



Private Equity Alert

Developments in private equity law

A publication of Nixon Peabody LLP

MARCH 18, 2008

California's Responsible Private Equity Investment Act of 2008

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Sovereign wealth funds have recently come under scrutiny in the United States and Europe due to their significant increase in size over the past decade. Sovereign wealth funds are state-controlled investment vehicles that manage a country's surplus savings in another country's currency. Such funds currently hold as much as \$2.5 trillion in assets in the United States and elsewhere, with forecasts projecting they will grow to \$12 trillion by 2015. More than 20 countries have these funds, but the holdings remain concentrated, with the top five funds controlling about 70 percent of total assets. Abu Dhabi boasts the largest fund, sized at \$600-\$700 billion.

Concern in the United States and among European policy makers is that these sovereign wealth funds lack transparency and that they have potential to exert inappropriate political influence. Last year, China purchased nearly a 10-percent stake in Blackstone. Norway's fund, although a model for transparency, recently pulled its investment in Wal-Mart due to accusations that Wal-Mart had violated child labor laws and frustrated efforts by employees to unionize. The United States is requesting that the IMF and World Bank encourage sovereign wealth funds to adopt and operate voluntary codes of conduct that disclose their investment methods and avoid interfering in a host country's affairs.

The California Legislature may be taking a different approach. California Assemblymember Torrico introduced Assembly Bill No. 1967 (AB 1967), on February 14, 2007, which proposes, *inter alia*, to enact the Responsible Private Equity Investment Act of 2008 (ResPEI). Legislative findings under the bill reflect concern over the growing influence of sovereign wealth funds, their potential to cause political or financial instability, their general lack of transparency, and their affiliation with governing regimes with unflattering human rights track records. California public retirement systems already invest in private equity firms owned in large part by sovereign wealth funds. However, ResPEI would prohibit the California Public Employees' Retirement System (CalPERS) and State Teachers' Retirement System (CalSTRS) from making investments in certain entities that are directly or indirectly connected with sovereign wealth funds affiliated with countries that are not parties to at least five of six specified international human rights treaties. The following is a summary of the proposed legislation.

Prohibited investments

ResPEI prohibits CalPERS or CalSTRS from making any additional or new investment, or renewing an existing investment, in a private equity company that is owned in whole or in part by a sovereign wealth fund, or in a fund managed directly or indirectly by such a private equity company, if any country or federation of countries with which the sovereign wealth fund is affiliated, either directly or indirectly, is not a signatory or party to at least five of the six following human rights treaties: (i) the International Covenant of Economic, Social, and Cultural Rights; (ii) International Covenant on Civil and Political Rights; (iii) International Convention on the Elimination of All Forms of Racial Discrimination; (iv) Convention on the Elimination of All Forms of Discrimination against Women; (v) Convention against Torture and Other Cruel, Inhuman, or Degrading Treatment or Punishment; or (vi) Convention on the Rights of the Child.

ResPEI defines a sovereign wealth fund as a government investment vehicle funded by foreign exchange assets and managed separately from the country's official reserves.

Exemptions from prohibition

ResPEI's prohibition does not apply if the State Department has determined, in the most recent applicable human rights report, that the country or federation of countries with which the sovereign wealth fund is affiliated "generally respects the human rights of its citizens." Additionally, the prohibition does not apply if the State Department did not prepare a human rights report for that country or federation of countries in the most recent year for which reports were prepared.

Required obligations before making or renewing investments

If the investment is not prohibited, ResPEI requires CalPERS and CalSTRS to take the following steps before investing in a private equity company owned in whole or in part by a sovereign wealth fund or a fund managed by such a private equity company:

- a. *Evaluate sovereign wealth fund*—CalPERS and CalSTRS must evaluate, based on public information or information CalPERS and CalSTRS may obtain by using best efforts, every sovereign wealth fund owning stock or shares in the private equity company according to the following criteria: (i) transparency (as to the sovereign wealth fund's investment activities and source of funding); (ii) political stability of the country or federation of countries with which the sovereign wealth fund is affiliated, with particular focus on respect for and enforcement of internationally recognized human rights; (iii) productive labor practices; and (iv) corporate social responsibility, which includes compliance with the Global Sullivan Principles of Corporate Social Responsibility and the United Nations' Principles for Responsible Investment.

- b. *Prepare detailed report*—CalPERS and CalSTRS must summarize their findings, and the final report will be made publicly available and available on the Internet at least 60 days before any final investment decision.
- c. *Consider the evaluation*—Before making an investment decision, CalPERS and CalSTRS must consider their evaluation of the sovereign investment fund.
- d. *Decision to invest*—If the evaluation reveals evidence that the sovereign wealth fund fails to meet the criteria in any one category listed above, CalPERS and CalSTRS must do both of the following: (i) not invest in the private equity company or fund unless CalPERS or CalSTRS determines that the failure to do so would be inconsistent with their fiduciary duties; and (ii) state in writing their investment decision, which shall be made publicly available on the Internet within 10 days.
- e. *Annual reports*—On or before January 1, 2010, and every year thereafter, CalPERS and CalSTRS shall file a report with the Legislature describing any decision not to make or renew an investment because it was prohibited by ResPEI, or because CalPERS or CalSTRS declined to invest after conducting its evaluation of the sovereign wealth fund.

We will continue to monitor the status of this legislation and update you accordingly.

We welcome your questions and comments. For more information, please contact:

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