For the Department of Higher Education, the Board was authorized to arrange for an alternate schedule of academic staff increases, limited to the extent that the cost of the increases could not exceed that of the standard increase scheduled for all agencies. The Board chose to defer the May-June increase for academic staff and thereby reduce the underfunding impact on the 1975-1977 biennium. The dollar effect of the decision has been summarized for the Education and General Services program as follows:

<table>
<thead>
<tr>
<th></th>
<th>1975-76</th>
<th>1976-77</th>
<th>Biennium</th>
</tr>
</thead>
<tbody>
<tr>
<td>24 months underfunding, academic and classified</td>
<td>$1,300,167</td>
<td>$1,312,268</td>
<td>$2,612,435</td>
</tr>
<tr>
<td>Deferral of May-June academic increase ($1,467,951 savings distributed to each year of biennium)</td>
<td>$750,664</td>
<td>$737,287</td>
<td>$1,467,951</td>
</tr>
<tr>
<td>Net underfunding</td>
<td>$569,503</td>
<td>$574,981</td>
<td>$1,144,484</td>
</tr>
</tbody>
</table>

The underfunding of $574,981 for year 1976-77 represents the deficiency which was carried into the annual dollar base used to develop the request for biennium 1977-1979. When the annual amount is extended to relate to two years of a biennium, it is apparent that the biennial base request was understated by $1,149,962. Similar calculations can be made to identify the amount of underfunding carried into 1977-1979 for the other programs administered by the Department of Higher Education.

Had the biennial amount of $1,149,962 been included in the base budget, the sum would have been included in the personal services upon which salary increases are calculated. To reflect the true deficiency, the salary increases authorized for 1977-1979 must be added to the base. The addition of this factor, underfunded in accord with rates applied to budgeted personal services, increases the deficiency to $1,250,396.

In 1977, the Legislature underfunded personal services by approximately 2% of the salary budget for all state agencies, except that the Department of Higher Education underfunding of academic services was limited to 1%. For the Education and General Services budget, the estimated 1977-1979 biennial underfunding totals $3,201,640. The cumulative effect of the underfunding now stands at $4,452,036 ($1,250,396 net underfunding carried forward from 1976-77 and $3,201,640 underfunding projected for biennium 1977-1979).

On the surface it would appear that all state agencies were treated similarly and that the concern in Higher Education should not exceed that of other agencies. The explanation relates to differences between Higher Education and other state agencies in the way the base budget is calculated. For other state agencies, the base budget for personal services is built from an inventory of authorized positions. Each position justifies a dollar amount in the budget request. When underfunding occurs, the dollars available are diminished but the base number of positions remains to be fully funded in the base for the succeeding biennium.

The Department of Higher Education has been treated differently. The salary base has been determined in terms of total dollars rather than in number of positions. The dollar amount of the 1976-77 underfunding was not restored to the base as is possible to do for other state agencies when the base number of positions is funded. Thus, in contrast with other state agencies, the 1975 underfunding carried forward in the Higher Education dollar base results in a diminished program level which is further underfunded by the 1977 salary funding policy.

It is intended that this deficiency in the budget process be corrected in the 1979-1981 biennial budget preparation. It remains, however, as a serious problem in the Department's 1977-1979 operating budget. It is proposed that the cumulative underfunding be reported to the State Emergency Board for consideration of financing to relieve the Department from an unintended program reduction.
The Chancellor reported that Mr. Louis B. Perry, President of the Board, had been selected Portland Citizen of the Year by the Board of Realtors.

Mr. Ingalls expressed his gratification and pleasure to Mr. Perry and extended congratulations on behalf of the Board.

The Chancellor stated that informal advice had been received from the Attorney General that there is a serious question about the legal capacity of the Board to implement the action taken by the Board on November 18, 1977, to divest investments in Southern African countries meeting certain criteria.

The Chancellor recommended that the Board authorize a request to the Attorney General for a clarifying opinion as set forth in the following suggested letter:

On November 18, 1977, the Board of Higher Education adopted the following motion:

That we instruct our managers to take two steps:

1. To proceed in an orderly manner to sell all of the endowment investments in the 27 companies which Mr. Holmer has identified as having substantial activity in Southern Africa; and

2. Not to acquire investments in any company which meets one of these three standards—employs more than 50 persons in Southern Africa, or (2) earns more than $500,000 from business operations in Southern Africa; or (3) which has investments in excess of $500,000 in fixed assets or loan portfolios in Southern Africa. For purposes of this motion South Africa means the countries of South Africa, Rhodesia, and Namibia.

In carrying out this action, the investment managers are requested to act prudently and in a manner which will not jeopardize the integrity of the endowment funds.

Inquiries have been made concerning the authority of the Board to take that action. As directed by the Board, we request your answers to the following questions:

1. Who has the authority to make investment decisions for Higher Education—the Board of Higher Education or the Investment Council?

2. Is the divestiture action of the Board controlling or does it have the status merely of a recommendation to the Oregon Investment Council?

3. In 38 Op Atty Gen 271, 285 (1976), it was said:

"We think it advisable for the Board to establish investment guidelines for the Investment Council to use in making investment decisions."

Was it intended by that statement to limit the investment authority of the Oregon Investment Council or was the statement intended as precautionary advice to avoid liability for alleged breach of trust in dealing with trust funds administered by the Board of Higher Education?

4. Is the authority of the Oregon Investment Council limited to determining what investments are sound and prudent or does it have the authority to determine policy questions such as that involved in the divestiture action by the Board?

5. Is a decision to sell stocks in companies doing business in South Africa a policy decision by the Board which the Oregon Investment Council must comply with?
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6. Would it be a violation of ORS 293.736(2) for either the Board of Higher Education or the Oregon Investment Council to direct the investment managers to sell or to refrain from buying certain stocks?

7. If the Board's decision to divest is carried out, will that be a violation of Ch. 395, Oregon Laws of 1977?

Sincerely,

R. E. Lieuallen
Chancellor

The Chancellor indicated that following receipt of the Attorney General's opinion, a report would be made to the Board for further consideration.

In response to questions, Mr. Branchfield explained that ORS 293.736(2) deals with duties of the investment officer and the authorization given to employ investment managers. It relates to whether anyone can instruct the investment managers on investments. Chapter 395 prohibits boycotting in business transactions.

Mr. Perry invited other questions or comments from the Board.

Mr. Ater said it was important to get an opinion from the Attorney General. However, if the relationship between the Board and the Oregon Investment Council is to be clarified, both the letter and the informal communication should deal with the larger relationship, not just the South African investments.

Mr. Perry said he assumed the Board was dealing with the larger issue, not just the matter of South African investments.

Mr. Ater pointed out that the suggested letter begins with a statement of the South African action and some of the questions are focused with specific references to that action. He said these questions might be rephrased in terms of the general relationship between the Board and the Oregon Investment Council.

Mr. Ater said the third question should be written so that it would not ask for a selection of alternatives. He commented with respect to question 4 that divestiture could be justified on the prudent man theory as well as on moral and policy judgments. The general question of the Board's authority to fix any kind of investment guidelines is stated in question 5. Mr. Ater said question 6 should be phrased in a discriminating fashion and the answer should be given considerable care, because a literal interpretation of the statute would say that it was improper for the Board to give investment managers rigorous guidelines.

Mr. Wyss said he disagreed with Mr. Ater's interpretation of question 6. It is not a matter of setting policy but a determination of whether the investment managers can be directed to sell or refrain from buying certain stocks. He suggested questions 6 and 4 should be 1 and 2. Mr. Wyss agreed the relationships with the Oregon Investment Council were of primary importance and consideration should not be restricted to South African investments. He commented that the South African resolution established objective guidelines for buying or selling securities. The basic question, he said, is whether the Board has any responsibility to fix guidelines and of what legal significance are such guidelines. If the Board has authority to set guidelines which have legal significance, it should also be determined what kinds of guidelines may be established.

Mr. Ingalls suggested that perhaps the Board might proceed with the divestiture action taken at the November 18 Board meeting.

Mr. Harms said the difficulty with that position was that an informal question has been raised as to the legality of the action which the Board took previously. He said sending the November 18 recommendation through for implementation without seeking an Attorney General's opinion would be shifting the burden to the Oregon Investment Council.
It was indicated that any communication to the investment managers should go through the Oregon Investment Council.

Mr. Ater said the actual legal authority in terms of the relationship between the Board and the Oregon Investment Council has not been clarified since the Council was created.

The Chancellor recommended that he and Mr. Branchfield review the questions and comments made during the discussion and, after appropriate consultation, submit the request for an opinion to the Attorney General.

The Board approved the Chancellor's recommendation, with the following voting in favor: Directors Anderson, Ater, Carpenter, Daniels, Feves, Harms, Ingalls, Moore, Wyss, and Perry. Those voting no: None.

Mr. Moore moved that (1) the Board divest stocks in accordance with the November 18, 1977, Board action, contingent upon a formal opinion by the Attorney General that the Board has the power to do so; and (2) if the Board does not have the power to divest, the recommendation to divest should be referred automatically to the Oregon Investment Council.

The motion was defeated by a tie vote of five to five. Those voting in favor of the motion were Directors Ater, Daniels, Feves, Ingalls, and Moore. Those voting against the motion were Directors Anderson, Carpenter, Harms, Wyss, and Perry.

Adjournment

The meeting was adjourned at 11:50 A.M., December 16, 1977.

Wilma L. Foster, Acting Board Secretary
Oregon State Board of Higher Education

Louis B. Perry, President

Wilma L. Foster, Acting Secretary