



**Investment Office**

P.O. Box 2749

Sacramento, CA 95812-2749

Telecommunications Device for the Deaf - (916) 795-3240

(916) 795-3400

June 15, 2009

**AGENDA ITEM 4**

**TO: MEMBERS OF THE INVESTMENT POLICY SUBCOMMITTEE**

- I. SUBJECT:** Responsible Contractor Program
- II. PROGRAM:** Real Estate
- III. RECOMMENDATION:** Recommend to the Investment Committee approval of the revised Statement of Investment Policy for Responsible Contractor Program
- IV. ANALYSIS:**

**INTRODUCTION**

CalPERS has been and continues to be a leader on labor policy issues in the institutional real estate (and now infrastructure) investment community. CalPERS first adopted its Responsible Contractor Program (RCP) policy (Policy or RCP) in 1994 and has amended it from time to time. Through the implementation of this Policy, CalPERS has demonstrated its support and encouragement of fair wages and benefits for workers and proper working conditions. Many institutional investors have developed RCP policies modeled after CalPERS Policy.

**BACKGROUND**

CalPERS approach to formulating the RCP was unique in that staff worked with labor representatives as well as investment managers to develop a policy that addressed the concerns of both sides.

Over time, as staff and the Investment Committee have received feedback and have assessed the RCP in operation, this Policy has been amended to require greater notice of contracting opportunities; more comprehensive reporting practices, including a responsible contractor worksheet to assist in the certification of responsible contractor status; and a complaint procedure.

The existing Policy generally applies to real estate and infrastructure investments that are more than 50% CalPERS-owned (RCP Investments). Its focus is RCP Investment construction and building services contracts worth \$50,000 or more (RCP Contracts).

Key objectives of the existing Policy include:

- Require that RCP Contracts be competitively bid,
- Require that responsible contractors (generally, employers that pay fair wages and benefits based on local market conditions) be notified of RCP Contract bidding opportunities,
- Except when investment performance would be harmed, require that RCP Contracts be awarded to a qualified responsible contractor if one has bid for the contract,
- Annual review of investment manager and contractor RCP compliance,
- Support for a position of neutrality in the event there is a legitimate attempt to organize workers,
- Factor RCP compliance into contract renewal decisions, and
- Complaint investigation and resolution process response to alleged RCP violations.

Since its inception, the RCP has been effective. CalPERS investment partners are utilizing responsible labor practices and CalPERS has been able to generate competitive investment returns consistent with sound fiduciary principles. Both labor representatives and investment managers have stated that the RCP works effectively the overwhelming majority of the time and meets the Policy's stated objectives. For fiscal year 2007-2008, the Real Estate program achieved 95.7% compliance with Policy goals and requirements.

## **POLICY REVISION PROCESS**

In 2008, organized labor expressed concerns that RCP labor neutrality and enforcement provisions were not strong enough. In response, in July 2008, at the direction of the Investment Committee, staff began a process for discussion and revision of the RCP Policy. Two law firms, Altshuler Berzon LLP (Altshuler) and Steptoe and Johnson LLP (Steptoe), were retained to address labor law issues raised by the Policy. Altshuler and Steptoe provided opinion letters addressing legal effects of potential changes to the RCP. Paul, Hastings, Janofsky & Walker LLP (Paul Hastings) was retained and provided an opinion on fiduciary duty. Staff also retained the consultant services of Pension Consulting Alliance (PCA) to assist with the Policy revision process.

Staff held a series of roundtable discussions and solicited comments from labor representatives and investment managers regarding the goals, objectives and applications of the Policy. On November 18, 2008, staff conducted a workshop for CalPERS board members where labor representatives, investment managers, legal counsel, and Investment Office staff presented and discussed issues related to the RCP. Meeting attendees acknowledged that RCP violations have been relatively few, are the exception, and have not prevented successful implementation of the Policy.

After the Board Workshop, Policy revisions were drafted and sent to stakeholders for comment. Comments on the Policy focused on the following issues: when and to whom does the Policy apply, monitoring, enforcement, and neutrality. The Executive Summary (Attachment 1) provides a detailed description of the comments staff received from investment partners and labor representatives. Also attached is a complete set of all comments received from labor representatives and investment managers (Appendix). Based on comments received, staff revised the draft Policy to address these issues. A redline copy of the draft Policy is also attached (Attachment 2).

## **PROPOSED POLICY REVISIONS**

The revised Policy draft is presented to the Investment Committee for discussion and consideration. The new draft Policy contains a section that defines capitalized terms used in this agenda item. The sections noted below refer to the proposed revised Policy. The proposed Policy includes many technical and clarifying revisions that improve but do not change the intent of the Policy.

Many of the comments received from labor representatives and investment partners have been incorporated into the proposed draft Policy. Of particular note, language defining or elaborating on competitive bidding, neutrality, and enforcement has been incorporated into the proposed draft. Examples of the proposed revisions are:

**Section II:** New language stating that infrastructure investments are subject to the Policy.

**Section III.E:** Clarification that only investment managers have fiduciary duties, but to the extent a Delegate has the discretion to make business decisions affecting RCP investments, CalPERS expects the Delegate to make sensible business decisions.

**Section III.J:** Clarification that an investment's status as an RCP Investment is determined when CalPERS first invests in it. Hence, if CalPERS only later acquires more than a 50% share of an asset (e.g., because it buys out another partner), the investment does not become subject to the Policy. However, the Policy continues to encourage managers of non-RCP Investments to comply with the spirit of the Policy.

**Section VI.I:** Improved bidding notification process with new language stating:

*“CalPERS encourages bidding notification websites to include a feature permitting potential bidders to sign up for automatic e-mail notification of projects open for bidding.”*

**Section VI.J:** New language clarifying that neutrality applies to investment partners and CalPERS, and new language that defines Neutrality as recommended by external legal counsel, Altshuler.

*“To remain neutral means not to take any action or make any statement that will directly or indirectly state or imply any support for or opposition to the selection by employees of a collective bargaining agent, or preference or opposition to any particular union as a bargaining agent.”* The proposed Policy goes on to state: *“Nothing in this Policy obligates or prohibits Managers or Delegates from entering into private neutrality, labor peace or other lawful agreements with a labor organization seeking to represent or who currently represents workers at a RCP Investment.*

**Section VI.K:** New language regarding remedies to address material violations to the Policy.

*“The Board expects Staff to diligently monitor Managers for compliance with the Policy, just as it expects Managers to diligently monitor their Delegates and Sub-Delegates for compliance. If staff determines that a Manager has materially violated the Policy...Staff is to consider all reasonably available remedies and implement any appropriate ones that it determines will best address the violation in a manner that satisfies the Staff’s Fiduciary Duty Requirement, or recommend that the Board take such actions. For example, to the extent that CalPERS has the right to cancel its contract with a Manager... or to the extent the Manager has the right to cancel its contract with a Delegate... Staff may cancel CalPERS contract with the Manager or request the Manager to secure cancellation of the Delegate or Sub-Delegate contract.”*

## **REVISIONS NOT RECOMMENDED**

While important changes are recommended, the Policy retains its original intent, stating a preference, rather than imposing an absolute requirement for responsible contractors. Compliance monitoring largely remains the role of the Manager coordinating the annual reporting of contractors’ self certification.

Labor representatives propose changes that would significantly change the administration of the Policy. Labor representatives requested a policy requiring strict adherence with strong monitoring requirements, audit requirements, and enforcement provisions that would potentially impact investment performance. Labor representatives proposed the following Policy revisions:

- Require written adherence to the Policy with retroactivity of proposed revisions,
- Monitor for compliance with the RCP Policy; and National, State and Local labor laws at all times, not solely while performing services with respect to RCP Investments,
- CalPERS or third party responsibility for Policy monitoring and enforcement,
- Housing Development Partnerships should be subject to the Policy (current Policy calls for voluntary compliance),
- Distribution of a fact sheet to all employees explaining the Policy and procedures to file a complaint. Staff and interested parties develop employee notification including a summary of the Policy, duties of employers, a complaint process, and whistle blower protections,
- Staff responsibility for additional due diligence for new investments, including a review, in consultation with relevant labor organizations, of the Managers' history with labor relations; including but not limited to their history with responsible contractors,
- Staff responsibility for holding annual Policy education sessions for stakeholders including but not limited to managers, delegates, and labor unions,
- Mandatory contractor pre-bid meetings with Manager and Delegates to discuss the RCP, and
- Implementation of an audit program for oversight and enforcement of the Policy, including an audit of no less than ten percent of parties covered by the Policy for review of self-certification forms. Staff shall also initiate an audit if a complaint has been filed to an administrative or judicial body by an employee of a manager, delegate or sub-delegate.

Staff and consultants gave serious consideration to each of the proposed revisions noted above. The proposed revisions would significantly alter the intent and administration of the program. Upon review and analysis, staff determined that labor's proposed RCP changes would require CalPERS to have the right and ability to perform fact finding, the authority to make binding determinations of compliance or non-compliance, and the requirement to terminate investment managers for Policy infractions.

Labor's proposed revisions raise several issues of concern, including increased staffing requirements, increased cost to administer the program, impaired alignment of interest with investment partners, and fiduciary duty. CalPERS would need to hire additional staff to perform the extra monitoring and enforcement that labor has suggested. Staff is not able to determine the cost associated with labor's proposed revisions, however based on the extent of the additional work that would be required, it appears that the cost would be meaningful.

Alternately, labor proposes that CalPERS could hire consultants to administer the Policy. A third party consulting entity would need to be "arms-length" and unbiased in appearance and practice. Staff has not found an existing entity that meets this description. It is hard therefore to determine what such consultants would cost, but it appears that this cost would also be meaningful.

According to Real Estate investment partners, the RCP changes proposed by labor representatives will reduce the number of investment managers and funds that would be willing to partner with CalPERS. Investment partners have voiced concern that a requirement that neutrality only apply to them and not to CalPERS, or that would apply to contractors and sub-contractors would significantly limit the number of businesses that would be willing to perform work and provide services to CalPERS investments. Managers have expressed concern that if investment partnerships are subject to termination; investments would be at risk, their alignment with CalPERS would be weakened; and CalPERS investment opportunities would be reduced. They state that it is critical for the goals of CalPERS and the partners to be aligned. As fiduciaries to CalPERS, it is investment partners' obligation to identify opportunities where CalPERS can achieve superior investment returns. They state that the changes labor has proposed would impact return on investment and place CalPERS at a competitive disadvantage in the open marketplace.

## **CONCLUSION**

Staff reviewed labor representatives' and investment managers' input and made every attempt to balance labor and manager interests. The proposed Policy seeks to balance these two interests while taking CalPERS overriding investment interests into account.

The revised draft that is recommended by staff contains many improvements to the RCP Policy. Important progress has been made to clarify and strengthen language regarding competitive bidding, neutrality and enforcement. The recommended Policy clarifies roles and responsibilities and makes many other technical and clarifying changes. All of these revisions will improve the reach and administration of the program. The proposed Policy furthers CalPERS continuing deep interest in the condition of workers employed on CalPERS Real Estate and Infrastructure investments. PCA has provided a concurrence letter recommending that the Policy Subcommittee approve the revisions to the RCP (Attachment 3).

Staff recommends Policy Subcommittee approval of the proposed revised RCP Policy.

**REMAINDER OF PAGE INTENTIONALLY LEFT BLANK**

**V. STRATEGIC PLAN:**

This item supports Goal VIII to manage the risks and volatility of assets and liabilities to ensure sufficient funds are available, first to pay benefits and, second to minimize and stabilize contributions.

**VI. RESULTS/COSTS:**

There are no costs associated with this item.

---

Laurie Weir  
Portfolio Manager  
Real Estate

---

Theodore Eliopoulos  
Senior Investment Office  
Real Estate

---

Kenneth W. Marzion  
Interim Chief Operating Investment  
Officer

---

Joseph A. Dear  
Chief Investment Officer