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Summary of Texas Government Code Chapter 809: Baker McKenzie

In brief

In an attempt to protect its oil and gas industry, Texas has passed legislation that seeks to punish investment firms that divest from fossil fuel related investments.

On 16 March 2022, the Texas Comptroller of Public Accounts, Glenn Hegar, sent a letter to 19 major financial companies which was not limited to US or Texas-based companies and included Japanese companies requesting verification that they do not engage in investment policies that result in the boycott of fossil fuel-based energy. This request was made pursuant to [Texas Government Code Chapter 809](#): recent legislation prohibiting the Texas Government from investing in financial companies that take any action intended to penalize, inflict economic harm, or limit commercial relations with a company based on the company's involvement in fossil fuel-based energy.

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If the Comptroller determines that any of these companies is "boycotting energy company", the consequences are severe. The names of a financial company boycotting energy company will be published on a public list. Unless such financial companies cease boycotting energy companies within certain period thereafter, Texas Government entities will be prohibited from contracting with that company, will need to divest any interest held in that company and will be prohibited from further investing in that company. The ramifications of Chapter 809 are significant because the state-run investment funds that Texas is threatening to divest from impacted investments collectively hold hundreds of billions of dollars in assets. For example, some of the funds identified in the bill include the USD 214 billion Texas Permanent School Fund; and the Employees Retirement System of Texas and Texas Municipal Retirement System funds, both of which manage around USD 35 billion. As Texas Government Code Chapter 809 does not rely on extraterritorial application, rather it governs the application of investment policy, companies which do not have any subsidiary, branch or representative office in Texas will still be subject to this legislation.

Importantly, financial companies that fail to provide a response to the Comptroller's request before the 61st day from receipt are presumed to be boycotting energy companies and will be included on a public list. Since the original 19 letters, Comptroller Hegar has sent similar letters to around 160 other publicly traded investment companies, and he intends to send more in the near future.

In a [Press Release](#), Comptroller Hegar stated that his frustration is rooted in financial companies that claim they are committed to the fossil fuel sector when directed to conservative, energy states, while conversely also pushing net-zero and other environmental, social, and governance (ESG) policies addressed towards the public sector. In an [Open Letter](#) to the Comptroller, the Lieutenant

Governor of Texas, Dan Patrick, reiterated these sentiments, targeting specific companies he believed to be counteracting Texas fossil fuel-based energy companies' best interests.

The thrust of all of this is simple: Texas is attempting to push back on these new investment trends using its influence as a powerful institutional investor.

Definition of boycott energy company

While the potential consequences of being deemed a "boycotting energy company" by the Comptroller are intimidating, the terms within the legislation are still ambiguous enough to warrant uncertainty regarding whether a company is truly at risk.

For example, in Section 809.001(1), refusing to deal with a fossil fuel-based energy company is not considered boycotting if it is committed pursuant to an "ordinary business purpose." The state of Texas has yet to define what conduct would constitute an "ordinary business purpose," and it is unclear how this standard will be applied in practice. For example, based on the language of the statute, it is undecided as to whether refusing to invest in a risky fossil fuel industry, such as arctic oil drilling, would be allowable. Moreover, it is also uncertain whether Texas would consider hedging between green and fossil fuel-based energy for regular diversification purposes as an ordinary business purpose or a full-blown boycott.

While Texas was undoubtedly inspired to pass this legislation due to policy motivations surrounding its prominent oil and gas industry, the extent to which other fossil fuel industries are protected is uncertain. Boycotting an industry such as coal may not cause a similarly targeted response from Texas legislators, but based on the language of the legislation, it would still be considered to be boycotting energy companies.

SEC scrutiny of ESG disclosure to investors

In connection with capital markets, in the event that financial companies publicly declare their ESG policy, such financial companies must ensure that their response to the Comptroller is harmonized with any similar disclosure to investors or filing with The U.S. Securities and Exchange Commission.

Through the initiation of recent Enforcement Actions by the SEC, it is clear that the SEC plans to thoroughly investigate funds that claim to be environmentally responsible in order to ensure that they are accurately incorporating ESG factors into their investment selection process. Thus, ensuring that a response to the Comptroller is in line with any similar disclosure to investors or filing with the SEC is important.

What happens next?

Texas legislators have proven their willingness to protect the state's oil and gas sector, but it is unclear how they will apply the reach of Chapter 809 in the process.

We expect the Comptroller's office to provide further clarity over the coming months. We also predict that the Comptroller's office will continue to serve these questionnaires upon various financial institutions, both before and after the formalization and publication of the initial list of financial institutions that "boycott energy companies."

If your firm receives a letter from the Comptroller's office, action is imperative. The strict 60-day deadline to respond to the request excludes the possibility of extensions, so it is important that a carefully-tailored response is provided on a timely basis. Your firm should also consider what, if any, further actions can be taken to ease the Comptroller's concerns.

If your firm has not yet been contacted by the Comptroller's office, we recommend considering whether Chapter 809 poses a material risk and if so, developing an action plan. As noted above, the deadline cannot be extended, so it is better to begin to gather documents and brainstorm potential responses before the clock starts running.

Finally, Texas is not alone in the fight to keep its fossil fuel industry entrenched. Similar bills that punish fossil fuel divestment and discourage carbon-neutral commitments have been introduced in other states, including West Virginia, Oklahoma, Indiana, and Louisiana. It appears that legislation to protect the fossil fuel industry is a primary goal for the Republican party this year, but the enforcement process remains uncertain. Thus, financial firms invested in states that have prominent fossil fuel-based energy industries should also begin to think about how they would respond to a similar request.

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