1934–35.

NEW ZEALAND.

PROPOSED SPECIAL LEGISLATION ARISING OUT OF REPORTS ON INVESTMENT EXECUTIVE TRUST OF NEW ZEALAND, LIMITED, AND ALLIED COMPANIES.

STATEMENT BY THE MINISTER OF FINANCE (RIGHT HON. J. G. COATES).

Laid on the Table of the House of Representatives by Leave.

My attention has been called to a cablegram appearing in the *Dominion* of the 22nd March, 1935, stating that the Premier of New South Wales announced in the Legislative Assembly his intention to introduce legislation affecting certain companies whose activities were recently investigated by a Royal Commission in Sydney. The cable message also attributes to the New South Wales Premier the statement that the New Zealand Government would act in concert with his Government.

It is perhaps desirable in the public interest and in the interests of debenture-holders that I should now make a statement.

PREVIOUS LEGISLATION.

I may be permitted firstly to point out what has been done so far. The New Zealand Parliament, acting on an interim report by the Company Promotion Commissioners decided that a case for inquiry into the McArthur group of trust companies was made out and it passed special legislation providing that a full investigation should be made by four prominent and independent public accountants who were to report to the Supreme Court and to the Attorney-General. These reports have now been made and are in the hands of the Attorney-General. The New South Wales Government, also acting on the interim report of our Company Promotion Commissioners, decided that there was a case for inquiry, and it appointed a Royal Commission of inquiry to sit in Sydney. A Judge of the Supreme Court of New South Wales was appointed sole Commissioner, and sat from the 9th August, 1934, to the end of October, 1934. This Commission sat in public, examined all available books and documents, and took evidence on oath. Mr. McArthur and other directors and officers of these companies appeared before this Commission, were represented and assisted by eminent counsel engaged by them, gave evidence, and were cross-examined. In addition, Mr. McArthur was permitted to read and hand in a long written statement containing his version of the transactions that were being inquired into. The Government of New South Wales has officially forwarded to the Government of New Zealand printed copies of all the evidence taken in Sydney, including Mr. McArthur's written statement, and of the interim and final reports of the Royal Commission. In the meantime both Governments have protected the assets of all companies by placing them in the hands of receivers.

FUTURE POLICY.

When the Inspectors' reports were filed and copies handed to the Attorney-General, the question of the next step to be taken claimed the very serious consideration of the Government.

Two possible courses would seem to be open. One is to use the processes of the existing law, and for the Attorney-General to put the companies into liquidation by an appeal to the existing law. The other is to devise special legislation to deal with the matter on the ground that the position is an unprecedented one and that the existing law would be ineffective. The same problem faced the Government in New South Wales and the Commonwealth Government, Canberra, and the question thus raised has been very seriously considered by the Governments with the aid of the best legal and accountancy advice available. The result is that the Governments in question have all decided, with the unanimous approval of their advisers, to adopt the course of meeting this unique position by special legislation. The reasons for this decision will appear in the following statement.

REPORTS PRINTED AND AVAILABLE.

The Government has printed in the form of a single volume the reports of the New Zealand Inspectors on the companies named in the Schedule to the Companies (Special Investigations) Act, 1934, and also the interim and final reports of the Royal Commission in New South Wales. These have all been considered carefully by the Government and its advisers, together with the official printed report of the evidence given before the Royal Commission in Sydney, and the attention of the public, and particularly of debenture-holders in the Investment Executive Trust, is directed to these reports.

FIRST PHASE OF DEALING WITH INVESTMENT TRUST FUNDS.

On page 5 of his interim report, Mr. Justice Halse Rogers says,—

> Whatever may have been Mr. McArthur's intention in establishing the Investment Executive Trust of New Zealand, Limited, or in commencing the active operations of that company, there is no doubt that it was in its early stages used by Mr. McArthur entirely for his own purposes. Practically the whole of the first £60,000 subscribed by the public for debentures in the Investment Executive Trust of New Zealand, Limited, was applied for the salvage of Mr. McArthur's assets through the medium of a company called the Sterling Investments Company (New Zealand), Limited. This company was nominally controlled at that time by another company in which Mr. Alcorn was practically the only shareholder, but it is scarcely disputed, and I find as a fact that in all the dealings of Mr. McArthur with the various companies, wherever Mr. Alcorn did anything he did it at the bidding of Mr. McArthur. The Sterling Investments Company (New Zealand), Limited, issued £60,000 worth of debentures, and these were taken up from time to time as money became available by the Investment Executive Trust of New Zealand, Limited. The only assets which the Sterling Investments Company (New Zealand), Limited, had at the time were the assets in which Mr. McArthur was interested, and actually the debentures were issued before the various assets were acquired; in other words, at the time of purchase by the Investment Executive Trust of New Zealand, Limited, the Sterling Investments Company (New Zealand) debentures had nothing to back them except the money paid for their purchase; but as the money became available the assets were acquired which did become a backing for the debentures. It has been claimed on behalf of Mr. McArthur that he was being attacked by strong financial interests in New Zealand, who were making an endeavour to crush him, and it has been put forward as a justification for his dealing with the money of the Investment Executive Trust of New Zealand, Limited, that the preservation of his assets was of interest and importance to debenture-holders of that company. If the Investment Executive Trust of New Zealand, Limited, had been an established concern when these transactions took place, and if Mr. McArthur's financial standing had then been a matter of importance to the debenture-holders, there might be some basis for the argument addressed to me, but there is no doubt that in the early stages of the Investment Executive Trust of New Zealand, Limited, the principles which should govern the management of such a company were entirely abandoned in order that the affairs of the managing director might be straightened out, and without the consideration of the interests of the subscribing public.

That extract gives briefly and accurately an account of what may be called the first phase of the life of the Investment Executive Trust of New Zealand, Ltd. It should be noted carefully that that finding was made after Mr. McArthur

and other directors of the Investment Executive Trust, Mr. Glasson and other officers of that company and allied companies, had given evidence at a public hearing at which eminent counsel had been retained to watch the interests of the directors of the Investment Executive Trust.

SECOND PHASE OF DEALING WITH INVESTMENT TRUST FUNDS.

As part of the scheme for carrying out the second phase of the operations of the Investment Executive Trust in Mr. McArthur's hands, it was necessary for him to form and operate a similar company in New South Wales, and hence the Southern British National Trust was incorporated in Sydney early in 1933, and it carried on the same sort of business as the Investment Executive Trust of New Zealand: it was similarly constituted and it had the same board of directors.

On page 7 of Mr. Justice Halse Rogers' interim report, he says,—

> On a consideration of the whole of the evidence that has been put before me, and the documents which existed before the commencement of the sittings of the Commission, I am definitely of the opinion that Mr. Monahan's charge that the object of the formation of the Southern British company was to enable Mr. McArthur and Mr. Alcorn to get the necessary ready cash for the alterations of the *Daily Telegraph* building, and so ultimately to turn a profit on paper of £287,000 into an actual profit to themselves has been established.

Again it should be noticed in considering this finding that the evidence on which it was based was largely the evidence of Mr. McArthur, Mr. Pilkington, Mr. Glasson, and Mr. Hewitt, supported by the books and records of the two trust companies and their subsidiaries.

This now introduces the second phase of the operations of the Investment Executive Trust in which the purchase and remodelling of the *Daily Telegraph* building in Sydney (also called the trust building) was undertaken with the debenture funds of the two trust companies.

A concise summary of this transaction will be found in the interim report of Mr. Justice Halse Rogers. It begins on page 6 with the words, "The history of this company is very largely bound up with the history of the transactions connected with the purchase by McArthur of the old *Daily Telegraph* building in Sydney," and ends on page 7. This extraordinary transaction has already received much publicity and it is not thought necessary to repeat its description here.

The two major phases in the history and transactions of the Investment Executive Trust, outlined and referred to above, represent transactions put through, not in the interests of the debenture-holders who supplied the cash, but adversely to those interests, and favourably to the personal interests and ambitions of the directors.

INVOLVED AND QUESTIONABLE TRANSACTIONS.

After the funds of the Investment Executive Trust and the Southern British National Trust had been committed to the second of these transactions—namely, the purchase and remodelling of the trust building in Sydney—many involved and tortuous transactions were passed through the books of all the companies in the group. The only explanation that can be given of some of these is that they were purposely designed to hamper inquiry and place difficulties in the paths of any persons who subsequently might try to trace the transactions. Some are designed to entrench the directors of the companies in the position which they had attained by making it possible for them to invoke principles of existing law to establish and confirm the purely legal result of their transactions. Again some have been designed to facilitate the immediate conversion into cash of as much as possible of the paper profits accruing to the directors as the result of the deal in the trust building; while others have been dictated by the necessity of taking cash from whatever source it was most easily available to carry out some scheme of the directors, and giving to the company from whom it was thus taken a supply of debentures issued by one or other of the companies in the group. As to still other transactions, no exercise of ingenuity has enabled the company's officers or the Government's advisers to offer any explanation of them or reason for them.

THE RESULT ON DEBENTURE-HOLDERS' STATUS.

It is most important for the debenture-holders in the Investment Executive Trust to note that the *result of this series of transactions is to fix their relative rights according to the mere accidental effects and results of these transactions.* They were put through for purposes wholly unconnected with debenture-holders' rights, and are wholly inconsistent with the undertakings on which debenture-holders' cash and property were entrusted to the directors of the Investment Executive Trust, but their effect is, if existing law is to be applied to existing records, to determine the rights of the debenture-holders. This statement relates not only to the rights of the debenture-holders in general against the Investment Executive Trust, but to the relative rights of the holders of each series towards the holders of other series; it relates to the relative rights of the Investment Executive Trust towards the Southern British National Trust; to the relative rights of these companies to the various subsidiary companies as they are all recorded in the books at the present time. All these respective rights as now recorded are the result of the artificial jungle of transactions based on the mixed motives described above.

All the Governments' advisers in New Zealand and New South Wales, both legal and accountancy, are unanimous in believing and stating that these considerations will inevitably tend to defeat and break down any attempt to reconstruct and carry on the affairs of the companies. *It is their unanimous belief that an attempt to straighten out these transactions by the application of the existing laws of the two States will result in expensive and wasteful litigation which might easily dissipate the funds of the debenture-holders.*

THE TRANSFER TO NEW SOUTH WALES AND ITS RESULTS.

Furthermore, debenture-holders of the Investment Executive Trust should note carefully that, although they were persuaded to subscribe to a purely New Zealand concern, with a New Zealand board of directors, their books and records and their securities were, without their consent, transferred to the State of New South Wales, from which State the directors of the Investment Executive Trust attempted to administer the affairs of the company.

Many of the transactions outlined above originated in one country and were carried to fruition in another. Thus, the company which purchased the trust building is incorporated in New Zealand, whilst the company which has the ninety-nine years' lease is incorporated in Canberra. The company formed to raise cash to remodel the building is incorporated in New South Wales. The building itself, and the mortgage on it, is subject to the laws of New South Wales. The large sale of B.N.I.T. shares originated in Auckland, but was accepted and made a binding contract in Sydney by a decision of the Canberra company to purchase shares.

Inquiries have been held on both sides of the Tasman Sea—in New Zealand by independent public accountants, acting as Inspectors, and in New South Wales by a Royal Commission. Neither of these inquiries could get a complete history or picture of the transactions involved without taking into account materials obtainable in the other State, and this added to their difficulties. This state of things would seem to have been designedly brought about by the directors whose transactions have been so roundly condemned, but whilst it hampered it did not preclude full inquiry. If, however, a new phase of inquiry should involve reference to the Courts under existing laws, there is presented a good opportunity to use the difficulties inherent in these facts to support technical legal objections and submissions.

It may be premised for a start, for instance, that any appeal to the existing law on either side of the Tasman Sea will be strenuously fought by those directors. In the report of the evidence and proceedings in New South Wales, before the Royal Commission, at page 495, in replying to a suggestion by the Royal Commissioner that in a winding-up a procedure might be found to obtain more for the debenture-holders than in an ordinary suit under the application of

existing law, counsel for the trust companies said, "I have considered that aspect of the matter, and I think that the most that can be said is that *it would lead to very expensive and protracted litigation.*" The New Zealand Inspectors, in their report on the Investment Executive Trust of New Zealand, in para. 257, say, "We think that if liquidation proceedings are commenced by petition to the Court and if such petition is opposed by the Investment Trust of New Zealand, Ltd., protracted and expensive litigation may ensue."

Nothing is more certain than that if any appeal is made under existing law to the Supreme Court of New Zealand, or to the Supreme Court of New South Wales, the fullest possible advantage will be taken of the difficulties created by the inter-State nature of the problem produced by these directors. If the Court in New Zealand, for instance, is asked to deal with a transaction which originated in Auckland but which was carried to fruition in New South Wales, it may be expected that an objection would be raised immediately to the admissibility even of the sworn testimony of Mr. McArthur himself, in relation to the whole of this transaction as tendered before the Royal Commission in Sydney, and it is probable that our Court would have to uphold the objection. If so, the matter could not be proceeded with further without the expensive procedure of endeavouring to take this evidence over again in New South Wales under a Commission appointed by the Supreme Court of New Zealand.

Conversely, if it should be sought to act in New South Wales before the Supreme Court of that State, objection would be raised to the admissibility of any evidence taken in New Zealand, however logically relevant it might be or however well it might be authenticated. To borrow a phrase from Mr. Justice Halse Rogers, it may be stated that "the jugglery is to keep within the letter of the debentures although the transaction is absolutely contrary to the spirit of the whole thing" (page 513, Official Proceedings of the Royal Commission in Sydney). The next act in the jugglery, and probably a successful act, would be to compel the Courts to keep within the letter of the rules of evidence and the existing law, to protect the original jugglery.

SOME TYPICAL TRANSACIONS AND THEIR RESULTS.

We shall now examine some of the transactions with a view of noting their effect on the present actual and relative positions of the debenture-holders:—

(1) Salvaging Mr. McArthur's private estate: The extract taken from the interim report of Mr. Justice Halse Rogers shows that practically the first £60,000 subscribed by the debenture-holders of New Zealand to the Investment Executive Trust was passed by that company to the Sterling Investment Co., which was wholly under the control of Mr. J. W. S. McArthur, and this cash was used by Mr. McArthur for his own purposes. In return, the Sterling Co. held properties and securities of Mr. J. W. S. McArthur, who alone decided the amounts to be advanced or paid for such properties. Further amounts were taken from the cash supplied by the Investment Executive Trust to the Sterling Co. for the purpose of improving and extending some of these properties. For example, money was spent on the completion of the yacht, which is now McArthur's, and on the improvement of his home property near Auckland. In March, 1933, Mr. McArthur purported to settle his indebtedness to the Sterling Co. arising out of these transactions and to retake possession of his properties. He effected this by transfer to the Sterling Co. of certain British National Trust debentures charged (in effect) on the Trust building in Sydney. Once again Mr. McArthur alone seems to have fixed the amount of such debentures which were to be handed over in settlement, and the valuations at which he took over his properties so salved and improved by the debenture-holders' money. He was not either a director or officer of the Sterling Co. at that time, but he had the transactions put through on his instructions and secured transfers of the properties to himself and to his company, the Wynwood Investments, Ltd., a company owned and controlled by himself. The chairman of directors of the Sterling Co. denies all knowledge of these transactions (see Inspectors' report on Sterling Co.) and, although they represent a deal involving from £60,000 to

£90,000 of property hitherto recorded in the accounts of the Sterling Co. there is no authorization of the transaction by the directors, and no mention of it in the minute-book of the company. Immediately after this transaction was put through Mr. McArthur instructed the secretary of the Sterling Co. to open a new set of books for that company showing the position as it was after that transaction had been put through (see para. 6 (*b*) of the New Zealand Inspector's report on the Sterling Co.). The books of the Sterling Co. containing records up to this point are said to have been "lost." On this point Mr. Justice Halse Rogers finds,—

> I am not at all satisfied that the Sterling books could not have been produced if there was any desire to produce them. Since the 9th August it has been stated quite definitely that the key to the whole position was the Sterling books, and I think that if there had been any real desire to produce the Sterling books, if they had not been destroyed, they would have been here.

Since the closing of the Royal Commission in Sydney, there is evidence that Mr. McArthur has been busily engaged trying to consolidate the position created by these transactions with his own assets. Certain operations are being conducted in Brisbane, and a trust company is being formed there. Two of the assets so taken over from Sterling—namely, the yacht and Mr. McArthur's property at Hillsboro have been first mortgaged, and later transferred to a Brisbane mortgagee and purchaser. Caveats against certain other properties have, within the last two months, been filed in public offices in Auckland in favour of the Brisbane trust company.

It is quite clear that unless the New Zealand and New South Wales Governments act in concert to put all the companies into liquidation, there is every prospect of one of two things happening. The first is that the postion arising out of the transactions described above will be consolidated and made impregnable, and the debenture-holders of the Investment Executive Trust will receive nothing in respect of the sum of from £60,000 to £90,000 of their money so diverted. The other alternative is that they will be involved in expensive litigation in endeavouring to follow their property through these devious transactions. If the companies involved in these transactions are wound up there will be let in the special powers of the Court under the winding-up provisions of the New Zealand Companies Act to procure disclosure of books and records and a thorough examination of directors and other officers of these companies. The debenture-holders probably could not do anything which would carry more relief to the late directors and controllers of the Investment Executive Trust and its subsidiaries than to attempt to carry out a reconstruction scheme which would tend to allow these transactions to slide into the limbo of the past without any redress. This, however, will tend to be the result of the adoption of the so-called reconstruction scheme.

DIRECTORS' CLAIMS IN COMPETITION WITH DEBENTURE-HOLDERS.

2. I have already referred to that part of the interim report of Mr. Justice Halse Rogers, which contains a description of the transaction by which Messrs. McArthur and Alcorn sought to make a personal profit by their deal with the trust building in Sydney. It will be noted that by putting the building in the name of the British National Investment Trust and immediately attributing to the shares in that company the appreciation in value which he attributed to the building, Mr. McArthur was able to make a profit by the sale of his shares in that company. Once again he, the party who was to profit most, seems to have fixed the valuation of the building, and consequently the value of his shares in the holding company. He sold those shares to another subsidiary company of which he was managing director—this was the British National Trust incorporated in Canberra. Mr. McArthur fixed the selling-price of these shares. In part consideration of this purchase price he and his associate received a large parcel of debentures of £1,000 each in the Canberra company, the British National Trust. These debentures, by many devious transfers, have passed through several hands, and many of them

are now held by several companies in the group. The Investment Executive Trust of New Zealand and the Southern British National Trust of New South Wales hold large parcels of these debentures as representing their cash put into the purchase and remodelling of the building. They hold other parcels, however, as a result of some of the transfers referred to. Other companies in the group now hold parcels of these debentures, and some are still held by directors and officers of the trust companies. All these debentures, according to existing law, are entitled to rank *pari passu*, and are in competition with one another as a charge on the proceeds and profits (if any) of the trust building. Unless the Governments of New Zealand and New South Wales and Canberra can agree on a legislative scheme that will give to the honest debenture-holders of the Investment Executive Trust and Southern British National Trust a first call on the proceeds of the building, those debenture-holders will find themselves thrown into competition to a greater or lesser extent with other holders of British National Trust debentures issued as part of the profits of Messrs. McArthur and Alcorn on the sale of their B.N.I.T. shares.

The Governments of New Zealand, New South Wales, and Canberra have agreed on a scheme which has been approved unanimously by their legal and accountancy advisers and by the Inspectors appointed to inquire into the New Zealand companies. The guiding principle, accepted unanimously by those Governments, is that the interests of those members of the public of both countries who are debenture-holders of the trust companies must be paramount, and that they should receive the net proceeds of the building before any other claimant is recognized.

A SIMPLE BUT PROFITABLE SHARE DEAL.

3. When Messrs. McArthur and Alcorn received, as representing their profits on the purchase of the building, debentures of the British National Trust Co., the lessee of the building, they converted certain of them into shares in the Investment Executive Trust and the Southern British National Trust respectively. They took up, for instance, parcels of Investment Executive Trust shares of a nominal value of 2s. each and these were issued as fully paid in return for British National Trust debentures at par. Thus, Mr. McArthur got 193,400 shares at 2s. each for £19,340, and effected settlement of this by the transfer of part of the consideration which he had obtained from the British National Trust. A few months later he sold 155,320 of these shares to the Southern British National Trust. It will be noted that these shares cost him £15,532, which he paid for, in effect, in debentures to that value issued to him by the British National Trust. When, however, he sold the shares to the Southern British National Trust, he valued them at four times the amount he had paid for them—namely, £62,128—and he took in return sixty debentures of £1,000 each in the British National Trust Co. Thus, by this simple transaction with two companies under his control, of each of which he was the managing director, he surrendered approximately *fifteen debentures of £1,000* each to procure the allotment to himself of the shares, and later received *sixty debentures of £1,000 each* when he sold them to the sister company. This transaction leaves these shares in the Investment Executive Trust amongst the investments of the Southern British National Trust, and it left £60,000 in debentures (£45,000 of which is a special profit) in the hands of Mr. McArthur. When debenture-holders are asked to consider a reconstruction scheme, which of two alternatives do they propose to adopt in relation to this transaction? One is to accept this transaction and let it lie as a factor in determining the relative position of the present holder of those debentures on the one hand and the innocent debenture-holders in the trust companies on the other hand. The other is that their new directors under the reconstruction scheme should attack it and attempt to undo it by reference to existing law. The advisers of the New Zealand Government have stated emphatically that this is one of the transactions which might easily involve the two innocent sets of debenture-holders in a dispute and waste their resources in litigation.

A TYPICAL TRANSACTION AND ITS RESULTS.

4. When, about October, 1933, it was decided by Mr. McArthur to buy the trust building in Sydney, it was necessary to pay a deposit of £50,000 in cash. This amount was taken from the funds subscribed by the debenture-holders in the Investment Executive Trust, and in return there was handed to the Investment Executive Trust debentures for £50,000 by the British National Investment Trust. Later, for some obscure reason, the directors of the Southern British National Trust applied for 110,000 preference shares of 10s. each in the British National Investment Trust, and these shares were allotted as fully paid. The amount due, £55,000, was paid by a cheque from the Southern British National Trust. The British National Investment Trust, having got this cheque, paid a cheque to the Investment Executive Trust in repayment of its debentures of £50,000. The Investment Executive Trust, having got this cheque, itself paid a cheque to the Southern British National Trust in return for debentures for £55,000 issued by that company. It may be pointed out that the terms on which the preference shares were issued to the Southern British National Trust entitle that company, on the liquidation of the British National Investment Trust, to receive repayment of their capital, £55,000, plus a premium of 10 per cent. Each company having given and received a cheque, the cheque transactions cancel each other out. The Investment Executive Trust has exchanged debentures in one company for debentures in another. This extraordinary transaction leaves the Southern British National Trust owing to the Investment Executive Trust £55,000 on debentures, which give a charge over the securities and investments held by the Southern British National Trust on account of that series of its debentures. All the Southern British National Trust holds in return for this liability is a parcel of preference shares in the British National Investment Trust, a company whose books show that its only asset is the trust building in Sydney. The British National Investment Trust, however, has granted to the Canberra company a ninety-nine years' lease of that building at a rental that merely covers the lessor company's outgoings in relation to the building. It therefore owns only a bare reversion which will not fall in for ninety-nine years. This transaction brings us to the following position: We have two companies whose funds are supplied by two innocent sets of debenture-holders and they have been in the control of the group of operators who put through transactions of this description. The advisers of the two Governments have informed their Governments emphatically that the only prospect of procuring a reasonable return for these members of the public who hold debentures in the trust companies is for the two Governments to find some amicable basis for dealing with this jungle of transactions in an attempt to retrieve the position. The New South Wales representatives, however, naturally raise the strongest objection to the Southern British National Trust Co. being required on a settlement to pay out of its cash funds £55,000 to the Investment Executive Trust as the result of the foregoing transaction. *Without agreement between the Governments and a mutually acceptable basis of settlement on the most satisfactory terms discoverable in the circumstances, there lie in this and other transactions possibilities of endless dispute, expense, and loss in negotiation and litigation.* Will the debenture-holders of the two trust companies fairly and carefully consider the following question? If they allow themselves to be persuaded to adopt the reconstruction scheme, which includes the acceptance of the existing position, comprising the present and other transactions referred to herein, what instructions would they respectively give to their boards of directors to straighten out this transaction, particularly in the light of the information given below as to the present involved state, legally and practically, of the trust building as an investment?

A CHANGE IN POLICY AND ITS RESULTS.

5. Since the year 1932 advances of Investment Executive Trust debenture-moneys have been continually made to the Sterling Investment Co., a company entirely under the control of Mr. J. W. S. McArthur. Till March, 1933, the Sterling Co., on receiving this cash, gave in return its own debentures to the

Investment Executive Trust, but from that date a change was made. The Investment Executive Trust continued to advance its money to the Sterling Co., but, in return, it received, *not Sterling debentures*, but *British National Trust debentures* charged on the trust building. The British National Trust handed these debentures to the Investment Executive Trust, and in its books it recorded Sterling as its debtor on the transaction. These transactions were presumably put through for the purposes of the directors of the Investment Executive Trust, but have tended to give to the Investment Executive Trust a gradually increasing charge on the building in competition with other British National Trust debentures that represent the cash of the Investment Executive Trust and the Southern British National Trust debenture-holders interested in the building. A consideration of these transactions and their present-day result, if they are to be tested by the existing law, affects the relative positions of the Investment Executive Trust, the Southern British National Trust, the British National Trust, and the Sterling Co. The following facts must not be lost sight of: A small private company, known as Farms and Farmlets, Ltd., owns all the shares in the British National Trust. The British National Trust owns all the shares in the Sterling Co., and by the above transactions is a very large unsecured creditor of the Sterling Co., the amount being about £90,000. The Sterling Co., by a recent transaction, now owns all the shares in Farms and Farmlets, Ltd. Thus we have completed a circle, and the legal and accountancy implications and results of this circuitous course of dealing are not easy to state or to prognosticate.

THE TRUST BUILDING: A LEGAL TANGLE.

6. Transactions relating to the trust building also represent a "tangle." The British National Trust (the Canberra lessee of the building) owns all the ordinary shares in the British National Investment Trust (the Auckland lessor of the building). The British National Investment Trust has given to the British National Trust a ninety-nine years' lease of this building, which is subject to a mortgage to an Australian mortgagee for £100,000. Under this lease the British National Trust has granted subleases of various parts of the building. Serious legal difficulties have now become apparent as the result of a disregard of business and legal precautions, which is unfortunately apparent all through the history of all these companies. *The instrument of lease is not dated; it is not stamped; it is not registered; and the consent of the mortgagee has not been obtained to it. The mortgagee now refuses to consent to the lease, and, as the lease is one for ninety-nine years, he has every right to refuse.* The legal tangle represented by these facts, plus the fact that the British National Co. has issued debentures to an amount of over £400,000 on the building, making the total charges against the property over half a million, raises a problem which the legal advisers of the Governments found extremely difficult to unravel. *They have now advised their Governments that there is no way out of this tangle, satisfactory to the holders of the debentures in the Investment Executive Trust and the Southern British National Trust, except by special legislation.* This legislation must be part of a general scheme for the protection of the debenture-holders, because, as already pointed out herein, their present rights, according to the books of the companies, are to be ascertained after taking into account devious transactions such as those described above. *The legal advisers of the Governments in question are agreed that, in the difficulties surrounding this lease and the mortgage, there are grave possibilities of dispersal of the debenture-holders' funds in wasteful litigation. Debenture-holders who believe themselves to be favourably inclined towards a reconstruction scheme which involves an attempt to untangle these matters by reference to the existing law and existing records should give their careful consideration to the problem represented by this and the immediately succeeding paragraph.*

THE TRUST BUILDING: A DRAIN ON DEBENTURE-HOLDERS' RESOURCES.

7. The trust building in Sydney has been for a year past, and will be for at least a year to come, a serious drain on the liquid resources of the debenture-holders. The building was officially opened in June, 1934, but it is not yet paying its own outgoings, and is unlikely to do so for many months to come. By the efforts of the Public Trustee of New South Wales, acting as Receiver, the interest on the mortgage of £100,000 has been reduced from 6 per cent. to 4 per cent., and the letting-value has been improved by £2,400 per annum. A statement of the position over the signature of the Public Trustee of New South Wales, under date 6th March, 1935, shows that, apart from the first floor, ground floor, and basement, approximately 70 per cent. of the building is now rent-producing. On that basis the annual income is now £10,077 per annum, but the outgoings on the present basis are not less than £11,537 per annum. These include taxation (Federal, State, and municipal), insurance, interest on the mortgage at 4 per cent., and administration expenses. The Public Trustee of New South Wales estimates that it will be at least eighteen months before the building can be fully let and overtake the present unsatisfactory position. This will involve the expenditure of at least another £1,500 in the erection of dividing walls on the upper floors. Various claims (under above headings) on the building due at the time the report was made amount to about £2,500, and land-tax and municipal rates amounting to another £2,200 will fall due before the end of June. The liquid resources of the debenture-holders of the Investment Executive Trust and the Southern British National Trust must be drawn on steadily for many months to come, to " nurse " the building.

THE TRUST BUILDING VALUATIONS.

8. One of the grounds put before debenture-holders to justify the adoption of the reconstruction scheme is that the building is an investment which ensures a return of 20s. in the pound of the debenture-holders' money, and which, pending sale, may be expected to return a good rate of interest on the money invested in it. The immediately preceding paragraph to some extent disposes of the second part of this argument. There is no room to doubt that attempts have been made to mislead the debenture-holders as to the value of the building, and to keep from them information that might raise doubts as to the likelihood of the building securing a full return of their money. A typical example of misstatement is afforded by a reference to the evidence of William Stuart, who gave evidence before the Commission in Sydney. His evidence is recorded on pages 473 and 474 of the official proceedings.

He set out three different bases of valuation, and on each basis he gave a valuation. The first basis gave the highest valuation—namely, £318,878; the lowest was £271,576. He was cross-examined about his first basis, and he admitted that he could not justify it. He said that he merely gave it as one way that might be adopted. He was then asked by counsel, " Which is the valuation you are standing on and that you want His Honour to take as your opinion of the value." His answer to that question was, " £271,576." This evidence was given on the 28th September, 1934. A circular letter went out from the Auckland office of the Investment Executive Trust of New Zealand to debenture-holders under date of 29th September, 1934, and under the heading " Debenture Securities proved." The third paragraph of that letter reads thus :—

> Sworn evidence before the Royal Commission, William Stewart, foremost building expert of Sydney, stated that the trust building, apart from the land, is worth £318,879.

That sum, it will be noticed, is the highest of the three valuations which the witness gave. It is one which he was not prepared to justify, and it is £47,000 higher than that which he gave on oath as his own opinion of the value.

An officer of the Valuer-General of the State of New South Wales was called to give evidence, and his evidence appears on page 407 of the official proceedings. His valuation of the property in September, 1934, was £270,000 and that includes the unimproved value of the land, £93,000.

On page 437 of the official proceedings before the Commission in Sydney, the Commissioner, in dealing with the valuation of the building, said, " Only two valuations of the building have been given so far and they are both less than £300,000."

I have been supplied with a certified copy of a valuation by a Sydney company, Richardson and Wrench, Ltd. It is addressed to J. W. S. McArthur, Esq., and is given in response to his written request; it is dated 21st September, 1934. The valuers go fully into details, and they finish, "We estimate the present market value of the property at £296,000."

This is not put forward as conclusive evidence of the value of the building, but merely to indicate to debenture-holders that if they have been influenced in favour of the idea of carrying on, by the publication of certain carefully chosen valuations and the suppression of others, they may realize that the financial success of their investment in this building is by no means assured. I am informed by the advisers of the Government in New South Wales that none of them anticipate a sale of the building at a price which, with all the other assets of the debenture-holders, will return them as much as 14s. in the pound.

RELATIVE POSITIONS OF DIFFERENT SERIES OF DEBENTURES.

9. One of the most troublesome problems that will arise, either in the liquidation of the companies or on any attempt to carry them on, if such attempt should be made, lies in the uncertainty relating to the relative positions of the different series of debenture-holders. Let us view the position for a start as it is between the A Series and the B Series of the Investment Executive Trust. The printed conditions on which the A Series of debentures were issued by the Trust, and taken by the debenture-holders, contain an undertaking that the company shall invest the moneys received by it from the sale of debentures in the series "in such of the investments and securities mentioned in the Schedule hereto as it shall think fit." The Schedule referred to sets out the investments which are to be chosen for the A Series. In brief, it may be stated that the only authorized investments for the A Series are Government and local-body stocks and authorized trustee investments under the Trustee Act, 1908, of New Zealand.

In the case of the B Series, however, the corresponding Schedule includes the above-mentioned securities, but, in addition, it includes shares, stocks, debentures, debenture-stocks, bonds, obligations, and securities issued or guaranteed by any company, bank, trust, or other corporation constituted or carrying on business in Great Britain, Australia, New Zealand, or in any other part of the world. In brief, the B Series debenture-moneys may be invested in the same Government, local-body, and trustee securities as the A Series, and, in addition, in the shares or debentures of *companies* or other *corporations*. The security of the B debenture-holders is the investments, according to the Schedule, held by the Trust as representing the investment of the debenture-moneys of the B Series holders.

The simple facts of the case are that the directors of the Investment Executive Trust seem to have made no attempt at all to carry out those conditions. They have never hesitated to use the debenture-moneys of all series or of any series to serve their own purposes. In the period in which the first £60,000 of the money of the debenture-holders passed through the Sterling Co. to serve the personal purposes of Mr. J. W. S. McArthur, the money of the A Series debentures was so used as well as the money of the B Series. If at any time money were wanted for either some specific purpose or for the general purposes and expenses of the company, the directors never hesitated to take it from whatever bank account seemed best able to supply their needs.

This means that, instead of the cash of a series or class of debenture-holders being invested in securities proper to that class, it will be found that it has been drawn out of the bank account of the series and paid into the bank account of another series to facilitate some transaction attributed to that series. Sometimes these sums of money have been paid back again, but the net result as shown in the books of the company is that a considerable amount of the money of the A Series debenture-holders, for instance, is represented not by investments in the authorized investments of the A Series, but by a record of money owing to the A Series by the B Series. Not only so, but the records show money owing to, say, the A Series, *by the shareholders;* and the latest accounts show quite a considerable sum under this latter heading, due to the fact that *the funds of the debenture-holders have been taken as required and transferred to the general account of the company to meet its general costs and expenses.*

The effect of all this is that the respective portfolios of investments allotted to the different series of debenture-holders is the result of a number of arbitrary and fortuitous decisions and investments. The result is so obviously unjust to some of the series in relation to some of the others that acceptance of the records of the company as showing the respective claims of holders of the different series on the assets in hand cannot be considered. When, however, a scheme of adjusting matters between the different series is taken in hand, many serious difficulties are apparent. It is unfortunately true that any attempt to make adjustments between the classes can only result in increasing the loss of one class to reduce the losses of another class. The shortages in some of the classes are due to the transfer of their funds to the general funds of the company represented in the books at the present time as a claim on the shareholders. This claim will certainly prove to be worth little. There is in these facts very little hope of a simple and amicable adjustment of these conflicting rights and plenty of scope for misunderstanding and litigation, and, in any event, it cannot be said that such questions should properly be included in suggested terms of reconstruction.

We come now to the second complication which affects the respective rights of the different series of debenture-holders. This arises out of the so-called conversion of the first B Series debentures into second B Series debentures. This transaction is described in paragraphs 96 to 112 inclusive of the Inspectors' report on the Investment Executive Trust of New Zealand. The money received by the Investment Executive Trust Co. for the sale of its second B Series debentures must, according to the conditions of the issue, be invested in investments which become the security of those second B debenture-holders. This money was used, as will be seen by the Inspectors' report, to buy up the debentures of the first B Series. The conversion, however, was not complete, and an appreciable number of the first B Series debentures are still held by the original holders. These debentures, according to their terms, are entitled to a charge on all the securities of the debentures purchased with funds of the B Series. The first B Series debentures which were purchased have not been cancelled, but are still treated as issued debentures in the hands of the New Zealand Shareholders Trust, Ltd., and they form part of the security for the second B Series debenture-holders.

The legal tangle which is created by these transactions is a most complicated one, and it is the considered opinion of the advisers of the Government that these complications cannot be cleared away but by legislation. The Government proposes to legislate in this matter. Any debenture-holder who seems inclined to favour the idea of the adoption of the so-called reconstruction scheme would be well advised to study the passages above referred to in the Inspectors' report relating to this conversion scheme, and picture the possible trouble and expense of trying, either by treaty amongst the debenture-holders, or by a recourse to the existing law, to straighten out this tangle.

10. It must be noted further that the devious and often apparently purposeless transactions and transfers of property referred to above affect not only the rights of the trust companies as between themselves and the relative rights of the holders of different series within those trust companies, but they affect the relative rights of debenture-holders and shareholders. The present shareholdings in the trust companies and in the British National Trust and the British National Investment Trust are largely the result of transfers of shares and debentures in which Messrs. McArthur and Alcorn have been personally interested. There have been transactions, other than those detailed above, which have directly affected the relationships between the trust companies and their debenture-holders. The funds of the debenture-holders have been withdrawn from their separate bank accounts and paid into the general account of the Investment Executive Trust, for instance, to meet general expenses and commitments sanctioned by the directors. All that the debenture-holders have to show for these transactions is the debit balance in the books of the trust showing the shareholders as owing the amount to the debenture-holders. The only principle that can be found as dictating these transfers is that when the cash was wanted it was withdrawn from the bank account that was best able to supply it.

If the proposed reconstruction scheme or any such reconstruction scheme is adopted, there will be preserved the existing constitution of shareholders and debenture-holders in the Investment Executive Trust. Is there a debenture-holder who has intelligently followed the course of dealings with his money by the directors of the Investment Executive Trust, both before and after the inquiries instituted by the Governments, who believes for a moment that those directors will cease their ingenious activities to consolidate their positions, and eventually to use their position and rights as shareholders to realize their profits ?

Mr. Justice Halse Rogers, in his final report, saw enough to lead him to state, on page 12, that, in his opinion, "the reconstruction plan was really inspired by Mr. McArthur." He was at that time dealing with the plan as it affected the New South Wales company and its debenture-holders. He continues,—

> It is a compromise, but the essentials come from him. His counsel impressed on me over and over again that Mr. McArthur had faith in the future of the company and wanted it to have an opportunity of making good although, on the face of it, Mr. McArthur is to have no position of control. It was suggested that he might be employed as manager or financial adviser. Apparently some of the debenture-holders, represented by Mr. Pitt, are anxious to employ the services of Mr. McArthur and have the advantage, as it was put, of his great experience in trust matters. Mr. Monahan pointed out, in my opinion quite rightly, that there was no evidence before the Commission of any ability in Mr. McArthur in the matter of trust administration, as the whole of his connection with trust companies had been marked by maladministration. There is no doubt that he is extremely anxious that the "plan" should operate. In view of the evidence before the Commission and of the devious ways of the principal parties, one is naturally apt to suspect a hidden motive in such anxiety.

This suspicion is shared by the Governments of New South Wales and New Zealand. The advisers of those Governments represent to them strongly that they have no faith in the possibility of any adequate safeguard being devised under the proposed reconstruction scheme that could be expected to guard against Mr. McArthur regaining control of the companies. *The reconstruction scheme will commit the debenture-holders to a continued adherence to a company the constitution of which involves control by shareholders and debenture-holders, and the shareholders will almost certainly be, directly or indirectly, openly or covertly, the persons who have to date brought the debenture-holders into such an undesirable position.*

NEW ZEALAND COMMITTEE.

11. In making this statement, I desire to add that I am satisfied as to the *bona fides* of certain gentlemen in New Zealand who have interested themselves in seeking to organize New Zealand debenture-holders to move for their own protection. I am satisfied that they are genuinely working in what they believe to be the interests of the New Zealand debenture-holders.

In settling the details of the proposed legislation the Government will give full consideration to any representation that may be made by these gentlemen or by any other debenture-holders or their respresentatives. It is for the purpose of enabling such representations to be made that this statement is issued at the earliest possible moment.

GOVERNMENT ACTION NECESSARY.

12. It has been made clear throughout this statement that the New Zealand Government is acting in concert with the Government of New South Wales. The two Governments are satisfied that this plan offers the best possible result to the debenture-holders of the two trust companies. The agreement and all the details of the scheme have in view as the paramount consideration, the preservation of the rights of those debenture-holders. The debenture-holders in New Zealand, if there are any, who will still be inclined to consider supporting the reconstruction scheme, should know that if they do so they must face the fact that nevertheless the New South Wales Government will take steps by legislation to wind up the Southern British National Trust and protect the debenture-holders of that company against the results of the devious transactions referred to above. They are

compelled to take this step, firstly, by the logic of the foregoing reasons, but, secondly, because the Southern British National Trust is faced with numerous claims in the form of actions for rescission of contracts to take debentures, the ground in each case being misrepresentation. Up to the beginning of March of this year, eighty-one such writs had been filed. It is feared that if these come to a hearing, most, if not all of them, will be successful, and each successful claim of this description means the substraction of at least 20s. in the pound to meet that debenture-holder's claim, and in consequence a heavier proportion of the loss to fall on other debenture-holders.

The New South Wales Government takes the view that, seeing that it is practically certain that nearly all, if not all, the contracts to take debentures were induced by misrepresentation, the only fair basis is to put all the debenture-holders on an equal footing. This also will act as a measure of protection to the debenture-holders of the Investment Executive Trust, most of whom, it is believed, could with equal reason claim that their debentures were taken up under misrepresentation.

AN INNOCENT COMPANY INVOLVED.

13. Finally, there is the position as affected by the activities of the Transport Mutual and General Insurance Co. (see the report of the Inspectors on the affairs of this company). The money of the debenture-holders of the Investment Executive Trust was passed to the Transport Mutual and General Insurance Co. and there extravagantly used to purchase, at appreciably more than current market prices, shares in certain other companies, chiefly those of a Dunedin trustee company. Mr. McArthur, in his written statement handed in to the Royal Commission in Sydney, thus describes his object (see page 250 of the official proceedings):—

> The plan to obtain a controlling interest in these companies is conceived primarily in the interests of the Investment Executive Trust debenture-holders, and its success will have the effect of adding to the Investment Executive Trust capital, a large amount of funds without appreciably increasing the costs of management and administration.

In their report on the Transport Mutual and General Insurance Co., the New Zealand Inspectors (see page 158 of printed reports) say:—

> The company has acquired by way of purchase from shareholders in the Trustees, Executors, and Agency Co. of New Zealand, Ltd., 3,845 shares in the latter company. The majority of these share transfers have not been registered in the books of the Trustees, Executors, and Agency Co. of New Zealand, Ltd., but under normal circumstances, and subject to any restrictions in the articles of association or the regulations of the company the shares of which are the subject of transfer, a holding of nearly 40 per cent. of the total shares issued would give the holders potential control. The Inspectors would draw attention to the facts that the companies concerned administer trust and other funds amounting in the aggregate to several millions of pounds, that these companies have been granted special privileges by private legislative enactments, and also are subject to certain restrictions with obligations on shareholders and on directors in regard to reserve liability in the event of winding up and in respect of domicile of shareholders. The activities of the Transport Mutual and General Insurance Co., Ltd., in the organized purchase of shares illustrates that it is practicable for the directorate of such a trust company to be superseded and the administration devolve on others who would have been unknown to the persons who had confided the management of their affairs to the trustee company.

The proposed reconstruction scheme clearly involves the preservation and perpetuation of this scheme to obtain control of the Dunedin company, which, to quote the words of Mr. McArthur, "would make a large amount of funds available." The funds in question are presumably the trust funds, running into some millions, of the Dunedin trustee company. Any benefit that might accrue from the successful consummation of this scheme of obtaining control is, however, no longer a benefit to the Investment Executive Trust, for an option over all the shares in the Dunedin trustee company has been given by the directors of the Transport Mutual and General Insurance Co. to a Brisbane citizen.

The effect of this scheme on the finance and credit of the Dunedin company may easily be imagined. Mr. McArthur makes it clear that his object is to change the control by making alterations on the directorate of the Dunedin company. He says that the directors at the present time are of an average age of over eighty

years, and, in his opinion, a change of control will be for the benefit of that company. It will probably not surprise anybody to know that that Dunedin company has appealed to the Government of New Zealand for protection. No more need be said here than that the Government does not propose to stand by and see those men who maladministered the trust funds of the Investment Executive Trust given control of an established Trustee company, with its large amount of funds. The Government believes that when these facts are placed before it Parliament will agree that it is proper to take such steps as will ensure that the control of a legitimate Trustee company which has the administration of a large amount of funds, representing deceased and other estates, shall not pass to the men whose misplaced ingenuity forms the text of this present statement.

CONCLUSION.

It is for these reasons that the Government has taken the responsibility of preparing legislation for submission to Parliament providing for the winding-up of certain companies in accordance with the recommendations of the Inspectors. This legislation will be submitted during this session of Parliament.

Approximate Cost of Paper.—Preparation, not given; printing (1,550 copies), £17.

By Authority: G. H. Loney, Government Printer, Wellington.—1935.

Price 6d.]