated WTO proceedings against the United States in the wake of the passage by Massachusetts of its law to deny government procurement contracts to U.S. and foreign companies doing business in or with Burma. This case was dismissed only after the Supreme Court declared the law to be unconstitutional.
- **State sanctions force American and foreign businesses to comply with 50 different foreign policies.** Sanctions by individual states impose enormous compliance difficulties for companies, as each state and local law is different, creating as many as 50 different foreign policies, each with different rules and different lists of sanctioned companies. These measures impose compliance costs on businesses. A company could be on a divestment list in New Jersey but not in California, which puts mutual funds in a difficult position, being told to divest to comply with legal requirements in one state, but having a fiduciary duty in

other states to consider a broader range of factors. Companies and investors also incur costs monitoring, researching, and complying with these proliferating laws, which may differ from federal policy. In Illinois, the combined lists of so-called “forbidden entities” doing business in Sudan named 233 companies. Had it not been declared unconstitutional, the law would have affected 581 vendors of investment products, and a screening of Morningstar’s database suggested at the time that over 900 equity mutual funds owned at least one forbidden entity.

- **In many cases, state measures are opaque and often rely on inaccurate or outdated information to compile lists of targeted companies.** There is no federal list to rely upon to identify companies which are doing business in particular countries, and the available alternatives are highly subjective in terms of their accuracy and the breadth of companies they target. Additionally, some lists of companies are linked to organizations that have foreign policy motives that inform their work, which call into question their validity and the evenhandedness by which the organization evaluates ties to countries like Iran. At the federal level, the Securities and Exchange Commission was forced to remove a deeply flawed list of companies purported to be involved in terrorist states when it came to light that at least one company on the list had announced it was ceasing business in Iran, while another was a pharmaceutical company developing a drug in Cuba with the express authorization of the U.S. Government. Furthermore, companies that are captured by the provisions of these state laws have no obvious recourse to object, in many cases may be unaware that they are on an exclusion list and have found it difficult to get off the list even if they are not involved in whatever actions resulted in their initial inclusion.
- **Recently-enacted federal legislation aims at limiting the scope of state action.** Recognizing the important constitutional questions outlined above, the U.S. Congress passed and the President signed the Sudan Accountability and Divestment Act (Public Law No: 110-174, S. 2271), which enables divestment in the case of Sudan according to narrow criteria. Given this very clear recognition by Congress as to the constitutional issues surrounding divestment, the fact that they have passed legislation enabling divestment in the narrow, particular circumstance of Sudan strongly suggests that any other State divestment initiative which goes beyond the purpose of divesting from Sudan is of dubious constitutionality. Furthermore, in any other case the state would not be protected from the “safe harbor” provisions of the federal law that would prevent legal action by injured parties.

Despite these serious practical and constitutional concerns, broad divestment bills continue to be proposed in state legislatures, and some are gaining momentum.

- In Michigan, SB 846, which would impose a broad divestment requirement against companies doing business with countries designated as state sponsors of terror, has passed the state Senate and is pending in the House.
- In Pennsylvania, bills (HB 1085, 1086 and 1087) were proposed last year that would have subjected over 140 major multinational companies to divestment from the State’s public retirement funds, according to a study prepared at the request of one of the major pension fund’s trustees. The study identified a number of companies whose ties to the nations in question were either misleading or wholly inaccurate.

- Legislators in California, Florida and Illinois have proposed measures which directly contravene the Supreme Court's unanimous decision in 2000 regarding federal preemption.
- These bills would impose procurement bans almost identical to the one that was struck down by the Court in 2000 and would appear to be highly vulnerable to a Constitutional challenge on the same grounds.

Forays by state legislators (and legislatures) into U.S. foreign policy are growing, and are likely to continue to escalate in number and scope unless they are checked by a strong federal response. In 2007 and 2008, states attempted to target a range of countries including Sudan, Iran, Burma, Cuba and China. With the exception of the labor representatives and the Consumers Union member, the Committee strongly encourages you to craft and lead a robust response to these efforts to make certain that the United States is able to speak effectively with one voice on U.S. foreign policy matters.

Thank you for your consideration of these comments.

Sincerely,



Theodore W. Kassinger
Chairman
Advisory Committee on International
Economic Policy



William Reinsch
Chairman
Subcommittee on Economic
Sanctions