



Testimony of
the Natural Resources Defense Council
before the
New York State Senate
Standing Committee on Finance
on the
Fossil Fuel Divestment Act - S.2126

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NATURAL RESOURCES DEFENSE COUNCIL

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Good morning Chairwoman Krueger and members of the Committee.

My name is Rich Schrader and I'm the New York Political Director of the Natural Resources Defense Council (NRDC). I'm joined today by my colleague Natalie Jacewicz.

NRDC is one of the nation's largest environmental organizations, with more than three million members and activists -- including more than 210,000 in New York State. We have engaged on a wide range of New York State environmental and public health matters for nearly five decades, including in recent years on fracking, natural gas pipelines and other fossil fuel and climate issues.

We are very pleased to be here to offer strong support for the Fossil Fuel Divestment Bill. And we thank the leadership of the Chair and this Committee for advancing this critical legislation over the past several years. We also want to acknowledge the important work Comptroller DiNapoli and his staff have pursued for many years on climate change issues.

Why We Need to Act Now!

The effects of climate change are apparent and all around us. Historic polar ice melts, coastal flooding, hurricanes and wildfires of increasing frequency and severity -- and a general sense that 100-year storms seem to occur on an annual basis have now become a part of our common experience.

The extraction and burning of fossil fuels is the central cause of climate change and has already driven global temperatures up by 1°C beyond pre-industrial levels. Current global fossil fuel reserves, if extracted and burned, would exceed—many times over—the international carbon budget for a worldwide average increase in temperatures of 1.5—2°C. Indeed, some analysts have calculated that to achieve only a 2-degree increase will require nearly 70% of all these assets to remain in the ground, undeveloped. Anything beyond that rise in temperature will bring immeasurably destructive changes to the way we live.

One global response to this climate crisis is to push large institutions to stop investment in fossil fuel companies. Drawing upon the divestment movement that combated South African apartheid, the fossil fuel divestment movement rests upon both financial and moral objectives. In enacting the Fossil Fuel Divestment Act, New York State will join a rapidly growing group of national and international institutional investors that have committed to cut the financial cord to the oil, gas and coal industries.

In total, more than 1,000 institutional investors globally have committed to divest almost \$8 trillion in holdings from fossil fuels. The list of organizations to divest in whole or in part is broad and widening—from governments (e.g., the District of Columbia Retirement Board, London, Ireland, New York City) to faith-based groups (e.g., World Council of Churches, the Islamic Society of North America, Japanese Buddhist temples) to foundations and associations (e.g., the Rockefeller Family Fund, the British Medical Association). The insurance industry has

also shown a strong desire to cut loose from fossil fuels—an industry that now represents a commitment to divest nearly \$3 trillion of this total \$8 trillion committed globally.

The Fossil Fuel Divestment Act

· The Fossil Fuel Divestment Act (S.2126) would require the New York State Comptroller to divest the \$209 billion New York State Common Retirement Fund (“Pension Fund”) from stocks, debt or other securities in the 200 largest publicly-traded fossil fuel companies, along with their subsidiaries, affiliates, or parent entities.

Passage of this bill would send a clear message to the industry that New York State will no longer countenance the oil, gas and coal industry practice of generating greenhouse gas emissions – even as growing evidence emerges, the industry knew decades ago how harmful the results would be for the planet.

These 200 companies are to be identified based on the carbon content of their oil, gas and coal reserves. Within five years—and one year for companies invested in coal—the Comptroller must completely divest from these companies, whether the fund holds the assets directly, through separate accounts, or comingled state pension funds. To ensure divestment advances, the fund must deliver annual progress reports to the state attorney general, the senate standing committee on civil service and pensions, and the assembly standing committee on governmental employees.

The Comptroller may pause divestment, however, if divesting is likely to harm the fund. Specifically, the bill includes an important safety valve that allows the Comptroller to stop divesting, continue investing, or begin reinvesting in fossil fuel companies if “clear and convincing evidence” shows that the New York pension fund has lost or would lose at least half a percent of the fund’s total worth.

An identical Assembly bill (A.1536) has also been introduced this session.

Decarbonization Report and Corporate Engagement

Before addressing NRDC’s legal analysis of this bill, we want to note, as others today will, that the recent “Decarbonization Advisory Panel Beliefs and Recommendations” report (April 2019) recognizes the need for a radical shift in the Pension Fund’s assessment of the fossil fuel industry’s value in future climate change impacts.

The Decarbonization Panel recommends that the Fund establish new criteria to measure return on investment, to assess the value of these assets over a longer time frame, and to consider an entirely new frame for investing decisions, that of withdrawing over time from companies that do not align their goals with a 2 degree future. The Panel states directly that “the Fund should no longer own securities in companies that do not meet or are not making progress toward” this general goal. The Panel also suggests a full removal of investment from these companies not supportive of a radically reduced carbon footprint by 2030. We respectfully submit this is not far from the goal or timing of the Divestment Bill.

As noted, the Divestment Bill provides the Comptroller with a safety valve for divestment – if the Fund diminishes by half a percent because of the divestment, the Comptroller can reinvest in the fossil fuel companies. But a long-term value reduction of the Fund is unlikely because of increasing global pressure on fossil fuel companies to shrink their extraction and production capacity to meet climate goals -- and that would reduce their earnings. Divesting of assets whose core business earnings are expected to shrink makes common sense. Indeed, Jeremy Grantham, the acclaimed international investor, argues that divesting from fossil fuels would just as likely increase returns as diminish them.

Clearly, if national, regional and municipal economies across the globe move forward to establish robust renewable energy systems in the next decade, as many have already planned, much of the fossil fuel industries' assets will be stranded. In that case, orthodox benchmarking and assessing by the Fund will result in mispriced and overestimated values for these stocks. The current structure of analysis by fund managers, not just in New York State, simply does not account for the drastic dislocations in global markets that climate change will cause. In this context, it appears that divestment is a prudent investment approach to protect funds from significant risks.

In Appendix B of the Report, one of the panelists, Timothy Smith calls for a continued commitment to a strategy of shared engagement with the industry. There is merit in this approach as a general practice. But as another panelist, Bevis Longstreth, writes in Appendix A, certain industries are largely immune to change via engagement, however thoughtful the approach. This was clear in the 1990s movement to diminish the tobacco industry's ability to advertise and sell their addictive product to teenagers. In fact, I was the Commissioner of Consumer Affairs in New York City at that time and a lesson learned was that negotiation and engagement were hollow efforts with an industry whose core business practice -- in this case selling cigarettes to a young market -- defied public health norms. The same is true here, as cited by Mr. Longstreth. To paraphrase, shared engagement will be less effective with a company whose profitability is tied directly to the extraction and sale of carbon-intensive products.

Apparently, the Comptroller's own experience in shared engagement has had its frustrations. In 2018, that office sponsored a proposal to require Exxon-Mobil to disclose climate risks in their drilling and sales strategies. The company claimed there were virtually no such risks. In 2019, Exxon-Mobil asked the SEC to block an investor proposal aggressively supported by the Comptroller, that would mandate the company to set targets to lower greenhouse gas emissions. This time, Exxon-Mobil called it "micromanaging," opposed the proposal and refused to cooperate.

None of this is in a vacuum – this company and the bulk of the industry has a vast advertising and lobbying budget that opposes bedrock environmental policy, from attempting to gut the Endangered Species Act so they can drill on the habitat of species struggling to survive, to continued attempts to drill in the Arctic and Atlantic regardless of the utterly predictable damage it will do to aquatic habitat, to efforts to destroy the Clean Water Rule that protects the drinking water of 100 million Americans. This is not a likely partner to engage effectively with.

Legal Analysis of the Fossil Fuel Divestment Bill

Now, we turn to NRDC's legal review of this bill. After undertaking a comprehensive legal analysis of this bill - including a review of the legislative history of the Retirement Fund and applicable case law - NRDC believes there are no statutory, fiduciary, constitutional or other legal impediments to enacting this bill. We briefly summarize our key points.

First, New York State statutory law clearly establishes the Legislature's authority to restrict the classes and kinds of investments the Comptroller can make with the New York pension fund. According to New York State Retirement and Social Security Law, the Comptroller may invest in securities "in which he is authorized by law to invest the funds of the state," and shall "be subject to all terms, conditions, limitations and restrictions by this article and by law upon the making of such investments." Art. 2 § 13(b), Art. 8 § 313(b).

Indeed, the history of the New York State Retirement and Social Security Law reveals that the Comptroller has never had unbridled freedom to invest the fund's assets. In the original 1955 statute creating this law, the Comptroller was significantly limited in the types of investments (e.g., municipal bonds, insured mortgages) he could make. Over the next few decades, the Legislature expanded the Comptroller's authority to invest in additional financial products (e.g., private securities). But at the same time, the Legislature also placed restrictions on this authority. For example, even as the Legislature permitted public pension funds to be invested in most public and private securities, it also limited the kinds of mortgages in which the funds could invest. Art. 4-A § 177(1)(a). In the 1980s, during a period of violence in Northern Ireland, the Legislature passed a law requiring the Comptroller to consider a number of factors before investing in companies doing business in that troubled region. Art. 9 § 423-a(3).

Second, NRDC believes that New York State's fiduciary duty principles do not prevent the enactment of this bill. In the past, a judge-made standard of fiduciary duty—the "prudent man rule"—governed public pension funds' trustees in New York. In 1995, the Legislature codified this standard in the Prudent Investor Act. Estates, Powers, and Trusts Law Art. 11 § 11-2.3. Under this standard, fiduciaries are judged by whether their investment decisions reflect reasonable care and caution in light of the entire investing portfolio. They are required to diversify assets, subject to the interests of a fund's beneficiaries and the limits set by terms governing the fund.

Especially because of the bill's safety valve, we do not believe the Fossil Fuel Divestment Bill conflicts with the Prudent Investor Act. As noted, the bill permits the Comptroller to consider the health of the entire fund's portfolio and pause divestment to protect the fund from losses. This ability preserves the Comptroller's ability to exercise care in investing. Further as to diversification, this bill only removes one type of industry from the fund's portfolio and does not prevent the Comptroller from otherwise diversifying. We would also add, as other observers have noted, that there is a strong argument that the Comptroller would not be fulfilling his fiduciary duties if state pension funds remained invested in fossil fuel dependent companies.

Third, we find that nothing in the New York State Constitution presents a legal impediment to advancing this bill. The provision of the Constitution that is most raised in this context – the so-called “Nonimpairment Clause” – prohibits the State Legislature from diminishing or impairing the benefits of public pensioners. Art. 5 § 7. But nothing in this provision, added in in 1938, prevents the Legislature from making changes to fund management, so long as the Legislature provides appropriate protection for the fund’s assets. Again, the safety valve language allows the Comptroller to pause divestment if evidence suggests divesting will diminish the fund’s returns by as little as half a percentage point.

And finally, relevant New York State caselaw supports our analysis. The Courts have repeatedly affirmed that the Legislature can restrict the classes and types of investments the Comptroller may invest pension funds in, so long as the Comptroller retains sufficient discretion in executing the specific investment decisions. One of the leading cases, *Sgaglione v. Levitt*, (1975) in the Court of Appeals, involved a challenge to a statute that ordered the Comptroller to invest \$125 million of the New York pension fund in Municipal Assistance Corporation bonds. Since the statute left the Comptroller no say in the matter, the Court concluded that the Legislature could not force the Comptroller to “mindlessly invest in whatever securities they direct, good, indifferent, or bad.” But even though the Court struck that particular legislation down, the state’s highest court also explicitly wrote that the Comptroller’s investing freedom was nonetheless “limited by the continuing power of the Legislature to expand or restrict the classes and kinds of investment in which he may place the funds in his care.”

We believe the Fossil Fuel Divestment Bill is consistent with this ruling, and other key cases (including *McDermott v. Regan* (1993)), by limiting the kind of investments the Comptroller can make, rather than forcing the Comptroller to invest in specific securities in specific amounts or changing the fund’s contribution structure solely to bail out the state, with no way for the Comptroller to intervene. Once again, the Divestment Bill this Committee is considering includes a safety valve that allows the Comptroller to exercise independent judgment, pause divestment, and even reinvest in fossil fuel companies if clear and convincing evidence suggests divesting may hurt the fund.

Conclusion

At a time when leading world experts warn the worst climate impacts will arrive much sooner than previously expected, swift, bold action is needed by all of us before it is too late. Of course, divestment alone won’t win the fight against climate change. But divestment shines an important light on the need to reject fiscal ties with powerful polluters -- and underscores the point that we can’t achieve our ambitious climate goals if we continue to gain profits from the companies and activities that are harming our planet the most. After an extensive legal analysis of the pending legislation, NRDC believes there are no statutory, fiduciary, constitutional or other legal impediments to advancing this bill.

Thank you again for the opportunity to testify today.

