



Agenda Item 6a

November 18, 2013

ITEM NAME: California Public Divest from Iran Act

PROGRAM: Global Equity

ITEM TYPE: Total Fund – Action

RECOMMENDATION

Approve staff's recommendation that four portfolio companies are not subject to the California Public Divest from Iran Act (Iran Act) based on information provided by the companies and third party sources such as the Governmental Accountability Office (GAO).

EXECUTIVE SUMMARY

Staff has engaged four companies and determined all four companies are not subject to the divestment provision of the Iran Act. The four companies are:

1. Edison SPA
2. Lukoil
3. Oil and Natural Gas Corp. (ONGC)
4. Petronet

STRATEGIC PLAN

This agenda item supports the CalPERS Strategic Plan goal to cultivate a high-performing, risk-intelligent and innovative organization. Meeting reporting requirements, like those required by the California Public Divest from Iran Act, is a key mitigation for compliance and reputational risk.

BACKGROUND

In October 2007, Assembly Bill 221 (AB 221) entitled the California Public Divest from Iran Act was enacted which provided for the identification, engagement and divestment of investments in companies engaged in specified business operations in Iran, subject to CalPERS overriding fiduciary duty.

In October 2011, Assembly Bill 1151 (Attachment 1), amended AB 221 to its current status as applicable to CalPERS under the requirements of Government Code section 7513.7. AB 1151 requires CalPERS to determine whether a company is taking substantial action to end or curtail business operations in Iran. Furthermore, it is required that this determination be supported by findings adopted by a roll call vote of the CalPERS Board following a presentation and discussion of the findings in open session.

ANALYSIS

CalPERS utilizes external third party resources including the U.S. GAO reports on Iran sanctions for the initial identification of companies subject to the Iran Act. In addition, staff coordinates with the California Department of General Services to acquire a list of companies prohibited from contracting with public entities in California per the California Iranian Contracting Act of 2010.

Once a company has been identified, CalPERS notifies each company, setting out the provisions of the Iran Act, and seeking a response which can be properly assessed. Following engagement with identified companies, staff considers the companies' status in compliance with the provisions of the Iran Act. CalPERS Board will make the final determination of the companies' compliance with the Iran Act.

The actions specified in the Iran Act are to be taken subject to being consistent with CalPERS Board's fiduciary duties as described in Section 17 of Article XVI of the California Constitution.

Table 1 shows CalPERS current equity positions in the four portfolio companies that staff considers are not subject to the divestment provisions of the Iran Act. Table 2 summarizes the key findings of the four companies engaged by CalPERS including substantial action taken, curtailed operations, or as no longer being engaged in business operations pursuant to the Iran Act. The summary in the table is based on the companies' written responses to CalPERS enquiries plus information provided by the GAO.

TABLE 1: CalPERS Equity Positions

	Company	Shares Held by CalPERS as of 9/30/2013	Market Value (US\$) of Shares Held by CalPERS
1	Edison SPA	0	\$0
2	Lukoil	1,351,133	\$85,849,205.64
3	Oil and Natural Gas Corporation (ONGC)	0	\$0
4	Petronet LNG	0	\$0

TABLE 2: Summary of Key Findings

	Company	Summary of Key Findings – Company Status
1	Edison Spa (Italy)	At its May 2011, meeting, the Investment Committee approved divestment of Edison Spa. Since CalPERS divestment, Edison Spa has demonstrated its withdrawal from Iran. The December 2012, GAO report stated Edison Spa has withdrawn from Iran. On July 6, 2012, the U.S. Department of State announced Edison Spa: • Withdrew from Iran’s energy sector, specifically its contract to explore Iran’s Dayyer natural gas field • Pledged not to engage in activity with Iran in the future that is subject to U.S. sanctions. • Secretary of State applied the Special Rule under Iran Sanctions Act (ISA) meaning as a company continues to act in accordance with its assurance, under the law, it will not be subject to an investigation into past Iran-based activities.
2	Lukoil (Russia)	The December 2012, GAO report stated Lukoil has withdrawn from Iran. On October 12, 2012, the Company stated it was: • Not engaged or invested in any business operations with entities in the defense or nuclear sectors of Iran; • Does not have an investment of \$20,000,000 or more in the energy sector of Iran. • Not invested in or engaged in business operations with entities in the energy sector, including a company that provides oil or liquefied natural gas tankers or products used to construct or maintain pipelines used to transfer oil; and • Not involved in any dealing with an Iranian organization labeled as a terrorist by the U.S. government.
3	Oil and Natural Gas Corporation (ONGC) (India)	On January 11, 2013, the Company stated: • Not engaged in any business activities in Iran as defined in the California Public Divest from Iran Act.

	Company	Summary of Key Findings – Company Status
		• Not engaging in investments activities in Iran. • Not currently commercially active with respect to any block or field or Project in Iran. • Not pursuing any activity in the development of South Pars Phase 12 Project.
4	Petronet LNG (India)	At its October 2012, meeting, the Investment Committee approved divestment of Petronet LNG. Since CalPERS divestment, Petronet LNG has communicated it's not subject to the California Public Divest from Iran Act. On January 16, 2013, the Company stated: • 2009 business development discussions that took place did not translate into any business opportunities. • Not engaged or invested in any business operations in Iran;

BENEFITS/RISKS

This item fulfills CalPERS compliance with the provisions outlined in the Iran Act, thereby eliminating the risk of non-compliance with legislative reporting requirements.

ATTACHMENTS

Attachment 1 – California Assembly Bill 1151

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Assembly Bill No. 1151

CHAPTER 441

An act to amend Section 7513.7 of the Government Code, relating to investments.

[Approved by Governor October 3, 2011. Filed with
Secretary of State October 3, 2011.]

LEGISLATIVE COUNSEL'S DIGEST

AB 1151, Feuer. Public retirement systems: investments: Iran.

The California Constitution provides that the Legislature may by statute prohibit retirement board investments if it is in the public interest to do so, and providing that the prohibition satisfies specified fiduciary standards.

The California Public Divest from Iran Act prohibits the Public Employees' Retirement System (PERS) and the State Teachers' Retirement System (STRS) from investing public employee retirement funds in a company with business operations in Iran that is invested in or engaged in business operations with entities in the defense or nuclear sectors of Iran, or the company is invested or engaged in business operations with entities involved in the development of petroleum or natural gas resources of Iran, and that company is subject to sanctions under federal law, as specified, or the company is engaged in business operations with an Iranian organization that has been labeled as a terrorist organization by the United States government. Existing law requires the Board of Administration of PERS and the Teachers' Retirement Board of STRS to sell or transfer any investments in a company with business operations in Iran, until Iran is removed from the United States Department of State's list of countries that have been determined to repeatedly provide support for acts of international terrorism and the President of the United States determines and certifies that Iran has ceased its efforts to design, develop, manufacture, or acquire a nuclear explosive device or related materials and technology, as specified. Existing law requires the boards of PERS and STRS, on or before June 30, 2008, to determine the companies that are subject to divestment and to notify those companies and request that those companies take substantial action to curtail or end business operations, as described above, in Iran. Existing law provides that the board is not required to divest if the board determines that the company has taken substantial action in a 90-day period to curtail or end those operations. Existing law excepts certain investments from these requirements, including those in companies providing humanitarian relief and promoting health, education, journalistic, religious, or welfare activities.

Existing law provides that nothing in those provisions requires the Board of Administration of PERS or the Teachers' Retirement Board of STRS to take action as described in those provisions unless the board determines, in

good faith and based on specified information, that the action is consistent with the fiduciary responsibilities of the board as described in a specified provision of the California Constitution.

This bill would prohibit the boards from investing in a company that has an investment of \$20,000,000 or more in the energy sector of Iran, as defined, including in a company that provides oil or liquefied natural gas tankers, or products used to construct or maintain pipelines used to transport oil or liquefied natural gas. The bill would require the boards to review their investments annually and would require that the boards' determinations that a company is taking substantial actions to end or curtail its operations, as described above, be supported by findings adopted by a rollcall vote of the boards following a presentation and discussion of the findings in open session, during a properly noticed public hearing of the full board. The bill would require all proposed findings to be made public 72 hours before they are considered by the board, and that the board maintain a list of interested parties to be notified of proposed findings 72 hours before the board's consideration. The bill would require the findings and any public comments regarding the adopted findings and determinations to be included in a report to the Legislature. The bill would make the same notice, rollcall vote, and public hearing requirements for adopted findings and determinations of the boards regarding divestments that are found to disadvantage the retirement funds. The bill would eliminate the exception provided for investments in certain companies providing humanitarian relief and promoting health, education, journalistic, religious, or welfare activities. The bill would revise the circumstances under which these provisions would cease to be operative to conform with current federal law. The bill would make findings regarding the California Public Divest from Iran Act and would provide that its provisions are severable.

The people of the State of California do enact as follows:

SECTION 1. The Legislature finds and declares that Section 7513.7 of the Government Code, known as the California Public Divest from Iran Act, is consistent with the authority to divest granted to state and local governments by, and is in accordance with, the provisions of Public Law 111-195, enacted July 1, 2010.

SEC. 2. Section 7513.7 of the Government Code is amended to read:

7513.7. (a) As used in this section, the following definitions shall apply:

(1) "Board" means the Board of Administration of the Public Employees' Retirement System or the Teachers' Retirement Board of the State Teachers' Retirement System, as applicable.

(2) "Business operations" means maintaining, selling, or leasing equipment, facilities, personnel, or any other apparatus of business or commerce in Iran, including the ownership or possession of real or personal property located in Iran.

(3) “Company” means a sole proprietorship, organization, association, corporation, partnership, venture, or other entity, its subsidiary or affiliate that exists for profitmaking purposes or to otherwise secure economic advantage. “Company” also means a company owned or controlled, either directly or indirectly, by the government of Iran, that is established or organized under the laws of or has its principal place of business in Iran.

(4) “Energy sector of Iran” means activities to develop petroleum or natural gas resources or nuclear power in Iran.

(5) “Invest” or “investment” means the purchase, ownership, or control of stock of a company, association, or corporation, the capital stock of a mutual water company or corporation, bonds issued by the government or a political subdivision of Iran, corporate bonds or other debt instruments issued by a company, or the commitment of funds or other assets to a company, including a loan or extension of credit to that company.

(6) “Iran” means the government of Iran and any agency or instrumentality of Iran.

(7) “Public employee retirement funds” means the Public Employees’ Retirement Fund described in Section 20062 of this code, and the Teachers’ Retirement Fund described in Section 22167 of the Education Code.

(8) “Substantial action” means a boycott of the government of Iran, curtailing business in Iran until that time described in subdivision (m), or selling company assets, equipment, or real and personal property located in Iran.

(b) The board shall not invest public employee retirement funds in a company which has business operations in Iran as identified by the board through, as the board deems appropriate, publicly available information including, but not limited to, information provided by nonprofit and other organizations and government entities, that meets either of the following criteria:

(1) The company (A) is invested in or engaged in business operations with entities in the defense or nuclear sectors of Iran or (B) has an investment of twenty million dollars (\$20,000,000) or more in the energy sector of Iran, including in a company that provides oil or liquefied natural gas tankers, or products used to construct or maintain pipelines used to transport oil or liquefied natural gas, for the energy sector of Iran, and that company is subject to sanctions under Public Law 104-172, as renewed and amended in 2001 and 2006.

(2) The company has demonstrated complicity with an Iranian organization that has been labeled as a terrorist organization by the United States government.

(c) Annually, on or before June 30, the board shall review its investment portfolio and determine which companies are subject to divestment.

(d) After the determination described in subdivision (c), the board shall determine, by the next applicable board meeting, if a company meets the criteria described in subdivision (b). If the board plans to invest or has investments in a company that meets the criteria described in subdivision

(b), that planned or existing investment shall be subject to subdivisions (g) and (h).

(e) Investments of the board in a company that does not meet the criteria described in subdivision (b) are not subject to subdivision (h) if the company does not subsequently meet the criteria described in subdivision (b). The board shall identify the reasons why that company does not satisfy the criteria described in subdivision (b) in the report to the Legislature described in subdivision (i).

(f) (1) Notwithstanding subdivisions (d) and (e), if the board's investment in a company described in subdivision (b) is limited to investment via an externally and actively managed commingled fund, the board shall contact that fund manager in writing and request that the fund manager remove that company from the fund as described in subdivision (h). On or before June 30, if the fund or account manager creates a fund or account devoid of companies described in subdivision (b), the transfer of board investments from the prior fund or account to the fund or account devoid of companies with business operations in Iran shall be deemed to satisfy subdivision (h).

(2) If the board's investment in a company described in subdivision (b) is limited to an alternative fund or account, the alternative fund or account manager creates an actively managed commingled fund that excludes companies described in subdivision (b), and the new fund or account is deemed to be financially equivalent to the existing fund or account, the transfer of board investments from the existing fund or account to the new fund or account shall be deemed to satisfy subdivision (h). If the board determines that the new fund or account is not financially equivalent to the existing fund, the board shall include the reasons for that determination in the report described in subdivision (i).

(3) The board shall make a good faith effort to identify any private equity investments that involve companies described in subdivision (b), or are linked to the government of Iran. If the board determines that a private equity investment clearly involves a company described in subdivision (b), or is linked to the government of Iran, the board shall consider, at its discretion, if those private equity investments shall be subject to subdivision (h). If the board determines that a private equity investment clearly involves a company described in subdivision (b), or is linked to the government of Iran and the board does not take action as described in subdivision (h), the board shall include the reasons for its decision in the report described in subdivision (i).

(g) Except as described in subdivisions (e) and (f), the board, in the board's capacity of shareholder or investor, shall notify any company described in subdivision (d) that the company is subject to subdivision (h) and permit that company to respond to the board. The board shall request that the company take substantial action no later than 90 days from the date the board notified the company under this subdivision. If the board determines based on credible information available to the public that a company has taken substantial action or has made sufficient progress toward substantial action before the expiration of that 90-day period, that company

shall not be subject to subdivision (h). The board shall, at intervals not to exceed 90 days, continue to monitor and review the progress of the company until that company has taken substantial action in Iran. Any determination made at each 90-day interval that a company has taken substantial action shall be supported by findings adopted by a rollcall vote of the board following a presentation and discussion of the findings in open session, during a properly noticed public hearing of the full board. All proposed findings of the board shall be made public 72 hours before they are considered by the board, and the board shall maintain a list of interested parties who shall be notified of proposed findings 72 hours before the board's consideration. The findings and any public comments regarding the adopted findings and determinations made pursuant to this subdivision shall be included in the report to the Legislature required by subdivision (i). A company that fails to complete substantial action within one year from the date of the initial notice by the board shall be subject to subdivision (h).

(h) If a company described in subdivision (d) fails to complete substantial action by the time described in subdivision (g), the board shall take the following actions:

(1) The board shall not make additional or new investments or renew existing investments in that company.

(2) The board shall liquidate the investments of the board in that company no later than 18 months after this subdivision applies to that company. The board shall liquidate those investments in a manner to address the need for companies to take substantial action in Iran and consistent with the board's fiduciary responsibilities as described in Section 17 of Article XVI of the California Constitution.

(i) On or before January 1, 2009, and every year thereafter, the board shall file a report with the Legislature. The report shall describe the following:

(1) A list of investments the board has in companies with business operations that satisfy the criteria in subdivision (b), including, but not limited to, the issuer, by name, of the stock, bonds, securities, and other evidence of indebtedness.

(2) A detailed summary of the business operations a company described in paragraph (1) has in Iran.

(3) Whether the board has reduced its investments in a company that satisfies the criteria in subdivision (b).

(4) If the board has not completely reduced its investments in a company that satisfies the criteria in subdivision (b), when the board anticipates that the board will reduce all investments in that company or the findings adopted in support of a determination made pursuant to subdivision (k) pertaining to why a sale or transfer of investments is inconsistent with the fiduciary responsibilities of the board as described in Section 17 of Article XVI of the California Constitution.

(5) Any information described in subdivisions (d) and (e).

(6) A detailed summary of investments that were transferred to funds or accounts devoid of companies with business operations in Iran as described in subdivision (f).

(7) An annual calculation of any costs or investment losses or other financial results incurred in compliance with the provisions of this section.

(j) If the board voluntarily sells or transfers all of its investments in a company with business operations in Iran, this section shall not apply except that the board shall file a report with the Legislature related to that company as described in subdivision (i).

(k) Nothing in this section shall require the board to take action as described in this section if the board determines, and adopts findings, in good faith and based on credible information available to the public, that the action described in this section would fail to satisfy the fiduciary responsibilities of the board as described in Section 17 of Article XVI of the California Constitution. Any adopted findings shall demonstrate how divestment disadvantages the fund and that any feasible investment alternatives would yield a lower rate of return with commensurate degrees of risk, or create a higher degree of risk with commensurate rates of return. Notwithstanding any other law, any determination that an action would fail to satisfy the fiduciary responsibilities of the board as described in Section 17 of Article XVI of the California Constitution shall require a recorded rollcall vote of the full board, following a presentation and discussion of findings in open session, during a properly noticed public hearing of the full board. All proposed findings of the board shall be made public 72 hours before they are considered by the board, and the board shall maintain a list of interested parties who shall be notified of proposed findings 72 hours before board consideration. The findings and any public comments regarding the adopted findings and determinations made pursuant to this subdivision shall be included in the report to the Legislature required by subdivision (i).

(l) This section shall cease to be operative if the President of the United States has made the certifications specified in paragraphs (1) and (2) of subdivision (a) of Section 8551 of Title 22 of the United States Code.

(m) This section shall be known and may be cited as the California Public Divest from Iran Act.

(n) The provisions of this section are severable. If any provision of this section or its application is held invalid, that invalidity shall not affect other provisions or applications that can be given effect without the invalid provision or application.