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# Challenges to the Constitutionality of the California Divestment Statute

In recent years, many Americans have become increasingly critical of the apartheid system in South Africa.<sup>1</sup> Growing racial tensions and outbreaks of violence in South Africa have caused many people to challenge the role of the United States government in South Africa.<sup>2</sup> Discontentment with apartheid has been evidenced by numerous student protests on university campuses and has resulted in major corporations ceasing operations in South Africa.<sup>3</sup> Opponents of apartheid have attempted to persuade the government to reduce or sever political and economic ties with South Africa.<sup>4</sup> Divestment has been advocated to achieve this end.<sup>5</sup> Typical divestment plans usually require that governmental entities sell all securities invested in corporations operating in or which have economic ties with South Africa.<sup>6</sup>

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1. Schmidt, *Impose Tough Sanctions on South Africa*, N.Y. TIMES, Jan. 17, 1986, at A31, col. 2 (argument for the United States government, businesses and educational institutions to impose tougher sanctions on South Africa).

2. See *Fighting Apartheid*, ECONOMIST Mar. 30, 1985, at 11; *Sanctions on South Africa*, ECONOMIST, Aug. 3, 1985, at 12.

3. See N.Y. TIMES, May 18, 1986, § 1, at 30, col. 1 (universities debate the costs of selling investment linked to South Africa); N.Y. TIMES, Feb. 2, 1986, § 1 at 14, col. 3 (pressure rises on colleges to withdraw South African interests); N.Y. TIMES, Oct. 3, 1986, at A8, col. 1 (Harvard divests South African holdings).

4. Schmidt, *Impose Tough Sanctions on South Africa*, N.Y. TIMES, Jan. 17, 1986, at A31, col. 2.

5. See N.Y. TIMES, Apr. 26, 1985, at B4, col. 3 (localities and state press South African Divestment effort). See, e.g., NEB. REV. STAT. § 72-1270 to 72-1276 (1986) (Nebraska divestment statute); R.I. GEN. LAWS § 35-10-12 (1985) (divestment of Rhode Island state funds and pension funds from any corporation doing business in South Africa); WIS. STAT. § 36.29(1) (1975). See also BERKELEY, CAL., RES. 52, 858-N.S. (July 30, 1985) (example of city ordinance requiring divestment).

6. See Note, *State and Local Anti-South Africa Actions as an Intrusion upon the Federal Power in Foreign Affairs*, 72 VA. L. REV. 813, 816-17 n.21 (1986) (distinguishes between the terms "divestment" and "disinvestment"). Divestment means the sale of investments while disinvestment refers to the process by which corporations withdraw operations. *Id.* Educational institutions have additionally divested stock in excess of \$410 million. *Id.* at 817.

Assembly Bill 134 (hereinafter AB 134) requires that California sever all economic ties with the government of South Africa by 1991.<sup>7</sup> To this end, AB 134 requires the State of California to divest all state funds from businesses connected to South Africa.<sup>8</sup> AB 134 further prohibits new investments in businesses tied to South Africa.<sup>9</sup>

One week after the passage of AB 134, Congress enacted the *Comprehensive Anti-Apartheid Act of 1986* (hereinafter the Act) over a presidential veto.<sup>10</sup> This statute establishes a federal mechanism to undermine the apartheid system and assist the victims of apartheid.<sup>11</sup> Under the federal law, American companies are not required to sever ties with South Africa.<sup>12</sup> The law merely restricts corporations from expanding their operations in South Africa.<sup>13</sup>

Several constitutional questions are raised after the enactments of AB 134 and the federal Anti-Apartheid Act. The first challenge to AB 134 may be brought under the doctrine of federal preemption. Since the United States Constitution states that federal law is supreme, the federal act will preempt the California statute if the two statutes directly conflict.<sup>14</sup> In absence of direct confrontation, AB 134 may also be preempted if Congress has expressly or impliedly occupied the entire field of regulation regarding apartheid.<sup>15</sup>

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7. CAL. GOV'T CODE §§ 16640-16650 (West Supp. 1987). See also *Review of Selected 1986 California Legislation*, 18 PAC. L.J. 543 (1987) (describing the California divestment law). The bill was signed by the governor on September 26, 1986. Act of Sept. 26, 1986, ch. 1254, sec. 1, 1986 CAL. LEGIS. SERV. 99, 101-02 (West).

8. CAL. GOV'T CODE §§ 16641, 16642, 16645, 16646 (West Supp. 1987). But see *id.* §§ 16642.5, 16642.7. (an exception for the noninvestment policy is made when the governing body of the business adopts a policy not to expand existing operations in South Africa). See also SACRAMENTO BEE, Mar. 10, 1987, at A10, col. 1 (California divestment law requires the state to sell \$11.4 billion in pensions funds).

9. CAL. GOV'T CODE § 16641 (West Supp. 1987).

10. See COMPREHENSIVE ANTI-APARTHEID ACT OF 1986, PUB. L. No. 99-440, 1986 U.S. CODE CONG. & ADMIN. NEWS (100 Stat.) 1086 (1986) (codified in scattered sections of 22 U.S.C.). This Act became law on Oct. 2, 1986. See N.Y. TIMES, Oct. 3, 1986, at A1, col. 6.

11. 22 U.S.C.A. § 5002 (West Supp. 1987). "The purpose of this Act is to set forth a comprehensive and complete framework to guide the efforts of the United States in helping to bring an end to apartheid in South Africa and to lead to the establishment of a nonracial, democratic form of government." *Id.*

12. See *id.* § 5060 (no national of the United States shall make any new investment in South Africa). The definition of national of the United States is any citizen, resident alien, or business organized under the laws of the United States. *Id.* § 5001(5).

13. *Id.* § 5060.

14. See, e.g., *Ray v. Atlantic Richmond Co.*, 435 U.S. 151, 158 (1979). A direct preemption will occur when compliance with both the state and federal law is impossible due to their inconsistency. *Id.*

15. See U.S. CONST. ART. IV, § 2 (the Constitution declares that federal laws are supreme). See also *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947). The Court

A second challenge to the validity of AB 134 may arise under the commerce clause of the United States Constitution.<sup>16</sup> Under the commerce clause, a state has limited powers to interfere with interstate and foreign commerce.<sup>17</sup> If the investment of funds is determined to be a "regulation of commerce" for the purposes of the commerce clause, AB 134 cannot unduly burden interstate or foreign commerce to further a legitimate local purpose.<sup>18</sup> If the legislation, however, falls within the market participant exception to the commerce clause, AB 134 may avoid being deemed unconstitutional.<sup>19</sup> Under the market participant exception, a state may exert an impact on a market when the state is acting as a participant rather than a regulator.<sup>20</sup> The market participant doctrine, however, has never been extended to allow a state to affect foreign commerce.<sup>21</sup>

Additionally, the validity of AB 134 may face a challenge based on the California state constitution.<sup>22</sup> The state is required by the California constitution to invest state trust funds for the exclusive purpose of serving beneficiaries of the trusts.<sup>23</sup> Since AB 134 uses the trust funds as a political boycott instead of primarily benefiting the trust participants, AB 134 may violate this provision of the state constitution.<sup>24</sup>

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sets out three ways a state statute may be indirectly preempted. First, the state statute is preempted if the state legislates in an area where the federal government has a comprehensive regulation plan. In addition, a statute may be preempted if the statute frustrates a federal purpose. Finally, if a state regulates in an area of dominant federal interest, the state statute is preempted. *Id.* See Rothschild, *A Proposed "Tonic" With Florida Lime to Celebrate our New Federalism: How to Deal with the "Headache" of Preemption*, 38 *MIAMI L. REV.* 829, 848 (1984) (discussion of implied preemption).

16. See U.S. CONST. ART. I, § 8, cl. 3.

17. See *infra* notes 113-23 and accompanying text.

18. See, e.g., *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970) (if the state regulation is evenhanded, then the burden on interstate commerce must be clearly excessive to be unconstitutional); *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979) (if the state regulation is discriminatory, then the state must show that less discriminatory alternatives were not available).

19. See *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 810 (1976) (if the market participant exception applies, the state actions are outside of the commerce clause).

20. *Reeves v. Stake*, 447 U.S. 429, 437 (1980); *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 810 (1976).

21. See *Reeves*, 447 U.S. at 437 n.9; *South Central Timber v. Wunnicke*, 467 U.S. 82, 99 (1984) (both cases suggested that the market participant doctrine should not be applied to regulation of foreign commerce).

22. CAL. CONST. ART. XVI, § 17 (allows the State of California to invest the trust funds).

23. *Id.* (limits the power of the state to invest the trust funds).

24. *Id.* § 17(b).

This comment will examine the constitutionality of the California divestment statute. Both the California statute and the federal apartheid legislation will be discussed.<sup>25</sup> The doctrine of preemption will be defined and applied to determine the constitutionality of the California legislation.<sup>26</sup> AB 134 will then be analyzed for a possible commerce clause violation.<sup>27</sup> Next, the applicability of the market participant exception to the commerce clause will be discussed and applied to AB 134.<sup>28</sup> Finally, the California divestment statute will be analyzed for possible violations of the California Constitution.<sup>29</sup> This comment will conclude that AB 134 is invalid because the statute has been preempted and violates both the commerce clause and the California Constitution.

#### ANTI-APARTHEID LEGISLATION

Both the state and federal apartheid statutes were enacted to condemn the apartheid system in South Africa.<sup>30</sup> The two statutes, however, approach the problem in different ways. The primary focus of the federal statute is to define a national policy condemning apartheid.<sup>31</sup> To this end, the Act regulates all aspects of United States relations with the government of South Africa.<sup>32</sup> The California statute addresses apartheid indirectly. AB 134 merely restricts state investments in businesses with economic ties to South Africa.<sup>33</sup>

##### A. *Comprehensive Anti-Apartheid Act of 1986*

The Comprehensive Anti-Apartheid Act of 1986 provides a framework for dismantling apartheid and provides relief for the victims of the system.<sup>34</sup> The Act establishes several sanctions against the

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25. See *infra* text accompanying notes 30-58.

26. See *infra* text accompanying notes 63-112.

27. See *infra* text accompanying notes 113-54.

28. See *infra* text accompanying notes 155-224.

29. See *infra* text accompanying notes 225-38.

30. Compare 22 U.S.C.A. § 5002 (West Supp. 1987) (primary purpose of the legislation is to end apartheid in South Africa) with Act of Sept. 26, 1986, ch. 1254, sec. 1, 1986 CAL. LEGIS. SERV. 99, 101-02, (West) (the legislative findings state that the system of apartheid is repressive and contrary to all basic principles of this country).

31. 22 U.S.C.A. § 5002 (West Supp. 1987) (the purpose of the statute is to give a comprehensive guide to the efforts of the United States in South Africa).

32. *Id.*

33. See CAL. GOV'T CODE §§ 16641, 16642 (West Supp. 1987). The California statute only deals with how the State of California may invest their trust funds. No direct regulation of businesses is affected by the statute. *Id.*

34. 22 U.S.C.A. § 5002 (West Supp. 1987).

government of South Africa.<sup>35</sup> Many of the sanctions merely codify the executive orders issued by President Reagan in September of 1985.<sup>36</sup> Among other things, the Act bans the import of krugerrands,<sup>37</sup> arms and ammunition,<sup>38</sup> the export of computer<sup>39</sup> and nuclear technology,<sup>40</sup> and loans to South Africa.<sup>41</sup> In addition to these sanctions, the Act prohibits United States companies from making new investments in South Africa,<sup>42</sup> importing certain South African products<sup>43</sup> and exporting petroleum products to South Africa.<sup>44</sup>

The Act also provides guidelines for the determination of future policy toward South Africa.<sup>45</sup> These guidelines may allow for the easing of existing sanctions.<sup>46</sup> The future policy is to be determined by the annual report of the President on the progress of the South African government in ending apartheid.<sup>47</sup> After making the report, the President will have the option of lifting some of the sanctions or suggesting further action.<sup>48</sup>

### B. AB 134

The California legislature enacted AB 134 in an effort to end apartheid.<sup>49</sup> AB 134 prohibits California from investing state trust funds in any business that has ties to the government or country of South Africa.<sup>50</sup> AB 134 additionally restricts the investment of

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35. PUB. L. NO. 99-440, TITLE III, 100 STAT. 1086, 1099 (1986) (to be codified in scattered sections of 22 U.S.C.).

36. EXEC. ORDER NO. 12,532, 3 C.F.R. 387 (1985). See SENATE COMM. ON FOREIGN RELATIONS, COMPREHENSIVE ANTI-APARTHEID ACT OF 1986, S. REP. NO. 370, 99TH CONG., 2D SESS., reprinted in 1986 U.S. CODE CONG. & ADMIN. NEWS 2334, 2335.

37. 22 U.S.C.A. § 5051 (West Supp. 1987) (importation of Krugerrands).

38. *Id.* § 5068 (exportation of arms and ammunition).

39. *Id.* § 5054 (computers).

40. PUB. L. NO. 99-440, § 307, 100 Stat. 1086, 1099-01 (1986) (to be codified in scattered sections of 22 U.S.C.) (nuclear technology).

41. 22 U.S.C.A. § 5055 (West Supp. 1987) (restriction on loans to South African entities).

42. *Id.* § 5060.

43. *Id.* §§ 5058 (uranium), 5070 (iron and steel), 5069 (agricultural products and food).

44. *Id.* § 5071.

45. *Id.* §§ 5091-5101 (the President can recommend additional measures to Congress if present standards are not effective to dismantle apartheid).

46. *Id.*

47. *Id.* § 5091.

48. *Id.* § 5092 (the President may lift sanctions if the President reports to Congress the efforts to end apartheid).

49. Act of Sept. 26, 1986, ch. 1254, sec. 1, 1986 CAL. LEGIS. SERV. 99, 101-02, (West).

50. See CAL. GOV'T CODE §§ 16641, 16645 (West Supp. 1987). See also *id.* § 16640(i) ("state trust moneys" means funds administered by the Public Employees' Retirement Fund,

the trust funds in banks or other lending institutions that make loans to South African corporations or governmental entities.<sup>51</sup> Businesses affected by the legislation, however, may be exempted from the noninvestment policy if the governing board of the business adopts a resolution not to expand or renew existing agreements or loans.<sup>52</sup> AB 134 also requires the state to divest all funds currently invested in businesses operating in South Africa.<sup>53</sup>

The legislature states two justifications in enacting AB 134. First, the system of apartheid is contrary to American religious and political beliefs.<sup>54</sup> The legislature believes that the investment of state trust funds in businesses closely tied to apartheid would be inconsistent with these beliefs.<sup>55</sup> A second justification for divestment is that the legislature found that investments in South Africa would be imprudent due to current political and economic upheaval in South Africa.<sup>56</sup> This view is bolstered by the fact that divestment actions already taken by other governmental entities were found to have had a negative impact on the value of corporate holdings in South Africa.<sup>57</sup> These actions were also found to have lowered the overall value of securities issued by corporations doing business there.<sup>58</sup>

#### CONSTITUTIONAL CHALLENGES TO AB 134

The passage of AB 134 and the federal Anti-Apartheid Act raises two constitutional issues. Since both statutes legislate on the same topic, the question of federal preemption must be addressed.<sup>59</sup> The federal statute must supersede AB 134 if the California legislation directly or indirectly undermines the purposes and goals of the federal actions.<sup>60</sup> Additionally, since the investment of funds affects

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the State Teachers' Retirement Fund, the Judges' Retirement Fund, etc.); *id.* § 16640(k) ("state moneys" means all money, bonds, and securities in possession of or collected by any state agency).

51. *Id.* §§ 16642, 16646.

52. *Id.* §§ 16642.5, 16642.7.

53. *Id.* § 16644.

54. Act of Sept. 26, 1986, ch. 1254, sec. 1(c), 1986 CAL. LEGIS. SERV. 99, 101 (West). The legislature found that the policy of apartheid restricts the freedom of black and colored people in South Africa. *Id.* § 1(d) at 101.

55. *Id.* § 1(e) at 101.

56. *Id.* § 1(h), at 101.

57. *Id.* § 1(g), at 101.

58. *Id.*

59. See *infra* notes 63-67 and accompanying text.

60. See *infra* notes 68-112 and accompanying text.

interstate commerce, AB 134 must sustain a commerce clause analysis to be valid.<sup>61</sup> AB 134 may violate the commerce clause of the Constitution if the California legislation unduly burdens commerce in the attempt to undermine apartheid.<sup>62</sup>

### A. Preemption and the Supremacy Clause

The United States Constitution declares the laws and policies of the federal government to be the supreme law of the land.<sup>63</sup> If a state statute is inconsistent with federal law or policy, the state law is invalid.<sup>64</sup> Preemption may occur in one of three ways. Congress can expressly prohibit the state from legislating in a certain field.<sup>65</sup> Second, a state law may be preempted if the law directly conflicts with a federal statute or policy.<sup>66</sup> Third, federal preemption may occur if the state action is inconsistent with an objective of a federal statute.<sup>67</sup> Since the Anti-Apartheid Act does not contain an express preemption provision, this comment will address direct and indirect preemption.

#### 1. Direct Preemption

Direct preemption occurs when the enforcement of both the state and federal laws is impossible due to the inconsistency of the laws.<sup>68</sup> If AB 134 directly conflicts with the federal Anti-Apartheid Act, the conflict would be in application rather than on the face of the

61. See *infra* notes 113-23 and accompanying text.

62. See *infra* notes 124-54 and accompanying text.

63. U.S. CONST. ART. IV, § 2. "This Constitution and the Laws of the United States which shall be made in pursuance thereof; and all Treaties made, or which shall be made under the Authority of the United States, shall be the supreme Law of the Land . . . ." *Id.*

64. See, e.g., *Ray v. Atlantic Richfield Co.*, 435 U.S. 151, 158 (1979) (a state statute is void to the extent that the statute actually conflicts with a federal act).

65. *California Fed. Sav. & Loan Ass'n v. Guerra*, 107 S. Ct. 683, 689 (1987) (when acting within constitutional limits, Congress is empowered to preempt state law by so stating in express terms). See, e.g., *Alessi v. Raybestos-Manhattan, Inc.*, 451 U.S. 504 (1981) (the Court interpreted an express preemption). See also *Rothschild*, *supra* note 15, at 842-48 (discussion of express preemption).

66. *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1, 15 (1824) (established that the state law must yield when a conflict exists between state and federal law). See also *Ray v. Atlantic Richfield Co.*, 435 U.S. 151, 158 (1979) (the state statute is void to the extent that the state action conflicts with a federal law).

67. *Rice v. Santa Fe Elevators*, 331 U.S. 218, 230 (1947) (if the state law produces a result that is inconsistent with the objectives of a federal statute, the state law will be preempted); *Hines v. Davidowitz*, 312 U.S. 52, 63 (1941) (states cannot make laws which alter existing federal laws relating to aliens). See also *Rothschild*, *supra* note 15, at 848-54 (describing the three tests for finding an implied preemption by Congress).

68. *Ray*, 435 U.S. at 158; *California Fed. Sav. & Loan v. Guerra*, 107 S. Ct. 683, 689.



statute,<sup>69</sup> since the California statute does not directly restrict businesses from operating in South Africa.<sup>70</sup> The two statutes may directly conflict in two ways. First, both the California and federal statutes restrict new investments in South African entities.<sup>71</sup> Specifically, the California legislation restricts the state from investing trust funds in businesses that have ties with South Africa.<sup>72</sup> California requires that the businesses agree to break all ties with South Africa before the statute will permit the investment of state funds in the business.<sup>73</sup> The federal statute restricts new investments but does not require a complete economic severance. The federal statute merely precludes businesses from expanding operations in South Africa.<sup>74</sup> Since the California and federal statutes directly conflict as to how to restrict new investments in South Africa, AB 134 may be preempted.

The second possible area of direct conflict is in the regulation of loans to South African entities.<sup>75</sup> As a condition of investment of state funds, AB 134 requires lending institutions not to make new loans or renew other loans to businesses dealing with South Africa.<sup>76</sup> AB 134 further requires the state to divest securities of all lending institutions that currently have outstanding loans to South African entities.<sup>77</sup> Similarly, the federal statute regulates loans by prohibiting

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69. Compare CAL. GOV'T CODE §§ 16641, 16642, 16645, 16646 (West Supp. 1987) (restricting state trust funds from being invested in businesses in South Africa, and lending institutions that have made loans to South African entities) with 22 U.S.C.A. §§ 5055, 5060 (West Supp. 1987) (businesses incorporated in the United States may not make *new* investments in South Africa or extend *new* loans to South African entities).

70. CAL. GOV'T CODE §§ 16641, 16645 (West Supp. 1987).

71. Compare CAL. GOV'T CODE §§ 16641, 16642, 16645, 16646 (West Supp. 1987) (restricting investment of state funds in businesses dealing with South Africa and lending institutions that have made loans to South African entities) with 22 U.S.C.A. §§ 5055, 5060 (West Supp. 1987) (United States businesses may not make new loans or investments to South Africa).

72. CAL. GOV'T CODE §§ 16641, 16645 (West Supp. 1987).

73. *Id.* §§ 16641, 16642, 16645, 16646. But see *id.* §§ 16642.5, 16642.7 (exceptions to the noninvestment policy require that businesses agree not to renew any existing ties with South Africa).

74. 22 U.S.C.A. § 5060 (West Supp. 1987) (no national of the United States may make new investments in South Africa). See *id.* § 5001(5) ("national" is defined as any citizen, resident alien or business organized under the laws the United States).

75. The California legislation prevents the investments of funds in a financial institution that make loans to South African entities. The federal law prevents the making of loans or extending of credit to the government of South Africa. Compare CAL. GOV'T CODE §§ 16642, 16646 (West Supp. 1987) with 22 U.S.C.A. § 5055 (West Supp. 1987) (United States nationals may not make *new* loans to South African entities).

76. CAL. GOV'T CODE §§ 16642, 16646 (West Supp. 1987).

77. *Id.* §§ 16642, 16646.

all future loans to South African entities.<sup>78</sup> The Act, however, provides an exemption to allow businesses to make loans to victims of apartheid for educational and humanitarian purposes.<sup>79</sup> Businesses that comply with the federal statute may still be subject to divestment under AB 134. Businesses that do not completely withdraw from South Africa or that make new loans to victims of the apartheid system will lose California as an investor. Since both AB 134 and the federal law regulates loans to South Africa, the inconsistent sections of AB 134 will be preempted.<sup>80</sup>

## 2. Indirect Preemption

Even if there is no direct conflict between state and federal law, AB 134 may be superseded by implied congressional intent to exclude state action.<sup>81</sup> The courts have generally been reluctant to find an implied congressional intent to preempt state action when a state is acting within its inherent police powers.<sup>82</sup> The courts presume that state police powers are not invalidated by the federal law unless Congress manifests a clear intent to occupy the area.<sup>83</sup> The United States Supreme Court in *Rice v. Santa Fe*<sup>84</sup> identified three situations from which an implied intent to preempt can be inferred. First, the scheme of federal regulation may be so pervasive and comprehensive that a reasonable inference can be drawn that Congress left no room for the states to supplement the scheme.<sup>85</sup> Second, preemption may occur when the act of Congress touches a field of federal interest so dominant that preclusion from state interference is presumed.<sup>86</sup> Finally, if the state law produces a result which is inconsistent with the objectives of the federal statute, the state law will be preempted.<sup>87</sup>

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78. 22 U.S.C.A. § 5055 (West Supp. 1987).

79. *Id.*

80. *Ray v. Altantic Richfield Co.*, 435 U.S. 151, 158 (1979).

81. *Rice v. Santa Fe Elevators*, 331 U.S. 218, 230 (1947) (criteria under which Congress may indirectly preempt the state legislation). *See also* *Hines v. Davidowitz*, 312 U.S. 52, 66-67 (1941) (strong national interest or comprehensive federal plan may preempt the state legislation); *Rothschild*, *supra* note 15, at 848-54 (discussion of ways Congress may impliedly preempt state action).

82. *Rice*, 331 U.S. at 230; *Ray*, 435 U.S. at 157; *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977).

83. *Rice*, 331 U.S. at 230.

84. 331 U.S. 218 (1947). For a full discussion of each test under *Rice* see *Rothschild*, *supra* note 15, at 848-54.

85. *Rice*, 331 U.S. at 230.

86. *Id.*; *Hines v. Davidowitz*, 312 U.S. 52, 62 (1941).

87. *Rice*, 331 U.S. at 230; *Hines*, 312 U.S. at 69.

Pursuant to *Rice*, implied preemption can be found when the federal law is so comprehensive that the inference can be drawn that Congress intended to occupy the entire field of regulation.<sup>88</sup> Congressional intent to preempt state action may be inferred from the comprehensive nature of the Anti-Apartheid Act. The stated purpose of the Act is to establish a "comprehensive and complete framework" to guide United States efforts to end apartheid.<sup>89</sup> To achieve this goal, the federal Act establishes political and diplomatic means to undermine the system of apartheid<sup>90</sup> and provides assistance to the victims of apartheid.<sup>91</sup> The Act also provides a framework for future United States policy toward South Africa.<sup>92</sup> The President has directed that the State and Treasury Departments establish rules and regulations in compliance with the Act.<sup>93</sup> Due to the comprehensive character of the Act, the Court may infer an intent by Congress to preempt state action.<sup>94</sup>

Implied preemption can also be found under *Rice* when a state attempts to regulate in a field of dominant federal interest.<sup>95</sup> Although the investment of state funds is in a field traditionally left to the states,<sup>96</sup> an impact on foreign affairs would bring the legis-

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88. The federal Act deals with all aspects of relations with South Africa. The Act sets forth the sanctions by the United States against South Africa and also the means to assist the victims of apartheid. Finally the Act provides the means by which the United States will address the future policy with South Africa. See COMPREHENSIVE ANTI-APARTHEID ACT OF 1986, PUB. L. NO. 99-440, U.S. CODE CONG. & ADMIN. NEWS (100 Stat.) 1086 (1986) (to be codified in scattered sections of 22 U.S.C.).

89. See 22 U.S.C.A. § 5002 (West Supp. 1987).

90. *Id.* § 5011.

91. See PUB. L. NO. 99-440, TITLE III, 100 STAT. 1086, 1099 (1986) (to be codified in scattered sections of 22 U.S.C.).

92. See PUB. L. NO. 99-440, TITLE V, 100 STAT. 1086, 1108 (1986) (to be codified in scattered sections of 22 U.S.C.) The Act provides the means to lift these sanctions against South Africa when the purposes of the statute have been fulfilled. *Id.*

93. See EXEC. ORDER NO. 12,571, 51 FED. REG. 39,505 (1986). See also 51 FED. REG. 41,906-11, 41,916-18 (rules and regulations from the Department of the Treasury implementing the Executive Order); 51 FED. REG. 41,912-14 (rules and regulations by the Department of State implementing the Executive Order).

94. See *Rice v. Santa Fe Elevators*, 331 U.S. 218, 230 (1947) (a pervasive federal scheme of regulation can lead to an inference that Congress left no room for the states to supplement the scheme); *Hines v. Davidowitz*, 312 U.S. 52, 69 (1941) (Congress has exclusively regulated the rights of aliens in this country, including how they may enter, how they may become citizens and the manner in which they can be deported).

95. *Rice*, 331 U.S. at 230 (if an act of Congress touches on a field of dominant federal interest, the federal system will be presumed to preclude enforcement of state laws on the same subject); *Hines*, 312 U.S. at 62 (the regulation of aliens is a specified power vested in Congress, and is in an area of foreign relations).

96. See Note, *supra* note 6, at 847 (the impact, however, of investment decisions upon international commerce and foreign affairs implicates national interests).

lation in the realm of national interest.<sup>97</sup> The United States Supreme Court in *Zschernig v. Miller*<sup>98</sup> held that state legislation that produces more than incidental or indirect effects on foreign relations is invalid because the legislation encroaches on federal powers.<sup>99</sup> In *Zschernig*, an Oregon statute that denied inheritance rights to non-resident aliens whose national government did not provide similar rights to Americans was ruled unconstitutional.<sup>100</sup> The primary purpose of the statute was to attack communism.<sup>101</sup> Although the Oregon legislature was exercising the inherent state power of establishing intestate succession laws, the exercise of that power to express foreign policy was unconstitutional.<sup>102</sup> The *Zschernig* decision casts doubt on the power of the states to enact laws that create "public policy" in international situations. AB 134 is similar to the Oregon statute in *Zschernig*. Both statutes were enacted to criticize another political system. As Oregon used the power of intestate succession to further foreign policy, the California statute uses the investment of state funds to establish foreign policy.<sup>103</sup> The attempt by Cali-

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97. *Id.* The Constitution affirmatively grants powers of foreign affairs to the federal government. See U.S. CONST. ART. I, § 10 (denies the states the power to enter into treaties or compacts with a foreign nation; to levy import and export taxes; and to engage in war); *id.* ART. I, § 8 (gives Congress the power to engage in war, to provide and maintain a Navy, and to establish a uniform rule of naturalization). See also L. HENKIN, FOREIGN AFFAIRS AND THE CONSTITUTION 228 (1972) (the language of the Constitution and the interpretation by the courts reduced the ability of the states to affect foreign relations).

The Supreme Court held that even without the express constitutional provisions, all of the foreign relations powers would be inherently vested in the national government. *United States v. Curtiss-Wright Export Corp.*, 299 U.S. 304, 316 (1936). See *Zschernig v. Miller*, 389 U.S. 429, 436 (1968). The Constitution entrusts foreign affairs and international relations solely to the federal government. *Id.* See also L. HENKIN, *supra*, at 227-28 (foreign relations is an area in which the federal interest is dominant, if not absolute).

98. 389 U.S. 429 (1968).

99. *Id.* at 434. See L. HENKIN, *supra* note 97, at 240-41 (the line between incidental and direct effect on foreign affairs is uncertain); Note, *supra* note 6, 843-44 (the primary concern of *Zschernig* was that the Oregon law had more than an indirect effect on foreign relations). But cf. Note, *State Buy-American Laws—Invalidity of State Attempts to Favor American Producers*, 64 MINN. L. REV. 387, 407 (1980) (states may have some indirect effects on foreign affairs because that the exercise of nearly all state powers has some effect on foreign affairs).

100. *Zschernig*, 389 U.S. at 437-38.

101. *Id.*

102. *Id.* at 439 (those rights must give way when they impair the effective exercising of the foreign policy of the federal government). The Oregon statute was struck down even though the Justice Department stated that the Oregon escheat law did not interfere with the conduct of foreign relations by the United States. L. HENKIN, *supra* note 97, at 239.

103. The Oregon statute was enacted to criticize communism. *Zschernig*, 389 U.S. at 437. AB 134 was primarily enacted as a criticism of the system of apartheid in South Africa. Act of Sept. 26, 1986, ch. 1254, sec. 1, 1986 CAL. LEGIS. SERV. 99, 101-02 (West). See Note, *supra* note 6, at 845. (After *Zschernig*, laws motivated by such inquires would not seem constitutionally defensible).

fornia to exercise that right to break all economic ties with South Africa would be an intrusion upon powers traditionally held by the federal government.<sup>104</sup> Since foreign relations powers are inherent in the national government, AB 134 is preempted from entering the field of foreign relations.<sup>105</sup>

Finally, *Rice* mandates that a frustration of federal purpose also results in implied preemption.<sup>106</sup> Pursuant to *Rice*, a state law that obstructs the accomplishment of the full purpose and objectives of the federal government must fall.<sup>107</sup> The policy of the federal Act is to encourage certain ties to South Africa.<sup>108</sup> The Act attempts to assist the victims of apartheid.<sup>109</sup> The Act does not advocate full withdrawal from South Africa by American companies, but merely restricts new investments in South Africa.<sup>110</sup> The California statute, on the other hand, is much broader in scope than the Anti-Apartheid Act. The intent of the California statute is to sever all economic links to South Africa.<sup>111</sup> Divestment by the State of California indirectly affects the victims, as well as the proponents of the system of apartheid. To this extent, the federal purpose of supporting the victims is frustrated by AB 134. Since AB 134 extends beyond and frustrates the federal purposes of the Anti-Apartheid Act, AB 134 should be preempted.<sup>112</sup>

The doctrine of federal preemption provides legitimate challenges to the constitutionality of the California divestment statute. AB 134 directly conflicts with the federal statute with respect to loans and new investments in businesses operating in South Africa. Furthermore, since the California divestment law intrudes upon the foreign relations powers of the federal government, Congress has impliedly

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104. See *Zschemig*, 389 U.S. at 437; L. HENKIN, *supra* note 97, at 239.

105. L. HENKIN, *supra* note 97, at 242.

106. See *Rice v. Santa Fe Elevators*, 331 U.S. 218, 230 (1947).

107. *Id.*; *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941); *California Fed. Sav. & Loan v. Guerra*, 107 S. Ct. 683, 689 (1987). 132 CONG. REC. S11,817-18 (daily ed. Aug. 15, 1986). In the opinion of Senator Richard Lugar, the states have been preempted by the passage of the Act. "I would just suggest that we clarify the entire predicament by stating that when we get into an antiapartheid law, the Federal Government is speaking for the Nation, not each city and each county. They might have spoken to try to get our attention. They have gotten our attention." *Id.* at S11,818.

108. See 22 U.S.C.A. § 5031 (West Supp. 1987) (the Act encourages the assistance to victims of the system).

109. *Id.*

110. See PUB. L. No. 99-440, TITLE II, 100 STAT. 1086, 1094 (1986) (to be codified in scattered sections at 22 U.S.C.A.).

111. Act of Sept. 26, 1986, ch. 1254, sec. 1, 1986 CAL. LEGIS. SERV. 99, 101-02, (West).

112. See *Rice*, 331 U.S. at 230.

barred any state action. AB 134 additionally frustrates some of the underlying purposes of the federal Anti-Apartheid Act. Since Congress did not clearly manifest consent to pass divestment statutes, AB 134 is an unconstitutional intrusion upon the powers of the federal government.

### *B. Commerce Clause*

The commerce clause provides an additional constitutional challenge to AB 134. The Constitution grants Congress the power to regulate interstate and foreign commerce.<sup>113</sup> The United States Supreme Court has interpreted this affirmative grant of power to Congress as implicitly restricting the power of the states to regulate commerce.<sup>114</sup> This implicit limitation has been referred to as the "dormant" commerce clause and has been used to invalidate state laws that unduly burden interstate commerce.<sup>115</sup> In the absence of federal action, however, the Court has allowed the states to regulate commerce when relying upon inherent police powers.<sup>116</sup> More extensive constitutional scrutiny is required when a state attempts to regulate foreign commerce.<sup>117</sup> A state statute may escape the purview of the commerce clause entirely if the state enters a specific market as a participant rather than a regulator.<sup>118</sup>

#### *1. Traditional Tests*

The Supreme Court has developed a two-part analysis to determine the extent of state power under the dormant commerce clause.<sup>119</sup> If a state law discriminates in favor of a local interest, the state bears the burden of proving that a legitimate local interest cannot be attained through less discriminatory means.<sup>120</sup> If, however, the state law does not discriminate on the basis of residency and effectuates a legitimate local purpose, the law will be upheld unless the incidental burden imposed on interstate commerce is clearly

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113. U.S. CONST. ART. I, § 8, cl. 3.

114. See *Cooley v. Board of Wardens*, 53 U.S. (12 How.) 299, 318-19 (1851).

115. *Hughes v. Oklahoma*, 441 U.S. 322, 330 (1979); *H. P. Hood & Sons, Inc. v. DuMond*, 336 U.S. 525, 532-41 (1949); *Southern Pac. Co. v. Arizona*, 325 U.S. 761, 781 (1945).

116. *Cooley*, 53 U.S. at 318.

117. See *Japan Lines v. County of Los Angeles*, 441 U.S. 434, 446 (1979).

118. *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 809-10 (1976) (the commerce clause does not prohibit states from participating in the market to favor their own citizens).

119. *County Commissioners of Charles County v. Stevens*, 473 A.2d 12, 14 (1984).

120. *Hunt v. Washington Apple Advertising Comm'n*, 432 U.S. 333, 353 (1977).

excessive in relation to the benefits acquired to further that purpose.<sup>121</sup> State laws which are enacted strictly to protect local economic interests rarely pass commerce clause scrutiny.<sup>122</sup> A statute that affects foreign commerce must undergo a more extensive constitutional scrutiny because of the possibility the state statute may prevent the federal government from maintaining a uniform foreign policy.<sup>123</sup>

If AB 134 affects both interstate and foreign commerce, the statute must satisfy the commerce clause or come within one of the recognized exceptions to the commerce clause to be constitutional.<sup>124</sup> "Commerce" has been interpreted broadly to include every type of movement of persons and things, tangible and intangible.<sup>125</sup> The investment of state funds into businesses and financial institutions would constitute commerce.<sup>126</sup> Since AB 134 restricts the ability of the state to invest in businesses operating in South Africa, the statute has an effect on interstate commerce.<sup>127</sup> The regulatory effect of AB 134 is evenhanded in application because the legislation does not distinguish between resident and nonresident businesses.<sup>128</sup> Therefore, AB 134 is constitutional unless the burden imposed on interstate commerce is clearly excessive in relation to the putative benefits furthering a legitimate local purpose.<sup>129</sup>

The primary purpose of AB 134 is to condemn and to attempt to eliminate the system of apartheid.<sup>130</sup> Traditionally, legitimate

121. *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).

122. *Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978) (economic protectionist statutes are per se unconstitutional because the statutes are contrary to the underlying principles of federalism).

123. *Japan Lines v. County of Los Angeles*, 441 U.S. 434, 446 (1979). In *Japan Lines*, the constitutionality of a state taxation statute was at issue. The Court held that the tax cannot enhance the risk of multiple taxation. In addition, the state action may not impair federal uniformity in an area where federal uniformity is essential. *Id.* at 448.

124. U.S. CONST. ART. I, § 8, cl. 3 (power vested in Congress).

125. *United States v. Southeastern Underwriters Ass'n*, 322 U.S. 533, 539 (1944).

126. *See Oklahoma-Texas Trust v. S.E.C.*, 100 F.2d 888, 890 (1939) (securities are the subject of interstate commerce). The investment of state funds in securities would have a substantial influence on interstate commerce. All the divestment actions of the various states, taken in the aggregate, could substantially burden interstate commerce. Even though the aggregate theory has only been applied to give Congress the power to regulate commerce, a similar argument could be made for the interference of state action on commerce. *See also Lewis v. BT Investment*, 447 U.S. 27, 39 (1980) (the same interstate attributes that establish the power of Congress to regulate commerce also support constitutional limitations on the power of the states). *See Note, supra* note 6, at 835 n.128.

127. *See CAL. GOV'T CODE* § 16640(b), (c) (West Supp. 1987). The statute does not make a distinction between resident and nonresident businesses, but affects all businesses that are operating in South Africa. *Id.*

128. *See Pike*, 397 U.S. at 142.

129. *See id.*

130. Act of Sept. 26, 1986, ch. 1254, sec. 1(a)-(h), 1986 CAL. LEGIS. SERV. 99, 101-02 (West).

purposes for commerce clause analysis have been limited to the protection of health, safety, and financial prosperity of the people and industries of the State.<sup>131</sup> Expression of moral outrage has never been found by the courts to constitute a legitimate purpose.<sup>132</sup> A statute with the sole purpose of expressing moral outrage therefore would not be a justifiable imposition upon interstate or foreign commerce.<sup>133</sup> A second purpose behind AB 134 is the protection of the investment of trust funds.<sup>134</sup> The legislature determined that an investment into securities of businesses with ties to South Africa is imprudent given the current political and economic stability of the country.<sup>135</sup> This may be a plausible purpose, if the businesses depended upon their South African connection for their continued viability.<sup>136</sup> California, however, cannot insulate state actions by creating other justifications for divestment in an effort to further an otherwise illegitimate purpose.<sup>137</sup> Since no legitimate local benefit is furthered by the legislation, any imposition on interstate commerce would be a violation of the commerce clause.

AB 134 must overcome a more extensive constitutional scrutiny because divestment involves foreign commerce.<sup>138</sup> The Supreme Court has consistently invalidated, with few exceptions,<sup>139</sup> state laws that created barriers between the trade of the United States and other countries.<sup>140</sup> In *Japan Lines, Ltd v. County of Los Angeles*,<sup>141</sup> the Court held that a more extensive constitutional inquiry is required

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131. See Note, *Constitutionality of the No Discrimination Regulating Univeristy of Wisconsin Investments*, 1978 Wis. L. Rev. 1059, 1064. Historically, the United States Supreme Court has defined legitimate local interests to include promoting the health and safety of state residents and maximizing the financial return of state industries. See *id.* at 1064 n.43. See, e.g., *Dean Milk Co. v. Madison*, 340 U.S. 349, 354 (1951); *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 143 (1970).

132. See Note, *supra* note 131, at 1064. A possible benefit of AB 134 is knowledge that a change in the apartheid system has been promoted through state's action. This intangible and rather tenuous benefit is not the type historically acknowledged as a legitimate local benefit. See *id.*

133. See Note, *supra* note 6, at 823.

134. Act of Sept. 26, 1986, ch. 1254, sec. 1(g)-(h), 1986 CAL. LEGIS. SERV. 99, 101 (West).

135. *Id.*

136. See Note, *supra* note 6, at 823 n.57.

137. *Hale v. Bimco Trading, Inc.*, 306 U.S. 375, 380 (1939) (rejecting Florida's attempt to justify the inspection of imported cement on safety grounds). See Note, *supra* note 6, at 834 (a state law which bases a divestment statute on ending apartheid should not be considered a legitimate interest); Note, *supra* note 131, at 1064 (no local public interest is furthered by the Wisconsin divestment statute).

138. See *Japan Lines, Ltd v. County of Los Angeles*, 441 U.S. 434, 446 (1979).

139. See Note, *supra* note 6, at 835.

140. *Brown v. Maryland*, 25 U.S. (12 Wheat.) 419 (1827).

141. 441 U.S. 434 (1979).



when a state attempts to regulate foreign commerce.<sup>142</sup> In that case, a state law that assessed a property tax against containers previously taxed in the originating country was invalidated.<sup>143</sup> The Court recognized that the tax would have been valid if the containers had merely been instrumentalities of interstate commerce.<sup>144</sup> Since the containers, however, were used constantly and exclusively for the transportation of cargo in *foreign* commerce,<sup>145</sup> two additional tests had to be satisfied for the tax to be constitutional.<sup>146</sup> First, the tax could not create a substantial risk of international multiple taxation.<sup>147</sup> More importantly, the tax could not prevent the federal government from maintaining a uniform foreign policy when regulating commercial relations with foreign governments.<sup>148</sup> Even though *Japan Lines* addressed tax regulation, the language of the opinion is broad enough to extend to all foreign commerce regulation.<sup>149</sup>

Since AB 134 affects participation of businesses in the international market, the legislation must meet the *Japan Lines* test to be upheld. While AB 134 is not a tax case, the statute may prevent the federal government from maintaining a uniform foreign policy.<sup>150</sup> Both the President and Congress have spoken out against apartheid.<sup>151</sup> These federal actions have established a comprehensive framework under which the United States intends to address the problems of apartheid. If each city, county, or state government was allowed to address the matter of apartheid individually, multiple signals might be sent to businesses connected with South Africa.<sup>152</sup> AB 134 encourages businesses to sever all ties with South Africa.<sup>153</sup>

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142. *Id.* at 446.

143. *Id.* at 436-37.

144. *Id.* at 445 (the state tax would have survived the *Complete Auto* test). See *Complete Auto Transit v. Brady*, 430 U.S. 274, 279 (1977) (the state tax is valid if the tax is substantially connected to the taxing state and does not discriminate against interstate commerce).

145. *Japan Lines*, 441 U.S. at 446 n.9.

146. *Id.* at 446.

147. *Id.* at 446-48.

148. *Id.* at 448-49.

149. See *Reeves v. Stake*, 447 U.S. 429, 437-38 n.9 (1980). The Supreme Court cited *Japan Lines* in a nontax case for the proposition that the commerce clause scrutiny may be more rigorous when restraint on foreign commerce is alleged. *Id.*

150. *Japan Lines*, 441 U.S. at 448-49.

151. See 22 U.S.C.A. § 5002 (West Supp. 1987).

152. See 132 CONG. REC. S11,817 (daily ed. Aug. 15, 1986) (statements by Senator Lugar) (stressing the need for the federal government to speak with one voice on apartheid by preempting state action).

153. See CAL. GOV'T CODE §§ 16642, 16646 (West Supp. 1987).

The federal Act encourages businesses to maintain and establish ties with the victims of apartheid in South Africa.<sup>154</sup> AB 134 therefore conflicts with the signal that the federal government intends to send to businesses and the government of South Africa. This interference with foreign commerce would not meet the stricter *Japan Lines* standard.

## 2. *The Market Participant Exception*

Even if AB 134 does not survive scrutiny of the commerce clause, AB 134 may still be valid if the market participant exception is applicable.<sup>155</sup> Generally, if the state enters the market as a participant, rather than a regulator, the actions of the state are beyond the reach of the commerce clause.<sup>156</sup> The state becomes a market participant when the state enters a particular market as a private trader, such as a buyer, seller, or employer.<sup>157</sup> A state is a market regulator when the state prescribes the rules of trade between private parties.<sup>158</sup>

### a. *The Development of the Doctrine*

The market participant doctrine was first established by the Supreme Court in *Hughes v. Alexandria Scrap*.<sup>159</sup> In *Alexandria Scrap*, a Maryland statute which allowed the State of Maryland to pay a bounty to licensed scrap processors for the destruction of abandoned autos titled in Maryland was upheld.<sup>160</sup> Before the scrap processor could receive the bounty, the processors had to submit specific documentations of ownership to the state.<sup>161</sup> The statute required more extensive documentation from out-of-state processors

154. See Pub. L. No. 99-440, TITLE II, 100 STAT. 1086, 1094 (1986) (to be codified in scattered sections of 22 U.S.C.).

155. See *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 806 (1976); *Reeves v. Stake*, 447 U.S. 429, 436 (1980); *White v. Massachusetts Council of Constr. Employers*, 460 U.S. 204, 210 (1983). See also Note, *The Market Participant Test in Dormant Commerce Clause Analysis—Protecting Protectionism?*, 1985 DUKE L.J. 697, 697 (if the state is a market participant, then the commerce clause does not apply to the transaction).

156. *Alexandria*, 426 U.S. at 806-07; *Reeves*, 447 U.S. at 436; *White*, 460 U.S. at 210; *South-Central Timber v. Wunnicke*, 467 U.S. 82, 95 (1984).

157. See Note, *supra* note 155 at 705; Note, *Setting Parameters on the Market Participant Doctrine: South-Central Timber Development, Inc. v. Wunnicke*, 30 J. URB. & CONTEMP. L., 241, 241 (1986).

158. See Note, *supra* note 157 at 241.

159. 426 U.S. 794 (1976).

160. *Id.* at 796-98.

161. *Id.* at 798.

than from their in-state counterparts.<sup>162</sup> The Maryland statute could have been invalidated as protectionist legislation.<sup>163</sup> The Court held, however, that the commerce clause did not forbid a state from favoring resident citizens over others because the state was participating in the market for a legitimate purpose.<sup>164</sup> Importantly, the Court found that the out-of-state processors were not barred from the market.<sup>165</sup> Therefore, the statute did not interrupt interstate commerce, but merely made the processing more lucrative in the state than out of the state.<sup>166</sup>

In *Reeves v. Stake*,<sup>167</sup> the Court further defined and expanded the market participant doctrine.<sup>168</sup> In *Reeves*, the State of South Dakota owned and operated a cement plant.<sup>169</sup> During a cement shortage, the state restricted the sale of the state-owned goods to accommodate the needs of South Dakota residents before offering the goods to other potential buyers.<sup>170</sup> After *Hughes v. Alexandria Scrap*, the Court would first determine if the state was an actual participant in the market. Next, the Court would determine if the intrusion on interstate commerce was excessive.<sup>171</sup> The *Reeves* Court held that the sole inquiry in determining the applicability of the doctrine was whether the challenged state action constituted actual participation in the market.<sup>172</sup> The Court justified the market participant doctrine on the grounds of state sovereignty,<sup>173</sup> the role of the state as trustee for people of the state,<sup>174</sup> and the recognized right of traders and manufacturers to exercise their independent discretion in determining the parties with which they will deal.<sup>175</sup> The Court suggested that a state acting as a proprietor should be as free as other "private traders."<sup>176</sup>

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162. *Id.* at 800.

163. *Id.* at 804. See also Note, *supra* note 155, at 708-09.

164. *Alexandria*, 426 U.S. at 809. The legitimate state purpose was the maintenance of clean and clear roadways. *Id.*

165. *Id.* at 810.

166. *Id.* at 806-07 n.15.

167. 447 U.S. 429 (1980).

168. *Id.* at 436-37.

169. *Id.* at 430.

170. *Id.* at 432-33.

171. *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 804 (1976).

172. *Reeves*, 447 U.S. at 439; *White v. Massachusetts Council of Constr. Employers*, 460 U.S. 204, 220 (1983).

173. *Reeves*, 447 U.S. at 438.

174. *Id.*

175. *Id.* at 438-39.

176. *Reeves*, 447 U.S. at 439. The Court included any form of state proprietary action in the definition of the exemption. *Id.*

The Court in *White v. Massachusetts Council of Construction Employers*<sup>177</sup> extended the market participant doctrine to the furthest limits. The Court upheld an order by the Mayor of Boston that required all construction projects funded in whole or in part by the city to hire a minimum of fifty percent of Boston residents.<sup>178</sup> Following *Reeves*, the *White* Court focused on whether the City of Boston was in fact a participant in the construction market or a regulator of that market.<sup>179</sup> Despite the substantial intrusion on interstate commerce by the City, the Court found the City to be a market participant and upheld the order.<sup>180</sup>

*White* extended the market participant doctrine beyond the original contracting parties.<sup>181</sup> Without setting any limits for the exception, the Court recognized that participation of Boston in the market could extend beyond the immediate contracting parties to affect a discrete, identifiable class of economic activity.<sup>182</sup> The fact that the employees affected by the order worked for the city was crucial to extension of the market participant exception beyond the boundaries of *Alexandria* and *Reeves*.<sup>183</sup>

The United States Supreme Court in *South-Central Timber v. Wunnicke*,<sup>184</sup> however, retreated from the broad language in *White*.<sup>185</sup>

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177. 460 U.S. 204 (1983).

178. *Id.* at 206.

179. *Id.* at 208 (citing *Reeves*, 447 U.S. at 436 n.7).

180. *Id.* at 208.

181. *Id.* at 217 (Blackmun, J., concurring in part and dissenting in part). The parties to the contract in *Reeves* were the state of South Dakota and the buyers of the cement. *See Reeves*, 447 U.S. at 431. The parties in *Alexandria* consisted of the State of Maryland and the scrap processors who received the bounty. *See Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 802 (1976).

182. *White*, 460 U.S. at 211 n.7.

Justice Blackmun's opinion dissenting in part argues that the Mayor's order goes beyond market participation because [the order] regulates employment contracts between public contractors and their employees. We agree with Justice Blackmun that there are some limits on a state or local government's ability to impose restrictions that reach beyond the immediate parties with which the government transacts business. We find it unnecessary in this case to define those limits with precision, except to say that we think the commerce clause does not require the city to stop at the boundary of formal privity of contract. In this case, the Mayor's executive order covers a discrete, identifiable class of economic activity in which the city is a major participant.

*Id.*

183. *Id.* *See South-Central Timber v. Wunnicke*, 467 U.S. 82, 95 (1984). The fact that the employees were 'working for the city' was crucial to the market participant analysis in *White*. *Id.* *See also United Bldg. & Constr. Trades Council v. Mayor of Camden*, 465 U.S. 208, 219 (1984).

184. 467 U.S. 82 (1984).

185. *See Note, supra* note 157, at 241.

In *South-Central*, the State of Alaska required that all buyers of Alaskan timber contractually agree that the timber be partially processed within the state.<sup>186</sup> The plurality of the Court limited the market participant doctrine to allow the state to affect only a discrete, identifiable class of economic activity in which the state is a major participant.<sup>187</sup> The Court stressed the necessity of narrowly defining the term "market" to prevent the principles of the commerce clause from being swallowed up by the exception.<sup>188</sup> The Court expressed two additional reasons for the limitation of the market participant doctrine. First, the interest of the state as a "private trader" is in the immediate transaction, not in what the purchaser does with the goods after the transaction.<sup>189</sup> Second, downstream restrictions have a greater regulatory effect than limitations on the immediate transaction.<sup>190</sup>

The parameters of the market participant doctrine are still obscure.<sup>191</sup> The test under *Reeves* and *White* is whether the state is a participant in the market rather than a market regulator.<sup>192</sup> After *South-Central*, a state may only participate in a market that is narrowly defined.<sup>193</sup> If the state exerts an influence beyond that limited market, the effect becomes regulatory in nature and the market participant exception does not apply.<sup>194</sup>

#### *b. Application of the Doctrine to AB 134*

AB 134 can avoid the commerce clause analysis if California is found to be a market participant rather than a market regulator.

186. *South-Central Timber*, 467 U.S. at 84-87.

187. *Id.* at 97 (citing *White v. Massachusetts Council of Constr.* 460 U.S. at 211, n.7).

188. *Id.* at 97-98. The term "market" must be relatively narrowly defined in order to prevent the commerce clause from being swallowed up by the market participant exception. States may not impose substantial burdens on interstate commerce even if they act with the permissible state purpose of fostering local industry. *Id.*

189. *Id.*

190. *Id.*

191. After *South-Central* several issues remained unresolved. First, the distinction between what state action constitutes market participation versus market regulation is unclear. A second issue is how narrowly the term "market" will be defined. Finally, the extent to which a participating state may affect commerce outside of that market is unclear. See Note, *supra* note 155, at 722.

192. *Reeves v. Stake*, 447 U.S. 429, 439 (1980); *White v. Massachusetts Council of Constr. Employers*, 460 U.S. 204, 210 (1983). See also Note, *supra* note 155, at 722. The *White* Court recognized possible limitations on the market participant doctrine without stating what the limitations might be. See *White*, 460 U.S. at 211, n.7; Note, *supra* note 157, at 244.

193. *South-Central Timber*, 467 U.S. at 98.

194. *Id.*

California is acting in a proprietary function under AB 134 because the state is investing moneys derived from the funds entrusted to the state.<sup>195</sup> As in *Alexandria Scrap*, California is merely acting as a "private trader" in determining with whom the state will invest the state trust funds. Under *Reeves* and *White*, the role of California as a private trader in the investment market would be sufficient to invoke the market participant exception.<sup>196</sup> The state, however, must overcome the obstacles presented in *South-Central* before invoking the exception.<sup>197</sup>

In *South-Central*, the Court held that the term "market" must be narrowly defined.<sup>198</sup> The application of the exception was also restricted to that market.<sup>199</sup> Any attempt by the state to impose conditions outside of the participating market would be regulatory in nature, and the market participant exception would be inapplicable.<sup>200</sup> California, through AB 134, is participating in the investment market.<sup>201</sup> The effect of AB 134 reaches beyond this market, at least to the extent that the statute conditions investment on the business agreeing to pull out of South Africa. The attempt by AB 134 to influence these operations in South Africa is regulatory in nature. Therefore, the market participant exception should not be applied to AB 134.

Even if California surpasses the obstacles presented by *South-Central*, the market participant doctrine may still not be applied to AB 134 for policy reasons. The market participant doctrine was established in *Alexandria Scrap* as a narrow exception to the commerce clause.<sup>202</sup> The rationale of the doctrine was to allow states to favor their own residents when participating in a market.<sup>203</sup> No subsequent market participant case has extended the doctrine beyond this rationale.<sup>204</sup> The *Reeves* Court reaffirmed this rationale by

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195. See *Reeves*, 447 U.S. at 439; *White*, 460 U.S. at 220 (proprietary activity not necessary for the market participant doctrine).

196. *Reeves*, 447 U.S. at 439; *White*, 460 U.S. at 220.

197. *South-Central Timber*, 467 U.S. at 98.

198. *Id.*

199. *Id.*

200. *Id.*

201. California may be a market participant when investing funds. AB 134, however, is not solely concerned with the investment of the trust funds. The legislation attempts to direct where the business will operate. See generally CAL. GOV'T CODE §§ 16641, 16642 (West Supp. 1987) (AB 134 applies to businesses or institutions that have economic ties to South Africa).

202. *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 804 (1976).

203. *Id.*

204. In *Alexandria*, the local economic interest was to benefit the local scrap processors.

stating that one justification for the exception was due to the fiduciary duties the state owed its residents.

AB 134 was not enacted primarily to benefit the residents of California.<sup>205</sup> The California divestment law does not tangibly benefit the residents of California.<sup>206</sup> The only true beneficiaries of the legislation are the South Africans who would benefit from the dismantling of apartheid.<sup>207</sup> Nor was AB 134 enacted to provide for any local economic interest. AB 134 was enacted as a political statement against the system of apartheid.<sup>208</sup>

Finally, the extent of the participation of California in the market under AB 134 is not as great as the governmental involvement in the market participant cases. In each of those cases, the government was involved in the creation of a particular product or market and each market was dependent upon the participation by the State for its existence.<sup>209</sup> In the situation at hand, the securities purchased by California were in the market prior to the enactment of AB 134. The securities will continue to exist even if California divests from the businesses in South Africa. For California to have a similar type of involvement in the creation of the market as the market participant cases, California would need to have been the issuer of the securities instead of the purchaser.<sup>210</sup> Since some of the inherent

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*Alexandria*, 426 U.S. at 802. Similarly in *Reeves*, the market participant doctrine was invoked to benefit the local cement market. *Reeves v. Stake*, 447 U.S. 429, 440 (1980). The *White* Court invoked the doctrine to provide employment for local residents. *White v. Massachusetts Council of Constr. Employers*, 460 U.S. 204, 221 (1983).

205. See *Reeves*, 447 U.S. at 438. The other two justifications stated in *Reeves* has been limited by two subsequent Supreme Court cases. The justification based on state sovereignty is questionable after *Garcia v. San Antonio Metro. Transit Auth.* The Court in *Garcia* held that states cannot avoid the commerce clause based on state sovereignty. See *Garcia v. San Antonio Metro. Transit Auth.*, 469 U.S. 528, 557 (1985). The second justification was that states should be able to decide the parties with whom they will deal. This justification is not at issue with AB 134 if the market is narrowly defined following *South-Central*. See *South-Central Timber v. Wunnicke*, 467 U.S. 82, 98 (1984); *supra* note 201 and accompanying text.

206. Act of Sept. 26, 1986, ch. 1254, sec. 1, 1986 CAL. LEGIS. SERV. 99, 101-02, (West).

207. See Note, *supra* note 131, at 1064.

208. Act of Sept. 26, 1986, ch. 1254, sec. 1, 1986 CAL. LEGIS. SERV. 99, 101-02 (West).

209. In *Alexandria*, the state of Maryland used state funds to pay a bounty to scrap dealers who processed abandoned autos. The market was state-created. This point was stressed in Justice Stevens' concurring opinion. See *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 815 (1976) (Stevens, J., concurring). In *Reeves*, South Dakota owned and operated its own cement plant. The market participant doctrine was involved only to the extent the sales were generated from that plant. See *Reeves*, 447 U.S. at 430. In *White*, the city of Boston hired employees for a particular construction project. See *White v. Massachusetts Council of Constr. Employers*, 460 U.S. 204, 206 (1983).

210. See *Alexandria*, 426 U.S. at 798 (Maryland was a seller of a bounty); *Reeves*, 447 U.S. at 430 (South Dakota sold cement); *White*, 460 U.S. at 206 (city of Boston was an employer for a construction project).

reasons underlying the market participant doctrine are not present with AB 134, the doctrine should not be extended to the divestment procedures of California.

*c. Foreign Commerce and the Market Participant Doctrine*

Even if a court determines California to be a market participant, an additional question arises since AB 134 affects foreign commerce. Each of the market participant cases upheld by the Supreme Court have dealt with interstate commerce.<sup>211</sup> *KSB v. New Jersey*,<sup>212</sup> an early state court decision, held that the market participant doctrine applied to Buy-American statutes<sup>213</sup> even though the legislation affected foreign commerce.<sup>214</sup> The New Jersey Supreme Court found that the differences between interstate and foreign commerce were insufficient to justify not applying the exception to the sphere of foreign commerce.<sup>215</sup> The United States Supreme Court, however, subsequently made a distinction between interstate and foreign commerce in *Japan Lines v. County of Los Angeles*.<sup>216</sup> *Japan Lines* held that regulation of foreign commerce was subject to a more rigorous constitutional scrutiny than interstate commerce.<sup>217</sup> Furthermore, in a footnote in *Reeves v. Stake*, the United States Supreme Court stated the market participant doctrine may not apply when dealing with natural resources or with the regulation of foreign commerce.<sup>218</sup> These limitations were later affirmed in dictum in *South-Central v. Wunnicke*.<sup>219</sup> The Court in *South-Central* stated that even if Alaska had been a market participant, the doctrine would not have applied because of the interference with foreign commerce.<sup>220</sup>

In light of these cases, an application of the market participant exception to AB 134 would be an unjustified extension of the doctrine. First, the reason for the market participant doctrine was

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211. See Note, *supra* note 6, at 823.

212. 75 N.J. 272, 381 A.2d 774 (1977).

213. "Buy-American" statutes generally require all products purchased by the government be made in this country. See *K.S.B. v. New Jersey*, 75 N.J. 272, 381 A.2d 774, 776, (1977).

214. *Id.* at 775.

215. *Id.* at 788.

216. *Japan Lines v. County of Los Angeles*, 441 U.S. 434, 446 (1979).

217. *Id.* The *Reeves* Court cited *Japan Lines* for the proposition that regulation of foreign commerce must undergo a more rigorous constitutional scrutiny. *Reeves v. Stake*, 447 U.S. 429, 437 n.9 (1980).

218. *Reeves*, 447 U.S. at 437 n.9.

219. *South-Central Timber v. Wunnicke*, 467 U.S. 82, 96 (1984).

220. *Id.* See Note, *supra* note 6, at 839.



to enable the states to fulfill their fiduciary and proprietary obligations with the same limited restrictions as other "private traders" when entering the market as a participant.<sup>221</sup> The doctrine has not been justified to express moral outrage or foreign policy. To extend the market participant doctrine to AB 134 for this purpose would seem to give the states enormous powers to avoid the Commerce Clause by disguising their actions as market participants.<sup>222</sup> Secondly, AB 134 not only affects interstate commerce, but also has a substantial impact on foreign commerce.<sup>223</sup> An extension to include foreign commerce has been criticized by the United States Supreme Court.<sup>224</sup> Thus, any further extension of the market participant exception to accommodate AB 134 would seem unlikely. Since AB 134 is not protected from the Commerce Clause by the market participant doctrine, the California divestment law is unconstitutional.

#### CALIFORNIA CONSTITUTION ARTICLE XVI, SECTION 17

California amended Article XVI, section 17 of the state constitution with the passage of Proposition 21 in June of 1984.<sup>225</sup> This amendment authorized the legislature to invest all trust funds from public pension and retirement systems.<sup>226</sup> When investing these funds, the legislature is required to exercise the skill and care of a prudent investor.<sup>227</sup> If the state exercises this power under Article XVI, section 17, the state has a fiduciary duty to the beneficiaries to provide the greatest returns with the least amount of risk.<sup>228</sup> In addition, the exclusive purpose for the investment of the funds must be to benefit the participants of the plans.<sup>229</sup>

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221. *Reeves v. Stake*, 447 U.S. 429, 438-39 (1980).

222. *See South-Central Timber v. Wunnicke*, 467 U.S. 82, 99 n.11 (1984). A state could avoid *South-Central* by merely including a provision in the contract stating that the title does not pass until the processing is complete. The substance of the transaction rather than the label, is the important factor that governs the commerce clause analysis. *Id.*

223. *See supra* notes 150-54 and accompanying text.

224. *Reeves v. Stake*, 447 U.S. 429, 437 n.9 (1980); *South-Central Timber*, 467 U.S. at 99.

225. Proposition 21 was passed by the people on June 4, 1984. *See CAL. CONST. ART. XVI, § 17.*

226. *Id.*

227. *Id.* § 17(c). "The fiduciary of the public pension or retirement system shall discharge his or her 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." (emphasis added). *Id.*

228. *Id.* § 17(d).

229. *Id.* § 17(b). The fiduciary shall discharge the duty *solely* in the interest of, and for the *exclusive* purposes of providing benefits to the participants. *Id.*

AB 134 limits the power of the legislature to exercise this fiduciary duty. Under AB 134, the state is restricted from investing in business with economic ties to South Africa.<sup>230</sup> Due to this limitation of investment power by AB 134, the statute may violate the California Constitution. In response to this constitutional provision, the legislature found that the investment into securities of businesses with ties to South Africa would be imprudent given the current political and economic stability of the country.<sup>231</sup> A mere legislative finding, however, may not overcome the constitutional duty imposed on the state.<sup>232</sup> A prudent investor should base the investment decisions on more reliable standards other than on the place where the business may have some contact.<sup>233</sup> Since the true purpose of the statute was to protest against apartheid,<sup>234</sup> the funds are arguably being used as a political boycott and not for the exclusive purpose of benefiting the participants.<sup>235</sup>

The duty of the state to perform in the sole interest of the beneficiaries must be exercised to provide the participants the greatest economic gain.<sup>236</sup> All other purposes are forbidden by the constitution.<sup>237</sup> AB 134 prevents the state from investing in certain businesses, primarily to protest against apartheid in South Africa.<sup>238</sup> Since the divestment statute infringes upon the power of the state to invest the trust funds, this infringement must be for the *sole* economic purpose of benefiting the participants to be constitutional. A "political boycott" use of the trust funds would be a direct violation of the state constitutional provision. Since AB 134 advocates the withdrawal of investment from South Africa without any true economic gain to the beneficiaries of the trusts, the action would violate the state constitution.

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230. See CAL. GOV'T CODE §§ 16641, 16642 (West Supp. 1987) (California restricts investments in businesses and lending institutions doing business in South Africa).

231. See Act of Sept. 26, 1986, ch. 1254, sec. 1, 1986 CAL. LEGIS. SERV. 99, 101 (West).

232. See CAL. CONST. ART. XVI, § 17.

233. See Note, *supra* note 6, at 823.

234. See Act of Sept. 26, 1986, ch. 1254, sec. 1(a)-(e), 1986 CAL. LEGIS. SERV. 99, 101 (West).

235. See CAL. CONST. ART. XVI, § 17. AB 134 may additionally require California to breach the constitutional fiduciary duty to the beneficiaries. Under § 17 of Article XVI, California must use the care of a prudent investor. The requirement to divest certain funds based solely on where the business operates may breach that duty. Additional investment criteria exist other than whether or not the business has contacts with South Africa. See *id.* § 17(c) (fiduciaries' standard of care).

236. *Id.* § 17(b).

237. *Id.*

238. See Act of Sept. 26, 1986, ch. 1254, sec. 1, 1986 CAL. LEGIS. SERV. 99, 101 (West).

### CONCLUSION

This comment has explored possible constitutional challenges to AB 134. The enactment of both the Comprehensive Anti-Apartheid Act and AB 134 raises a possible federal preemption challenge. Since both statutes regulate new investments and loans to South Africa, AB 134 may be directly preempted to the extent the statute is inconsistent with the federal Act. AB 134 may also be indirectly preempted since the legislation regulates in a field traditionally held by the federal government. AB 134 may additionally be challenged as a violation of the commerce clause because the statute is an unjustified imposition on both interstate and foreign commerce. Since the market participant exception to the commerce clause does not apply to AB 134, the statute is unconstitutional. Finally, a third challenge to the validity of AB 134 may be based on the California Constitution. Under the state constitution, the investment decisions must be made with the exclusive purpose of serving the beneficiaries of the trust. The use of the funds as a political boycott is in direct violation of the enabling provision of the state constitution.

The statute, however, may not be challenged in the near future. The stigma of supporting apartheid awaits any challenger to AB 134. After the political unrest over apartheid has subsided, AB 134 will probably still be law in California. Eventually, businesses affected by the legislation may be more willing to assert the constitutional violations created by the enactment of AB 134. The California divestment statute, however, will serve the purported purposes by having a lasting effect on the State of California, the businesses in the United States, and the country of South Africa. This effect will occur whether the statute is constitutional or not.

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