

1934.  
NEW ZEALAND.

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## COMMISSION OF INQUIRY INTO COMPANY PROMOTION METHODS, ETC.

(SECOND INTERIM REPORT OF COMMISSIONERS).

*Presented to both Houses of the General Assembly by Command of His Excellency.*

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MAY IT PLEASE YOUR EXCELLENCY,—

### INTRODUCTORY.

We beg respectfully to refer to the Companies (Special Investigations) Act, 1934, and to our interim report dated the 9th day of June, 1934.

The enactment provides, by section 2, that Your Excellency may add to the Schedule thereof the name of any company in respect of the affairs of which we, your Commissioners, recommend an investigation. The first interim report [H. 25], at page 12, contains a reference to a group of timber-plantation and bond-issuing companies controlled by Mr. J. W. S. McArthur as a group which had not assisted us in our inquiries. On the same page we quote, from a letter which we received from the solicitors of that company, the following words which were contained in the letter 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.”

Whilst we were thus refused co-operation or assistance by this company, it was of no advantage that we should seek information from any lesser member of the group.

We wish to say, however, that we have obtained full assistance and ready co-operation in our inquiries from the original trustees for the debenture-holders of the Redwood Co.—namely, the New Zealand Insurance Co., Ltd.—and also from the two new trustees, Messrs. T. H. Dawson and L. Knight. Officers of the New Zealand Insurance Co., Ltd., and also Messrs. Knight and Dawson, have attended upon request and have answered all our questions and given us all the information that we have required of them relating to the subject-matter of our inquiries.

We are writing and submitting this second interim report because we are of opinion that an investigation should be made forthwith of the affairs of the said New Zealand Redwood Forests, Ltd., and certain other companies referred to in detail hereafter, these being companies associated through common directors and shareholders or through reciprocal transactions with either New Zealand Redwood Forests, Ltd., or certain companies named in the Schedule of the said Act.

## PART I.

## (a) NEW ZEALAND REDWOOD FORESTS, LTD., AS A BOND-ISSUING COMPANY.

This company is one of a number of companies which will be referred to in our final report under the generic description of "Land Utilization Companies." It is one of the class which raises the bulk of its capital by the issue of so-called "bonds" or debentures.

This company, on the 1st September, 1925, issued a prospectus of a debenture issue of 6,000 profit-participating forest debentures of £35 each. A copy of this prospectus is attached hereto [Prospectus not printed]. In the said prospectus the purposes of the issue are stated thus:—

"The proceeds of this issue will be allocated as follows:—

- "(a) £21 per Debenture fully paid up to be set aside to provide an Investment Fund and Realization Reserve in accordance with the terms of a Trust Deed dated the first day of September, 1925, with the N.Z. Insurance Co., Ltd., as Trustees for the Debenture-holders.
- "(b) £4 10s. per acre to reimburse the Company for the actual cost of 6,014 acres (approximately) of freehold land.
- "(c) The balance of the proceeds will be applied to the cost of seed, establishment of nursery, clearing, preparing, and planting the land in trees, . . . ." (and all incidental processes and works).

The company covenanted to plant in forest trees at least 1 acre for each debenture fully paid up.

The company therefore sought to raise the sum of £210,000 from the public. According to the above statement, this would be utilized as follows, and in the order given:—

(1) To carry out through all its processes the afforestation scheme which the company undertook to carry out, £9 10s. per acre	£
(or per debenture) . . . . .	57,000
(2) To recoup the company the cost of purchase of 6,000 acres of land at £4 10s. per acre (or per debenture) . . . . .	27,000
(3) Investment Fund and Realization Reserve, £21 per acre (or per debenture) . . . . .	126,000
	<hr/>
	£210,000

The debentures contain a covenant by the company to repay the sum of £35 in respect of each debenture, provided that if the company duly carries out its obligations to plant and maintain the forest and facilitate the realization of the forest at the end of the stipulated period, the debenture-holders must look to the proceeds of the forest for the return of this money. For better securing the payment of all moneys owing on the security of the debentures, and the observance and performance of all covenants and conditions of the debentures, the debentures gave a floating charge over all the property and assets of the company both present and future.

The prospectus announced that the New Zealand Insurance Co., Ltd., was the trustee for the debenture-holders. The company undertook (in the prospectus) to transfer to and vest in the trustee for the debenture-holders all its estate and interest in the lands (later described in the prospectus) on which the forests were to be grown; and, further, that the above-mentioned sum of £21 per debenture (£126,000 in all) would be invested by New Zealand Redwood Forests, Ltd., in trustee securities. These were to form an Investment Fund and Realization Reserve in the name of the New Zealand Insurance Co., Ltd. The debenture-holders were given the right to elect one director of the company, and George William Hutchison, a public accountant of Auckland, was announced in the prospectus as the first director representing the debenture-holders.

According to the prospectus a Realization Board is to be set up at any time between 31st December, 1940, and 31st December, 1950. This Board is to assume control of the said lands and forests and proceed with their realization and disposition in accordance with directions given by the debenture-holders.

The prospectus contains the statement that the New Zealand Redwood Co. had, at the date of the prospectus, purchased three valuable properties, and a locality plan showed the site as being close to Putaruru on the Auckland–Rotorua Railway and having a total of approximately six miles of railway frontage. The land is described in the prospectus in three parcels:—

Block.	Area in Acres.	Vendor.	Purchase Price.	Instalment already paid.	Terms regarding Balance.
1	2,082	Selwyn Timber Co., Ltd.	£   s.   d. 9,371   10   0	£ 4,825	Balance payable in three years with interest at 6 per cent. with right to pay off all or any part at any time without notice.
2	2,777	Beulah Land Co., Ltd.	12,496   12   0	7,225	Ditto.
3	1,155	J. W. S. McArthur   ..	5,197   10   0	3,025	„
	6,014		27,065   12   0	15,075	

On the same page the prospectus states that J. W. S. McArthur, one of the vendors, had applied for and had been allotted 16,150 shares in the company, and that the Selwyn Timber Co., Ltd., one of the vendors, had applied for and had been allotted 12,500 shares in the company. Lower down on the same page the statement is made that the directors had allotted 30,600 shares paid up to 10s. per share.

The company had an authorized capital of £40,000 in 40,000 shares of £1 each, and the prospectus states that the preliminary expenses of and incidental to the formation and establishment of the company and until the company should commence business were estimated to amount to  $2\frac{1}{2}$  per cent. of the nominal capital of the company. A calculation shows that this estimate of preliminary expenses is £1,000.

(b) BROKERAGE ON DEBENTURES.

In the prospectus, under the heading “Brokerage and Flotation Costs,” there appears the statement:—

“The company has subscribed sufficient capital to pay the costs of the formation and establishment of the company and to pay the expenses of this debenture issue, including brokerage and commission.”

In this connection it should be noted that there is no authority anywhere for the deduction of “brokerage” or “commission” from the debenture-moneys. The foregoing allocation of the debenture-money accounts for the full £35 per debenture, without any reference to brokerage or commission. It is true that by clause “firstly” of the trust deed the company may apply any money not required for the stipulated purposes of the first £9 10s. to such purposes as the directors may determine. It is certain, however, from the history and accounts of the company that that position has never arisen. This most important matter is referred to again on page 4 hereinafter, under the heading “Brokerage and Selling Costs.”

In the prospectus there is also a disclosure of the interest of directors. This purports to be in compliance with the Companies Act, 1908, and is in the following words:—

“J. W. S. McArthur (one of the directors of the company) is the promoter of the company, and was interested in the promotion of the company and in the property purchased by the company to the extent of his interest as shareholder in both the Selwyn Timber Co., Ltd., and the Beulah Land Co., Ltd., and as the vendor of the lands described as Block III.”

\*             \*             \*             \*             \*

We have above briefly set out the salient features in the constitution of this company and its promotion scheme as a company having a share capital and issuing to the public a prospectus for debentures. In Part III of this report a comparison will be made between these various statements in the prospectus and the actual facts as disclosed to us by the transactions themselves.

(c) THE NATURE OF THE CONTRACT BETWEEN THE COMPANY AND THE  
BONDHOLDER.

The instruments offered to subscribers who act on the offer made in this prospectus are described as debentures. They are not debentures in the ordinary sense of the term; they are, in fact, rather hard to classify. They are not evidence of a debt unconditionally due or necessarily due by the New Zealand Redwood Forests, Ltd. The real nature of the instrument seems to be that it is a memorandum of a contract between the holder and the Redwood Co., the terms of the contract being as follow:—

The holder undertakes to pay the sum of £35 to the company. In consideration of this payment the company (1) warrants (a) that it has bought the land in question, and (b) that it has subscribed sufficient capital to pay the costs of formation and establishment of the company and the expenses of the debenture issue, including brokerage and commission; and (2) undertakes to plant that land with redwood trees; and (3) to maintain the forest thus planted; and (4) eventually to hand over land and forest to the Trustee for the debenture-holders or to the Realization Board. Land and forest are then to be sold or otherwise disposed of to the best advantage, and the net proceeds are to be applied, firstly, in repayment of the amount of the debenture, £35. Of the remainder, 90 per cent. is to go to the debenture-holders, and 10 per cent. to the company. Unless the forest planting and selling venture is sufficiently successful, the debenture-holders will not receive the return of their £35 per debenture. If the Redwood Company carries out its undertaking to acquire, clear, and plant the land, and tend the forest till it comes to maturity, it has done all it has undertaken to do; it is entitled to retain, either as the cost of the foregoing processes, or as profit, the whole of the £35. The question of whether a debenture-holder will get back £5, £35, or £350 for his debenture, therefore, depends entirely on the commercial success of the afforestation scheme. The security by way of floating charge was a security to ensure the due performance of the company's warranties and obligations with regard to the acquisition of the land and the planting, care, and supervision of the forests.

(d) BROKERAGE AND SELLING COSTS.

We have pointed out on page 3 hereof that the debenture prospectus warrants that the Redwood Co. has subscribed sufficient capital to pay (*inter alia*) "the expenses of this debenture issue, including brokerage and commission," and that under the heading "Purposes of this Issue," it sets out the allocation of the £35 of each debenture, with no reference to "brokerage."

Nevertheless, the company has made substantial payments by way of expenses of debenture issue, brokerage, and commission, and has paid these *out of the debenture-money, treating these payments as a first charge upon the debenture-moneys as received*. These payments amount, in the aggregate, to many thousands of pounds, being, according to the evidence submitted to us, over 15 per cent. of the debenture-money received.

This wrong use of the debenture funds is perhaps the most potent single factor in bringing the company to its present position. That position is that the company cannot carry out its existing obligations to its debenture-holders without the assistance of funds procured by the sale of further debentures.

## PART II.

## A BRIEF OUTLINE OF THE GROUPING OF COMPANIES HEREIN REFERRED TO.

The foregoing description of the financial constitution of the Redwood Co. introduces the Selwyn Timber Co., Ltd., and the Beulah Land Co., Ltd., as vendors of land to the New Zealand Redwood Forests, Ltd. These three companies are thus linked by this transaction, and also by the fact that J. W. S. McArthur, promotor, director, and principal shareholder in the Redwood Co., held a controlling interest as shareholder and managing director of the Selwyn Timber Co., Ltd. In addition, the Selwyn Timber Co., Ltd., held over 97 per cent. of the shares in the Beulah Land Co.—J. W. S. McArthur and members of his family also being shareholders.

The Selwyn Timber Co., Ltd., went into liquidation in June, 1930, and its affairs were finally settled by an arrangement made with a new company incorporated under the name of Wynsel Timber Co., Ltd. This company is the successor of the Selwyn Co. Operations and transactions between New Zealand Redwood Forests, Ltd., Selwyn Timber Co., Ltd., and Wynsel Timber Co., Ltd., on the one hand, and the Sterling Investments Co. (New Zealand), Ltd., and Wynwood Investments, Ltd., on the other hand, tend to link up this group with the group of investment trust companies referred to in our first interim report. Edgecumbe Forests, Ltd., and Kotahi Lands, Ltd., were both incorporated in 1926, and they became connected with the present group of companies by important transactions during the year 1930, particularly with Redwood Forests, Ltd. At the time these transactions were put through, the directors of Edgecumbe Forests, Ltd., were J. W. S. McArthur, M. H. Hampson, and W. L. Wiseman. At the same time, Messrs. McArthur and Hampson were directors of New Zealand Redwood Forests, Ltd., whilst Messrs. Hampson and Wiseman were solicitors to both companies. At this time, also, the shareholders in Edgecumbe Forests, Ltd., comprised three other companies in the present group, viz., Overana Land Co., Ltd., Modern Homes, Ltd., and Selwyn Timber Co., Ltd. The shareholders in Kotahi Lands, Ltd., in 1930 were Edgecumbe Forests, Ltd., M. H. Hampson, and J. W. S. McArthur.

We now refer to Modern Homes, Ltd.: This is a private company incorporated on the 19th day of July, 1923. In 1932 it was a shareholder in Sterling Investments Co. (New Zealand), Ltd. In the year 1930 it was used by Mr. J. W. S. McArthur to facilitate an important share transaction affecting New Zealand Redwood Forests, Ltd., Selwyn Timber Co., Ltd., and Edgecumbe Forests, Ltd. At that time the principal shareholders in Modern Homes, Ltd. were Mr. J. W. S. McArthur and Mrs. E. M. McArthur. Other shareholders were Mr. H. C. Glasson, Secretary of New Zealand Redwood Forests, Ltd., and Mr. W. L. Wiseman, one of the firm of solicitors to New Zealand Redwood Forests, Ltd.

We refer also to Overana Land Co., Ltd., another company of the group. This company was registered as a private company at Auckland in February, 1916. The memorandum of association was subscribed by M. H. Hampson, K. H. Hampson, Arthur Overall, and S. J. Overall; the capital being £1,450 in fifty-eight shares of £25 each. At the time of the transactions herein referred to the whole of the shares in the company were held by M. H. Hampson and Katherine H. Hampson.

The positions and relationships of other companies affected by this report will appear in the history of transactions set out hereinafter.

## PART III.

## SOME TRANSACTIONS OF THE GROUP.

I. (a) *New Zealand Redwood Forests, Ltd.*

The debenture scheme set out in the foregoing description of the New Zealand Redwood Forests, Ltd., was varied in the year 1930. A proposal was put to the debenture-holders in February of that year. A letter above the name of W. McArthur, chairman, was sent to each debenture-holder, briefly setting out the details of a proposed reconstruction scheme, which was more fully described in a circular which accompanied the letter. The circular stated that the reconstruction

scheme was put forward because recent developments had shown that certain advantages would follow the acquisition and planting of a larger acreage than the 6,014 acres originally purchased; and, further, that it had been proved that profitable by-products of redwood trees could be manufactured. The scheme, in brief, was that the company should acquire further parcels of land and plant them in redwoods. The debenture-holders were asked to surrender their existing interest-bearing debentures and accept under the new scheme in place thereof two non-interest-bearing debentures in respect of each of which an acre of trees would be planted and maintained. If adopted, this scheme would double the area to be planted, and give to each of the original debenture-holders two debentures for each one originally subscribed for. As already pointed out, the original debentures entitled the holders to interest, whilst the new debentures were to be non-interest-bearing. As the debenture-holders were scattered and it was not practicable for the greater number of them to attend a meeting, they were invited to assign their existing debentures to two proposed assignees named by the company, Messrs. Kenneth Seymour Cox, of Ongaroto, near Putaruru, run-holder, and William Lyall Wiseman of Auckland, solicitor, and an instrument of assignment designed to effect the transfer of debentures for this purpose was enclosed with the circular letter. If the scheme were carried, an alteration was to be made in that proportion of the debenture-money which, by the original scheme, was to be held as an Investment Fund and Realization Reserve. Under the original scheme, the sum of £21 out of each fully-paid debenture of £35 was to be held by the trustees to provide an Investment Fund and Realization Reserve; but under the new scheme this was reduced to £7 per debenture, whilst the other £14 was to be vested in New Zealand Redwood Forests, Ltd. A meeting of debenture-holders was held on the 11th September, 1930, at which were present officers of the Redwood Co., and of the New Zealand Insurance Co., Ltd., as trustee, counsel for various parties, and about thirty debenture-holders. There was a great deal of opposition to the scheme, and both before and at the meeting many allegations detrimental to the scheme and its sponsors were freely made. A resolution approving of the scheme was put to the meeting, a poll being taken. The result was that the resolution was carried; the votes exercised by Messrs. Cox and Wiseman as assignees of debentures represented a total of £53,787, whilst all the remaining votes cast represented a total of £14,579. This resolution was, at a later date, after abortive litigation, acted upon.

Prior to this meeting, the New Zealand Insurance Co., Ltd., had stated that it was not prepared to continue to act as trustee if the scheme were carried. A new trust deed had therefore been prepared, and two reputable professional men in Auckland had been named therein as trustees. The New Zealand Insurance Co., Ltd., withdrew from the trust on the carrying of the resolution, and the new trustees took over, as the new trust fund, an amount equal to £7 per debenture of the debentures originally subscribed for. The balance of the Investment Fund and Realization Reserve reverted to the company. This scheme is further referred to hereinafter on page 10.

*(b) Preliminary Expenses of Redwood Co.*

We refer on page 3 of this interim report to two statements contained in the prospectus of this company relating to preliminary expenses, and estimating their total at £1,000.

The statutory report and balance-sheet filed with the Registrar of Companies show that by June, 1926, the preliminary expenses of the company had been paid to an amount of £5,095, whilst it was estimated that there was a further sum of £2,000 to be paid under this heading. It is difficult to understand the necessity for this expenditure, for (with negligible exceptions) the only shares subscribed for were those allotted to the subscribers of the memorandum, and to the Selwyn Timber Co., Ltd., and its nominees, in exchange for the land taken over by the Redwood Co. We have evidence that this £7,000, preliminary expenses, includes substantial payments to J. W. S. McArthur out of money paid in by debenture-holders; and that Mr. McArthur's claim to this money is in respect of travelling and other expenses incurred by him (prior to the formation of the Redwood Co.) on visits to America and Australia to procure information and make arrangements preparatory to the formation of the company. There is no disclosure of this alleged claim in the prospectus.

*(c) Further Non-disclosure in Prospectus.*

On the issue of the prospectus of New Zealand Redwood Forests, Ltd., the three parcels of land to be acquired and planted were subject to a mortgage of over £11,000, and J. W. S. McArthur was personally liable for this sum. There is no disclosure of this fact in the prospectus.

*(d) Land Transactions.*

(1) The three parcels of land described in the prospectus were all contiguous. In equity they were the property of the Selwyn Timber Co., Ltd. The interest of New Zealand Redwood Forests, Ltd., in them was evidenced by three separate memoranda of agreements for sale and purchase dated the same day as the prospectus. The land was fairly heavily encumbered, the parcels and boundaries to be conveyed to the Redwood Co. by the Beulah Co. were not defined, and the block in McArthur's name was Native land, the title to which required a great deal of legal work and consideration by the Native Land Court before any dealing with it could be registered. Nevertheless, the Redwood Co. straightway exchanged cheques totalling over £15,000 with the Selwyn Timber Co., Ltd. These represented payments of instalments on the land on the one hand, and payment of 10s. per share on about 31,000 shares of £1 each allotted to the Selwyn Timber Co., Ltd., and its nominees, on the other hand. With no change in this position, other than the receipt of debenture-moneys, tree-planting on a large scale was undertaken on this land, and a substantial amount of purchase-money was paid in cash to the Selwyn Co. to enable it to pay calls on shares held in Mr. McArthur's name.

(2) When Block 2, which was the land sold by the Beulah Land Co., Ltd., was ultimately transferred to the Redwood Co. in October, 1931, an area of over 100 acres was excluded from the total area of 2,353 acres covered by the certificate of title. This area of about 100 acres was known as the "Mill Site." It was centrally situated in the whole area purchased, and strips giving access to it were also excluded from the area transferred to the Redwood Co. The only means of identifying the land thus transferred, with the land purported to be described in the original memorandum of agreement, is by reference to the block survey number, and the total acreage agreed to be transferred. The selection of the portion to be excluded was apparently within the discretion of Mr. McArthur, who was managing director of both vendor and purchaser companies. The part actually excluded was the most valuable of the whole, because of the mill and equipment upon it.

*(e) Exchanging of Cheques.*

It is stated in the prospectus that instalments totalling over £15,000 had been already paid on the land there described. Later there is an unrelated statement: "The Directors have allotted 30,600 shares paid up to 10s. per share."

The justification for these statements is the exchanging of cheques between the Redwood Co. and the Selwyn Co. referred to in paragraph (d) (1) above—a transaction which took place over two months after the issue of the prospectus.

*(f) Extravagance and Mismanagement.*

During 1928 and 1929 the Redwood Co.'s financial position became desperate. The balance of purchase-money had fallen due, as had the mortgage on the lands; neither the Redwood Co. nor the Selwyn Co. could raise the money. The mortgagee was threatening to exercise his power of sale. The bank had stopped the company's credit, and wages of workmen at the company's nursery were in arrears. It is true that lapses of debentures by non-payment of instalments were heavy, and this was a substantial contributing cause of the trouble. On the other hand, however, substantial sums paid by the debenture-holders in Australasia and India seem to have been wasted by extravagance, mismanagement, and unjustifiable payments, whilst heavy brokerage had been made the first charge upon the debenture-holders' money. We exemplify these practices as follows:—

(1) *Double-payment of Rates.*—In November, 1928, the Matamata County Council threatened to sue for £133 for rates due on one of the blocks. It transpired that the amount of these rates had been duly paid by the Redwood Co. to the Selwyn Co., but that company had not paid them to the rating authority. The Redwood Co. had to pay again.

(2) *Payment of McArthur's Personal Liability.*—Early in 1928 J. W. S. McArthur went to India to open a debenture-selling campaign, and he was there for about one year. He there launched a personal libel action against a firm of brokers who attacked the methods adopted on behalf of the Redwood Co. He cabled to New Zealand for authority to bring this action in the company's name. This was refused. The directors were opposed to it, and the company's solicitors advised against it strongly. The directors cabled accordingly. McArthur cabled in reply, "Am consequently maintaining private suit." Some months later, McArthur cabled requesting money for purposes of the action, and the directors cabled refusing the request, and adding "Case proceeded with in opposition Board's instructions, therefore all costs your personal liability." The action was abortive, and the costs were over £5,000. On McArthur's return he procured the passing of resolutions by the directors; these ratified his actions and agreed to pay the costs out of the company's funds. This seems to be a payment, *ultra vires* of the company, of the costs of an action to which it was not a party.

(3) *First Instalment of McArthur's India Expenses.*—When Mr. McArthur was instructed to visit India, the directors of the company voted him the sum of £400 to cover his expenses. That sum was very greatly exceeded, and we have evidence that no proper accounts were ever submitted by Mr. McArthur to show the details of this expenditure, but that he simply retained what he required out of the proceeds of debentures sold in India.

(4) *Second Instalment, McArthur's India Expenses.*—In addition to his expenditure from debenture-money, Mr. McArthur, whilst in India, procured remittances from the Selwyn Timber Co., Ltd., amounting to over £1,000 for his travelling and personal expenses. A demand for refund was made by his co-directors of the Selwyn Co. after his return, and McArthur stated that it was "clearly the liability of the Redwood Co." The directors of that company refused to recognize the liability, but after the change of directors, hereafter referred to, the amount was paid by the Redwood Co.

(5) *India Travelling Expenses paid by Selwyn Co.*—During the year in which Mr. McArthur was absent from New Zealand, he was wholly on the business of the Redwood Co. He nevertheless drew from the Selwyn Co. a sum of over £1,000 as "salary and travelling-expenses." This is in addition to the sum of £1,000 referred to in paragraph (4) above. The Redwood Co. is interested in this matter, for in 1929 neither McArthur nor the Selwyn Co. were able to pay the calls due on their Redwood shares levied at the instance of the bank.

(6) *Selling-costs in India.*—The costs of selling the company's bonds in India (including McArthur's expenses) were very heavy. We have evidence that at a point of time when the total amount actually paid by the debenture-holders in India had reached approximately £30,000, the amount remitted to New Zealand was less than that part of the amount paid which was to go to the trust fund. If this is so, it means that the whole of those constituent parts of the debenture-money which were to be allocated to purchase of land and planting and maintenance of forest had been dissipated in selling-costs and expenses.

(7) *Misapplication of Investment Fund.*—On the 6th June, 1928, in response to a cable which the secretary in Auckland had sent, under pressure from the bank, Mr. McArthur cabled the sum of £1,000 from India to reduce the bank overdraft. This was remitted without comment or instructions, and it was some months later that the directors found, on checking Indian statements, that the money belonged to the Investment Fund and Realization Reserve—i.e., the Trust Fund.

(8) *Directors' Instructions ignored.*—After Mr. McArthur's return from India he was unable to pay the calls due on his shares in the company, and his seat on the Board was liable to be vacated if these calls were not paid by 31st March, 1929. He asked that payment of the balance of purchase-money on the block of land of which he was nominal vendor should be made by the company so that he might pay the calls therewith. Accordingly, the directors passed a resolution on 28th March, 1929, authorizing the payment. The resolution concluded, "And that the Secretary be authorized to instruct the company's solicitors to prepare the necessary transfer and that upon the same being executed a cheque for the amount required be handed to Mr. McArthur." No transfer was executed, and none could have been executed, for no such dealing with the (Native) land was then possible. Nevertheless, Mr. McArthur procured the cheque, and paid the calls before the end of the month.



*(g) Change in Directorate.*

We have evidence to the following effect :—

In 1929 when the mortgagees of the land on which the forests were planted were threatening to exercise their power of sale, Mr. McArthur proposed to meet the position by an investment of the "trust funds." Although the New Zealand Insurance Co., Ltd., was trustee for the debenture-holders, the trust deed contained the peculiar provision that the investment of the funds was to be made by the Redwood Co. and the instruments of security handed over to the trustee. Mr. McArthur's suggestion was that the directors should lend £12,000 of the trust funds to the Selwyn Co. so that that company could thereby pay off the mortgage on the land, including overdue interest. This proposition was put forward more than once by Mr. McArthur, but strongly resisted by the other directors, including Mr. G. W. Hutchison, the debenture-holders' representative on the Board. McArthur also proposed to take the steps necessary to alter the articles of association so as to give the company power in general meetings to postpone payment of calls in arrears. He proposed further to place the office arrangements of the Redwood Co. in the hands of the secretary of the Selwyn Co., dispensing with the services of Mr. Twigden, who was the Redwood secretary, and requiring Mr. Glasson, the Selwyn secretary, to take over the secretaryship of both companies. These proposals were objected to by the other directors. Mr. McArthur then announced that he thought that the number of directors should be increased from four to six, and that it was his intention to propose that Messrs. Hampson and Hockly, who would shortly become shareholders, should be added to the Board. Mr. G. W. Hutchison, debenture-holders' representative, expressed concern at these proposals, and pointed out that with Messrs. Hampson and Hockly as the Chairman's nominees, Messrs. Wallis, O'Brien, and himself could be outvoted at a directors' meeting; and that in view of the fact that Mr. McArthur held a preponderance of shares he could carry any resolution at a shareholders' meeting, which would create an undesirable position.

At the same directors' meeting three transfers of shares were submitted to the meeting and approved. The transferor in each case was Albert Edward Olsen, and a cheque for £100 arrears of calls accompanied the transfer forms. The transferees were, respectively, Frank Franklin Hockly, 100 shares; Edgecumbe Forests, Ltd., 150 shares; and Maslin Heywood Hampson, 150 shares.

At the general meeting of the company held five weeks later a resolution to increase the number of directors was carried in spite of strong objection urged by three directors, Messrs. Hutchison, Wallis, and O'Brien. Messrs. Hockly and Hampson were then elected. The newly constituted Board met a fortnight later—viz., on the 27th September, 1929—and Mr. McArthur moved that Mr. H. C. S. Glasson be appointed secretary to the company. This was declared carried on the casting-vote of the Chairman (J. W. S. McArthur). Mr. Twigden's services were then dispensed with on an exercise of the same voting-power.

Following on this, Messrs. Hutchison, Wallis, and O'Brien resigned, and Mr. Hutchison, as debenture-holders' representative, gave notice by letter, addressed to the trustee for the debenture-holders, of the reasons for his resignation. (See pages 60 and 61 of the printed Case on Appeal, *New Zealand Insurance Company, Limited v. New Zealand Redwood Forests, Limited*, filed in the Supreme Court as Number M. 296 of the year 1930, for a copy of Mr. Hutchison's letter of resignation; and pages 183 to 188 of the same Case on Appeal for an affidavit filed therein sworn by Mr. Hutchison.)

*(h) The New Regime.*

(1) We can find no evidence of any audited balance-sheet having been prepared since the year 1929; we have, on the contrary, evidence that no balance-sheet has been prepared and audited.

(2) From about September, 1929, Messrs. Hampson and Wiseman commenced to act as solicitors for the Redwood Co., *vice* the solicitors acting formerly.

(3) *Investments*.—In the printed Case on Appeal above referred to, there appears on page 123 an affidavit by Robert King, a solicitor employed as trust officer for the New Zealand Insurance Co. Ltd. It contains the following :—

“ The following securities have been arranged by the defendant company subsequent to the resignation of Messrs. J. J. O’Brien, P. S. Wallis, and G. W. Hutchison from the board of directors of the said company, and during the period when Messrs. Hampson and Wiseman, solicitors, of Auckland, were acting as solicitors for the defendant company in place of Messrs. Earl, Kent, Massey, and Northcroft, who up to that time had prepared securities for the said defendant company :—

- “ (a) Mortgage from Kotahi Limited, £10,000.
- “ (b) Mortgage from F. O. Turner, £900.
- “ (c) Mortgage from Alexander Keys, £15,000.
- “ (d) Mortgage from P. V. Owen, £550.
- “ (e) Transfer of mortgage from Mrs. A. Endean, £2,000 at 5 per cent. per annum.”

These investments are all referred to in the affidavit of the principal officer of the Trust Department of the New Zealand Insurance Co., Ltd., commencing on page 11 of the printed Case on Appeal. It contains the following allegations, which, as far as we can learn, have never been satisfactorily answered.

That the mortgage from F. O. Turner is a dummy transaction, involving the transfer of vacant sections of land from the Selwyn Timber Co., Ltd., to Turner, a mortgage from Turner, and a payment of the amount of the mortgage, £900, in cash, to the Selwyn Timber Co. We have evidence that when, after an unsatisfactory history, the trustee-mortgagees took steps with a view to exercising their powers of sale under this security, Messrs. Hampson and Wiseman intervened, and the property was purchased by Sterling Investments Co. (New Zealand), Ltd.

That in the case of mortgages (c), (d), and (e) the securities were unsatisfactory, and in two cases rates were seriously in arrears at the time of the advance. Further, that in granting loans or purchasing mortgages in cases (c), (d), and (e) the object was not to obtain a proper investment of the trust funds, but to give some advantage to interested parties on the directorate of the Redwood Company.

We are strongly of opinion also that the transaction involved in the mortgage from Kotahi Lands, Ltd., is one that requires investigation and report.

(4) *Reconstruction Scheme*.—The evidence afforded to us by the contents of the printed Case on Appeal already referred to and the testimony of witnesses that appeared before us, supplemented by references to minutes of directors’ meetings, make it abundantly clear, to our minds, that the genesis of this reconstruction scheme is traceable to the financial difficulties of the Redwood Co. in 1928 and 1929, and the desire of Mr. McArthur to get a large portion of the debenture-holders’ trust funds into his hands to relieve the company’s necessities. In this connection, we beg to refer to the minutes of meetings of directors held on the 6th day of March, 1929 (page 2), and on the 22nd day of March, 1929 (page 12).

The reconstruction scheme as communicated to the company by Mr. McArthur’s circular and letter cleverly placed before debenture-holders the advantage of possessing two debentures, representing two acres of redwood forest, in place of one. He did point out, *per contra*, that the new debentures would be non-interest-bearing, whilst the original debentures entitled the holders to interest.

The following matters, however, came out only in the storm of discussion and opposition that arose later. Unfortunately, by the time the opposition was organized, the assignees nominated to receive transfers of debentures for voting purposes had received a sufficient number of assignments to give them a preponderance of voting-power at the meeting.

The circular sent out by Mr. McArthur gave no hint at all of the names of the vendors of the new areas of land of which he spoke in eulogistic terms. It was only later that the facts were disclosed that the land was in the name of Kotahi Lands, Ltd., and that the option to purchase was granted by Edgecumbe Forests, Ltd.

Investigation showed that the shareholders in Kotahi Lands, Ltd., were Edgecumbe Forests, Ltd., M. H. Hampson, solicitor, and John William Shaw McArthur, both of whom were directors of the Redwood Forest Co.; whilst the shareholders in Edgecumbe Forests, Ltd., included the Selwyn Timber Co., W. L. Wiseman, M. H. Hampson, H. C. Glasson, J. W. S. McArthur, and two of his relatives, and Modern Homes, Ltd. The latter company was the biggest shareholder in Edgecumbe Forests, Ltd., and was in the control of J. W. S. McArthur and his wife.

One of the proposed assignees to whom debenture-holders were asked to assign their debentures for voting purposes was Mr. W. L. Wiseman, who was one of the firm of solicitors to New Zealand Redwood Forests, Ltd., of which company he was a director. He was also, as will be seen above, a shareholder in Edgecumbe Forests, Ltd., and Modern Homes, Ltd. This man purported at the meeting to exercise in a fiduciary capacity on behalf of debenture-holders a discretion in voting on the reconstruction scheme.

The reconstruction scheme temporarily lifted New Zealand Redwood Forests, Ltd., out of its financial difficulties, for it divided the existing Trust Fund of £21 per debenture into two parts. It provided that £7 per debenture went to the new trustees, whilst the remainder was handed over to Redwood Forests. Out of that, a large sum was immediately lent by the Redwood Co. to Kotahi Lands, Ltd., and the allegation is strongly made in the printed Case on Appeal that this money found its way back to the Redwood Co. If this is true, it would seem to be the consummation of the purpose of Mr. McArthur to procure the trust funds for the repayment of the mortgage on the company's lands. This matter, in our opinion, demands close investigation by independent Inspectors.

Whilst the original debentures gave the debenture-holders a floating charge over the whole of the assets of New Zealand Redwood Forests, Ltd., this security was omitted from the new debentures.

(5) *Settlement with Selwyn Company.*—There is evidence that on the final settlement of the land-purchase transaction between the Selwyn Co. and the Redwood Co., amounts were included in the terms of the settlement requiring payment of substantial sums by the Redwood Co. where no obligation to pay existed—these payments being made for the benefit of the Selwyn Timber Co., Ltd. They resulted in a balance of some thousands of pounds due back to the Redwood Co., and after much pressure this was settled by an advance from the Sterling Investments Co. (New Zealand), Ltd., to the insolvent Selwyn Co.

(6) *Selwyn Co.'s Affairs.*—It is impossible to separate the affairs of the Selwyn Co. from those of the Redwood Co. during the years 1928 to 1934, because there are many transactions in both sets of books due to Mr. McArthur's habitual use of his position as managing director of both companies for his own ends. The transactions referred to under the immediately preceding heading are examples of these. We have further evidence of transactions recorded in Selwyn books in which Mr. McArthur was personally interested, and which (supported by entries in the minute-book showing on the face of them that such minutes are irregular and *ultra vires*) represent a gain to Mr. McArthur and a corresponding loss to the Selwyn Co. Some of these, when subsequently seriously challenged, were "settled" by the transactions being taken over by the Sterling Investments Co. These transactions took place at a time when the Selwyn Timber Co., Ltd., was unable to pay calls due to the Redwood Forests, Ltd., and that company was badly in need of money.

(7) *Debenture-holders' Directors.*—After the resignation of Mr. G. W. Hutchison, three directors were appointed to sit on the Board to watch the interests of debenture-holders. This was a commendable move, but its value has been greatly lessened by the fact that they are not shareholders, and therefore have no right to attend at general meetings.

(8) *Some Informative Resolutions.*—At a general meeting held in April, 1931, the Chairman, J. W. S. McArthur, was voted a sum of £1,755 which was charged to "Administration Account," and a further sum of £3,676 for special services since the inception of the company. It was at the same meeting that the company decided to accept liability for £1,074 advanced by the Selwyn Timber Co. to Mr. McArthur for his India expenses.

At a general meeting in May, 1932, a general ratifying resolution was passed expressing general approval of all the actions of the Chairman covering the total operations of the company; also a resolution ratifying and confirming all actions of the Chairman whether sanctioned by the board of directors or not.

A general meeting of shareholders held on the 2nd August, 1932, is worthy of attention. There were present—Mr. J. W. S. McArthur, Chairman; Mr. W. C. Hewitt, solicitor; Mr. T. R. McArthur; a clerk from the office of the Redwood Co., and another from the office of Messrs. Hampson and Wiseman, solicitors; and, finally, Mr. H. Glasson, secretary of the company. That meeting voted the sum of £3,676 to Mr. J. W. S. McArthur, the amount being described as covering—

“£914, specially referred to;

*Third instalment of McArthur's India expenses* “£1,002, further balance of expenses connected with visit to India and certain other New Zealand expenses.

“£1,760, Special services.”

(9) *Present Position of Redwood Co.*—Finally, we have evidence that in order to carry on its present work and complete its present commitments the company must either sell more debentures or, if possible, borrow.

It has made arrangements to sell debentures through the Sterling Investments Co. (New Zealand), Ltd., and has sold many debentures in this way in the last two years. From the point of view of New Zealand's credit overseas, it is an exceedingly regrettable fact that most of these have been sold in India. We are of opinion that this is a most reprehensible policy, having regard to the present position of the company.

The arrangement with the Sterling Co., made on 1st September, 1933, for sale of the Redwood Co.'s debentures, gives the selling-rights to the Sterling Co., and permits that company to buy the debentures from the Redwood Co. at a substantial discount. As the Redwood Co. has no capital or other funds to pay this discount, or commission, it is obviously deducted from the debenture-money.

We recommend an investigation into the affairs of this group of companies because we consider, firstly, that it may reveal the necessity and means of protecting the debenture-holders in the future; and, secondly, because there is strong presumptive evidence that money which may be recovered for the benefit of debenture-holders has been wrongly disbursed from the company's funds.

#### (i) *The Need for Inquiry.*

The transactions detailed in this report begin in the year 1925. Most of them lie in the period between 1925 and 1930. Many of them have been the subject of inquiry by interested parties, and there have been several attempts to procure further inquiry and to secure the reversal of some of the transactions. Some of the points raised have been keenly debated and strong feelings aroused. Some aspects of the reconstruction scheme were the subject of litigation. New interests have arisen and older interests have tended to weaken. New trustees are earnestly endeavouring to maintain and improve the position for the debenture-holders.

These aspects of the situation suggested to us that there was much to be said for a policy of leaving the problem where it is and allowing interested parties, if they wish, to seek their own remedies. Our minds have been exercised by these considerations, and strong inducement to act upon them was afforded by our desire to avoid even the appearance of victimizing the principal party in the series of transactions.

Certain contrary considerations have, however, led us to conclude differently. The first is that unchecked and undisclosed transactions of the above description lead to a gradual lowering of the standards of commercial morality. Their continuance in this case has been possible only by the fact that a policy of compromise and private settlement without publicity has been followed, and in many cases inquiry has been successfully burked.

It is possible that there are other companies whose affairs show transactions and policies as reprehensible as those of New Zealand Redwood Forests, Ltd., but, if so, our attention has not been directed to them. In the whole course of our

inquiry we have found nothing at all comparable to the foregoing facts and transactions in relation to any existing company. The only comparable case is that of a group of companies which ended in liquidation in the year 1930, and which will be referred to in our final report. Inquiry culminated in a lawsuit, which would have exposed the whole scandal, but the matter was settled by private compromise, and did not reach hearing in the Court. It is probable that if the matter had then been properly ventilated in a healthy publicity the subsequent history of company promotion would have revealed higher standards and more honest methods.

Secondly, it is desirable to safeguard the position of the existing debenture-holders, while avoiding the necessity for the continued sale of debentures to other individuals whose investments might be subsequently endangered. Some of the funds which appear to have been misapplied should be recoverable to existing debenture-holders without the necessity of drawing into the net new investors from India or elsewhere. Finally, certain of these companies are inter-related by their transactions with some of the companies listed in the Schedule of the Companies (Special Investigations) Act, 1934.

In these circumstances, we have no doubt as to where our duty lies. We have no discretion to compromise public interests, and we believe that such interests demand a full inquiry.

## II. *Liberty Motors Corporation, Ltd.*

The Inspectors appointed by Your Excellency under the above-named Act have reported to us that they are of opinion that in order to render their examination of the affairs of the Pacific Exploration Co., Ltd., and Sterling Investments Co. (New Zealand), Ltd., complete and effective it is desirable to add the name of Liberty Motors Corporation, Ltd., to the Schedule of the Act. They find that Pacific Exploration Co., Ltd., holds 499 out of 1,000 shares in this company, and that the Sterling Investments Co. has made substantial advances to it. They require access to the records of Liberty Motors Corporation, Ltd., to enable them effectively to trace these moneys to their final destination.

## III. *Auckland Provincial Town Properties, Ltd.; New Zealand Freeholds and Buildings, Ltd.; Freeholds Ltd.*

The Inspectors appointed by Your Excellency are of opinion that it is desirable that the names of these companies should also be added to the Schedule of the Act. In the case of each of these three companies there are or were substantial shareholders who are also shareholders in the group of companies now included in the Schedule to the Act. Further, each of these three companies is or was a debenture debtor to at least one of the companies already named in the Schedule to the Act.

## PART IV.

### EVIDENCE.

The statement of facts contained in this report is based on the following evidence:—

- (1) The contents of documents in the files of the Registrar of Companies at Auckland.
- (2) The contents of instruments registered in the Land Transfer Office and the Deeds Registration Office at Auckland.
- (3) Evidence, taken on oath, of witnesses who appeared before us.
- (4) Documentary evidence submitted, as exhibits, by the above-mentioned witnesses. These include reliable secondary evidence of the minutes of New Zealand Redwood Forests, Ltd., for a period of nearly two years—these being accepted by us in view of the refusal of the company to produce the original.

## PART V.

## OUR RECOMMENDATION.

We respectfully recommend to Your Excellency that, for the foregoing reasons, there be added to the Schedule of the Companies (Special Investigations) Act, 1934, the names of the following companies :—

New Zealand Redwood Forests, Limited.  
 The Selwyn Timber Company, Limited.  
 The Wynsel Timber Company, Limited.  
 The Beulah Land Company, Limited.  
 The Edgecumbe Forests, Limited.  
 Kotahi Lands, Limited.  
 Overana Land Company, Limited.  
 Modern Homes, Limited.  
 Liberty Motors Corporation, Limited.  
 Auckland Provincial Town Properties, Limited.  
 New Zealand Freeholds and Buildings, Limited.  
 Freeholds Limited.

In witness whereof we, Your Excellency's most obedient servants, have hereunto set our hands and seals at Auckland this twenty-eighth day of August, one thousand nine hundred and thirty-four.

[L.S.]

JOHN S. BARTON, Chairman.

[L.S.]

H. BELSHAW,

[L.S.]

F. E. GRAHAM, } Members of Commission.

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

*Approximate Cost of Paper.*—Preparation, not given; printing (850 copies), £13 10s.

By Authority G. H. LONEY, Government Printer, Wellington.—1934.

Price 6d.]