

1934.
NEW ZEALAND.

COMMISSION OF INQUIRY INTO COMPANY PROMOTION METHODS, ETC.

(INTERIM REPORT OF).

Laid on the Table of both Houses of the General Assembly by Command of His Excellency.

EXPLANATORY NOTE.—*Portions of the report containing the evidence of certain witnesses have been omitted, a promise having been given by the Commissioners that no publicity would be given to their evidence. The place of each omission is marked by dots and asterisks.*

COMMISSION

TO INQUIRE INTO AND REPORT UPON TENDENCIES AND DEVELOPMENTS APPARENT IN THE DOMINION IN RELATION TO THE PROMOTION, FINANCIAL METHODS, CONTROL, AND OPERATIONS OF CERTAIN COMPANIES AND OTHER CORPORATIONS WHICH SEEK TO RAISE CAPITAL AND LOAN FUNDS IN THE DOMINION.

BLEDISLOE, Governor-General.

To all to whom these presents shall come, and to JOHN SAXON BARTON, Esquire, Stipendiary Magistrate, of Wellington; HORACE BELSHAW, Esquire, of Auckland; and FRANK EDWARD GRAHAM, Esquire, of Christchurch: Greeting!

WHEREAS it is desirable in the public interest that an investigation shall be conducted into the promotion, financial methods, control, and operation of companies with a view to instituting any necessary modifications in the law relating thereto:

Now, therefore, I, Charles, Baron Bledisloe, the Governor-General of the Dominion of New Zealand, in exercise of the powers conferred by the Commissions of Inquiry Act, 1908, and of all other powers and authorities enabling me in that behalf, and acting by and with the consent of the Executive Council of the said Dominion, do hereby constitute and appoint you, the said

JOHN SAXON BARTON,
HORACE BELSHAW, and
FRANK EDWARD GRAHAM,

to be a Commission to inquire into and report upon tendencies and developments apparent in the Dominion in relation to the promotion, financial methods, control, and operations of companies and other corporations which seek to raise capital and loan funds in the Dominion and particularly—

- (1) (a) The methods of promotion and administration of such companies, including their subsidiary companies and syndicates:
- (b) The scheme of control of such companies and the relative powers and rights of promoters, subscribers of shares, and subscribers of debenture, bond, or security certificate issues:

- (c) The financial schemes of such companies with particular reference to the relative application of the companies' and bondholders' property and funds to (1) remuneration and profits to promoters and subsidiary companies, (2) formation, working and administration expenses, and (3) protection and furtherance of the interests of holders of long-term debentures, bonds, security certificates, and like instruments or securities :
- (d) Whether the benefits which may be found at present to accrue to promoters or shareholders in bond-issuing companies through the surrender or forfeiture of bonds should be applied and credited to bondholders' funds in the particular group or series of any such bonds surrendered or forfeited, or otherwise :
- (e) Whether the provisions of the Companies Act, 1933, relating to prospectuses and otherwise requiring disclosure of material contracts and transactions and prospective contracts and transactions are reasonably adequate to protect intending investors in shares, debentures, bonds, security certificates, and other like instruments :
- (2) (a) The financial structure of financial investment and trust companies, and as to whether any additional legislative provision should be made to afford investors a greater measure of protection for their capital moneys and other interests in such companies :
- (b) The desirability of regulating in the public interest the formation and operation of trust companies and investment companies dealing in company shares, Government, local body, and other forms of security.
- (3) The operation of the present statute governing the constitution and registration of stock exchanges in New Zealand ;

and generally what steps, if any, should be taken by way of modifying existing statute law and regulations thereunder having regard to the present and prospective welfare of the investing public and the community generally :

And with the like advice and consent I do further appoint you

JOHN SAXON BARTON

to be Chairman of the said Commission :

And for the better enabling you, the said Commission, to carry these presents into effect, you are hereby authorized and empowered to make and conduct any inquiry under these presents at such places as you may deem advisable and at such times as you may deem expedient, with power to adjourn from time to time and from place to place as you think fit, and to call before you and examine on oath or otherwise, as may be allowed by law, such person or persons as you think capable of affording information in the premises ; and you are also empowered to call for and examine all such books or records as you deem likely to afford you the fullest information on the subject-matter of the inquiry hereby directed to be made, and to inquire of and concerning the premises by all lawful means whatsoever :

And, using all diligence, you are required to submit a report to me under your hands and seals not later than the first day of April, one thousand nine hundred and thirty-four, of your opinion as to the aforesaid matters :

And you are hereby strictly charged and directed that you shall not at any time publish or otherwise disclose, save to me in pursuance of these presents or by my direction, the contents or purport of any report so made or to be made by you :

And it is hereby declared that these presents shall continue in full force and virtue although the inquiry is not regularly continued from time to time or from place to place by adjournment.

Given under the hand of His Excellency the Governor-General of the Dominion of New Zealand, and issued under the Seal of the said Dominion, this 17th day of January, 1934.

GEO. W. FORBES, Prime Minister.

Approved in Council.

F. D. THOMSON,
Clerk of the Executive Council.

INTERIM REPORT.

MAY IT PLEASE YOUR EXCELLENCY,—

We have the honour to report that, acting on Your Excellency's Warrant of appointment and instructions to inquire and report, we duly commenced and have prosecuted to date our inquiries into tendencies relating to the promotion, constitution, and control of certain companies.

We have decided, after considerable anxious thought, to adopt the unusual course of making an interim report on certain matters and facts, because we believe that the situation which they reveal is sufficiently serious to warrant special consideration by Your Excellency's Advisers, with a view to deciding whether or not urgent action should be taken in reference thereto.

EVIDENCE.

We shall in this report refer to evidence given by
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This evidence was given on oath in each case.

Our references to documents filed in State Departments are verified as follows: In the case of documents relating to the Transport Mutual and General Insurance Co., Ltd., the Assistant Registrar of Companies at Auckland attended, was sworn, and produced the actual documents for production to the other witnesses summoned in that case.

In other cases, we have (a) procured certified copies from the Registrar of Companies, or (b) made an actual inspection of the documents filed in the Registrar's Office, by two members of the Commission attending and inspecting separately.

In the case of references to companies incorporated in New South Wales, we have procured search notes by a leading public accountant and a leading share-broker of Sydney. These men have acted independently and forwarded to us search notes and reports compiled from the records in the Companies Registration Office at Sydney.

Our sittings have been held *in camera*, because our experience satisfied us that in many cases it was only by that procedure we could obtain the evidence we required.
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PART I.—INTRODUCTORY.

Paragraph 2 of our order of reference requires us to inquire into and report on, *inter alia*, "The financial structure of financial investment and trust companies, and as to whether any additional legislative provision should be made to afford investors a greater measure of protection for their capital moneys and other interests in such companies"; and "The desirability of regulating in the public interest the formation and operation of trust companies and investment companies dealing in company shares, Government, local-body, and other forms of security."

In the course of our inquiries into concerns of this class, we have gathered much information relating to a group of companies which includes investment trusts and affiliates of various types. These companies, mostly registered in Auckland, have been formed and operated by a comparatively small group of persons. The names of these persons appear freely in the lists of members and directors of these companies, and there is little room for doubt that the common ownership and control thus evidenced has made possible and has facilitated developments and transactions that call for close scrutiny.

PART II.—GENERAL.

(1) *Definition and Characteristics of Investment Trusts.*

(a) *General.*—Investment trusts are a characteristically British development, and have had a long history in Great Britain. Of recent years, more especially since the war, the investment-trust idea has spread to other countries, more especially to the United States. The establishment of investment trusts in New Zealand is very recent, and few, if any, of the companies whose affairs we have investigated are more than four or five years old.

When transplanted to other countries, the investment-trust idea has frequently been modified in such a way as to violate the principles which are laid down as axiomatic in Great Britain, and to make the investment trust a source of grave potential danger instead of an instrument of financial progress. This applies especially to certain of the trusts which have been established in New Zealand and Australia. Had all such investment trusts followed closely the British model, there would have been no need for this interim report.

(b) *Definition.*—There is no satisfactory legal definition of an investment trust, and the investment trust must be defined generally in terms of its methods and objects. We define an investment trust thus:—

“An agency by which the combined funds of different participants are placed in securities showing a distribution of risks such as to introduce the law of average in protection of the principal, and which aims solely at the safe and reasonably profitable employment of the subscribed investment funds while definitely avoiding any and all of those responsibilities of control, management, finance, discretion, or special interest which are sometimes tied in with investment.”

—*Robinson*, “Investment Trust Organization and Management,” page 13.

The economic functions of the investment trust may be described briefly as follows:—

- (i) It combines the small units of investment of individual investors into a large aggregate or pool:
- (ii) This pool is invested in a wide range of securities:
- (iii) The individual investor in the trust receives a return from the earnings of the securities purchased out of the pooled funds, in the proportion that his investment in the trust bears to the total pool:
- (iv) The diversification of securities held by the trust enables risk to be reduced in a manner not possible to the small individual investor:
- (v) By expert management, it is possible to derive a higher rate of return than would be possible to the individual investor who could only effect a corresponding reduction of risk by investing in “gilt-edged” securities, such as Government Bonds, bearing a low rate of interest.

These may be described as the “ideal” economies possible under a wisely managed investment trust, but it must be clear that they depend upon a considerable measure of skill in management, a high degree of integrity in directors, strict conformity to a properly devised policy of investment diversification, and adequate safeguards by way of audit and the election of trustees. It is essential that operations should be purely financial in nature, and that the funds should not be used to obtain control or management of other business enterprises, nor used to finance undertakings in which those who control the trust are interested.

Investment trusts are of many types, which may be classified in various ways; but for our purposes it is sufficient to distinguish two types only. These are the British or management type, and the contractual type. The former is exemplified by the New Zealand Investment Trust (Wellington), and the latter by the Investment Executive Trust of New Zealand, Ltd. (Auckland), the Dominion Executive Trust (Dunedin), and the Gold and General Investment Trust (Christchurch).

(2) *Comparison of Investment Executive Trust of New Zealand, Ltd., with British Type.*

A comparison of the constitution and policy of the Investment Executive Trust of New Zealand, Ltd., which exemplifies the contractual type of trust, with the British type, will serve to reveal the structural weaknesses which have made possible (or at least facilitated and encouraged) the dangerous and objectionable practices referred to in greater detail in Parts III and IV of this report.

(a) *Capital Composition*—The capital resources of investment trusts are procured by means of ordinary shares, preference shares, and debentures. The ordinary rule in trusts of the British type is that at no time should the debenture capital exceed the share capital. The total capital of sixty-three such trusts is distributed as follows:—

Ordinary shares . .	£34,550,000	
Preference shares	£36,334,000	

Total share capital . .	£70,884,000	
Total debenture capital . .	£45,192,000	

From this it will be seen that, in practice, the debenture liability is substantially less than the total share capital.

The capital composition of the Investment Executive Trust of New Zealand, Ltd., is in marked contrast with British practice. The nominal capital is £100,000, but prospectuses so far issued provide for debentures totalling £4,000,000. The total nominal capital is *one-fortieth* of the total nominal value of debentures which may be issued. Paid-up share capital as at 17th October, 1933, totalled approximately £30,000 (ordinary £24,000, preference £5,675), but the debenture issue totalled £493,290, or *over sixteen times* the share capital. Of the ordinary capital of £24,400, two individuals, Messrs. J. W. S. McArthur and C. G. Alcorn, hold £22,575. The control of debenture funds totalling nearly £500,000 is in their hands. In the same way, other contractual trusts operating in New Zealand show a small ratio of share capital to debenture liability.

(b) *Security*.—In the case of trusts of the British type, the security to debenture-holders consists of the total assets of the undertaking. The debenture capital is backed by the whole of the paid-up share capital of the company, and this is normally in excess of the debenture capital. The debenture carries a fixed rate of interest and is a mortgage secured against the whole of the assets of the trust.

The debenture of the Investment Executive Trust of New Zealand, Ltd., is a contract to pay over a certain proportion of the net revenue proceeds derived from the investments made with the debenture funds. These appear to be reduced, before investment, by capital charges in respect of brokerage and administration costs which have totalled up to 10 per cent. of the nominal value of the debentures. Debenture-holders may require repayment of their debentures if the average interest over any two successive years falls below 3 per cent. per annum, or on winding-up of the company; but the assets of the company are not charged by the debentures of any series. The share capital of the company is free from liability in respect of debentures. Hence, the security behind debentures in any series consists simply in the securities and funds held to the credit of the series, and arising from transactions with the funds provided by debenture-holders themselves.

A further essential difference having relation to the question of security is the appointment of trustees. Many, if not all, British trusts appoint trustees with power to inspect security portfolios and power of audit. While the power of trustees will be circumscribed by the conditions of the trust deed, their appointment does provide an additional safeguard against abuse. The Investment Executive Trust of New Zealand, Ltd., appoints no trustee, and debenture-holders have no powers of audit.

The essential bearing of the above on the facts which are disclosed in Parts III and IV of our report is this: By the provision of a small share capital, a small group of individuals has obtained control over a large volume of funds and used

these, unhampered by trustees or by incurring any risk of loss of their own capital. There is nothing to prevent them from manipulating the funds to their own advantage, but, even apart from such possible manipulation, they stand to gain a very high rate of return on their own capital, while avoiding any loss which may result from using the debenture funds in speculative investments. In such circumstances it becomes all the more imperative that those who direct policy should be men of undoubted integrity.

(c) *Investment Policy*.—Two basic canons of investment policy should be the diversification of investments and the avoidance of speculative investments. One authority states that a trust with a capital of £2,000,000 should not invest more than £3,000 in any one enterprise. As a general principle, securities should not be purchased save in established undertakings with ample assets, and which have been proved by experience to be sound. The Investment Executive Trust of New Zealand, Ltd., violates both these canons.

Its debenture certificates provide that, on completion of an issue of debentures, not more than 10 per cent. of the funds contributed shall be in any one security; but this provision does not apply *until* the issue is completed. Hence, it can be deliberately evaded by refraining from completing an issue, and the appearance of security through diversification is illusory. The existence of a large number of subsidiary or related companies facilitates such evasion; for it is possible to place investments in several such concerns and then divert them to a particular object, which may be selected primarily because it furthers the interests of the directors themselves. The interests of debenture-holders are subsidiary. Investment trusts which are mindful of the interests of those who invest with them, and anxious for their own reputation, should refrain from the establishment of subsidiary or interlocked companies, except for such ancillary purposes as the marketing of their debentures. The Investment Executive Trust Group, hereinafter described in detail, comprises at least fifteen companies which are connected by common shareholders or directors, shareholdings in each other, or other forms of financial interdependence. No elaborate argument is required to demonstrate the openings which this gives to use the funds of debenture-holders to serve the personal ends of those in control, or to obtain profits by way of commission, or the danger that the security of debenture-holders may be steadily whittled away.

The second basic canon, the avoidance of speculative securities, has also been flagrantly violated; for it will be shown that a considerable proportion of the funds of the debenture-holders has been used in the purchase and renovation of a building. This is certainly neither an established concern nor a proven enterprise, but is definitely a speculative investment. It will be shown that the device of subsidiary or related companies has been used to facilitate this investment. At the same time, it has enabled the transaction to be undertaken in such a way as to throw the burden of risk on the debenture-holders, while leaving it open to the directors to enjoy any exceptional profits which might conceivably be realized. Debenture-holders have no means of obtaining knowledge of the transactions directed to the purchase of this building, because they have no powers in regard to inspection of the portfolios of securities.

PART III.—ORGANIZATION OF COMPANIES IN THE INVESTMENT EXECUTIVE TRUST GROUP.

In this section we describe the organization of fifteen companies which comprise the Investment Executive Trust of New Zealand, Ltd., and its affiliates.

We desire to point out that the respective lists of shareholders are not complete lists; we have chosen names that are common to most of the companies, for the purpose of showing the intermeshing ownership and control. The concentration of control is effected through the holding of shares by one company in another. The names of companies which hold shares in other companies of the group are in italic type.

(1) *The Investment Executive Trust of New Zealand, Ltd.*.—This is a public company incorporated in New Zealand in May, 1929. It is an investment trust following fairly closely the lines of what is known as a contractual trust company. Its present authorized capital is £100,000 in 250,000 ordinary

shares of 2s. each, and 75,000 preference shares of £1 each. A prospectus dated April, 1934, states that the paid-up capital is £29,970. According to the same document its directors are: J. W. S. McArthur, W. A. Pilkington, and H. H. Pollard. In addition to the directors, its shareholders include C. G. Alcorn, Stanley Grange, Katherine I. Grange, Richard Glover-Clark, V. B. McInnes, *Alcorn Trower and Co., Ltd.*, *The Investment Securities Association, Ltd.*, and *Sterling Investments Co. (N.Z.), Ltd.* The prospectus referred to above offers "First Mortgage Perpetual Income Debentures" to a total of £4,000,000.

(2) *The Sterling Investments Company (N.Z.), Ltd.*—This is a public company, incorporated in October, 1930. It is an investment company of a kind which is hard to classify. Its memorandum of association gives it power to carry out all kinds of financial operations. Its nominal capital is £50,000 in shares of £1 each. Its paid-up capital as at 28th March, 1934, is shown as £2,350 14s. Its directors are shown as Charles Graham Alcorn and Kenneth C. Aekins. Its largest shareholder is the *Investment Securities Association, Ltd.*, which holds 20,801 shares, whilst other shareholders hold in the aggregate 206 shares. Its latest return filed at the Registrar's Office on the 28th March, 1934, shows the amount of debt due under mortgages as nil, but it has had at times mortgages and charges registered up to a maximum of £165,000.

(3) *The Investment Securities Association, Ltd.*—This is a private company, incorporated in December, 1930. The capital is £1,000, divided into 750 shares of £1 each and 5,000 shares of 1s. each. According to its latest return, its shareholders are: C. G. Alcorn, Elizabeth Roberta Alcorn, and Katherine Isobel Grange.

(4) *The British National Investment Trust, Ltd.* (New Zealand).—This was incorporated in November, 1931, under the name of "The Stock Exchange Corporation of New Zealand, Ltd.," but it subsequently changed its name to the above. This company is formed to act as broker or trustee for any person or company, and as promoter or founder of companies; also to take full control of or take part in the management of companies or undertakings. The latest return filed in December, 1933, shows that Stanley Grange is sole director. Its capital is £100,000, in 250,000 ordinary shares of 2s. each, and 150,000 preference shares of 10s. each; of this there is paid up £3,187. Its shareholders include: C. G. Alcorn, S. Grange, J. W. S. McArthur, V. B. McInnes, R. Glover-Clark, T. R. McArthur, *The Investment Securities Association, Ltd.*, *The British National Trust, Ltd. (Canberra, N.S.W.)*, and *The Southern British National Trust, Ltd., of Sydney, N.S.W.* The maximum amount of charges registered by this company at any time was £100,000.

(5) *The New Zealand Shareholders Trust, Ltd.*—This company was incorporated in December, 1931. Its objects include those which are common to investment-trust companies; but its primary purpose was *nominally* to act as an association of investors throughout New Zealand to provide information and protect their interests. Its capital is £60,000, divided into 100,000 ordinary shares of 2s. each, and 50,000 cumulative preference shares of £1 each. Its paid-up capital at 9th April, 1934, is returned as £1,071. At the same date it registered its total indebtedness in respect of debentures and charges at £264,000. The maximum charges registered at any time is £500,000. Its directors are: C. J. Lovegrove, R. S. Abel, and R. Glover-Clark. The largest shareholder is the *Sterling Investments Company (N.Z.), Ltd.*, which holds 8,779 out of 10,476 ordinary shares. Other shareholders are S. R. Grange and R. Glover-Clark.

(6) *Wynwood Investments, Ltd.*—This company was incorporated as a private company in August, 1930. Its capital, originally £1,000, was increased to £10,000 in October, 1933. As it is a private company, its paid-up capital cannot be ascertained. Its shareholders in April, 1932, were: C. G. Alcorn, 1; J. W. S. McArthur, 1; *Sterling Investments Co. (N.Z.), Ltd.*, 988; and *The Investment Securities Association, Ltd.*, 10. The latest return is dated March, 1934, and gives the shareholders as: Stanley Grange, 100; J. W. S. McArthur, 9,900. In December, 1933, this company registered as a charge a debenture issue of £100,000.

(7) *The Pacific Exploration Company, Ltd.*—This is a private company, incorporated in May, 1932. Its original subscribers were: *The Sterling Investments Co.*

(N.Z.), Ltd., 9,999 shares; and M. Gregory, 1 share. The latest list gives *The Sterling Investments Co. (N.Z.), Ltd.*, 9,979; M. Gregory, 1; C. G. Alcorn, 10; and T. R. McArthur, 10. There is evidence that the object of this company was to procure and finance the building of a somewhat luxurious seagoing yacht . . .

(8) *Farms and Farmlets, Ltd.*—This was incorporated in August, 1928, as a private company. The subscribers are: W. C. Hewitt, Solicitor, 500 shares; and his wife, Flo. Hewitt, 500 shares. The authorized capital was £1,000 in shares of £1 each. Its objects are, in the main, those which one would expect to find prepared for a small farming company, but it also has powers to deal in money, investments, securities, and property. Its capital was increased, in June, 1933, to £25,000 in shares of £1 each. In May, 1934, the Registrar of Companies wrote to the office of the company, at our request, asking if any of the shares in the increased capital had been subscribed, and received the reply that the information could not be given, because the managing director was in Sydney. This company, firstly, gave an ordinary chattel security to the National Bank of New Zealand over its farming assets. In June, 1933, it registered as a charge £100,000 in 500 bearer debentures of £200 each. This company now appears as the principal shareholder in the British National Trust, Ltd., incorporated in Canberra, Australia; it holds 51,200 shares of £1 each in that company.

(9) *The First Mortgage Freehold Security Company of New Zealand, Ltd.*—This is a private company, registered in November, 1924. Its objects are: The carrying-on of the business of financiers, financial brokers, the issue of debentures, and the receiving of money for investment. Its original capital was £1,000 in shares of £1 each, but it was increased in March, 1930, to £10,000 in 6,000 shares of £1 each and 80,000 shares of 1s. each. The principal shareholder is C. G. Alcorn, who holds 19,800 shares; the remaining 500 shares are held by: *Investment Securities Association, Ltd.*, Eliz. R. Alcorn, *Alcorn, Trower, and Co., Ltd.*, and R. S. Abel. In March, 1925, this company filed notice of a charge by way of mortgage debentures to the amount of £100,000.

(10) *The Transport Mutual and General Insurance Company, Ltd.*—This company was incorporated in November, 1933, as a public company. The authorized capital is 100,000, in 100,000 shares of £1 each. The subscribers to the memorandum were seven nominees or dummies, who subscribed for one share each. In February, 1934, 60,000 shares of £1 each were allotted to the *Investment Executive Trust of New Zealand, Ltd.*, and the statutory report filed on the 21st February, 1934, shows that the Investment Executive Trust had paid up 10s. per share on these shares, or £30,000 in all, and had also paid up cash in advance of calls £1,500. Further reference will be made later in this report to the use of "dummy" subscribers and "dummy" directors in this company.

(11) *The Southern British National Trust, Ltd.*—This company was registered in Sydney, New South Wales, in January, 1933. It has a nominal capital of £500,000, and a paid-up capital of £97,500. It has issued a prospectus in New South Wales offering for subscription debentures to an amount of £5,000,000. The principal shareholders in the latest annual list filed are: W. A. Pilkington, H. H. Pollard, H. C. Glasson, Madge Gregory, Richard Glover-Clark, and J. W. S. McArthur, the latter holding 17,000 shares. The objects may be stated briefly as being to acquire and deal in all forms of securities and investments. The company may be adequately described, for our present purposes, as being the equivalent in Sydney of the Investment Executive Trust, New Zealand, in Auckland. Its directors are: W. A. Pilkington, H. H. Pollard, and J. W. S. McArthur. The close correspondence between the directors and shareholders in the two companies should be noted.

(12) *The British National Trust, Ltd.*—This company was incorporated in January, 1933, at Canberra, Australia. The nominal capital is £1,000,000 in shares of £1 each. Of these, 65,007 have been subscribed, and £1 per share called up, and the return at the Registrar's Office in May, 1933, shows these shares as fully paid up. The seven subscribers to the memorandum of association of this company are again "dummies," being clerks and secretaries in the offices of the above companies, or their brokers and solicitors. These signatories are all resident in Auckland, and are therefore out of the jurisdiction of the territory and State in

which the company is registered. The principal shareholders in the company are : Thomas R. McArthur, C. G. Alcorn, J. W. S. McArthur, and *Farms and Farmlets, Ltd.*

(13) *V. B. McInnes and Co., Ltd.*—This company was incorporated in New Zealand as a private company in May, 1932. Its capital is £1,000 in shares of £1 each, the subscribers being : V. B. McInnes, 900 shares, and *Investment Securities Association, Ltd.*, 100 shares. Its objects are to act as broker, trustee, and agent, also to exercise many of the objects of investment trusts, and to act as director or manager, and to take full control or part control of another company or business.

(14) *Alcorn Trower and Co., Ltd.*—This company was incorporated in Wellington as a private company, on the 24th June, 1914. The solicitor registering the company was William C. Hewitt. Its capital is £3,000, in shares of £1 each. The subscribers were : C. G. Alcorn and A. S. Trower, with £1,500 shares each. On the 11th January, 1923, the shareholders were returned as : C. G. Alcorn, 1,500 ; and Eliz. R. Alcorn, 1,500. On the 30th June, 1931, the company registered as a charge three bearer debentures of £200 each. It is a shareholder in the Investment Executive Trust of New Zealand, Ltd., and the First Mortgage Freehold Security Co. of New Zealand, Ltd.

(15) *Financial Publications, Ltd.*—This company was incorporated at Auckland as a public company in May, 1933. Its capital is £5,000 in shares of £1 each. The promoters and present directors are : C. J. Lovegrove, R. S. Abel, and R. Glover-Clark. This company owns and publishes *The Financial Review*, a monthly financial magazine published in Auckland.

PART IV.—SOME TRANSACTIONS OF THE INVESTMENT EXECUTIVE TRUST GROUP.

(1) *Sterling Investments Co. (N.Z.), Ltd.*, seems to have been for years a kind of clearing-house for transactions in which J. W. S. McArthur and companies controlled by him are interested. We have direct evidence of several transactions whereby threatened litigation or other adverse action against McArthur or one of the other companies, has been averted by a settlement effected by a payment by the Sterling Co. Several such transactions relate to McArthur's personal liabilities in relation to the Selwyn Timber Co., Ltd., in liquidation, and the New Zealand Redwood Forests, Ltd. At a time when the paid-up capital of the Sterling Investments Co. (N.Z.), Ltd. was only £50, it lent several thousands of pounds to the Selwyn Timber Co., Ltd., in liquidation. During 1931 and 1932 the Sterling Co.'s paid-up capital was £50 14s., whilst on 1st September, 1932, it had registered with the Registrar of Companies, as mortgages or charges, debenture issues totalling £165,000.

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The latest filed return of Sterling Investments Co. (N.Z.), Ltd., shows its paid-up capital as £2,350, but it has subscribed for shares of a nominal value of £10,883 in other companies included in the foregoing list. Of these, £9,979 is in the Pacific Exploration Co., Ltd., a company formed to finance the building of a luxurious yacht which is now registered in the name of J. W. S. McArthur as owner.

(2) *The Transport Mutual and General Insurance Co., Ltd.*, illustrates the typical methods of the group. It was incorporated in November, 1933, and its memorandum of association and articles of association were signed by seven most obvious "dummies." Four of them are girl clerks in the offices of companies in the foregoing group. The articles of association provide that the first three subscribers to the memorandum shall be the first directors. They are : Margaret Muriel Dunn, Marjorie Hawley, and Henry Davenport Williamson, who each signed the memorandum for one share. Then, in February, 1934, the Investment Executive Trust of New Zealand, Ltd., was allotted 60,000 shares of £1 each in the capital of the Transport Mutual and General Insurance Co., Ltd., and paid up 10s. per share, or £30,000 in all. The three "directors" named above filed their statutory report a month later, showing the receipt of this £30,000 from the Investment Executive Trust, together with a further £1,500 as an advance in anticipation of

calls, and they showed as the approximately corresponding asset: "Sundry Investments, £30,500." We summoned these three "directors" to appear before us on the 6th June, 1934. Margaret Muriel Dunn deposed that she was twenty-one years of age; that she had no experience of the requirements and form of an insurance company; that a Mr. Glover-Clark had asked her to sign the memorandum for one share and to act as a director *pro tem.*; that at a "meeting of directors" the solicitor of the company, Mr. M. G. McArthur (a brother of J. W. S. McArthur) brought a list of investments, and the "directors" were asked to sign their approval, and did so, exercising no choice or judgment of their own; that, later, Mr. Glover-Clark, Mr. C. G. Alcorn, and Mr. T. H. Macky, became directors and took over. Marjorie Hawley is nineteen years of age, and corroborated Miss Dunn's evidence; she simply did what she was told by Mr. Glover-Clark and Mr. McArthur. Henry Davenport Williamson described himself as an agent, sixty-one years of age; he admitted his signature to the filed documents, including a statutory declaration that he had made a reasonable investigation and inquiry as to the requirements of the company and was of opinion that the capital subscribed was sufficient to justify the company in commencing business; but he disclaimed all responsibility, and said that he had no voice in the matter, and that he was not in any sense in charge nor was he, at any time, asked his opinion on any point.

Taking the least serious view of this whole transaction, it enables the common controllers of the two companies, by the intermediate investment in shares of the Transport Insurance Co. to invest the funds of the Investment Executive Trust in investments which the auditor of the latter company would not pass. A more serious possibility is that the funds may be used for speculative purposes designed to secure collateral advantages to the directors of the companies. We have, in this connection, ascertained facts which demand a close inquiry.

(3) *The Various Investment Trust Companies.*—The focal centre of this group in New Zealand has been the Investment Executive Trust of New Zealand, Ltd., of which J. W. S. McArthur is the managing director. It may be repeated here that this company has a paid-up capital of £30,000, and has issued a prospectus for the issue of mortgage debentures to a total of £4,000,000.

* * * * *

(4) *Pacific Exploration, Ltd.*—The "objects clause" of this company's memorandum of association can only be described as fantastic. The main object is: "To seek for and secure openings for the employment of capital in the Pacific or in any other part of the world." Its other objects include subsidizing laboratories and experimental work; scientific and technical research; supplementing the remuneration of scientific or technical professors or teachers; to carry on as farmers, dairymen, and as butchers and sausage-manufacturers, and to produce, construct, charter, or hire wharves, ships, &c. It has been extremely difficult to get any information about this company, although it is commonly reported that it was formed to finance the building of a yacht which McArthur has used as his own.

* * * * *

It is also a fact that the yacht is registered on the books of the Royal New Zealand Yacht Squadron at Auckland in the name of J. W. S. McArthur, and the entry is supported by an affidavit of McArthur that it is his own property. It is also registered in McArthur's name with the Customs Department. These facts should be considered in the light of the evidence, cited later, as to McArthur's unfinancial position a few years ago. McArthur now signs documents as sole attorney for Pacific Exploration, Ltd.

(5) *Farms and Farmlets, Ltd.*—This is a private company. The shareholders are W. C. Hewitt, solicitor, and his wife. Hewitt is largely occupied in legal work for McArthur and his companies. He is now in Sydney, New South Wales, with McArthur. The company has registered with the Registrar of Companies at Auckland an issue of bearer debentures—500 of £200 each: total, £100,000. It is the largest shareholder in the British National Trust, Ltd., of Canberra, by virtue of its holding of 51,200 shares of £1 each.

(6) *Financial Publications, Ltd.*—This company publishes a monthly magazine, *The Financial Review*, to give financial advice to investors and to disseminate information on financial matters. Its directors are: C. J. Lovegrove, R. S. Abel, and Richard Glover-Clark. One or other of these men is interested in each of the New Zealand investment trusts described herein. Its balance-sheet as at 6th March, 1934, shows a paid-up capital of £54, but its “sundry creditors” appear as £6,101. The year’s profit and loss account shows that its total revenue from “Subscriptions, sales, and advertising and inquiry fees was £171.” It nevertheless completed its year with revenue disbursements of £5,739, including “£350 directors’ fees,” the result being a net loss of £5,568.

(7) *Transfers of Shares in Affiliated Companies.*—Transfers of shares between members of the foregoing group are fairly frequent, and sometimes for large parcels. As illustrating the possibilities in this connection, we would refer to the following facts culled from official records in the offices of the Registrar of Companies and Stamp Duties Department:—

In Company Registration Offices—

Return of allotments filed 3rd March, 1933, by British National Investment Trust, Ltd. (New Zealand), ordinary shares of 2s. each allotted to—

C. G. Alcorn	..	49,598	} Paid up to 2½d. per share (twopence and two-fifths of a penny).
J. W. S. McArthur	..	190,395	

239,993

On 2nd March, 1933, McArthur bought 9,000 such shares from Investment Securities Association, Ltd., for £100.

In Stamp Duties Office, 26th March, 1933—

Requisition No. 21221 for stamping transfer of shares in British National Investment Trust, Ltd. (New Zealand)—

	Stamp Duty paid.
	£ s.
From C. G. Alcorn 49,848 shares 2s. each, sold at over £1 each ..	200 19
From J. W. S. McArthur 199,395 shares 2s. each, sold at over £1 each	803 12

The transferee in each case is the British National Trust (Canberra).

The consideration money was expressed as £287,000, or *over ten times* the nominal value, and *over eighty times* the paid-up value of shares allotted three weeks previously.

It is noteworthy that at the date of this transfer, J. W. S. McArthur was managing director of the purchasing company (domiciled in Canberra), which is an investment trust operating in Australia. The latest return filed by this purchasing company in New South Wales shows its total paid-up capital as £65,007, or less than one-fourth of the consideration money for these shares.

PART V.—J. W. S. McARTHUR: THE PERSONAL FACTOR.

This man controls the four main investment trusts of the group—two in New Zealand and two in New South Wales.

In the year 1930 he was financially embarrassed. He was interested in and controlled a group of timber and afforestation and allied companies, as intermeshed in proprietorship and transactions as the group of investment trust companies described herein. He owed £3,000 to the State Forestry Department; legal proceedings were instituted and judgment was obtained against him; he wrote admitting inability to pay, and suggested paying off £350 per annum out of his director’s fees. A bankruptcy notice was issued against him. In July, 1932, at the latest moment possible if bankruptcy were to be averted, he paid the whole amount in cash. (*Vide* files of State Forestry Department and of the Crown Solicitor at Auckland.)

* * * * *

The foregoing pages have revealed the extent to which Mr. J. W. S. McArthur is involved in the control and operations of the Investment Executive Trust of New Zealand, Ltd., and its affiliates.

In this connection, it is, in our opinion, an important, disquieting fact that many of the liquid investments of the Investment Executive Trust of New Zealand, Ltd., are held either in the name of J. W. S. McArthur personally, or in the name of vendors from whom McArthur holds a power of attorney. This power of attorney is full and unqualified, and permits McArthur to effect transfers of the shares and investments of such vendors, when and to whom he pleases.

It is true that holding companies like the Investment Executive Trust of New Zealand, Ltd., are compelled to appoint a trustee or trustees to hold in their own names shares, stock, and other forms of security issued by corporations which will not place the names of other corporations on their share ledgers or stock and debenture registers. A recognized safeguard is to appoint at least two directors or officers of known integrity to act as trustees, and to adopt, for safe custody of the scrip, checks devised and required by an experienced auditor.

* * * * *

No effective audit of the companies controlled by Mr. J. W. S. McArthur and his associates is possible, unless it is a comprehensive and contemporaneous audit of all these companies made at a common date.

PART IV.—OUR POWERS ARE LIMITED.

All the timber, plantation, and bond-issuing companies have assisted us in our inquiries, and have given us all the information we require, except the group controlled by J. W. S. McArthur and his associates.

All the investment trusts have responded to our invitation to co-operate with us and give us information, except the McArthur group.

The New Zealand Investment Trust, Ltd., of Wellington, instructed its solicitors, secretary, and a director to appear before us; they gave us all the information we required, and offered to disclose all details of their portfolio of investments to any independent auditor of standing whom we chose to nominate, and to permit him to report to us.

We approached the Investment Executive Trust of New Zealand, Ltd., in the same spirit, with the same request for amicable co-operation, and we received from their solicitors, Messrs. Hampson and Wiseman, of Auckland, a letter dated 21st May, 1934, containing the following, under the heading "New Zealand Redwood Forests, Ltd.":—

"The fact that this inquisition is sought by your Commission compels us to state in clear and unequivocal terms that our client company will not disclose to a hostile, biased, and interested Commission, which has been declared to be not a judicial tribunal, the business of this company of four years ago or to-day."

Under the heading "Investment Executive Trust of New Zealand, Ltd.," in the same letter, the writers say:—

"It is clear that as your Commission desires to discredit Mr. McArthur as chairman of directors of New Zealand Redwood Forests, Ltd., different treatment cannot be expected to be accorded to Mr. McArthur, as managing director of the Investment Executive Trust of New Zealand, Ltd. We are instructed by this company that it adopts the same attitude as New Zealand Redwood Forests, Ltd."

The writers of this letter are the solicitors who acted for the parties who made application to the Supreme Court recently for a writ of prohibition against this Commission of Inquiry.

Our present order of reference does not authorize us to inquire into the nature and effect of the transactions we have referred to herein, except to establish general principles. After the judgment of the Full Court was delivered, counsel for the Crown (Mr. J. B. Callan, K.C.) advised us, *inter alia*, that—

". . . the Commission is a Commission set up merely for the purpose of searching for and suggesting remedies to evils which the Government believes to exist; that it is not the purpose of the Commission to ascertain which companies or individuals have been following undesirable practices, or, alternatively, which companies or individuals have entirely clean hands. It does not, however, follow that the Commission is not to inquire into the doings or misdoings of individual companies. On the contrary, no Commission can intelligently suggest remedies unless it knows sufficiently the nature of the evils and abuses to be prevented. And it cannot know the nature of evils or abuses in the abstract. It has to make their acquaintance in concrete facts and happenings. For this reason, and this reason only, it is forced to inquire into the affairs of individual companies."

In these circumstances, we have had a difficult task in shaping our policy and procedure towards the affairs of the two groups of companies referred to. These companies have, through their solicitors, refused to co-operate with us on any amicable basis, and have, in our opinion, watched every move we made with a view to attacking our procedure and securing at least delay by a further application to the Court.

In the affairs of these companies the line between inquiries which lie within the limits of the proper exercise of our power and inquiries which transgress those limits, cannot be drawn with precision. In many instances it seems to us that their propriety could be determined only by reference to the motives and objects underlying each particular line of inquiry.

Furthermore, we submit that the matters properly within the scope of our order of reference tend, as to moral gravity and urgency, to be overshadowed by the issues raised by the facts herein set out.

These issues, in our opinion, call for immediate further inquiry and action in the interests of the debenture-holders in particular, and of the community in general.

Our legal position under the Commissions of Inquiry Act, 1908, as interpreted by the Full Court is so delicate (in relation to disaffected companies) that we are reluctant to pursue such further inquiries under our existing powers.

PART VII.—NEED FOR URGENCY.

There is evidence that the financial and administrative control of the investment trusts of New Zealand are being transferred to Sydney, New South Wales.

(1) *Financial Control*.—By the transfer of shares, Alcorn and McArthur to British National Trust, Ltd. (Canberra), referred to on page 11 hereof, the share control of the British National Investment Trust, Ltd. (N.Z.), is transferred to New South Wales. The Canberra company now holds 249,000 out of 250,000 ordinary shares in the New Zealand company.

In May, 1934, Alcorn and McArthur transferred to the Southern British National Trust Co., Ltd. (Sydney, New South Wales) 194,000 shares in the Investment Executive Trust of New Zealand, Ltd. The Sydney company now holds 194,000 out of 250,000 shares in the Investment Executive Trust of New Zealand, Ltd.

(2) *Personal Control*.—In the last few months the following persons have left New Zealand for New South Wales :—

J. W. S. McArthur, managing director of the Investment Executive Trust of New Zealand, Ltd., British National Investment Trust, Ltd. (New Zealand), Southern British National Trust of Sydney, N.S.W., and of British National Trust (Canberra).

H. C. Glasson, secretary of the Investment Executive Trust of New Zealand, Ltd., and several other companies controlled by McArthur.

M. C. O'Neill, the auditor of the Investment Executive Trust of New Zealand, Ltd.

W. C. Hewitt, solicitor to several of the companies herein referred to, and one of the two shareholders in Farms and Farmlets, Ltd.

(3) *Daily Telegraph Building, Sydney*.

* * * * *

This building seems to be the financial kernel of the whole group of McArthur's financial companies, and the work of reconstruction is being pushed on rapidly. The financial scheme of all the companies seems to be a gamble on this speculation, the money of innocent bond-holders being committed to it.

(4) *Possible Financial Readjustments and "Doctoring" of Records*.—The desirability of urgency is strengthened by the possibility that certain financial arrangements and documentary adjustments are now in train or contemplated. These may take the form of financial rearrangements and manipulation of records, with a view to placing certain transactions or the general position in a more favourable light. The Investment Executive Trust and its affiliated companies are still operating actively.

PART VIII.—OUR RECOMMENDATION.

It is because we believe that our conclusions will commend themselves to Your Excellency and your Advisers, that we are submitting this interim report.

We humbly submit that a case is made for consideration of the advisability of appointing some Inspector or body of Inspectors with power to inquire fully into these matters, to demand full disclosure of books and documents, and to report as directed, with a view to such further action as should be deemed to be necessary. This procedure would seem to require legislation.

We recommend accordingly.

We now resume our inquiries into the general matters to which our Warrant of appointment has directed us, with a view to submitting our report thereon as soon as possible.

Dated at Auckland, this 9th day of June, 1934.

We have, &c.,

JOHN S. BARTON, Chairman.

H. BELSHAW,

F. E. GRAHAM,

} Members of Commission.

To His Excellency the Governor-General, Dominion of New Zealand.

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