The Florida Senate

PROFESSIONAL STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: Judiciary Committee

BILL: CS/SB 2142

INTRODUCER: Governmental Operations Committee, Senator Deutch and others

SUBJECT: Investments of the State Board of Administration

DATE: April 23, 2007 REVISED: 04/23/07

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Pardue/Skelton	Skelton	MS	**Favorable**
2.	Wilson	Wilson	GO	**Fav/CS**
3.	Luczynski	Maclure	JU	**Favorable**
4.			GA	
5.				
6.				

I. Summary:

The bill provides a series of legislative findings relative to current conditions in the countries of Sudan and Iran. It describes, in detail, declarations by the U.S. Congress, U.S Secretary of State, and the U.S. President regarding the ongoing genocide and atrocities against citizens of regions of Sudan. The bill recognizes that Sudan is designated as a State Sponsor of Terror by the U.S. Department of State and that the U.S. government applies trade sanctions against Sudan for its ongoing actions. The findings include information regarding universities, municipalities, states, and private pension plans that have chosen to divest of securities with equity ties to companies doing business with the Government of Sudan.

The bill recognizes that Iran has failed to suspend its uranium-enrichment activities; the United Nations Security Council and the United States have imposed sanctions against Iran; and the United Nations has imposed an embargo on Iranian arms exports which is a freeze on assets abroad of an expanded list of individuals and companies involved in Iran’s nuclear and ballistic missile programs.

The bill finds that it is the responsibility of the State of Florida to decide how, where, and by whom financial resources in its control should be invested. Moreover, it is the prerogative of the state not to participate in ownership or capital-providing capacity with entities that provide significant practical support for genocide, including certain non-U.S. companies presently doing business in Sudan. Further, the bill recognizes that there are financial risks with investments in publicly traded companies that have business activities in and ties to Iran’s petroleum-energy sector. It finds that divestment from markets that are vulnerable to embargo, loan restrictions, and sanctions from the United States and the international community, including the United Nations Security Council, is in accordance with the rules of prudence. The bill finds that the act

should remain in effect only if it continues to be consistent with and does not unduly interfere with the foreign policy of the United States.

The bill requires the State Board of Administration (SBA) to perform certain tasks related to the "Public Fund." The Public Fund is defined as all funds, assets, trustees, and other designates under the State Board of Administration.

The SBA is required to make its best efforts to identify all scrutinized companies in which the Public Fund has direct or indirect holdings or could possibly have such holdings in the future. The definition of "scrutinized company" as to Sudan, includes a company with business operations in Sudan with revenues or assets linked to oil-related or power-production activities under certain circumstances, or the company is complicit in the Darfur genocide, or the company supplies military equipment within Sudan under certain conditions. The definition of "scrutinized company" as to Iran, includes a company with business operations that involve the Government of Iran or certain companies, and have revenues or assets linked to Iran and involve oil-related or mineral-extraction under certain conditions.[1]

A company designated as a "social-development company" that is not complicit in the Darfur genocide is not considered a scrutinized company.

The SBA is required to assemble a list of "scrutinized companies." The list shall be updated quarterly.

The Public Fund is required to actively engage any company on the list to encourage the company to refrain from active business operations with the Government of Sudan.

For a company which is newly identified on the list as having active business operations, the Public Fund is required to send the company a written notice of its status as a scrutinized company and the possibility that it may become subject to divestment by the Public Fund.

If, after 90 days following the Public Fund's first engagement through written notice, the company on the Scrutinized Companies List continues to have scrutinized active business operations, the Public Fund is required to sell, redeem, divest, or withdraw all publicly traded securities of the company, subject to certain exceptions, within 12 months after the company's most recent appearance on the Scrutinized Companies List. If a company resumes active business operations in Sudan, it is to be added back to the Scrutinized Companies List immediately.

The Public Fund is prohibited from acquiring securities of any companies on the Scrutinized Companies list which have active business operations in Sudan or Iran, with certain exceptions.

The divestment provisions do not apply to indirect holdings in actively managed investment funds. The Public Fund is required to send letters to the managers of such funds requesting that they consider removing those companies from the fund or create an alternative fund. If an

[1] *See* Section III, Effect of Proposed Changes for more detailed definition of scrutinized companies.

alternate fund is created, the Public Fund is required to replace all applicable funds with the new fund.

The Public Fund must file a report with each member of the Board of Trustees of the State Board of Administration, the President of the Senate, and the Speaker of the House of Representatives that includes the Scrutinized Countries List for Sudan and Iran within 30 days of the creation of the list. At each quarterly meeting of the Board of Trustees thereafter, the Public Fund must file another report with additional information as specified in the bill. This report is also to be distributed to the U.S. Presidential Special Envoy to Sudan and to the U.S. Presidential Special Envoy to Iran.

The act expires if certain conditions are met as specified in the bill.

With respect to this act, the Public Fund is exempt from any conflicting statutory or common law obligations, including any obligations with respect to choice of asset managers, investment funds, or investments for the Public Fund's security portfolios.

The Public Fund may cease divesting, or reinvest, in certain scrutinized companies if the value of all assets under management by the Public Fund becomes equal to or less than 99.50 percent, or 50 basis points, of the hypothetical value of all assets under management by the Public Fund assuming no divestment had occurred under the divestment provisions of this act. Such activities require an additional report to the Board of Trustees of the State Board of Administration, the President of the Senate, and the Speaker of the House of Representatives.

The act includes a severability clause.

This bill creates sections 215.442 and 215.473, Florida Statutes.

II. Present Situation:

History of the Conflict in the Republic of the Sudan and Darfur[2]

According to the U.S. Department of State, Sudan is the largest country in Africa comprising an area almost the size of the continental United States east of the Mississippi River. Sudan's population is one of the most diverse on the African continent. The country has two distinct major cultures, "Arab" and "black African," which include hundreds of ethnic and tribal subdivisions and language groups.

Sudan was a collection of small, independent kingdoms until 1820-1821 when Egypt conquered and unified the northern portion of the country. A nationalist revolt led by religious leader Muhammand ibn Abdalla resulted in a brief period of independence beginning in 1885. In 1898, an invading force led by Lord Kitchner established a period of Anglo-Egyptian rule that lasted until Sudan achieved independence on January 1, 1956.

[2] U. S. Department of State, Background Note: Sudan, February 2007.

Independent Sudan was established under a provisional constitution that was silent on two issues that were considered crucial for southern Sudanese leaders—the secular or Islamic character of the state and its federal or unitary structure. Due to the failure of the Arab-led government in Khartoum to create a federal system as promised, southern army officers led a mutiny that resulted in 17 years of civil war (1955-1972). Sudan has been at war with itself for more than three-quarters of its existence since 1956.

In 1972, an agreement was signed in Addis Ababa granting the South a measure of autonomy. The western regions of Darfur and Kordofan then sought similar privileges but were denied. Political maneuvering continued until 1979 when Chevron discovered oil in the South. Northern pressure began to build to abrogate those provisions of the peace treaty granting the South financial autonomy. Ultimately in 1983, the Southern Region was abolished, Arabic was declared the official language, traditional Islamic punishments derived from Shari'a (Islamic Law) were incorporated into the penal code, and control of the southern armed forces was transferred to the central government. The second Sudan civil war effectively began in January 1983.

The 1990's saw a succession of regional efforts to broker an end to the Sudanese civil war. In July 2002, an agreement was reached on the role of the state and religion and the right of Southern Sudan to self-determination. This was followed by an agreement in November 2004 committing to a final comprehensive peace agreement and a United Nations Security Council Resolution 1574 calling for an end to the violence in Darfur. The Comprehensive Peace Agreement (CPA) was formally signed on January 9, 2005. The CPA established a new Sudanese Government of National Unity and the interim Government of Southern Sudan with a call for wealth and power sharing, a ceasefire, withdrawal of troops from Southern Sudan, and security arrangements between the two parties.

In 2003, while the historic north-south conflict was on its way to resolution, increasing reports of attacks on civilians especially aimed at non-Arab tribes began to surface. A rebellion broke out in Darfur, in the extremely marginalized western Sudan, led by two rebel groups–the Sudan Liberation Movement/Army (SLM/A) and the Justice and Equality Movement (JEM). These groups represented agrarian farmers who are mostly non-Arabized black African Muslims. In seeking to defeat the rebel movements, the Government of Sudan increased arms and support to local tribal and other militias, which have come to be known as the Janjaweed.

Attacks on the civilian population by the Janjaweed, often with the direct support of Government of Sudan forces, have resulted in the deaths of tens of thousands of persons and the displacement of approximately 2.5 million people.[3]

On September 9, 2004, Secretary of State Colin Powell told the Senate Foreign Relations Committee, "genocide has been committed in Darfur and that the Government of Sudan and the Janjaweed bear responsibility—and that the genocide may still be occurring." President Bush echoed this in July 2005, when he stated that the situation in Darfur was "clearly genocide."

[3] Note: The United Nations estimates that more than 200,000 have died in the conflict in Darfur.

In March 2005, United Nations Security Council Resolution 1590 established a UN mission in Sudan, with up to 10,000 African Union military personnel, in order to foster peace in Darfur. Security Council Resolution 1591 subsequently criticized the Government of Sudan and rebels in Darfur for failing to comply with several previous resolutions, for ceasefire violations, and for human rights abuses.

On May 5, 2006, the Government of Sudan and a faction of the SLM/A signed the Darfur Peace Agreement. Shortly thereafter, the conflict in Darfur intensified, led by rebel groups who refused to sign the agreement. After government forces began a major offensive on rebel areas in northern Darfur in late August 2006, Security Council Resolution 1706 authorized the transition of the African Union mission to a more robust UN peacekeeping operation. The Government of Sudan has resisted the establishment of such an UN operation.

On November 16, 2006, UN Secretary General Kofi Annan announced in Addis Ababa, Ethiopia, that further agreement on peacekeeping forces had been reached. However, recent reports indicate that Sudanese President Omar Hassan al-Bashir has refused to accept the plan.

In an attempt to document the atrocities in Darfur, the U. S. State Department characterized the situation in 2004 as a humanitarian crisis. At that time, 405 villages in Darfur had been completely destroyed and another 123 substantially destroyed. Approximately 200,000 persons had sought refuge in eastern Chad and the UN reported an estimated 1.2 million internally displaced persons remained in western Sudan.[4]

Since that assessment, the situation has become worse. As previously stated, the current estimate of displaced persons is approximately 2.5 million. Humanitarian relief efforts for displaced persons camps have been blocked and aid workers have been forced to leave. Day to day life in and around the camps is dangerous with an ever present threat of rape, torture, or murder.

The United Nations and the international community are continuing efforts to arrive at peace in Darfur.

Sudan’s Economy

Sudan had a gross domestic product of $22.75 billion in 2005 with a per capita income of $2,100. Sudan has modest reserves of oil, natural gas, gold, iron ore, copper, and other industrial metals. Its primary resources are agricultural with products including cotton, peanuts, sorghum, sesame seeds, gum Arabic, sugarcane, millet, and livestock. However, oil production and export has taken on increasing importance since October 2000 when oil began to be exported. There are indications of significant potential reserves of oil and natural gas in Southern Sudan, the Kordofan region and the Red Sea province.

Sudan’s major markets include Egypt, the Persian Gulf states, Saudi Arabia, Malaysia, China, and South Korea. Sudan’s major suppliers include the European Union, China, Malaysia, Canada, the United Kingdom, Italy, Germany, Saudi Arabia, Egypt, the Persian Gulf states, and surrounding East African nations.

[4] U. S. State Department, State Publication 11182, Documenting Atrocities in Darfur, September 2004.

Sudan has an estimated population of approximately 41 million people. Of these, approximately 22 million live in the northern region including most of the urban centers. Six million live in the southern region. The remaining population is located in the eastern and western regions.

State Sponsors of Terrorism

Countries which are determined by the United States Secretary of State to have repeatedly provided support for acts of international terrorism are designated as "State Sponsors of Terrorism" and are subject to sanctions under the Export Administration Act[5], the Arms Export Control Act,[6] and the Foreign Assistance Act.[7] The four main categories of sanctions resulting from designations under these acts are: restrictions on U.S. foreign assistance, a ban on defense exports and sales, certain controls over exports of dual use items, and miscellaneous financial and other restrictions.[8] Some of the miscellaneous restrictions include opposition to loans by the World Bank and other financial institutions, removal of diplomatic immunity to allow victims of terrorism to file civil lawsuits, denial of tax credits to companies and individuals for income earned in named countries, authority to prohibit U.S. citizens from engaging in transactions without a Treasury Department license, and prohibition of Department of Defense contracts above $100,000 with companies controlled by terrorist-list states.[9]

The five countries currently designated by the U.S. Secretary of State as "State Sponsors of Terrorism" are Cuba, Iran, North Korea, Sudan, and Syria.[10]

The Republic of the Sudan was recognized as a State Sponsor of Terrorism on August 12, 1993, and has retained that designation continuously since that time. While terrorist activity appears to have subsided in recent years, concerns remain. In the April 2006 "Country Reports on Terrorism" released by the Office of the Coordinator for Counterterrorism for the U.S. Department of State, Sudan is cited for its continued cooperation against known and suspected international terrorist elements believed to be operating in and out of Sudanese territory. The report cited Sudan's cooperation with the international community in calling for strong condemnation of terrorism. However, the report cautions that Sudan's history of hosting al-Qaida leader Usama bin Ladin in the 1990s continues to reflect heavily on any assessment of Sudan's role in international terrorism. While there is considerable international concern about Sudan's handling of internal rebel movements, the report indicates that there is no current data indicating that international terrorists operate in Darfur. The flow of weapons into and out of Sudan has weakened international efforts to stabilize the region. There is continued concern that Sudanese fighters are among the insurgents in Iraq. There is evidence of their presence, and of the Sudanese government's attempts to curb this activity.

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5 Section 6(j), U.S. Export Administration Act.
6 Section 40, U.S. Arms Export Control Act.
7 Section 620A, U.S. Foreign Assistance Act.
8 U.S. Department of State website, http://www.state.gov/s/ct/c14151.htm, Office of Coordinator for Counterterrorism, "State Sponsors of Terrorism."
9 U.S. Department of State website, http://www.state.gov/s/ct, "Country Reports on Terrorism."
10 See Footnote 4 above.

The U.S. government attributes progress made in working with Sudan to reduce terrorism to diplomatic actions and economic pressure applied by sanctions, both U.S. and international.

Current U.S. Sanctions Against Sudan[11]

The United States has imposed trade sanctions on the Government of Sudan since November 1997. Executive Order No. 13067, its successor orders, and associated regulations have remained in effect continuously. Among the reasons for the ongoing trade sanctions are the continued support for international terrorism, the ongoing efforts to destabilize neighboring governments, the prevalence of human rights violations including slavery, and the denial of religious freedoms.

In addition to U.S. sanctions, the United Nations Security Council (UNSC) issued Resolution 1591 and Resolution 1672 condemning the actions of the Government of Sudan and calling on member nations to take certain measures against persons responsible for continuing conflicts.

In response to UNSC Resolution 1672, President Bush issued a new Executive Order (EO) expanding on the original sanctions of EO No. 13067. The expanded order specifically names persons subject to its provisions and authorizes the Department of Treasury and Department of State to designate additional persons, as needed.

Persons named as, or doing business with persons named as “Specially Designated Nationals” of Sudan face the following sanctions:

- U.S. persons are prohibited from transacting business with these individuals and entities, and all of their property in the United States or in the possession or control of a U.S. person is blocked.
- Any U.S. individual or organization engaging in transactions with foreign nationals must take reasonable care to make certain such foreign nationals are not owned, controlled by, or acting on behalf of Sudan.
- U.S. individuals or organizations that violate the regulations may be subject to civil or criminal prosecution.

Goods or services of Sudanese origin may not be imported into the United States, either directly or indirectly without a license. Except for certain exempted goods (information, donated articles to relieve human suffering, and licensed export of agricultural, medicine and medical devices), no goods, technology or services may be exported from the U.S. to Sudan. No U.S. bank may do business with Sudanese customers or customers doing business with the Sudanese government.

All property and interest in property of the Government of Sudan in U.S. possession or control is frozen and may only be released with approval of the U.S. Department of Treasury, Office of Foreign Assets Control. All unspecified transactions with Sudan are prohibited. United States persons are prohibited from facilitating trade with Sudan.

[11] U.S. Department of the Treasury, Office of Foreign Assets Control, “What You Need To Know about U.S. Sanctions – Sudan.

Florida State Pension Funds and Annuities

The State Board of Administration is created in Article IV, Section 4(e) of the State Constitution. Its members are the Governor, the Chief Financial Officer, and the Attorney General. The Board derives its powers to oversee state funds from Article XII, Section 9 of the Constitution.

The State Board of Administration (SBA) has responsibility for oversight of the Florida Retirement System (FRS) Pension Plan and the FRS Investment Plan, which represent approximately $129 billion or 73 percent of the $177 billion in assets managed by the SBA (as of December 31, 2006). The Pension Plan is a defined benefit plan and the Investment Plan is a defined contribution plan that employees may choose in lieu of the Pension Plan.[12] The FRS receives employer contributions from approximately 950 employers (local government entities). The state share of the FRS equals approximately 25 percent of the total annual contributions with the remainder coming from other government sources.[13]

Investment decisions for the pension plan are made by fiduciaries hired for that purpose by the state. Investment decisions for the investment plan are made by individual employees who may design their own portfolios based on participating offering companies.

The State of Florida has adopted federal fiduciary standards for management of the FRS funds. The Employee Retirement Income Security Act of 1974 (ERISA) is regulated by the U.S. Department of Treasury and is the Florida standard for management of public funds.[14] The Trustees of the SBA and all fiduciaries who manage Florida funds are bound by law to follow the standards established in ERISA.

The SBA investment managers are contractually bound to follow all federal and state laws in performance of their services to the state. The SBA does not invest in the securities of any company domiciled in countries on the U.S. State Department list of State Sponsors of Terrorism, which as previously mentioned includes Sudan and Iran.[15]

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 protective device if a particular investment carries a high level of risk to the performance of a fund.

Several tools are available to fund managers, and their trustees, to protect funds against harm. The federal government has established the Office of Global Security Risk within the Securities and Exchange Commission to provide information to fund managers about potential risks of securities becoming unstable or losing value due to risk conditions, either political, or economic, that might exist in certain circumstances or locations around the world. Since fiduciaries are

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[12] SBA Staff Analysis of HB 703, February 9, 2007.
[13] *Id.*
[14] Section 112.661(4), F.S.
[15] SBA Staff Analysis of HB 703, February 9, 2007.

required to divest using prudent expert standards, they must have valid economic reasons for making decisions related to investment, divestment, or repositioning in any particular security. The purpose of the Office of Global Security Risk is to provide fund managers with the information needed to make those decisions; however, the SEC does not take a position about investing in individual companies.[16] There is no known definitive federal list of companies that have equity ties to, or do business with, Sudan. Several organizations provide lists of companies suspected of doing business in or with these countries, but none are definitive. The Department of Treasury does keep a list of “Specially Designated Nationals” (SDN) made up of companies or individuals who are not authorized to do business with the United States or its citizens. These SDN lists are either specific to a particular country designated as a State Sponsor of Terrorism or generic to the Global War on Terrorism.[17]

“Engagement” is a tool that fund managers can use to attempt to change the behavior of a company that appears to be at high risk of exposure to losses. This process involves a direct conversation with a company by stockholders to express concerns about the high risk activity of the company. Companies may be asked to change their behavior to reduce investment risk. Engagement has been credited with changing the investment strategies of several large companies over time. Recently, ABB (Swiss power engineering group) and Siemens AG (German electronics and electrical engineering company) have suspended business operations in Sudan as a result of the engagement process which included the possibility of divestment.[18]

If the engagement process fails, or if it is not used, the next tool available to fund managers is to divest of a security. Generally, this practice is only used in the most dire circumstances.[19] Divestment, or “Targeted Divestment,” may be used to illustrate to an offending country that the actions of its government are causing companies that do business with the country to lose money. Divestment on a large scale may apply enough economic or political pressure to change the behavior of a country.

The State of Florida has practiced divestment twice in modern history. From 1986 to 1993, the Legislature directed the SBA to divest of companies doing business with South Africa. 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. There are no specific records to quantify the impact of the South Africa divestment by Florida, but the overall boycott campaign was successful in changing the social environment in South Africa.[20] The tobacco divestment was done related to a court case and was not directed toward a specific social change.

Organized Divestment Movements

Several states, local governments, and universities have initiated efforts to practice divestment of their holdings to protest the ongoing genocide and atrocities against humanity in the Darfur

[16] Phone conversation with Cecelia Blye, Chief of the Office of Global Security Risk, Division of Corporate Finance, Securities and Exchange Commission; cited in SBA Staff Analysis of HB 703, February 9, 2007.
[17] http://www.treasury.gov/offices/enforcement/ofac/sdn/index.shtml
[18] http://www.sudandivestment.org/divestment.asp#q6
[19] *Id.*
[20] “The Effect of Socially Activist Investment Policies on the Financial Markets: Evidence from the South African Boycott,” 1999 Journal of Business.

region of the Republic of Sudan.[21] Some states have used the Sudan Divestment Task Force Model Legislation,[22] while others have drafted legislation or policy that is either more or less restrictive than the model legislation. In addition, there are multiple resolutions and bills filed in the 110th Congress calling for divestment of public funds by federal and state and local government entities to protest the Sudan situation.

The State of Illinois passed a broad divestment bill, which addressed the deposit of certain funds in banks in the state as well as securities which were prohibited. The U.S. District Court for the Northern District of Illinois found the legislation to be unconstitutional.[23] A permanent injunction against implementation of the legislation was ordered. In the portion of the holding related to the prohibited actions on the part of the state managed pension funds, the court held that the Illinois law violated the Foreign Commerce Clause of the U.S. Constitution.[24]

III. Effect of Proposed Changes:

The bill provides a series of legislative findings relative to current conditions in the countries of Sudan and Iran. It describes, in detail, declarations by the U.S. Congress, U.S Secretary of State, and the U.S. President regarding the ongoing genocide and atrocities against citizens of regions of Sudan. The bill recognizes that Sudan is designated as a State Sponsor of Terror by the U.S. Department of State and that the U.S. government applies trade sanctions against Sudan for its ongoing actions. The findings include information regarding universities, municipalities, states, and private pension plans that have chosen to divest of securities with equity ties to companies doing business with the Government of Sudan.

Further, the bill finds that it is the responsibility of the State of Florida to decide how, where, and by whom financial resources in its control should be invested, and it is the prerogative of the state not to participate in ownership or capital-providing capacity with entities that provide significant practical support for genocide, including certain non-U.S. companies presently doing business in Sudan. It finds that divestment should only be used sparingly and judiciously and that a Congressional and Presidential declaration of genocide satisfies this high threshold. The bill finds that the act should remain in effect only if it continues to be consistent with and does not unduly interfere with the foreign policy of the United States.

The bill requires the State Board of Administration (SBA) to perform certain tasks related to the "Public Fund." The Public Fund is defined as all funds, assets, trustees, and other designates under the State Board of Administration.

Within 90 days of the effective date of this bill, the SBA is required to make its best efforts to identify all "scrutinized companies" in which the Public Fund has direct or indirect holdings or could possibly have such holdings in the future. "Scrutinized company" is defined as a company that meets any of the following criteria:

[21] www.SudanDivestment.org
[22] *Id.*
[23] Nat'l Foreign Trade Council, Inc. v. Giannoulias, No. 06 C 4251, 2007 WL 627630 (N.D. Ill. Feb. 23, 2007).
[24] See Section IV, Constitutional Issues for a more detailed discussion.

1. The company has business operations that involve contracts with or provision of supplies or services to the Government of Sudan, companies in which the Government of Sudan has any direct or indirect equity shares, consortiums or projects commissioned by the Government of Sudan, or companies involved in consortiums or projects commissioned by the Government of Sudan; and:

   a. More than 10 percent of the company's revenues or assets linked to Sudan involve oil-related activities or mineral-extraction activities; less than 75 percent of the company's revenues or assets linked to Sudan involve contracts with or provision of oil-related or mineral-extraction products or services to the regional government of Southern Sudan or a project or consortium created exclusively by that regional government; and the company has failed to take substantial action;[25] or
   b. More than 10 percent of the company's revenues or assets linked to Sudan involve power-production activities; less than 75 percent of the company's power-production activities include projects whose intent is to provide power or electricity to the marginalized populations of Sudan; and the company has failed to take substantial action.

2. The company is complicit in the Darfur genocide.
3. The company supplies military equipment within Sudan, unless it is clearly shown that the equipment cannot be used to facilitate offensive military actions or the company implements rigorous and verifiable safeguards to prevent use of the equipment by forces participating in armed conflict.
4. The company has business operations that involve contracts with or provisions of supplies or services to the Government of Iran or other specified entities and:

   a. More than 10 percent of the company's total revenues or assets are linked to Iran and involve oil-related activities or mineral-extraction activities; and the company has failed to take substantial action;[26] or
   b. The company has, with actual knowledge, on or after August 5, 1996, made an investment of $20 million or more, or any combination of investments of at least $20 million in any 12-month period, and which directly or significantly contributes to the enhancement of Iran's ability to develop the petroleum resources of Iran.

Within 90 days after the effective date of this act, the SBA is required to assemble all scrutinized companies that fit any one of the above criteria 1, 2, or 3 into a "Scrutinized Companies with Activities in Sudan List" and all scrutinized companies that fit the above criterion 4 into a

[25] "Substantial action specific to Sudan" means adopting, publicizing, and implementing a formal plan to cease scrutinized business operations within 1 year and to refrain from any such new business operations; undertaking humanitarian efforts in conjunction with an international organization, the government of Sudan, the regional government of Southern Sudan, or a nonprofit entity evaluated and certified by an independent third party to be substantially in a relationship to the company's Sudan business operations and of benefit to one or more marginalized populations of Sudan; or, through engagement with the Government of Sudan, materially improving conditions for the genocidally victimized population in Darfur.
[26] "Substantial action specific to Iran" means adopting, publicizing, and implementing a formal plan to cease scrutinized business operations within 1 year and to refrain from any such new business operations.

"Scrutinized Companies with Activities in the Iran Petroleum Energy Sector List." This report with generally refer to these two lists as the Scrutinized Companies List. The SBA is required to update the list quarterly.

A company designated as a "social-development company" that is not complicit in the Darfur genocide is not considered a scrutinized company.

The Public Fund is required to provide written notice to any company on the list with inactive business operations to encourage the company to continue to refrain from initiating active business operations in Sudan or Iran until it is able to avoid scrutinized business operations. A new written notice is to be sent semiannually.

For a company that is newly identified on the list as a scrutinized company with active business operations, the Public Fund is required to send the company a written notice of its status as a scrutinized company and the possibility that it may become subject to divestment by the Public Fund. The notice is to inform the company of actions it can take to avoid qualifying for divestment. The requirement is that the company must cease scrutinized business operations or convert to inactive operations within 90 days.

If a company on the Scrutinized Companies List fails to take action within 90 days after engagement through written notice, the Public Fund is required to sell, redeem, divest, or withdraw all publicly traded securities of the company, subject to certain exceptions, within 12 months after the company's most recent appearance on the Scrutinized Companies List. A company that the U.S. government affirmatively declares to be excluded from federal sanctions related to Sudan or Iran is not subject to divestment. Further, the divestment provisions do not apply to indirect holdings in actively managed investment funds.

If a company that ceased scrutinized active business operations resumes scrutinized active business operations, it is to be added back to the Scrutinized Companies List immediately. The written notice process begins again for that company.

The Public Fund is prohibited from acquiring securities of any companies on the list which have active business operations in Sudan or Iran, with certain exceptions. A company that the U.S. government affirmatively declares to be excluded from federal sanctions related to Sudan or Iran is not subject to the investment prohibitions. Additionally, the investment prohibition provisions do not apply to indirect holdings in actively managed investment funds. However, the Public Fund is required to send letters to the managers of such funds requesting that they consider removing those companies from the fund or create an alternative fund. If an alternate fund is created, the Public Fund is required to replace all applicable funds with the new fund.

The bill creates another exclusion for defined contribution plans. However, the Public Fund is required to engage the manager of the investment offerings in such plans requesting that they consider removing scrutinized companies from the investment offerings or create an alternative offering without scrutinized companies.

The Public Fund must file a report with the Board of Trustees of the State Board of Administration, the Senate President, and the House Speaker which includes the Scrutinized

Companies List within 30 days of the creation of the list. The report is a public document. At each quarterly meeting of the Board of Trustees thereafter, the Public Fund must file another report with additional information as specified in the bill. This report is also to be distributed to the U.S. Presidential Special Envoy to Sudan and to the U.S. Presidential Special Envoy to Iran. The report is to include:

1. A summary of correspondence with companies engaged by the Public Fund that are active or inactive scrutinized companies;
2. All investments sold, redeemed, divested, or withdrawn in compliance with the divestment provisions of the bill;
3. All prohibited investments under the investment prohibition provisions of the bill;
4. Any progress made toward the removal of scrutinized companies from actively managed investment funds or the creation of similar funds without scrutinized companies; and
5. A list of all publicly traded securities held directly by the State of Florida.

The act expires upon the occurrence of all of the following conditions:

1. The Public Fund is no longer required to assemble the Scrutinized Companies with Activities in Sudan List, shall cease engagement and divestment of such companies, and may reinvest in such companies[27] because one of the following has occurred:

    - The Congress or the President declares that the Darfur genocide has been halted for at least 12 months;
    - The United States revokes all sanctions against the Government of Sudan;
    - The Congress or the President declares that the Government of Sudan has honored its commitments to cease attacks on civilians, demobilize and demilitarize the Janjaweed and associated militia, grant free and unfettered access for deliveries of humanitarian assistance, and allow for the safe and voluntary return of refugees and internally displaced persons, or
    - The Congress or the President declares that mandatory divestment of the type required in this act interferes with the conduct of U.S. foreign policy.

and

2. The Public Fund is no longer required to assemble the Scrutinized Companies with Activities in the Iran Petroleum Energy Sector List, shall cease engagement and divestment of such companies, and may reinvest in such companies[28] because one of the following has occurred:

    - The Congress or the President states that the Government of Iran has ceased to acquire weapons of mass destruction and support international terrorism;
    - The United States revokes all sanctions against the Government of Iran; or
    - The Congress or the President declares that mandatory divestment of the type required in this act interferes with the conduct of U.S. foreign policy.

[27] The Public Fund may reinvest in such companies if they do not satisfy the criteria for inclusion in the Scrutinized Companies with Activities in Iran Petroleum Energy Sector List.
[28] The Public Fund may reinvest in such companies if they do not satisfy the criteria for inclusion in the Scrutinized Companies with Activities in Sudan List.

With respect to this act, the Public Fund is exempt from any conflicting statutory or common law obligations, including any obligations with respect to choice of asset managers, investment funds, or investments for the Public Fund's security portfolios.

The Public Fund may cease divesting, or reinvest, in certain scrutinized companies if the value of all assets under management by the Public Fund becomes equal to or less than 99.50 percent, or 50 basis points, of the hypothetical value of all assets under management by the Public Fund assuming no divestment had occurred under the divestment provisions of this act. Such activities require an additional report to the Board of Trustees of the State Board of Administration, the President of the Senate, and the Speaker of the House of Representatives.

The act includes a severability clause.

The bill provides that it shall take effect upon becoming a law.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

Article VII, section 18(a) of the Florida Constitution (the unfunded mandate provision) provides that "[n]o county or municipality shall be bound by any general law requiring such county or municipality to spend funds." The bill may result in divestment costs that are estimated to range from $3 million to $20 million. It is unclear what percentage of these costs could be related to the participation of local government. To the extent that local government absorbs more than an insignificant percentage of these estimated costs and that the absorption of these costs could be characterized as a requirement to spend funds, the bill might violate the unfunded mandate provision of the constitution.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. Other Constitutional Issues:

In *National Foreign Trade Council, Inc. v. Giannoulias,*[29] the Federal District Court held unconstitutional the Illinois Act to End Atrocities and Terrorism in the Sudan (Act), which imposed various restrictions on the deposit of state funds in financial institutions whose customers have certain types of connections with Sudan and on the investment of public pension funds in Sudan-connected entities. The court discussed the following three arguments asserting that the Act violated the U.S. Constitution:

[29] Nat'l Foreign Trade Council, Inc. v. Giannoulias, No. 06 C 4251, 2007 WL 627630 (N.D. Ill. Feb. 23, 2007).

1. The Act violates the Supremacy Clause because it is preempted by federal law governing relations with Sudan;
2. The Act interferes with the federal government's ability to conduct foreign affairs; and
3. The Act violates the Constitution's Foreign Commerce Clause.[30]

The Act amends the Deposit of State Moneys Act and the Illinois Pension Code to prohibit certain investments in the government of Sudan and companies doing business in or with Sudan. The Act's effect on the Illinois Pension Code is somewhat analogous to this bill. The Act amends the Illinois Pension Code in pertinent part to prohibit the fiduciary of any pension fund established under the Code from investing in any forbidden entity. A "forbidden entity" is essentially any company transacting business in Sudan, lending or investing in Sudan, or domiciled in Sudan.

The court held that the Act did not violate the Supremacy Clause or interfere with the federal government's ability to conduct foreign affairs. However, the court did hold that the Act violates the Constitution's Foreign Commerce Clause.

Foreign Commerce Clause

The court noted that "State regulations that facially discriminate against foreign commerce are *per se* invalid."[31] Additionally, "nondiscriminatory state regulations affecting foreign commerce violate the Foreign Commerce Clause if they create a substantial risk of conflicts with foreign governments or impede the federal government's ability to speak with one voice in regulating commercial affairs with foreign states."[32]

The opinion noted that courts are split on the issue of whether the market participation exception to the Commerce Clause applies to the Foreign Commerce Clause. However, the court did not have to resolve the issue because it found that Illinois is not acting exclusively as a market participant through its enforcement of the Illinois Sudan Act. The act affects the pension funds of municipal entities, which are not part of the state for purposes of the market participant doctrine. Thus, with regards to the pension funds of the municipal entities, the state of Illinois is a regulator. Therefore, even if the market participant doctrine applies to the Foreign Commerce Clause, it would not apply in this situation.

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, arguably this bill does not violate the Foreign Commerce Clause.

[30] *Id.* at *5.
[31] *Id.* at *15 (citing Piazza's Seafood World, LLC v. Odom, 448 F.3d 744, 750 (5th Cir. 2006)).
[32] *Id.*

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

The intended impact of the legislation is to reduce the state's investment in companies that are included on the Scrutinized Companies with Activities in Sudan List or the Scrutinized Companies with Activities in the Iran Petroleum Energy Sector List. Depending on the size of such holdings in the Public Fund, some private companies could suffer losses from divestment.

C. Government Sector Impact:

The State Board of Administration (SBA) may be required to divest of certain holding in companies on the Scrutinized Companies with Activities in Sudan List or the Scrutinized Companies with Activities in the Iran Petroleum Energy Sector List. 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 Public Fund in the form of a revised investment policy statement or by higher employer payroll contribution rates. The table below reports what are believed by the SBA to be the scale and scope of the divestitures affected by this bill, assuming that none of the scrutinized companies cease scrutinized business operations within 90 days after engagement. The following is an explanation of the columns in the table:

1. The column labeled "Sponsor List SB 2142" represents an estimate of the number of companies, the estimated cost of divesting, and the estimated asset values of the companies that would be included on the Scrutinized Companies with Activities in Sudan List, based on the application of certain criteria to a list of companies provided by the sponsor of the bill to the SBA which was matched up with the FRS holdings as of February 28, 2007. This column is based on the pre-committee substitute version of the bill.
2. The column labeled "Sponsor List SB 2250" represents one estimate of the number of companies, the estimated cost of divesting, and the estimated asset values of the companies that would be included on the Scrutinized Companies with Activities in the Iran Petroleum Energy Sector List, based on the application of certain criteria to a list of companies provided by the sponsor of the bill to the SBA which was matched up with the FRS holdings as of February 28, 2007. This column is based on the pre-committee substitute version of the bill.
3. The column labeled "SBA Estimate SB 2142" represents an estimate of the number of companies, the estimated cost of divesting, and the estimated asset values of the companies that would be included on the Scrutinized Companies with Activities in Sudan List, based on the application of certain criteria to a list of companies obtained from Institutional Shareholder Services which was

matched up with the FRS holdings as of February 28, 2007. This column is based on the pre-committee substitute version of the bill.

4. The column labeled “Sponsor List SB 2250” represents one estimate of the number of companies, the estimated cost of divesting, and the estimated asset values of the companies that would be included on the Scrutinized Companies with Activities in the Iran Petroleum Energy Sector List, based on the application of certain criteria to a list of companies obtained from Institutional Shareholder Services which was matched up with the FRS holdings as of February 28, 2007. This column is based on the pre-committee substitute version of the bill.
5. The column labeled “Peer SBA Estimate CS/SB 2142 [CALPERS]” represents an estimate of the number of companies, the estimated cost of divesting, and the estimated asset values of the companies that would be included on the Scrutinized Companies with Activities in Sudan List, based on the list of companies that satisfy the criteria for divestment under a somewhat similar California law which was matched up with the FRS holdings as of February 28, 2007. This column presents estimates that appear to be based on criteria closer to the committee substitute version of the bill.

There is disagreement as to the scale and scope of the effects including the names of the affected companies. Attempts to narrow the differences are ongoing, but there is considerable factual uncertainty since the assumptions of the parties and the data sources used cannot be presently reconciled:

	(1) Sponsor List SB 2142	(2) Sponsor List SB 2250	(3) SBA Estimate SB 2142	(4) SBA Estimate SB 2250	(5) Peer SBA Estimate CS/SB 2142 [CALPERS]
Number of Companies	20	20	45	130	20
FRS Costs of Divesting	$ 3 MM	$ 7 MM	$20 MM	$ 45 MM	$6.8 MM[33]
Estimated Asset Values	$ 525 MM	$ 1 B	$ 3.5 B	$ 6 B	$ 1 B
Historical Performance Results	N/R	N/R	-2 to -38 basis points	+2 to -53 basis points	N/R

The SBA bill analyses for the pre-committee substitute versions of SB 2142 (HB 1431) and SB 2250 provide more detailed estimates of the FRS Pension Plan implementation

[33] Committee staff estimated cost of divesting based on the application of the average cost of divestment in columns 1-4.

costs associated with these bills. In addition to providing the estimated costs of divestment, the analyses provide an estimate of the higher annual fees that SBA believes would be necessary because of anticipated changes in investment vehicles. Additionally, the analyses provide estimates for increased SBA staffing requirements, and increased costs of research and communications. As the committee substitute contains substantial changes, including the addition of sanction provisions related to Iran, the cost estimates based on the pre-committee substitute version of the bill is not included in this professional staff analysis. The SBA indicated that it is in the process of updating its analysis to reflect the committee substitute version of the bill.

VI. Technical Deficiencies:

The third provision of the bill[34] specifying what best efforts in the identification of scrutinized companies includes appears to be missing the words “Reviewing the” at the beginning of the provision. The Legislature may wish to amend this provision to correct this apparent omission.

The provision in the section of the bill concerning the identification of scrutinized companies provides an exception for social-development companies that are not complicit in the Darfur genocide. The exception appears to have an inapplicable reference to the criterion that would qualify a company to be included on the Scrutinized Companies with Activities in the Iran Petroleum Energy Sector List.[35] The Legislature may wish to consider deleting this reference.

VII. Related Issues:

None.

[34] See page 15, line 4 of the CS for SB 2142.
[35] See the reference to “subparagraph (1)(t)4.” on page 15, line 27, of the CS for SB 2142

VIII. Summary of Amendments:

None.