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ATTORNEY GENERAL



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Honorable Roland Machold
Director, Division of Investment
GN-290
Trenton, New Jersey 08625

FORMAL OPINION NO. 1 - 1985

Dear Director Machold:

The Division of Investment has raised numerous questions concerning the interpretation and implementation of L. 1985, C. 304, N.J.S.A. 52:18A-69.1 et seq. the South African divestiture legislation enacted into law on August 27, 1985. The legislation prohibits the Division from making certain South African-related investments, requires it to diversify its portfolio of investments, and prescribes certain reporting requirements concerning the implementation of the first two parts.

In regard to the prohibitory provision of the legislation, Section 1 provides in pertinent part, as follows:

no assets of any pension or annuity fund under the jurisdiction of the Division of Investment . . . shall be invested in any bank or financial institution which directly or through a subsidiary has outstanding loans to the Republic of South Africa . . . its instrumentalities, and no assets shall be invested in the stocks, securities or other obligations of any company engaged in business in or with the Republic of South Africa.

The paramount question raised is the meaning of the phrase, "any company engaged in business in the Republic of South Africa." The phrase is not defined in the statute nor is it susceptible to a precise definition. Material Research Corp. v. Mellon, 54 N.J. 74, 79 (1963). Whether a foreign corporation is doing business in this country is a question dependent primarily on the facts and circum-

stances of each particular case, considered in light of the language and objects of the pertinent statute or constitutional provision involved. 36 Am. Jur.2d, Foreign Corporations, §317 (1984). As a general proposition, however, subject to such modifications as may be necessary in view of the purpose of particular statute involved, it is recognized that a foreign corporation is "doing" "transacting," "engaging in," or "carrying on" business in a particular state or country when it has entered the state by its agents and is there through such agents engaged in carrying on and transacting some substantial part of its ordinary or customary business. The business activity is deemed to be usually continuous in the sense that it may be distinguished from merely casual sporadic or occasional transaction and isolated acts. *Id.* at §317.

There is no question, of course, that under this general definition a foreign company is engaged in business in a state or country where it maintains an office, factory, plant, or like location, from which it operates its customary or ordinary business. The real question here concerns whether there are any circumstances under which companies that do not actually maintain a physical presence in a state or country, but merely trade with entities in such state or country, nevertheless are engaged in business there.

The legislative history of the statute suggests that the legislature did not intend to cover trading transactions. Assemblyman Brown, the leading sponsor of the bill commented at the legislative hearings held before the Assembly's State Government, Civil Service, Elections, Pensions and Veterans' Affairs Committee, as follows:

I have introduced legislation, A1309, that would require the divestiture of all investments of the State's public pension and annuity funds which are directly or indirectly linked to the South African regime.

Businesses engaged in investment in South Africa are not only profiting from an immoral, [repressive] system, they are directly playing an active role in maintaining the system and are, therefore, perpetrators of apartheid.

Unfused African corporate investment, including loans, in South Africa has exceeded about \$5 billion dollars in recent times. Clearly, unattached United States investment in South Africa is thereby supportive in the well being and related strength of the government.

The United States corporations have come to dominate the sectors of the South African economy most vital to its health and growth, and most strategic when considering the country's vulnerability: petroleum, computers and high technology, mining, and heavy engineering

There are approximately 6,350 companies listed on the major exchanges in this country, of that number, less than 200 do business with South Africa, and these companies are apt to be heavy industrial or mature companies whose future growth rate might be lower than smaller companies. (Emphasis added).

(July 10, 1985 Hearing, pp. 14-15). Assemblyman Brown's references to businesses which are involved in South Africa, to businesses which have investments there, and to businesses which dominate key sectors of its economy, indicate that the concern of the legislature was with companies that maintained some sort of physical presence or operation in that country. This view is supported by the following written statement submitted to the committee by a co-sponsor of the bill, Assemblyman Eugene Thompson:

... Many of South Africa's black leaders believe that foreign investors should pull out of the country....

In the United States public and private organizations are enacting a variety of policies to bring pressure upon corporations and financial institutions to cease operations in South Africa. (Emphasis added).

(July 10, 1984 Hearing, Exhibit 3749. Thus, co-sponsor Thompson referred here to the need for companies to "pull out" of South Africa and to "cease operations" thereby suggesting that the companies in mind are those that had a physical presence in South Africa in the first place.

An estimate by Assemblyman Brown that only 200 companies would be effected by the proposed legislation is significant. A survey undertaken by the Investor Responsibility Research Center Inc. (IRRC), a non-profit organization which monitors the involvement of foreign companies in South Africa, states there are approximately 200 companies which either directly own assets in South Africa, or which own at least 10% of an affiliate or subsidiary which does own assets in South Africa. There is no indication that Assemblyman Brown based his estimate on this survey, but it is clear as a matter of common knowledge there are far more than 200 foreign companies in the world which trade with entities located

inside of South Africa. This would lead one to assume that Assemblyman Brown viewed the phrase, "any company engaged in business with or in South Africa," to exclude trading transactions by a foreign company, where no physical presence or operation is maintained by it in South Africa.

Furthermore, in a closely analogous context, the New Jersey Supreme Court has interpreted the phrase, "transact business in New Jersey," in New Jersey's corporate qualification law, as not applying to foreign corporations that merely sold goods from outside the state to a New Jersey citizen, even if the sale was solicited by the corporation's New Jersey sales agent, where the sale was subject to final acceptance by the foreign corporation. Matefial Research Corp. v. Metron, supra, at 79.

Moreover, if the phrase, "engaged in business ... in South Africa," were intended to cover that kind of trading transaction, the additional prohibition in the law on engaging in business with the Republic of South Africa would have been unnecessary. The former prohibition would have been broad enough to cover the latter transaction. It is axiomatic that the legislature is not presumed to enact redundant statutory provisions. Gabrin v. Skyline Cabana Club, 54 N.J. 550 (1969). The fact that the legislature felt it necessary to add the prohibition on doing business with the Republic of South Africa must be construed as demonstrative of its intent to construe the phrase, "engaged in business," as generally noninclusive of mere trading activities. For these reasons, it is our interpretation of the legislative intent that the ban on investments in companies engaging in business with South Africa does not encompass those companies which trade with, export to, or import from South Africa, but do not maintain a physical presence, such as a factory, office or plant, either directly or indirectly through subsidiaries or affiliated corporations in that country. Id.

In some instances, though, foreign corporations which only trade with South African entities may have special concerns that relationship with them, in fact such entities rarely are acting as the agents of the foreign corporation, for example, dealers, licensees, franchisees and other entities. If the content of such foreign laws, where a foreign corporation has effective control over such entities, they are deemed to be transacting business in the territory in which such agents operate. 35 Am. Jur. 2d Foreign Corporation, §335, (1963-2001 (1988)). Business operated by Carroll

* However, as noted, it is clear that the divestiture language also prohibits investment by the division in companies which are engaged in business with the Republic of South Africa. Thus, it is clear that if a foreign company actually trades with the Republic of South Africa or its subsidiaries, it has been such companies are subject to the provisions of this legislation.

corporation through intermediaries over whom they exercise effective control can be just as vital to the economy of South Africa as that generated by foreign corporations maintaining a presence there in their own name or capacity. Accordingly, it must be assumed the Legislature intended to proscribe investment in companies that operate not only directly in South Africa, but also through the vehicle of intermediaries over whom they exercise effective control.

The Division should adopt regulations which establish criteria as guidance to determine whether effective control is being exercised in individual instances. For example, as part of an inquiry as to whether an issuer has a disqualifying relationship to an agent, franchisee or distributor in South Africa, it would be important to know whether it has the contractual power to exercise discretion as to any of the following matters: (1) the price of goods sold to third parties; (2) the payment terms; (3) the acceptance of orders; (4) the recall of products; (5) the settlement of disputes over the quality or quantity of goods delivered; or (6) the nature of promotional or advertising campaigns. In addition, an ability to share in the profits of the intermediaries, would be indicative of control. An affirmative answer as to any of these questions would more likely than not support a determination that the corporation is transacting business in South Africa.

You have also asked whether the divestiture's mandate applies to corporations which, while they do not engage in business in South Africa in their own name, do so through subsidiaries or affiliates. As in the case of controlled intermediaries, it is clear that the divestiture law applies to foreign corporations that have subsidiaries or affiliates operating in South Africa. In order to interpret a statute, the purpose of the legislation must be considered. Where a literal rendering will lead to a result not in accord with the essential purpose, a design of an act, the spirit of the law will control the letter. New Jersey Turnpike Revenue Bond Act, Local No. 194 I. E. R. E. R. Act, CIO v. Non-Jersey Turnpike Authority, 200 N.J. Super. 49, 53 (App. Div. 1985). The divestiture's purpose of the statute is to induce foreign companies to divest themselves of capital investment in "pull out" subsidiaries in South Africa, thereby pressuring the investment there to end and prevent the defeat that purpose is for foreign companies seeking capital from our pension funds which contributed to be not subject to the divestiture's law merely because such companies do not operate in South Africa.

The divestiture's law does not have the resources to retroactively verify the responses given. It would be an adequate approach to require the corporate officer authorized by resolution of an issuer's board of directors to sign the inquiry and to certify to the truth of the answers. Random checks could then be performed to verify certain of the responses.

South Africa through their own corporate identities, but instead carry out their business purposes through the medium of subsidiaries or affiliates. Since the reality is that many, if not most, foreign corporate entities operate in South Africa in the latter fashion, and keeping in mind the remedial nature of the statute, it is concluded that the term, "company," in the phrase, "company engaged in business . . ." must be read liberally to include any subsidiary or affiliate of a corporate issuer.

By the same token, the word "company" must be read to include any issuer which is itself a subsidiary or affiliate of a parent company engaged in business in South Africa. This situation is of importance to the Division because it invests a significant amount of money in short-term debt securities of finance companies that are subsidiaries of parents engaged in business in South Africa. The finance companies themselves operate only domestically. However, any investment in a subsidiary plainly benefits a parent company. It would equally defeat the salutary purpose of the legislation if pension and annuity funds were to be indirectly invested in companies engaged in business in South Africa through subsidiaries or affiliated companies rather than directly through a single parent corporate entity.

The Division has also asked whether it would be permissible to rely on the findings of the IRKC as to which companies are engaged in business in South Africa. Absent express statutory authorization, an administrative agency is not empowered to delegate discretionary duties to outside parties. Application of North Jersey District Water Supply Commission, 175 N.J. Super. 157 (App. Div. 1980). The legislation provides no authority for the delegation of any discretionary duties relating to its implementation. Although the canvassing or surveying of companies involves, to a certain extent, a fairly mechanical or ministerial task, the interpretation of the data received still requires some discretionary or interpretive judgment on the part of the party gathering the information. Therefore, the Division should directly ascertain for itself whether an issuer is one which is engaged in business with or in the Republic of South Africa in accordance with the regulations establishing standards and criteria. The most practical and effective procedure would be to prepare a questionnaire embodying the guidelines established by the Division and to send one to each issuer in which the Division is contemplating investment. This would be accompanied by a notice to each such company that the purpose of the questionnaire is to ascertain eligibility for investment under the legislation and, further, that the failure to respond within a certain period shall be taken as presumptive proof

that the company is in fact engaged in business with or in the Republic of South Africa.*

You have also asked whether the legislation applies to investments of the New Jersey Cash Management Fund. That fund, (the "CMF"), is a common trust fund maintained by the Division of Investment in which are deposited surplus monies of the State, municipalities and local agencies, and also pension and annuity monies. These monies are then invested by the Division in certificates of deposit, commercial paper and other short-term debt securities. As provided in the regulations of the State Investment Council, the depositors in the CMF essentially share in the gains and losses resulting from the investments on a pro rata basis. Since the legislation is applicable to all assets of the pension and annuity funds and the CMF is an asset of pension funds to the extent of their proportional share therein, it is clear that the CMF is subject to the divestiture law as long as the pension and annuity funds continue to own shares therein. Application of the statute to the CMF, however, would cease were the Division to withdraw the pension and annuity funds from the CMF and establish a similar common fund strictly applicable to them, one that would have a South African-free portfolio.

Another question raised is whether the Division is prohibited from entering into repurchase agreements with dealers and banks, if such companies are engaged in business in South Africa. The legislation prohibits the Division from investing pension and annuity funds in "... the stocks, securities or other obligations..." of any company engaged in business in South Africa. Repurchase agreements ("repos") are written agreements entered into between dealers or banks, on the one hand, and investors, on the other, whereby the former sell to the investors securities of third parties, consisting usually of government obligations or certificates of deposit, and promise to buy them back within a stated period of time at a premium. There are two basic types of repos: wholesale repos and retail repos. See Note, Lifting the Cloud of Uncertainty Over the Repos Market: Characterization of Repos as Separate Purchases and Sales of Securities, 37 Vand L. Rev. 401, 403-407 (1984). The former are typically short-term contracts to sell and repurchase large-denomination government securities. These repos are entered into by the Federal Reserve to carry out monetary policies or by government securities dealers to acquire

* This is not to say, however, that the Division may not consider the IRRC findings. The IRRC publication may be used as source material and as a guide but the final determination as to which companies are engaged in business in South Africa should always be made by the Division.

short term funds. Id. at 405. Retail repos are usually longer term contracts to sell government securities or certificates of deposit and are usually entered into by depository institutions. Id. Wholesale repos are sold to sophisticated investors, whereas retail repos are often mass-marketed to smaller investors having varying levels of sophistication and expertise. Id.

While repos certainly represent contractual obligations of the dealer or bank, we do not read the phrase "... or other obligations," to mean any contractual or legal obligation of a party with whom the Division may deal. The legislation specifically bars investments by the Division, not any and all contracts entered into by it with companies doing business in South Africa. Indeed, on signing the bill, Governor Kean recommended that executive action now be considered restricting state contracts with vendors that engage in business in South Africa, making it clear that he did not intend it to encompass such normal contractual obligations between the State and outside parties. It is also an axiom of statutory construction that in the construction of a statute in which special language is followed by general language, the special language is, under the doctrine of ejusdem generis, definitive of the general language, and the general words are not to be construed in their widest sense, but are meant to apply only to things of the same general kind of class as those specifically mentioned. Atlantic City Transportation Co. v. Walsh, 6 N.J. Super. 262 (App. Div. 1950). Thus, the phrase, "or other obligations," must be read to apply only to the same general kind of class as those specifically mentioned, i.e. stocks and securities; it refers to "bonds", "notes" and other instruments designed and used to raise capital for a corporation.

The term "securities," a generic class of which the term "stocks," is itself a species, is generally defined as any financial scheme involving an investment of money by a party in a common enterprise, with the profits to come solely from the efforts of others. 69 Am. Jur. 2d, Securities Regulation, §37 (1977). Since the United States Securities and Exchange Commission (SEC) is charged with the duty of enforcing and administering the federal securities laws, it is appropriate in this context for the agency's judgment as to whether a particular transaction or device constitutes a security of similar-type of investment vehicle. In the absence of any definition in the divestiture law, in this regard, it is noted that the SEC has issued a policy statement wherein it has determined that wholesale repos are not in themselves securities subject to the registration requirements of the federal securities laws, but only represent, instead, a purchase and sale transaction in respect to the underlying security. SEC Staff Report, 423 Cong. Rec. 46,637 (1983). Similarly, in two notes on Repos issued by the SEC, the SEC has implicitly determined to treat retail repos as securities and sales of such underlying securities are not as the securities themselves. Id. citing 46 Reg. 49,637 (1981). Our review of the case law in the field has

