

SENATE JUDICIARY COMMITTEE
Senator Thomas Umberg, Chair
2021-2022 Regular Session

SB 1173 (Gonzalez)
Version: April 6, 2022
Hearing Date: April 19, 2022
Fiscal: Yes
Urgency: No
AM

SUBJECT

Public retirement systems: fossil fuels: divestment

DIGEST

This bill prohibits the Board of the Public Employees' Retirement System (PERS) and the Teachers' Retirement Board of the State Teachers' Retirement System (STRS) from making any additional or new investments or renewing existing investments of public employee retirement funds in a fossil fuel company, and requires PERS and STRS to liquidate investments in a fossil fuel company on or before July 1, 2027, as provided.

EXECUTIVE SUMMARY

A worldwide movement of divestment from fossil fuels is currently underway, with roughly 1,500 institutions that hold over \$39 trillion in assets already committing to divestment, including the University of California and the California State University System. This bill seeks to have PERS and STRS follow suit by prohibiting the board of PERS and STRS from making any additional or new investments or renewing existing investments in a fossil fuel company, and requires them to liquidate investments in a fossil fuel company on or before July 1, 2027, as provided. The Legislature has passed bills to require PERS and STRS to divest from South Africa during Apartheid, from Sudan, Iran, and Turkey if a specified federal law is passed, and from coal.

The bill is sponsored by California Faculty Association and Fossil Free California. The bill is supported by numerous environmental organizations, various labor associations, and the California State Treasurer Fiona Ma. The bill is opposed by STRS, associations representing the fossil fuel industry, and various labor organizations. The bill was voted out of the Senate Committee on Labor, Public Employment and Retirement on a vote of 3-1.

PROPOSED CHANGES TO THE LAW

Existing law:

- 1) Grants the retirement board of a public employee retirement system plenary authority and fiduciary responsibility for investment of moneys and administration of the retirement fund and system. (Cal. Const., art. XVI, § 17.)
- 2) Provides that the Legislature may by statute continue to prohibit certain investments by a retirement board where it is in the public interest to do so, and provided that the prohibition satisfies the standards of fiduciary care and loyalty required of a retirement board pursuant to the Constitution. (Cal. Const., art. XVI, § 17 (g).)
- 3) Prohibits the retirement boards from making investments in certain countries, such as Sudan and Iran, and in thermal coal companies, as specified, subject to the boards' plenary authority and fiduciary responsibility for investment of moneys and administration of the systems. (Gov. Code § 7513.6, § 7513.7, § 7513.75.)
 - a) Prohibits the retirement boards from making investments in the government of Turkey upon passage of a federal law imposing sanctions on the government of Turkey for failure to officially acknowledge its responsibility for the Armenian Genocide. (Gov. Code § 7513.74.)

This bill:

- 1) Provides that the Legislature finds and declares all of the following:
 - a) the combustion of coal, oil, and natural gas, known as fossil fuels, is the single largest contributor to global climate change;
 - b) climate change affects all parts of the California economy and environment, and the Legislature has adopted numerous laws to mitigate greenhouse gas emissions and to adapt to a changing climate;
 - c) fossil fuel companies' plans to expand production, public relations campaigns, and efforts to obstruct climate stabilization policies are incompatible with California's climate goals, and our obligation to current and future generations;
 - d) the production of fossil fuels and the effects of climate change resulting from the use of fossil fuels all lead to disproportionate adverse impacts on low-income communities and communities of color;
 - e) a transition away from fossil fuels to clean energy will create greater employment, support the economy, and improve public health; and
 - f) the purpose of this section is to require the Public Employees' Retirement System and the State Teachers' Retirement System, consistent with, and not in violation of, their fiduciary responsibilities, to divest their holdings of fossil fuel company investments as one part of the state's broader efforts to

decarbonize the California economy and to transition to clean, pollution-free energy resources.

- 2) Prohibits the board of PERS and STRS from making any additional or new investments or renewing existing investments of public employee retirement funds in a fossil fuel company, and requires PERS and STRS to liquidate investments in a fossil fuel company on or before July 1, 2027.
- 3) Provides that the board of PERS and STRS is not required to take action unless the board determines in good faith that the action is consistent with the fiduciary responsibilities of the board described in Section 17 of Article XVI of the California Constitution.
- 4) Requires PERS and STRS to submit an annual report to the Legislature, beginning on February 1, 2024, that includes all of the following:
 - a) a list of fossil fuel companies of which the board has liquidated its investments;
 - b) a list of fossil fuel companies with which the board still has not liquidated its investments; and
 - c) a list of fossil fuel companies of which the board has not liquidated its investments as a result of a determination made pursuant to Section 17 of Article XVI of the California Constitution and the board's findings adopted in support of that determination.
- 5) Defines the following terms:
 - a) "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;
 - b) "company" means a sole proprietorship, organization, association, corporation, partnership, venture, or other entity, or its subsidiary or affiliate, that exists for profitmaking purposes or to otherwise secure economic advantage;
 - c) "investment" means the purchase, ownership, or control of publicly issued stock, corporate bonds, or other debt instruments issued by a company, and also includes purchase, ownership, or control of mutual funds and exchange-traded funds, unless the board is satisfied on reasonable grounds that a mutual fund or exchange-traded fund is unlikely to have in excess of 2 percent of its assets, averaged annually, directly or indirectly invested in fossil fuel companies;
 - d) "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;
 - e) "fossil fuel" means petroleum oil, natural gas, and thermal coal. Thermal coal is coal used to generate electricity, such as that which is burned to create

- steam to run turbines. Thermal coal does not mean metallurgical coal or coking coal used to produce steel; and
- f) “fossil fuel company” means one of the 200 largest publicly traded fossil fuel companies, as established by carbon content in the companies’ proven oil, gas, and coal reserves.

COMMENTS

1. Stated need for the bill:

The author writes:

California is a world leader in taking actions to combat the causes of climate change and has set historic carbon reduction goals and taken meaningful steps to help prevent environmental destruction and protect communities who bear the overwhelming brunt of carbon emissions. Despite these forward-thinking actions, California’s multi-billion dollar retirement pension funds are actively investing close to \$10 billion in the very fossil fuel companies that are driving climate change. SB 1173 ends the contradictory and incongruous investment policy that positions the state as a leader in the fight against climate change, while simultaneously investing billions in the principal driver of climate change.

The climate crisis affects all of us, but is especially harmful to children and to the low-income communities of color where most oil and gas infrastructure is located. Acting now for these communities is critical, as our window to turn back the impacts of climate change is rapidly closing. SB 1173 seizes the momentum of the worldwide divestment movement and joins an estimated 1,500 institutions with over \$39 trillion in assets that have already been committed to divestment, including the University of California and the California State University system, the State and City of New York, the State of Maine, the Vatican, and the province of Quebec.

2. Background

The Senate Committee on Labor, Public Employment and Retirement analyzed the bill’s effect on the fiduciary duty of the Board of PERS and STRS and concluded:

This bill is highly likely to conflict with the pension board’s fiduciary duty because it interferes with the board’s professional investment judgement for objectives that are unrelated to the purpose of the pension plan and the beneficiaries’ exclusive interest. Moreover, it does so in a manner that is unlikely to achieve its objectives because there exist substantial market support for energy companies, both domestically and internationally. Thus, other institutional investors will substantially neutralize any divestment by CalSTRS and CalPERS. The bill, instead of leading to reduced carbon

emissions, will undercut both funds' substantial engagement programs with energy companies.¹

That Committee also noted that if the bill's objective of denying fossil fuel companies investment capital is achieved, it could create additional restraints on the supply of fossil fuels, which the "Covid pandemic and the Russian war against Ukraine has already significantly disrupted."² They further opined, that if a period of stagflation or recession occurred due to further inflationary pressures, this could cause challenges for pension fund assets, cash flow, and liabilities.³

The author and supporters of the bill counter this by pointing to the fact that roughly 1,500 institutions have committed to divesting from fossil fuels and that these institutions represent nearly \$40.3 trillion worth of assets.⁴ In addition, Governor Newsom in his Executive Order N-19-19 ordered that the state government "redouble its efforts to reduce greenhouse gas emissions and mitigate the impacts of climate change" by leveraging the state's \$700 billion investment portfolio to advance California's climate leadership through a framework that, among other things, provides a timeline and criteria to shift investments to, among others, carbon-negative, carbon-neutral, climate resilient, and clean energy technologies.⁵ The executive order specifically stated that the framework should align with the fiduciary responsibilities of PERS and STRS.

3. The bill does not run afoul of the California Constitution

The California Constitution provides that the Legislature may by statute continue to prohibit certain investments by a retirement board where it is in the public interest to do so, and provided that the prohibition satisfies the standards of fiduciary care and loyalty required of a retirement board pursuant to the Constitution. (Cal. Const., art. XVI, § 17 (g)). While this bill does require the termination of investments of public employee retirement funds in a fossil fuel company, the bill also contains a provision that states nothing in the bill requires the board of PERS or STRS to take action unless the board determines in good faith that the action is consistent with the fiduciary responsibilities of the board described in Section 17 of Article XVI of the California Constitution.

¹ Sen. Com. on Lab., Employment and Retirement, Analysis of Sen. Bill No. 1173 (2021-2022 Reg. Sess.) as introduced Feb. 17, 2022 at pg. 2-3.

² *Id.* at 3.

³ *Ibid.*

⁴ Global Fossil Fuel Divestment Commitments Data Base available at <https://divestmentdatabase.org/> (as of Apr. 6, 2022).

⁵ Governor's Exec. Order No. N-19-19 (Sept. 20, 2019).

4. Statements in support

The California Faculty Association, a sponsor of the bill, writes:

California has been a world leader in taking steps to combat the causes of climate change, have set historic carbon reduction goals and taken meaningful actions to help prevent environmental destruction and protect communities who bear the overwhelming brunt of carbon emissions.

Despite these forward-thinking actions, California's multi-billion-dollar retirement pension funds are actively investing billions of dollars in the very fossil fuel companies that are causing climate change.

CalPERS and CalSTRS, which invest the pension funds of state employees and teachers, have an investing power of \$469 billion and \$327 billion, respectively. A recent report estimates that out of these funds, CalPERS invests \$5.5 billion in fossil fuel companies and CalSTRS invests \$3.4 billion.

With the explosion of investment and development in carbon-free technologies, and consumer choice and governmental regulation driving markets away from fossil fuels, it has become clear that the fossil fuel industry may be a risky and myopic financial investment. Major investment management firms, BlackRock and Meketa, have concluded that divestment from fossil fuels actually improves, not weakens, investment returns. A further study has shown that if CalPERS and CalSTRS had divested from fossil fuels in 2010 they would have gained \$11.9 billion and \$5.5 billion respectively in returns by 2019. [...]

SB 1173 seizes the momentum of the worldwide divestment movement and continues the bold and progressive actions that California must take to address climate change. SB 1173 ends the contradictory and incongruous polices that position the state as a leader in the fight against climate change, while simultaneously investing billions in the fossil fuel companies that are causing climate change. (footnotes omitted)

5. Statements in opposition

The California State Teachers' Retirement System, in opposition, writes:

The board's policy is to oppose legislation that restricts or infringes on the plenary authority of the board to administer the retirement plans as provided in Section 17 of Article XVI of the California State Constitution. It is also the board's policy to oppose legislation that infringes on the investment authority of the board or is inconsistent with the investment policy adopted by the board as presented in the CalSTRS Investment Policy and Management Plan.

By requiring the largest public pension funds in the United States to divest from fossil fuel companies, this bill would severely hinder the future success of institutional investor collaborations to effect meaningful change in the fossil fuel industry. In addition, by limiting engagement and requiring divestment, this bill would ignore CalSTRS' exposure to the broader economy and undermine efforts to reduce emissions and transition to a low-carbon world. The risks associated with climate change cannot simply be divested away.

CalSTRS is focused on ensuring a secure retirement for California's nearly one million working and retired public school educators. Liquidating these investments would reduce the diversification of the portfolio and create tracking error, increasing risk and creating potential opportunity costs, which would place the CalSTRS Funding Plan at risk. Any resulting costs would increase the unfunded liability and also may result in an increase in the state's contribution to the Defined Benefit Program.

SUPPORT

California Faculty Association (sponsor)

Fossil Free California (sponsor)

1000 Grandmothers for Future Generations

350 Bay Area

350 Bay Area Action

350 Butte County

350 Conejo / San Fernando Valley

350 Humboldt: Grass Roots Climate Action

350 Marin

350 Sacramento

350 Silicon Valley

350 South Bay Los Angeles

350 Southland Legislative Alliance

350 Ventura County Climate Hub

Active San Gabriel Valley

All Rise Alameda

Alliance of Nurses for Healthy Environments

Ashby Village

Asian Pacific Environmental Network

Atmos Financial, PBC

Azul

Ban SUP (Single Use Plastics)

Bay Area Youth Climate Action Team

Beyond Terra

Black Women for Wellness

Building the Base Face to Face

California Climate Voters

California Green New Deal Coalition

California Environmental Voters (formerly CLCV)

California Interfaith Power & Light

California Nurses Association

California Nurses for Environmental Health and Justice

California State Treasurer Fiona Ma

CALPIRG

CFT

City of San Mateo Climate Action Team

Change Begins With Me

Citizens' Climate Education, Tri-Valley Chapter

Citizens Climate Lobby

Citizens' Climate Lobby - Alameda County Chapter

Citizens Climate Lobby, Fresno Chapter

City of Long Beach

Clean Water Action

Cleanearth4kids.org

Climate Action Santa Monica

Climate Equity Policy Center

Climate First: Replacing Oil & Gas (CFROG)

Climate Hawks Vote

Climate Health Now

Climate Psychiatry Alliance

Cloverdale Indivisible

Coalition for a California Green New Deal

Compassion, Peace and Justice Ministry of Davis Community Church

Conejo Climate Coalition

Contra Costa MoveOn

Cool Davis

Dayenu Circle At the Orchard

Defenders of Wildlife

Defending Our Future: Indivisible in CA

Direct Action Everywhere

Divest the CSU of Fossil Fuels

Earth Action. Inc.

Earth Guardians

Earth Guardians, San Francisco Bay Area

East Valley Indivisibles

El Cerrito Progressives

Elected Officials to Protect America - California

Environment California

Environmental Working Group

Equity Transit

Extinction Rebellion San Francisco Bay Area
Families Advocating for Chemical and Toxics Safety
Feminists in Action (Indivisible)
Feminists in Action Los Angeles
Friends Committee on Legislation of California
Fullerton College Sustainability Committee
Future Coalition
Green Party of Santa Clara County
Green Party of Sonoma County
Harmony Union Teachers Association
Hillcrest Indivisible
Hyde Consulting
Indi Squared
Indivisible CA-3
Indivisible CA-7
Indivisible CA-25 Simi Valley-Porter Ranch
Indivisible CA-29
Indivisible CA-33
Indivisible CA-37
Indivisible CA-39
Indivisible CA-43
Indivisible 30/Keep Sherman Accountable
Indivisible 36
Indivisible 41
Indivisible CA: StateStrong
Indivisible Alta Pasadena
Indivisible Auburn CA
Indivisible Beach Cities
Indivisible California Green Team
Indivisible Claremont/Inland Valley
Indivisible Colusa County
Indivisible East Bay
Indivisible El Dorado Hills
Indivisible Elmwood
Indivisible Euclid
Indivisible Lorin
Indivisible Manteca
Indivisible Marin
Indivisible Media City Burbank
Indivisible Mendocino
Indivisible Normal Heights
Indivisible North Oakland Resistance
Indivisible North San Diego County
Indivisible OC 46

Indivisible OC 48
Indivisible Petaluma
Indivisible ReSisters Walnut Creek
Indivisible Ross Valley
Indivisible Sacramento
Indivisible San Bernardino
Indivisible San Jose
Indivisible San Pedro
Indivisible Santa Barbara
Indivisible Santa Cruz County
Indivisible Sausalito
Indivisible Sebastopol
Indivisible SF
Indivisible SF Peninsula and CA-14
Indivisible Sonoma County
Indivisible South Bay LA
Indivisible Stanislaus
Indivisible Suffragists
Indivisible Ventura
Indivisible Windsor
Indivisible Yolo
Indivisible: San Diego Central
Indivisibles of Sherman Oaks
International Longshore and Warehouse Union (Northern California District Council)
Let's Green Ca!
Livermore Indivisible
Local Clean Energy Alliance
Long Beach Alliance for Clean Energy
Los Angeles Indivisible
Mill Valley Community Action Network
Mountain Progressives
Movement Generation
National Nurses United
Nothing Rhymes with Orange
Oakland Education Association
Oil and Gas Action Network
Orinda Community Church Creation and Justice Committee
Orinda Progressive Action Alliance
Our Revolution Long Beach
Pacifica Climate Committee
Paddle Out Plastic
Physicians for Social Responsibility - Los Angeles
Physicians for Social Responsibility - Sacramento Chapter
Physicians for Social Responsibility - San Francisco Bay Area Chapter

Planting Justice

Plastic Oceans International

Plastic Pollution Coalition

Richmond Our Power Coalition

RiseUp

Rooted in Resistance (Indivisible)

San Diego Pediatricians for Clean Air

San Diego 350

San Diego Indivisible Downtown

Santa Barbara Standing Rock Coalition

Santa Cruz Climate Action Network

Santa Cruz Coalition for a Healthy & Safe Environment (C.H.A.S.E.)

Santa Monica Democratic Club

Save Our Shores

Schools for Climate Action

Sequoia District Teachers Association

SFV Indivisible

Sierra Club California

Sonoma County Transportation Authority

Stand.earth

Sunflower Alliance

Sunrise Movement San Diego

Tehama Indivisible

The 5 Gyres Institute

The Center for Oceanic Awareness, Research, and Education (COARE)

The Climate Center

The Climate Reality Project, San Fernando Valley Chapter

The Greenlining Institute

The Protect Our Communities Foundation

The Resistance Northridge

Third Act

TIAA Divest! From Climate Destruction

Together We Will Contra Costa

Together We Will: San José

Tri-Valley Citizen's Climate Education

TWW/Indivisible - Los Gatos

UDW AFSCME Local 3930

Vallejo-Benicia Indivisible

Venice Resistance

Warriors for Justice

Women's Alliance Los Angeles

West Valley-Mission Federation of Teachers, AFT 6554

Wishtoyo Chumash Foundation

Yalla Indivisible

Yolo Climate Emergency Coalition
Yolo Interfaith Alliance for Climate Justice
Youth Climate Strike Los Angeles
Youth Vs. Apocalypse

OPPOSITION

Arcadia Police Officers Association
Burbank Police Officers' Association
California Association of Highway Patrolmen
California Coalition of School Safety Professionals
California Independent Petroleum Association
California-Nevada Conference of Operating Engineers
California Professional Firefighters
California State Teachers' Retirement System
Claremont Police Officers Association
Corona Police Officers Association
Culver City Police Officers' Association
Fullerton Police Officers' Association
Inglewood Police Officers Association
Los Angeles School Police Officers Association
Newport Beach Police Association
Peace Officers Research Association of California
Palos Verdes Police Officers Association
Placer County Deputy Sheriffs' Association
Pomona Police Officer Association
Retired Public Employees Association
Riverside Police Officers Association
Riverside Sheriffs' Association
Santa Ana Police Officers Political Action Committee
State Building & Construction Trades Council of California
Upland Police Officers Association
Western States Petroleum Association

RELATED LEGISLATION

Pending Legislation:

SB 1328 (McGuire, 2022) would prohibit PERS and STRS from investing public employee retirement funds in companies engaged with business operations in Russia or Belarus or a company that supplies military equipment to Russia or Belarus, as provided. The bill is currently pending in the Senate Appropriations Committee.

SB 457 (Portantino, 2021) would require the boards of administration of PERS and STRS to provide employers that are school districts and cities that participate in the systems an option to elect an investment portfolio that does not contain investment vehicles that are issued or owned by the government of the Republic of Turkey. The bill is currently pending in the Assembly Public Employment and Retirement Committee.

Prior Legislation:

AB 33 (Bonta, 2018) would have required PERS and STRS to divest from private prison companies, as provided. The bill died without a hearing in the Assembly Public Employment and Retirement Committee.

AB 20 (Kalra, Ch. 575, Stats. 2017) requires PERS and STRS to submit a report to the Legislature and Governor regarding investments in, and engagement activities with, companies constructing, or funding, the construction of the Dakota Access Pipeline.

AB 946 (Garcia, 2017) would have prohibited PERS and STRS from investing public employee retirement funds in companies engaged in business related to the border wall proposed by the Trump Administration. This bill died without a hearing in the Assembly Public Employees, Retirement, and Social Security Committee.

AB 1410 (Nazarian, 2015) would have prohibited PERS and STRS from investing public employee retirement funds in specified investments issued by, owned, controlled, or managed by the government of Turkey. This bill was held on suspense in the Assembly Appropriations Committee.

AB 1551 (Allen, 2015) would have required public retirement funds, on or after January 1, 2017, to make no additional investments or renew existing investments in business firms or financial institutions that engage in business practices in furtherance of the boycott of Israel, among other provisions. This bill was held in the Assembly.

AB 2650 (Nazarian, 2015) would have prohibited PERS and STRS from investing public employee retirement funds in specified investments issued by, owned, controlled, or managed by the government of Turkey. This bill was held in the Assembly.

SB 185 (De León, Ch. 605, Stats. 2015) prohibits PERS and STRS from investing public employee retirement funds in thermal coal companies, as specified.

AB 761 (Dickinson, 2013) would have prohibited PERS and STRS from investing in companies that manufacture firearms or ammunition for a recipient other than the U.S. military, subject to a process specified in the bill and consistent with previous divestment legislation, but subject to the board's fiduciary duties. This bill was held in the Assembly Appropriations Committee.

AB 221 (Anderson, Ch. 671, Stats. 2007) prohibits PERS and STRS from investing in companies that have specified energy or defense-related operations in Iran.

AB 2941 (Koretz, Ch. 442, Stats. 2006) prohibits PERS and STRS from investing public employee retirement funds in a company with business operations in Sudan, as specified.

AB 107 (Knox, 2000) would have prohibited new or additional investments in tobacco companies by PERS and STRS on and after January 1, 2001, and would have required divestment from existing investments by July 1, 2002. This bill was held on concurrence in the Assembly.

AB 2251, (Margolin, Ch. 1351, Stats. 1992) prohibits state trust fund and state money investments in business firms or financial institutions that engage in discriminatory business practices after January 1, 1994, relating to the Arab League's economic boycott of Israel.

AB 134 (Waters, Ch. 1254, Stats. 1986) prohibits the use of state trust funds or state monies to make additional or new investments, or renew existing investments in firms doing business with or in South Africa, as of January 1, 1987.

PRIOR VOTES:

Senate Labor, Public Employment and Retirement Committee (Ayes 3, Noes 1)
