

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 959 Scrutinized Companies
SPONSOR(S): Bileca and others
TIED BILLS: **IDEN./SIM. BILLS:** SB 1144

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Government Operations Subcommittee		Meadows	Williamson
2) Civil Justice Subcommittee			
3) State Affairs Committee			

SUMMARY ANALYSIS

The State Board of Administration (SBA or board) is established by Article IV, s. 4(e) of the Florida Constitution, and is composed of the Governor as Chair, the Chief Financial Officer as Treasurer, and the Attorney General as Secretary. The board derives its powers to oversee state funds from Art. XII, s. 9 of the Florida Constitution.

In 2007, the Legislature enacted the Protecting Florida's Investments Act (PFIA). The PFIA requires the SBA, acting on behalf of the Florida Retirement System Trust Fund, to assemble and publish a list of scrutinized companies that have prohibited business operations in Sudan and Iran.

The bill expands the scrutinized companies list to include companies with prohibited business operations in Cuba and Syria. It prohibits the SBA from investing in companies that have specified business relationships with Cuba and Syria. In addition, it requires divestiture of investments in certain situations.

The bill requires the SBA to create a "Scrutinized Companies with Activities in Cuba List," and a "Scrutinized Companies with Activities in Syria List," and to use those lists consistent with the duties in the PFIA.

The bill provides that a contract with an agency or local government, after July 1, 2012, must include a provision allowing for termination if the company is found to have submitted a false certification or been placed on a scrutinized companies list.

The bill directs the Department of Management Services to inform the Attorney General of the United States of the inclusion of companies on the Scrutinized Companies with Activities in Cuba List and the Scrutinized Companies with Activities in Syria List.

The bill has a significant fiscal impact on state government.

The bill provides an effective date of July 1, 2012.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Current Situation

State Board of Administration

The State Board of Administration (SBA or board) is established by Article IV, s. 4(e) of the Florida Constitution, and is composed of the Governor as Chair, the Chief Financial Officer as Treasurer, and the Attorney General as Secretary. The board members are commonly referred to as “Trustees.” The board derives its powers to oversee state funds from Art. XII, s. 9 of the Florida Constitution.

The SBA has responsibility for managing investments for the Florida Retirement System (FRS) Pension Plan and for administering the FRS Investment Plan, which represent approximately \$125.1 billion (85 percent) of the \$147.5 billion in assets managed by the SBA, as of November 30, 2011.¹ The SBA also manages 33 other investment portfolios, with combined assets of \$21.7 billion², including the Florida Hurricane Catastrophe Fund, the Florida Lottery Fund, the Florida Pre-Paid College Plan, and various debt-service accounts for state bond issues.

Divestiture from Cuba

Current law prohibits the SBA from investing in stocks, securities, or other obligations of any institution or company domiciled in the United States that does business of any kind with Cuba, in violation of federal law.³ In addition, the SBA is prohibited from investing in any company domiciled outside of the United States if the President of the United States has applied sanctions against the country in which that company is domiciled.⁴

Florida law also provides that state agencies are prohibited from investing in any financial institution or company domiciled in the United States, which directly through the domestically domiciled company or a foreign subsidiary, issues a loan, extends credit, or makes purchases or trades goods with Cuba.⁵ State agencies are also prohibited from investing in any foreign company if the President of the United States has applied sanctions to the country in which that company is domiciled.⁶

The Protecting Florida’s Investments Act

In 2007, the Legislature enacted the Protecting Florida’s Investments Act (PFIA)⁷. The PFIA requires the SBA, acting on behalf of the Florida Retirement System Trust Fund (FRSTF), to assemble and publish a list of scrutinized companies that have prohibited business operations in Sudan and Iran.⁸ Once placed on the list of scrutinized companies, the SBA and its investment managers are prohibited from acquiring those companies’ securities and are required to divest those securities if the companies do not cease the prohibited activities or take certain compensating actions.⁹ The implementation of the PFIA by the SBA does not affect any FRSTF investments in United States companies; the PFIA affects foreign companies with certain business operations in Sudan and Iran involving the petroleum or energy sector, oil or mineral extraction, power production, or military support activities.¹⁰

¹ See State Board of Administration of Florida, *Monthly Performance Report to the Trustees*, November 30, 2011, issued December 31, 2011, at 7 (on file with the Government Operations Subcommittee).

² *Id.*

³ See s. 215.471, F.S.

⁴ *Id.*

⁵ Section 215.472(1), F.S.

⁶ Section 215.472(2), F.S.

⁷ See chapter 2007-88, L.O.F.

⁸ See s. 215.473(2)(a) and (b), F.S.

⁹ See s. 215.473(3), F.S.

¹⁰ Substantive Analysis for HB 1417, State Board of Administration, January 9, 2012, at 3 (on file with the Government Operations Subcommittee).

Iran and Sudan

Current law provides for the identification and divestiture of funds in certain companies with prohibited business operations with Iran and Sudan.

Florida law provides that the public fund¹¹ must make best efforts to identify all scrutinized companies in which it has direct or indirect holdings or could possibly have such holdings in the future. A scrutinized company means any company that:

- Has business operations involving contracts with or provides supplies or services to the governments of Iran or Sudan; companies in which such governments have any direct or indirect equity share, consortiums, or projects commissioned by the government; or companies involved in consortiums or projects commissioned by such governments.
- Is complicit in the Darfur genocide.
- Supplies military equipment within Sudan, unless it clearly shows that the military equipment cannot be used to facilitate offensive military actions in Sudan or the company implements rigorous and verifiable safeguards to prevent use of that equipment by forces actively participating in armed conflict.¹²

The public fund must create a “Scrutinized Companies with Activities in Sudan List” and a “Scrutinized Companies with Activities in the Iran Petroleum Energy Sector List”.¹³ The lists must be updated quarterly and made publicly available.¹⁴ The public fund must file a report with each member of the board of trustees of the SBA, the President of the Senate, and the Speaker of the House of Representatives that includes the scrutinized company lists, within 30 days after the creation of the list.¹⁵

The public fund must provide written notice to any company, with inactive business operations, informing the company of this act and encouraging it to continue to refrain from initiating business with Iran or Sudan. Correspondence must occur semiannually.¹⁶

For any scrutinized company having active business operations with Iran or Sudan, the public fund must send written notice informing the company of its scrutinized status and informing the company that it may become subject to divestment.¹⁷ If, within 90 days, a company ceases scrutinized business operations, then that company must be removed from the lists.¹⁸ The public fund must sell, redeem, divest, or withdraw all publicly traded securities of the company within 12 months if, after 90 days, the company continues scrutinized active business operations.¹⁹

A company that the United States affirmatively declares to be excluded from present or future federal sanctions regime relating to Sudan or Iran is not subject to divestment or the investment prohibition.²⁰ In addition, divestment and the investment prohibition do not apply to indirect holdings in actively managed investment funds.²¹

¹¹ Section 215.473(1)(q), F.S., defines “public fund” as all funds, assets, trustees, and other designates under the SBA pursuant to chapter 121, F.S.

¹² Examples of safeguards include post-sale tracking of such equipment by the company, certification from a reputable and objective third party that such equipment is not being used by a party participating in armed conflict in Sudan, or sale of such equipment solely to the regional government of southern Sudan or any internationally recognized peacekeeping force or humanitarian organization.

¹³ Section 215.473(2)(b), F.S.

¹⁴ Section 215.473(2)(c), F.S.

¹⁵ Section 215.473(4)(a), F.S.

¹⁶ Section 215.473(3)(a)2., F.S.

¹⁷ Section 215.473(3)(a)3., F.S.

¹⁸ Section 215.473(3)(a)4., F.S.

¹⁹ Section 215.473(3)(b)1., F.S.

²⁰ Section 215.473(3)(d), F.S.

²¹ The public fund, however, must submit letters to the managers of such investment funds containing companies that have scrutinized active business operations requesting that they consider removing such companies from the fund or create a similar actively managed fund having indirect holdings devoid of such companies.

Current law requires the public fund to issue quarterly reports to the board of trustees of the SBA, President of the Senate, Speaker of the House of Representatives, United States Presidential Special Envoy to Sudan, and United States Presidential Special Envoy to Iran.²² The reports must include:

- A summary of correspondence with engaged companies;
- A listing of all investments sold, redeemed, divested, or withdrawn;
- A listing of all prohibited investments;
- A description of any progress related to external managers offering PFIA compliant funds; and
- A list of all publicly traded securities held directly by the state.²³

Current law provides that relevant portions of the act are discontinued if the United States Congress, or the President of the United States passes legislation, or issues an executive order or other written certification that:

- Darfur genocide has been halted for at least 12 months;
- Sanctions imposed against the Government of Sudan are revoked;
- The government of Sudan honors its commitments to cease attacks on civilians, demobilize and demilitarize the Janjaweed and associated militias, grant free and unfettered access for deliveries of humanitarian assistance, and allow for the safe and voluntary return of refugees and internally displaced persons;
- The government of Iran has ceased to acquire weapons of mass destruction and support international terrorism;
- Sanctions imposed against the government of Iran are revoked; or
- Mandatory divestment of the type provided for by the PFIA interferes with the conduct of United States foreign policy.²⁴

Divestment of Securities

Divestment of securities is one method of applying economic pressures to companies, groups, or countries whose practices are not condoned by shareholders. Divestment may be used in conjunction with or in lieu of other sanctioning methods such as economic embargoes, and diplomatic and military activities. Alternatively, divestment may be used as a protective device if a particular investment carries a high level of risk to the performance of a fund.

The State of Florida has practiced divestment four times in modern history.²⁵ From 1986 to 1993, the Legislature directed the SBA to divest from companies doing business with South Africa.²⁶ Beginning October 1, 1988, the Legislature placed restrictions on investments in any institution or company doing business in or with Northern Ireland.²⁷ From 1997 until 2001, the SBA made a decision to divest of 16 tobacco stocks due to pending litigation involving the state and those companies.²⁸ From 2007 to present, the Legislature has directed the SBA to divest funds of companies that are actively seeking and providing certain business opportunities with Iran and Sudan.²⁹

Effect of Proposed Changes

The bill adds Cuba and Syria as nations subject to the PFIA and requiring investing prohibitions and potential investment divestiture by the SBA.

²² Section 215.473(4)(b), F.S.

²³ Section 215.473(4)(b)1. – 5., F.S.

²⁴ See s. 215.473(5), F.S.

²⁵ Information provided on February 3, 2012, by Mr. Ron Poppell, Senior Defined Contribution Programs Officer, State Board of Administration.

²⁶ *Id.*

²⁷ See s. 121.153, F.S.

²⁸ Information provided on February 3, 2012, by Mr. Ron Poppell, Senior Defined Contribution Programs Officer, State Board of Administration.

²⁹ See s. 215.473, F.S.

The bill expands the definition of “scrutinized companies” to include institutions or companies with prohibited business operations in Cuba and Syria. It provides that the definition of scrutinized companies now includes any company that:

- Has business operations involving contracts with or provides supplies or services to the governments of Cuba³⁰ or Syria³¹; companies in which such governments have any direct or indirect equity share, consortiums, or projects commissioned by the government; or companies involved in consortiums or projects commissioned by such governments; and
- Supplies military equipment within Sudan, unless it clearly shows that the military equipment cannot be used to facilitate offensive military actions in Sudan or the company implements rigorous and verifiable safeguards to prevent use of that equipment by forces actively participating in armed conflict.

The bill requires the SBA to create a “Scrutinized Companies with Activities in Cuba List,” and a “Scrutinized Companies with Activities in Syria List,” and use those lists consistent with the duties in the PFIA.

The bill provides that if any of the following occur, the SBA may no longer scrutinize the affected company, no longer produce the scrutinized companies list, and cease divestment and investment prohibitions:

- The Congress or President of the United States affirmatively and unambiguously states, by means including, but not limited to, legislation, executive order, or written certification from the President to Congress, that the government of Cuba or Syria has ceased to acquire weapons of mass destruction and support international terrorism;
- The United States revokes all sanctions imposed against the government of Cuba or Syria; or
- The Congress or President of the United States affirmatively and unambiguously declares, by means including, but not limited to, legislation, executive order, or written certification from the President to Congress, that mandatory divestment of the type provided for in this act interferes with the conduct of United States foreign policy.

The bill provides that a contract with an agency or local government, for goods or services of \$1 million or more entered into or renewed on or after July 1, 2012, must include a provision allowing for termination if the company is found to have submitted a false certification or been placed on a scrutinized companies list. It also provides conditions that state agencies and local governments may use to determine, on a case by case basis, whether to enter into a contract for goods or services in excess of \$1 million with a company on a scrutinized companies list.

The bill directs the Department of Management Services to inform the Attorney General of the United States of the inclusion of companies on the Scrutinized Companies with Activities in Cuba List and the Scrutinized Companies with Activities in Syria List.

The bill provides for an effective date of July 1, 2012.

B. SECTION DIRECTORY:

Section 1 amends s. 215.473, F.S., to provide legislative findings; to revise and provide definitions; to create divestiture requirements related to Cuba and Syria.

³⁰ With regards to Cuba, more than 10 percent of the company’s total revenue or assets are linked to Cuba, and the company has failed to take substantial action; and, the company has, with actual knowledge, on or after January 1, 1959, made an investment of \$20 million or more, or any combination of investments of at least \$10 million each, which in the aggregate equals or exceeds \$20 million in any 12-month period.

³¹ With regards to Syria, more than 10 percent of the company’s total revenues or assets are linked to Syria and involve oil-related activities, and the company has failed to take substantial action; or the company has, with actual knowledge, on or after March 8, 1963, made an investment of \$20 million or more, or any combination of investments of at least \$10 million each, which in the aggregate equals or exceeds \$20 million in any 12-month period, and which directly or significantly contributes to the enhancement of Syria’s ability to develop the petroleum resources of Syria.

Section 2 amends s. 287.135, F.S., to prohibit a state agency or local government entity from contracting for goods and services of more than a certain amount with a company that is on the Scrutinized Companies with Activities in Cuba List or the Scrutinized Companies with Activities in Syria List; to require a contract provision if the company is found to have been placed on such list; to provide exceptions; to require the Department of Management Services to notify the United States Attorney General after the act becomes law.

Section 3 provides an effective date of July 1, 2012.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

Unknown.

2. Expenditures:

The SBA estimates that it will cost \$20 - \$30 million during fiscal year 2012-2013, to divest and reinvest funds with ties to Cuba and Syria.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

Unknown.

2. Expenditures:

Unknown.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The SBA would be prohibited from investing in those companies placed on a scrutinized companies list. Staff of the SBA advises that as proposed, the bill could potentially affect up to 13 foreign companies with business operations in Syria, 194 foreign companies with business operations in Cuba, and 33 United States companies with business operations in Cuba.

D. FISCAL COMMENTS:

The SBA will be required to divest of any holdings that have equity ties to Cuba or Syria. If this activity results in lost investment income, or administrative costs associated with divestment and replacement of the divested funds, those costs will have to be absorbed by the FRS or ultimately, the State of Florida, to maintain the solvency of the FRS Pension Plan.

The SBA provided the following fiscal comments:

As proposed the, the bill creates material negative short-term and potentially material long-term impacts on the FRS:

- The sale of \$9.2 billion in Cuba and Syrian related securities and reinvestment would have direct and indirect costs of \$30 million.
- In the most recent year, the securities lending program earned \$5.6 million lending Cuban and Syrian related securities. This trust fund income would be lost if the securities were prohibited.
- Roughly 8 percent of the universe of United States stocks and 21 percent of the universe of foreign stocks would be prohibited. These large

exclusions will increase trust fund portfolio risk and may cause higher employer contributions.³²

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not applicable. The bill does not appear to require counties or municipalities to spend funds or take an action requiring the expenditure of funds; reduce the authority that counties or municipalities have to raise revenues in the aggregate; or reduce the percentage of a state tax shared in the aggregate with counties or municipalities.

2. Other:

Federal Issues – Federal Commerce Clause

In 2006, a constitutional challenge was filed by the National Foreign Trade Council, Inc. (NFTC), eight municipal pension funds and eight individual beneficiaries of state and local pension funds impacted by the 2005 Illinois Act to End Atrocities and Terrorism in the Sudan (“Illinois Sudan Act”).³³ The intent of the Illinois Act was to help stop the atrocities in the Republic of Sudan. It contained two major changes, one dealing with Deposit of State Moneys and another with the public Pension Code. The intent of the provisions dealing with the Pension Code was to prohibit a fiduciary of a public retirement system or public pension fund from investing in any entity with ties to Sudan and ultimately, to compel total divestment of pension assets with ties to Sudan.

The plaintiffs based their challenge on four grounds: (a) that the Act violated the United States Constitution’s Supremacy Clause because the Act is preempted by federal laws governing relations with Sudan; (b) that the Act intrudes on the federal government’s exclusive authority to conduct foreign affairs; (c) that the Act violates the Foreign Commerce Clause of the United States Constitution; and (d) that the provisions relating to the Deposit of State Moneys is preempted by the National Bank Act.³⁴

On February 23, 2007, the Federal District Court for the Northern District of Illinois declared the entire Illinois Sudan Act unconstitutional and permanently enjoined enforcement of the Act. The Court found the Pension Code amendments unconstitutional as violative of the Foreign Commerce Clause of the United States Constitution.³⁵

The opinion noted that courts are split on the issue of whether the market participant exception to the Commerce Clause applies to the Foreign Commerce Clause.³⁶ The United States Supreme Court has not addressed whether a “market participant” exception applies to the Foreign Commerce Clause. To the extent that the market participant exception to the Foreign Commerce Clause does apply and to the extent that the State Board of Administration acts exclusively as a market participant as to the public fund, the bill may not violate the Foreign Commerce Clause.

³² Memorandum provided by the State Board of Administration, delivered on January 31, 2012, by Mr. Ron Poppell, Senior Defined Contribution Programs Officer, State Board of Administration (on file with the Government Operations Subcommittee).

³³ See National Foreign Trade Council, Inc. v. Giannoulis, 532 F.Supp.2d 731 (N.D.Ill., 2007).

³⁴ *Id.* at 737.

³⁵ *Id.*

³⁶ *Id.* at 747. See also College Sav. Bank v. Fla. Prepaid Postsecondary Ed. Expense Bd., 527 U.S. 666, 685, 119 S.Ct. 2219, 144 L.Ed.2d 605 (1999) (“Since state proprietary activities may be, and often are, burdened with the same restrictions imposed on private market participants, evenhandedness suggests that, when acting as proprietors, States should similarly share existing freedoms from federal constraints, including the inherent limits of the Commerce Clause.”); Reeves, Inc. v. Stake, 100 S.Ct. 2271, 2278 (1980)(Moreover, state proprietary activities may be, and often are, burdened with the same restrictions imposed on private market participants. Evenhandedness suggests that, when acting as proprietors, States should similarly share existing freedoms from federal constraints, including the inherent limits of the Commerce Clause.)

The Commerce Clause – Market Participant

The United States Constitution provides that Congress shall have the power “to regulate commerce . . . among the states.”³⁷ The Commerce Clause acts not only as a positive grant of power to Congress, but also as a negative constraint upon the states.³⁸

Courts have used a two-tiered analysis to determine whether a statutory scheme violates the Commerce Clause:

1. “If a statute ‘directly regulates or discriminates against interstate commerce, or [if] its effect is to favor in-state economic interests over out-of-state interests,’ the court may declare it unconstitutional as applied, without further inquiry.”³⁹
2. “. . . if the statute regulates evenhandedly and if it has only an indirect effect on interstate commerce, the court must determine whether the state’s interest is legitimate and, if so, whether the burden on interstate commerce exceeds the local benefits.”⁴⁰

However, when a state or local government is acting as a “market participant” rather than a “market regulator,” it is not subject to the limitations of the Commerce Clause.⁴¹ A state is considered to be a “market participant” when it is acting as an economic actor such as a purchaser of goods and services.⁴²

B. RULE-MAKING AUTHORITY:

The bill does not appear to create a need for rulemaking or additional rulemaking authority.

C. DRAFTING ISSUES OR OTHER COMMENTS:

Other Comments - SBA

The SBA provided the following comment:

If plan participants, retirees, or their associations believe that divestment threatens the security or level of their benefits, they may seek class action or individual relief in the courts on different grounds including impairment of contract and breach of fiduciary duty. This risk is particularly acute for defined contribution plans as their benefit (i.e., account value) is directly related to investment returns. In addition to claims to make the trust fund or individual accounts whole, there is the risk of damages against plan fiduciaries for breach of duty.⁴³

Drafting Issue

On line 832 of the bill, the word Cuba should be replaced by Syria.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

Not Applicable.

³⁷ U.S. CONST. art. I, s. 8, cl. 3.

³⁸ See Gibbons v. Ogden, 22 U.S. 1 (1824).

³⁹ National Collegiate Athletic Ass’n v. Associated Press, 18 So. 3d 1201, 1211(Fla. 1st DCA 2009) (citing Brown-Forman Distillers Corp. v. New York State Liquor Authority, 476 U.S. 573, 578-579).

⁴⁰ *Id.* (citations omitted); See Bainbridge v. Turner, 311 F.3d 1104, 1108-1109.

⁴¹ See White v. Massachusetts Council of Constr. Employers, 460 U.S. 204, 204 (1983).

⁴² *Id.*

⁴³ Substantive Analysis for HB 959, State Board of Administration, January 9, 2012, at 9 (on file with the Government Operations Subcommittee).