1934.

NEW ZEALAND.

COMMISSION OF INQUIRY INTO COMPANY PROMOTION METHODS, ETC.

(FINAL REPORT OF COMMISSIONERS).

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

COMMISSION

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

BLEDISLOE, Governor-General.

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

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

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

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

to be a Commission to inquire into and report upon tendencies and developments apparent in the Dominion in relation to the promotion, financial methods, control,

and operations of companies and other corporations which seek to raise capital and loan funds in the Dominion and particularly—

(1) (*a*) The methods of promotion and administration of such companies, including their subsidiary companies and syndicates:

(*b*) The scheme of control of such companies and the relative powers and rights of promoters, subscribers of shares, and subscribers of debenture, bond, or security certificate issues:

(*c*) The financial schemes of such companies with particular reference to the relative application of the companies' and bondholders' property and funds to (1) remuneration and profits to promoters and subsidiary companies, (2) formation, working and administration expenses, and (3) protection and furtherance of the interests of holders of long-term debentures, bonds, security certificates, and like instruments or securities:

(*d*) Whether the benefits which may be found at present to accrue to promoters or shareholders in bond-issuing companies through the surrender or forfeiture of bonds should be applied and credited to bondholders' funds in the particular group or series of any such bonds surrendered or forfeited, or otherwise:

(*e*) Whether the provisions of the Companies Act, 1933, relating to prospectuses and otherwise requiring disclosure of material contracts and transactions and prospective contracts and transactions are reasonably adequate to protect intending investors in shares, debentures, bonds, security certificates, and other like instruments:

(2) (*a*) The financial structure of financial investment and trust companies, and as to whether any additional legislative provision should be made to afford investors a greater measure of protection for their capital moneys and other interests in such companies:

(*b*) The desirability of regulating in the public interest the formation and operation of trust companies and investment companies dealing in company shares, Government, local body, and other forms of security:

(3) The operation of the present statute governing the constitution and registration of stock exchanges in New Zealand;

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

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

JOHN SAXON BARTON

to be Chairman of the said Commission:

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

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

---

* This date was by subsequent Warrants under the hand of His Excellency and issued under the Seal of the Dominion extended to the 15th day of October, 1934.

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

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

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

GEO. W. FORBES, Prime Minister.

Approved in Council.

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

CONTENTS.

CONTENTS—*continued.*

CONTENTS—*continued.*

Tables.

Diagram.

CONTENTS—*continued.*

Appendices.

FINAL REPORT OF COMMISSIONERS.

To His Excellency the Right Honourable Lord Bledisloe, G.C.M.G., K.B.E., Governor-General and Commander-in-Chief in and over His Majesty's Dominion of New Zealand and its Dependencies.

MAY IT PLEASE YOUR EXCELLENCY :—

PART I.—INTRODUCTORY.

We took up the duties assigned to us soon after our appointment and met in Wellington on the 17th day of January last to plan the method and form of our inquiry. We quickly realized that in its scope and nature the inquiry presented peculiar difficulties. There were no specific complaints laid against any parties, and therefore no parties that could be cited to whom we could look to prepare a case and present it to us as a basis for examination and further inquiry.

We thereupon examined leading departmental officers in the Government service to ascertain the genesis of our appointment. We learned that in the Treasury Department, the Forestry Department, the Industries and Commerce Department, the Stamp Duties and Company Registration Department, and in the offices of the Prime Minister and the Minister of Finance there were numerous and voluminous files. The contents of these files, put together, presented a *prima facie* case for inquiry. They mostly took the form of letters of complaint, with departmental inquiries for further information, followed in some cases by concerted action by complainants with more or less formal reports and statements of facts. These were followed by departmental inquiry and report, with recommendations. The whole presented a cumulative demand for inquiry spread over some years.

The complaints referred to came from persons in all parts of New Zealand, from various States in Australia, from Canada, and the United States, and from India and other countries in the East. In most cases they came from small investors, who complained of misrepresentation, of inability to get information concerning their investments, of high-handed attempts (sometimes successful) to effect changes in the terms of their investments, of delays and disillusionment. The companies referred to in these complaints were, almost without exception, companies formed within the years 1924 to 1934, and, in the main, came within the category of land-utilization companies or investment companies issuing so-called "bonds" or "debentures."

The field of inquiry opened up by this preliminary survey was extensive; its subject-matter was diffused and incoherent. We thereupon considered the advisability of having learned counsel appointed to assist us by preparing a case for presentation to us, but decided that this would involve delay, expense, and duplication of effort. We came to the conclusion that there was no better method than that of tackling the mass of information available and reducing it to order ourselves. This occupied us fully for several months, including a period of seven weeks during which our full activity was restrained by litigation.

Most of the companies whose affairs we have investigated are registered and have their offices in Auckland, and it is in that city that our work for the last five months has been done. It became apparent to us early in this phase of our work that our objects would be better achieved if we made our inquiries in private. Much of the evidence we required was of a kind that must have been given grudgingly, and with a bias towards non-disclosure, if taken in public with the press present. The publicity given to many phases of the evidence would have been unnecessarily harmful to the companies. We therefore prepared a questionnaire, directed not to companies or individuals, but to general practices, tendencies, weaknesses, and evils. We handed a copy of this to the directors or solicitors of companies into whose affairs we inquired, and invited their co-operation.

We are gratified by the success of these methods. The representatives of thirty-two companies have either appeared before us and frankly disclosed to us all that we desired to know, or have entered into correspondence with us and answered individual questionnaires directed to their particular affairs. In many cases they frankly admitted to us the difficulties created and experienced in the formulation and administration of novel and hitherto untried methods of corporation investment; they invoked our assistance in meeting and dissipating these difficulties, especially where they seem to require legislation for their removal. In this connection we must acknowledge valuable assistance from the legal advisers of several of these companies.

INTERIM REPORTS :—

In the case of a few companies under the control of a small group of directors we were refused assistance. In relation to these companies we have submitted to Your Excellency two interim reports.

We are exceedingly anxious that these interim reports, which have attracted a great deal of public attention, should not create a false sense of proportion and distract attention from this report. The interim reports cover a series of developments and transactions falling within the scope of our work, but raising issues outside its province. They represent largely a necessary digression from our principal task. The refusal of these companies to assist us has affected that task chiefly by rendering statistical and accounting information less complete.

We believe that the conclusions and recommendations contained in this report relate to matters of deep and permanent importance to the community, and demand the earnest attention of Your Excellency's advisers and an informed public.

History.—We respectfully ask Your Excellency's acquiescence in our decision to omit here the history, usually recorded in such a report, of our movements, sittings, and procedures, with lists of witnesses. This report will of necessity be a long one, and we desire to shorten it where possible. The Chairman has kept throughout our proceedings a diary setting out in detail our daily doings, and this diary will be filed with the records of the Commission.

Evidence.—Evidence has been taken on oath, either orally or by affidavit, and a book containing a copy of the evidence thus taken, and comprising 594 pages, will accompany the report. [Not printed.]

We have accepted as evidence copies of entries and documents in the offices of the Registrar of Companies, of the Commissioner of Stamps, and of the Registrar of Deeds and Land Transfers. Where it seemed to us to be necessary to do so, we obtained certified copies under the seals of the respective statutory officers. These are in some cases attached as exhibits to the notes of evidence of official witnesses, and in some cases they appear in the files relating to the respective companies concerned.

Files.—There appears as Appendix No. VI to this report a list of the files constructed by us giving the name of the company or subject-matter.

Acknowledgments.—We desire to make some acknowledgments of special services rendered to us. In the first place we wish to express our indebtedness to the Consul-General for the United States in Wellington and the Consular Representative in Auckland. We learned of important reports that were on file as State documents in the State of New York, relating to practices and evils that seemed to bear a close resemblance to those that we were inquiring into. These had led to legislation in that State amending the company law, and making provision for its better administration and enforcement. They had also resulted in special legislation relating to the constitution and administration of the Stock Exchange. The Consular offices above referred to placed their services at our disposal, and at our request used their telegraphic codes and services to obtain documents for us at the shortest possible notice.

We have also to express our thanks to the law officers, particularly of the State of New York, who have kept us supplied with reports and statutes likely to assist us.

We also desire to express our thanks to officers of the Crown Law Department of the Australian States recently visited by the Chairman. It became obvious in the course of conversations that certain recent developments covered by this report will require consideration of the possibility of reciprocal action in the permanent general law of the Dominion and the States as it relates to company promotion and control. These matters were discussed on a basis that augurs well for future legislation and amicable settlement of difficulties that may be inherent in the present position.

We are also under a deep debt of gratitude to the Chairman of Directors and the officers of the Auckland Electric-power Board. When we first went to Auckland in March we found difficulty in procuring suitable premises. The gentlemen referred to met us very generously by offering to make two rooms available to us, and we assured them, in all good faith, that we expected to be there for about a month. There followed soon after litigation which delayed the commencement of our sittings for seven weeks. A few weeks later it became necessary for the Chairman to visit Australia, and that extended the work of the Commission by at least two months. These facts extended the period during which we required accommodation in Auckland, and, with the consent of the Power Board officials, we remained in the rooms allotted to us in their building. The above situation might well have strained the patience and goodwill of the most indulgent landlord, but the position was met in a most cordial and generous spirit throughout, and the rooms, as well as the Board room from time to time, were placed at our disposal throughout this long period without payment of rent. We wish to place on record our appreciation of this public-spirited attitude on the part of the Board.

We also desire to acknowledge the assistance that we have received from several of the Government Departments. In particular, we must mention the Registrar of Companies and his deputies and the Land Transfer Registrar and his deputies. Our inquiries and requisitions have placed a great deal of extra work on these officers and their staffs at Auckland, and all our requirements have been met with ready courtesy and promptitude. The skilled assistance given by officers of the State Forestry Department must be mentioned here: we refer to it more fully on page 78.

PART II.—SCOPE AND METHOD OF INQUIRY.

We have found it convenient to group the subjects coming within our Order of Reference under certain headings relating to the main types of companies to which such subjects have application.

Part III of our report refers to the operations of companies engaged in *land-utilization* projects on a large scale.

Part IV is concerned with finance companies of the kind commonly known as *investment trusts*.

Part V covers a small group of companies which have *combined the investment trust idea with* proposals to obtain concessions for the running of *lotteries* in other countries.

Part VI relates to a type of company which raises a portion of its capital by the issue of *employee shares*, employment by the company being conditional upon subscribing for shares in the company.

Each of these various classes of company exemplifies new or unusual features in regard to promotion, financial organization, control, or administration, which seem to us to demand legislative or other action in the public interest.

In Part VII of the report we deal with certain miscellaneous problems of a general character.

Part VIII deals with the operation of the present statute governing the constitution and registration of stock exchanges in New Zealand, together with our recommendations in regard to stock exchanges.

Our own investigations, together with the opinions of many witnesses, have convinced us that, while some amendments to the law are necessary and desirable, yet a purely legal remedy can never be sufficiently effective in preventing undesirable practices without seriously restricting legitimate enterprise

and experiment. Hence we recommend that the purpose of the law in safeguarding the investor, while at the same time avoiding undue restriction on business, should be reinforced by the establishment of a special bureau with certain defined and limited discretionary powers. The case for such a bureau is argued in Part IX, wherein we embody also our recommendations regarding its constitution, powers, duties, and finance.

We have received disturbing evidence relating to the effects on New Zealand's credit overseas of the operations of some New Zealand companies. These are discussed in Part X.

A final section, Part XI, summarizes such of our findings as have led to specific recommendations, and embodies a list of such recommendations.

There are certain important matters which come partly within, partly without, our Order of Reference. For example, the negative conclusion that a considerable number of small units of savings, reaching in the aggregate a formidable total, has been misdirected or wastefully applied has forced us to the opinion that some positive measures should be devised to direct small savings into channels where they can be remuneratively applied without incurring the risks inherent in the financial scheme of many of the enterprises we have examined. We have discovered also that many land-utilization companies have failed to make adequate provision in their trust deeds or articles of association for the realization of their assets, and that legislation is needed to remove many of the difficulties now facing bondholders.

In order not to complicate unduly our main report we have relegated these and other matters to appendices. Apart from such instances as fall within, but may extend beyond, our Order of Reference, we embody in this report only such matters as are covered by our instructions. We have received evidence relating, for example, to the *commercial prospects* of companies engaged in large-scale land utilization. Such matters are of considerable economic and social importance to New Zealand, and may have political reactions as well; but we have avoided any reference to them in our report because we do not regard ourselves as competent to form a reliable judgment on such matters, and because they fall outside our terms of reference.

Nor have we felt it our duty to inquire fully into the individual grievances which have been presented to us from time to time, nor into the detailed transactions of particular companies, except in so far as these have appeared to raise general principles calling for investigation or action.

We have considered it advisable to confine our inquiries to the types of company described in Parts III, IV, V, and VI of our report, and to the operations of stock exchanges. We have no doubt that new tendencies worthy of investigation are in evidence in other types of company, but we have limited ourselves to the above types of company because they appear to us to illustrate the most important and striking tendencies and reveal the most serious actual or potential dangers. We have preferred to make an intensive and comprehensive survey over a narrow field rather than dissipate our efforts by the pursuit of tendencies along every path which was opened to us. Such a task would have been never-ending.

In procuring evidence for our report we have made a full search of the relevant records of the State Forestry Department, the Department of Industries and Commerce, the Treasury, and the Registrar of Companies. The available files, records, prospectuses, and other documents, as well as reports in financial journals, relating to one hundred and forty-two companies have been searched and sixty-eight witnesses have appeared before us (some of them on several occasions) or have presented sworn statements.

In addition, a number of individuals have forwarded to us statements relating to various topics. Except where such information has been obtained on oath, it has not been used in this report. On our request the Registrar of Lands, Auckland District, has caused to be searched the land transactions relating to fifty-eight land-utilization companies. In addition to the above, we have made full use of available reports, statutes, books, and other publications dealing with tendencies, practices, or legislation in other countries.

PART III.—LAND-UTILIZATION COMPANIES.

(We use the word "bonds" in this part of the report, except where the context clearly indicates otherwise, as a generic term to include forestry and other land-utilization bonds, investment securities, debentures, and other similar instruments issued in series. The nature of these is discussed below.)

1. EXTENT OF OPERATIONS.

The companies which we have described as land-utilization companies are formed for the purpose of planting land in forests, tung oil, citrus and other trees, tobacco, or flax. The statistical or other information available from official sources relating to land-utilization companies is far from complete, and we are forced to make an approximate estimate of the extent of their operations. In some cases these estimates are subject to a wide margin of error, but they are sufficiently accurate to indicate the magnitude of these operations.

Afforestation companies are first in importance as regards number of companies, area planted, and capital invested. We have knowledge of forty-six afforestation companies—exclusive of subsidiary or affiliated companies—which have operated in New Zealand during the past ten years, and we have inquired into the affairs of thirty-six such companies.

The area in exotic forests as at 31st March, 1933, according to Forestry Department records, was as follows:—

	Acres.
Exotic State forests	393,000
Planted by afforestation companies	250,000
Plantations owned by local bodies, individuals, and educational authorities, &c.	60,000
Total	703,000

The price of " bonds " sold by afforestation companies varies from about £20 per acre to £55 per acre. If we take as a conservative basis the sum of £25 per acre, inclusive of both share and " bond " capital, this represents a total of £6,250,000 invested in afforestation during the past ten or twelve years. The above calculation takes no account of capital which may have been raised in respect of standing forests held by afforestation companies. On the same basis the whole area held by afforestation companies (447,000 acres), when planted, would represent an investment of £11,175,000.*

Statistical information covering the operations in tobacco, flax, tung oil, and other products is even less complete than that relating to afforestation.† We have knowledge of thirty-seven companies of the above types, excluding subsidiary and affiliated companies. In the case of six such companies (which appear to be representative), the aggregate of bond and paid-up share capital is somewhat over £334,000, or an average of about £56,000 per company. On this basis the aggregate of capital invested in thirty-seven such companies would be over £2,000,000.

We conclude that between £7,000,000 and £8,000,000 has been invested in land-utilization companies (including forestry companies) during the past ten or twelve years, and that the higher figure is likely to be nearer to the truth. *Much of this capital has already been lost to investors.* (See Table 5, page 41.) The bulk of the capital has been raised in New Zealand and Australia, but an appreciable sum has been raised in India, the Far East, and Great Britain. Hence the problems under investigation have important international bearings which may reflect on the credit of New Zealand overseas, and which add to the difficulties of arriving at a satisfactory solution.

---

* Returns relating to afforestation companies are published annually in the " New Zealand Official Year-Book." The liabilities and assets of twenty-seven forestry companies are given as follows as at 31st March, 1932 (" New Zealand Official Year-Book," 1934, p. 361)—

Liabilities.	£	*Assets.*	£
Paid-up share capital	833,782	Land for afforestation	510,671
Loan-money	4,333	Land for other purposes	..
Forfeited Shares Account	8,433	Development Account	2,406,366
Mortgages	140,022	Investments	976,406
Sundry creditors	137,388	Goodwill and preliminary expenses	29,349
Bondholders	2,853,654	Other	287,761
Other	232,941		
	£4,210,553		£4,210,553

Receipts and payments for the five years ended 31st March, 1932, are as follow. (NOTE.—Receipts are from the cash point of view and must not be confused with revenue.)

	1927–28.	1928–29.	1929–30.	1930–31.	1931–32.	Totals.
Receipts.	£	£	£	£	£	£
Share capital	117,316	124,566	101,025	78,952	92,730	514,589
Instalments on bonds	417,880	607,889	662,876	624,568	454,971	2,768,184
Loan-money	5,243	2,400	2,230	..	..	9,873
Other receipts	21,875	47,352	72,049	137,968	79,759	359,003
	562,314	782,207	838,180	841,488	627,460	3,651,649
Payments.	£	£	£	£	£	£
Tree-raising	20,290	22,191	25,169	23,057	14,884	105,591
Establishment charges	114,345	134,816	91,508	85,168	38,903	464,740
Maintenance	13,602	22,024	32,296	28,767	25,694	122,383
Management, &c.	172,266	226,628	223,338	277,469	146,509	1,046,210
Land purchase	90,916	79,372	100,005	70,515	34,530	375,338
Other	136,951	308,346	369,206	300,247	380,073	1,494,823
	548,370	793,377	841,522	785,223	640,593	3,609,085

The Official Year-Book states :—

" The nine companies engaged in the sale of forest areas effected sales involving 16,030 acres of land during the twelve months ended 31st March, 1932, making a total of 262,790 acres sold up to that date. The instalments paid in accordance with the contracts of sale entered into during the year under discussion amounted to £413,096, while the total instalments paid up to 31st March, 1932, on all bonds amounted to £3,327,757. The total commitments of the investing public on account of contracts entered into during the year amounted to no less than £503,544, bringing the total for this item to £6,693,600 at 31st March, 1932.

" Against the foregoing must be set contracts involving 89,876 acres, of a total selling-price of £2,437,437, which have been cancelled by the purchasers. Instalments amounting to £115,057 were paid up on these cancelled contracts."

Note that the aggregate amount received from the sale of bonds by *six* companies, of which the Commission has adequate records, exceeds £4,850,000. This includes sums received on bonds forfeited, but excludes payments due on unforfeited bonds. The aggregate of paid-up share capital and receipts from the sale of bonds in *six* companies totals £5,207,000. These figures cover operations during a period of years longer by about two years than the period covered by the official figures.

The total area planted by these companies was over 200,000 acres, and in addition some 18,000 acres were held in native bush. These figures suggest that our estimate of £6,250,000 for the total of capital invested in all companies is not excessive.

† The estimates of the areas in crops other than forests have been supplied by the Department of Agriculture. They are—Tung oil, 3,110 acres (as at 27th February, 1934); tobacco, 2,448 acres (1933–34 season); flax, 64,206 acres (1932–33 season). These figures furnish no guide to the amount invested in tung-oil, tobacco, and flax companies.

2. INADEQUACY OF OFFICIAL STATISTICS.

We have been seriously hampered in our inquiry by the paucity of official statistics relating to the types of company referred to above. There is no complete list of companies operating in New Zealand, no adequate record of areas planted, nor of the amount of capital raised. There is no official information relating to the distribution according to the territories from which they have been raised, of the bond-moneys received, nor of the objects on which bond-moneys have been expended.

The economic importance of the operations of land-utilization companies, the large amount of capital involved, and especially the peculiar significance which should be attached to the manner in which they raise their funds in the form of contracts made, usually with small investors, are such as to justify a greater measure of publicity than is required of ordinary industrial or commercial undertakings. We feel strongly that all land-utilization companies raising capital for use in New Zealand should be required to furnish adequate statistics of their operations. This is desirable to enable a drift to be detected, and to provide the basis for an informed public opinion or for Government policy.

We recommend, therefore,—

(1) **That all companies raising capital for the purpose of planting land with trees or other crops in New Zealand shall be required to furnish to the Government Statistician an annual statement covering the information as set out in Appendix I.**

(2) **That this shall apply to such companies registered in other countries as well as in New Zealand.**

(3) **That the Government Statistician shall publish an annual table, or tables, summarizing the information thus obtained.**

3. GENERAL SCHEME OF OPERATION.

In this section it is proposed to describe in outline the scheme of finance and control adopted by land-utilization companies. Later in the report the methods described are discussed in greater detail under separate headings.

The companies investigated apply the joint-stock principle, with or without modifications, to the planting of areas of land, and the harvesting, processing, and marketing of the crops. The first companies were formed for the purposes of afforestation, about the year 1923, so that few, if any, companies are more than twelve years old. The application of the company form of organization to flax, tobacco, and tung-oil is more recent. By 1925 or 1926 the idea was being applied to flax and tobacco, and by 1929 to tung oil. The areas acquired or planted vary very much in size, the largest being an afforestation company with a planted area of over 150,000 acres, and an aggregate capital, including both "bond" and share capital, of nearly £4,000,000. Another large company has a total paid-up capital, including bond capital, of over £841,000 at the present time, and has about 69,000 acres in planted trees or native bush. The remaining companies are much smaller, and few represent an aggregate investment of over £100,000. In most cases, provision is made for the issue of shares or bonds, particularly the latter, substantially greater than the number so far taken up and fully paid. With the exception of banks and insurance companies there are few types of business enterprise operating in New Zealand in which the normal unit has so large a capitalization.

The majority of companies are registered in New Zealand, but about ten companies, including two or three of the largest, are registered in Australia.

The company form of organization possesses some advantage over ordinary farming methods in the types of enterprise under consideration. This applies particularly to afforestation. Normally, the farmer, whose main income is from the soil, requires an annual return from his crops, commencing at an early date. The initial returns from planted forests are delayed for a period of from twelve to thirty years. The returns from tobacco, flax, and tung oil may be expected within a period of from two to five years, so that they are more suited to ordinary farming. Nevertheless, in these cases, as well as in afforestation, the joint-stock company possesses certain advantages. It enables the accumulation of a considerable capital which can be directed to large-scale enterprise, because the investor who would not be prepared to embark his whole resources of labour and capital on an untried venture may be persuaded to risk some portion of his savings. Under proper conditions the company form of organization permits of cheaper and more efficient management of the plantations and enables an economical realization and marketing unit to be established. The preparation and marketing of the crops may be undertaken more cheaply and efficiently.

Land-utilization companies conform to two types—those which apply the ordinary joint-stock principles and raise the whole of their capital by means of shares and those which raise the bulk of their capital by selling contracts, variously described as bonds, debentures, or certificates. The former are usually public companies: the latter may be either private or public. In very many cases bond-issuing concerns are formed as private companies and are later converted into public companies with an enlarged nominal capital for which they may invite the public to subscribe.

While the purely share companies are not free from certain objectionable features, there is nothing peculiar about their system of finance and control, and the difficulties applicable to them are equally applicable to the bond-issuing companies to which our main attentions have been directed, and which exemplify certain other undesirable tendencies as well. Hence no special consideration need be given to purely share companies.

The device of raising capital by the sale of contracts, or "bonds," is the product of the past ten years, and appears to be a New Zealand invention. This method of finance has been very successful in encouraging investment in land-utilization companies, and the aggregate of "bond" moneys raised by such companies has been substantially greater than that raised by share companies of the orthodox type. The organization and practice of companies using this method of raising finance differ in detail, but exhibit certain general well-defined characteristics.

The common practice is that a small group of people form a company which purchases, or agrees to purchase, an area of land, or obtains an option over land. This may, or may not, be free from encumbrances. Normally, though not universally, the paid-up capital is small, both absolutely and in relation to the proposed undertaking. The company then proceeds to issue a "prospectus" inviting the public to subscribe for "bonds" or other forms of "contract."* Apparently the "sales resistance," especially of the experienced investor who normally buys securities through his broker, is too strong to permit of the sale of any considerable number of bonds without a special sales organization, and the sale of bonds tends to become the function of specialized concerns. These employ "high-powered" salesmen who have usually adopted the method of door-to-door canvass or "hawking."

In the formation procedure the bond-selling company may be a private company preceded by other companies or syndicates which are interposed between the original vendor of land and the bond-issuing company. At a later stage the bond-issuing company may be converted into a public company and issue a prospectus inviting subscription for shares. By the device of a private company, and of precedent syndicates and companies, transactions in land and the particulars of other material contracts may be effectively concealed.

Usually the value of the bond issues provided for (and issued) is very much greater than the nominal capital, and especially than the subscribed or paid-up capital. This is illustrated in Table II (page 29). The summarized results are as follow:—

The original nominal capital of fifteen land-utilization companies was approximately £210,000, the subscribed capital £147,000, and the paid-up capital £114,000, of which £54,000 was paid up in cash and £60,000 for considerations other than cash. According to the latest return the nominal capital was £860,000, subscribed capital £657,000, and paid-up capital £601,000. Of the paid-up capital £315,500 was received in cash and £285,600 for considerations other than cash. The aggregate bond-moneys received amounted to £5,265,591, and the value of bonds the issue of which was provided for was about £7,165,000. The value of bond issues provided for up to June, 1934, was over sixty times the original paid-up capital, including shares issued for considerations other than cash, and nearly twelve times the paid-up capital at that date. The amount received from the sale of bonds in June, 1934, was over forty-six times the original paid-up capital, and nearly nine times the paid-up capital at that date.

In considering the implications of the above figures it should be noted that in many cases the value of the consideration for which fully-paid shares have been received is entirely fictitious, while it is by no means certain that shares described as paid up in cash always represent a genuine cash transaction. It is interesting to note that included in the above amount of £285,600 for consideration other than cash are the shares of one company, represented as £146,000 fully paid up, which are issued in exchange for shares to the value of £13,007 in another company governed by the same directors, the assets of which were (fictitiously) written up eleven-fold.

Bonds are issued in denominations varying from £20 to £55 per bond. They consist of a contract to transfer to the bondholder on a specified date (or to a trustee appointed to look after his interests) a certain unencumbered area of land duly planted and maintained. In the case of forestry companies, the contract covers an acre of land per bond. In the case of flax, tobacco, and tung-oil companies, the area is usually one-quarter, one-third, or one-half acre per bond. The contract covers an agreement to replant areas which have failed or been destroyed. In some cases the company agrees to plant an area in excess of that covered by bonds sold, as an additional security.

The bondholder does not normally have title to a particular individual acre, but he shares his rights in common with other bondholders over the particular area of land to which his bond-series relates. His right consists in a share in a particular area in the proportion that his holding of bond bears to the total bonds issued against the area, and in an equivalent proportion of the proceeds from the realization of the area. In some of the earlier issues of forestry companies, they contracted to pay interest on bonds. Forestry companies soon abandoned this practice, but it is still common for tobacco, tung-oil, and flax companies to pay interest for a stated period of years, at the end of which the plantations are expected to be ready for realization.

In some cases provisions relating to the transfer of title are ambiguous, and in one or two cases the bondholders have no title to the land, but only to the proceeds from the crops when they are marketed.

The function of the "parent" company is to acquire the area, sell or arrange for the sale of bonds, plant the area as bonds are sold, and maintain it until the lands are transferred. It makes its profits out of the difference between the value of bonds sold and the sum of the costs involved in promotion, land-purchase, bond-selling, planting, administration, and maintenance.

---

* The use of the term "contract" to describe the subject-matter of a subscriber's interest is of recent adoption, and the company's officials tend to shelter behind it when the question of the precise nature of the instrument is discussed. As between salesman and intending purchaser, however, the term "bond" or "debenture" has been, and is, used, and the idea carefully fostered that the instrument represents a "gilt-edged" class of security. This idea is strengthened by the use of a prospectus, which is a procedure legally necessary to the sale of debentures and such securities to the public, but quite unnecessary, legally, to the procuring of "contracts" in series.

As security for the performance of its contract, the parent company usually agrees to set aside, as a trust fund, a certain amount from, or proportion of, the price received for each fully paid-up bond. This amount, or proportion, varies from company to company. The trust fund itself, and usually the income from the fund, are the property of the company as long as its contract is properly performed. The trust deed usually provides that a given amount or proportion of the trust fund shall be paid to the company each year, as long as the area is satisfactorily maintained, and that the balance of the fund shall be handed over on completion of the contract. In some cases sufficient from each bond is held in the fund to cover the estimated cost of the plant necessary for processing the product.

In the case of most companies issuing bonds trustees have been appointed to look after the interest of bondholders. The conditions of their appointment, the circumstances under which they may be removed and new trustees elected, their powers and duties, their relation with bondholders, the powers and duties of bondholders, and the conditions of the contract embodying the obligations of the company are set out in a trust deed. The original trustees will be appointed by the company and the conditions of the trust deed which determine and limit their powers and duties will be drawn up by the company.

The constitution and personnel of the trustees varies a great deal. The trustee may be an insurance or trustee company, a public trustee, an individual or group of individuals, or a separate company set up for the purpose.

In some cases no trustee has been appointed, the companies merely contracting to set up a trust fund.

4. FINDINGS.

A. PROMOTION.

(1) Methods of Flotation.

Reference has been made earlier in this report to the very common practice of establishing a land-utilization project by means of the flotation by a small group of people of a private company with a small paid-up share capital. We have disturbing evidence of many undesirable features associated with this method of promotion: these arise largely from the prominence, as promoters and original directors, of land-holders or holders of options over land, and of agents and brokers. The names of some such individuals appear as promoters and original directors in the documents of several companies. In many cases they are sole promoters, retain the largest interest in the company, and dominate its policy. In more than one instance the interests of such individuals have been at variance with those of other directors and shareholders, have led to internal conflict, and have endangered the success of the company. These results frequently follow the control of a subsidiary brokerage company by directors of a "parent" company. The practice has undoubtedly been an important contributory factor to the failure of more than one company, for it has loaded the company with excessive capital charges or excessive brokerage costs. We have convincing evidence that in many cases the main incentive has been the desire to earn large profits from the sale of land or from brokerage on the sale of bonds. There is little doubt that in such instances the ultimate success of the company as a land-utilization venture was or became a subservient consideration in the minds of its promoters and directors. Later in this report we shall furnish evidence of the inflation of land-values, which strongly supports our opinion. The common practice of floating a subsidiary company with the sole right to sell bonds or shares is corroborative evidence. Excessive charges in respect of land, brokerage, and promotion services have been facilitated by the device of the private company, because in such case the publicity afforded by the filing of a statement in lieu of prospectus and the checking and oversight of the early transactions by the statutory report and statutory meeting are avoided. By this procedure and by the device of antecedent companies or syndicates dealing in land and subsidiary brokerage companies, excessive profits accruing to promoters and others may be effectively concealed.

(2) (*a*) Inflation of Capital and the Loading of Excessive Costs.

We quote below a number of examples of companies in which costs of promotion and brokerage appear to have been excessive, or whose assets have been inflated to a fictitious value. It will be noted that in many cases the devices referred to in the preceding paragraphs have been used to facilitate these practices.

The companies and witnesses are referred to by numbers, a confidential key being attached to the report. This procedure is adopted to fulfil a promise given to many companies and witnesses who supplied freely a great deal of confidential information and gave us copies of their accounts.

Company No. 5 is a public (forestry) company with a nominal capital of £25,000, of which £7,509 was subscribed on going to allotment. The original promoters were three individuals, who were included among the first directors. Two of these were vendors of land to the company, amounting in the aggregate to 5,414 acres. Information is not available in respect of all transactions,

but of this area one block of 1,284 acres was bought by these two men for £3,217 and sold the same day to the company for £5,147. Other blocks, totalling 1,129 acres, were bought in 1918 and 1919 by one of the promoters and his wife for the sum of £1,036. In 1920 they were sold to two individuals for the sum of £4,520. In 1926 the original vendors resumed possession under a mortgage for a consideration of £3,391, and in 1929 sold to the company for the sum of £4,522. One of the vendor-promoters received 2,000 fully-paid-up shares out of the £7,509 subscribed—the consideration being "for services rendered in the promotion of the Company". The witness who appeared before us was unable to inform us as to the nature of these services. The three promoters were directors in the brokerage company which sold the company's bonds. They had a controlling interest in the land-utilization company. Of £80,000 received from the sale of bonds, £43,000 went in brokerage and management. Within four years after incorporation, the company was in difficulties, and "it must soon have been forced into liquidation had the policy of inanition continued" (Witness No. 1). The majority directors then sold out their interests, and a new directorate was appointed.

Company No. 3 was registered, with a capital of £5,000 fully subscribed, as a private company. There were six subscribers to the memorandum of association, of whom two (1,000 shares each) were vendors of land and one was broker to the company. The amount paid to the vendors of land was £15,404 for 2,653 acres. No evidence was given as to previous dealings in land, but a witness stated: "I have no reason to believe that an excessive profit was made, but my personal view is that it was a mistake to have these vendors on the directorate—their interests and the company's interests being sometimes at variance" (Witness No. 2). For a period of two years after incorporation the broker was chairman of directors. His successor, who gave evidence before the Commission, stated: "I was not altogether satisfied that the interests of the bondholders were receiving due protection, particularly as regards the quantity and condition of growing timber and the tending thereof" (Witness No. 2). Brokerage was £10,524, out of a total amount received from bonds of £58,659. Included among the factors causing difficulty to the company are "the high cost of sale of bonds" and "inability to sell the whole issue." A witness stated: "Mr. ——, who was first chairman of directors of the company, was a shareholder in the brokerage firm. He was a member of the firm. I consider this a most undesirable state of things. The interests of the brokerage firm and the company must be in conflict. That probably is part of the explanation for the high amount of brokerage" (Witness No. 3).

Company No. 7 is a tung-oil company, which was formed as a private company with a nominal and subscribed capital of £2,500. The vendor of land received 500 shares in part payment for land, but we received no evidence of promoters' shares or of excessive profit in respect of land. One of the promoters, who was managing director of the company and who held 1,100 shares out of the 2,500 subscribed, held a controlling interest in the brokerage company. "The fact that —— was chairman of directors and was also interested in the brokerage company, caused many bitter disagreements on the board, and led to the resignation of ——, a gentleman of the highest integrity. A series of disagreements finally culminated in the cancellation of the brokerage contract and the resignation from the board of ——. The brokerage company had not proved a great success, as sales were obtained on ridiculous terms, and many purchasers made no further payments beyond the deposit, which in many cases was reduced by this company in order to effect sales" (Witness No. 4). The brokerage company received 15 per cent. of the price of bonds. On the termination of the contract the company undertook its own selling, and was able to operate on a selling cost of 8⅓ (eight and one-third) per cent.

Company No. 8 is a tung-oil company which was incorporated as a private company with a capital of £1,400, the whole amount being subscribed. At the first meeting of directors the nominal capital was increased to £20,000, and a year later the company was converted into a public company. Of the 1,400 original shares of £1 each, 500 were issued as fully paid up to the promoter, as payment for an option to purchase 1,318 acres of land. The promoter and vendor of land were original directors to the company. Each of the three original directors was a shareholder in the brokerage company selling the company's debentures. The commission on the sale of each debenture of a nominal value of £25 was £5 12s. 6d., or 22½ per cent. Later series of debentures were issued at a premium of £2 10s., of which the brokers were to receive one-half. A witness states: "About a year ago, the services of the brokers were dispensed with, thus effecting a very considerable saving in commission, &c." (Witness No. 5).

Company No. 16 is a tung-oil company which was incorporated with a nominal capital of £50,000. The total amount subscribed on going to allotment was £5,653, and the cash received was £1,081. The two promoters, each of whom has been associated with other unsuccessful ventures, were to receive £1,500 in cash for "valuable services rendered." The company went into liquidation without selling any bonds. One of the reasons given for its non-success was the failure of one of the two promoters, who was sales-organizer (and a member of a brokerage firm) to carry out his duties efficiently. The directors lost their money over the venture.

An interesting and illuminating example is supplied by the following:—

Companies 10, 11, 17, 18, 19. On the 25th May, 1929, a farmer was in financial difficulties in connection with a mortgage on his farm, due to a financial company which we shall call the "mortgage company." He granted an option to purchase that farm, containing about 750 acres, to the managing director of the mortgage company. We shall call the grantee the "option-holder." The option was to be exercised by a buyer nominated by the option-holder, and the price was to be £10 per acre; the total price was therefore £7,500.

The option-holder then proceeded with the formation of a syndicate, and on the 30th May a memorandum of agreement setting out the constitution and objects of the syndicate and the rights of the thirty-five members, *inter se*, was executed.

On the 14th June, 1929, the option-holder formed a company, which we shall call the "land-sales company." It was a private company, the members being the option-holder and his wife; the capital of the company was £350 in shares of £1 each. The option-holder nominated this private company as his nominee to exercise the option to purchase at £10 per acre; and it was duly exercised on 8th July, 1929.

The syndicate was busy in the meantime arranging the formation of a company which we shall call the "promotion company." The principal objects of this company were to carry on the business of planting, cultivating, curing, manufacturing, and sale of tobacco; and to purchase the land containing 750 acres already referred to. This company had a capital of £150,000, divided into shares of £1 each, and the option-holder was one of its original directors. This company then proceeded to allot shares to the members of the syndicate, and to seven "dummies," or nominees, who signed the memorandum of association of the company. Each of the then members of the syndicate, and each member of the land sales company, received 250 shares, and each nominee, or dummy-subscriber, to the memorandum of association received one share, so that 10,007 shares were thus allotted. In addition, 2,500 shares were allotted as fully paid to the company, which we have called the "land sales company," and 500 were allotted to a brokerage company which was formed about the same time.

On 28th June the promotion company carried a resolution to the effect that the company exercise the option granted to it by the land sales company to purchase the block of 750 acres. As a matter of fact, at the date this resolution was passed the land sales company had not given any option to the promotion company—the option was given the next day, and it was an option to purchase the land at £20 per acre, or £15,000 in all. As is pointed out above, the land sales company exercised its option to purchase at £10 per acre on the 8th July, 1929.

The promotion company then purchased other blocks of land in the same locality at about £15 per acre. It seems to have purchased land at a cost, according to its books, of about £34,000 in all.

The next step was the formation of a bond-selling company, which was incorporated on 9th July as a public company, with an authorized capital of £250,000 in 250,000 shares of £1 each. Its principal objects were to carry on the business of planting, cultivating, curing, manufacturing, and selling tobacco, and the acquisition of the necessary lands, and to acquire and hold shares and debentures in any other company having objects similar to its own. The directors of the bond-selling company were the option-holder and four other members of the original syndicate, all of whom had become members of the promotion company. The option-holder, it will be remembered, had been one of two members of the land sales company, a member of the syndicate, a director of the promotion company, and was now also a director of the bond-selling company.

In anticipation of the formation of the bond-selling company, the directors of the promotion company had procured valuations of the land. The first of these, dated 12th June, describes the land in glowing terms; it does not descend to such details as value per acre, but it assures those to whom it is addressed that the soil is "of a moist, kindly nature." The valuer also referred to "kindly loam" and to a gravel drift, adding, "It is possible that these gravel deposits will become of great value, as metal or gravel is much needed for roading purposes." Another valuer, whose report is dated 8th July, showed more courage, for he concluded his report boldly, "For tobacco-growing purposes, I estimate this land to be worth at least £85 per acre, and I have no doubt that with that development contemplated a much higher figure will be sought for this class of land." A third valuer valued the 750-acre block at £87 10s. per acre over the whole area; this was on 19th July, 1929. A fourth valuer, reporting on some of the other parcels of land acquired by the promotion company, valued them at £82 10s. per acre.

The promotion company, with a kindly sentiment comparable to the quality of its soil, thereupon solemnly passed a resolution writing up the value of the land in its books to £70 per acre. The resolution reads, under date of 20th July, 1929:—

> "That the company's capital assets should be written up to £176,000 at an average of £70 per acre, in accordance with the two valuations submitted by the two independent valuers."

The next step was the decision by the directors of the bond-issuing company to purchase the assets of the promotion company at this inflated valuation. The purchase was effected, the bond-issuing company buying all the shares in the promotion company, apparently transferring some of them to some of its members so as to comply with the provisions of the law that requires seven members in a company. The basis of the purchase was that the bond-selling company should allot to the members of the promotion company as fully paid 2,807 £1 shares in the bond-issuing company for every 50 £1 shares held in the promotion company. This gave the shareholders in the promotion company the equivalent of £11 4s. 6d. for every £1 share in the company. The whole of the foregoing transactions took place between the 25th May and the 17th July, 1929. The purchase of the shares was effected by the procedure, now quite familiar, of exchanging cheques. The bond-issuing company issued cheques totalling £146,000, and handed them over to the shareholders in payment for their shares in the promotion company, and the promotion company handed cheques back again as payment of £1 on each share of 146,000 shares to be issued to the members of the promotion company.

The statutory report, filed with the Registrar of Companies in compliance with the Companies Act, refers to this transaction thus: "The total number of shares allotted to date is 146,000, all of which have been issued for cash." Entries relating to these transactions were passed through the bank account of the bond-issuing company, the only previous entry in that bank account being a debit of £2 for stamp duty on a cheque book.

The stage was now set for the issue of a prospectus to the public. On the 18th and 31st days of July respectively two prospectuses offering bonds to the public were filed with the Registrar of Companies; each prospectus described the company as having an authorized capital of £250,000 divided into 250,000 ordinary shares of £1 each, "of which £146,000 were issued and fully paid." The first prospectus offered for subscription 3,000 freehold bonds of £30 each.

A brokerage company had been formed, and it undertook to sell the bonds. By the 22nd August, 1929, the company's bank account had a credit balance of £855. This represented the balance of £1,250 which had been received from bondholders, against which the company had drawn cheques of £395 for expenses. There were dealings between the bond-issuing company and the brokerage company, which were possible only by reason of the fact that the companies had directors in common, and trouble arose between the companies by reason of this conflict of interests.

The records of the bond-issuing company show that, in all, 613 bonds were sold in New Zealand and 234 in Australia. From the sale of these, the bond-selling company received a gross sum of £18,440. In addition, it received £2,667 from the issue of preference shares. Of the total of £21,102 thus obtained, the sum of £16,556 was paid by way of selling-expenses.

Although sufficient bonds had been sold and the bond-issuing company was bound to appoint a trustee and execute a trust deed, this was never done, although the matter was discussed by the directors from time to time. Further, the bond-issuing company never at any time owned any land, although the said corporation was bound by the terms of its bonds to transfer land to the trustee for bondholders.

The company at this stage found itself unable to carry on, and it went into liquidation. At the date of liquidation the amount of cash which, according to the terms of the debentures should have been in a trust fund, was only a little more than 10 per cent. of the amount that should have been there. One specific sum of £545 was traced on 20th November, 1929, as having been expressly drawn from the trust account and paid into the company's general account. The bondholders lost heavily.

Proceedings were taken against the directors, alleging that they were guilty of misfeasance, negligence, breach of trust, and breach of duty in the management of the business of the company, but the proceedings were settled by private negotiation.

It is convenient at this point to anticipate the subject-matter of a later section by showing the interlocking of the various companies referred to above through common shareholding or directorates:—

Mr. A.—

Managing director of bond-selling company	No. 11
Director of promotion company	No. 10
Chief shareholder in land-sales company	No. 17
Managing director of mortgagee company	No. 19

Mr. B.—

Director of promotion company	No. 10
Director in bond-selling company	No. 11
Shareholder in brokerage company	No. 18

Mr. C.—

Joint solicitor to bond-selling company	No. 11
Joint solicitor to promotion company	No. 10
Shareholder in bond-selling company	No. 11
Shareholder in brokerage company	No. 18
Director in promotion company	No. 10

Mr. D.—

Shareholder in promotion company	No. 10
Shareholder in brokerage company	No. 18

Mr. E.—

Joint solicitor to bond-selling company	No. 11
Joint solicitor to promotion company	No. 10
Shareholder in bond-selling company	No. 11
Shareholder in promotion company	No. 10
Shareholder in brokerage company	No. 18
Shareholder in mortgagee company	No. 19

Mr. F.—

Director in bond-selling company	No. 11
Shareholder in promotion company	No. 10
Director in mortgagee company	No. 19

Mr. G.—

Director in bond-selling company	No. 11
Shareholder in promotion company	No. 10
Director in mortgagee company	No. 19

Mr. H.—

Director in bond-selling company	No. 11
Shareholder in promotion company	No. 10

Mr. I.—

Director in bond-selling company	No. 11
Shareholder in promotion company	No. 10

Mr. J.—

Shareholder in bond-selling company	No. 11
Shareholder in promotion company	No. 10
Director of mortgagee company	No. 19
South Island manager of brokerage company	No. 18

The conflict of interests to which these interrelationships might give rise requires no elaboration.

Company No. 12 was a public company incorporated for the growing of tobacco. The promoter was a vendor of land to the company. He bought 540 acres for £3,562, and two days later sold to the company for £20,000. The original nominal capital was £25,000 in shares of £1. Of these, 13,500 were issued as fully paid up to the promoter as part payment for the land. The promoter was a director of the company.

Company No. 13 is a flax company, incorporated in New South Wales. A prospectus promising enormous profits from the sale of bonds was issued inviting the public to subscribe for shares. This prospectus was marked "Confidential: For Private Circulation only." The promoters were two brothers, who were also promoters of four other flax companies, all of which have since gone into liquidation. One or other of them has also been interested in other unsuccessful land-utilization ventures.

The original nominal capital was £20,000 in shares of £1 each. Of these, 19,180 shares were issued, 11,180 being for cash. The promoters were to receive 4,000 shares as part consideration for an option to purchase land and £3,800 in part payment for land. They were managing director and New Zealand director respectively, and they were to be permanent directors as long as they held 500 shares each. Another director was a member of the brokerage firm. Bond issues totalling £272,706 were provided for, the estimated profit being £63,420. We have no evidence of the amounts actually paid in brokerage, but the estimated cost of selling, management, and advertising was £5 per bond of £21 10s., or 23¼ per cent. Each bond represented one-third of an acre.

The total amount received from the sale of bonds was £168,000, yet this amount was insufficient to prevent the company from going into liquidation. Even as late as June, 1934, the land was encumbered, and the trust funds were not intact. Bondholders were required to raise further capital to clear the title. The representatives of the bondholders who appeared before us stated that the value of the assets was £18,000. Hence the loss to bondholders was £150,000.

(*b*) Examples of Land Inflation.

In order to obtain information relating to the land transactions of land-utilization companies, we arranged with the Registrar of Lands, Auckland District, to search the records covering the land transactions of fifty-eight companies. In many cases no adequate records were available, but the search-notes furnished to us afforded striking corroborative evidence of the loading of assets in land with a fictitious value. We give below a table setting out in summary form certain of the transactions of eighteen companies. The list is not a complete record of "inflationary" dealings. In some cases we have been able to append notes showing the relationship of vendors to the company, but it must not be considered that no relationship exists where we have attached no note to that effect.

TABLE NO. I.—LAND TRANSACTIONS.

Summary of Extracts from Search-notes into Land Transfers of Afforestation, Tobacco, Flax, and Tung-oil and other Companies, *showing Inflation in the Price of Land* :—

—	Area.	Date of Transaction.	Price.	Remarks.
	Acres.		£	
Company No. 2	22,154	20/11/29	5,551	
		Between 2/9/31 and 13/1/33	33,350	Includes a further 1,000 acres bought in 1931 for £414.
Company No. 4	8,451	27/2/25	1,495	
		27/2/25	11,064	
Company No. 5	1,284	7/8/30	3,216	Vendors are the promoters and directors of purchasing company.
		7/8/30	5,147	
Company No. 6	5,796	1920	11,595	The owner resumed possession under a mortgage and became chief shareholder in the bond-issuing company.
		1927	75,000	
Company No. 12	540	4/7/29	3,562	The vendor, 6th July, 1929, is director and secretary to purchasing company.
		6/7/29	20,000	
Company No. 24	995	4/11/25	3,831	The purchasers on 4th November, 1925, are three individuals who are directors in a company to whom the land was sold on 9th February, 1926. The land is then sold to a second company which is floated by the first; the three individuals referred to are directors in this company also.
		9/2/26	15,500	
		11/2/26	25,000	
Company No. 25	1,776	5/3/20	12,433	
		23/4/26	11,544	
		6/5/26	22,500	
Company No. 26	469	5/8/27	1,876	
		21/3/28	3,517	
Company No. 27	2,476	3/7/28	2,476	Vendor is a provisional director of the company to which the land is sold.
			17,000	
Company No. 28	25,185	23/9/07	3,913	Vendor on 28th July, 1925, is promoter and director of purchasing company. This sells to another company on 3rd November, 1925.
		28/7/25	25,185	
		3/11/25	55,000	
Company No. 29	12,700	2/6/25	20,637	
		20/7/26	41,275	

Company No. 30	17,040	21/11/25	Lease for 33 years at £852 per annum	Two companies with common directors are vendor and purchaser respectively on 17th January, 1928.
		17/1/28	Sells lease for £21,000.	
			£	
Company No. 31	899	17/4/23	3,271	
	208	17/4/23	1,135 } £5,971	
	690	17/9/23	4,836 }	
Company No. 32	3,823	6/10/28	2,960	
		8/11/28	19,115	
Company No. 33	41,224	23/4/18	39,965	Purchaser in first transaction is a land company. Purchaser, 9th June, 1926, is another land company which sells on 10th June, 1926, to an afforestation company. The land company which sells on 10th June, 1926, has three directors who are respectively director, attorney, and secretary to the purchasing company.
		9/6/26	Area was mortgaged for £40,000, and on this date bought in in default for £1,000.	
		9/6/26	Sold for £25,000.	
		10/6/26	„ £74,250.	
			£	
Company No. 34	74	15/9/30	55	
		2/12/30	405	The vendor is a director of the purchasing company.
Company No. 35	205 acres in four blocks	30/11/28 to 1/3/29	5,177	
		30/11/28 to 2/3/29	16,570	
	Acres.			
	148	9/4/29	3,724	
		29/4/29	11,918	
	160	15/10/25	5,000	
		27/2/30	6,000	
		8/8/30	8,800	
Companies Nos. 36 and 37 ..	1,125	31/5/29	4,500	
		30/8/29	6,750	
		30/8/29	23,500	
Company No. 38	223 (various blocks)	8/6/29	6,181	The vendor, 9th October, 1929, to 17th April, 1930, is a company which promotes the company buying the land.
		Between 9/10/29 and 17/4/30	17,726	

In some of the above examples the inflation of land-values revealed may be capable of a reasonably satisfactory explanation; but the transactions taken together present overwhelming support to the view that assets tend to be unduly inflated.

The above examples, which must be regarded as representative rather than comprehensive, serve to show the extent to which an enterprise may be loaded, and its success imperilled, by excessive costs in respect of promotion and brokerage, and by the inflation of assets. They show that little reliance can be placed on the estimates of "independent" valuers, who may be too amenable to suggestion from interested parties. These evils are facilitated by the common association of landowners, holders of options over land, and brokers, in the capacity of promoters or directors, and may be effectively concealed by the device of the private company, by dealings through intermediary companies, or syndicates, or by affiliated or subsidiary companies.

(3) Interlocking, Affiliated, and Subsidiary Companies.

The examples quoted above reveal the existence, and establish the danger, of interlocking, affiliated, or subsidiary companies—whether formed before, contemporaneously with, or subsequent to the formation of the main company. In further elaboration of this point it will be sufficient to quote one additional example.

This example will be found fully set out in our Second Interim Report—it forms the subject-matter of that report, and involves the transactions of companies Nos. 20, 21, 22, 23, and 42. There is revealed a managing director holding a controlling interest in the shares of a vendor company and a purchasing (afforestation) company, between which companies a contract for purchase and sale of land has been entered into. A study of the facts shows that there was no effective check on the details of this transaction by either vendor or purchaser company. The managing director in question was in substantial control of both companies, and the purchasing company entered into possession of the land and commenced operations upon it without any of the usual steps which should be taken by a purchasing company to ensure the safety of such a proceeding. At a time when the titles to the land had not been examined, when these titles were in such a state that transfers and conveyances could not have been made, and when the land was heavily encumbered, the purchasing company made large payments on account of the purchase-money, firstly by an allotment of shares credited with a large payment as paid up, and, secondly, by substantial payments in cash. That cash was received from the forestry debenture-holders. At a later stage in the history of this purchasing company it entered into negotiation for purchase of large areas of land with other companies which were under the control of the same managing director and some of his associates. The principal company, the afforestation company referred to above, was one which issued debentures to the public, and it made an arrangement for a subsidiary company, under the control of its managing director, to enter into a bond-selling campaign. The terms of the arrangement between these two affiliated companies involved the allowance to the "subsidiary" of a large amount by way of discount on its purchase of the debentures of the afforestation company.

There is also evidence of many transactions between the two affiliated companies which were governed by the same managing director, these transactions being to the detriment of one company and at the same time entirely to the benefit of the other company or of the managing director personally. It is not thought necessary to recapitulate all the facts as set out in the Second Interim Report—the above summary will suffice to indicate the existence of dangers which we are now considering.

(4) Prospectuses and other Publications.

(*a*) *General.*

We believe that investors in land-utilization companies are entitled to full publicity in regard to these matters, and to adequate safeguards against the inflation of assets. On this last question it has been suggested to us in evidence that the purchaser of a contract in respect of land is in the same position as the purchaser of goods, and that to force the disclosure of profits arising from transactions in land is not in accord with established practice. The principle of *caveat emptor* should apply (Witness No. 6). There is some force in this contention, but there are a number of relevant differences between the type of transaction we have in mind and transactions in goods.

Some commodities, such as vacuum-cleaners, are sold by door-to-door canvas, but the majority of commodities are purchased from stores. In either case the purchaser is able to inspect the goods, and, where he desires, have their use demonstrated or, possibly, take the goods on trial. By skilful salesmanship he may be persuaded to pay more for a commodity than it is worth, but it will normally satisfy with reasonable efficiency the need for which it was purchased.

Bonds are evidence of a contract in respect of land, which the buyer cannot inspect, and the quality of which he is not competent to judge in any case. He must form a judgment on reports of "experts" and "valuers," and on the price paid, which is presumed to be indicative of the fertility of the land. The type of salesman engaged in selling bonds is usually more expert than the type of salesman engaged in selling vacuum-cleaners or similar commodities, and is more able to misrepresent the true position because of the less-familiar nature of the proposition and the inability to inspect or have it demonstrated. He must rely, to a great extent, on the integrity and efficiency of the company which sells him the contract. The purchaser of goods is not vitally concerned with the financial scheme of the company marketing the goods, because, although he may pay more for them than they are worth, he does at least have them in his possession. The financial scheme of a bond-selling company, on the other hand, may prove vital to its success; for if the venture is unduly loaded with excessive promotion, land, or brokerage costs it is likely to fail. The bondholder has neither the

land nor any satisfactory redress against the company, for he is not normally in a position to enforce his claim, and in many cases the company may have nothing to satisfy it with. The sale of a commodity may be checked because it becomes known that it is unsatisfactory, or not worth its price by comparison with other similar commodities. The failure or incomplete success of a bond-selling proposition may not be known for some years, and meanwhile the sale of bonds goes on. Not only does the bondholder lose his investment, which is greater than the price of most goods, but also there is considerable social waste because labour and capital have been used in an unsuccessful enterprise. Finally, it is unconvincing to argue that no action should be taken to remedy a particular evil because similar, even equally serious, evils remain unchecked. If this attitude were adopted, there are few evils which could be remedied.

Our investigations prompt us to make the following recommendations :—

(4) That an invitation to subscribe for so-called "bonds," "debentures," or other forms of contract issued in series (if their continued use is to be permitted), should be regarded as a prospectus, and that all provisions relating to prospectuses for shares or debentures proper should apply.

(5) That every prospectus shall be required to state all dealings with land or other assets or any interest in such land or assets known to the directors or any one of them, within, say, two years prior to the incorporation of the company, or made in contemplation of the formation of the company.

(6) That every prospectus should include a statement of the price or prices at which land was transferred during the previous five years, or in respect of the three previous transfers, whichever covers the longer period.

The evils arising from the common danger of furthering, while concealing, the interests of promoters and directors by the device of antecedent, affiliated, or subsidiary companies may, we think, be satisfactorily dealt with if the provisions of the Companies Act, 1933, are effectively amended, supplemented, and administered along various lines suggested in this report.

(*b*) *Valuers' Reports.*

We have drawn attention to the fact that valuations of property taken over are not reliable because valuers have proved unduly amenable to the wishes of promoters. Having regard to the interests of honest promotion and the effects of fictitious valuation on the future prospects of concerns through loading of capital, it is highly desirable that reliable and independent valuations should be procured.

We wish to refer again, for example, to one glaring instance of unjustifiable valuations provided by a tobacco company and its immediate antecedents. The whole of the relevant transactions are related on pages 16–18 hereof. The land was purchased in May, 1929, for £7,500, being £10 per acre, and was valued by three valuers at from £80 to £87 10s. per acre in June and July of the same year. Even the most charitable interpretation possible of these valuers' reports would require us to believe that the valuers have taken into account the potential value of the land if successfully used for the purpose which the promoters claimed to have in view. The valuers must have known, or should have known, the price at which the promoters purchased the land—namely, £7,500—and the knowledge was available to them that similar land could be bought in the same locality at a price of from £10 to £15 per acre. Nevertheless, these valuers purported to value the land "for tobacco-growing purposes," and in this fact, and in the fact that their valuations purport to show a value up to eight times the amount at which the land was purchased a few weeks earlier, there is an irresistible inference that they were amenable to the wishes of the directors and promoters. If the eventual bond-selling tobacco-growing company had succeeded in raising the share capital and bond capital it required, and had with efficiency planted, grown, manufactured, and sold tobacco, the plain facts of the case are that the promoters, with the help of the valuers, had capitalized the future prospects of this industry, added them to the original price of the land, secured the profit of this transaction to themselves, and thus precluded the business from having any reasonable prospect of success.

We have not been able to formulate a practicable method whereby this evil can be wholly eliminated, but suggest the following provisions as at least a step in the right direction.

We recommend,—

(7) That whenever a valuer is required to make a report for inclusion in a prospectus he must be informed by the promoters or directors of that purpose.

(8) That in every such report the valuer must include a statement to the effect that he was informed by the directors that his report was intended for inclusion in a prospectus.

(9) That all transactions in the land or other assets the subject of the valuation, known to the promoters to have taken place prior to the issue of the prospectus, shall be disclosed by them to the valuer (including the selling-price in each case), no matter who the parties to such transactions were.

(10) That the valuer, in his report, shall refer to such transactions, and, in his valuation, shall justify any profits or intended profits indicated by the selling-prices in those transactions.

(11) That no valuer shall give a valuation for inclusion in a prospectus unless he is registered as a valuer with the Corporate Investments Bureau.

The above recommendations are all in the direction of greater publicity. This we consider to be the most adequate safeguard against unconscionable profits out of all proportion to any services

rendered, and the formulation of financial schemes which enable unscrupulous promoters or directors to exploit the public under cover. We have had evidence from a number of witnesses supporting the view that the utmost publicity should be required in the transactions of land-utilization companies, more especially those which issue contracts of the sort described. For example, one witness with a wide experience of land-utilization companies, stated in evidence :—

> "I thoroughly agree that great evils have developed in the business. I agree that there are great evils, and that it is a fair function of the Government that the small investor should be protected, if necessary, against himself.
>
> "Underlying all regulation, control, public administration, &c., the one great safeguard that will keep the business honest is publicity, registration of all documents, literature, &c., used in conjunction with the promotion, flotation, and operation of the business under review." (Witness No. 8.)

(c) *Misleading Statements.*

We have referred to the fact that prospectuses and invitations to subscribe for "bonds" (which have in many cases been issued as prospectuses) are frequently calculated to mislead, because they do not fully reveal the extent to which unreasonable profits have been obtained (or provided for) through loading by excessive costs, or because they include unreliable valuations of, or give a fictitious value to, the assets of the company. Other types of misrepresentation are very common. This takes place in the following ways :—

(*a*) *Exaggerated estimate of prospective profits.*

Such estimates have been based primarily on misleading statements in regard to (1) rate of growth of trees; (2) estimated value of timber, pulpwood and pulp, or other crops; (3) the natural advantages of New Zealand as a pulp-producing country, or for producing crops other than timber. It is evident, also, that potential but unproved growing qualities are taken into account for immediate land-valuation purposes.

(*b*) *The misuse of official and other reports by using them for a purpose for which they were not intended, or by quoting extracts and omitting significant passages.*

We have had access to official correspondence showing the existence of this practice.

(*c*) *Misleading statements regarding the results which have been achieved by the industry in the past.*

In some cases this takes the form of quoting returns from individual plantations at some previous period, and basing estimates of prospective yields on such returns. This practice is misleading, because (1) conditions of demand may have changed in the meantime; (2) marketing prospects may be substantially different when account is taken of the large areas planted by the State and afforestation companies; (3) the plantations from which the returns are quoted are located in other areas. This affects both the rate of growth and the marketing prospects. Obviously the prospects are different for a small plantation favourably situated to meet a particular local demand, and for one which must, or expects to, enter a world market.

In others, misrepresentation takes the form of claiming the successful establishment of an industry which is still in the experimental stage. The following quotations from the "prospectus" for bonds of a tung oil company will be sufficient to illustrate the point. The prospectus states: ". . . . it has been proved *beyond all question* that the Northland is ideal for the production of tung oil." (Company No. 8.) In regard to this statement, the witness giving evidence on behalf of the company said: "I am of opinion that at that time there was no justification for that statement. In the light of experience to date, I would say that there is a reasonable prospect of that portion of the Auckland District being found suitable for the production of tung oil." (Witness No. 5.)

A further statement in the prospectus was to the effect that bondholders would have ". . . full participation in the profits of a proven enterprise that has never failed to make a very handsome return to those engaged in it." In reply to questions the witness stated: "There have been no operations in New Zealand to justify this claim. The edition of the prospectus on which we have been working since September, 1932, is much less optimistic in tone, and it should be mentioned in extenuation that the growing of tung trees in the United States has been very successful."

In other cases, statements are made which, though true, are likely to mislead investors, while important particulars and qualifications are printed inconspicuously in small type. Even where no statement, taken singly, can be proved to be incorrect, the general effect of a prospectus can be shown, in many cases, to be definitely misleading.*

(*d*) *The misleading use of photographs, or misleading inferences from photographs.*

This is a familar device which can be effectively used to assist in conveying an unduly optimistic impression to investors, even though the photograph is real and the "sales-talk" written round it is not incorrect. The photograph of a certain tung-oil tree growing in an Auckland garden has done splendid service. It has probably been very effective in promoting the sale of bonds, despite the fact that the tree is a day's journey from most of the plantations, which are located on different soils, with

---

"In the *King* v. *Kylsant* ([1932] 1 K.B. 442), it was held by the Court of Criminal Appeal that where a prospectus was composed of statements which in themselves were perfectly true, . . . but . . . taken as a whole, gave a false impression of the position of the company, a misdemeanour had been committed and the directors responsible for it were criminally liable.

varying aspects. In some cases photographs have been wrongly described, even as to the country in which they were taken. In any case, promoters may be expected to select for photographing samples favourable to their purpose rather than representative samples. Further, the investor has no means of discovering whether the land on which his trees are to be planted is suitable, even though he may be shown photographs of beautiful trees on contiguous areas, for contiguous areas frequently vary greatly in quality. We have seen in prospectuses no photographs of plantations which have failed.

(*e*) *Statement by alleged experts as to the suitability of areas.*

It is common for invitations to subscribe for bonds to be supported by statements to the effect that the areas selected are suitable for the purposes intended. We are not convinced that the persons making such reports are always competent to do so. This view is supported by the failure of plantations in areas stated to be suitable, and complaints in regard to the standing, training, and experience of companies' "experts."

(*f*) *Misleading or inadequate information regarding the nature of the security behind bonds or other contracts.*

We discuss below the nature of the security behind the so-called "bonds" or "debentures," but we would refer at this juncture to the usual connotation of these terms. They carry with them a special sense of security which is wholly unwarranted when applied to contracts of the type under discussion. There is little doubt that the use of such terms has been taken advantage of and reinforced by effective propaganda through prospectuses, other publications, and sales-talk to give a false sense of security.

For example: One prospectus (that of Company No. 8), for "debentures," describes the security as "gilt-edged," and claims that its debentures are superior, in the matter of security to "bonds," on the grounds that—

> "Freehold debentures have a definite date of maturity.
>
> "These freehold debentures bear interest at 6 per cent. from the date they are paid up until January, 1936. Freehold debentures guarantee title to the land; and, further, are a charge on the co-operative enterprise of the company, and are secured further by all the assets of the company, including uncalled capital.
>
> "Freehold debentures are issued under and subject to the provisions of the New Zealand Companies Act, 1908, which Act contains several clauses framed for the special purpose of protecting the investing public.
>
> "In other words, freehold debentures are conservatively safe and offer a measure of security not provided by bonds or shares, yet at the same time freehold debentures assure the debenture-holders participation in the profits of the co-operative tung-oil groves."

We were unable to discover any differences sufficiently significant to justify the claim of the company.

The uncalled capital of this company was only £225 at the stage when the above prospectus was issued; and £4,021 on the date of giving evidence. In view of the fact that it was proposed to issue bonds totalling more than £50,000, and that the total amount received from the sale of bonds to date is £24,528, the additional security represented by the uncalled capital can hardly be described as ample. In addition, the agreement to pay interest has proved a source of embarrassment which in effect weakens, rather than strengthens, the security.

Witness No. 5 deposed that: "The outcome would, of course, depend largely on the commercial success of the enterprise; . . . the security should not be described as gilt-edged, at any rate at this early stage"; and stated: "In the light of past experience, I have concluded that a venture of this nature financed by way of shares would be more economically sound than by bonds or debentures."

A further example relates to a misleading statement in regard to a transaction which had an important bearing on the security of bondholders because it affected their title to the land.

We refer again to certain transactions of Company No. 20 (a debenture-issuing afforestation company), as set out in some detail in our second interim report, pages 8 and 9.

It issued a prospectus in which (*a*) it warranted its purchase of the land, and (*b*) stated that it had made substantial payments on account of purchase-money; and (*c*) put these facts forward as an assurance of security to the bondholders, this security being "all its estate and interest in the lands on which the forests are to be grown in manner hereinafter set forth."

(*a*) *The purchase of the land:—*

The prospectus issued by this company, in allocating the £35 of each debenture to the purposes of the issue, specified "(*b*) £4 10s. per acre to reimburse the company for the actual cost of 6,014 acres (approximately) of freehold land."

Further on in the prospectus the promoters say, under the heading "Security": "The company has acquired the following freehold lands in trust for the debenture-holders . . . and the company agrees without in anywise limiting its liability for the planting, care, and supervision of the forests, and without releasing it from liability to pay any purchase and other moneys owing in respect thereof—(*a*) When called upon so to do by the trustee for the debenture-holders to transfer to such trustee all its estate and interest in"—(the said lands, in three parcels, progressively, as debentures are taken up and fully paid).

Later on, under the heading "Land to be planted," we read, "The company has purchased three valuable properties adjoining the Auckland–Rotorua railway. . . . The price the company has paid for this land is £4 10s. per acre, which is the value placed upon it by a reputable independent valuer." Further on in the prospectus there is the following statement: "The lands proposed to planted were purchased by the company as follows: . . ."

(*b*) *Payment for the land:*—

There follows a description, under the headings "Block 1," "Block 2," and "Block 3," and the following figures, which we give in totals:—

Area	6,014 acres	
Instalments already paid ..	£15,075.	
Balance	£11,990,	payable in three years with interest at 6 per cent., with right to pay off all or any part at any time without notice.
Total purchase-price ..	£27,065.	

The prospectus is dated 1st day of September, 1925. The real truth is that on that date not one penny had been paid in respect of this land. The three blocks of land were the property of one vendor, Company No. 21, and the managing director of that company was the principal promoter of, and the largest shareholder in, the purchasing company. Three agreements for sale and purchase had been made, and they bear the same date as the prospectus—namely, 1st September, 1925. The land was subject to a mortgage of about £12,000, and the promoter of the purchasing company was personally liable for the amount of this mortgage. Two months after the issue of the prospectus there was an exchange of cheques between the purchasing company and the vendor company, both under the control of the same managing director. These cheques totalled exactly the amount which (by the prospectus issued two months earlier) was stated as the total of the instalments that had been paid on the land. As handed from the purchasing company to the vendor company, they purported to be payment of these instalments. As handed by the vendor company to the purchasing company, they purported to be payment of 10s. per share on about thirty thousand shares. The prospectus, which, it will be remembered, was issued two months earlier, contained a statement unrelated to and out of juxtaposition with the statement about payment of instalments on the lands, in the following words: "The directors have allotted 30,600 shares paid up to ten shillings per share."

(*c*) *The land as a security:*—

The land eventually to be conveyed to the purchasing company pursuant to the above-named agreements was not properly delineated; it was, as to one important block, described as being part of a lot and a part of the land comprised in a certain certificate of title. There was no plan or map and no statement of the boundaries of the land to be conveyed. When the conveyance was made a few years later, a central portion with strips giving access to roads was excluded from the transfer, leaving the area transferred to the purchasing company approximately that named in the original agreement for sale and purchase. A few years later the purchasing company was in difficulties. The mortgagee was threatening to exercise his powers of sale over this land on which in the meantime the money of the debenture-holders had been spent for afforestation purposes. The trustee (company) for the debenture-holders was dissatisfied with the position, and demanded the conveyance to itself of the land in question; but it was met by the contention of the managing director of the company, based on the prospectus referred to above, that all he was called upon to transfer was "all the estate and interest of the purchasing company in this land," and he referred the trustee to the agreement for sale and purchase.

We believe that the foregoing statements as made in the prospectus, and as they would be understood by the average honest and intelligent investor, are grossly misleading in the light of the actual facts of the case.

We think that the evils to which we have drawn attention above are very real, and that the evidence before us establishes the need for some check on the over-optimism of company promoters and their over-anxiety to make sales. Not only are investors invited to subscribe for bonds on what, in many cases, amounts virtually to false pretences, but also the future reputation of sound companies and the credit of New Zealand are endangered when it is found that extravagant estimates of future returns cannot be realized.

One witness (No. 9) with many years' experience in afforestation, stated: "The promoters' success in obtaining several millions of the public's investment funds for private afforestation work is due solely to misrepresentations regarding the financial yields of the forests. Almost without exception, promoters have admitted their exaggeration of official and authoritative data, but excused their actions as necessary for the successful disposal of bonds." ". . . The cumulative result of the various exaggerations is such that the promoters of the various companies must be considered guilty of gross misrepresentation."

This indictment is, perhaps, unduly severe, if applied in general terms to all companies, but it is justifiable when applied to many in each class of land utilization company under survey.

In regard to the above matters, we recommend,—

(12) That a certified copy of all documents and publications issued to the public—including advertisements, newspaper statements, brochures, and leaflets—be filed with the Registrar of Companies.

(13) That all such documents and publications be identified and approved by resolution at a meeting of directors before being issued to the public.

It is recognized that the above recommendations would add to the bulk of documents filed, but we point out that large sums and important public issues are at stake. We think that the above proposals would tend to *place* the responsibility for statements made, and to give directors a sense of responsibility which has not always been present in the past.

We have considered the advisability of requiring that every prospectus should be formally approved by a State Department or officer before issue. We do not consider this desirable because it would place the imprimatur of the State on ventures which might later prove to be of dubious character. It might be used as a selling point by promoters or salesmen, with State certificates in their pockets. "A certificate of character under the Seal of the State in the hands of a person who had larceny in his heart would be far too formidable a weapon." (Report of Attorney-General, of New York State, 1931, page 48.) We do, however, consider that the Corporate Investments Bureau which we recommend should exercise certain functions in regard to prospectuses. These are discussed in Part IX of the report.

The foregoing recommendations are all in the direction of greater publicity. The utmost publicity should be required in the transactions of land utilization companies, more especially those which issue contracts of the sort described.

Our view is that the honest concern which seeks to make its profits out of the main purpose for which it was nominally established has little to fear and much to gain from publicity of the above kinds.

We desire, however, at this stage to make two recommendations which are based on the fact that the Companies Act is freely used as a working code by business men and other laymen in law. We think it desirable for that reason that in the provisions of the Act relating to the contents of a prospectus, and the liability for misstatements in a prospectus, emphasis should be given to the fact that there is also a criminal liability for making misleading statements with intent to induce intending investors to entrust money or other property to a company. We think that there should be a pronouncement of this criminal liability, in the form of a definition of the offence; and the enactment of a penalty in the Companies Act itself. We suggest that it should be contained in the sections of the Act which relate to prospectuses.

In England, in 1932, Lord Kylsant was proceeded against criminally for participation in a misleading prospectus; he was found guilty and sentenced to a term of imprisonment. The offence was charged, not under the provisions of the Companies Act, but under section 84 of the Larceny Act of 1861. If a prosecution for a similar offence were taken in New Zealand, the information would be laid under section 257 of the Crimes Act. Whilst every man is supposed to know the law, we think that there are obvious advantages in placing the penal provisions in juxtaposition with those enabling and directive provisions to which the business man is certain to give his attention.

We therefore recommend,—

(14) That the offence of publishing a misleading prospectus be defined and incorporated with a penal clause in section 46 of the Companies Act, 1933.

We are of opinion, further, that in defining the offence of publishing a misleading prospectus, an attempt should be made to indicate in the definition the principles according to which the acts the person charged would be tested. The judgment in the case of *King* v. *Kylsant* ([1932] 1 K.B. 442) was based on principles laid down in a series of cases which the Judges cited with approval, and enunciated as the basis of their judgment. The facts in the case in question were that, admittedly, there was not a single statement in the prospectus in question that was not true, but it was nevertheless held that by reason of the omission of certain facts, the statement of true facts which was made would convey to the mind of a reader a wholly false impression. The following passages from an earlier judgment of Lord Halsbury was quoted with approval:—

> "It is said that there is no specific allegation of fact which is proved to be false. Again I protest, as I have said, against that being the true test. I should say, taking the whole thing together, was there false representation? I do not care by what means it is conveyed—by what trick or device or ambiguous language; all those are expedients by which fraudulent people seem to think they can escape from the real substance of the transaction. If by a number of statements you intentionally give a false impression and induce a person to act upon it, it is not the less false although if one takes each statement by itself there may be a difficulty in showing that any specific statement is untrue."

We think that the reasonableness and justice of those words will appeal to every business man. Nevertheless, it is desirable—in fact, it is only fair—that an attempt should be made by the Legislature to embody the principle of these words in a definition of the offence of issuing a misleading prospectus. The task of putting the principle into appropriate words should not be a difficult one.

The standard of morality amongst business men in these matters has unfortunately become a lax one, and some of them have come to look upon the provisions of the Act rather as a challenge to a battle of wits than as an obligation to give information to the public according to the standard of the above legal pronouncement. A business man allowing himself to be inveigled into the framing of a prospectus in conformity with the existing standard and practices, might, we think, have some grounds for feeling that he was unjustly treated if, on prosecution under section 257 of the Crimes Act, he was convicted and imprisoned for failing to comply with standards which he had never heard of, and which were recorded only in volumes of law reports to which he had no access.

We have, therefore, a further recommendation to make, one which involves an innovation in the publication of statutes in New Zealand.

We recommend,—

(15) That, in publishing the Companies Act, the Government Printer should be instructed to insert as a footnote at the bottom of the page which contains section 46 of the Companies Act, 1933, a brief reference to the case of the *King* v. *Kylsant* ([1932] 1 K.B. 442), with a brief statement of the principles enunciated by the Judges, who affirmed the conviction in that case.

While such a footnote would be an innovation, as far as we are aware, in the official printing and publishing of New Zealand statutes, it is a practice that is followed in some other States in the Empire.

(5) Misrepresentation by Salesmen.

The usual method adopted in the sale of bonds has been by door-to-door canvass or "hawking." This method is conducive to serious abuse through misrepresentations by salesmen, or by misleading information or instructions being given to salesmen by principals of brokerage houses. Misrepresentation ranges all the way from the careful selection and emphasis of good selling points and the concealment of weaknesses in the proposition or of essential conditions in the contract, to deliberate untruths.

It is not easy to obtain direct evidence from bondholders on such matters, but we have had access to departmental files which place it beyond doubt that misrepresentation has been very common. A familiar method has been to allege that the New Zealand Government is guaranteeing a venture, or has appointed trustees, or is interested in some other way. The following quotations from letters on departmental files illustrate some, but not all, of the kinds of misrepresentations which occur:—

> "With reference to company, the prospectus of the company shows such profits that one wonders why they ask for bonds. The agents say that bondholders are protected by the contract held by the company from the New Zealand Government."
>
> Needless to say, no such contract existed.

Again:—

> "A friend of mine has interested herself in some investments with the company. The company is stated to be backed by the New Zealand Government."

Another letter states,—

> "May I ask you to advise me regarding . I understand that the Government has appointed a Board of Trustees to safeguard the interests of the bondholders."

The above three quotations are from overseas communications. The following is from a New Zealand correspondent:—

> "Regarding the bonds, could you kindly inform me if the Government guarantees a dividend of not less than £20 per annum after the expiry of two years three months. The agent for that industry states that these bonds are guaranteed and stamped by the Government to that effect on being issued."

The above problem is one for which there appears to be no satisfactory remedy by direct action. It involves questions of control which are best dealt with in relation to Stock Exchange constitution and methods, and the Corporate Investments Bureau.

B.—FINANCIAL SCHEME.

(1) General.

Brief reference has been made earlier in this report to the financial scheme of land utilization companies. This consists in the raising of share capital by the formation of a private or public company, and the later issue of bonds or contracts to which the public is invited to subscribe. The moneys thus obtained are used in the purchase of land, the payment of brokerage and other selling costs connected with the issue of bonds, the planting and maintenance of land in trees and other crops, the establishment of a trust fund which eventually becomes the property of the company, and in providing profits for the undertaking.

The scheme of administration and control consists of promoters who provide the idea; a parent company which performs the contract; bondholders who provide most of the money and eventually acquire the area duly planted and maintained; and the trustee, whose function is to enforce the contract within the limits provided and made possible by the trust deed.

(2) Initial Share Capital.

It has been shown that the paid-up capital of the "parent" company is usually small, relative to the size and scope of the enterprise or the value of bonds the issue of which is contemplated. The paid-up capital at the present time is, in general, also small, relative to the moneys actually subscribed by bondholders. Further, much paid-up capital is not represented by cash or any tangible assets.

The above facts are well brought out in Table II, which gives details of the share and bond capital of companies whose records have been adequate for the purposes of the table.

TABLE II.—SHOWING THE FOLLOWING IN RESPECT OF BOND-ISSUING COMPANIES:—

(*a*) Original Nominal, Subscribed, and Paid-up Capital:
(*b*) Latest Return of Nominal, Subscribed, and Paid-up Capital:
(*c*) Value of Aggregate Bond Capital, the issue of which was provided for, together with the amount of Bond Capital received (latest return).

No. of Company.	(*a*) Original Share Capital.				(*b*) Share Capital (Latest Return).				(*c*) Bond Capital.	
	Nominal.	Subscribed.	Paid Up.		Nominal.	Subscribed.	Paid Up.		Total Issue provided for.	Amount received.
			Cash.	Other than Cash.			Cash.	Other than Cash.		
	£	£	£	£	£	£	£	£	£	£
1	11,500	11,500	1,750	..	250,000	241,341	159,236	38,300	(3,878,037)	3,878,037
2	40,000	21,000	5,250	..	100,000*	66,750*	25,750*			
					33,000†	33,000†	33,000†			
					133,000	99,750	58,750	41,000	1,700,000	780,529
3	5,000	5,000	1,375	..	(5,000)	(5,000)	(1,375)	..	(58,659)	58,659
4	12,000	12,000	4,050	3,000	(12,000)	(12,000)	(4,050)	(3,000)	200,000	40,444
5	25,000	9,059	7,059	2,000	50,000	49,768	47,424	2,000	225,000	80,000
‡6	2,500	2,500	2,500	..	2,500	2,500	2,500	..	202,860	14,000
7	2,500	2,500	2,000	500	50,000	25,000	24,500	500	(36,689)	36,689
8	1,400	1,400	900	500	20,000	5,995	1,608	500	50,000	24,528
9	20,000	4,050	50	4,000	10,000	4,050	50	4,000	90,000	4,860
§10	15,000	13,007	(13,007)	..	..	..	..	..	..	..
§11	..	..	..	..	250,000	146,000	..	146,000	90,000	18,440
12	25,000	17,201	1,701	15,500	(25,000)	(17,201)	(1,701)	(15,500)	45,000	32,463
13	20,000	19,180	11,380	7,800	(20,000)	(19,180)	(11,380)	(7,800)	272,706	168,000
§14	5,000	5,000	3,000	2,000	7,000	5,000	3,000	2,000	128,500	101,254
§15	25,000	25,000	..	25,000	25,000	25,000	..	25,000	187,500	27,688
Totals ..	209,900	148,397	54,022	60,300	859,500	666,785	315,574	285,600	7,164,951	5,265,591

* Ordinary. † Preferential. ‡ Shareholders also own land. § Indicates related companies.

NOTE.—The figures in brackets in column (*b*) are interpolations. Where companies have given no information in respect of these figures, it is assumed that there is no change from the figures in column (*a*).

The figures in brackets in column (*c*), bond capital, total issue provided for, are interpolated. Where no information has been given in respect of these, we have assumed that the amount actually received from the sale of bonds is the amount provided for. Actually the figures in parentheses will be a substantial understatement in some cases.

It is not necessary to recapitulate the figures in the preceding Table II, but it is worth while drawing attention to one or two of the companies exemplified therein.

Company No. 9 had an orignial subscribed capital of £4,050, of which only £50 was in cash. It proposed to issue debentures aggregating £90,000 in value. The 4,000 shares of £1 issued for consideration other than cash were in return for services rendered in promotion and for an option over land. The company possessed an advantage over most, in that it was able to make an arrangement favourable to itself in regard to the purchase of land. Payment for land was to be made by instalments as bonds were sold and fully paid.

Company No. 8, with a paid-up capital in cash of £900, invited subscription for bonds totalling £50,000. Its present paid-up capital is £2,108, only £1,608 being in cash, but the company has received £24,528 from the sale of bonds.

Company No. 12 had an original paid-up capital of £17,201, of which only £1,701 was in cash. Of the £15,500 shares issued for consideration other than cash, £13,500 were to a promoter who was also a vendor of land, and £2,000 to a brokerage concern in part consideration for brokerage services to be rendered. The vendor of land purchased the area for £3,562, and sold it to the company two days later for £20,000, including the fully-paid-up share referred to above as part of the purchase price.

The history of companies Nos. 10 and 11 has been related in some detail on pages 16 to 18. It will be noted that the paid-up capital of £146,000 (see column (*b*)) is almost entirely fictitious, and represents an elevenfold inflation of the value of the assets in land. The company has gone into liquidation.

It is hardly necessary to exemplify further.

The original paid-up capital of the fifteen companies listed in the table is somewhat over £114,000, of which £54,000 is in cash. The remainder, £60,000, represents a value for services rendered which is often grossly inflated and represents an initial loading of capital. These companies proposed to issue bonds aggregating, in 1934, an amount in excess of £7,160,000. They have already received £5,265,000 from the public for the sale of bonds. The paid-up capital, according to the latest return, is substantially greater than the initial paid-up capital—partly no doubt as the reflection of profits from bond-selling which have been returned to the enterprises, but it is still less than one-eighth of the bond-moneys received, even when the value of shares for consideration other than cash is included. The amount received from the sale of bonds is about seventeen times the amount of cash paid up on shares issued, and this latter amount does not always represent genuine cash transactions.

It is clear from the above analysis that the amount of actual cash risked by promoters is frequently small in relation to the size and scope of the enterprise contemplated, and that success depends almost entirely on the capital provided by "bondholders." If the sale of bonds is successful the original shareholders stand to gain a very high rate of return on their original investment, whether the enterprise is eventually successful as a commercial venture or not. If it fails they are likely to suffer a loss which is small in relation to the prospective gains, and such bondholders as have subscribed are likely to share in the loss; for the commercial success depends in a large measure on the sale of an "economic unit" of bonds and on the capacity of the company to sell enough bonds to finance its contract with bondholders.

The above conditions take on a special significance when it is remembered that the bondholders, who provide the bulk of the funds, have little effective voice and control. Until the time arrives for realization, effective control is in the hands of the shareholders, whose stake is small.

Hence the above facts should be considered in relation to the schemes of finance and control which are described below.

(3) Bond Capital.

(*a*) *General.*

The great bulk of the capital invested in land-utilization companies has been obtained from the sale of bonds. As shown in the previous section, the amount received from the sale of bonds by fifteen companies aggregates £5,265,000. Some companies have obtained their finance entirely by the issue of shares, but such companies provide a small proportion only of the aggregate. In bond-issuing companies, paid-up share capital (both in cash and for considerations other than cash) represents a small proportion of bond capital—say, one-eighth. In an earlier section of this report we estimate that the total amount of capital, including both share and bond capital, which has been invested in land-utilization companies, is between £7,000,000 and £8,000,000, so that the total bond capital would be between £6,000,000 and £7,000,000. We consider these estimates to be conservative, and we should not be surprised to find that the total capital invested has been in the neighbourhood of £10,000,000, including total bond capital of between £8,000,000 and £9,000,000.

We are unable to form an estimate of the amounts raised by the sale of bonds in various countries. A considerable proportion of the money has been raised in New Zealand, but large sums have been raised in Australia and India, and smaller sums in Java, China, and other Eastern countries, and in the United Kingdom.

The price paid per bond varies from £20 to £55—the most common price probably being between £25 and £35. In some cases, single bonds are divisible into smaller units. Bonds have been sold to all classes of the community and in varying amounts; but the majority appear to have been sold to small investors in units of one or two bonds.

(*b*) *The Bond Contract.*

The term "bond," in the sense in which it has been used by land-utilization companies, has no special legal significance such as attaches to shares or debentures. The term is not defined in the Companies Act (except in section 343, where it is of limited application), and is not found in the standard works on company law. The absence of special legal significance remains if the document, analogous to a bond certificate, is described as a debenture, debenture certificate, forestry certificate, or by any other name, unless the agreement which is covered differs in substantial particulars from that which is described below.

In the earlier stages land-utilization companies themselves do not appear to have been clear as to the precise nature of a bond, and there seems little doubt that the bondholders themselves are not always in a position to determine the precise connotation of the term from the manner in which invitation to subscribe are presented. We have already suggested that such invitations and the "literature" and sales talk used in support are frequently calculated to mislead the investor as to the nature of the security. This result is facilitated by the use of a term which, through common usage, has been regarded as describing a title to a property-right which is peculiarly free from risk and embodying a high ideal of private obligation.

The evidence tendered to us by legal practitioners shows that the legal significance of the bond is now clearly understood, at least by the companies themselves, even though it is not subject to precise legal definition. The transition to a more precise interpretation is illustrated in the case of one company which, in its first "prospectus," described the investment as a "*forestry bond*," and referred to the moneys subscribed as "*bond capital*" or "*loan capital*." Later, the bond was described as a "*forestry investment*," and was referred to as a "*contract*."

The "bond," however named, may be described as a right to the fulfilment of a contract entered into between a company and an individual. In the last analysis it would seem to be a right of action. The bond certificate is issued as written evidence of this right. The terms of the contract are embodied in a trust deed, and, usually, also are summarized on the bond certificate. As security for the performance of the contract, a portion of the moneys received from the sale of fully paid-up bonds is set aside as a trust fund.

The conditions usually embodied in the contracts are outlined in Section III, 3 (pages 13 to 15), and it is not necessary to recapitulate. It is necessary, however, to draw attention to certain features of the bond system, more particularly with reference to the nature of the security.

Attention has already been drawn to the fact that an invitation to subscribe for bonds has not always been regarded as a prospectus within the meaning of the Companies Act, and that the terms of the contract are frequently ambiguous and inadequately set out. We have recommended that, if the practice of issuing bonds is to survive, an invitation to subscribe for bonds and similar contracts, when issued in series, should be regarded as a prospectus, and thereby brought within the provisions of the Companies Act in regard to prospectuses. A full statement of the extent and nature of the

security should also be required on such prospectuses. We make the following additional observations and compare bond contracts with shares or debentures in certain important particulars.

The bondholder has no rights other than the performance of the contract between him and the company, or, in the alternative, an action for damages. In one instance (and possibly there are others) contracts are secured against the uncalled capital of the company; but this is of little value if the uncalled capital is small or unrealizable.

The bondholder is not entitled to the repayment of his capital, but only to the resumption of the trust-moneys which he has himself provided. Beyond this his only remedy would seem to be an action for damages. The chances of such actions being undertaken are remote, except through the trustee, for bondholders are scattered, it is difficult to register a decision, and the bondholder is likely to be reluctant to "throw good money after bad" for the purpose of safeguarding an investment which is probably small in relation to the cost of the action. The trustee may enter into litigation on his behalf; but frequently the trustee has no funds with which to fight. The company, on the other hand, can use money provided by the bondholder himself, with which to fight him—provided that there is any money left. If the drift goes far enough to imperil the security of the bondholder, the company is hardly likely to be worth proceeding against in any case.

In some cases the company has a substantial interest in the form of "over-planted" areas; in others it expects to derive profits from a share in the proceeds on realization. There is then likely to be a strong incentive to it to fulfil its contract with bondholders; but where these conditions do not apply, the incentive may be small.

The appointment of trustees to watch over the interests of the bondholder is an additional safeguard, and in the majority of cases trustees appear to have fulfilled their duties faithfully; but their powers are circumscribed by the conditions of the trust deed.

By contrast, the debenture-holder (in the correct use of the term) is entitled to the repayment of his capital, together with interest until the date prescribed for the repayment of his loan. His title is normally secured by way of mortgage over the assets of the company, and on default he may appoint a receiver. He is a secured creditor.

The shareholder is entitled to a share in the capital of the company and to a dividend *pro rata* from the profits of the company. Nominally at least, he has a share in controlling the affairs of the company, and is protected by a body of law which does not apply to the bondholder. He is entitled to a statement of accounts and balance-sheet, and may express his views at an annual meeting. He has a voice in the election of directors and of auditors. Of more importance, shareholders have power to procure an inspection under sections 142–145 of the new Act.

Whilst the provisions of the Companies Act, 1933, relating to prospectuses give a shareholder or debenture-holder certain special rights of action in the event of his subscription's being induced by misrepresentation or deceit, a bondholder would appear to have only the ordinary remedies of the common law.

Further, in the matter of parties, the shareholder's or debenture-holder's right of action will be against any director or promoter or any person who has authorized the issue of the prospectus. Such are liable to pay compensation to any person who may subscribe for shares or debentures on the faith of the statements set out in the prospectus in respect of any loss or damage which he may have sustained by reason of any untrue statement in the prospectus. The bondholder, on the other hand, must rely on the common law to fix liability on any person who, he claims, has used misrepresentation or deceit against him.

Having regard to the above conditions as they affect security, we have carefully considered whether bond contracts offer any counterbalancing advantages over shares or debentures which justify their being preferred over shares or debentures as a method of finance. We have concluded strongly that they possess no such advantages as will outweigh the dangers and limitations which have been revealed by experience and which are inherent in them. It has been represented to us that bond contracts are analogous in principle to other forms of executory contract—such as a contract to build a house. One witness stated that the remedy of the forest-holder is more drastic than that of the employer of a builder, because he has "a definite remedy vested in a trustee who has the funds in hand." The witness agreed that this was not the case "if the company had not provided much capital," because "the remedy of taking over the maintenance fund and the undertaking would not hurt them much, and the personal remedy might not be worth pursuing" (Witness No. 7). This, however, is to concede our main points of criticism. While, in principle, the two forms of contract may possess some points of resemblance, they differ fundamentally in their application, for it should be apparent that a single employer is in a better position to exercise his remedy, and more likely to be prepared to do so because he has more to lose than is a member of a body of scattered bondholders with a small individual investment at stake. Furthermore, the employer of a contractor in a building contract is not required to pay to that contractor in advance the estimated cost of the building, let alone a further substantial sum to be held in trust in case the builder should fail to carry out his part of the contract.

It has been suggested to us (Witnesses Nos. 7 and 10) that there are two advantages of bonds as contrasted with shares as a method of finance. These advantages were stated thus:—

(*a*) In the case of a company that raises the finance for its land by means of bonds, the land would not be available to meet the claims of the company's creditors; and

(*b*) If desired, bond-money may be returned to contributors without the statutory restrictions of the Companies Act which apply when it is sought to return share capital. The assets provided by a bond issue may be distributed *pro rata* from time to time as the assets are realized, and the trust may then be ultimately extinguished with comparatively few formalities.

The first of these alleged advantages assumes that the lands purchased by the bond moneys will be vested in the bondholders or their trustee, free of encumbrance to the company's creditors. The evidence which we have received does not justify us in making this assumption. In fact, in many cases the land is held by the company.

The latter argument is of doubtful practical importance, save in the event of failure, when it avoids the formality of liquidation. The distribution of assets is unlikely to take place.

In all cases where bond companies have come to us asking our assistance in finding means of escape from the difficulties inherent in the bond system, they have suggested the conversion of bonds into shares and the incorporation of bondholders on that basis. It is perhaps convenient to point out here that by section 57 of the Companies Act, 1933, there is power for a company to issue redeemable preference shares. We refer to this provision elsewhere, and content ourselves here by saying that we believe that this provision offers a satisfactory alternative to the bond system.

(c) Trustees as Business Administrators.

There is another disadvantage of the bond system with its utilization of trustees to hold a proportion of the bondholders' funds and to administer them in certain contingencies.

It lies in the fact that trustees are placed at peculiar disadvantages when seeking to carry on a business. This is too well known to require elaboration in legal and business circles. In the case of trustees for bondholders that difficulty is accentuated by the number and distribution of their beneficiaries; for the trustees are unable to communicate with them effectively. If the trustees desire to approach the Court for advice and instructions, the task of giving notice to all interested parties is always difficult and expensive, and often impossible.

It should be noted that witness No. 10, whose opinion is given above, expressed the view that bonds possessed no advantage over shares, other than advantage (*b*) quoted above. He stated: "I would never again be a party to the incorporation of a forestry company involving a bond issue. The existing machinery of the Companies Act is adequate for the purpose of raising capital."

Amongst the weaknesses which he stated as being connected with the bond method were: (1) The scattered nature of the bondholders, who were unable to act in concert; (2) the limited resources available to bondholders to enforce rights when the trust fund was not available for this purpose; (3) lack of control over the assets; (4) the possible inadequacy of the working capital of the company and the difficulty of obtaining additional capital.

Other witnesses, including those who had acted as solicitors to or officers of bond-issuing companies, were equally critical of the bond method of finance. Thus one witness stated,—

> "In my experience the cost of selling of bonds is prohibitive.
>
> "I consider, without any doubt, that the marketing of this type of bonds in recent years has been a quite uneconomic proposition. It really amounts to a scheme for selling land at a higher price. The money is got out of the bondholders easily under a scheme from which they do not at the time gather that they are really buying an interest in land, plus a contract to do something to that land. Their only remedy would be an action for specific performance, plus an action for damages.
>
> "I think there are some advantages attaching to bonds, which do not attach to shares, but that is only in relation to a financial company, not in relation to a planting or other commercial enterprise." (Witness No. 11.)

Another witness (witness No. 12) stated that he could not see any advantages in the issue of bonds for carrying out the objects of an afforestation company, that could not be obtainable equally well by an issue of shares. "The bond system enables too many sources of profit to be covered up, and encourages such devices as subsidiary companies formed to exploit the same object."

The bond system of finance has been adopted, not because it offers special net advantages to the investor over the method of raising capital entirely by shares, or because it has special economic or social advantages, but because it promised to be more lucrative to the promoters, directors, and shareholders of the "bond-issuing" company. By risking a small share capital on the chance that bonds will not sell, the "parent" company has the prospect of a considerable profit from the sale of bonds, while leaving the commercial risks inherent in the venture to be borne by the bondholders. It can conceal avenues of profit effectively, because bonds escape many of the provisions of the Companies Act relating to shares, and is able to retain effective control of the enterprise until it is transferred to bondholders. Thereafter it is still possible, in many cases, to share for a time in such profits as may be earned in realization. This may be achieved without requiring shareholders to invest any additional capital other than a proportion in some cases of that which accrues by way of profits from the operations of the "parent" company. This company will have been financed by the bondholders' money.

Another incentive to the bond system is that it escapes the payment of the annual license fee levied on share capital. This results in loss of revenue to the State, and unfair competition with companies that rely on share capital to prosecute their main object.

The sale of bonds has, no doubt, been more successful than the sale of shares would have been, but this is due largely to the fact that investors do not appreciate the significant differences between shares and bonds. There are few (if any) advantages possessed by bonds which could not be made to apply equally to shares, and the preference of the investor for bonds is mainly irrational.

It is only fair to state that, in many cases, failure to sell sufficient bonds has resulted in the loss of share capital as well as bond capital, and that in at least one important case (company No. 12) shareholders have demonstrated their faith in the commercial prospects of the project by returning their profits to the enterprise and taking up shares in the realization company.

If the bond system of finance is to continue, it will be necessary to insist on the fullest possible publicity, and bring the conditions relating to such issues as closely as possible into conformity with those relating to share issues. In addition, it will be necessary that bondholders have the same powers of investigation into the affairs of a land-utilization company as are granted to shareholders.

(d) Title to Land.

The security of the bondholder is obviously affected by the extent of his ability to obtain a clear unencumbered title to the land, either direct or through a trustee. In some companies the land still remains encumbered though several years have elapsed since they commenced to sell bonds. In one such case, the prospectus stated that the title was clear. In another case, the company went into liquidation, and on taking over, the bondholders were required to raise additional capital to clear the title. In some cases it may be too restrictive to provide that the title shall be clear and unencumbered when a bond-issuing company commences operations, but it would seem reasonable to require that the position in regard to title should be clearly stated in the prospectus.

It has been represented to us (Witness No. 13) that the title of bondholders to the land is, in some cases, imperilled by limitations imposed by the Land Act of 1924, which are directed against land aggregation. Section 386 of the Land Act is devised to exclude afforestation companies from these limitations. We beg respectfully to draw Your Excellency's attention to that section, the effect of which is to exclude trustees or trustee companies from acquiring areas in excess of that laid down by the Act, because such companies, though interested in afforestation, are not companies "whose object or principal object is afforestation." This affects existing companies, and in order to overcome this difficulty and to extend the scope of the Act to cover other types of land-utilization company, we recommend,—

(16) That the law be amended to extend to trustees for bondholders of land-utilization companies the same concessions in the matter of land aggregation as are now extended to land-utilization companies.

(e) Payment of Interest on Bonds or other Contracts.

It is a common practice for tobacco, flax, and tung-oil companies to contract to pay interest on the moneys subscribed for fully paid up bonds until such time as it is expected that the plantations will come into profit. This policy has been abandoned by afforestation companies. In some cases, the contract promises to pay interest as high as 8 per cent. It has sometimes been the intention to pay the interest out of profits earned from catch crops, but such crops seldom appear to have been remunerative. Except where this source of income is available, the interest is paid out of capital—in effect, out of the moneys paid by bondholders themselves.

This practice is objectionable because it reduces the working capital available to the company for the fulfilment of its contract, and may, in fact, endanger the success of the undertaking. Although the purpose is to offer an additional encouragement to subscribe by providing an earlier return to the bondholder in the shape of interest, the effect is to weaken his security and reduce the ultimate prospects of profit by encroaching on maintenance funds. Our objections to the practice have been supported by a number of witnesses.

Witness No. 5 deposed,—

> "Most of the interest so far distributed has been contributed by the debenture-holders themselves. The promoters of the company anticipated that the revenue from 'catch crops' would be much greater than it has been, the amount derived from that source being only £288 16s., and that in the earlier stages of the company. . . . Sales in prospect should enable us to pay interest at the end of next month, for which approximately £600 will be required."

From the above evidence it would appear that success in meeting the interest payments provided for in the contract depends on the sale of additional bonds, or, in this instance, on the uncalled capital of the company.

Another witness (Witness No. 4) stated,—

> "The company does not contract to pay interest on bonds sold prior to the areas coming into production. It has always been considered by the company that any such contract is wrong in principle, as the money required to pay such interest can only be a return of actual capital. If this were done by a share-issuing company, it would, of course, be illegal."

He agreed that such payment would deplete the funds of the company.

We conclude, then, that the practice of paying interest out of capital is prejudicial to the interests of bondholders because it depletes the resources of the company and makes it more difficult for the company to fulfil its contract. We see no reason why bonds should be different from shares in this respect.

(4) Distribution of Expenditure.

In order to provide an estimate of the relative distribution of bond moneys over different objects, the following table has been prepared from the records of ten companies, including five afforestation companies and five companies engaged in planting tung-oil trees, tobacco, and flax. These were the only companies whose records were complete enough to enable us to make an analysis.

TABLE III.—DISTRIBUTION OF EXPENDITURE OF TEN LAND-UTILIZATION COMPANIES AS AT LATEST DATE FOR WHICH FIGURES ARE AVAILABLE, IN EACH CASE, PRIOR TO JUNE, 1934.

Object of Expenditure.	Afforestation.		Other.		All Companies.	
	Amount.	Per Cent. of Total.	Amount.	Per Cent. of Total.	Amount.	Per Cent. of Total.
	£		£		£	
Land	497,559	10·4	54,049	22·7	551,608	11·0
Brokerage	883,000	18·5	84,303	35·4	967,303	19·3
Planting and maintanance	1,025,781	21·5	66,085	27·8	1,091,866	21·8
Trust fund	794,451	16·7	12,827	5·4	808,278	16·1
Other	1,571,689	32·9	20,745	8·7	1,592,434	31·8
Total	4,772,480	100·0	238,009	100·0	5,011,489	100·0

Certain observations must be made in explanation of the above table. In one or two cases total expenditure is somewhat in excess of the total amount received from the sale of bonds, so that the aggregate expenditure includes a certain amount of share capital. This will have been necessary to meet preliminary expenses and in some cases to pay for land in advance of the receipt of bond-moneys. The net effect is to increase slightly the percentage expenditure in land and "other," but it is unlikely that the expenditure of share capital represents as much as 5 per cent. of the total, and the general significance of the table is very little affected.

It should be noted also that the table summarizes the position on the basis of returns furnished by the various companies on particular dates, and the companies are of different ages. The position on the completion of the contract will not be the same as that revealed on any previous date. On completion, the trust fund will have disappeared, and will have been used to meet planting, maintenance, and administration costs, or will have been distributed as profits. In some cases a proportion of the trust fund is set aside to erect plant, which will eventually be paid for by bondholders out of additional capital subscribed by them. The net effect on completion of the contract is likely to be the disappearance of the trust fund, a greater proportionate expenditure on planting, maintenance, and "other," and a somewhat smaller proportionate expenditure on land and brokerage. The proportionate expenditure on land is likely to be less because some land has been purchased in advance of bond sales; and on brokerage because at the present time brokerage will have been paid on some bonds sold but not fully paid up. Against this must be set any changes in the proportion of forfeitures to total sales, because on the average the amount received on forfeited bonds in excess of brokerage is small.

Notwithstanding these qualifications, we are of the opinion that the above table presents a reasonably accurate picture of the position at the present time. If anything, it understates the proportionate expenditure on brokerage and land, because the table excludes many companies which have failed, in which the contributing causes of failure have been especially high charges for land and brokerage, and which have spent very little on planting and maintenance.

We now proceed to discuss the various items of expenditure seriatim:—

(*a*) *Land.*

In respect of this item, little need be added to what has already been said. To date, about 10½ per cent. of the expenditure of the forestry companies included in the above table and about 23 per cent. of the expenditure of other companies has been for land purchase. The higher proportion in the latter companies is probably due, in the main, to the fact that the land purchased is of better average quality. We have shown that the inflation of land-costs has been a common feature of land-utilization companies.

(*b*) *Brokerage and Selling Costs.*

In the ten companies whose figures are tabulated, brokerage and selling costs exceed 19 per cent. of the total expenditure to date. This percentage is lower than the normal because the average in the table is affected by the inclusion of one very large forestry company with the unusually low brokerage and selling cost of 13 per cent. This is also the main reason why brokerage-costs in forestry companies included in the table are lower than in the other types of company included. If this company is excluded, brokerage represents nearly 36 per cent. of the total expenditure. The cost *per fully-paid-up bond* would be less than this, because the estimate includes brokerage on forfeited bonds, which would return little, if anything, over the cost of brokerage.

The spread of the ratio of brokerage-costs to total expenditure in the companies in the above table is as follows:—

13 per cent.	20·8 per cent.	35 per cent.
18 per cent.	28 per cent.	39 per cent.
20 per cent.	31·3 per cent.	43 per cent.*

* Average of two related companies.

In other cases which came before our notice brokerage and selling costs were equally high, the most glaring example being that of a company which received £18,440 from the sale of bonds and £2,668 from the sale of preference shares, out of which sum £16,556, or 78 per cent., went in brokerage and other selling costs.

It must not be assumed that the high percentage-cost of bond-selling is due entirely to forfeitures. In many cases brokerage agreements are extremely generous. This may be illustrated by quoting one or two examples.

Company No. 4 entered into a contract in the following terms with a brokerage company, one of whose principal shareholders was a director in the bond-issuing company :—

1. That brokerage company was to be the sole broker.
2. Brokerage was to be paid at the rate of 20 per cent. of the nominal value of the bond.
3. The following bonuses were to be paid in addition : 1 per cent. if 8,000 bonds sold within four years ; 1½ per cent. if 8,000 bonds sold within three years ; 2½ per cent. if 8,000 bonds sold within two years.
4. The bond-issuing company was to advance up to £500 free of interest to the bond-selling company, to be repaid within two years. This sum was guaranteed by the director mentioned, who was also a shareholder in the bond-selling company.
5. If less that five hundred bonds were sold within six months, the bond-issuing company was entitled to terminate the agreement.

   In addition, the bond-selling company was to receive a commission of 2½ per cent. on the collection of instalments.

Company No. 6 is a forestry company issuing bonds to the nominal value of £35 per bond. Brokerage is £19 per bond. The brokers may sell bonds at a premium of up to £20 per bond, and this they keep. On a bond sold at the maximum premium they therefore receive £39 out of the £55 charges for the bond.

Company No. 7 is a tung-oil company, which contracted to pay 15 per cent. brokerage to a selling company of which its chairman of directors was one of two main shareholders. Advertising, printing, and the collection of instalments were undertaken by the parent company. The arrangement was found unsatisfactory, and the company thereupon undertook its own selling at a cost of 8⅓ per cent.

Company No. 12 entered into the following agreement with an Australian firm which was to sell its bonds :—

1. The brokerage company was to be the sole selling agent in Australia. The prospectus stated that the bonds were to be sold only in Australia.
2. The company was to receive—
   (*a*) £1,000 per annum for the first year.
   (*b*) A commission of £12 10s. for every bond of £50 sold—*i.e.*, 25 per cent. of the price to be collected as follows :—
      Where sold on £5 deposit and £4 per month—
         Brokers to keep first £5. Brokers to keep £4 out of second £5. Brokers to keep £3 10s. out of third £5.
      Where sold on £5 deposit and £2 per month—
         Brokers to receive first £5. £2 out of first instalment. £2 out of second instalment. £1 10s. out of third instalment. £2 out of fourth instalment.
   (*c*) Such further commission as the company may allow.
   (*d*) The sum of £8 6s. 8d. per month for an office in each of the Australian States, the brokers to open an office in each State.
   (*e*) The immediate allotment and issue to the agents of 4,000 fully-paid-up shares, out of which the agents might sell 2,000 shares. (Under a supplementary agreement the allotment was reduced from 4,000 to 2,000 shares.)
   (*f*) The right to a seat on the directorate.
3. Brokers were to visit Auckland every three months if required, expenses to be paid by the bond-issuing company.
4. After the brokers had collected £25 per bond, the responsibility for collecting further instalments was to rest with the company.
5. Forfeited bonds were to be resold if the cash received was less than £25, and the agents were to receive a further commission.
6. The brokers guaranteed to sell 1,500 bonds within twelve months, and 3,000 within eighteen months, provided that if the company's accountants and the trustee for bondholders were of the opinion that the agents had made reasonable efforts to sell, a further period of six months might be granted.

   The representative of the brokerage company acting as director in the bond-issuing company also received director's fees.

The justification offered for agreements on such generous terms is that the cost of selling bonds by door-to-door canvass is high and that large commissions are necessary to cover the costs and return profits to the selling agents. This is no doubt true, though some large and well-established land-utilization companies are able to do their own selling on a much lower commission. When account is taken of forfeited bonds, the cost of collecting bond capital is, of course, very much increased.

The evidence quoted serves to demonstrate that the selling of bonds is an extremely wasteful process, largely because door-to-door selling has had to be resorted to. It is true that the selling-cost of goods at retail is often as high and is not free from waste of various sorts, but the retailer does provide additional service by way of assembling a wide variety of goods and holding them in stock for the convenience of the consuming public. To a much greater extent, the bond-salesman must persuade the "prospect" into investing in an undertaking in which, initially, he is not interested.

When once the financing of enterprise through the issue of bonds is conceded, it is difficult to see how the diversion of a considerable proportion of capital into the costs of selling can be prevented. Nevertheless, the waste involved is closely conditioned by the source from which selling costs are derived. It seems clear that when the bondholder provides the funds from which brokerage is to be deducted, there is in many cases little or no incentive to economy; on the contrary, the selling arrangements adopted in such cases may be used as a device to facilitate the reaping of a secret and unconscionable profit by the directors and other promoters of the company. We are of opinion that it is unreasonable and against public policy to permit a company to issue a prospectus to raise capital from bondholders under any scheme, a feature of which is that the shareholders are not required to risk, by prepayment in cash, even the cost of marketing the bonds.

(*c*) *Planting and Maintenance.*

In the companies listed in Table III, planting and maintenance comprise 21·8 per cent. of the total expenditure. The amount and proportion of total expenditure under this head will increase with the age of the plantations. The amount required will differ with different types of enterprise and with differences in location, management, and size of plantation. The expense is a necessary one, and it will be to the interests of the company to keep the cost as low as possible, consistent with fulfilling its contract. To decide whether or not expenditure under this head is reasonable or adequate and whether the areas have been properly planted and efficiently maintained, is a matter for experts, and we offer no opinion in this report.

(*d*) *Trust Funds.*

The trust fund is created by the setting aside into a separate account of a certain sum from each fully-paid bond. The amount set aside is usually the last to be paid by the bondholder. It is regarded as a guarantee, provided by the bondholder himself, that the company's contract with him will be fulfilled, by providing a sufficient sum to meet expenses of maintenance until the time arrives for handing over the plantations. Reference to Table III shows that, in the companies listed, the trust fund amounted to 16·7 per cent. in the case of forestry companies and 5·4 per cent. in the case of other companies, the average for the ten companies being 16·1 per cent. The amount and the proportion will decrease as the contract reaches maturity.

The usual condition is that a certain proportion of the trust fund is handed over to the company each year if the trustee is satisfied that the contract has been properly fulfilled. On the completion of the contract, the company receives what is left. Hence the trust fund is the property of the company. In some cases a certain sum from the sale of each bond is earmarked for the erection of plant, which will be the property of the company and must be paid for by bondholders if they take it over.

Income from the trust fund is also the property of the company. Expenses of trustees are usually met from the trust fund.

It has already been pointed out that the existence of a trust fund is not always a satisfactory guarantee that the contract will be observed. The larger the trust fund the greater the incentive to the company to fulfil its contract, and the greater the capacity of the bondholders or their trustee to adequately maintain the areas in the event of default by the company.

The security of the bondholder will be impaired (*a*) if the company fails to make the payments into the fund in terms of its contract, or (*b*) if the fund is not properly invested. We have evidence of the violation of both these conditions.

The former condition, (*a*), is the more likely to occur, because it is the common practice not to make the payment to the trust fund until the bond is fully paid. We think that this is an unsound practice; we are of the opinion that a proportion of the first and of each succeeding instalment should be allocated to the trust fund until the payment to the fund is completed.

The latter condition, (*b*), occurs when the investment of trust funds is in the hands of the company itself, and not of the trustees. Occasionally a company appoints no trustees, but simply agrees to establish a trust fund. There is then little effective safeguard against the misapplication of trust funds.

A glaring example of the improper use of trust funds is the following:—

In the case of Company No. 20, a trustee had been arranged for and its name was disclosed in the prospectus prior to the offer of the forestry debentures to the public. The trust deed provided that the trust fund should be paid to the company, and that a proportion of the money received in respect of each debenture "shall as the same is received be set aside and invested by the company in the name of the trustee upon securities" of the nature of authorized trust funds. This course was adopted. The company made the investments and handed the instruments representing the investments to the trustees. The history of the company shows that this method was unsatisfactory. In some instances investment policy was dictated by the interests of the company itself, and the representative of the debenture-holders on the board of directors of the company, and also the trustee company, made strong protests against some of the proposed investments and some of the actual investments.

We think the undesirable nature of this provision is so apparent that it calls for no comment on our part. We are of opinion that a trustee should be appointed in every case, and that it is he and not the company who should select and make the actual investments. Where there are separate series of bonds and groups of bondholders we think it desirable that there should be a separate trustee for each group, and that he should have the rights indicated above.

(*e*) "*Other.*"

"Other" expenditure is an omnibus item which includes all payments not included under headings previously discussed. Among these would be initial expenses, administrative costs, legal charges, and profits to the shareholders.

(5) Forfeitures.

The number and nominal value of bonds forfeited is very high. This is shown by the following table, which gives particulars in respect of eight companies. These companies have been chosen not because they display unusual features, but because they are the only companies which have supplied us with evidence adequate for the purposes of the table.

Table IV.—Bonds forfeited.

Table showing (in respect of Eight Companies) Number and Nominal Value of Bonds forfeited, together with Amount received on Forfeited Bonds and Total Amount received from the Sale of all Bonds.

Number forfeited	92,308
Amount received	£387,806
Nominal value of bonds forfeited	£2,575,089
Total amount received from sale of bonds	£4,962,521
Total amount received from sale of bonds, less amount received on forfeited bonds	£4,604,715

The table shows that the nominal value of bonds forfeited is over 50 per cent. of the total amount received from the sale of bonds, and is 56 per cent. of this amount less the amount received on bonds which have been forfeited. The amount paid on the 92,308 bonds forfeited is £387,806, or just under 14 per cent. of the nominal value. This is less than average brokerage. Some portion of the amount received from the sale of bonds is for bonds which are not yet fully paid up. Some of these will be paid in full, others forfeited. Our estimate would be that out of three bonds sold one is forfeited, on the average. This further demonstrates the heavy waste involved in the sale of bonds, for, since on balance the amount received is less than the brokerage, it is collected to no purpose other than to make a contribution to the expenses and profits of brokerage firms.

Our terms of reference require us to make recommendations concerning the allocation of moneys received on forfeited bonds.

The above analysis would suggest that the question is of little practical importance, because the amount received does not, on the average, more than cover brokerage. Nevertheless an average may conceal appreciable individual variations, and the above generalization may not always apply.

It has been represented to us with some reason that the company is entitled to receive the benefit of the proceeds from forfeited bonds, because it incurs the risk that its share capital will be lost if bonds are not sold. It should be equally clear that bondholders who own fully paid bonds bear a similar risk because, if insufficient bonds are sold, the company will be unable to fulfil its contract.

We consider that if the bond system is to continue, the most equitable arrangement would be a division of the proceeds from forfeited bonds, between the company and the bondholders.

We have made a suggestion on page 44, which, if adopted, would build up the trust fund from the beginning by the allocation to it of a proportion of the instalments as paid. The same procedure should be adopted in order to ensure that bondholders receive a reasonable proportion of the amounts obtained from forfeited bonds.

In other words, such a provision will have a two-fold effect:—

(*a*) It will enable the trust funds to be built up from payments made by instalments as they are received, instead of from the last instalment received.

(*b*) It will give tacit recognition to the fact that the bondholder, as well as the shareholder, bears some of the risks of the enterprise.

(6) Publicity in regard to Allocation of Bond-moneys.

We have shown that the position of the bondholder is inferior to that of the shareholder in regard to the information which must be disclosed in prospectuses, and in other ways. It is also inferior in respect of the information which must be provided by law, or which can be demanded, concerning the financial operations of a company. We have shown that bondholders provide a substantially greater amount of capital than shareholders, and that the risk they run of losing this capital may be considerable. Yet the company is under no obligation to give to bondholders information concerning the allocation of the moneys which they provide. If the risk to bondholders consisted solely in the commercial risk that the marketing of the product might ultimately prove unsuccessful, the condition would be unobjectionable, but we have shown that there is the additional risk that the financial position may so deteriorate, or that such unconscionable charges may be incurred, as to imperil the successful completion of the contract. It is not sufficient that bondholders may take over the area when default has actually occurred. They should be in a position to apply the remedy suggested on page 43, Recommendation 22 (*i.e.*, of inspection of affairs with a report to the Court) by having sufficient information to enable them to form a judgment on the financial position underlying their contract.

One witness (a solicitor with a wide experience of bond companies) did not think it "right or proper that bondholders as a general proposition should have the same right to information, disclosure, and accounts as the shareholders" (Witness No. 7), and drew attention to the fact that the bondholder has the same right as the general public of inspecting statutory reports, accounts, and other documents filed with the Registrar of Companies. "He is entitled to information as to his particular contract and as to the resources of the contracting company, and in my experience this is always supplied and published."

Another solicitor (Witness No. 10), equally conpetent to offer an opinion, was asked, "Do you see any objection to an afforestation or other such company's being required to file annual accounts with the Registrar showing, under appropriate headings, its expenditure of bond-moneys?" The witness replied as follows:—

> "No, and I would go further and say that provision might also be made for that account to be furnished to individual bondholders, because in practice it is not sufficient merely that accounts should be available at some central point.
>
> "The principal reasons that occur to me for such a course are:—
>
> "(1) That the exhibition of accounts would check the misapplication of bond-moneys and improper expenditure.
>
> "(2) Bondholders would see that the company was properly fulfilling its undertaking."

With this opinion we concur, for, in view of the magnitude of their stake in the undertaking, bondholders are not less vitally interested in its financial transactions than are shareholders, and should be given substantially the same rights in the matter of financial information. It is not sufficient to file accounts at the office of the Registrar of Companies because bondholders are too scattered to enable them to have adequate access to such records. If the bond system is to continue, we are of opinion that, within one month of its annual meeting, every land-utilization company should be required to forward a copy of its annual accounts, duly audited, to every bondholder; and that accompanying such accounts there should be supplied an audited analysis of the expenditure (under defined heads). A suggested set of heads for such analysis is given on page 44—Recommendation No. 26.

C. CONTROL AND ADMINISTRATION.

The general scheme of control and administration will have been gathered from the preceding discussion. We now proceed to recapitulate and elaborate.

(1) The Parent Company.

The parent company acquires, or obtains an option over, the area to be planted, determines the price at which bonds are to be sold, the number of bonds, and the conditions of the contract. It appoints the original trustees, if any, decides the conditions under which the appointment of trustees may be terminated and new trustees appointed, and the rights of bondholders relating to the dismissal or appointment of trustees. It decides the powers of bondholders in regard to the registering of a decision on any matter, whether by meetings or postal ballot, determines who shall take the initiative, and decides what majority is required to make a decision effective, and so on. It determines the powers and duties of trustees in regard to the presentation of reports to bondholders, inspection of areas, and investment of trust funds. It decides how much of the proceeds from each bond shall be invested in the trust fund and in what manner, and also the conditions under which the trust fund is to be transferred to itself, or possession of trust funds assumed by trustees for bondholders. It determines the date on which trustees are to enter into possession of the areas, and its own rights and duties in respect of realization. All these and other conditions relating to the contract are embodied in the trust deed, which the company draws up.

It makes all the necessary arrangements and agreements for the sale of bonds, including the brokerage or other selling costs to be paid, the purchase of land, the planting and maintenance of the areas, and in some cases the erection of plant and the marketing of the crop.

As long as the conditions of the contract are observed, the company has conplete control over the undertaking until the contract matures.

(2) Trustees.

(*a*) *Personnel.*

The personnel of the trusteeship varies greatly. In some cases an individual or individuals are appointed. In others, the trustee is an insurance or trustee company or a public trustee. In others, the trustee is a separate company set up for the purpose. In at least one case the trustees are the members and directors of a company specially set up for the purpose, these individuals being scattered over seven separate States. We found that in one or two cases no trustee was appointed.

In some companies one or more of the trustees is an officer of the parent company. While we do not suggest that such a dual relationship is *necessarily* prejudicial to the interests of bondholders, we regard it as improper because it may lead to a conflict of interest and because it has been a factor making for suspicion among bondholders against trustees. It is probable that, wherever a real conflict of interest could be found to exist, the law relating to trusts and trustees is sufficient to protect bondholders, if they pursue their remedies.

The difficulties experienced by trustees on the one hand, and bondholders on the other, seem to arise, firstly, from neglect to make certain necessary provisions in the trust deed, and, secondly, from the inherent difficulty involved in dealing with a scattered body of bondholders who are the beneficiaries under the trust. Many of the trust deeds, for example, have been defective in that they have made no adequate provision for summoning meetings of bondholders, or for voting-powers at meetings, or for otherwise obtaining the voice of the bondholders on any matter that might affect their interests. Few, if any, of them seem to have made any provisions for application to the Court under the many appropriate provisions of the Trustee Act, 1908, if it should be desired to remove a trustee or to secure the appointment of new trustees. Even if the trustees should desire, with the consent of such bondholders as they can get in touch with, to approach the Court for directions, or for consent to certain proposals, there is the difficulty created by the fact that it is impossible for the trustees to give such notice as the Court would require to all beneficiaries likely to be affected by the proceedings.

We have tried at several points to draft recommendations in the form of such provisions to be included or implied in trust deeds, but we have found some of these difficulties insurmountable. We are of opinion that legislation will be necessary before they can be overcome. This legislation must touch a highly specialized branch of law—namely, the law of trustees—and we do not consider ourselves competent to make any recommendations in this direction. On pages 43 and 44 we make some recommendations covering certain difficulties where it appears to us that a remedy is practicable. If legislation is to be passed in an endeavour to meet such difficulties, it must be done by those who are qualified to undertake the task of fitting the proposed legislation into the framework of the law relating to trustees.

(*b*) *Location of Trustees.*

Certain of the land-utilization companies raising finance by the sale of bonds in New Zealand are located in other States, and the trustee and the trust funds are outside the jurisdiction of the Courts of the Dominion. This weakens the position of bondholders in New Zealand, and renders it much more difficult to enable a drift to be detected or to enforce a remedy in the event of default. One such case which has come under our notice demonstrates the dangers inherent in such a situation. The trustee was the Public Trustee of another State, and representatives of bondholders deposed (witness No. 14, company No. 13):—

> "The investment was attractive to many because the Public Trustee of —— was appointed as trustee for all three groups (of bondholders) . . . "

And he then gave details of the difficulties and delays experienced by the New Zealand bondholders.

On page 44 we make a recommendation (No. 24) to remove the unsatisfactory position of bondholders which results when the trust fund and the trustee are beyond the jurisdiction.

There are other difficulties arising out of the international range of operations of bond-issuing companies. These seem to call for inter-State action.

(*c*) *Appointment of Trustees.*

It seems unavoidable that the first trustees shall be appointed by the parent company. This is a weakness, for there is nothing to prevent the parent company from appointing a pliant man. Since the trustee is nominally appointed to safeguard the interests of bondholders, and since he may prove unsatisfactory after appointment, it is highly important that bondholders should have clear and unequivocal rights in regard to dismissal and replacement. Such rights are not always so defined, and in very few cases are they adequate.

It is very rarely that bondholders have power over the dismissal and election of trustees, though in a few companies trustees may be removed on a requisition of bondholders. Usually in such cases the new trustee is appointed by the company. We regard the present position as unsatisfactory, and this is one of the matters in respect of which we have set out a Recommendation (No. 27, on page 44).

(*d*) *Powers and Duties of Trustees.*

(i) *Control of Funds.*—In most cases the investment of funds is in the hands of the trustee, and we have stated our opinion that this should apply in all cases.

(ii) *Expenses of Trustees.*—It is the general practice for the fees of trustees and expenses incurred by them in the fulfilment of their duties to be met out of the trust fund or out of income derived from investment of the trust fund. The position in regard to legal costs which may be incurred in litigation against the company is not so clear. In some companies provision is made for such costs to be met in the same way as fees and ordinary expenses; but in very many instances no such provision is made, and trustees would require to rely on the discretion of the Court as to the allocation of costs. In such cases trustees would be likely to be deterred from taking action against the company. If trustees are to be in a position to protect bondholders' interests by entering into litigation against the company to enforce the fulfilment of the contract, or to claim damages for non-fulfilment, it would seem that there should be funds available to meet the expenses of an action. Probably section 83 of the Trustee Act, 1908, meets this position.

(iii) *Inspection and Report.*—Trustees are normally required to satisfy themselves that the contract has been fulfilled in respect of planting and maintenance, or in other ways, before paying over the amounts due from the trust fund from time to time to the parent company. In most cases, they report annually to bondholders on the state of the plantations and the amount in the reserve fund. The rights and duties of trustees in regard to inspection and the presentation of reports are not always clearly defined in the trust deed, nor their powers to appoint independent experts

to advise on the state of the plantations. A report on the state of the plantations and on conditions relating to planting and maintenance loses much of its value if it is prepared on the basis of advice from the company's own experts. Since the trust deed is a working code for the trustees, we think that every trust deed should contain provisions requiring and enabling the trustees to procure and distribute to bondholders at stated intervals independent expert reports on the state of the plantations.

(iv) *Meetings of Bondholders.*—From time to time situations may arise when it is desirable that bondholders should be consulted by the trustee and a decision made by them. It then becomes important that adequate provisions shall be laid down in the trust deed indicating the circumstances under which this is to be done, the procedure to be adopted, and the method of arriving at a decision. Trust deeds do not always make such provisions.

Circumstances in different companies differ to such an extent that it is inexpedient to determine these conditions rigidly, but on page 44 we make recommendation No. 29.

(v) *Realization.*—Trustees have certain powers and duties in respect of realization of the assets. Realization projects vary from company to company, though certain difficulties connected with realization are fairly general. The problem of realization is dealt with below.

(*e*) *Trust Deed.*

Since the trust deed embodies some of the terms of the contract between the company and the bondholders, and since it determines and limits the powers and duties of trustees, it becomes a document of first importance to the success or failure of the enterprise. We think that for the convenience of bondholders, as well as of the public, a copy of the trust deed should be filed at the office of the Registrar of Companies.

The trust deed is drawn up by the parent company. Normally, the trustee accepts, and is content to accept, the responsibilities as defined and limited by the trust deed. The trustee may or may not approve of the conditions of the trust or think them adequate. In one or two cases trustees have insisted on modifications of the deed before accepting the trust, but we have no reason to believe that this is general.

Subsequent experience may reveal the trust deed to be unsatisfactory. We have had evidence to show, for example, that many trust deeds have failed to make provision that a majority of bondholders may give effect to a decision binding on themselves or on the bondholders as a whole. As the result, any decision may be upset by a single dissentient, and it becomes impossible to make any change in the contract, or make adequate provisions for realization by legislation. We see no remedy for this problem except making the rights of bondholders, in this matter, comparable with those of shareholders.

(3) Bondholders.

The foregoing account shows the extent to which the rights and powers of bondholders are limited by contrast with those of shareholders. We are of opinion that the rights and powers of bondholders should be extended to make them more consistent with the importance of their stake in the enterprise. The weaknesses to which reference has been made are all the more important because bondholders are scattered and difficult to organize, and because in many cases no provision is made to enable bondholders to call meetings or take the initiative in registering a decision. Should bondholders require to take legal action against the company or trustee, they must in most cases provide their own legal costs. In view of the fact that bondholders are scattered, and that the amount which each individual bondholder has at stake makes him reluctant to risk any considerable sum on litigation, the chance of bondholders combining to institute and finance legal proceedings is usually remote. There is, however, a protection that could be easily made available to bondholders—viz., the granting to them of the same powers of requiring inspection of the affairs of their company, as is now enjoyed by shareholders. We therefore recommend—

(17) That, if the bond system of finance is to continue, sections 142, 143, 144, and 145 of the Companies Act, 1933, be amended to extend the same powers to holders of bonds or other contracts in series as are granted to shareholders, the cost of such inspection or action being chargeable against the trust fund or the company at the discretion of the Court.

We think, further, that (if the bond system is to continue) the powers of bondholders to requisition the calling of a meeting, initiate and conduct a postal ballot, or act in concert in other ways, require to be more definitely stated and strengthened. We set out, therefore, on page 44 a recommendation (No. 29) that all future trust deeds relating to bonds shall contain adequate provisions dealing with these matters.

D. REALIZATION.

Conditions in regard to the harvesting, preparation, and marketing of the crop on maturity vary from company to company.

In some instances no provision is made for marketing, the parent company merely contracting to hand over the area by a certain date. The responsibility then falls on the bondholders. In any such cases no legal provision has been made to enable the bondholders to take over, and the difficulties in the way of their incorporation for this purpose require a legal remedy.

In other cases provision is made for the bondholders to make the necessary arrangements for realization, by incorporation or other means, on a majority vote of the bondholders. One recently established company, profiting by the experience of others, provides that each fully-paid-up bond

automatically entitles the bondholder to a fully-paid-up share in a separate realization company. In the absence of such provisions, a unanimous vote of bondholders is necessary before bondholders can put any realization policy into legal effect, and this is virtually impossible to get. In one case a merger has been effected between bondholders and shareholders. The company has converted its profits into shares in a new company, and bondholders have also received shares in proportion to their bondholdings.

In many instances the company contracts and has the right to harvest and market the produce for a stated period of years, during which it receives an agreed proportion of the net profits. It usually contracts to erect the necessary plant. At the end of the stated period the contract may be renewed or modified, or bondholders may harvest and market the crop themselves. Unless provisions similar to those referred to in the preceding paragraph have been made in the original contract, bondholders may still find it legally impossible to establish and operate the necessary organization.

It is scarcely necessary in this report to describe in detail the various realization schemes proposed or incorporated in trust deeds. The important problem before the Commission is to ensure that adequate provision is made to enable bondholders to carry into legal effect a properly devised scheme, and to ensure that realization is not wrecked by a small recalcitrant minority. We have had abundant evidence that the conditions embodied in or omitted from existing trust deeds are seriously embarrassing many companies, trustees, and groups of bondholders, and we have considered it desirable to deal with the problem separately. Our recommendations on this matter are embodied in Appendix III.

We feel it important to ensure that similar difficulties do not occur in respect of future bond issues, if such are to be permitted. We are satisfied that no workable scheme of realization can be formulated unless provision is made for incorporation of the bondholders. This means, in effect, the conversion of bondholders into shareholders, and serves to emphasize further the undesirability of the bond method of finance.

E. CAUSES OF FAILURE.

Out of a total of seventy land-utilization companies of which we have knowledge, twenty-seven have been struck off the register. All of these companies have been formed during the past ten or twelve years. The figures for the various types of company are as follows:—

TABLE V.—MORTALITY AMONG LAND-UTILIZATION COMPANIES.

Type of Company.	Number.	Number struck off the Register.
Afforestation	29	7
Tung oil	8	1
Flax	17	7
Tobacco	14	10
Other (citrus and passion-fruit) ..	2	2
	70	27

This is not a complete mortality list, because it excludes companies which may be moribund but which have not yet been struck off the register, and also overseas companies concerning which no information is available. Where it is not known that overseas companies have gone into liquidation, or are still in active operation, they are included in the total.

The rate of mortality is high, and undoubtedly represents a heavy loss of capital—how much we are unable to estimate. Amongst the causes which have placed the above companies in difficulties—as well as other companies which have so far been able to avoid liquidation—may be mentioned the following:—

(1) High cost of land.
(2) Mistakes in planting, and the cost involved in replanting.*
(3) High cost of selling bonds, and failure of selling organizers to carry out their duties effectively.
(4) Failure of underwriters to fulfil contracts, and inability of bond-issuing company to secure adequate compensation owing to inadequate financial resources of underwriters.
(5) Defalcations of salesmen and misrepresentation by salesmen.
(6) Extravagant expenditure by directors.
(7) Failure to sell a sufficient number of bonds.

It is difficult to suggest any remedies which will prevent these causes from operating. In general, a drift is more likely to be checked and a remedy enforced in time if our recommendations are adopted that bondholders shall have adequate rights to receive information on financial matters, and shall have powers of inspection in the same way as shareholders, reinforced by an application to the Court. In addition, we have recommended full disclosure in regard to land transactions and brokerage and other

* In the case of one company the land was found to be unsuitable, and a new area was selected and planted, the bondholders' rights being transferred to the new area (Company No. 7). This company appears to have been able to maintain a satisfactory financial position. Other companies have not been so fortunate.

agreements, and that brokerage shall be provided for by the company. These would provide some check on the more flagrant type of abuse imperilling the success of a company. In regard to such causes as the failure of underwriters to fulfil contracts, and defalcations of and misrepresentations by salesmen, it is difficult to see what remedies can be applied other than the exercise of greater care and better judgment by bond-issuing companies and purchasers of bonds, together with the application of ordinary legal remedies for fraud, misrepresentation, and non-fulfilment of contracts.

The failure to sell a sufficient number of bonds to place a company on a sound basis is in another category and requires a special remedy. It is important that some remedy should be attempted, because it is one of the most important, if not the most important, single cause of failure.

In respect of each type of company there will be a certain area below which the realization of the plantations will be uneconomical. Unless a sufficient number of bonds is sold to cover such an area, the realization is likely to be unprofitable to bondholders, even if the scheme is otherwise soundly conceived and wisely and honestly managed. This is a deferred risk which does not mature until the plantations are ready. In addition, the failure to sell an adequate number of bonds brings the risk that the company may be unable to fulfil its contract unless its paid-up share capital is adequate. The company may require to complete the purchase of an area of land in excess of the area covered by bond sales. As the number of bonds sold increases, overhead expenses are spread over a large number of units, and represent a smaller cost per bond. Hence a minimum number of fully paid-up bonds is required if the company is to fulfil its contract and the bondholders are to have a reasonable chance of realization at a profit. In the case of share companies, the importance of having an adequate subscribed capital for the purposes of the company is realized, and legal provision is made in the Third Schedule (Companies Act, Third Schedule, Part I, Clause 5), requiring prospectuses to state the minimum amount which, in the opinion of the directors, must be raised to provide the capital necessary for the purposes of the company. It is *prima facie* desirable in our opinion that a similar provision should apply to bond issues, but we find ourselves unable to frame a workable recommendation to that effect. Forfeitures are always heavy. If bonds sold and afterwards forfeited are to be counted in the minimum subscription, the provision will be illusory; if they are not to be counted in, the task of trying to overtake the "leeway" they cause will make the provision practically impossible of fulfilment.

This consideration further illustrates the inherent defects in the bond system.

(The conditions disclosed in the above section of this Report have had important reaction on the reputation of New Zealand companies in other countries, and have reflected prejudicially on New Zealand's credit overseas. We return to this question in a later section of this Report.)

F. THE BOND SYSTEM DISCREDITED.

(1) Abolition of System recommended.

On the facts presented to us and marshalled in the preceding pages we believe that the system of raising capital sums by the issue of "bonds" is a discredited system. We find that it is wasteful and uneconomic; that it lends itself to abuses; and that its success has been due chiefly to the skill of trained salesmen who have created and maintained an illusory atmosphere of security and extravagant expectation round the instruments they vend.

We think it is undesirable to attempt to adapt the Companies Act to the continued use of these instruments by giving them a definition and a status, and adding provisions to check the abuses they foster.

The general purpose of undertaking the consolidation of our company law in 1933 was to bring our law into harmony with the Imperial Act known as the Companies Act, 1929. That harmony is possible only whilst the basic principle of each is recognition of the joint-stock principle in a scheme which assumes that the shareholder-proprietors of the company shall subscribe sufficient capital to exploit its main purpose. The features of the legislative scheme embodying that assumption are—

(1) Definition of shares and of shareholders' rights and liabilities, with inviolability of capital, except with statutory safeguards:
(2) Control by shareholders, delegated to directors with the following safeguards:—
  (*a*) Regulations defining and limiting directors' powers.
  (*b*) Power in shareholders to alter those regulations.
  (*c*) Control by general meeting.
  (*d*) Right of shareholders to elect auditors and apply to Court for inspectors.
  (*e*) Compulsory publication of accounts to shareholders.

The bond-issuing system, at one important point, violates a basic principle of the joint-stock method of co-operative enterprise as outlined above. It gives to the directors a discretion to discriminate between bondholders, holding some of them to their contracts, whilst agreeing to release others and even to return to them all or a part of the bond capital paid up by them. This is a dangerous discretion to allow to any body of directors, as it must, when exercised, tend to operate unfairly against other subscribers who have held to their contracts.

If this bond system is to be legislated for in New Zealand by provisions parallel to share provisions, to define "bonds" and "forestry contracts" and protect the bondholders (who, without being members, supply the capital necessary to exploit the main project) the principle of harmony with Imperial legislation will be sacrificed. The alterations necessary are structural, for they introduce a new constituent into the company scheme.

One effect will be to create a status and a class of rights in relation to which English and Empire case law will have either no application at all, or an uncertain application through the puzzling medium of analogy. This would involve the loss of one of the principal advantages attaching to harmony in Empire legislation.

If the bond system possessed conspicuous merits, it might be justifiable to strain the framework of company law to make a place for it. But it is not worth while to modify our law to accommodate a device which is discredited.

We submit that there is no legitimate advantage attainable by an issue of "bonds" that is not equally attainable by an issue of shares. If it is desired to define capital and revenue rights for a distinct class of investors, that may be done by creating and defining a distinct class of shares. Any appropriate name that is desired could be attached to that class to distinguish it from the others. The holders of that class of shares could have special representation on the board of directors, or, if they wished, a distinct board of directors. Holders of shares in that class might have their own arrangements for meetings to deal with matters affecting their peculiar interests, and they could have their own rules as to voting-power. They could provide for the accounts showing their capital receipts, and their capital and other expenses to be kept separately and shown separately in the annual accounts. They could elect their own auditor. All these things involve merely the making of appropriate provisions in the memorandum and articles of association of the company.

The Companies Act, 1933, by section 73 recognizes the device of having different classes of shares, with provision where desired for variation of the rights attached to any class, with machinery for submitting proposed variations to meetings of members of such class, and for giving effect to the will of the majority. It also includes a provision protecting the minority against *mala fides* or injustice.

There is no difficulty in making provision for the property representing the share capital of a class of shareholders to be realized independently of the general assets of the company.

Furthermore, section 57 of the Companies Act, 1933, provides for the issue of redeemable preference shares. We think that this provision could be made to meet all requirements if the section were amended by defining "profits" in subsections (*a*) and (*c*) to include the net proceeds of the forest or crop on the realization of a land-utilization scheme of the kind we are now considering. It could then be provided that such proceeds as and when received should be accumulated and recorded as a "Capital Redemption Reserve Account." These redeemable preference shares might embody such of the foregoing features as may be thought desirable to protect or further the peculiar interests of the class.

It is very important to note that most of the companies which have reached the stage of seriously considering the realization of their forests or crops, find themselves involved in legal difficulties from which they can suggest no escape, except by incorporating their bondholders and converting them into shareholders. Representatives of such companies have conferred with us, and we have spent hours in trying to find an acceptable way out of their difficulties.

We have sought to frame recommendations, based on the assumption that the bond system should continue, and designed to bring the rights and protections of bondholders into line with those of shareholders. In very many cases the result has been to create new difficulties as fast as we devised means to remove old ones. This experience has confirmed us in the opinion that the bond system is inherently bad, and not worthy of a place in our system of company law.

We therefore recommend,—

(18) That the issue of bonds, investment certificates, or similar instruments or contracts issued in series (with or without a prospectus) shall be prohibited for the future.

(19) That the Companies Act, 1933, section 57, be amended by defining the term "profits" as used in paragraph (*a*) of subsection (1) so that it shall include the net proceeds of any land or forest or other crop thereon on the realization of a land-utilization scheme financed by the issue of redeemable preference shares.

(2) An Alternative Recommendation.

If, however, Your Excellency's advisers should decide not to accept our advice and recommendation to prohibit the use of the bond system of finance, we would respectfully draw Your Excellency's attention to such practicable methods as we have been able to devise to remedy some of the defects and abuses which we find to be inherent in the bond system. We would repeat that such recommendations are not adequate to solve the problem with which we have been confronted. There are many defects and dangers inherent in this system for which we can find no remedies except such as introduce objectionable complications and difficulties. We can suggest no practicable remedies, for example, for the defects of trustee-ownership and trustee-administration of lands which are to be utilized and realized for a scattered body of unincorporated bondholders.

With the above reservations, we recommend that the following provisions be made applicable to all existing and future bond-issuing companies:—

(20) That all provisions of the Companies Act relating to prospectuses for shares and debentures proper be made applicable (as far as possible) to proposed issues of bonds, forestry, and land-utilization contracts, and such instruments in series.

(21) That in addition to all requirements under No. (20) above, every prospectus for bonds, and every bond certificate, should contain a definitive statement, in a prominent place, in large type, giving the nature and effect of the instrument and the security (if any).

(22) That the right to apply to the Court for an inspection of affairs granted to shareholders by sections 142 to 145 (inclusive) of the Companies Act, 1933, be extended to bondholders.

(23) **That payment of interest on bonds shall be prohibited if and to the extent to which it is paid out of the capital of the bonds.**

(24) (*a*) **That all companies, whether registered within or outside of New Zealand, raising capital by the sale of bonds or other similar contracts in New Zealand, whether the lands in respect of which bonds are issued are located in New Zealand or elsewhere, shall be required to appoint a trustee or trustees domiciled in New Zealand to represent bondholders in New Zealand, and that all moneys allocated to the trust fund shall be invested by the trustee and not by the company.**

(*b*) **That where two or more series of bonds are issued by any company a separate trust deed shall be drawn up in each case covering each such series.**

(*c*) **That in respect of such issues by a company incorporated outside New Zealand a separate trust fund shall be established in New Zealand, the fund to be invested by the New Zealand trustee.**

(25) (*a*) **That as money is received from the sale of bonds, not less than one-half of each payment received should be placed in the trust fund until an amount has been paid into the trust fund equal to the amount agreed upon in respect of each bond.**

(*b*) **That the amount so received and placed in the trust fund in respect of any bonds which shall be subsequently forfeited should be paid by the trustee to the company to be expended by the company on its main land-utilization purposes and the area or rights in such area so planted should vest in the trustee for the benefit of bondholders generally.**

(26) **That within one month of its annual meeting every land-utilization company should be required to forward a copy of its annual accounts, duly audited, to every bondholder, accompanied by an audited analysis (under defined heads) of the expenditure of the bond moneys received. We would suggest the following table of heads under which the analysis should be made :—**

Total payments out of bond-moneys in respect of—

(*a*) **Land ;**
(*b*) **Brokerage ;**
(*c*) **Other selling-costs ;**
(*d*) **Plant and maintenance ;**
(*e*) **Administration ;**
(*f*) **Trust fund ; and**
(*g*) **Other expenditure.**

(27) **That every trust deed shall include a provision enabling a stated proportion of the bondholders, not less than 20 per cent., to take the initiative by steps provided in the trust deed, to effect the removal and replacement of the existing trustee.**

(28) **That every trust deed shall contain provisions requiring and enabling the trustee to obtain and distribute to bondholders at stated intervals independent expert reports on the state of the plantations.**

(29) **That every trust deed shall contain provisions relating to the convening and holding of meetings of bondholders, and defining voting-power and providing for its exercise.**

(30) **That a copy of every such trust deed be deposited with the Registrar of Companies.**

(3) The Problem of Existing Companies.

There remain the difficulties created by existing issues of bonds, and revealed and developed by attempts to administer the trusts relating to them.

In several cases it is quite clear to us, and is admitted by the directors of the companies concerned, that legislation is necessary to provide the means and method of resolving those difficulties and finding a working-basis.

In the case of several such companies, including two of the largest in New Zealand, we have had several conferences with directors and legal advisers, and the task of devising and formulating the necessary legislation was admitted on all sides to be an urgent and extremely difficult one. We have used the knowledge of the problem which we have gained in these conferences in the formulation of a general Act designed to make provision for the incorporation of all bondholders on a basis that will enable them to undertake the realization scheme which is attached to the proprietary interests evidenced by their bonds. This Bill is the subject-matter of Appendix III.

There are probably some forty or fifty land-utilization companies incorporated and operating more or less actively in New Zealand at the present time. When these are studied from the point of view of their legislative requirements to enable them to carry out their realization schemes, they seem to fall into three classes.

The first class includes those which have been established long enough and have been active enough to be now approaching the period when they must consider a realization scheme for marketing or otherwise disposing of their products.

The second class comprises those which, though still more or less active, have not been in existence long enough to render the consideration of a realization scheme a matter of immediate urgency.

The third class comprises those which have failed to secure sufficient support from the public to give them any chance of success. Any scheme of land utilization of the kind we are considering requires to have a minimum area of land and a minimum amount of capital available to operate an economic unit, and there are, unfortunately, many that have failed to reach this position.

We have endeavoured to formulate an enactment that would meet the requirements of companies in regard to realization. It is necessary that there should be some means of incorporating bondholders and some machinery whereby the bondholders, converted into shareholders, should be able, through their directors, to approve of and undertake a definite realization scheme. This scheme must, on the one hand, avoid the injustice to a majority which would be afforded if a minority were able to block a useful and well-considered scheme; and, on the other hand, the injustice to a minority which might find itself committed, without any representation or redress, to an ill-considered scheme, fathered by a majority.

We therefore present as an appendix to this part of our report a draft Bill entitled "The Land-utilization Companies Empowering Bill," and we believe that it will meet the difficulties of and provide legislation and administrative facilities for all the companies in the first two classes outlined above. The basic scheme is that companies in classes (1) and (2) should be required to undertake the incorporation of their bondholders within twelve months of the passing of the suggested Act, and that companies in class (3) should be brought to the point where they must face their respective positions and make some move towards the reconstruction which is necessary. This may mean, according to the circumstances of the case, liquidation or amalgamation, or some other form of co-operation, to coalesce small individual planted areas into economic units, in an endeavour to save the investments of shareholders and bondholders. In respect of the third class of companies, successful realization demands a measure of rationalization the incentive to which is not likely to come from the companies themselves, and some measure of Government action is likely to be necessary in the direction of encouraging amalgamation of interests. The setting-up of a Commission as recommended in Appendix III provides the necessary machinery whereby such amalgamation may be encouraged or effected.

PART IV.—INVESTMENT COMPANIES.

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

We have had the honour to present an interim report dealing with this type of company, and we propose to incorporate certain of the material embodied in that report, together with additional facts and conclusions, in the following section.

Our order of reference covers "financial, investment, and trust companies." These terms might be interpreted so generously as to include an extremely wide range of companies which are amply covered by the present law, and whose financial and administrative schemes are well understood and embody no new or unusual features. We have considered it expedient to limit our inquiries to types of company embodying tendencies new to New Zealand, displaying new evils, and revealing new dangers. The companies revealing these features are popularly described as investment trusts. In addition, there is a small group of companies which has grafted the idea of running a lottery on to the investment trust plan. These latter companies are described in Section V.

The records of thirty-nine companies at the office of the Registrar of Companies were searched. Of these, seventeen were included in a nest of companies more or less closely related by common directors, common shareholders, shareholdings in each other, or financial relations with each other. Not all of these are properly described as investment companies, but they have been made to serve, or are capable of serving, the financial interests of the central controlling group. Two of these companies are registered in Australia.

An examination of the records of the majority of the remaining companies showed that they were unlikely to reveal any special characteristics calling for further inquiry, but seven were considered to warrant further investigation. Representatives of these companies gave evidence before us or submitted on oath written answers to questions.

In other sections of our report we have refrained from mentioning the names of companies whose affairs have been investigated and described. It was our intention to follow this procedure in regard to investment trusts. In our interim report, which has already been published, it was necessary to mention names of companies and individuals, so that there is now no advantage to be gained from concealing them. On the contrary, the ramifications of one group, which we describe as the Investment Executive Trust Group, are such that an account of their interrelations will not be intelligible unless their names are used.

1. DEFINITION AND CHARACTERISTICS OF INVESTMENT TRUSTS.

(*a*) General.

The first company approximating in purpose and policy to the investment trust appears to have been formed by the Dutch in 1882. This company, which was established by King William of Holland, undertook various banking and financial activities as well. In 1852 the Credit Mobilier was formed in Belgium, "with the twofold object of giving shareholders the advantage of expert management and a diversification of risk, to an extent unattainable by the small investor."*

* G. Benson, article on Investment Trusts, in *Lloyds Bank Limited Monthly Review*, Vol. 2, No. 22, December, 1931.

The emergence of the idea of the investment trust in Great Britain took place in Scotland in the form of the establishment of a trustee to administer the estates of groups of individuals. These were usually the co-heirs to large estates. Apparently the first investment trust company, which was established in London in 1863, was inspired by the success of such trusts. The investment trust company grew rapidly in popularity.* During the Baring crisis in 1891, investment trusts suffered severely. Thereafter the movement flourished. Most companies successfully weathered the war and post-war periods. At the present time the funds of investment trusts in Great Britain are estimated to be in excess of £300,000,000.

Investment trusts may now be regarded as a characteristically British development. The investment trust movement has made little headway on the Continent, but of recent years a large number of investment trusts have been established in the United States.

The establishment of investment trust companies in New Zealand is very recent, and few, if any, of the companies whose affairs we have investigated are more than four or five years old, though some of the companies which have been drawn into the Investment Executive Trust Group are older.

When transplanted to other countries, the investment trust idea has frequently been modified in such a way as to violate the principles which are laid down as axiomatic in Great Britain, and to make the investment trust a source of grave danger instead of an instrument of financial progress. This applies especially to certain of the trusts which have been established in New Zealand and Australia.

(*b*) Definition.

There is no satisfactory legal definition of an investment trust, and it must be defined generally in terms of its methods and objects. We define an investment trust thus:—

> "An agency by which the combined funds of different participants are placed in securities showing a distribution of risks such as to introduce the law of average in protection of the principal, and which aims solely at the safe and reasonably profitable employment of the subscribed investment funds while definitely avoiding any and all of those responsibilities of control, management, finance, discretion, or special interest which are sometimes tied in with investment."
>
> —Robinson, "Investment Trust Organization and Management," page 13.

Although there is no clear distinction, in law, between investment trusts and other types of finance company, such a distinction is usually made in practice, and is recognized, for example, by the London Stock Exchange in its classification of companies under the headings of "Investment Trusts" and "Financial Trust Land and Property." The distinctions between investment trusts and finance companies are given by one authority as follows:—†

> (i) "The primary object of an investment trust company is to purchase investments to hold, not with a view to their resale at a profit, but for the sake of the income they yield or are expected to yield in the future." . . . "The business of a finance company, on the other hand, is to acquire interests in undertakings or in stocks and shares with a view to turning them over at a profit. Profits of this nature are the object of the company's existence and form the main part of its income. The amount at stake in any one venture is not limited to a small percentage of the company's funds,‡ and as the business is concerned more with financial deals, it is apt to be speculative in character."

The distinction is not a rigid one, because an investment company should constantly "review its investments with a view to making advantageous exchanges, to disposing of any investment whose market price may have risen to a figure which appears to be out of relation to present or prospective earnings, or is otherwise unjustified, or to disposing of any investment the prospects of which have become unfavourable."§

> (ii) In an investment trust the profits representing the difference between the purchase and sale price of securities are regarded as capital and are not available for distribution as dividends. Such profits are the main source of income of the finance company, and so are distributed as dividends.
>
> (iii) An investment company may pay a dividend even though the market value of its investments has depreciated. This it can do because its income arises from the return it receives on its investments, and not from profits on the sale of investments. A finance company is unable to make a distribution which does not leave its capital intact.

In New Zealand the main distinction lies between investment trusts and companies which raise capital mainly for the purpose of lending on various classes of security, but the above comparison will be shown to be useful, because it suggests that some companies in New Zealand are really finance companies masquerading as investment trusts.

---

* Benson, *op. cit.* p. 493.

† "Investment Trusts" by Wm. Walter Brock, in *Lloyds Bank, Ltd., Monthly Review*, Series Vol. I, No. 9, November, 1930.

‡ This is a recognized principle of the investment trust.

§ *Ibid.*, p. 303.

(c) Types of Investment Trusts.

Investment trusts may be of several different types, though in Great Britain they conform closely to a representative pattern. Greater variety exists in the United States.

From the point of view of capital composition, investment trusts may be divided into—

(a) Those which raise all or practically all of their capital by means of shares;

(b) Those which raise a large proportion of their capital by means of shares, usually at least one half, and the rest by means of debentures at a fixed rate of interest; and

(c) Those which raise a small amount by means of share capital and a large sum by means of contracts—called debentures in New Zealand—entitling the investor in the contract to a variable dividend based on the net return from the investment.

The first two classes correspond closely to what is described as the British type, and the last to the "contractual type."

Investment trusts may be classified into management or fixed trusts, according to the investment policy. The former exercise the function of management, by selling securities and reinvesting the proceeds, with a view to improving the security and earning-power of their holdings. Discretion in management may be limited by provision in the articles of association as to the proportions of securities of different types which may be invested in. Such trusts may be general in the sense that they invest in a wide variety of securities, or specialized in the sense that they limit their investments to particular kinds of securities, such as bonds or mortgages, common stocks of public-utility undertakings, shares of financial institutions, and so on. Fixed investment trusts "stand in contrast with the other types of trust because in most cases the underlying stocks may not be materially altered after the participating shares have been issued to the public. Continuous management, upon which general investment trusts have been built, is either considerably curtailed or else lacking altogether."*

This classification is not intended to be comprehensive.

(d) Characteristics of the British Type.

i. *Capital Structure.*

Although the capital structure of investment trust companies in Great Britain differs in detail, certain well-established principles are clearly defined. These are recognized and accepted by every authority to which we have had access. It is the almost invariable rule that borrowing-powers are limited to the issue of debentures not exceeding the issued share capital, or in some cases the share capital plus reserves, together with provision for a small amount which may be borrowed for temporary purposes. The share capital is usually converted into ordinary and preference stock in equal proportions or in the proportions 40 per cent. ordinary and 60 per cent. preference.

The total capital of sixty-three British investment trusts is distributed as follows:—

Ordinary shares	£34,550,000	
Preference shares	£36,334,000	
Total share	————	£70,884,000
Debentures		£45,192,000

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

The principal of debenture stock is commonly repayable after a period of twenty-five to thirty-five years, though sometimes terminable debentures are issued which may be repaid within from three to five years at the option of the lender. In some cases perpetual debentures are issued.

Debentures can usually be issued at a low rate of interest because they have priority in security over shares, so that they are recognized as a very safe form of investment. Preference shares, coming next in order of security, are issued at a slightly higher rate.

Investors in ordinary shares bear the greater part of the risk, but enjoy the prospects of substantially greater returns, especially as the rate at which debentures, in particular, are issued is expected to be below the average rate of return on the investments of the trust.

ii. *Security.*

The funds thus obtained are used to purchase a wide range of investments, which are the security behind the whole of the capital. A well-established trust will normally have accumulated substantial reserves which form additional security.

The debenture is a mortgage secured against the whole of the assets of the undertaking. Since the debenture-holder's lien is prior to that of the shareholder, and since the debenture capital is less than the share capital, the security may be described as gilt-edged. Preference shares are scarcely less secure since the depreciation in the value of investments would require to be sufficient to wipe out the reserve fund and all the ordinary capital before their security was entrenched upon.

iii. *Trustees.*

As an additional safeguard, most British investment trusts appoint trustees with power to inspect security portfolios and power of audit. While the powers of trustees will be circumscribed by the conditions of the trust deed, their appointment does provide an additional safeguard.

* Report on "Investment Trust" by the Attorney-General of New York State (1927), quoted L. R. Robinson *op.* at p. 48.

iv. *Investment Policy.*

(i) *Object.*—Authorities are agreed that the primary object of investment trusts should be to purchase securities as permanent investments, regard being given primarily to their income-yield rather than the prospects of capital appreciation. They should be regarded as a source of income, and not of speculative profit through resale. Continued supervision of investments is, of course, desirable with a view to avoiding losses and increasing profits through the disposal of securities whose earning-capacity is expected to decline and the purchase of those whose earning-capacity is expected to increase; but such a policy is very different from one calculated to make a speculative profit out of capital appreciation or fluctuation. "In the investment and reinvestment of its capital funds, the investment trust has no other object than the creation and maintenance of a sound investment position."*

(ii) *Diversification.*—It is the policy of British investment trusts to spread risks by diversifying investments. One authority states that in a company controlling £2,000,000 or funds it is not usual to find more than £3,000 in any one security.†

The following analysis of the investments of a well-known English company demonstrates this policy very well.‡ The investments as at 31st May, 1931, stood in the balance-sheet at £9,034,305.

This sum was spread over 715 investments, distributed as follows :—	Percentage of Valuation.
British Government securities	3·6
Railways, including street railways	23·5
Telephone, gas, electric lighting, and other public works	16·4
Commercial and industrial	28·6
Trust companies	12·2
Foreign Government and municipal loans	10·9
Steel, coal, and iron	4·8
	100·0
These were classified as follows :—	
Bonds, debentures, or debenture stocks	53·9
Preference and guaranteed shares or stocks	25·2
Ordinary shares or stocks	20·9
	100·0
The following is the classification according to countries :—	
Great Britain	37·4
British dominions and dependencies	6·3
United States of America	15·4
Cuba	0·6
Argentine	8·5
Brazil	4·0
Other South American countries	3·3
Mexico	0·5
Central America	1·0
Continental Europe	19·1
Other countries	3·9
	100·0

As shown by the above table, a threefold diversification is adopted—according to types of enterprise, types of security, and geographical location.

The advantages of diversification of the above kinds should be apparent. "Deep and basic in the investment trust form is the insurance principle, its most distinguishing characteristic. The theory of all forms of insurance is the substitution of a risk distributed over a large group for a concentrated risk borne by one or few. The investment trust as an institution is, in effect, an investment-insurance company, in that it carries into operation, as it applies to investments, the law of large numbers, better known as the law of average. The result is that with careful management a maximum return can be had with a minimum risk based upon safe marketable collateral."§

(iii) *Underwriting.*—Most investment trust companies are prepared to use a portion of their funds in subscribing for, or underwriting, new issues, and this may be a useful source of profit, but such transactions are limited in amount and confined to securities which the company is prepared to hold as a permanent investment.

---

* L. R. Robinson, "Investment Trust Organization and Management," p. 8. Another authority expresses this principle as follows: "While on the one hand the trust company certainly hopes not only to make a good revenue, but also a capital profit out of its investments; on the other hand, it does not, so to speak, take investments with the view of turning them over continuously and making dealers' or jobbers' profits. It takes the investment rather with the view to holding it more or less permanently, but in the belief that having secured the investment originally on favourable terms it will sooner or later be saleable at an enhanced price."

† Durst, "Analysis and Handbook of Investment Trusts," p. 9.

‡ Benson, *op. cit.*, pp. 495–96.

§ Theodore J. Grayson, "Investment Trusts, Their Origin, Development, and Operation," p. 7.

Thus the secretaries of the Scottish Northern Investment Trust, Ltd., give the following opinion :—

> " These companies do not take any part in financing special enterprises or in issuing stocks for other companies, the securities held being practically all bought and sold on the Exchange, although we not infrequently subscribe to new issues, and when we get the opportunity we also underwrite new issues, but subject to this limitation : that we confine ourselves to the class of security which we are prepared to take and hold on its merits as an investment. This, of course, enables us occasionally to get desirable holdings at a slightly lower price than that at which they might be purchased."*

(iv) *Investment Motives.*—In the properly devised investment trust there is a complete absence of non-investment motives. This is laid down as a basic principle by all authorities, because otherwise the security to debenture and preference shareholders becomes subservient to the pecuniary interest of the owners of the trust—*i.e.*, the ordinary shareholders.

The viewpoint of an investment trust is " purely an objective searching for investment values. The investment trust has no ulterior motives of controlling, influencing control, developing, reorganizing, combining, or even sharing in the direction of any enterprises in whose issues at any time it may have placed a part of its funds†."

Similarly, Grayson considers that an inherent characteristic of a British trust is " Restriction of the power of the trust management to acquire a controlling interest in any company or companies whose securities are purchased for investment purposes‡."

When these principles are violated by utilizing the trust as a holding company, or operating through subsidiaries, the trust becomes a device for utilizing the funds of subscribers to further the ends of those in control, rather than as a means of safe and profitable investment.

Later we shall cite the case of a New Zealand company in which (according to its latest prospectus) the shareholders have contributed about £30,000, and control nearly £700,000 of debenture money, so called. By the device of subsidiary companies they are in a position to use the debenture-holders' funds for their own purposes and leave them to bear the risk§.

Non-investment motives should be entirely absent from investment policy, and the device of the holding company or of subsidiary companies rigorously avoided, except possibly for the sale of their shares and debentures. Even this is not free from danger.

v. *Dividend and Reserve Policy.*

All authorities are agreed that profits resulting from the sale of investments should not be distributed as dividends‖. By its articles of association an investment trust includes as revenue only dividends accruing from its investments during the accounting period. Capital profits are reinvested to strengthen reserves, which may also be augmented by accretions out of cash income. Shareholders receive the benefit in the form of greater security through the increase in the value of the assets of the company, and a higher income from investments in subsequent years.

In addition to utilizing capital appreciations for the purpose of strengthening reserves, investment trusts may provide that a certain proportion of the net income shall go to reserves.

Assets are entered in the balance-sheet at cost or market value, whichever is the less. This principle is also strongly enunciated by leading authorities in accountancy as the only sound commercial principle on which continuous trading or dealing can be conducted. Hence many companies have considerable secret reserves. The success of British trust companies is aptly ascribed by one writer to the practice of " constructive pessimism persisted in over a long period of years."¶ He goes on to say:—

> ". . . the writing-down of book values not only discounts potential losses in advance, but, in so far as such losses are not incurred, constitutes as real a reserve fund as do the formal reserves. Book values are never written up, no matter how far they may be below market values. . . . According to its booked assets, the break-up value, for instance, of London Trust ordinary stock on March 31st, 1928, was about 150. Its real break-up value, as the chairman indirectly indicated at the 1928 meeting, was at least 360. . . . In the case of most of the first-class companies, the invisible reserve is a more important factor than the visible reserve."**

---

* Messrs. Paull and Williamson, secretaries to the Scottish Northern Investment Trust, quoted Grayson, *op. cit.*, p. 36.

† Robinson, *op. cit.*, p. 8.

‡ *Op. cit.*, p. 33 *et seq.*

§ We have evidence that this company put through a conversion scheme whereby a substantial quantity of its B. 1st B. debenture series was exchanged for debentures in a later series. The conversion scheme was put through one of its subsidiary companies, and we have reason to believe that in the books of the issuing company this subsidiary appears as the holder of the converted debentures. If this is so, the value of debentures in the hands of the public will be substantially less than £700,000.

‖ See, for example, Brock, *op. cit.*, p. 303 ; Grayson, *op. cit.*, pp. 35 and 95 ; Durst, " Analysis and Handbook of Investment Trusts," p. 8 *et seq.* ; and Glasgow, " The English Investment Companies," p. 6 *et seq.*

¶ G. Glasgow, quoted by Durst, *op. cit.*, p. 9.

** *Op. cit., loc. cit.*

vi. *Publicity in regard to Investments.*

Most investment trusts make public a general classification of investments, but both opinion and practice are divided in the matter of making public the detailed distribution of investments in individual securities. This is a question to which we shall return.

* * * * * * *

We have discussed the characteristics of British investment trusts at some length, because this type of concern may well be set up as a standard by which to judge investment trusts in New Zealand. Certain companies operating in New Zealand, especially those in the Investment Executive Trust Group, have violated almost every principle laid down as axiomatic in Great Britain, despite the fact that they have based their propaganda largely on the achievements of British investment trusts.

(*e*) *Economic Advantages of British Type.*

The economic advantages to be derived from a well-constructed and well-managed investment trust are considerable. The essential function of an investment trust is to combine the small units of investment of individual investors into a large aggregate or pool, and invest the pool in a wide range of securities. The individual investor in the trust receives a return from the earnings of the securities purchased out of the pooled funds. The return to the debenture-holder and preference shareholder will be at a predetermined rate; that to the ordinary shareholder will be his share of the total income distributable after dividends or interest are paid to preference shareholders or debenture-holders. The diversification of securities held by the trust enables risk to be reduced in a manner not possible to the small individual investor. Provided that the capital composition conforms approximately to the distribution into ordinary, preference, and debenture capital, in the proportions of 25, 25, 50, and provided that the investment trust is honestly managed, the security of debenture-holders and preference shareholders is as great as can be obtained by almost any type of investment. If the investment trust is expertly managed, the ordinary shareholder bears substantially less risk than he would incur from industrial or commercial investments, and very little more than in gilt-edged securities bearing a much lower rate of interest. In return for this slightly greater risk he has the prospect not only of a higher return on his investment, but also of capital appreciation. The investment trust places the small investor on a more equal footing with the large investor, because it enables him to obtain the same diversification of investment and expert management for his small investment as the large investor is able to obtain with the large funds at his disposal.

These may be described as the "ideal" economies possible under a wisely managed investment trust which conforms to the principles adopted by the representative British trust. In so far as these principles are departed from, investment trusts will fall short of the "ideal," and new elements of danger and insecurity will be introduced. In particular it must be clear that the benefits to the investor depend upon considerable skill in management, conservative policy in regard to the valuation of securities, the placement of profits from capital appreciation to reserves, strict conformity to a properly devised policy of investment diversification, economy in administration, and adequate safeguards by way of audit and the election of trustees. Above all, *a high degree of integrity in directors* is demanded, and the avoidance of operations which are not purely financial in character. The funds must not be used to obtain control or management of other business enterprises, nor to finance undertakings in which those who control the trust are interested. The holding company and the subsidiary "milking" company must be scrupulously avoided. If these conditions are observed, the investment trust becomes a source of financial strength and stability. If they are violated, it may become a serious menace, and it is of first-rate importance to devise means of regulation and control which, while encouraging the investment trust as an instrument of progress, safeguard the investor against the flagrant exploitation which in certain circumstances may become possible.

The large and increasing volume of investments in investment trusts in Great Britain, and the increase in dividends and the appreciation of capital in many companies, suggest that the investment trust has served a useful purpose. Yet even in Great Britain, where the representative trust is formed on sound lines, the need for regulation is felt. After describing the investment trust as "the best form investment for the small man," the authors of "Britain's Industrial Future" conclude that "the very rapidity of their growth suggests the need for regulation"; and they proceed to recommend a new type of popular investment trust subjected to special safeguards.*

In the pages which follow we shall demonstrate beyond question the need for regulatory action in New Zealand, and we have arrived independently at the opinion that a new type of quasi-public concern should be established in New Zealand to encourage the investment of small savings, under expert management, but with proper safeguards.

2. TYPES OF INVESTMENT TRUST IN NEW ZEALAND.

For the purposes of this report we shall classify investment trusts in New Zealand into three types. These are as follows:—

(1) Those raising their capital entirely by the issue of shares.

Such companies have not, as yet, issued debentures or contracts. This type of company does not appear to reveal any exceptional features calling for investigation and report.

* "Britain's Industrial Future," being the report of the Liberal Industrial Inquiry (1928), p. 258 *et seq.*

(2) Companies which conform to the British type and which raise capital by means of both shares and debentures.

As an example of this type of company we quote the New Zealand Investment Trust, Ltd., registered in Wellington in 1933. The managing director of this company, two other directors, and three officers of the company appeared before us and gave full information to the Commission on all matters in which we were interested.

The original capital of this company was £200,000, divisible in 20,000 shares of £10 each. Each share is convertible into £4 ordinary and £6 of 5-per-cent. cumulative preference stock. The first prospectus provided for the issue of £200,000 of 5-per-cent. first-mortgage convertible debenture stock. This prospectus gave power to increase the debenture issue to £500,000 conditional on an increase in the nominal share capital to £500,000.

The nominal value of shares allotted as at 31st July, 1934, was £43,010, the amount paid up in cash being £37,497. The nominal value of debentures issued at 31st July, 1934, was £71,157. The debentures are first mortgage debentures secured against the whole of the assets of the company. The ratio share capital paid up to debenture capital subscribed is smaller than that in the representative British trust, but, according to a witness who appeared before us, the aim is a pound-for-pound cover of shares to debentures. In addition it is provided in the trust deed as follows, in regard to debenture stock:—

> "Within five years from the date or respective dates of an issue of stock made pursuant to this deed, the company will give each of the stockholders of such issue one of the three following options—
>
> "(1) The option to convert each £10 of debenture stock held by such stockholder into £10 preference stock of the company.
>
> "(2) The option to convert each £10 of debenture stock held by such stockholder into £10 ordinary stock of the company.
>
> "(3) The option to convert each £10 of debenture stock held by such stockholder into £6 preference stock of the company and £4 ordinary stock of the company."

The company is to decide which option is to be offered.

Trustees for the debenture-holders have been appointed by the company, and the debenture-holders have the power to appoint or remove trustees by election. A meeting of debenture-holders may be convened by the company, the trustee, or debenture-holders. Copies of annual reports and balance-sheets must be sent to debenture-holders, and both trustees and debenture-holders may have an independent audit of the company's affairs. Trustees have the power to inspect the security portfolio and any scrip. Debenture-holders are represented on the directorate by two directors. These were nominated by the company, approved by the trustee, and elected by debenture-holders.

Debenture-holders have power to take up shares in the company.

Diversification of investments is provided for by the following provisions in the articles of association:—

> "3. (*a*) No purchase or acquisition of any particular security or investments shall be made by which at the price paid therefor by the company the holding of the company in such security or investment or in any one company, corporation, or undertaking would exceed in amount one-twentieth part of the combined subscribed share and debenture capital or one-tenth part of the subscribed share capital of the company for the time being, whichever is the greater.
>
> "(*b*) Investments outside of Great Britain, Australia, and New Zealand shall not in the case of any one country be made to an amount which would exceed one-fifth part of the combined subscribed share and debenture capital of the company."

The distribution of investments as at 31st May, 1934, was as follows:—

Type of issuer—	Per Cent.
Government	19·4
Local Body	8·5
Private	72·1
	100·0

Class of stock—	
Bonds and Debentures	39·0
Preference Shares	20·0
Ordinary Shares	41·0
	100·0

Type of enterprise—	Per Cent.
Government and Municipal	27·9
Banks, Insurance, and Financial	27·5
Commercial and Industrial	44·6
	100·0

Geographical distribution—	
England	2·0
America	2·1
Australia	19·5
New Zealand	76·4
	100·0

Article 134 provides:—

> "No dividend shall be payable except out of the net profits of the company. Accretions from the sale of investments shall be accretions to capital and shall under no circumstances be distributed as dividends."

Such accretions are brought into reserve account and either used to write down the investment portfolio or write off preliminary expenses, or go into capital reserve.

In addition, the company may accumulate reserves, either "visible," or "secret," out of net revenue.

Witness No. 16, who gave evidence on behalf of the company, regarded it as undesirable to use capital accretions as dividends, on the grounds—

(1) The profit is taxable (see section 117, Land and Income Tax Act, 1923). There would be an undesirable tendency to take profits and an equally undesirable tendency in a falling market not to stop losses.
(2) It would also operate against the creation of reserves.
(3) On a rising market it would mislead the average investor as to the prospects of dividends which might be earned on their investments in debentures in such companies.

It is the policy of the company to value investments at cost price or market value, whichever is the less.

Except for the fact that the proportion of share to debenture capital is somewhat less at the present time than in the representative British Trust, the company described above follows closely the British model. Provided companies on the above lines are efficiently and honestly managed, and provided any temptation to establish subsidiary or intermeshed companies with a financial purpose is resisted (with the possible exception of a share or debenture selling company) they should provide a valuable avenue for investment, particularly for the small investor.

(3) Investment Trusts of the Contractual Type:—

In this type of trust the share capital is small and the bulk of the funds is provided by the sale of what are described as debentures, but which are, in effect, contracts to invest the moneys provided, in accordance with certain conditions as to deductions for brokerage and the like, in certain broadly defined classes of securities, and to return a proportion of the net proceeds to the contract holders by way of dividend. Our interpretation is that the instruments of contract are not secured against the share capital of the company, but against the securities purchased with the balance of the money subscribed by debenture-holders after brokerage and other costs are met. Since the majority of our criticisms are levelled against investment trusts of this class, a detailed description is deferred to the following section.

3. FINDINGS.

(1) Extent of Operations.

It is impossible to make a reliable estimate of the amount which has been invested in investment trusts in New Zealand. It is difficult to determine whether many companies which have raised their capital entirely by shares can be properly described as investment trusts, while it is possible that concerns registered under other Acts may perform some of the functions of investment trusts.

The following table gives some idea of the capital and debenture issue, or debentures and other charges registered, of certain investment trusts operating in New Zealand, and of companies affiliated in some way with them:—

Table VI.—Investment Trusts in New Zealand.

Capital composition (according to latest information) of investment trusts or affiliated companies issuing "debentures."

Name of Company.	Share Capital (Latest Return).		Debenture Capital.	
	Nominal.	Paid up.	Authorized.	(*a*) Maximum Debentures issued, or (*b*) Maximum Debenture and other Charges registered.
Investment Executive Trust Group—	£	£	£	£
Investment Executive Trust of N.Z., Ltd.	100,000	30,010	4,000,000	689,510*(*a*)
Sterling Investments Company (N.Z.), Ltd.	100,000	2,351	..	165,000 (*b*)
British National Investment Trust, Ltd. (N.Z.)	100,000	3,187	..	100,000 (*b*)
N.Z. Shareholders' Trust, Ltd.	60,000	1,071	..	264,000 (*b*)
Wynwood Investments, Ltd.	10,000	Not known	..	100,000 (*b*)
Farms and Farmlets, Ltd.	25,000			100,000 (*b*)
First Mortgage Freehold Security Co. of N.Z., Ltd.	10,000			100,000 (*b*)
The Southern British National Trust, Ltd. (N.S.W.)	500,000	97,500	5,000,000	Not known.
British National Trust, Ltd. (Canberra)	1,000,000	65,007	..	Not known.
Other—				
New Zealand Investment Trust, Ltd.	200,000	37,497	200,000	71,157 (*a*)
Gold and General Investment Trust, Ltd.	2,500	500	250,000	3,000 (*a*)
Dominion Executive Trust, Ltd.	2,500	2,000	100,000	63,800 (*a*)

* As to this total, see footnote § on page 49.

The following comments should be noted:—

(1) The table does not give a complete list of related companies in the Investment Executive Trust Group.
(2) Two of the companies mentioned are registered in Australia.
(3) The table may not include all investment trusts operating in New Zealand and issuing debentures.

The total value of debentures issued, or debentures and other charges registered, by the New Zealand companies in the foregoing table is £1,656,467. The total paid-up capital is about £77,000. The debentures or other charges registered by companies related to the Investment Executive Trust of New Zealand do not represent a net addition to borrowing from the public. In part at least (probably almost entirely) they represent borrowing from the Investment Executive Trust itself. Further, not all charges have been alive at the same time, so that the sum of the charges registered is greater than the maximum at any one date. If we exclude these charges, the total debenture issue of the four remaining New Zealand companies in the table would be in excess of £827,000. This probably would include the converted debentures referred to in footnote on page 49. The whole of this amount has been raised during the past three or four years.

The maximum debenture issue authorized by the four companies is £4,550,000, and there is nothing to prevent this figure from being increased. The total paid-up share capital of the four companies is under £70,000, or 8·5 per cent of the debentures so far issued, and a little over 1·5 per cent. of the authorized debenture issue. The ratios of paid-up capital to debentures issued in the four companies are 4·4 per cent., 52·8 per cent., 16·6 per cent., and 3·1 per cent., respectively.

(2) Inadequacy of Official Statistics.

As in the case of land-utilization companies, official statistics relating to investment trusts are quite inadequate, and it is equally important that they should be available—at least in the case of companies issuing debentures or "contracts" in series. Accordingly we recommend:—

(31) That all companies raising moneys in New Zealand by the issue of debentures (or contracts) in series, however these may be defined, and using the proceeds for investment in securities of any kind, shall be required to furnish to the Government Statistician an annual statement as set out in Appendix II.

(32) That this shall apply equally to companies registered in other countries but issuing debentures (or contracts) in series for sale in New Zealand, and to companies registered in New Zealand but issuing debentures (or contracts) in series in other countries.

(33) That the Government Statistician shall publish an annual table or tables summarizing the information thus obtained.

(3) Promotion.

(*a*) *Initial Capital.*

The usual practice in the formation of investment trusts and subsidiaries or related companies has been to float a company with a small paid-up capital. Thus, the directors of *The Investment Executive Trust of New Zealand*, on the 2nd February, 1931, filed with the Registrar of Companies a declaration to the effect that (*a*) the company's paid-up capital at that date was £75, and (*b*) that in their opinion that sum was sufficient to justify the company in commencing business. On the 14th day of March, 1931, they issued a prospectus inviting subscription for 100,000 "first-mortgage perpetual income debentures" of £10 each—*i.e.*, of a total nominal value of £1,000,000. The statutory report dated 18th March, 1931, shows that 22,457 ordinary shares of 2s. had then been allotted, and £2,180 1s. 9d. received from application and allotment moneys. Payments included £2,177 10s. for "Statistics, records and research." We are unable to determine whether these represent in effect a consideration for which the majority of shares were allotted. The nominal capital of the company consisted at that time of £10,000 divided into 7,500 preference shares of £1 and 25,000 ordinary shares of 2s. each.

In the same way other New Zealand companies in the Investment Executive Trust Group with financial powers analogous to those of investment trusts show a very small paid-up capital on going to allotment, and also at the present time. Thus, the declaration that the *New Zealand Shareholders Trust, Ltd.*, is entitled to commence business shows that the amount of capital of the company for which shares have been subscribed and allotted with a liability to pay wholly or partly in cash was £75 14s. The latest return shows the paid-up capital as £1,071.

The first statutory report of *Sterling Investments Company (N.Z.), Ltd.*, shows that 307 shares had been allotted. No cash had been received in respect of allotted shares. Of these, 7 were subscribed for in the memorandum, and 300 were allotted to promoters as fully paid "for valuable services rendered." There were no receipts and payments on capital account. The latest return shows the paid-up capital as £2,351.

The original nominal capital of the *Investment Securities Association, Ltd.*, another related company, was only £1,000. This is a private company, and there is no information as to the amount of cash received on shares allotted.

The *British National Investment Trust, Ltd.*, was registered at Auckland on 2nd November, 1931. By December, 1932, the share capital *subscribed* was £1,017 10s. On the date of the latest return, the *paid-up* capital was £3,187.

Another company in the group is *Wynwood Investments, Ltd.* This is a private company with an original nominal capital of £100. The nominal capital is now £10,000. No information is available as to how much is paid up.

Two other investment trusts outside the group are *Gold and General Investment Trust, Ltd.*, and *The Dominion Executive Trust, Ltd.* At the present time the paid-up capital of these companies is £500 and £2,000 respectively.

The above paragraphs illustrate two dangerous practices: (1) The formation of investment trusts and companies established for investment purposes with a small paid-up share capital, and (2) their formation as private companies.

We consider that such companies are similar to insurance companies, in that they require a substantial capital if they are to perform their functions effectively and give adequate security to investors and other contracting parties. This applies especially to investment trusts, which are justified only by their capacity to insure against investment risks by means of a wide diversity of investments. If the capital is not adequate for these purposes, they are in no sense capable of operating satisfactorily as investment trusts. It is true that adequate capital may be obtained from the issue of debentures, but this possesses special dangers of its own if the share capital is small. We return to this below.

We recommend,—

(34) That no investment trust company and no company whose main purpose is the investment of its capital in securities, shall be permitted to commence business as an investment trust unless and until it has a subscribed capital of not less than £40,000, of which at least £20,000 shall be fully paid up in cash.

In view of the difficulty of framing a satisfactory legal definition of "Investment Trust" or of "A company whose main purpose is the investment of its capital in securities," we recommend—

(35) That the Corporate Investments Bureau recommended in Part IX of this Report be empowered to determine whether or not a company falls within the classes defined in recommendation No. 34 above, and that any company or proposed company which is aggrieved by such determination shall have the right to appeal to the Supreme Court.

We further recommend—

(36) That the Companies Act, 1933, be amended to provide that in any prospectus, statement in lieu of prospectus, or other document issued by any company, or in any return filed with the Registrar of Companies by any company, no allotment of any shares shall be described as an allotment for a cash consideration unless payment for the same is made to the company either by bank-note, coin, or bill of exchange payable on demand by an applicant or subscriber to the memorandum of association who, in good faith, makes such payment uninfluenced by and without reference to any complementary or related obligation by or transaction with the company or any person acting for or on behalf of the company.

We make this recommendation because we think it is possible to frame a definition of "cash consideration" that will exclude a mere colorable compliance with the law whereby an alleged cash payment to the company is part only of a transaction which, as a whole, involves a corresponding payment or transfer of property by the company.

We have framed the recommendation so as to make it applicable to all companies. We found several instances of land-utilization companies adopting this same device of exchanging cheques of identical amounts with their subsidiary or affiliate companies. In each case they described the pseudo-transaction in subsequent prospectus and statutory return as "an allotment of shares for a cash consideration." This is exemplified in the case of Company No. 11 (see page 17 of this report), whose promoters had, in a period of three months, controlled a series of sales of a block of land which they bought at the beginning of the period for £7,500. They finally transferred it to their bond-issuing company for 146,000 shares of £1 each, issued as fully paid. They exchanged cheques totalling £146,000 between the vendor and the purchaser companies at a time when the purchaser company had not 146 farthings in its bank account. They forthwith announced in a prospectus to intending purchasers of bonds that the company had an issued capital of £146,000 "fully paid"; and filed with the Registrar of Companies a return stating that these shares had been issued for cash.

(b) Private Companies.

We refer above to two investment companies in the Investment Executive Group which originally registered as private companies, and by that means were able to keep from the register at the office of the Registrar of Companies all information relating to the constitution of the share capital and the holders of shares. The provisions in our Companies Acts relating to "private companies" are designed to give business men the privilege of limited liability whilst avoiding the disclosure, relating to certain of its operations, of particulars required of public companies. The private company, for instance, is not required to file a statutory return showing the details of the collection and disbursement of its capital funds within three months after it commences business; and it is also exempted from filing a return of allotments showing the amount paid up on allotted shares and the consideration for shares allotted otherwise than for cash. These concessions may be considered reasonable if allowed to the proprietors of small trading or manufacturing companies, who propose to embark their own funds in such concerns, and seek the benefit which the law allows them of limiting the amount of their resources which are to be exposed to the risks of trading and manufacturing.

We cannot, however, see any justification at all for the registration, as a private company, of one established mainly for finance or investment purposes. We are strongly of opinion that such companies should be required to disclose all the information which is now required of public companies. We would include in this requirement all companies whose objects comprise the performance of services

in which personal qualities are usually expected and appraised—*e.g.*, land and estate agents and brokers. These are frequently formed as mere affiliates or subsidiaries of bond-issuing and investment companies, and in that relationship they often afford a useful cover for transactions that it is desired to shield from the view, not only of the public, but also of co-directors and co-investors.

Accordingly we recommend,—

(37) That all investment and finance companies, and all companies of the kind indicated in the previous paragraph, be required to register as public companies under the Companies Act, 1933.

We recommend further,—

(38) That, if there should appear to be difficulty in framing a workable definition designed to secure the application of this recommendation, the Corporate Investments Bureau be given power to classify any proposed company as one which must be formed under Part II of the Act, and to require any such company registered as a private company to re-register as a company under Part II of the Act. If necessary, the right of appeal against this determination might be given. On re-registration a statement in lieu of prospectus should be filed.

(c) Investment Trusts incorporated under other Acts.

It has come to our knowledge in the course of our investigation that there is at least one company in New Zealand carrying on business similar to that of an investment trust whilst it is incorporated and registered under the Industrial and Provident Societies Act, 1908. There may be others. We think that this is undesirable, and that all companies carrying on such business should be required to conform to the same legal standards and provisions. Unless this is done, the recommendations we have already made in relation to investment trusts may, in certain cases, be rendered ineffective, as companies registered under other Acts will be outside their scope.

We therefore recommend,—

(39) That all companies, societies, or other associations of persons operating or seeking to operate as investment trusts with a corporate status shall be required to register under the Companies Act, and shall be precluded from registering under any other Act; and

(40) That all such companies, societies, or associations now existing but registered under any other Act or Acts, shall be required to re-register as companies under the Companies Act within three months of the passing of legislation embodying the above recommendation.

(d) Signatories to the Memoranda of Association.

It has been a common practice amongst many types of company, including investment trusts, for the signatories to the memoranda of association to be individuals of little financial experience or standing. Thus the memorandum of association of *the Investment Executive Trust of New Zealand* is signed by seven clerks. Of these, four are women clerks who subscribed for one share each. It is not stated whether the shares are preference shares of £1 each or ordinary shares of 2s. each, so that the subscribed capital may be £7, or 14s. The subscribers are clearly "dummies," who state that they are "desirous of being formed into a company in pursuance of this memorandum of association." The articles provide that the first directors of the company shall be appointed by the majority of the subscribers to the memorandum of association.

The subscribers to the memoranda of association of other companies in the group, including the *New Zealand Shareholders Trust, Ltd.*, the *British National Investment Trust, Ltd.*, and the *Transport Mutual and General Insurance Company, Ltd.*, are also "dummies."

In the case of the *British National Trust, Ltd.* (Canberra) the seven subscribers to the memorandum and articles of association are all clerks and secretaries in the offices of companies in the group, or of their brokers and solicitors. All are resident in Auckland, and are therefore out of the jurisdiction of the territory and State in which the company is registered.

Several professional witnesses who appeared before us tried to justify this practice on the ground of convenience, but we are of opinion that there is nothing to be said in its favour. There can be no doubt but that the practice represents an attempt to gain the benefits and protection afforded by the Act whilst rendering in return only an ostensible compliance with its reasonable provisions. The Companies Act requires that there shall be seven or more persons associated together for a lawful purpose as a condition precedent to the formation of a company. It then requires that these persons shall sign their names to a memorandum of association, each person stating opposite his name the number of shares he takes, and adding to his signature his description and address. The reason for these provisions is that the Legislature has considered it desirable that the public in general, and persons seeking to do business with the company in particular, shall have the means of knowing who are the persons who thus desire to be registered as a company. We consider that the expression "We are desirous of being formed into a company in pursuance of this memorandum of association," should have a real meaning to those who subscribe to it by their signatures.

The practice has grown up whereby these provisions, like the provisions of the Act relating to prospectuses, have been viewed by promoters not as requirements to make an honest and candid disclosure for the protection of the public, but as a challenge to their ingenuity to find a way of appearing to comply with the letter of the Act whilst violating its spirit. By the practice now in question they deny to the public and the Registrar all information as to the identity of the promoters and real foundation members of the company.

It seems to us that it is at least arguable that the practice does not even comply with the letter of the Act, for, as already pointed out, section 13 of the Act requires that any seven or more persons shall be *associated*. It has been fully proved to us in more than one case that the seven signatories to a memorandum of association were not in association in any real or permanent sense, but had only an ephemeral relationship determined by the interests of the promoters. The evil thus disclosed does not need to be enlarged upon; the practice is one that needs only to be fully stated to carry its own condemnation.

We therefore recommend,—

(41) That the subscribers to a memorandum of association must be in fact and in law persons genuinely desirous in their own names and in furtherance of their own interests of being formed into a company in pursuance of the memorandum of association; and

(42) That no agency or trust between any subscriber to a memorandum and any other person shall be recognized or enforceable at law or in equity unless the existence of such agency or trust and the identity of the parties thereto is disclosed as such in the form of signature.

If the recommendation is left in this form, it is probable that misplaced human ingenuity will be used again to find a means of making a superficial compliance with the law, whilst defeating its purposes, and we believe that compliance with a law that permits the taking of one share only will tend to facilitate the practice. It would be very easy to arrange a conference between seven persons, and give them just enough information and incentive to suggest a plausible motive to procure subscriptions for seven shares of 1s. each.

We therefore recommend,—

(43) That all subscribers to the memorandum of association must be required to subscribe for a substantial holding of shares.

(44) That the provision of the Act that no subscriber shall subscribe for less than one share shall be repealed and replaced by the provision that subscriptions of subscribers to the memorandum of association shall be in accordance with a scale designed to give effect to the principle embodied in recommendation No. 43.

In order to prevent the evasion of the above by registration of a company with a small share capital, fully subscribed, followed by an increase of capital at a short interval after incorporation,

We recommend,—

(45) That no company having a share capital shall increase its share capital within twelve months after its incorporation unless it first obtains the consent thereto of the Minister of Finance.

In giving his consent, the Minister may fix such conditions as he thinks fit; and, in particular, may require that such proportion of the new shares as he shall prescribe shall be subscribed for in a Memorandum of Subscription in the form (*mutatis mutandis*) set out in the Eighth Schedule of the Companies Act, 1933.

(*e*) *Inflation of Capital.*

We have referred to the fact that the capital of land-utilization companies has frequently been inflated by the transfer of real estate at a fictitious value. The writing-up of assets in the form of real estate may also occur in the case of investment trusts, though the technique of asset inflation is not necessarily the same. As an example of another type of asset inflation, we give the following:—

The balance-sheet of the Investment Executive Trust of New Zealand, Ltd., for the year ended 31st December, 1932, showed an item "Statistics, Records, and Establishment, £31,970." This included the sum of £12,768 paid to V. B. McInnes and Co., Ltd., brokers to the company, for additional fees over and above the disclosed brokerage. In addition, it is probable that a substantial portion of the remainder represented a payment in shares or cash to promoters for real or nominal "services rendered." Since the company refused to give evidence before us, we have been unable to investigate this item fully; but since it was used to conceal payments to brokers, and a similar device was used by another company under the same control, it may equally well have been used to conceal payments to promoters in the present instance. The danger must be guarded against even if it has not occurred in this instance.

A more flagrant example of the possibilities of capital inflation is revealed in our Interim Report (p. 11), where attention is drawn to the transfer of shares in the British National Investment Trust, Ltd. (New Zealand), at a grossly inflated value. Shares totalling 239,993 of a nominal value of 2s. paid up to twopence and two-fifths of a penny were allotted to Messrs. J. W. S. McArthur and C. G. Alcorn, and transferred some three weeks later to the British National Trust (Canberra) for a consideration over ten times the nominal value and over eighty times the paid-up value. J. W. S. McArthur was at the time Managing Director of the purchasing company, whose total paid-up share capital on the date of the latest return was £65,007, or less than one-quarter of the consideration money for shares referred to.

This particular transaction occurred after the establishment of both the companies mentioned, but there is nothing to prevent it from being adopted closely following on promotion.

The above devices enable promoters to obtain a controlling interest in a company by the investment of little or no cash, and by the ingenious use of subsidiary or related companies to convert an asset of little value into a large cash sum or other consideration of high real or nominal value.

The problems raised by the existence of subsidiary companies and companies related in other ways will be dealt with later. In the present connection, we recommend,—

(46) That prospectuses for shares, debentures, or contracts in series shall state all payments to promoters, directors, brokers, or underwriters, made up to the date of the prospectus or contemplated to be made out of the proceeds of the money subscribed in response to the prospectus, whether in cash, shares, or in any other form, by way of remuneration for promotion, brokerage, underwriting, or other service, or of payment for any asset, and the nature of the service for which consideration is paid.

(47) That where the asset for which consideration is given or is to be given is in the form of securities of any kind, the nature of the security, the nominal value of the security, its market value, and the amount paid up thereon as at the date of the prospectus shall be stated in the prospectus.

(f) Transactions by Interested Directors.

Most of the reprehensible practices that we have referred to in the preceding pages have been inspired and carried into operation by directors. In almost every case an investigation of these transactions shows that all, or practically all, have one feature in common. That feature is that they are made possible, in the form in which they have been put through, only by reason of the fact that a director (or directors) with a dominating position in one or both companies concerned is personally interested in the transaction. An examination of the transactions that we have been considering will show that they generally involve, as between a parent and a subsidiary company, or between two affiliate companies, firstly the relationship of purchaser and vendor, broker and employer, or principal and agent; and secondly, acts and decisions of directors holding shares or other interest in each company.

This is a matter that has already had the attention of the Legislature, and there are provisions relating to it in the Companies Act, 1933. Thus it is provided by section 155 of that Act that it shall be the duty of a director of a company who is in any way, whether directly or indirectly, interested in a contract or proposed contract with a company to declare the nature of his interest at a meeting of the directors of the company. The section further provides that he may make a specific declaration in relation to a specific transaction, or a general declaration in relation to a series of contracts or possible future contracts with another company. It is also provided that he is to make the required declaration at the meeting at which the question of entering into such a contract is first taken into consideration, or at the first opportunity when he is absent from that meeting or when his interest arises subsequently to the making of the contract.

The evidence tendered during our inquiry convinces us that these provisions are ineffective. They seem to be based on the assumption that the co-directors of a director will naturally watch the interests of themselves, the shareholders, and the company as against the interested director. That assumption is not justified in the case of many companies investigated by us. We have found instances of a declaration of an interest made in compliance with section 155 to a body of directors all of whom were likely to benefit personally by reason of their substantial interest in the subsidiary company with which the transaction was made.

In some instances such companies are operating mainly with money provided by debenture-holders, very little share capital having been contributed. In any case, it should be clear that there is very little protection afforded to shareholders or debenture-holders as against directors, especially when it is remembered that there is no right in shareholders to inspect the directors' minute-book. To meet this evil we recommend,—

(48) That every declaration of interest made as required above shall be clearly and fully entered in the minutes of the meeting at which the declaration was made.

(49) That within one week of the making of any such declaration at a directors' meeting, it shall be the duty of the directors, the secretary, or any officer of the company to transmit to the Corporate Investments Bureau a copy of such minute.

(50) That failure to comply with the above provisions shall render the director or officer at fault liable to a fine not exceeding £100.

(g) Prospectuses and other Publications.

In the section dealing with land utilization companies we drew attention to the prevalence of misleading statements in prospectuses and other publications. Frequently the literature of investment trusts is also misleading, but more indirect and subtle methods are adopted. The statements made are usually true enough, but are inapplicable to the companies issuing them in the conditions under which they will operate. The most common practice is to enlarge upon the advantages of trusts of the British type, quote authorities in their favour, and give examples of their profits and capital appreciation, and then apply these by inference to the prospects and policy of the issuing company.

For example, the first prospectus of the Investment Executive Trust of New Zealand, Limited, refers to a list of thirty British trusts which showed an average dividend of 13½ per cent. in 1929, and states that "the Investment Executive Trust of N.Z., Ltd., will follow the investment practice of leading British investment trusts." The investor in "debentures" of the New Zealand company is not likely to know that its capital composition is so different from that of the British type as to materially affect the security of debenture-holders; nor is he likely to appreciate the fact that the dividends referred to are on the ordinary *share* capital of the British companies and that these are made possible because interest on as much as three-quarters of the capital in the form of preference

shares and debentures is at a fixed rate. If the income from investments is only 1 per cent. above this fixed rate, it makes possible an increase of 3 per cent. in dividends to shareholders. Practically the whole of the capital in the New Zealand company is derived from the sale of its debentures. Hence, even if the *Investment Executive Trust of New Zealand* earned the same net return on investments as the British type of trust, it would be impossible to pay as high a rate on "debentures" as is paid on ordinary shares in the British company, save out of capital profits.

Further, it will be shown that the investment policy of the Investment Executive Trust has *not* been in conformity with the practice of British trusts.

A brochure published by J. W. S. McArthur under the title of *Insuring Investments*, states :—

> "The experience of properly conducted Investment Trust Companies shows that it is possible to employ money and achieve the three desiderata of sound investment—
>
> "1. Security,
>
> "2. High rate of income,
>
> "3. Capital appreciation,
>
> without sacrificing one whit of the security 'gilt-edge' owners prize so much."

This is true. But it is equally true that these depend upon principles which the Investment Executive Trust of New Zealand, Ltd., has violated. For example, the security of debenture-holders has been imperilled by investment in debentures of subsidiaries and in concerns in which Mr. J. W. S. McArthur has been personally interested. Much of the debenture-holders' money has gone into financing and renovating a building, and this is a speculative investment the character of which is not affected even if the speculation succeeds. The trust has paid a high annual dividend to debenture-holders; but this would have been impossible had the basic canon been observed that profits from the sale of appreciated securities should not go into dividends.

Finally, the capital appreciation characteristic of British trusts results in large measure from the placing of such capital profits into reserves. The New Zealand company has used these to pay dividends. But of these and other practices more will be said later.

An example of what appears to be a deliberate intention to mislead relates to the interest which the company contracts to pay on "debentures." Debenture issues are subject to the following condition :—

> "The holders of this debenture shall not be entitled to call in or compel payment of the said principal sum of £10 unless an order is made or a special or extraordinary resolution passed for winding up the trust Provided always that if the trust shall fail for a period of two consecutive years after the 31st day of March, 1933, to earn a total income on the investments of this series including reserves amounting in the aggregate for such period to 6 per cent. on the moneys invested in this series excluding reserves . . . the debenture-holder may demand repayment."

A similar condition is endorsed upon the debentures of the Gold and General Investment Trust, Ltd., registered at Christchurch.

In our opinion, this statement is calculated to mislead. Our opinion is supported by a reliable witness (Witness No. 17), a solicitor who included debenture-holders of the Investment Executive Trust among his clients. He stated,—

> "Many people imagine that under clause 11 of the Conditions of the Second B Series of that company's debentures they will be entitled to call up their money if they fail to receive 6 per cent. per annum on the amount of their investment. There are similar provisions in the other debenture issues of the same company. In my opinion such an interpretation of the clause is incorrect, but I find it commonly interpreted in that manner, and the clause is so drawn as to lend itself to such an interpretation. Upon my interpretation of the clause the debenture-holder might receive as low as 3 per cent. per annum for many years and still have no right to call up his investment."

It is clear that the debenture-holder is not entitled to repayment unless his dividend falls below an average of 3 per cent. per annum for two consecutive years. There is no reason why the condition should not have been stated in this way unless there was the intention to deceive the investor.

Misrepresentation in the prospectuses and publications of investment trusts is more difficult to remedy than that which occurs in relation to land-utilization companies, because it consists in making statements which are true but which are likely to be misunderstood, or in creating a favourable sales atmosphere by quoting the achievements of British trusts and applying them inferentially to its own prospects. Such inferences are false, because the New Zealand company adopts neither the capital composition nor the investment policy of British trusts.

(*h*) *Misrepresentation by Salesmen.*

As in the case of "bonds" in land-utilization companies, debentures in investment trusts have been sold by door-to-door canvass or "hawking." We consider this method equally objectionable in both cases. Indeed, there is the additional objection in the case of investment trusts that a large number if not most of the debentures have been procured by the exchange of good marketable securities. The common procedure has been to search the list of shareholders in reliable concerns and persuade them, by enlarging on the security and earning power of investment trusts, to take debentures in exchange for their shares or other securities. Many established enterprises are seriously disturbed by this practice, and there is reason to believe that many shareholders have exchanged good securities for more hazardous debentures. We do not see how this particular practice can be prevented. Nor is it necessarily objectionable if the investment trust is honest and well managed.

It was the intention of section 343 (known as the share-hawking clause) to put a stop to door-to-door selling. We have good reason to believe, from evidence submitted to us, that the practice, though temporarily discouraged, is now reviving.

We think that the activities of the Corporate Investments Bureau, together with our recommendations, will provide a strong deterrent to the continuance of the method of sale by door-to-door canvassing.*

(i) Attitude of Stock Exchange.

In Great Britain and the United States investment trusts are listed by stock exchanges. So far, the New Zealand stock exchanges have refused to place investment trusts on their official list. We believe that in the experimental stages of the investment trust in New Zealand this is a wise and reasonable policy; but we see no reason why established, soundly managed, and honest investment trusts should not be officially listed. On the contrary, this would do much to facilitate investment in such concerns, and would assist the investor in separating the sheep from the goats. It is recognized, of course, that the stock exchange should exercise great care before listing investment trusts.

(j) Remedies relating to (g) and (h) preceding.

Before passing to consideration of a remedy, it will, we think, be useful to recapitulate briefly the defects in the existing law and the more flagrant evils which have grown up in recent years. There are, firstly, two disturbing facts,—

(*a*) That none of the subscribers to the memorandum of association of a company to be incorporated in New Zealand need be within the jurisdiction of the New Zealand Courts; and

(*b*) That, whilst the Companies Act requires a company to have a registered office in New Zealand and to keep certain records and books of account, there is nothing to prevent the directors from establishing the principal office outside the jurisdiction, and removing all the books, records, and securities of the company there.

We now refer to the evil of the inflation or watering of capital by the issue of shares to promoters and directors for so-called "valuable services" for statistics, records, and researches. There is a possibility, per medium of subsidiary companies, of treating the shares in a subsidiary as assets in return for which a large block of shares in the parent company giving a controlling interest over the destinies of that company may be allotted as fully paid. Such transactions can give to a small group of persons a controlling interest over companies entrusted with large sums of public money, whilst the promoters and directors risk none of their own resources.

We have suggested one remedy for some of these evils by requiring the Corporate Investments Bureau to be advised of all contracts in which directors are interested, and thus give the officers of the bureau a clue to transactions which may require watching and investigating. We think that other remedies must be provided by some additional provisions in relation to the issue and contents of prospectuses. We have already made some suggestions of this kind in the section of the report dealing with land-utilization companies. Some of these we repeat here for convenience and emphasis. Some that we now propose to put forward for the first time were deferred to the present section of the report, although they are equally applicable to the case of land-utilization, and, indeed, all other companies.

The evils of misrepresentation, misleading statements and suggestions are greater and more subtle in form and effect in the case of trust investment companies than in the case of land-utilization companies. Some of the prospectuses that we have referred to in the preceding pages are intended to be read by would-be investors to whom the ordinary methods of finance are a mystery, and who are more likely to be caught by specious financial sophistry than by sound financial schemes.

We think that the recommendations we have made for the appointment of a Corporate Investments Bureau and for registration by that bureau of all directors, promoters, brokers, and salesmen, with power to strike such persons off the register for malpractice, will act as a powerful deterrent. In addition, *we make the following recommendations:—*

(51) That the Companies Act be amended by providing that all subscribers to the memorandum of association shall be at the time domiciled within the Dominion, and on an electoral roll within the Dominion.

(52) That it shall be a punishable offence for any director or officer or agent of a company to remove or to attempt to remove or to assist in removing from the Dominion any books, documents, papers, records, investments, or securities of a company, unless the consent in writing of the Minister of Finance is first had and obtained.

(53) That a certified copy of all documents and publications issued to the public, including advertisements, newspaper statements, brochures, and leaflets, be filed with the Registrar of Companies.

(54) That all such documents and publications be identified and approved by resolution at a meeting of directors before being issued to the public.

(55) That every prospectus offering for subscription by the public any debentures or other securities or contracts in series, and every debenture or debenture-certificate or other such contract, shall contain a definitive statement in a prominent place in large type giving the nature of the security, if any.

(56) That the offence of publishing a misleading prospectus be defined and incorporated with a penal clause in section 46 of the Companies Act, 1933.

* Note particularly recommendations in section dealing with "Stock Exchanges."

(57) That, in publishing the Companies Act, the Government Printer shall be instructed to insert as a footnote at the bottom of the page which contains section 46 of the Companies Act, 1933, a brief reference to the case of *The King* v. *Kylsant*, (1932) 1 K.B. 442, with a brief statement of the principles enunciated by the Judges who affirmed the conviction in that case.

(58) That the subsection defining and incorporating the offence with a penal clause under section 46 of the Companies Act shall contain a recital that the true intent and purpose of section 46 is to provide and ensure that every prospectus shall set forth a candid and fair statement of all such matters as should be reasonably disclosed to the public and intending investors to inform them fully and fairly of the relevant facts and transactions known to the directors and promoters ; and shall provide that any statement of a transaction or part of a transaction which, though taken by itself, may be true, nevertheless tends to hide certain related transactions or parts of transactions and thereby conceals from the public another view of the said transaction or transactions equally true but more favourable to the interests of the directors or promoters and/or less favourable to the interests of the public and the design of the prospectus shall be evidence of an intention to mislead, and shall be actionable accordingly.

(4) Financial Scheme.

(*a*) *Capital Composition.*

We have shown that, in the representative British trust, the share capital equals or exceeds the debenture capital. Ordinary shares are usually between 40 per cent. and 50 per cent. of the share capital. Since debentures are secured against the whole of the assets of the undertaking, the security behind the debenture issue is very high. The nearest approach to the representative British type in New Zealand is the New Zealand Investment Trust, Ltd. (of Wellington), the paid-up share capital of which is 52·8 per cent. of the debenture capital so far subscribed, these debentures being secured against the whole of the assets of the company. Reference to Table VI will show that in no other company listed on the table does the paid-up share capital exceed 17 per cent. of the amount received from the sale of debentures. The percentage ratio of share capital paid up to debenture issues *authorized* is in all cases substantially smaller.

(*b*) *Security behind Debentures.*

In the case of the New Zealand Investment Trust, Ltd., and the Dominion Executive Trust, Ltd., debentures are secured against the whole of the assets of the company, but in the latter company the paid-up share capital is too small to make any substantial difference to the security.

In the Investment Executive Trust, Ltd., and the Gold and General Investment Trust, Ltd., the security behind debentures consists simply in the securities and funds held to the credit of the debenture series and arising from transactions with funds provided by debenture-holders themselves.

The nature of the security will be clear from the following extract from a form of debenture quoted in a prospectus for first mortgage perpetual income debentures issued by the Investment Executive Trust of New Zealand, Ltd., on the 3rd day of April, 1934 :—

> "2. The trust HEREBY CHARGES with the due performance of its obligations hereunder—
>
> "(*a*) All investments and securities from time to time forming or representing investments of the net proceeds of sales of debentures of this series and of any reserve in respect of this series ;
>
> "(*b*) All moneys being net proceeds of sales of debentures of this series from time to time held by the trust pending investment as provided in the said conditions ;
>
> "(*c*) All moneys being net proceeds of the sale realization or release of any such investments and held by the trust from time to time pending reinvestment ; and
>
> "(*d*) The annual net earnings (as defined in the said conditions) from the said investments held by the trust from time to time pending appropriation and distribution."

From the moneys received, brokerage and administration costs are deducted before investment. The amount which may be deducted in this way is not always clearly stated, but we have evidence that it has been as much as 10 per cent.

The net proceeds are then distributed on what one trust describes as a "profit-sharing" basis. The conditions relating to the distribution of net profits in respect of debentures issued by the *Investment Executive Trust of New Zealand, Ltd.*, are stated as follows :—

(Prospectus issued 3rd April, 1934.)

> "8. The costs, charges, taxes, commissions, and expenses incurred and moneys paid in the formation and registration of the trust and in obtaining the share capital thereof, and in the investment of such share capital and remuneration payable to directors of the trust shall not be charged against debenture capital or income therefrom, but all other costs, charges, taxes, commissions, and expenses incurred and moneys paid by the trust on any account whatsoever (hereinafter called "debenture charges") shall be charged from time to time by the trust in such proportions as the directors of the trust may determine against the moneys received by the trust from the sale of debentures in this and any other series now or hereafter issued by the trust and against the income and profits from investments of the proceeds of the sale of such debentures.

"10. Not later than the 31st day of March in each year during the currency of this debenture the trust shall determine the income and profits during the twelve months prior to the preceding 31st day of December from the investments referred to in paragaph 9 hereof, and, after deducting therefrom such proportion of the debenture charges referred to in paragraph 8 hereof, and all costs, charges, taxes, as the directors of the trust shall deem proper in respect of that period, and also the proportion (if any) of the Establishment Account of this series written off during such period, the balance (hereinafter called "the annual net earnings") shall be appropriated as follows:—

"95 per cent. of the annual net earnings shall be set aside for the holders of the debentures of this series as interest, and such interest (less 10 per cent. thereof, or such greater percentage thereof as the directors shall determine, which shall be retained by the trust and placed to the Reserve Account for this series until such reserve amounts to 100 per cent. of the face value of the debentures of this series allotted up to that time, and less also such further sum not exceeding 5 per cent. of such interest as the trust may think fit, which further sum will be carried forward to the debenture-holders' interest of the following year) shall be paid *pro rata* to the holders of debentures of this series and the balance of 5 per cent. shall be the property of the trust and shall cease to be charged by this debenture: Provided always that if the trust shall at any time be required to pay any tax in respect of any such interest payable to such debenture-holders, whether as agent for such debenture-holders or otherwise, the trust shall be entitled to deduct the same from the interest so payable."

We consider that the conditions relating to capital deductions for brokerage and administration and to deductions from the earnings of investments are sufficiently elastic to permit of excessive charges under these heads; and recommend,—

(59) **That the maximum charges deductible by way of brokerage, administrative, and other charges on the sale of debentures shall be clearly stated as a percentage of the nominal value of debentures on every prospectus for debentures and on every debenture certificate.**

(60) **That, when the dividend payable to debenture-holders is not a fixed sum but is a proportion of net income, the same obligation shall apply to costs and charges other than taxes deductible from the income received from investments.**

(61) **That, when the dividend payable to debenture-holders is a proportion of the net profits, an investment trust shall be required to furnish annually to debenture-holders a report (audited by an auditor appointed on behalf of the debenture-holders) covering the following items:—**

(*a*) Nominal value of debentures sold.
(*b*) Amount of cash or value of securities received in respect of such debentures.
(*c*) Particulars of deductions therefrom in respect of brokerage, administration costs, or other charges.
(*d*) Net amount available for investment, divided into—
(1) Amount invested in securities at cost:
(2) Amount represented otherwise (specify).

Also,—

(*a*) Total income from investments held in respect of each series of debentures.
(*b*) Particulars of deductions by way of administration costs, taxes, or other charges.
(*c*) Amounts carried to reserve.
(*d*) Net amount distributed to debenture-holders.

As the result of the conditions we have outlined in previous pages, it is possible, by the provision of a small share capital, for a small group of individuals to obtain control over a large volume of funds. Even if there is no "rake-off" by way of brokerage, administration, or other charges, they may gain a very high rate of return without incurring any risk of loss of their own capital. There is no trustee to impose a check, and debenture-holders have no powers of audit. There is nothing to prevent them from directing the use of funds to their own advantage. It will be shown later that this is especially likely to occur when subsidiary or affiliated companies exist, for they enable such transactions to be more effectively concealed, and provide a channel through which moneys may be directed to further the interests of those in control of the trust.

When account is taken of the disclosures in our interim report, and in subsequent paragraphs in this report, we feel it our duty to propose measures which will effectively prevent trusts of the contractual type from operating, and force them into a scheme or reorganization modelled along the lines of British trusts.

Accordingly we recommend,—

(62) **That in no case shall investment trusts be permitted to issue debentures, whether at a fixed rate of dividend or at a rate of dividend expressed as a percentage of net profits, of a nominal value exceeding twice the sum of the ordinary and preference share capital of the company which has been allotted and paid up in cash, or three times the amount of ordinary share capital allotted and paid up in cash, whichever is the lesser.**

(63) **That the term "cash" shall be interpreted as in Recommendation No. 36, page seventy-four.**

(64) **That all such debentures shall be secured against the whole of the assets of the undertaking.**

The problem created by the existing investment trust companies must now be faced. The majority of them are in the Investment Executive Trust Group, and are at the present time undergoing inspection under the provisions of the Companies (Special Investigations) Act, 1934. The inspectors, on the completion of their work, are to report to the Court and the Attorney-General, and, if the Attorney-General thinks fit, he may make application to the Court for an order for winding up. The future of these companies, including the adjustment of all rights, must therefore be considered as matters which are *sub judice*, and we therefore address ourselves to the position of the remaining investment trusts.

These are few in number, and they have met all our requirements for information and disclosure of their positions. Our inquiries disclose nothing that would lead us to suggest that there should be any special investigation of their affairs. Certain of them appear to show reasonable conformity with the standards of financial constitution and policy which we have set out in the foregoing recommendations. Others do not conform to those standards.

In framing our recommendations, we have endeavoured to set a reasonable minimum standard of safety and probity in the interests of the investing public. If our recommendations are adopted and embodied in an amendment to the Companies Act, their requirements will then become a legislative standard.

We are strongly of opinion that all existing investment trusts should be required, within a limited time, to conform to that standard. In some cases this will involve the subscription and payment of further share capital, and some modification of the conditions of debenture issues. The former requirement—namely, the obtaining of further capital—will be a matter entirely for the directors and members of the companies. The Legislature has already set up financial tests and standards for banking companies and insurance companies, and we believe that there is every justification for extending similar appropriate provisions to investment trust companies, and requiring that such companies as do not conform to those standards shall do so within a limited time or go out of existence. We consider that in this matter the public interests and conformity with a reasonable criterion of methods and transactions, so intimately bound up with the public credit, should be safeguarded.

The adjustment of existing rights between these companies and their debenture-holders should offer no difficulty. If our recommendations are accepted a company must embody in its contract with debenture-holders the minimum requirements consonant with the legislative standards. As these make for the improvement of the debenture-holders' position, there should be no difficulty in procuring their consent.

There is an existing procedure which will afford every facility for such rearrangement with the "debenture creditors." It is to be found in sections 159–161 inclusive of the Companies Act, 1933, and involves an application to the Supreme Court for its approval of any scheme of rearrangement. If the conditions of the debentures in the case of any company make provision for calling meetings of debenture-holders, passing resolutions whereby the majority can bind a minority, and otherwise obtaining the voice of the debenture-holders, the company should be able to go to the Court with an expression of the will of its debenture-holders on the matter. If no provision has been made for this procedure, the sections we have just called attention to will be found to meet the case, and the Court will give directions, where necessary, for the summoning and holding of meetings of creditors, and arriving at a decision.

We therefore recommend,—

(65) That all existing investment trust companies other than those named in the Schedule to the Companies (Special Investigations) Act, 1934, shall, within six months after the enactment of any provisions embodying the above recommendations, be required to apply to the Court for approval of an amended constitution and financial scheme bringing the company's capital and debenture constitution and terms into line with such enactment, unless such is already complied with.

If any such company does not, within the prescribed period, apply to the Court, or if, as a result of such application, its capital and debenture constitution and terms are not brought into conformity with the legislative requirements and standards, the Attorney-General may petition the Court for the winding-up of that company on the ground that it is just and equitable that it should be wound up. On any such petition for winding-up, the Court, in considering what is just and equitable, shall take into account such legislative standards, and failure to conform to those standards shall be deemed to be a sufficient ground for winding up the company.

(*c*) *Investment Policy.*

(i) *Diversification.*—We have drawn attention to the fact that the diversification of investments and the avoidance of speculative investments, should be cardinal principles of investment policy. Securities should not be purchased save in established undertakings with ample assets, except that a small proportion of the funds may be used to purchase or underwrite securities in new concerns which are regarded as likely to prove a sound and remunerative investment.

In the earlier issues the debenture agreements of the Investment Executive Trust provide that not more than 10 per cent. of the funds contributed shall be in any one security. This provision does not apply *until* the issue is complete. Thus the first prospectus for debentures, dated the 14th March, 1931, states that the company "undertakes that, upon the completion of this issue of debentures in each series, not more than 10 per cent. of the total debenture capital received shall be invested in any one security." There is a similar provision relating to the distribution of investment of debenture-moneys by the Dominion Executive Trust, Ltd., and the Gold and General Investment Trust, Ltd.

According to our reading, this provision can be deliberately evaded by refraining from completing an issue. If this interpretation is correct, the appearance of security to investors through diversification is illusory. One witness (Witness No. 17), a prominent legal practitioner, held the view that such evasion would be illegal, and deposed: "I am of opinion that in order to comply with that condition the company could not lawfully invest in any one security any more than 10 per cent. of the debenture capital for the time being subscribed. Unless this is so, the company could give no guarantee that it might not break this condition, as it could not guarantee that the whole or any particular part of the debenture capital would necessarily be applied for." He further stated, "I know of one instance in which more than 10 per cent. of the total debenture capital was invested in one security (debentures of an allied company), and another instance in which more than 10 per cent. of the debenture capital actually received was invested in one security. I noticed that the second series of debentures omitted that reservation with regard to a limit of 10 per cent. to which I have just referred." The removal of the 10-per-cent. restriction takes away whatever safeguard ensuring diversification existed in the first issue.

Other witnesses corroborated the evidence that more than 10 per cent. of debenture-moneys had been invested in one security.

The articles of association of the New Zealand Investment Trust, Ltd, of Wellington, provide, on the other hand, that not more than one-twentieth of the combined share and debenture capital subscribed, or one-tenth of the subscribed share capital, whichever is the greater, shall be invested in any one security; nor more than one-fifth of the combined subscribed share and debenture capital in any one country other than Great Britain, Australia, or New Zealand.

The annual and interim reports of certain companies give information regarding the spread of securities which may be entirely misleading, without being untrue. Thus the annual report of the Investment Executive Trust of N.Z., Ltd., for the year ended 31st December, 1933, states,—

> "One hundred and eighty separate securities and investments distributed over New Zealand Government stocks and other trustee investments in the A series, and first-mortgage debentures, ordinary and preference shares in banking, insurance, industrial and finance corporations in the B series, were held by the trust at the end of the financial year."

It should be noted that the distribution of investments relates to the two series taken together, and the result could be obtained by a wide diversification in one series and concentration on a few securities in the other, or by heavy investments in a few securities and small investments in a large number of others.

The audited certificate of investment distribution in the B series is as follows:—

PERCENTAGE SPREAD OF SECURITIES IN INVESTMENT EXECUTIVE TRUST OF NEW ZEALAND, "B" SERIES DEBENTURES.

	Percentage of Total Value.			
	To 30th June, 1932.	To 31st December, 1932.	To 31st December, 1933.	To 31st December 1933 (Second B Series).
(1) Government stocks, local-authority debentures, company and corporation debentures	27·37	48·67	36·902	87·202
(2) Preference and ordinary shares of banks, insurance, investment, and finance companies	26·20	28·84	21·826	8·582
(3) Preference and ordinary shares in public utility, shipping, and industrial companies	46·43	22·49	41·272	4·216
	100	100	100	100

A natural inference would be that a high proportion of investments, varying from 27·37 per cent. in June, 1932, to 87·202 per cent. (second B. Series) on 31st December, 1933, represented high-grade securities in the form of Government stocks, local authority debentures, and company and corporation debentures. In fact, we have evidence to the effect that substantial sums were invested in the debentures of related companies, with no tangible assets of their own at the time of issuing the debentures, and that these sums were used in large measure to finance the purchase and renovation of a building or to assist companies in which a director of the Investment Executive Trust was interested. The auditor to the company on 31st December, 1932, commented unfavourably on certain of these investments in his report on the operations of the company during the year ended 31st December, 1932, and this proved unacceptable to the directors. The auditor resigned, after some months of dispute, his report was not published, a young and less-experienced auditor was appointed in his place, and the accounting period was extended to 30th June, 1933 when accounts for eighteen months were submitted to the new auditor.

The danger to the security of debenture-holders appears to us to be so great if a proper diversification of investments is not adopted, especially if the trust is controlled by unscrupulous men, or men

with an easy sense of responsibility, that we consider that the proportion which may be invested in any one security or company should be prescribed by law, and recommend,—

(66) That in no case shall investments made by an investment company in the *securities* issued by any one company exceed one-twentieth of the combined subscribed share capital and debenture capital nor one-tenth of the subscribed share capital of such investment company, whichever is the less.

(67) That in no case shall investments made either directly or indirectly by an investment company in the securities of all kinds issued by any company, exceed one-tenth of the aggregate market value of the securities of such issuing company at the time of purchase.

(ii) *Publicity.*—There is a considerable difference of opinion as to whether investment trusts should publish a detailed list of investments. Practically all British companies publish an analysis of securities into broad classes, but less than 50 per cent. of English and no Scottish companies publish a detailed list showing individual investments.*

In favour of full disclosure, the argument is used that investors who provide the money are entitled to know how it is invested. Although lists include investments held at given dates only, and do not disclose transactions in between such dates, they give a clear indication of the general investment policy of the trust.† It should be apparent also that full and frank disclosure would make it more difficult to invest large sums in transactions in which the directors are personally interested.

Opponents of this view object on the grounds that disclosure may embarrass the investment policy of the trust, because changes in holdings would be taken as an indication that a trust was buying or selling particular securities, and so affect the market price. Such changes might also be accepted as a guide to shareholders in their own investments, " unmindful of the possibility that the company might have made the investments under different circumstances and at very different prices from those ruling when the shareholder received the list, and that the company perhaps would not make the investments at that time and might in fact have disposed of them."‡ Further, the investment trust will make changes in the list of its security holdings as a whole, and a company with large numbers, possibly hundreds, of different securities will be influenced by considerations which the small investor in a few securities cannot take into account.

Witness No. 16 objected to the disclosure of particulars of investments on the grounds that " Where the trust is acquiring a substantial holding, and has so far only obtained a partial holding, it would force the market up against itself, but where it was shown as the holder of a large block of stock and commenced realization it would force the market down on itself as soon as the first transfers went through."

We regard the above arguments as being sufficiently valid to make us reluctant to require by law a detailed statement of investments held, but we consider that the analysis of investments into classes should be more exhaustive than is customary. We also think that a uniform system of analysis and presentation possesses advantages.

We therefore recommend as follows:—

(68) That investment companies be required to include in their annual report to shareholders and/or debenture-holders an analysis of investments in the following classes, giving in respect of each class—

(*a*) Aggregate value of investments in each class expressed as a percentage of the total valuation of all investments;

(*b*) Number of securities in each class;

(*c*) The percentage ratio of the valuation of the maximum investment in any one security in each class to the total valuation of all investments;

Date of return.

Aggregate valuation of securities as shown in balance-sheet. (State basis of valuation.)

Classes of security:—

Bonds, Debentures, and Debenture Stock—
Government and local body.
Industrial and commercial.
Financial—Banks.
Insurance companies.
Other.

Preference and Guaranteed Stocks and Shares—
Industrial and commercial.
Financial—Banks.
Insurance companies.
Other.

Ordinary Shares and Stocks—
Industrial and commercial.
Financial—Banks.
Insurance companies.
Other.

Geographical distribution—
Domiciled in—New Zealand.
Australia.
Great Britain.
Other.

---

* Benson, *op. cit.*, p. 305.
† C. F. Brock, *op. cit.* pp. 304–305.
‡ Brock, *op. cit.*, p. 305.

(iii) *Reserve and Dividend Policy.*—We have shown that it is the policy of British trusts to place capital profits resulting from the sale of securities at an enhanced price to reserve, and not to distribute them as dividends. A similar policy is adopted by some New Zealand companies. Other companies credit the proceeds from the purchase and sale of investments to the Profit and Loss Account and distribute them as interest or dividends. We consider that this policy is undesirable, because it militates against the creation of adequate reserves, and because, on a rising market, it misleads the investor as to the prospects of the enterprise.

The high rate of returns paid by some companies have been made possible because they have been operating on a rising market. When conditions stabilize, the maintenance of equivalent rates will be impossible and the security of debenture-holders and shareholders will be less by the amount of the capital profits, which have already been distributed. A large volume of funds will have been attracted on the basis of illusory prospects created by the use of capital profits to pay dividends. While most companies make some provision for reserves by the allocation of a proportion of net profits to this purpose, we consider that reserves should be further strengthened by the allocation of capital profits to reserve. In view of the special claims as to security made by investment trusts, and of the dangers which may result if reserves are inadequate on a falling market, we recommend,—

(69) That all investment trusts raising capital by the issue of debentures or contracts in series be forbidden to distribute capital profits resulting from the sale to securities as dividends, and be required to place them to reserve.

(iv) *Non-investment Motives: Speculation and the Device of Subsidiary, Affiliated, or Interlocking Companies.*—We have drawn attention to the absence of non-investment motives in a properly devised and managed investment trust of the British type. We have had unmistakable evidence of the existence of such motives in certain New Zealand companies, particularly among the companies in the Investment Executive Trust Group.

In our first interim report we drew attention to fifteen companies in the Investment Executive Trust Group which were connected by common directors and shareholders, or by shareholdings in each other. We add the following to the list:—

(16) *Modern Homes, Ltd.*—This was a private company registered in 1920 under the name of Union Timber and Hardware Co., Ltd., the name being changed to Modern Homes, Ltd., in 1923. The original capital was £4,000 in shares of £1. The subscribers to the memorandum of association were A. C. McArthur (1,000 shares), J. W. S. McArthur (100 shares), and *Selwyn Timber Co., Ltd.* (2,900 shares). J. W. S. McArthur was a director in the Selwyn Timber Co. Later shareholders included H. C. Glasson, W. L. Wiseman, and Alcorn Trower and Co., Ltd. Modern Homes, Ltd., has been a shareholder in Sterling Investments, Ltd.

(17) *Liberty Motors Corporation, Ltd.*—This is a private company registered in Auckland in May, 1934. Its main objects are to act as importers and dealers in cars. The capital of the company is £1,000. The subscribers to the memorandum of association were Mrs. Eileen A. Lewis (999 shares) and Cyril Henry Lewis (1 share). The first directors were the signatories to the memorandum of association. The secretary was M. V. Bates, who is associated with the Stock Exchange Corporation. On 11th June, 1934, Mrs. E. A. Lewis transferred 499 shares to the *Pacific Exploration Co.* for the sum of 1s., nothing being paid up. On 23rd June, 1934, M. V. Bates was added as a director, and Madge Gregory appeared as secretary to the company.

We have reason to believe that the addition of the above two companies does not complete the list.

In our first interim report we described the relationship between the various companies in the group, and made reference to certain of the transactions between them. It is unnecessary to traverse the same ground again in detail, but we summarize the relationships which exist, or have existed, in the following table and diagram. We then make brief reference to one or two significant relationships or transactions by way of illustrating the main dangers.

We would draw attention, in addition, to the liquidation of *V. B. McInnes and Co., Ltd.* (of New Zealand), and V. B. McInnes and Co., Ltd. (of New South Wales), and the formation of McInnes and Co., Ltd., incorporated in Canberra, to secure the goodwill and assets of the two companies in liquidation. These companies secured a big income during the years 1932 and 1933 from their connection with and sale of the debentures of companies in the Investment Executive Group.

The scheme underlying the liquidations and the acquisition of the business by the new company involves, in effect, the capitalization of these profits as goodwill. This goodwill is to be sold for cash to the new company, which has issued a prospectus inviting the public to subscribe for its shares.

Table VII shows the extent to which certain individuals, prominent in the group, appear as directors or shareholders in the various companies. At the foot of the table, companies holding shares are given in brackets. The shareholdings of the various companies in each other are also given in the diagram immediately following the table. The table and diagram show relationships which have existed at any time during the past four or five years. These relationships have been constantly changing through the transfer of shares. Table VII appears as page 66 and the diagram as page 67.

Table VII.—Interlocking Control.

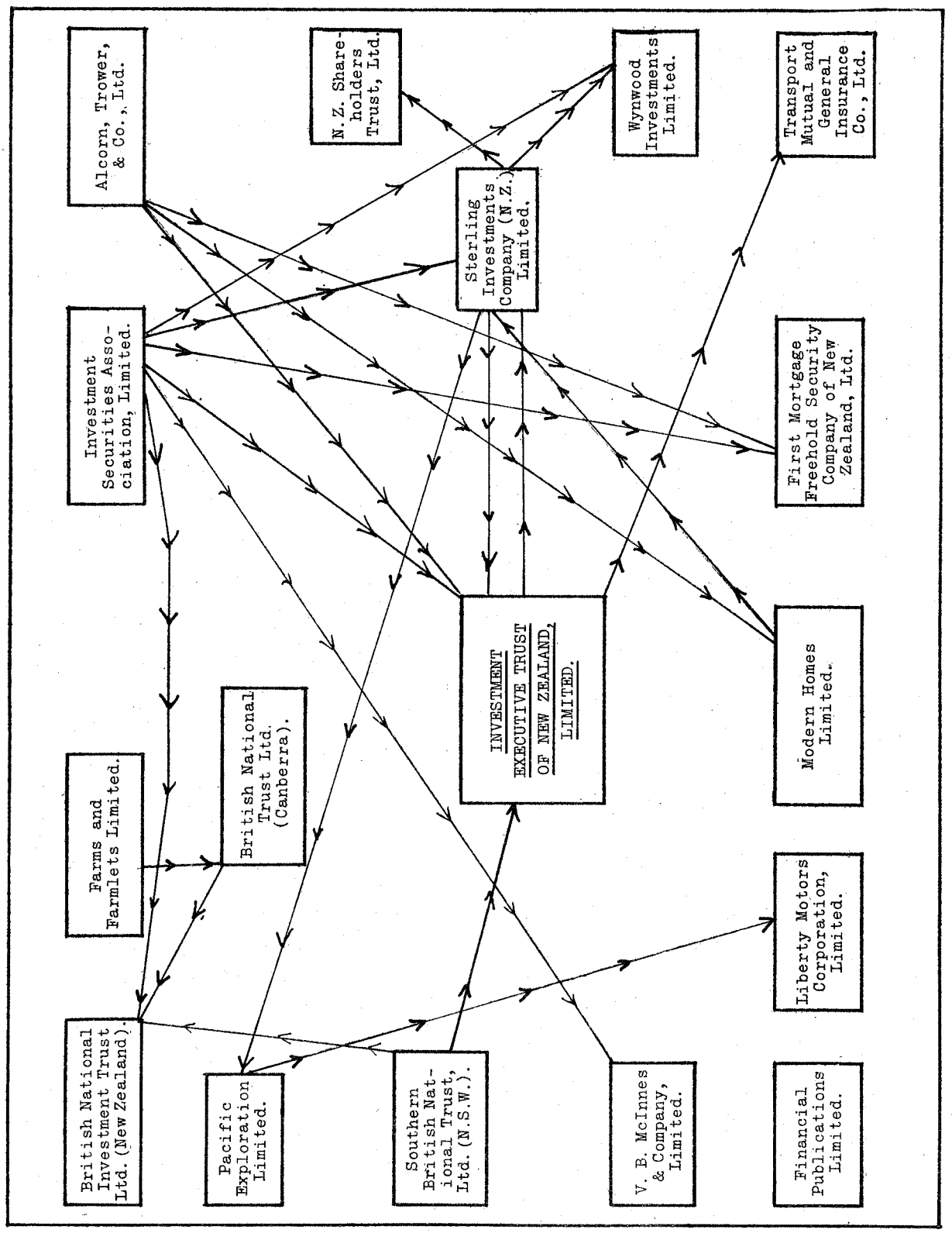
Showing the Manner in which Companies in the Investment Executive Trust Group are, or have been, connected by Common Directors or Shareholders or by Shareholdings in each other.

Note.—Companies holding shares in each company are indicated at the bottom of the respective columns.

—	Investment Executive Trust of N.Z., Ltd.	Sterling Investments Co. (N.Z.), Ltd.	Investment Securities Association, Ltd.	British National Investment Trust, Ltd. (N.Z.).	N.Z. Shareholders Trust, Ltd.	Wynwood Investments, Ltd.	Pacific Exploration Co., Ltd.	Farms and Farmlets, Ltd.	First Mortgage Freehold Securities Co. of New Zealand, Ltd.	Transport Mutual and General Insurance Co., Ltd.	V. B. McInnes and Co., Ltd.	Alcorn, Trower, and Co., Ltd.	Financial Publications, Ltd.	Liberty Motors Corporation, Ltd.	Modern Homes, Ltd.	Southern British National Trust, Ltd. (N.S.W.)	British National Trust, Ltd. (Canberra).
1. J. W. S. McArthur	D.	..	..	S.	D.	S.	Attorney	..	..	..	..	..	..	..	S.	D.	D.
2. T. R. McArthur	S.	..	..	D.	S.	..	S.	..	..	..	..	..	..	..	S.	..	D.
3. C. G. Alcorn ..	S.	D.	S.	D.	..	S.	S.	..	S.	D.	..	S.	..	..	..	..	D.
4. E. R. Alcorn ..	..	..	S.	..	..	..	..	..	S.	..	..	S.	..	..	..	..	..
5. W. A. Pilkington	D.	..	..	..	D.	..	..	..	..	..	..	..	..	..	..	D.	..
6. H. H. Pollard ..	D.	..	..	..	..	..	..	..	..	..	..	..	..	..	..	D.	..
7. R. Glover-Clark	S.	D.	..	..	D.	S.	..	..	..	D.	..	..	D.	..	..	S.	..
8. S. Grange ..	..	..	..	D.	..	S.	..	..	..	..	..	..	..	..	..	..	..
9. Kath. I. Grange	..	..	S.	..	..	..	..	..	..	..	..	..	..	..	..	..	..
10. R. S. Abel ..	..	..	..	..	D.	..	..	..	S.	..	..	..	D.	..	..	..	..
11. C. J. Lovegrove	..	..	..	..	S.	..	..	..	..	..	..	..	D.	..	..	..	..
12. W. C. Hewitt ..	..	..	..	S.	..	..	..	D.	..	..	..	..	..	..	..	..	..
13. H. C. Glasson ..	S.	..	..	..	..	..	..	..	..	..	..	..	..	..	S.	S.	..
14. M. V. Bates ..	..	..	..	..	..	..	..	..	..	..	..	..	..	D.	..	..	..
15. B. B. McInnes ..	S.	..	..	D.	..	..	..	..	..	..	D.	..	..	..	..	..	..
16. K. C. Aekins ..	..	D.	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..
	(Alcorn, Trower, and Co., Ltd.) (Investment Securities Association, Ltd.) (Sterling Investments, Co. (N.Z.), Ltd.) (Southern British National Trust, Ltd. (N.S.W.).)	(Investment Securities Association, Ltd.). (Modern Homes, Ltd.). (Investment Executive Trust of (NZ., Ltd.)	..	(Investment Securities Association, Ltd.) (British National Trust, Ltd. (Canberra).) (Southern British National Trust, Ltd. (Sydney).)	(Sterling Investments Co. (N.Z.), Ltd.)	(Sterling Investments Co. (N.Z.), Ltd.) (Investment Securities Association, Ltd.)	(Sterling Investments Co. (N.Z.), Ltd.)	..	Investment Securities Association, Ltd.) (Alcorn, Trower, and Co., Ltd.)	(Investment Executive Trust of N.Z., Ltd.)	(Investment Securities Association, Ltd.)	..	..	(Pacific Exploration Co., Ltd.)	(Alcorn, Trower, and Co., Ltd.)	..	(Farms and Farmlets, Ltd.)

DIAGRAM SHOWING INTERRELATIONSHIPS OF COMPANIES IN INVESTMENT EXECUTIVE TRUST GROUP.

NOTE.—The direction of the arrows indicates companies owning shares in other companies in the Group.



It will be seen that J. W. S. McArthur is or has been a director in four companies, attorney of at least one company, and a direct shareholder in three companies. T. R. McArthur is or has been a director in two companies and a shareholder in four. C. G. Alcorn is or has been a director in four companies and a shareholder in six. Other individuals mentioned in the table are also directors or shareholders in several companies. In addition, they may have an indirect interest or control, because they are directors or shareholders in *shareholding* companies.

The diagram shows that there is only one company in the group—Financial Publications, Ltd.—which is not interlocked by means of its holding of shares in other companies or by the holding of its shares by other companies. Its connection with the group is established by the fact that its directors are also directors or shareholders in other companies in the table, and that it has been financed by the Investment Executive Trust.

The practice of forming subsidiary or related companies is not confined to the Investment Executive Trust, but no other group is so extensive or complicated in its ramifications, and in no other case is the danger so menacing.

While in certain circumstances there may be some justification for the formation of companies to perform a subsidiary or ancillary purpose, in the case of Investment Trust Companies the relationship should be clearly defined and the purpose made public.

Among the dangers which result from the above practices, the following may be noted :—

(1) The limitation on investments in one security designed to ensure proper diversification may be evaded. Let us suppose, for example, that it is stipulated that not more than one-tenth of the funds subscribed may be invested in any one security. There is nothing to prevent the trust from investing one-tenth of its funds in each of two or more related companies, and then directing the money to a single purpose. We have evidence which causes us to believe that this has taken place with moneys subscribed by debenture-holders in the Investment Executive Trust. For example, the sum of £52,000 was invested in debentures of the British National Investment Trust, Ltd., and £36,358 in debentures of Sterling Investments Co. (N.Z.), Ltd. The latest return shows the paid-up capital of these companies as £3,187 and £2,357 respectively. (See Table VI, page 52). It is clear that the companies themselves held no assets to provide adequate security against advances of these dimensions. From other evidence we have obtained, we are of opinion that these funds were directed to the purchase and renovation of the Sydney *Daily Telegraph* Building, and to serve the purpose of companies in which directors of the Investment Executive Trust were personally interested.

(2) Funds may be used to make speculative investments under such circumstances that the debenture-holders bear all the risk, and those in control of the trust reap the speculative profit. It is no justification for such an investment that the speculation succeeds. Practically the whole of the shares in the British National Investment Trust, Ltd., are held by British National Trust, Ltd. (Canberra), the main shareholders in which are J. W. S. McArthur, T. R. McArthur, and C. G. Alcorn. The transfer of shares referred to on page 15 of our first interim report and on page 56 of this report then assumes a sinister significance. According to our latest information, the main shareholders in Sterling Investments are the Investment Executive Trust (801 shares) and Investment Securities Association, Ltd., which in April, 1933, was allotted 20,000 out of a total of 21,007 shares. The directors of the latter company as at 28th March, 1934, were Charles Graham Alcorn and Kenneth Curtin Aekins.

The debenture moneys referred to in the previous paragraph were used, we believe, in the purchase and renovation of the Sydney building. The debenture-holders in the Investment Executive Trust presumably receive interest on the debentures in the British National Investment Trust, Ltd. (N.Z.), and Sterling Investments Co., Ltd. There is nothing to prevent profits on the building in excess of this from going to the shareholders in these two companies, in which the controllers of the Investment Executive Trust are the main shareholders. If the speculation fails, the security to debenture-holders then becomes the assets of the British National Investment Trust, Ltd. (N.Z.), and of Sterling Investments, Ltd. In short, it will be represented largely by the building. The money with which the risk is taken is then provided, in part at least, by *debenture-holders* in the Investment Executive Trust. The speculative profits (if they materialize) on that part of the investment represented by debenture-holders' money, may then filter through, by a devious route, into the pockets of some of the *shareholders* in the Investment Executive Trust.

There may be a plausible explanation of the above transactions which puts them in a more favourable light ; but *as long as subsidiaries are capable of being used in the above manner* they must be roundly condemned.

(3) Funds may be used to further the personal interests of those who control the trust. We draw attention to transactions of the Sterling Investments Co. (N.Z.), Ltd., with the Selwyn Timber Co., Ltd., in Liquidation (page 9 of First Interim Report). At a time when its paid-up capital was £50 14s., it lent several thousands of pounds to the Selwyn Timber Company. J. W. S. McArthur was a large shareholder in this company, and a director. In addition, Sterling Investments Co. (N.Z.), Ltd., held shares to the nominal value of £10,883 in four other companies in the group, at a time when its paid-up capital was £2,350. Of these, £9,979 was invested in the Pacific Exploration Company, which was formed to finance the building of a yacht now owned by J. W. S. McArthur.

(4) As a natural corollary to the above, subsidiaries make it easier for debenture moneys to be used to enable controllers of the trust to obtain a controlling interest in other companies.

Among the objects of the Investment Executive Trust are the following :—

"(*a*) To take full control or otherwise take part in the management, supervision, or control of the business or operations of any company or undertaking, and for that purpose to appoint and remunerate any directors, accountants, or other experts or agents."

Such an object is foreign to the tradition of British trusts. It is objectionable because it is a direct encouragement to the controllers of the trust to use other people's money to serve their own purposes. The interlocking relationships described in our First Interim Report and in Table No. VII and related diagram indicate the extent to which the control of other undertakings has become a part of the settled policy of the Investment Executive Trust. The purchase of the Sydney Daily Telegraph Building is in fulfilment of such a policy. An insurance company, a company formed to deal in motors, a company to build a yacht and explore the Pacific, and pursue a variety of other objects, are already within the orbit of control, though one may feel doubts as to whether the insurance company will ever sign up any policies, the motor company sell any cars, or the exploration company equip any expeditions, subsidize any professors, or manufacture any sausages.* But why should control stop at selling cars or making sausages?

(5) The existence of related companies to perform subsidiary or ancillary functions is conducive to the deduction of excessive charges for brokerage, administration, and other services. As one witness put it: "The existence of subsidiary companies whose financial interest is closely identified with the executives of the debenture-issuing company, creates a temptation to be overgenerous in fixing the amount of administration costs, and is not, I think, conducive to the obtaining of the most reasonable brokerage and promotion charges." (Witness No. 17.)

We have drawn attention to the additional payments made to V. B. McInnes and Co. and disguised under the heading "Statistics, Records, and Establishment."

(6) An alternative method of diverting debenture-holders' moneys into the pockets of those who control the trust is described by witness No. 17 as follows:—

> "Another feature which I do not think is appreciated by investors arises from the existence of interlocking companies. An investor purchasing £100 worth of debentures may have only £90 worth of security. But that £90 in cash may be lent to another allied company on the security of debentures to the face value of £90. But the debentures of that allied company may in turn have been reduced by 10 per cent. for 'brokerage and administration costs,' so that those debentures are worth only £81. The investor's security for his £100 would in such a case be reduced to £81, which, of course, by judicious management may be materially increased, but which may also be materially reduced. If there are many allied companies, this process may go on again and again, and with each investment the investor's £100 is reduced by 'brokerage and administration costs.' I am unable to ascertain whether such methods have in fact been adopted by the investment companies I have referred to, but it cannot be denied that such a procedure could be followed and the constitution of these companies and the terms and conditions of the debentures would prevent the debenture-holders from realizing the position until their security had very considerably diminished. In the hands of unscrupulous directors there is all the material for great mischief. I have endeavoured to find out whether in fact any such course of action has been adopted, but with the means at my disposal I have been unable to ascertain particulars of the investments held by the various companies. I feel confident that the average investor is unaware of the possibilities that I have mentioned in this subparagraph of my affidavit."

We regard the existence of companies subsidiary to or affiliated with investment trusts as presenting a danger of the utmost gravity, and requiring strong action. Unfortunately the problem of finding a remedy is extremely difficult, because it is impossible to frame a definition which will cover all the various types of relationship which we know to exist, without including companies which are not, in fact, affiliated or subsidiary.

The definition of "subsidiary" in section 135 of the Companies Act, 1933, definitely and certainly fails to meet the problem, and the letter and spirit of the enactment can be readily evaded. The connection may be established by inter-share relationships among the companies themselves, common shareholders or directors, the use of "dummies," and possibly in other ways. The relationship may be direct; or indirect through an intermediary company. The problem is further complicated by the fact that it is part of the normal function of an investment trust to acquire shares in other undertakings. In our view, there is no satisfactory solution which depends solely on the strict application of a legal definition expressed in concrete terms, but the problem is so important that a definition in terms of general principle must be attempted. Such a definition necessarily raises more difficult questions of interpretation than arise in respect of a definition which can be expressed in clear objective terms. To meet this difficulty we shall recommend the vesting of some discretionary power in the application of such definition, in the Corporate Investments Bureau.

---

* These are included amongst the objects of this Gilbertian enterprise.

The definition which we attempt is as follows:—

Definition of Subsidiary Company.—A company shall be deemed to be a subsidiary of another company when the degree of community of proprietorship, control, and interest between such companies is such that—

(*a*) The said companies, either as to the whole or any part of their affairs and transactions, pursue a common policy or embark upon transactions having a common or single purpose in view; and

(*b*) When they negotiate and enter into such transactions and compacts not as normally independent contracting parties each free to consider its own interest and policy without responsibility or desire to further the interests and policy of the other, but as component parts of an organization or scheme under a common proprietorship or control:

Provided that compacts and transactions entered into between companies for the purpose of procuring economy of working or advancement of a common interest under circumstances that do not give to any director, manager, or shareholder of either company, or any class or group of directors, managers, or shareholders, an advantage or benefit involving detriment to or extra risk or responsibility on any other directors, shareholders, or on any creditors of the company, shall not make either such company a subsidiary.

Accordingly we recommend,—

(70) That the Corporate Investments Bureau be empowered to declare any company to be a company subsidiary to, or affiliated with, an investment trust when there is reason to believe that such company falls within the above definition, and thereupon such relationship shall be deemed to exist, the investment trust to have a right of appeal to the Court against such declaration.

(71) That, save with the permission of the Bureau, the aggregate of investments of an investment trust company in the securities of all such subsidiary or affiliated companies taken together shall in no case exceed at any time one-twentieth of the combined share and debenture capital of such investment trust company subscribed and paid up at that time; nor more than one-fortieth in any one such subsidiary or affiliated company.

(72) That an investment trust shall be required to include in its annual accounts the names of all subsidiary or related companies, together with (*a*) the maximum amount invested in each of such companies at any time during the preceding financial period; (*b*) the maximum number and nominal value of shares in any such company held by any director of the investment trust or his nominee or trustee during such financial period.

(73) That whenever the relationship of subsidiary and parent shall exist between an investment trust and any other company or companies, the Corporate Investments Bureau may of its own initiative, and shall on being required so to do by any such company or the auditor of any such company affected thereby, fix a date common to both or all of such companies as the date at which its accounts shall be balanced and as at which its balance-sheet and revenue accounts shall be prepared and audited.

(74) That copies of the accounts and reports of each of such companies shall be forwarded to the auditors of the other company or of each of the other of such companies forthwith after they are completed and audited.

(5) Scheme of Control and Administration.

In view of the evils, existing and potential, which have been discussed in preceding sections, the scheme of control becomes a question of considerable importance. In order to throw into relief the extent to which the scheme of control adopted by some companies may facilitate, or make possible, practices endangering the security of debenture-holders, we cannot do better than compare the scheme of control of the New Zealand Investment Trust, Ltd., with that of certain other companies, especially the Investment Executive Trust of New Zealand, Ltd.

By way of preliminary, we again draw attention to the capital composition of the various companies. As shown in Table VI, the paid-up capital of the New Zealand Investment Trust, Ltd., at the 31st July, 1934, is £37,497, or 52·8 per cent. of the debenture issue paid up of £71,157. The paid-up capital of the Investment Executive Trust of New Zealand, Ltd., at the 3rd April, 1934, is £30,010, or nearly 4·4 per cent. of the moneys received by way of debentures, £689,510.* As at 17th October, 1933, J. W. S. McArthur held 194,150 shares, C. G. Alcorn held 31,600 shares, and Alcorn, Trower, and Company, Ltd., 16,750 shares, out of a total of 244,007 ordinary shares issued.

The ratio of paid-up capital to paid-up debenture capital in the Gold and General Investment Trust, Ltd., and the Dominion Executive Trust, Ltd., has also been shown to be low.

---

* These figures are taken from the company's prospectus, dated 3rd April, 1934, and appear to include converted debentures.

The following points of contrast should be noted:—

(*a*) *Shareholding of Debenture-holders.*—In the New Zealand Investment Trust, Ltd., a large number of debenture-holders are also shareholders. We were informed on oath that "shareholders and debenture-holders are practically identical." In addition, the company must convert debentures into preference and/or ordinary stock under one of the three options to be determined by the company within five years of the issue of the stock. (See page .) As far as we know, there is nothing to prevent debenture-holders in other companies from taking up shares in such companies, and evidence given by the Dominion Executive Trust stated: ". . . it is suggested to every debenture-holder who takes up debentures that an application for at least five or ten shares should be made." We do not think it likely, however, that debenture-holders own many shares in these companies. As at 17th October, 1933, there seem to have been few, if any, ordinary shareholders in the Investment Executive Trust of New Zealand, Ltd., outside the controlling group.

While there is no guarantee that debenture-holders who possess small shareholdings in a company will be able to exercise an effective voice in control, yet it is a partial safeguard.

(*b*) *Trustees.*—The New Zealand Investment Trust, Ltd., has appointed trustees for debenture-holders, whom debenture-holders have power to remove and replace. The other companies mentioned above have not appointed trustees.

We recommend,—

(75) That every investment company issuing debentures or contracts in series shall be required to appoint a trustee for debenture-holders.

(76) That in the case of such companies as do not at present have trustees, the first trustees shall be appointed by the Court from a panel selected by the company, such appointment to be made within a period of six months from the legislative adoption of these recommendations. If the company does not so apply within the said period of six months, any debenture-holder may thereafter apply, and the Court may appoint such trustee as it thinks fit; the costs of this application to be borne by the company.

(77) That debenture-holders shall be given adequate powers in regard to the dismissal and election of trustees.

(*c*) *Meetings of Debenture-holders.*—Excepting the New Zealand Investment Trust, investment companies appear to make no provision for the convening of meetings of debenture-holders.

We recommend,—

(78) That investment trusts shall, in their trust deeds, make adequate provision for the summoning and holding of meetings of debenture-holders, and the exercise of voting-powers.

(*d*) *Representation of Debenture-holders on the Directorate.*—In view of the fact that debenture-holders have a large capital at stake in investment trusts, we consider that they should have some representation on the directorate. The New Zealand Investment Trust already makes such a provision.

We recommend,—

(79) That the debenture-holders in investment companies issuing debentures in series shall be entitled to elect at least one director.

(*e*) *Inspection and Audit.*—In the New Zealand Investment Trust, both the trustees and the debenture-holders have independent powers of audit, and trustees have full powers to inspect the portfolio of investments. These conditions do not apply to the other companies referred to in this section. We consider that the debenture-holders should have power to appoint an auditor, and that trustees should have full powers to inspect the security portfolio.

Accordingly we recommend,—

(80) That trustees for debenture-holders in an investment company issuing debentures in series shall have full power to inspect the portfolio of investments at all times.

(81) That debenture-holders in such companies shall have power at a general meeting of debenture-holders to appoint an auditor for debenture-holders upon the terms and subject to the conditions on which shareholders may, under the Companies Act, 1933, appoint an auditor.

Since debenture-holders provide a substantial proportion of the capital of investment companies, we consider that debenture-holders should have the same powers of investigation into the affairs of an investment company issuing debentures in series as are granted to shareholders.

We recommend,—

(82) That Recommendation No. 17 (page 51) apply, with the necessary verbal alterations, to investment companies.

In support of this recommendation, we may quote the evidence of Witness No. 17 :—

> "I am of opinion, however, that the most salutary and most effective safeguard would be the provision of some means whereby, in a proper case, the affairs of the company could be investigated and reported upon at the request of a substantial body of the debenture-holders whose capital is at stake. The mere existence of such a right would, I think, act as a strong deterrent against any such procedure as I have referred to. Even if the deterrent were not sufficient, debenture-holders would be in a position to have the affairs of their debtor company investigated, and if the report disclosed that their security was being jeopardized, I apprehend that the Supreme Court already has power to appoint a receiver to realize the security. The difficulty at present is to get evidence that the security is being jeopardized. I am of opinion that if amending legislation were adopted to give debenture-holders the same rights as shareholders enjoy under section 142 of the Companies Act, 1933, most of the evils would never occur, and even those that did occur would speedily be detected and put an end to. Once the debenture-holders prove that their security is being wasted away, they have a remedy in the Courts which they can readily enforce without further legislative provision."

(*f*) *Holding of Securities.*—The nature of the business of an investment trust requires that its officers shall have control of scrip, certificates, deeds, and other forms of securities, constituting the title of the trust to its investments. A well-managed trust or other company with large investments and securities always makes careful arrangements for the safe custody and convenient handling of these instruments, and we took the evidence of experienced auditors relating to established practices in New Zealand in this connection.

The difficulties and dangers disclosed by this evidence are of two kinds. Firstly, there are those relating to registration of transfers of securities to the investment trust; and, secondly, there are those relating to the physical custody of the instruments of title.

Dealing firstly with the matter of procuring registration of a transfer of stock or other security to an investment trust, we find that the practice in the majority of cases is to procure the registration of the purchasing investment trust as transferee, and therefore as owner of the stocks, in the books of the issuing company. This should be done promptly where it is possible, because it gives to the purchasing investment trust that protection which comes from the system of registered proprietorship.

In some cases, however, this procedure is not possible. Firstly, there are classes of stock or other security which do not provide for ownership by registration. There are, for instance, bearer debentures and bearer stocks and there are different kinds of inscribed stock. In these cases it is not possible to procure a new instrument of title as evidence of registration of ownership in the books of the issuing company. This is met in the case of bearer stock by the receipt and safe preservation of the instrument of title, which shows that it confers all the benefits of ownership on the holder or bearer. In the case of inscribed stock it is usual to search the register in which the inscription of proprietorship is made after the transfer is inscribed, and in some cases an acknowledgment can be obtained of the entry inscribed on the register at a given date.

We now revert to instruments of title issued to registered proprietors.

There are some cases in which an investment trust company cannot procure such an instrument of title in its own name. Some issuing companies have refused to register transfers to some investment trusts. Others are required by their articles to refuse to register any transfer to a corporation. When an investment trust company acquires the stock or debentures of such issuing companies they have no alternative, when they wish to take title to such securities, but to appoint a trustee or trustees to hold securities on behalf of the investment trust. The procedure is, then, for the trustee or trustees to take a transfer into their own names and hold the stock as trustees for the investment trust. It is a principle of the law of corporations that an issuing company will not, on its register of proprietors and holders of shares, stock, and debentures enter any notice of a trust, and therefore when trustees are appointed to hold such shares or debentures they must hold in their own names personally without disclosing the trust. This suggests, as the primary precaution, the appointment of men of undoubted integrity as trustees.

We now come to the difficulties of the second class—namely, those connected with the physical custody of the instrument of title and the proper recording of all investments held. The practice which is recognized as sound is to have the instruments in the custody of at least two reputable officers of known integrity. The actual instruments may be lodged with the bank or in a safe deposit vault or in the investment trust's own safe or strong-room under check keys requiring the simultaneous attendance of all the appointed custodians to procure possession of the instruments.

The practice of all well organized and carefully managed trust companies, in relation to these difficulties and dangers, centres round the selection of two or more men of integrity and discretion to procure title to the investments in the safest manner possible, and to provide for the custody of the actual scrip and other instruments of title according to the foregoing rules. Evidence given before us satisfies us that this is the practice of most companies holding large investments and securities.

In relation to the Investment Executive Trust and its subsidiaries, however, we view the position revealed as disquieting. The evidence satisfies us that it has been the practice for purchases of shares, stock, and debentures in the name of and with the funds of the Investment Executive Trust to be effected by either transfers or powers of attorney made by the vendor in favour of the Managing Director, Mr. J. W. S. McArthur, personally and solely.

We have evidence that financial investments of a liquid nature, covering large sums of money, are held in this way. Where actual transfers have been made, they have been registered in the name of J. W. S. McArthur personally. In other cases the investments remain in the name of the vendor or transferor, whilst the Investment Executive Trust holds a power of attorney in favour of J. W. S.

McArthur according to which he may execute a transfer of the shares as the attorney of the vendor as and when he pleases, and, in the meantime, may exercise all other powers and rights of ownership. We have evidence that these investments are made and are changed by Mr. McArthur without reference to his co-directors and at his own discretion. We have evidence, further, that some of these transactions involve transfers between the Investment Executive Trust and its subsidiary or affiliate companies. There can be no doubt that the existence of such subsidiary companies exaggerates the difficulties and dangers we have called attention to.

We view this position with some misgiving, and we believe that it is not in the interests of the debenture-holders in the Investment Executive Trust. These debenture-holders at present have no auditor to watch their interests or to report to them. Further, it should be obvious to any one with a knowledge of methods of accounting and auditing that in these circumstances no audit of the affairs of the Investment Executive Trust and its affiliates can be effective unless it is made at a common date either by an auditor or auditors appointed to deal with all the companies, or by some system or arrangement which allows of close co-operation between the auditors if they are appointed separately to the various companies.

We consider that recommendations Nos. 81 on page 71, and 73 and 74 on page 70, in the preceding subsections of this report, make as adequate provision as is practicable to meet this problem. These recommendations give to debenture-holders the power to appoint an auditor, and the statutory provisions as to qualification of auditors should ensure the appointment of men of sufficient standing to safeguard the interests of debenture-holders.

The power given to the Bureau to fix a common balance day for investment trusts and their subsidiaries will make effective audits possible, and the supply of the respective balance-sheets to the different auditors will assist in the same direction. Attention may be called also to the right of the auditor to appeal to the Corporate Investment Bureau for advice and co-operation.

The above recommendations have been made to bring investment trusts into line with the tradition and practice of the best British trusts. If they appear to be unduly severe, we would point out that the majority of them are already incorporated in the scheme of one New Zealand company, and are in conformity with practice in Great Britain. We believe it to be of great importance to New Zealand that investment trusts should be regulated and controlled from this early stage in their development in such a way as to prevent the flagrant abuse of responsibility and financial power and control which may be exercised and practised by unscrupulous men. We repeat that, unregulated, the investment trust is a serious menace imperilling the savings of thousands. Properly regulated and controlled, it may provide a secure and lucrative avenue for investment, especially for the man of small or moderate means, and assist materially in the mobilization of savings for socially desirable purposes.

PART V.—INVESTMENT *CUM* LOTTERY COMPANIES.

This ingenious type of company can be described in a few words. We have received evidence relating to two companies, Nos. 40 and 41, which exemplify the type. Both are private companies, with nominal capitals of £500 and £5,000 respectively. The general scheme is as follows :—

Bonds are issued to a nominal value of £1 per bond, which may be purchased for 25s. The company guarantees to invest £1 out of each £1 5s. received, either on deposit with a bank, or "in Government or in such securities as are customarily invested in by an investment trust company." The investment is terminable within a stated period—say, two to four years. At the end of such period, the investor receives back the sum of £1 for every £1 5s. subscribed.

The promoters of these ventures quote with enthusiasm the unusual phenomenon of a company which is able to guarantee the return of £1 for every £1 5s. invested. "Never before," states one prospectus, "have investors been given an absolute guarantee against *loss of capital* and that *80 per cent.* of their original capital payment can be withdrawn at the end of four years if they so desire." The director of the company who gave evidence before us, was hard pressed to explain how even an 80 per cent. guarantee could be given, since the debenture moneys might be invested in securities and these might depreciate in value.

The companies appoint trustees to watch the interests of bondholders.

The sum of 5s. to be retained by the company is to cover the cost of establishment and of any subsidiary companies, and of the selling of bonds, and to provide the capital or funds of such subsidiary as may be established to transact its business.

The main purpose of the company is to use the moneys obtained in this way to obtain a concession, either directly or through a subsidiary, for the conduct of a lottery in a foreign country, but one of the companies proposes also "to carry out the general undertakings of an investment trust company."

The profits from the concessions obtained are to be used—

(*a*) To pay a commission of 20 per cent. to the company :
(*b*) To create reserves or acquire property :
(*c*) To distribute as dividends to bondholders.

Little need be said about companies of this type. The promoters appeared to us to be men of little financial reputation or substance, and with little to lose. The financial scheme of such companies is, in our opinion, unsound, but there is no need to engage in detailed criticism. They are adequately condemned on the grounds that they are incorporated in New Zealand to engage in an undertaking in another country, which is unlawful in New Zealand. The position will be met if the following recommendation is given effect to, other matters being covered by our recommendations in regard to investment companies.

We recommend,—

(83) That no company, incorporated in New Zealand, shall be permitted to raise moneys in New Zealand or elsewhere for the pursuance in another country of any object which is unlawful in New Zealand ; and any existing company having any such object may be wound up by the Court on the application of the Attorney-General.

PART VI.—EMPLOYEE SHAREHOLDING COMPANIES.

We have knowledge of one company which has invited subscription for shares as a condition of employment. This arrangement is different from employee-co-partnership schemes in which a special class of labour shares is issued, because the shares are ordinary or preference shares which may be transferred.

The company in question (company No. 39) was incorporated as a private company in January, 1932, to act as fishers, packers, shippers, &c. Later the capital was increased by successive stages to £2,500, £5,000, £20,000, and £270,000, and the company incorporated as a public company.

The feature of interest in this company is the granting of employment conditional upon the purchase of shares in the company, the majority of these being preference shares. Apparently preference shares did not, at first, carry voting-rights, but now all preference and ordinary shares rank equally as to voting.

The following is a *summary of the main conditions* included in the contract between the company and employee shareholders :—

Unless terminated under certain specified conditions, employment was to be given for at least eighteen months. Rates of pay were to be the same as for other employees engaged in the same type of work, but not less than 1s. 8d. per hour for a week of forty-four hours. Overtime was to be at the same rate as ordinary time. Deductions might be made at agreed amounts from wages, to be applied as part payment for shares purchased. The employee was to warrant his efficiency and agree to obey the instructions of the company or its officers, and to keep its secrets. Should employment be terminated, the employee was to have no claim on the company for refund of moneys subscribed for shares, but might sell them in the open market, subject to the provision that the company might require them to be transferred to it or to its nominee at the market price, or, failing agreement on this, at a price determined by arbitration. Wages of the employee were to cease during absence on account of sickness or accident.

The company was to have power to terminate the contract upon the following grounds :—

1. Breach by the employee of all or any of the conditions or warranties contained in this contract.
2. Drunkenness of the employee during the course of his employment.
3. Insubordination of the employee.
4. Inefficiency of the employee in the performance of his duties.
5. Bankruptcy.
6. Should the employee be found guilty of any offence punishable by imprisonment either with or without hard labour.

The company was to be the sole judge of the validity or sufficiency of any grounds for dismissal.

It should be noted that the company has wide powers to terminate the contract, subject only to arbitration in the event of dispute as to the interpretation of the contract.

We found it extremely difficult to obtain satisfactory information concerning this company.

The witness who appeared before us (Witness No. 18) stated that about eighty contracts had been entered into, but he was unable to state how many shares had been subscribed for. It appeared that too many contracts had been signed and that not all employees could continue to be profitably employed. At the time when the evidence was given, the company had been in active operation for about ten months but was then temporarily closed. Arrangements were being made whereby all employment contracts were to be cancelled.

Employees of the company who presented statements to the Commission deposed that wages were in arrears and that they were having difficulty in obtaining them.

So far as we were able to gather, the company appeared to be making an effort to fulfil its contract, but we gained the impression that the scheme had not been well conceived nor efficiently executed.

A similar attempt was made to float a company in England, with similar objects. The promoter of this company was connected with the early history of the company described above, and there seems to have been some sort of relationship between the two projects. At best, the English project can be described as the product of a fantastic optimism. Not only was a large fleet of vessels to be engaged in catching fish, which were to be exported to Australia and the East, but also 41,824 acres of land were to be acquired at a "nominal" cost of £1 per acre. On the area tobacco, flax, tung-oil and citrus trees were to be grown.

It was proposed to encourage English fishermen and others to invest on a promise of employment. The following is a copy of an advertisement which appeared in *The Fishing News*, Aberdeen, on the 15th October, 1932 :—

> "AN OPPORTUNITY TO BE GRASPED.—FISHERMEN and others with a knowledge of fishing industry would you like
>
> "AN ASSURED INCOME
>
> of at least SEVEN POUNDS PER WEEK with a House to live in and ten acres of ground ?
>
> "An Established Dominion concern wishes to engage services of men under contract, with experience of Seine Net Fishing. Earning capacity actually averages £7 weekly. Capital required, £450 fully secured by shares in the Company.
>
> "Send applications, with personal particulars, to Box 6, *Fishing News*, 200 Gray's Inn Road, London, W.C. 1."

The prospects in regard to both fishing and farming were extravagantly exaggerated, and indeed grossly misrepresented. It is fortunate that the promotion was unsuccessful.

The dangers inherent in inviting investment as a condition of employment will be apparent, especially when projects are sponsored by individuals who may be euphemistically described as fantastic visionaries, and to whom less charitable epithets might be applied with some show of reason. It is unlikely that prospective employee-shareholders will be in a position to form a reliable judgment on the merits of the enterprise. The dangers are all the more real, when the prospects are remote from the areas in which companies are to operate, and when attractive pictures are painted to unemployed workers who may have accumulated small savings which they are tempted to invest in order to obtain work.

In view of the different conditions under which employee-shareholding schemes may be applied, we do not think it expedient to elaborate a detailed statement of the conditions under which they should operate, but *recommend*,—

(84) That all companies which invite subscription for shares as a condition of employment, must obtain the approval of the Department of Labour to the schemes proposed.

PART VII.—MISCELLANEOUS.

In this section we deal with a number of miscellaneous problems relating, in the main, to the provisions and operation of the Companies Act, 1933. In some cases we have taken evidence from more or less expert witnesses, and in other cases we have thought formal evidence unnecessary, seeing that the points involved are either matters of interpretation of the Act, or are the application of the provisions of the Act to matters of fairly common knowledge.

1. BROKERAGE AS DISTINCT FROM COMMISSION.

The Companies Act, 1933, deals in three places with the matter of *commission* payable to persons for subscribing or procuring subscriptions to shares in a company's capital. Firstly, it is provided by section 54 that it shall be lawful under circumstances set out in that section, for a company to pay *commission* not exceeding 10 per cent. to any person in consideration of his subscribing or agreeing to subscribe or to procure subscriptions for any shares in the company. The conditions include requirements that this payment shall be authorized by the regulations, and it must be disclosed in the prospectus or statement in lieu of prospectus. Secondly, section 55 of the Act provides that every company which has paid sums by way of *commission* in respect of its shares or debentures shall disclose such payment in its balance-sheets. Thirdly, Part I of the Third Schedule to the Act provides that there must be disclosed in every prospectus of shares issued to the public the amount of *commission* payable by the company to any person in consideration of his agreeing to subscribe for or agreeing to procure subscriptions for shares.

There is no reference in these provisions or elsewhere in the Act to any disclosure of payments by way of brokerage. The distinction between the two terms, *commission* and *brokerage*, can be made quite clear only by an historical survey of the foregoing provisions in the Act, but it is not thought necessary to embark fully on such a survey. The commission that is referred to in sections cited above is a commission payable to an underwriter or other party who contracts with the company to place or to procure the placing of a parcel of shares, which is usually large. Originally, such payments were unlawful; the deduction for such commission was deemed to be indistinguishable from a discount on the shares. At the present time, by section 55 of our Act, the right to pay commission is allowed up to a limit of 10 per cent. That statutory recognition has been tardy. The Legislature has, firstly, recognized the principle and then, from time to time, increased the permissible limit of these commissions. The point we wish to make clear is that, until the Legislature specially permitted these commissions, it was unlawful to pay them.

Brokerage, however, is on a quite different footing. It never was unlawful for a company to pay a broker for services rendered by him in negotiating individual sales of or subscriptions for shares. This distinction was declared by a section added to the Companies Acts in England soon after the statutory recognition of the right to pay commission was granted. The declaratory section has been reproduced from time to time, and it now appears as subsection (3) of section 54 in the following words:—

> "Nothing in this section shall affect the power of any company to pay such brokerage as it has heretofore been lawful for a company to pay."

The distinction between the two kinds of payment would seem to be this: A company could lawfully instruct its own servants, while in the company's pay, to negotiate with probable subscribers for or purchasers of shares, and procure such contracts with such persons. Similarly, it could employ a person specially, as a whole-time occupation, to take up such work for a time, and the payments made to that person would be, whether called wages or brokerage, payments for services rendered in bringing the company into touch with individual subscribers for its shares. Commission, on the other hand, may be described as the consideration payable to a wholesale dealer, known as an underwriter, whose contract related to a large parcel of shares and who undertook the task, as a financial expert, of floating or issuing that parcel of shares.

In New Zealand the financial organization and practice differs from that in England. Here we have no recognized money market or "city" with established financial agents available and waiting to undertake the placing of either whole issues of shares or substantial parts of issues for a commission. We have instead a large number of share salesmen or brokers who undertake the task, for brokerage, of placing individual contracts for purchase of shares or subscription for shares. In spite of this

difference, our Companies Act follows the English Act precisely, and it requires the disclosure of amounts paid or agreed to be paid for *commission*, but requires no disclosure of amounts paid or agreed to be paid as *brokerage*. As our law stands, it is not unlawful to enter into a brokerage agreement, nor is it necessary to disclose the amount of brokerage paid in the balance-sheet, or in the prospectus, or in the statement in lieu of prospectus.

We are of opinion that the English Act has been followed here without any knowledge or recognition of the foregoing facts. In the meantime, there has grown up an established calling whose members undertake the sale of shares for a remuneration called brokerage. Round the practices of the members of this calling there have grown up serious abuses, but as the law stands there is no statutory check on these abuses.

We therefore recommend,—

(85) That there be added to section 55 of the Companies Act a new provision requiring that there be stated in every balance-sheet of a company a statement of all sums paid by way of brokerage (as distinct from commission) in respect of any shares or debentures issued by the company, and that brokerage on debentures shall be provided for out of share capital.

(86) That the matters required in the prospectus or statement in lieu of prospectus include all payments made or to be made by way of brokerage.

2. AUDIT OF LIQUIDATORS' ACCOUNTS IN VOLUNTARY LIQUIDATIONS.

It is provided by section 231 of the Companies Act, 1933, that, in the event of a voluntary winding-up continuing for more than a year, the liquidator shall summon a general meeting of the company at the end of the first year and of each succeeding year, and lay before the meeting an account of his acts and dealings and of the conduct of the winding-up during the preceding year. There is no provision in the Act providing for the audit of the accounts of such a liquidator, and we are of opinion that this omission should be remedied. Firstly, it is desirable as an ordinary business precaution in relation to all such accounts. Secondly, it should be a protection to creditors and shareholders against the possibility of a winding-up being unduly drawn out, with the result that its assets tend to be dissipated by the costs of liquidation.

We therefore recommend,—

(87) That there be added to section 228 of the Companies Act, 1933, a provision that the company in general meeting, on appointing liquidators, shall also appoint an auditor or auditors to audit the liquidator's accounts, and shall fix his remuneration.

3. AUDITOR'S NAME ON PROSPECTUS.

We have in the course of our inquiries come across many cases in which a prospectus of an intended or newly-formed company has been issued bearing on its face the name of a reputable and well-established firm of auditors. In many such cases we have ascertained that those auditors have never been called upon to perform any duty in that capacity, in relation to the company. The auditors are so named on the prospectus by the promoters, but they are not actually appointed, for there is (at that stage) no company to appoint them; and, even if they are eventually appointed to act, it may well be twelve or eighteen months before they are called in. In the meantime, their names have been published on the prospectus, and that publication may have influenced many persons favourably towards the project set out in the prospectus.

We recommend,—

(88) That every auditor named in the prospectus of a company shall have the rights given to the auditor of a company by subsections (2) and (3) of section 141 of the Companies Act, and shall, if and when required by the Corporate Investments Bureau, examine the books and records of the company and report on the same to the Bureau at the expense in all things of the company, or of the directors and promoters named in the prospectus.

4. SIMILARITY IN NAMES OF COMPANIES.

Section 30 of the Companies Act, 1933, provides restriction on registration of companies by certain names. This includes the provision that no company shall be registered by a name which is identical with that of a company carrying on business in New Zealand, whether registered in New Zealand or not. That provision would be effective to prevent a New Zealand company from registering with the name of, say, an Australian company carrying on business in New Zealand. We have, however, had our attention drawn to a case in which an investment trust company has been registered in New South Wales with a name identical with that of an investment trust company registered in New Zealand.

We recommend,—

(89) That the Governments of the Australian States be approached and invited to reciprocate with the Dominion in legislation designed to meet this difficulty, and an administrative practice to make that legislation effective.

5. ABUSE OF PROVISIONS RELATING TO PRIVATE COMPANY.

We have in the preceding parts of this report referred to certain abuses arising from the recognition of and provision for private companies. There is another abuse to which our attention has been called, and which we have verified by conference with the Registrar of Companies in Wellington and the Assistant Registrar in Auckland. There have been several cases in which a private company has been formed to take over an existing business by the common method of assuming the business as a going concern. The practice we desire to call attention to involves the allotment to the vendors (the original proprietors) not of shares, but of mortgage debentures, as the consideration for the balance represented by the excess of assets over liabilities. The vendor proprietors will, it is true, take a few shares merely to provide some subscription for shares on the memorandum of association, but it may be only five or ten shares of £1 each on the sale of a business worth many thousands. The result is that the late proprietors of the business become secured creditors; and if subsequently the business should prove to be unprofitable and should go into liquidation, these quondam proprietors exercise the ordinary rights of secured creditors under their mortgage debentures. They may thus take the assets, which will include stock in trade, and current creditors who have provided the stock in trade and other assets may receive very little, or nothing. It is unnecessary to labour this point. The practice needs only to be named and described to be condemned.

We recommend,—

(90) That a provision be included in the Companies Act to the effect that no mortgage or charge fixed or floating shall be given by a private company except in respect of a *bona fide* cash advance made by the mortgagees contemporaneously with the execution of the mortgage.

6. GENERAL PENAL CLAUSE.

There are some provisions in the Act which require certain things to be done by companies or officers of companies, but in respect of which there is no penalty if such things are not done.

We recommend,—

(91) That there shall be added to the Act a general penal clause providing a penalty applicable where any such act or thing is required to be done and no penalty is fixed in relation to any failure or refusal to perform such act.

7. EVASION OF LIABILITIES AND RATIFICATION OF IRREGULARITIES.

We now refer to two objectional devices, the first of which is designed to evade liabilities; the second to obtain the ratification of invalid acts. These are especially likely to be used when control is in the hands of a small group with a common interest opposed to other interests in the company. In the pursuit of the former objective the directors may assign for valuable consideration all rights of action which a company may possess against the directors or any of them in relation to any act or omission of such directors or any of them. The following case was put to us:—

A managing director feared the possibility of an action for recovery of moneys against himself by the liquidator of the company in the event of winding up. He therefore procured the assignment by the company to one of his friends of all rights of action the company might have against him for misfeasance or nonfeasance. This assignment was for a small cash consideration, and was made in the expectation that the friend would never use the right of action. It was intended, nevertheless, to be an effective bar against the future maintenance of any action by the company or any person on its behalf against the director concerned.

The second device referred to is that of a general ratifying resolution, of the kind sometimes described as a "whitewashing" resolution. Our attention was called to such a resolution, which was passed at a general meeting of the company attended only by friends and subordinates of the chairman of directors. It was in approximately the following terms:—

> "That this meeting approves of all the actions of the chairman covering the total operations of the company up to date, and hereby ratifies and confirms all things done by the chairman, whether sanctioned by the board of directors or not."

Practically all the funds used in the transactions and operations of the company were supplied by debenture-holders who were not represented at the meeting in question, and were not entitled to accounts, and had no voting-rights and no power to appoint an auditor.

We recommend,—

(92) That whenever on any proceedings based upon or involving an inquiry into the alleged acts or omissions of promoters, directors, or officers of a company a ratifying resolution of a meeting of directors or of a general meeting of the company shall be pleaded in bar of the proceedings, the Court shall have jurisdiction to inquire into the circumstances of the case; and if it appears to the Court that the alleged acts or omissions affect the interests of any persons or any class of persons who were not present or represented at the meeting in question, the Court may thereupon inquire into such acts or omissions and adjudicate thereon as if such ratifying resolution had never been passed, whether the said resolution shall have been passed before or after this enactment.

(93) That whenever on any such proceedings a prior assignment of all rights of action by the company shall be pleaded in bar of the proceedings the Court may inquire into the circumstances in which such assignment was made; and if it appears to the Court that the said assignment is collusive only and designed to protect promoters, directors, or officers of the company the Court shall have power to declare such assignment to be collusive and invalid and to set it aside accordingly.

8. SECTION 50 OF THE COMPANIES ACT.

This section deals with the minimum subscription required to be stated in a prospectus, and it provides that if the minimum subscription is not obtained within four months from the date of issue of the prospectus all moneys received from applicants for shares shall be forthwith repaid to them without interest. It has been represented to us that these provisions will be unduly restrictive in their application to large issues of shares, and, seeing that there is a distinct tendency towards large-scale capitalization, the time-limit in question might prove to be a prohibition to a legitimate and desirable enterprise.

This point is worthy of consideration, and we are of opinion that the difficulty would be met if a discretion were vested in some responsible authority to extend the period on proper and sufficient grounds being shown.

We therefore recommend,—

(94) That where after inquiry the Corporate Investments Bureau deems it to be in the public interest so to do, it may extend the period of four months to such longer period as the Bureau shall think fit, not exceeding eight months in all.

9. RECIPROCAL ACTION WITH AUSTRALIAN GOVERNMENTS.

We have in one division of this part referred to the necessity of reciprocal legislative action with Australia. We desire to call attention to the fact that several problems arise out of the operation of Australian companies registered and acting in New Zealand as foreign companies, and *vice versa*. Several of the difficulties and problems created by this practice appear to require negotiation between the Dominion and the Australian Governments, followed by reciprocal legislation, and we desire hereby to call attention to this aspect of company legislation and administration.

10. EVIDENCE OF STATE FOREST SERVICE.

Amongst the most valuable evidence which we have received is that presented by the Director and officers of the State Forest Service. Much of this evidence, which is separately presented in Appendix No. VII, falls within the scope of our inquiry, and has been used in this report. Much of it relates to matters of considerable economic importance having a bearing on future Government policy. Such matters fall outside our terms of reference, and we have no special qualifications to deal with them. There is, for example, the evidence relating to the commercial prospects of afforestation and costs of establishing forests. This appendix must rank as an invaluable contribution by disinterested experts.

We recommend this evidence to the attention of Your Excellency's Advisers in case it raises issues demanding further inquiry or affecting Government policy.

11. TRUSTEE SHAREHOLDERS—A VULNERABLE POINT IN THE COMPANIES ACT.

The Companies Act, 1933, embodies two conflicting principles. The first may be stated thus: Members of companies are required, as the price of the undoubted advantages of incorporation, to disclose their identity in a register kept at the company's office, and on records in the office of the Registrar of Companies.

The second principle may be stated thus: As between the company and its members, a person whose name is so disclosed on the register of members shall be viewed, for all purposes, as the real member, and the company shall never be called upon to inquire as to whether such registered member is the real owner of the shares or not. Furthermore, the company shall never be fixed with any duty or liability at the instance of one who claims to be the real owner of the shares on the ground that the registered owner is a trustee for such claimant. This second principle is embodied in Section III of the Act, which provides that "no notice of any trust, express, implied, or constructive, shall be entered on the register or be receivable by the Registrar."

The interplay or conflict between these principles provides a loophole that has let in many nefarious practices. A director of or investor in a company desirous of putting any such practices into operation, and requiring the rights inherent in a certain number of shares to effect his purpose, does so by finding some person willing to act as his nominee, or "dummy," in the matter. This nominee applies to the company for shares, or purchases shares from an existing member, and has the allotment or transfer, as the case may be, registered in his own name on the company's register of members, and at the office of the Registrar of Companies. Thereafter, under the safe cover of this device, the real operator may put his transactions through without any disclosure of his identity with the transactions. The very least of the evil is that any members of the public who search the records to ascertain the identity of the members of a company fail to learn that the operator in question is a member of the company. At the worst, the position may be that the inquirer is positively deceived.

The practice we are now describing is a device that has tended to facilitate all or nearly all of the worst of the evils disclosed in the foregoing pages. We believe that in scale and effect the practice has now reached a stage when it is an appreciable menace to commercial morality, and the public interests demand that, if possible, it should be ended.

There is no single feature of the Act, as at present framed, that so facilitates questionable practices as the use of "dummy" names on the register of members for the purpose of hiding the identity of questionable operators.

We believe that there is a simple remedy which, if put into operation, will inform the public of the true identity of shareholders and at the same time will not add to companies any burden or possible liabilities in relation to trusts. Section 106 of the Companies Act, 1933, provides that, with the exception there named, every company shall keep an index of the names of its members according to its register of members. We propose, firstly, that the qualification shall be removed from this section, making it applicable to all companies; and, secondly, that it shall be enacted that wherever the registered owner of shares according to the register of members of a company is a trustee or a nominee for some other person that fact must be notified to the company and recorded in the index of members, as a memorandum for the information of the public. An enactment to this effect should and may provide that this requirement shall be without prejudice to the provisions of Section III of the Act. We suggest that substantial penalties should be attached to failure to comply with this proposed provision of the Act.

We therefore recommend,—

(94A) That section 106 of the Companies Act, 1933, be amended—

(i) So that every company shall keep an index of the names of its members;

(ii) To provide that (without prejudice to Section III) all trusts in relation to shareholdings in a company shall be notified to the company, and a minute of the same shall be entered opposite the shareholder's name in the index;

(iii) So that non-compliance with this provision shall be a punishable offence, and that any trusts not so notified shall be unenforceable at law or in equity.

PART VIII.—OPERATION OF THE PRESENT STATUTE GOVERNING THE CONSTITUTION AND REGISTRATION OF STOCK EXCHANGES IN NEW ZEALAND.

1. ECONOMIC FUNCTIONS OF A STOCK EXCHANGE.

The primary function of a stock exchange is to establish a market in which standardized securities of all kinds may be bought and sold. In the main, the market is concerned with the purchase and sale of securities of established concerns, but, in addition, brokers who are members of an exchange may assist in the disposal of securities of new enterprises.

The members who form an exchange perform a complex of functions on which the effectiveness of the market depends. In the first place they act as intermediaries between buyers and sellers, arranging transactions in parcels of a size to suit buyer or seller, or both. As specialists in investment they are able to advise clients as to the relative merits of different securities, their value as an investment, and the best time to buy and sell. By forming a market in which buying and selling are active they establish a price for each security dealt in, and this tends to move more closely in accord with the actual or prospective value of the security as a source of income than if no such market existed. This is true despite conspicuous exceptions such as the gross inflation of security values during the Wall Street boom, and the fictitious value attached to securities involved in the Hatry and other scandals.

The determination of a price has a directive influence on new investment, since a rise in the price of securities in a particular type of enterprise draws the attention of company promoters to profitable avenues for new investments.

The existence of an active market on which securities may readily and easily be bought and sold facilitates investment in established securities, because it becomes easy to buy. The opportunity of ready sale which it offers is equally important, because it enables the investor to turn his investment into cash by sale to a new investor while still permitting of a continuity of investment in an undertaking through the transference of the function of investing from one person to another. In short, a continuity of investment becomes possible by the linking-up of a number of short and discontinuous investments by individuals. For similar reasons investment in new enterprises is encouraged because the purchaser of securities in such enterprises anticipates that they will later be quoted on an exchange and thereby become readily saleable.

The net result is that, though the investor bears the risk inherent in the enterprise, he is able largely to avoid the risk of holding a security which is "frozen" at a time when he may want to convert it into cash.

If an exchange is properly performing its function, he is able to make a reasonable assessment of the risk, both by making use of the advice of brokers, who are specialists in investment, and by noting the relationship between the price of a security and its yield.

Certain conditions are essential for the establishment of an effective market. In the first place. there must be a sufficient number of members in contact to make for active buying and selling. Secondly, meetings on the exchange must be frequent enough to enable business to be practically continuous, Thirdly, the efficiency and integrity of the individuals who comprise the exchange must be such as to create a justifiable feeling of confidence among investors.

While the first two conditions are essential, we attach special importance to the third. Since the investor relies largely on the advice of the professional broker, he must be reasonably assured that the advice which he receives is disinterested and not actuated either by the personal interests of the broker or of other parties for whom he is acting. This is all the more important in that stock exchanges usually list securities, and such listing is regarded as an assurance that the issuing

companies or authorities are sound and honest. In addition, the name of a member of an exchange on a prospectus is regarded as evidence that it has been investigated by a reputable and experienced specialist who considers it a good investment. Further, brokers should be men of financial standing because they may be required to undertake at least temporary liability for a purchase, if their client fails to complete the deal. In all dealings on the stock exchange brokers act as principals to each other, and the buying broker must pay on delivery of valid documents. From unavoidable causes a broker frequently has to advance considerable sums on account of his client.

Provisions usually made to ensure that brokers are men of standing, character, and some financial strength are—First, a careful consideration of applicants for membership of an exchange; second, the formulation of rules under which members must operate and violation of which may lead to expulsion or other penalties; and third, in some countries, the public licensing of brokers and the requiring of approval of the rules of an exchange by some public authority.

It is far from being contended that stock-exchange operations are free from abuses, or that the regulation and control of their operations should be left entirely to the exchanges themselves. It is clear, however, that organized stock exchanges perform valuable economic functions which justify their existence under modern conditions. Normally they develop a tradition embodying standards of business conduct which are higher than those in the unregulated market; and abuses are less serious, less frequent, and more readily checked. If any measure of further regulation and control is necessary it can be more readily applied through an organized market than through the unorganized market which operates outside an exchange, and which itself provides no regulating machinery or authority.

2. THE SECURITY MARKET IN NEW ZEALAND.

(1) The Stock Exchange Association of New Zealand and its Affiliates.

(*a*) *Organization.*—The Stock Exchange Association of New Zealand comprises seven affiliated exchanges, the membership of which was as follows in March, 1934:—

	Members.	
	Maximum.	Actual.
Auckland	40	30
Wellington	40	27
Christchurch	35	35
Dunedin		23
Invercargill		12
Gisborne		6
Taranaki		10
Total		143

Sharebrokers residing outside a radius of twenty miles from an exchange in any one of the four main centres may be elected country members. The country members were as follows: Auckland, 7; Wellington, 34; Christchurch, 16; Dunedin, 11: total, 68.

Country members are entitled to trade with members of affiliated exchanges at net rates. They are bound by the rules of the exchange to which they are attached, but have no voice in the management. Each affiliated exchange has a room or building in which business is transacted.

The control of the Stock Exchange Association of New Zealand is in the hands of representatives appointed by the affiliated exchanges in proportion to membership. These meet in conference annually and pass rules for the conduct of the affiliated exchanges. The executive committee consists of the chairman of the four metropolitan exchanges, and acts between conferences.

(*b*) *Rules.*—Each affiliated exchange has its own rules. In addition there are the rules of the Stock Exchange Association of New Zealand. These over-ride the rules of the affiliated exchanges in the event of a difference.

The Stock Exchange Association of New Zealand may inflict penalties on members of affiliated exchanges, or may fine an affiliated exchange, or cancel affiliation.

The rules relate to such matters as conditions of membership, entrance fees and annual fees, forfeiture and disposal of interest in membership, management and control, commissions, meetings for business, and the conduct of such meetings, quotations, delivery, and settlement, penalties for violation of rules, and so on.

The rules of a stock exchange must be approved by the Governor-General in Council and gazetted before they are permitted to come into force.

(*c*) *Membership.*—Membership is confined to licensed sharebrokers. Limited liability companies are not eligible for membership. In three out of the four metropolitan exchanges there is a maximum limit to membership. In one case only, that of the Christchurch exchange, is actual membership equal to the maximum.

Application for membership in an exchange must be supported by two members of at least twelve months' standing. The applicant must then satisfy the committee of his financial position and integrity. He is then elected by ballot, the rules laying down the majority necessary for election. The entrance fee is usually high, on the grounds that the elected member is buying a valuable vested interest.

We would draw attention to the fact that the existing stock-exchange members in no sense possess a monopoly of organized brokerage in New Zealand. In only one exchange is the maximum membership filled, and this maximum could be increased. Witnesses deposed that applicants for membership of good repute and adequate financial backing are not likely to be refused. A substantial payment for a seat is required, but this is a common practice in other countries and is

justified on the grounds that membership gives a share in a valuable business interest, as well as in the assets of the exchange. These assets are built up by the original purchase price of seats, and are augmented by a substantial proportion of the goodwill obtained when seats are transferred.

Further, there is nothing to prevent new exchanges from being formed. From time to time ephemeral exchanges have, in fact, been established, while an existing body, the Stock Exchange Corporation of New Zealand, was formed recently, and another is in process of formation.

(*d*) *Calls and Quotations.*—The metropolitan exchanges hold two, or in some cases three, calls daily, at which a price is established for the securities dealt in. The average daily attendances at the metropolitan exchanges for 1933 were as follows:—

	Number of Members.	Average Daily Attendance at Calls.
Auckland	30	25
Wellington	27	17
Christchurch	35	27
Dunedin	22	19

Having regard to the small size of the security market in New Zealand, these attendances appear to be sufficient to ensure the proper establishment of a price, especially when interrelations between exchanges are considered.

In addition to establishing a price, which is not likely to vary by very much or for more than a short period in different parts of New Zealand, the exchange performs a useful function in making public the price quotations from day to day. On this point witness No. 22 stated,—

> "We hold two calls daily and one on Saturday. Our quotations of prices at such calls are made public by handing them to the press immediately after the call; the members have their notice boards outside their offices; and the secretary has a copy of the quotations. These are taken from a book in which entries are made as the call proceeds, and it is initialled by the chairman. The rule is that sales completed between the calls are reported at the next call by the selling broker. Our secretary also supplies to the broadcasting company and the quotations are given over the air. He also writes a short *résumé* each day, and every week a *résumé* is published in the press. I think that these two features of publishing quotations and personal attendance at calls are essential features of a stock exchange, and that they are of paramount importance. A body that did not possess those features I would not consider a true stock exchange. They do not help to establish prices, and that is the chief feature of a stock exchange. I have spoken of the daily call and the publication of prices as being of paramount importance, and I think it is desirable that these should be made essential features of a stock exchange by legislation."

(2) The Stock Exchange Corporation of New Zealand.

This concern was registered as a limited-liability company in November, 1931, with a capital of £10,000 divided into 15,000 preference shares of 10s. each and 25,000 ordinary shares of 2s. each. It was one of the companies in the Investment Executive Trust Group. As at 7th March, 1932, its shareholders were as follows:—

Investment Securities Association	9,000
C. G. Alcorn	250
T. R. McArthur	250
W. C. Hewitt	250
V. B. McInnes	250
	10,000

Its directors were V. B. McInnes, S. Grange, and Thos. R. McArthur. All of the above shareholders or directors are closely connected with other companies in the Investment Executive Trust Group.

The corporation applied for registration as a stock exchange, the registration being refused on the ground that it was an incorporated company. On 3rd December, 1932, the name of the registered limited-liability company (the Stock Exchange Corporation of New Zealand, Ltd.) was changed to The British National Investment Trust, Ltd., and this company assumed the functions of a holding company through which the controllers of the Investment Executive Trust operated.

Application was at the same time made for the registration as a stock exchange, the name "Stock Exchange Corporation of New Zealand" (an incorporated body) being used. Since the corporation was no longer a company, it was registered as a stock exchange, the members being—

Victor Benbow McInnes	Auckland.
Stanley Grange	Auckland.
Thomas R. McArthur	Auckland.
Arthur Duncan Charles Dunn	Wellington.
Richard Glover Clark	Auckland.
Stanley Osborne Clarke	Wellington.
Osmond Arthur Bridgewater	Christchurch.

It will be noted that the seven members were resident in three different centres. Since that time thirteen members have been added, so that the corporation comprises twenty members. Of these, nine are in Auckland, four in Wellington, two in Christchurch, and five in Dunedin. The secretary to the corporation is Maurice Bates, who, at the time of writing, is acting as manager in New Zealand of the Investment Executive Trust of New Zealand, Ltd.

We extended to this exchange the same invitation to give evidence before us as was extended to the Stock Exchange Association of New Zealand and its affiliates. The latter appeared before us and freely answered all questions put to them. Mr. Maurice Bates, as secretary to the Stock Exchange Corporation of New Zealand, refused in the following terms:—

"Stock Exchange Corporation of New Zealand.

"We are instructed by this corporation that they do not propose to disclose any of their business to a Commission which is pecuniarily interested. The Christchurch Stock Exchange, of which Mr. Graham is a member, will benefit by any legislation that reacts adversely to the Stock Exchange Corporation of New Zealand."

In the face of this refusal we were unable to obtain direct evidence or give the Stock Exchange Corporation of New Zealand the opportunity of replying to criticisms; but it is clear to us that the corporation possesses serious shortcomings, which make it impossible for it to operate satisfactorily as a stock exchange.

In the first place, the undoubted connection of the corporation with the Investment Executive Trust Group presents a serious danger, which would not be entirely removed if this group of companies was beyond reproach. It is clear that the members of the corporation will be under a persistent temptation to temper their advice to clients by considerations relating to the investment policy of the Investment Executive Trust and its affiliates. It is too much to expect that individuals so closely connected with the trust will give entirely disinterested advice to clients, for the pecuniary interest of many of them is involved in the fortunes of the trust group as directors, shareholders, brokers, or officers.

In the second place, it should be apparent that the Stock Exchange Corporation of New Zealand cannot properly function as an exchange. The number in personal contact in any one centre is too small to establish a market, and apparently they neither hold daily calls nor make published quotations. As a basis for business, the corporation must, in these circumstances, rely on the quotations determined by the old established exchanges.

We draw attention also to the similarity in name between the Stock Exchange Corporation of New Zealand and the established Stock Exchange Association of New Zealand. Witness No. 23 said,—

"I think there should be provision in the Sharebrokers' Act giving protection to existing stock exchanges and the association against a similarity of name, in the same manner as is provided in the Companies Act, 1933, against registration of similar names. There have been evidences of such similarity in the form of 'The Stock Exchange Corporation of New Zealand.' Correspondence has been delivered to the corporation which was addressed to the president of the association."

We are of opinion that the general public is even more likely to make a mistake of this sort than a careful department such as the Post and Telegraph Department. Great care should be taken to obviate the possibility of similar occurrences in the future.

(3) The Dominion Stock Exchange.

This is an exchange which is in the process of registration at the time of writing. We have no comment to make other than to draw attention to the name. The exchange is a local one, operating in Wellington. We consider it unfortunate that the law permits of a name which gives a purely local exchange an apparently national status, and in the process prevents the use of the name in the future by nation-wide organizations. Our intention was to recommend that the use of such a name by a local exchange be prohibited. We find that the practice of using this name and names with a similar connotation is so common among other types of enterprise that it would be unfair to prohibit its use in this instance.

(4) The Outside Market.

This consists of a large number of independent licensed brokers or brokerage companies which are not members of an exchange. The market is therefore unorganized. Many of the constituents of the unorganized market are primarily engaged as brokers for particular companies such as bond-issuing companies, and many specialize in particular types of business such as the sale of shares in mining companies. We are strongly of the opinion that insufficient care has been exercised in the past in the granting of licenses to such individuals or companies.

3. RECOMMENDATIONS.

(1) Size of Membership.

We have drawn attention to the fact that a stock exchange cannot properly exercise the function of establishing a market (this being the main justification for the association of individuals in the form of an exchange) if the membership is small or scattered. We consider that individuals are not entitled to the privileges which go with registration of an exchange unless they are in a position to perform the functions of such a body. Under the present Act the minimum membership required before an exchange can be registered is fixed at seven, without reference to their place of residence or business. We consider that this number is too low and that a body comprising seven members is an exchange in name only. Nor can an exchange operate if its members are resident in different towns.

Accordingly, we recommend,—

(95) That the minimum membership of any stock exchange registered in New Zealand shall be as follows :—

In towns with a population of not more than 20,000 inhabitants, 12 members ; 50,000 inhabitants, 15 members ; over 50,000 inhabitants, 20 members.

(96) That for the purpose of the computation of membership as above, the separate members of any firm or the employees thereof shall not be considered separately, but only one member shall be counted for each such firm.

(97) That the members of any such exchange shall be resident within a twenty-mile radius of the post-office of the town in which the exchange is formed, and that their place of business shall be located in such town.

(98) That all existing stock exchanges shall be required to conform to the above conditions within a period of six months from the passing of the Act embodying the above recommendations ; and that failing compliance registration shall be cancelled.

We regard it as important that membership of an exchange shall be effective and not nominal, and

We recommend,—

(99) That the Secretary of an exchange shall keep a roll of members present at all calls of the exchange, as hereinafter provided for.

(100) That any member who attends less than two-thirds of the calls in any financial year of an exchange of which he is a member shall forfeit membership, provided that the Stock Exchange Association of New Zealand may reinstate such member in cases where, in its opinion, a good and sufficient reason is shown.

(101) That where the membership of an exchange falls below the minimum numbers set out in Recommendation No. 95 above, for a period of three consecutive months, the Corporate Investments Bureau shall have power to cancel the registration of such exchange.

(102) That the Corporate Investments Bureau shall have power to cancel the registration of an exchange where the average attendance at calls falls below the following for any period of six months ended 31st December and 30th June in any year :—

In towns with a population of not more than—

20,000 inhabitants, an average attendance of 8 members.
50,000 inhabitants, an average attendance of 10 members.
over 50,000 inhabitants, an average attendance of 15 members.

(2) Calls and Quotations.

We recommend,—

(103) That every registered exchange shall have a regular place of meeting, the location of which shall be notified to the Corporate Investments Bureau.

(104) That at such place of meeting calls or meetings shall be held at least once daily save on such public holidays or other occasions as are prescribed in the rules of the exchange.

(105) That sales and quotations made at such calls or meetings shall be made available to the press for publication on the day during which the calls or meetings take place.

Since quotations of the prices at which small parcels are sold may be misleading, we recommend,—

(106) That no sales be recorded save where the number or value of securities sold is equal to or greater than the following :—

(*a*) Local-body debentures £200 face value.

(*b*) New Zealand Government stock, bonus, or debentures—
Where free of tax £500 face value.
Where not free of tax £200 face value.

(*c*) Other securities except mining shares : 100 shares or £100 worth, whichever is lower in value.

(*d*) Mining shares—

Up to 1s. quoted price	**300 shares.**
Over 1s. to 2s. 6d. quoted price	**200 shares.**
Over 2s. 6d. to 5s. quoted price	**100 shares.**
Over 5s. quoted price	**50 shares, or £50 worth.**

(3) Organization and Control of Stock Exchange.

We have come to the conclusion that the organization and control of stock exchanges and the statutes governing brokers and stock exchanges in New Zealand are inadequate to protect the investing public and the reputation of reliable brokers and exchanges. The law relating to sharebrokers and stock exchanges is embodied in the Sharebrokers' Act, 1908 (No. 176), and the Finance Act, 1931 (No. 4), section 17. These provide for the licensing of sharebrokers and the registration of stock exchanges, which may adopt rules subject to the approval of the Governor-General in Council.

The main dangers appear to be two:—

(i) The licensing of sharebrokers appears to have been regarded in the main as a formal matter. The only statutory requirement is that the application for a license must be approved by a Magistrate who is required to satisfy himself as to the fitness of the applicant. The practice seems to be to require the applicant to submit, with his application, testimonials as to his general character, and a statement of his financial position; and to require the police to submit a report. This does not necessarily imply a high standard, and men of little financial strength and standing have received licenses. We are of opinion that more care should be exercised in the licensing of sharebrokers, and make recommendations on this matter below.

(ii) There appears to be little to prevent people from forming a stock exchange whose sole qualifications are that they have been granted a license according to the above standard and practice, and because they wish to form an exchange. The Act requires that the rules of such an exchange must be approved by the Governor-General in Council, but this provides no assurance that they will be observed. There is nothing to prevent a stock exchange or its members from operating in the interests of financial groups, listing companies which a reputable exchange would refuse to list, or lending their names to the prospectuses of dubious companies. Since the investor is not always in a position to discriminate between exchanges which have a reputation to maintain, and those which have a reputation to hide, or between honest brokers and those who might be described in other terms, the existing legislative and administrative policy may be conducive to much damage to investors, or to the existing exchanges with which new exchanges may be confused.

The problem is to devise a system of organization and control which will ensure that the business of dealing as a member of an exchange remains an honourable profession without giving existing exchanges a monopoly. Existing exchanges are not entitled to make any claim to a close preserve, but they are entitled to expect that no exchange shall be formed except under such a system of uniform organization and control as will associate the enjoyment of privileges with the exercise of responsibility.

Having regard to the above situation, we recommend as follows:—

(107) That the Stock Exchange Association of New Zealand be incorporated by statute as a society or association.

(108) That all stock exchanges at present existing or hereafter established shall be affiliated to the Stock Exchange Association of New Zealand.

(109) That the Stock Exchange Association of New Zealand shall prepare rules governing such matters as conditions of membership, the conduct of stock exchanges, and the infliction of fines or other penalties on affiliated stock exchanges, such rules before adoption to be approved by the Governor-General, on the recommendation of the Corporate Investments Bureau.

(110) That the rules of all stock exchanges shall be approved, before adoption, by the Governor-General in Council, on the recommendation of the Corporate Investments Bureau.

(111) That in the case of conflict between the rules of the Stock Exchange Association of New Zealand and of any Stock Exchange, the rules of the former shall override those of the latter.

(112) That the control of the Stock Exchange Association of New Zealand shall be in the hands of a conference which shall meet at least once annually.

(113) That each Stock Exchange shall be entitled to representation at such conferences on the basis of one representative for each ten members and each fraction thereof exceeding five, but less than ten.

(114) That there shall be an executive committee which shall be elected annually by the conference.

In addition, we recommend,—

(115) That every broker or salesman of shares or other securities shall be registered with the Corporate Investments Bureau.

(116) That each broker or salesman of shares or other securities whose name is placed on the register shall be an individual, and in no case shall a limited liability company be registered.

(117) That every applicant for registration shall be required to apply in writing to the Corporate Investments Bureau, giving such particulars as are required by the Bureau.

(118) That accompanying the application for registration there shall be required—

(*a*) A certificate of approval from the Magistrate presiding or exercising jurisdiction in the district in which the applicant resides;

(*b*) Such financial guarantees as may be required from time to time by the Governor-General in Council.

(119) That applications for membership of a Stock Exchange shall be approved by the Corporate Investments Bureau, and the applicant shall then be eligible for membership of such Stock Exchange subject to election under its rules.

(120) That power to cancel membership for a breach of its rules shall lie with a Stock Exchange in respect of its members, subject to the rules of such Stock Exchange.

(121) That subject to a right of appeal to the Court, the Corporate Investments Bureau shall have power to cancel the registration of any broker or salesman of shares or other securities, or to close any Exchange.

(122) That the Stock Exchange Association of New Zealand shall present an annual report to the Corporate Investments Bureau on such matters as are required by the Bureau, together with reports on such special matters as may be demanded from time to time.

In regard to the listing of securities, it is recommended,—

(123) That the Corporate Investments Bureau shall have power to veto the official listing of any security on any Exchange.

It is further recommended,—

(124) That the proposed Act incorporating the Stock Exchange of New Zealand shall embody the foregoing recommendations.

PART IX.—CORPORATE INVESTMENTS BUREAU.

We must not make a scarecrow of the Law,
Setting it up to fright the birds of prey,
And let it keep one shape till custom make it
Their perch and not their terror.
—*Measure for Measure.*

1. THE CASE FOR A BUREAU WITH LIMITED AND DEFINED DISCRETIONARY POWERS.

The foregoing sections of this report have demonstrated the existence of serious evils connected with company promotion and with the conduct of companies after they have become established. It should be unnecessary for us to labour the obvious fact that these evils have been possible despite the existence of a considerable body of law designed to prevent abuse and protect the investor. Yet it is this very imperfection of the law, as an instrument of control and correction, which has forced us irresistibly to the conclusion that the time is overdue for the adoption of a new principle designed to strengthen and supplement the operation of the law as it applies to companies. This principle consists in the vesting of a defined and limited discretionary power in the hands of a body which we describe as a Corporate Investments Bureau. The constitution and powers of such a Bureau are considered below.

The case for the establishment of such a Bureau may be stated thus,—

(1) The statement and proper application of the law demands the formulation of precise definitions which shall include all persons, corporate bodies, conditions, or actions, possessing the characteristics relevant to the purpose of the law, but which shall exclude all others. Unfortunately, the characteristics capable of such definition are not always those which really matter, while on the other hand the characteristics which matter in some instances are irrelevant in others. The intention of the law may be frustrated both because it is frequently impossible to include all relevant examples or types without at the same time including examples or types in which the law is not interested; and because astute lawyers may evade the law by superficial changes which leave the real character of a transaction unaffected.

We may illustrate this problem by reference to difficulties with which we have been faced in preceding pages in our report. In our view it is necessary that special legislation should apply to investment trusts; but while careful inquiry should demonstrate clearly enough when a company or other concern is operating as an investment trust, we are unable to frame a satisfactory legal definition covering all companies which so operate but excluding all others. Similarly it is necessary to legislate in regard to subsidiary or affiliated companies, but neither the definition in the Companies Act, 1933 (section 135), nor any other definition which may be devised is likely to be deemed satisfactory, because such a definition must be in terms of readily discernible, concrete characteristics such as shareholdings in each other, common shareholdings, or directorates. The real determinants are common control and common purpose, but these may be made in a variety of ways which are incapable of effective definition in concrete terms; conversely, shareholdings in each other and common shareholdings or directorates, though superficially indicative of common control or common purpose, may, in fact, be quite misleading as evidence of subsidiary or affiliate relationships.

We consider that in these and similar cases power should be given to a Bureau such as we recommend to determine whether or not a particular company comes within a particular definition or legal provision, such a decision being subject to appeal to the Courts.

(2) The law is not sufficiently flexible as an instrument of control or correction. Usually substantial changes in statute law occur at wide and infrequent intervals. Hence evils may be rampant for years before a remedy is applied. A Companies Act was passed in 1908. Some twenty-six years later a new Act was passed. The setting-up of the present Commission is *prima facie* evidence that even this was not considered entirely adequate. Further, many of the abuses revealed in this report have been in existence for at least ten or twelve years, and were legally possible under the Act of 1908. Many of them are legally possible under the Act of 1933. (This point was emphasized, in effect, by the

Hon. the Minister of Finance in introducing the Companies Act of 1933, and by the setting-up of the present Commission.) Such a state of affairs is no reflection either on the Legislature or on its advisers. It merely serves to demonstrate that the law can only provide against abuses which have already appeared, and only to a limited extent in anticipation of evils which may yet appear; that a law appropriate to one set of circumstances is no longer appropriate when those circumstances change; and that it is not beyond the wit of men to devise safe means of circumventing the law, or even of making it

Their perch and not their terror.

We are impressed with the gravity of the dangers which may arise during the present period of extraordinarily rapid economic and social change if the rigidity of the law unduly hampers social change or leaves too many loopholes for anti-social practices. In so far as the law relating to companies is concerned, we believe that a Corporate Investments Bureau could perform a valuable service by exercising a continuous watch for new tendencies and scrutiny over the operation of existing laws. It would then be in a position to recommend legislation to prevent abuses or remove restrictions as the need became apparent.

(3) Even though the law may be adequate and wisely conceived, it may be ineffective because it is not called into operation. This may arise, first, because it is nobody's business to put the law into operation. This applies, for example, in the case of prospectuses. The formal fufilment of the requirements of the law insisted upon by the Registrar of Companies provides some, but insufficient, safeguard against misrepresentation and other abuses, and we think that the prior oversight of prospectuses by a Bureau would have a salutary effect and act as a powerful deterrent.

This ineffectiveness may arise also because shareholders may be unaware of abuses in the companies in which they are interested, or because it is unduly difficult for a sufficient number of them to take action as a body. Further, there may be a strong personal disinclination on the part of a director, who has gradually become aware of undesirable tendencies and practices, to lay an information against co-directors. The powers of inspection which we recommend be given to the Bureau would act as a deterrent to such abuses and make them easier to discover and check.

The case for some modification of the traditional attitude is strengthened not only because we have already entered upon an era in which change is extremely rapid, but also because many of the companies now established, or likely to be established in the future, exhibit features which are new to New Zealand. The scale of operations, measured in value of capital, is substantially larger than was contemplated in the past, the methods of raising capital are different, and subscribers for capital are scattered over wide areas extending to several other countries. As is shown in Part X, the good name and national credit of New Zealand overseas are closely involved in these developments.

2. PRECEDENTS.

We would point out that there are precedents for the adoption of the principles we have outlined in the preceding paragraphs, though in most cases the purpose has been somewhat different. Thus in March, 1926, the Government of Norway passed an "Act regarding the Control of Limitation of Competition and Improper Manipulation of Prices." In order to put this into effect an Office of Control and a Council of Control were instituted.

The powers of the Office of Control include many which are embodied in our Board of Trade Act, 1919 and 1923. The Office of Control must keep a register, in which are entered the names of all persons combined for the purpose of regulating prices or conditions of production and marketing, together with arrangements and agreements for the above-mentioned purposes. The Control officials have power to demand information, powers of inspection, and power to cancel arrangements or agreements, or to dissolve associations and combines if such appear to be injurious.*

In the same way, more than one precedent for the principle we recommend could be found in the United States, but it will be sufficient to refer to two examples. The *New York Herald Tribune* of 27th April, 1934, quotes a report on *The Federal Securities Exchange Bill* submitted to the Senate on 26th April, 1934. The Committee which reported on the Bill recommended that the Act be administered by a commission of five specifically set up for the purpose. The Bill itself confers discretionary and elastic powers reinforced by penal and civil sanctions, including the infliction of criminal penalties. Imprisonment may be inflicted for violation of the statutory provisions of the Bill. In addition, the Commission may, in certain cases, suspend or withdraw the registration of an exchange or of a security, and suspend or expel a member or officer of an exchange. Where an exchange fails to adopt satisfactory rules for the conduct of its affairs it may order the adoption of such rules. It has powers to investigate alleged violations of the Act.

Strong support for the type of remedy herein recommended is also found in the influence and records of the Bureau of Securities under the control of the Attorney-General in the State of New York. Its distinguishing features and functions are: power to inquire; power to demand publicity; skilled investigators and administrators; prompt legal action to prosecute wrongdoers; and restrain improper practice by legal injunction.

---

* M. Clemens. Lammer's *Review of Legislation on Cartels and Trusts.* Publications of the League of Nations, C.E.1, 35, p. 16.

In his 1933 report the Attorney-General of the State of New York says: "Injunctive relief afforded by the Martin Act is, of course, effective in dealing with stock frauds, but **it is my belief, based upon experience, that nothing so much instils fear into the minds of fraudulent stock operators as criminal prosecution.**"

It is easy to believe the foregoing. A fraudulent stock operator or company promoter or director naturally fears the punishment that may follow a criminal prosecution; but preceding, and probably outweighing that, is the fear of publicity which will kill his schemes.

The principle of inspection and control was also recommended by the Liberal Industrial Inquiry Committee (Great Britain) in respect of certain types of company, defined in its report as "Public Corporations," the distinguishing features of such companies being size, diffusion of ownership, and especially, their preponderating position in their own industry and trade. In respect of such companies, the report recommends powers of inspection, investigation, and report, and, where necessary, remedial action in the public interest.*

The above schemes and proposals are mainly directed to the regulation and control of monopolies, the prevention of improper price-manipulation, or the control of Stock Exchange practices, but they are of interest to us in the present connection, because they embody the principle of a Bureau or Office, in which are vested powers of inspection, regulation, control, or prohibition, analogous to that which we contemplate in the more general field of company operation in New Zealand.

3. CONSTITUTION, POWERS, DUTIES, AND FINANCE OF PROPOSED BUREAU.

A. Name and Constitution.

It is suggested,—

(1) That a Bureau be established to be known as the Corporate Investments Bureau.

(2) That the Bureau be administered by a Controller and a Council of three members, known as the Corporate Investments Council, these members to be nominees of—

(i) The New Zealand Law Society;
(ii) The New Zealand Society of Accountants;
(iii) The New Zealand Stock Exchange Association,

respectively, and appointed by the Governor-General in Council.

(3) That the Controller, as a Government officer, shall have a skilled staff at his disposal, and be empowered, where necessary, to employ outside accountants and auditors.

B. Functions of Bureau.

(1) *Prospectuses and other Publications.*—We consider it important that control over company promotion should be exercised at the source. This will be achieved, in large measure, by the provisions embodied in the Companies Act, but, as has been pointed out, this is not likely to be fully effective. In addition, therefore, we propose that the Corporate Investments Bureau should exercise supervision over prospectuses and other publications. Copies of these should be sent to the Bureau, which would examine them for inherent defects or obvious non-disclosures. The names of directors, promoters, and brokers would be compared with the register and their records searched. Further lines of investigation might be suggested thereby. For example, it might be considered desirable to search land transactions at the Land Transfer Office, agreements and other documents at the office of the company or of the company's solicitor, and entries in the company's books.

Future procedure in relation to the prospectus would depend on the results of such inspection. In most cases amicable discussion would be sufficient to effect the necessary changes. In the exceptional cases where this did not suffice it would be a matter for the discretion of the Controller to decide whether or not an appeal should be made to the Courts for an injunction.

We think that oversight exercised in the above manner would have a considerable moral effect on company promotion, and that the occasions when action was taken through the Courts would be rare.

The prospectus would then be filed and made the basis of comparison when the statutory report and return were filed, or of further inquiry, if specific complaints should be made subsequently.

(2) *Powers of Definition.*—Throughout this report, and in the opening paragraphs of this section, we have indicated that the proper application of the law is rendered very difficult because, in many cases, it is impossible to frame definitions which include all relevant examples and types of transaction, or company, while excluding all others. By way of example, we have referred to the difficulty of framing a satisfactory definition of "subsidiary" or "affiliate" companies. We think that, in certain cases, the law may best frame definitions in more or less general terms, and that in such cases its effectiveness will depend upon vesting in the bureau the power to decide after inquiry that certain companies or transactions come within the definitions laid down. We think that such powers should be carefully limited and prescribed and the cases in which they may

* See "Britain's Industrial Future," pp. 94–96.

be exercised should be determined by Parliament. It must be noted that the purpose is not to fix or interfere with rights or to impose penalties, but to *determine* the application of particular definitions for the future.

(3) *Statutory Discretion.*—A discretion might be vested in the Bureau to relax, in appropriate cases, the provisions of the Act or any regulations where absolute inflexibility might work harm.

For instance, the time-limit of four months, fixed by section 50 of the Companies Act, 1933, as the limit of time allowed to a company to secure its minimum subscription is likely to be a prohibition in case of large issues or overseas offers. It might be considered desirable to allow the Bureau, if satisfied after inquiry that the law as it stands might endanger or restrict legitimate enterprise, to extend that period.

(4) *Registration of Stock Exchanges, Brokers, Company Promoters, Directors, and Officers, &c.*—The Bureau should keep a register of all promoters and directors of companies and of all companies on the register, as well as of valuers, brokers, share salesmen, and stock exchanges. No person should be competent to act in any of the foregoing capacities excepting whilst he is registered by the Bureau as the holder of such office.

No license should be issued by the Bureau to any such persons, and it should be a punishable offence for any such person by advertisement or notice to claim to be licensed, or on any document to be issued to the public to refer to the fact that he was registered, or to do any other thing calculated to lead the public to believe that he was licensed or in any way acting under the sanction of the Bureau or any Department of State.

The Council should have power to strike off the register the name of any person enrolled thereon when, in the opinion of the Council, his conduct in relation to the affairs of the company justified such action, or when, for any other reason touching the integrity of such party, the Council thought proper so to do. Any person whose registration is refused or whose name is so struck off the register should receive notice forthwith from the Bureau of such refusal or striking-off, and should have a right of appeal to the Supreme Court against the decision of the Bureau.

(5) *Powers of Inspection and Action.*—Attention has been drawn to the fact that, even where the law itself is adequate, there may be a variety of reasons why it is not likely to be put into operation. Unscrupulous men may rely on the probable immunity this gives to them to put through transactions from which they would be deterred if powers of inspection and report lay with the Bureau. During the past few months, we, as a Commission, have received numerous complaints for which there are legal remedies, but in respect of which the law has not been invoked. Our experience suggests to us that the Bureau would be used in the same way, and that this would provide a most powerful deterrent to undesirable practices.

Accordingly, we consider that the Bureau, through the Controller and his officers, should have the right of access to all books, documents, and records of all companies at all times. In brief, it should have rights of search and inquiry as full as those of the inspectors recently appointed under the Companies (Special Investigations) Act of 1934. All balance-sheets and published accounts of all companies should be sent to the Bureau promptly.

All auditors of companies should have the right to report to the Bureau confidentially, and, on the same basis, to invoke its assistance. Where in a prospectus the name of an auditor is mentioned as auditor of a proposed company it should be provided that he may be required by the Controller at any time to make an audit to date and report to the Bureau. All secretaries and officers of the company should be required to forward to the Bureau promptly copies of all minutes in either the minute-book of the general meetings or the minute-book of the directors' meetings, disclosing transactions and relations in which a director is personally interested. On the basis of information obtained from these sources the Bureau should have power at its discretion to call a meeting of shareholders or debenture-holders and to report to them. In appropriate cases, where a more drastic remedy is required, the Bureau should be in a position to apply to the Court for an injunction, or to institute proceedings alleging an offence against the Act. The powers of injunction which should be given to the Court should be to enable it to deal with practices described in general language to be interpreted by the spirit rather than the letter of the Companies Act. Unconscionable transactions and profits or commissions or fees should be subject to review by the Court, which should have power either to disallow them or to demand full publicity to the satisfaction of the Court. There is no new principle involved in this latter requirement, for the Courts have power now by certain statutes to inquire into transactions said to be unconscionable. The Court can even reopen such transactions after they are settled and order a refund or other settlement on a basis dictated by the Court.

Any act or course of conduct or business calculated or put forward with intent to deceive the public or the purchaser of any security as to the nature of any transaction or as to the value of such security should be subject to like powers in the Court. Where a provision or requirement in the Companies Act is inserted for the protection of the public or of investors, any form of words which, in the opinion of the Court, is either a mere colourable compliance with the Act, or is one which, while complying with the letter of the Act, is an intentional breach of its true spirit and intent, should be subject to like powers of the Act.

In relation to the above it should be the duty of the Bureau to institute prosecutions promptly in all cases which become known to them of breaches of the law. Offences should be stated in two classes—summary and indictable—and the Controller might, wherever he thinks fit, institute summary proceedings. In the case of indictable offences it should be the duty of the Controller to place the facts before the Council and to prosecute only by direction of the Council. In such cases the Controller's

function should be to recommend a prosecution, and the decision should be taken by a majority of the members of the Council, excluding the Controller. Complaint in any matter might be made direct to the Council, and if a majority of the Council directed a prosecution, either summary or indictable, the Controller should take action accordingly. The conditions precedent to an action for an injunction should be the same as those prescribed above for proceedings on indictment.

(6) *Secrecy.*—It should be enacted and required of the Bureau that the strictest secrecy be observed in respect of all information given to or obtained by the Bureau and its officers, save where the action required of the Bureau is one the nature of which requires publicity as a remedy or one which involves an application to the Court.

(7) *Relation to Stock Exchanges.*—Elsewhere in this report we have made recommendations relating to the constitution and control of stock exchanges and the control of sharebrokers. We consider that the Bureau should exercise powers of regulation and control over sharebrokers and stock exchanges. The Bureau should keep separate registers of sharebrokers and stock exchanges, and none of these should be permitted to operate if unregistered. The rules of stock exchanges should require the approval of the Governor-General on the recommendation of the Bureau. Application for registration of sharebrokers, salesmen, and stock exchanges should be made to the Bureau under the conditions recommended in Part VIII of this report, subject to appeal to the Court; subject to a right of appeal to the Court the Bureau should have power to cancel the registration of any broker, salesman, or exchange for a breach of or non-conformity with the law.

(8) *Reports of the Bureau.*—In order to facilitate desirable changes in the law, the Bureau should be required to make an annual report to the Minister in Charge on the operations of the Bureau for the year, and in that report should recommend such legislation as might be deemed necessary.

Once at least in every year each member of the Council should make to the body which nominated him a report on practices and methods and tendencies revealed to him by the work of the Bureau since the date of his last report, and bearing on the work of members of his profession or calling. Within three months of the receipt of this report the society or association in question should, by resolution, declare its policy in relation to such practices, methods, and tendencies, and communicate it to the Bureau. Every such resolution if and to the extent to which it is adopted by the Bureau should thereafter be taken into account by the Bureau in considering standards of conduct.

(9) *Finance.*—The cost of the Bureau would be small, and should be met by a levy on all companies, because, in the long-run, they will derive the benefits from its operation through the deterrent effects on undesirable practices. An annual registration fee might also be charged to sharebrokers and share salesmen.

We are unable at this stage to estimate the amount required, but think that the percentage levy on the capital of each company would be trivial. A small fee chargeable on the filing of each prospectus is also justifiable, and would make no appreciable levy on legitimate business ventures. It is suggested that each existing company should pay its annual levy with its annual license fee as required by the Stamp Duties Act.

We recommend,—

(125) That a Bureau be incorporated embodying the above powers, duties, and principles.

PART X.—NEW ZEALAND'S CREDIT OVERSEAS.

We have received disturbing evidence of the unenviable reputation which New Zealand enjoys in other countries as the home of unsound, often unscrupulous, company promotion. Possibly New Zealand is no worse in this respect than many other countries; nevertheless, its reputation should be a cause for concern. Scathing criticism of New Zealand companies, headed by contemptuous captions, are common in the Australian press. One such criticism more tempered than many, is as follows:—

"*Forestry Bonds—Are they Safe?*

". . . It is only recently that the bond-selling method of financing new ventures became popular. First adopted for the launching of forestry schemes, the plan was quickly extended to flax- and tobacco-growing enterprises. It has opened up a very lucrative field to the company promoter and attracted the savings of many small wage-earners, who, for the most part, know nothing worth speaking of about their investments. The alluring tails tied to the kites by some of the promoting organizations largely explains the success thus far attained in raising funds.

"Money raised by the sale of these bonds is inevitably expensive; there is, therefore, the danger of excessive capitalization. This has already been made abundantly clear in the Maoriland flax- and tobacco-growing industries. Generally speaking, the promoting organizations have placed themselves in positions to gather fine harvests as (1) vendors, (2) bond salesmen, and (3) managing-agents. Indeed, the pickings would make an old-time company promoter's mouth-water.

". . . The whole position calls loudly to the Australian and Maoriland Governments to take steps to place these companies under supervision and have their accounts and affairs independently audited. It should be said that some of the forestry companies have asked for these measures to be applied." (*Wild-cat Monthly*, Sydney, 7/6/30.)

Another criticism, expressive of a very general attitude towards New Zealand, reads as follows :—

"*Another Get-rich-quick Company Proposition from New Zealand.*

" . . . The company in question is known as ——, and, needless to say, has emanated from New Zealand." (*Smith's Weekly*, 3/2/34.)

In Great Britain also, criticism of New Zealand planting companies has been made in financial journals.

Criticism is, indeed, very widespread. One reliable witness who has visited many countries, stated in evidence,—

" . . . Not in a single country visited has evidence been lacking in this connection.

"It is common knowledge that many reputable financial critics and newspapers in Australia have roundly condemned not only the financial structure of the various companies, but also their misrepresentation of facts. In Melbourne, in particular, considerable discussion was experienced regarding the necessity for legislating against such operations, which had compelled the various insurance, bank, and other investing bodies to be much more cautious than previously over their New Zealand investments.

"In America the whole conception of the private forestation effort was likened to the eucalyptus boom in California at the end of last century, when millions of Australian trees were planted because of their phenomenally rapid growth. Except to beautify the landscape and provide local firewood-supplies, the effort was a failure, the wood not proving suitable for the poles, sleepers, and other purposes for which many of them had been planted. As far as I was able to ascertain, relatively few were planted by companies specially created for that purpose, but, commenting upon the operations of the New Zealand companies, the American authorities were definitely of the opinion that they transgressed the so-called "blue-sky laws" formulated in a number of States to prevent wild-cat promotion of this type. Invariably the authorities objected to the prostitution of the term "bond" in its investment significance, pointing out that, as used by the New Zealand forestation companies, it conformed only to the dictionary meaning of 'a writing by which a person binds himself to do some act,' whereas in the investment sense it failed to meet any of the accepted tests." (Witness No. 15.)

The witness stated that "A common complaint related to the laxity of the law in failing to provide adequate protection of investors' interests, the system of so-called trusteeship adopted by the companies being regarded as entirely misleading to those not versed in financial matters."

A report on official files by a Government officer who visited the East shows that the unsavoury reputation of some New Zealand companies has extended to the East Indies. It contains the following :—

"New Zealand is particularly well-known because of the systematized sale and advertising of forestry bonds in both Malaya and the Netherlands East Indies. Unfortunately, many responsible men in big businesses seem to be suspicious of this form of raising money outside New Zealand. They said that '*as friends of New Zealand*' they felt they should express the hope that all of the promises made in connection with these bonds will materialize. These gentlemen say that if these bonds do not turn out what they are represented to be New Zealand will eventually suffer seriously because of the natures of the natives, Chinese and Dutch, who are becoming bondholders in increasing numbers.

"I informed these people that, as far as I knew, the forests were being faithfully developed, and that I actually saw the trees growing well. I said that the value of the bonds on maturity was necessarily *estimated* on some basis of value of timber or pulp produced. Each retorted, rather abruptly, I thought, by saying that the *problematical element* was not sufficiently stressed in the advertisements appealing to this particular class of Eastern peoples." (File produced by Witness No. 15.)

In some cases overseas criticism may be extravagant and might apply equally well to local companies, but the findings in this report will have demonstrated that such criticisms are substantially justified by the operations of many companies.

The above conditions may have many bearings. Many companies are honest, well-conceived within the limitations of the method of finance and scheme of control adopted, and efficiently managed. Such companies are likely to suffer equally with those against which criticism is justifiable. They are likely to benefit from and should welcome legislation preventing unwise practices or legalized exploitation. In addition, companies promoted in New Zealand and seeking to raise capital in other countries are likely to suffer even though they may be operating in an entirely different type of business on well-established and orthodox lines; for they have the taint of origin in a country whose reputation has been besmirched by less scrupulous financiers.

The following more restrained criticism would suggest that this is no idle fear. We quote from a book entitled "The Call of the Southern Cross," by Ardaser Sorabjee N. Wadia, M.A., sometime Professor of English and History, Elphinstone College, Bombay; Dakshina Fellow in Natural History.

" . . . Frankly speaking, the thermal wonders of boiling springs and ever-bubbling mud-pools excited but my passing curiosity, nor would the rising forest industries have enlisted more than my passing interest had not the very enterprising forestry gentry taken a voyage of seven thousand miles to my native land and managed by holding out

high hopes of a 100 per cent. profit each year * to dispose of an enormous quantity of their bonds, mainly to a class of small investors who could ill afford to risk their hard-earned savings in any venture that had not a sound commercial basis. A well-known English stockbroker of Bombay, realizing his obligations to the investing public, issued to his clients a series of reports in which he attempted to prove, and not unsuccessfully, that the hopes held out by certain New Zealand forestry companies to their bondholders were so wildly extravagant that they would in no circumstances be able to fulfil them. As a consequence, one of the companies concerned sued the stockbroker in the Bombay High Court, and the Judge, while awarding on purely legal grounds contemptuous damages of a farthing to the company, observed that in his opinion the defendant had generally justified his remark that the company was not conducting honestly its business in India, an observation which reflected no credit on the New Zealand forestry business in general."

After describing his visit in the Putaruru district to a company's forest, where he saw " miles and miles of hills and dales all covered with well and evenly planted *pinus insignus* trees of three, four, and five years' growth," the author continues :—

" I have no manner of doubt that these serried ranks of young trees will in the course of the next fifteen or twenty years be magnificent forests, and will then be a very valuable national asset to New Zealand and its people, irrespective of the advantage or otherwise to the foreign bondholder. If the hopes held out to the bondholder depended for their fulfilment solely on the possession of fully grown forests, the companies without doubt would make good their promises in the next twenty years. But it is one thing to have forests as a good national asset ; it is quite another to have them as a good business proposition. I, therefore, throughout my extended tour of the two Islands, took to inquiring about the commercial possibilities of the forests. A local promoter of one of the companies had got out the story that as every man, woman, and child in New Zealand held a forest-bond, they had to come out to India to sell their surplus stock of bonds. Imagine, therefore, my surprise to find that the hundreds of New-Zealanders I came across on my tour not only held no bonds of any company whatever, but there was not the least enthusiasm about the forestry business among the people at large. On the contrary, they argued that owing to the prevalent high wages in New Zealand, the charges for cutting, milling, land-carriage, and water-transportation would be so prohibitive that they would practically absorb all the possible profits of the business. ' Even were it otherwise and the business as profitable a proposition as your companies make it out to be, I cannot understand,' I argued, ' the short-sighted policy of your Government which allows foreign capital to come into the country and drain off the profits of its natural resources.' "

This commentary by a reputable and observant critic is in a different category from newspaper articles, and, though more restrained in tone, it comes to substantially the same conclusions.

Further, the general credit of New Zealand may be impaired because (*a*) as has been shown in Part III on page 28 of this report, it has been represented by some salesmen that the New Zealand Government supports land-utilization companies by guarantees, inspection, or appointment of trustees. Hence the New Zealand Government is likely to share in the blame where companies fail ; (*b*) conversely, the New Zealand Government may be blamed for failure because it has not exercised regulatory supervision. Such a view may be unreasonable and illogical, but it may be potent nevertheless ; (*c*) it may be considered that, in the event of failure on a large scale, a financial crisis may develop which will embarrass the Government because the amounts involved are very large.

Obviously the reaction on New Zealand's credit will be closely conditioned by the commercial success or failure of the plantations when they reach maturity. We are not competent to pass judgment on the commercial prospect of existing land-utilization projects, and have no comment to make under this head ; but we would draw attention to the fact that political as well as financial questions may be involved. In the event of failure to operate plantations with profit, there is something more than a remote possibility that pressure will be brought to bear on the Government by bondholders. In such circumstances the presence of a large number of bondholders domiciled in other countries may prove an additional source of embarrassment to the Government.

We have no recommendation to make having a special bearing on this question ; but it is intimately bound up with the problems involved in putting the financial schemes and schemes of control of land-utilization companies and investment trusts on a satisfactory basis. Consideration of the manner in which the operations of companies of the above types may affect the credit of New Zealand in other countries strengthens the case for applying the remedial measures we have outlined.

---

* "Each Rs. 300 cash invested with —— Company will give a return of at least from Rs. 3,500 to Rs. 4,500 every twelve to fifteen years, or Rs. 6,000 to Rs. 7,000 every twenty to twenty-five years."

PART XI.—SUMMARY.

RECOMMENDATIONS AND SUMMARY OF FINDINGS LEADING TO RECOMMENDATIONS.

Our Major Recommendation: The Corporate Investments Bureau.

Reference to the various recommendations which follow will show that many of them assume, and depend for their effectiveness upon, the existence of an institution of a type new to New Zealand, possessing certain discretionary powers. This we have described as the Corporate Investments Bureau.

Since the proper appreciation of such recommendations requires an understanding of the reasons leading up to our recommendations for the creation of such a bureau, and some knowledge of its general features and functions, and since we regard it as the most important of our recommendations, we propose to deal with it first.

No. of Recommendation.	Summary of Findings and Recommendations.	Page in Report.	Order of Reference Paragraph.
	PART IX.—CORPORATE INVESTMENTS BUREAU.	85	(1) (*a*) to (*e*) (2) (*a*) and (*b*). (3).
	We must not make a scarecrow of the Law, Setting it up to fright the birds of prey, And let it keep one shape till custom make it Their perch and not their terror. —*Measure for Measure.*		
	The evils referred to in our report occur despite the existence of a considerable body of law designed to prevent abuse and protect the investor. The very imperfection of the law as an instrument of control and correction forces us irresistibly to the conclusion that the time is overdue for the adoption of a new principle. That new principle consists in vesting a defined and limited discretionary and inspectional power in a Corporate Investments Bureau.		
	CASE FOR THE BUREAU.		
	(1) The statement and application of the law demands precise definitions. The law thus stated can be evaded and frustrated. It is impossible to include and anticipate all relevant examples and types coming within a definition while excluding all others. Our report refers, by way of example, to the difficulty of defining an "investment trust" and "subsidiary company" in concrete terms. We recommend the vesting of power in a bureau to make authoritative declarations as to the application of statutory definitions, with right of appeal to the Court. (2) The law is not sufficiently flexible as an instrument of control or correction. Changes are rapid, and the law becomes inadequate, ineffective, and, in many cases, restrictive. (3) Persons interested, and even persons injuriously affected, will not use the processes of law. This tends to give immunity to unscrupulous operators. (4) There are precedents for this institution in the law of other countries.		
	SUMMARY OF FUNCTIONS, POWERS, AND DUTIES.		
	Name.—Corporate Investments Bureau. *General Functions.*—Supervise prospectuses; investigate complaints; demand candid disclosure; prosecute breaches of the Act; apply for injunction against unconscionable and specious schemes and representations; power within statutory limits to relax rigid provisions of Act; registration of promoters, directors, brokers, and salesmen, and valuers, with power to strike off register, none to operate save when registered; full powers of search and inquiry such as those given by the Companies (Special Investigations) Act, 1934. *Stock Exchange.*—Bureau to have similar powers of regulation and control over sharebrokers and stock exchanges. *Reports.*—Bureau to report annually to Minister on its operations for each year, with recommendations for new legislation. *Finance.*—The cost should be small, and may be met by a small levy on companies. *Secrecy.*—Secrecy, such as that enjoined on other confidential State Departments, to be observed.		
	We strongly urge that Part IX be studied closely in the light of the findings of the report.	89	
	Recommendation:—		
(125)	**That a Bureau be incorporated embodying the powers, duties, and principles as set out in Part IX of the report.**	89	(1) (*a*) to (*e*). (2) (*a*) and (*b*). (3).

SUMMARY—*continued.*

No. of Recommendation.	Summary of Findings and Recommendations.	Page in Report.	Order of Reference Paragraph.
	PART III.—LAND-UTILIZATION COMPANIES.		
	2. INADEQUACY OF OFFICIAL STATISTICS.		
	We have been hampered in our inquiry by the paucity of official statistics relating to land-utilization companies. There is no complete list of such companies operating in New Zealand, no adequate record of areas planted, nor of the amount of bond capital raised, nor of the nature and distribution of the expenditure of such capital.	13	(1) (*a*). (1) (*c*).
	These are matters of great economic importance on which information should be available.		
	We recommend,—		
(1)	**That all companies raising capital for the purpose of planting land with trees or other crops in New Zealand shall be required to furnish to the Government Statistician an annual statement covering the information as set out in Appendix I.**	13	(1) (*a*). (1) (*c*).
(2)	**That this shall apply to such companies registered in other countries as well as in New Zealand.**		
(3)	**That the Government Statistician shall publish an annual table, or tables, summarizing the information thus obtained.**		
	4. FINDINGS.		
	A. *Promotion.*		
	(4) *Prospectuses and other Publications* :— There is uncertainty as to whether an offer to the public to subscribe for an issue of " bonds " in series is an invitation falling within the statutory definition of a prospectus. This uncertainty should be removed.	15 *et seq.*, especially 15–18	(1) (*a*). (1) (*c*). (1) (*e*).
	Land-utilization companies are apt to be " loaded " and their success imperilled by— (*a*) Excessive costs of promotion and brokerage : (*b*) Inflation of the value of land and other assets. These evils are facilitated by— (1) Association of landowners, option-holders, and brokers acting as promoters and directors : (2) Such devices as— (i) Formation of private companies to avoid publicity : (ii) Formation of subsidiary or affiliate companies : (iii) Dealings arranged by interested brokers and directors : (3) The use of amenable valuers to value and report on properties.		
	We recommend,—		
(4)	**That an invitation to subscribe for so-called " bonds " or " debentures," or other forms of contract issued in series (if their continued use is to be permitted) shall be regarded as a prospectus, and that all provisions relating to prospectuses for shares or debentures proper, should apply. (See, however, recommendation No. (18), which advises that the raising of capital by means of " bonds " be prohibited in the future.)**	23	(1) (*e*).
(5)	**That each prospectus shall be required to state all dealings with the land or other assets or any interest in such land or assets known to the directors or any one of them, within, say, two years prior to the incorporation of the company or made in contemplation of the formation of the company.**		
(6)	**That each prospectus shall include a statement of the price or prices at which land was transferred during the previous five years, or in respect of the three previous transfers, whichever covers the longer period.**		
	4. A. (4) (*b*) *Valuers' Reports.*		
	We have discovered flagrant examples of the over-valuation of land by valuers who have proved unduly amenable to the wishes of promoters. Promoters, with the aid of valuers, have capitalized the future prospects of the ventures, thereby destroying any chances of profitable realization by bondholders. In some cases even this interpretation is unduly charitable.	23	(1) (*a*)

SUMMARY—*continued.*

No. of Recommendation.	Summary of Findings and Recommendations.	Page in Report.	Order of Reference Paragraph.
	We recommend,—		
(7)	**That, whenever a valuer is required to make a report for inclusion in a prospectus, he must be informed by the promoters or directors of that purpose.**	23	(1) (*a*). (1) (*e*).
(8)	**That in every such report the valuer must include a statement to the effect that he was informed by the directors that his report was intended for inclusion in a prospectus.**		
(9)	**That all transactions in the land or other assets the subject of the valuation known to the promoters to have taken place prior to the issue of the prospectus shall be disclosed by them to the valuer (including the selling-price in each case) no matter who the parties to such transactions were.**	23	(1) (*a*). (1) (*e*).
(10)	**That the valuer, in his report, shall refer to such transactions, and, in his valuation, shall justify any profits or intended profits indicated by the selling-prices in those transactions.**	23	
(11)	**That no valuer shall give a valuation for inclusion in a prospectus unless he is registered as a valuer with the Corporate Investments Bureau.**	23	
	4. A. (4) (*c*) *Misleading Statements.*		
	Frequently prospectuses or other invitations to subscribe are misleading because they do not reveal the extent to which unreasonable profits have been obtained or provided for, or because they include unreliable valuations of the assets of the company.	24	(1) (*a*). (1) (*e*).
	Other types of misrepresentation are very common. These include—		
	(*a*) Exaggerated estimates of future profits :	24	
	(*b*) Misuse of official and other reports :	24	
	(*c*) Wrong inferences from results which have been achieved in the past :	24	
	(*d*) Misleading use of photographs, or misleading inferences from photographs :	24	
	(*e*) Statements by alleged experts as to the suitability of areas :	24	
	(*f*) Misleading or inadequate information regarding the value of the security behind bonds or other contracts.	24	
	We recommend,—		
(12)	**That a certified copy of all documents and publications issued to the public—including advertisements, newspaper statements, brochures, and leaflets—be filed with the Registrar of Companies.**	26	(1) (*e*).
(13)	**That all such documents and publications be identified and approved by resolution at a meeting of directors before being issued to the public.**	26	
	The above recommendations would tend to place the responsibility for statements made, and to give directors a sense of responsibility which has not always been present in the past. We consider that emphasis should be given to the fact that there is a criminal liability for making misleading statements with intent to persuade intending investors to entrust money or other property to a company. The penal provisions should be incorporated in the Companies Act in juxtaposition with those enabling and directive provisions to which the business man will give his attention. The Companies Act is a layman's working code.		
	We recommend,—		
(14)	**That the offence of publishing a misleading prospectus be defined and incorporated with a penal clause in section 46 of the Companies Act, 1933.**	27	(1) (*e*).
	The judgment in the case of *The King* v. *Kylsant* ([1932] 1 K.B. 442) cites and reaffirms the principle that a prospectus or other publication may be false and lay those responsible open to punishment, even though every individual statement taken separately is true. Their combined effect may be to convey a false impression. The principles enunciated in this case should be brought prominently before the notice of business men.		

SUMMARY—*continued.*

No. of Recommendation.	Summary of Findings and Recommendations.	Page in Report.	Order of Reference Paragraph.
(15)	We recommend,— **That, in publishing the Companies Act, the Government Printer should be instructed to insert as a footnote at the bottom of the page which contains section 46 of the Companies Act a brief reference to the case of *The King* v. *Kylsant*, with a brief statement of the principles enunciated by the Judges who affirmed the conviction in that case.**	28	(1) (*e*).
	4. B. FINANCIAL SCHEME. (3) *Bond Capital.* (*d*) *Title of Land.* The title of bondholders to land is imperilled, in some cases, by limitations enforced by the Land Act of 1924, which are directed against land-aggregation. Section 386 of the Land Act excludes afforestation and other land-utilization companies from these limitations, but not trustees or bondholders. Hence trustees or bondholders are unable to acquire areas in excess of those laid down in the Act.	28	(1) (*b*). (1) (*c*).
(16)	We recommend,— **That the law be amended to extend to trustees for bondholders of land-utilization companies the same concessions in the matter of land-aggregation as are now extended to land-utilization companies.**	33	(1) (*b*). (1) (*c*).
	4. C. CONTROL AND ADMINISTRATION. (3) *Bondholders.* Despite the fact that bondholders provide the greater part of the capital in Land-utilization companies, the rights and powers of bondholders are closely limited by contrast with those of shareholders. Their rights consist solely in their title to the performance of a contract between them and the company, the enforcement of which normally rests with trustees. They have no share in the direction of the enterprise. They possess no powers of audit or inspection, and are not entitled to the information regarding the financial affairs of the company which may be claimed by shareholders. It is difficult to exercise such limited powers as they possess, because bondholders are scattered, and it is difficult to combine in order to institute and finance legal proceedings.	38	(1) (*b*).
(17)	We recommend,— **That if the bond system is to continue, sections 142, 143, 144, and 145 of the Companies Act, 1933, be amended to extend the same powers to holders of bonds or other contracts in series as are granted to shareholders, the cost of such inspection or action being chargeable against the trust fund or the company at the discretion of the Court.**	40	(1) (*b*).
	4. F. THE BOND SYSTEM DISCREDITED. (1) *Abolition of System recommended.* On the facts presented to us and described and analysed in Part III of our report, we conclude that the system of raising capital by the issue of "bonds" is a discredited system. It is wasteful and uneconomic. Those who provide the greater part of the capital have little share in control. Their security is often unsatisfactory and may be whittled away by abuses of which they are frequently unaware until it is too late, and against which there is little redress. The bond system provides abundant openings for abuse, which appear to have attracted many who are prepared to take full advantage of them. The success of the system in encouraging investment has been due chiefly to the skill of trained salesmen who have created and maintained an illusory atmosphere of security and extravagant expectation round the instruments they vend. We have endeavoured to devise remedies for the abuses which are all too apparent in the system. We have found this to be impossible, because many of the remedies considered in order to make the system sound would have created new and equally serious difficulties. There is no legitimate advantage attainable by an issue of "bonds" that is not equally attainable by an issue of shares. We draw attention in our report to the possible use of redeemable preference shares (see section 57, Companies Act, 1933). It is necessary to incorporate a share company before satisfactory realization schemes can be put into operation.	42 *et seq.*	(1) (*a*) to (*e*).

SUMMARY—*continued.*

No. of Recommendation.	Summary of Findings and Recommendations.	Page in Report.	Order of Reference Paragraph.
	The alterations in company law necessary to place the bond system on a sound basis are structural. The alterations which are practicable are inadequate. They sacrifice the principle of harmony with Imperial legislation. It is not worth while to strain the framework of company law to accommodate a device which is discredited and which lowers the tone of commercial morality because of the opportunity it affords for exploiting the investor.		
	We recommend—		
(18)	**That the issue of bonds, investment certificates, or similar instruments or contracts issued in series (with or without a prospectus) shall be prohibited for the future.**	43	(1) (*a*) to (*e*).
(19)	**That the Companies Act, 1933, section 57, be amended by defining the term "profits" as used in paragraph (*a*) of subsection (1) so that it shall include the net proceeds of any land or forest or other crop thereon on the realization of a land-utilization scheme financed by the issue of redeemable preference shares.**		
	4. F. (2) AN ALTERNATIVE RECOMMENDATION.		
	We strongly urge the adoption of the above recommendations. Failing such adoption, we draw attention to the alternative recommendations, Nos. 20 to 30, set out at the end of this summary, pages 110–113, and suggest that their provisions be made applicable to all existing and future bond-issuing companies. Those recommendations are not adequate to solve the problems with which we have been confronted. They leave many inherent defects and dangers for which we can find no satisfactory remedies.	43	
	PART IV.—INVESTMENT COMPANIES.		
	(NOTE.—Certain of the following recommendations apply equally to bond-issuing companies. Some recommendations already given are repeated.)	45	
	3. FINDINGS. (2) INADEQUACY OF OFFICIAL STATISTICS.		
	As in the case of land-utilization companies, official statistics relating to investment trusts are quite inadequate, and it is important that they should be available at least in the case of companies issuing debentures or "contracts" in series.	53	(2) (*a*) (*b*).
	We recommend,—		
(31)	**That all companies raising moneys in New Zealand by the issue of debentures (or contracts) in series, however these may be defined, and using the proceeds for investment in securities of any kind, shall be required to furnish to the Government Statistician an annual statement as set out in Appendix II.**	53	(2) (*a*).
(32)	**That this shall apply equally to companies registered in other countries but issuing debentures (or contracts) in series, for sale in New Zealand, and to companies registered in New Zealand but issuing debentures (or contracts) in series in other countries.**	53	(2) (*a*).
(33)	**That the Government Statistician shall publish an annual table or tables summarizing the information thus obtained.**	53	(2) (*a*).
	(3) PROMOTION.		
	(*a*) *Initial Capital.*		
	Many companies with financial powers analogous to those of investment trusts have a very small paid-up capital. Such companies are similar to insurance companies in that they require a substantial capital if they are to perform their functions effectively and give adequate security to investors and other contracting parties. Investment trusts are justified only by their capacity to ensure against investment risks by means of a wide diversity of investments. This requires large capital resources. Such may be obtained from the issue of debentures, but this possesses special dangers of its own, to which we refer later.	53 *et seq.*	(2) (*a*) (*b*).

SUMMARY—*continued.*

No. of Recommendation.	Summary of Findings and Recommendations.	Page in Report.	Order of Reference Paragraph.
	We recommend,—		
(34)	**That no investment trust company and no company whose main purpose is the investment of its capital in securities shall be permitted to commence business as an investment trust unless and until it has a subscribed capital of not less than £40,000, of which at least £20,000 shall be fully paid up in cash.**	54	(2) (*a*) (*b*).
	It is difficult, if not impossible, to frame a legal definition of an investment trust or of "a company whose main purpose is the investment of its capital in securities" which will include all such companies but exclude other types to which this provision is not intended to apply.	54	(2) (*a*) (*b*).
	We recommend,—		
(35)	**That the Corporate Investments Bureau recommended in Part IX of this report be empowered to determine whether or not a company falls within the classes defined in recommendation No. (34) above and that any company or proposed company which is aggrieved by such determination shall have the right of appeal to the Supreme Court.**	54	(2) (*a*) (*b*).
	It is a common practice for cheques of identical amounts to be exchanged for services or assets on the one hand and shares on the other, such shares being described as fully paid in cash. Such a procedure is objectionable because it is misleading and because it enables individuals to obtain the control of companies for a consideration of little or no value, frequently on terms which those who benefit determine for themselves. Practices of this sort would render recommendation No. (34) abortive. We think it possible to frame a definition of "cash consideration" that will exclude a mere colourable compliance with the law.		
	We recommend,—		
(36)	**That the Companies Act, 1933, be amended to provide that in any prospectus, statement in lieu of prospectus, or other document issued by any company, or in any return filed with the Registrar of Companies by any company, no allotment of any shares shall be described as an allotment for a cash consideration unless payment for the same is made to the company either by bank-note, coin, or bill of exchange payable on demand by an applicant or subscriber to the memorandum of association who, in good faith, makes such payment uninfluenced by and without reference to any complementary or related obligation by or transaction with the company or any person acting for or on behalf of the company.**	54	(2) (*a*) (*b*).
	(*b*) *Private Companies.* It is undesirable that investment companies and companies whose objects comprise the performance of services in respect of which much importance is attached to personal qualities should register as private companies. Some investment companies have registered in this way, and have been able to keep from the register at the office of the Registrar of Companies all information relating to the constitution of share capital and the holders of shares.		
	We recommend,—		
(37)	**That all investment and finance companies, and all companies of the kind indicated in the previous paragraph, be required to register as public companies under the Companies Act, 1933.**	55	(2) (*a*) (*b*).
(38)	**That, if there should appear to be any difficulty in framing a workable definition designed to secure the application of this recommendation, the Corporate Investments Bureau be given power to classify any proposed company as one which must be formed under Part II of the Act, and to require any such company registered as a private company, to re-register as a company under Part II of the Act. If necessary, a right of appeal against this determination might be given to applicants and companies. On re-registration a statement in lieu of prospectus should be filed.**		

SUMMARY—*continued.*

No. of Recommendation.	Summary of Findings and Recommendations.	Page in Report.	Order of Reference Paragraph.
	(*c*) *Investment Trusts Incorporated under other Acts.*		
	At least one concern operating as an investment trust is incorporated under another Act, and not under the Companies Act. This is undesirable, because it will enable our recommendations in regard to investment trusts to be evaded.	55	(2) (*a*) (*b*).
	We recommend,—		
(39)	**That all companies, societies, or other associations of persons operating or seeking to operate as investment trusts with a corporate status shall be required to register under the Companies Act, 1933, and shall be precluded from registering under any other Act; and**	55	(2) (*a*) (*b*).
(40)	**That all such companies, societies, or associations now existing but registered under any other Act or Acts shall be required to re-register as companies under the Companies Act, 1933, within three months of the passing of legislation embodying the above recommendation.**		
	(*d*) *Signatories to Memoranda of Association.*		
	It is common for the signatories to memoranda of association to be of the type commonly designated as "dummies"; people of little financial standing who have no interest in the companies incorporated, and who cannot be regarded as in any real sense desirous of being associated or "desirous of being formed into a company." Such a practice denies to the public and the Registrar of Companies information as to the identity of the promoters and real foundation members of the company. There is no justification for this practice.	55	(1) (*a*). (2) (*a*) (*b*).
	We recommend,—		
(41)	**That the subscribers to a memorandum of association must be in fact and in law persons genuinely desirous in their own names and in furtherance of their own interests of being formed into a company in pursuance of the memorandum of association; and**	56	(1) (*a*). (2) (*a*) (*b*).
(42)	**That no agency or trust between any subscriber to a memorandum and any other person shall be recognized or enforceable at law or in equity unless the existence of such agency or trust and the identity of the parties thereto are disclosed as such in the form of signature.**		
	The above provisions might still be defeated by a superficial compliance with the law. It would be very easy to arrange a conference between seven persons, and give them just enough information and incentive to suggest a plausible motive to procure subscription for, say, seven shares of one shilling each.	56	(1) (*a*). (2) (*a*) (*b*).
	We recommend,—		
(43)	**That all subscribers to the memorandum of association must be required to subscribe for a substantial holding of shares.**	56	(1) (*a*) (*b*) (*c*).
(44)	**That the provision of the Act that no subscriber shall subscribe for less than one share shall be repealed and replaced by the provision that subscriptions of subscribers to the memorandum of association shall be in accordance with a scale designed to give effect to the principle embodied in recommendation No. (43).**		
	In order to prevent the evasion of the above by registration of a company with a small share capital, fully subscribed, followed by an increase of capital at a short interval after incorporation.		
	We recommend,—		
(45)	**That no company having a share capital shall increase its share capital within twelve months after its incorporation unless it first obtains the consent thereto of the Minister of Finance.**	56	(1) (*a*). (2) (*a*) (*b*).
	(*e*) *Inflation of Capital.*		
	Inflation of assets has occurred in the case of investment trusts, though the technique has sometimes been different from that employed in land-utilization companies. Asset inflation may take the form of the transfer of real estate at a fictitious value, excessive payment for services rendered, the transfer of shares or other securities at a fictitious value, and in other ways. By these means investors may obtain a controlling interest with a small investment of cash, or no cash at all. The use of these devices is facilitated by the existence of subsidiary or affiliated companies.	56	(1) (*d*). (2) (*a*) (*b*).

SUMMARY—*continued.*

No. of Recommendation.	Summary of Findings and Recommendations.	Page in Report.	Order of Reference Paragraph.
	We recommend,—		
(46)	**That prospectuses for shares, debentures, or contracts in series shall state all payments to promoters, directors, brokers, or underwriters made up to the date of the prospectus or contemplated to be made out of the proceeds of the money subscribed in response to the prospectus, whether in cash, shares, or in any other form, by way of remuneration for promotion, brokerage, underwriting, or other service, or of payment for any asset, and the nature of the service for which consideration is paid.**	57	(1) (*a*). (2) (*a*) (*b*).
(47)	**That, where the asset for which consideration is given or is to be given is in the form of securities of any kind, the nature of the security, the nominal value of the security, its market value, and the amount paid up thereon as at the date of the prospectus shall be stated in the prospectus.**		
	(*f*) *Transactions by Interested Directors.*		
	Many of the reprehensible transactions referred to in our report are possible in the form in which they are put through because directors hold a dominating position in two or more companies. Such transactions involve, as between such companies,— (*a*) The relationship of purchaser and vendor, broker and employer, or principal and agent; and (*b*) Acts and decisions of directors holding shares or other interests in each company. Existing provisions requiring the declaration by a director of his interest in a transaction are ineffective, because co-directors do not always watch the interests of shareholders and debenture-holders, as against those of the interested director. The danger becomes greater when the bulk of the funds of the company is provided by debenture-holders who have no share in management and no adequate information as to financial transactions.	57	(1) (*a*) (*b*) (*c*). (2) (*a*) (*b*).
	We recommend,—		
(48)	**That every declaration of interest made as required above shall be clearly and fully entered in the minutes of the meeting at which the declaration was made.**	57	(1) (*a*) to (*c*). (2) (*a*) (*b*).
(49)	**That within one week of the making of any such declaration at a directors' meeting it shall be the duty of the directors, the secretary, or other official of the company to transmit to the Corporate Investments Bureau a copy of each such minute.**		
(50)	**That failure to comply with the above provisions shall render the director or officer at fault liable to a fine not exceeding £100.**		
	(*g*) *Prospectuses and other Publications.*		
	A common practice is to enlarge upon the merits of British trusts and quote the profits they have earned and apply these inferentially to companies to which they are not applicable because their capital composition, scheme of organization and control, and investment policy are different. Prospectuses may be misleading in other ways. Material contracts, especially those involving the inflation of assets and excessive payments for services, are not fully disclosed. Statements in regard to brokerage, the nature of the security, and other matters are ambiguous. Provisions in regard to payment for brokerage and other services are unduly elastic. The dangers are intensified because of the existence of subsidiary or affiliate companies.	57	(1) (*a*) (*e*). (2) (*a*) (*b*).
	(*h*) *Misrepresentation by Salesmen.*		
	Debentures of investment companies have been sold by door-to-door canvass. The evils are the same as those associated with similar practices adopted by land-utilization companies. Misrepresentation is common and difficult to check. There is the added objection in the case of investment trusts that a large number, if not most of the debentures, have been procured by the exchange of good marketable securities. The practice of share-hawking, though temporarily discouraged by section 343 of the Companies Act, 1933, appears to be reviving.	58	

SUMMARY—*continued.*

No. of Recommendation.	Summary of Findings and Recommendations.	Page in Report.	Order of Reference Paragraph.
	(*j*) *Remedies.*		
	The problem of devising and applying a remedy for the above evils is complicated because—	59	(1) (*a*) (*e*). (2) (*a*) (*b*).
	(*a*) None of the subscribers to the memorandum of association of a company incorporated in New Zealand need be within the jurisdiction of the New Zealand Courts; and		
	(*b*) There is nothing to prevent the directors of a New Zealand company from establishing the principal office outside the jurisdiction and removing to it all the books, records, and securities of the company.		
	Certain of the following recommendations have been made in Part III. For convenience these are repeated here (recommendations Nos. 53–57).		
	We recommend,—		
(51)	**That the Companies Act, 1933, be amended by providing that all subscribers to the memorandum of association shall be at the time domiciled within the Dominion and on an electoral roll within the Dominion.**	59	(1) (*a*) (*e*). (2) (*a*).
(52)	**That it shall be a punishable offence for any director or officer or agent of a company to remove or to attempt to remove or to assist in removing from the Dominion any books, documents, papers, records, investments, or securities of a company, unless the consent in writing of the Minister of Finance is first had and obtained.**		
(53)	**That a certified copy of all documents and publications issued to the public, including advertisements, newspaper statements, brochures, and leaflets, be filed with the Registrar of Companies.**		
(54)	**That all such documents and publications be identified and approved by resolution at a meeting of directors before being issued to the public.**		
(55)	**That every prospectus offering for subscription by the public, any debentures or other securities or contracts in series and every debenture or debenture-certificate or other such contract shall contain a definite statement in a prominent place in large type giving the nature of the security, if any.**		
(56)	**That the offence of publishing a misleading prospectus be defined and incorporated with a penal clause in section 46 of the Companies Act, 1933.**		
(57)	**That in publishing the Companies Act, 1933, the Government Printer shall be instructed to insert as a footnote at the bottom of the page which contains section 46 of the Companies Act, 1933, a brief reference to the case of *The King* v. *Kylsant*, (1932) 1 K.B. 442, with a brief statement of the principles enunciated by the Judges who affirmed the conviction in that case.**	60	
(58)	**That the subsection defining and incorporating the offence with a penal clause under section 46 of the Companies Act, 1933, shall contain a recital that the true intent and purpose of section 46 is to provide and ensure that every prospectus shall set forth a candid and fair statement of all such matters as should be reasonably disclosed to the public and intending investors to inform them fully and fairly of the relevant facts and transactions known to the directors and promoters, and shall provide that any statement of a transaction or part of a transaction which, though taken by itself, may be true, nevertheless tends to hide certain related transactions or parts of transactions and thereby conceals from the public another view of the said transaction or transactions equally true, but more favourable to the interests of the directors or promoters, and/or less favourable to the interests of the public and the design of the prospectus, shall be evidence of an intention to mislead and shall be actionable accordingly.**		
	(4) *Financial Scheme.* (*b*) *Security behind Debentures.*		
	Conditions relating to capital deductions for brokerage and administration and deductions from the earnings of investments to meet various costs are sufficiently elastic to permit of excessive charges under these heads. Such excessive charges have, in fact, occurred. This endangers the security of debenture-holders.	60 *et seq.*	(2) (*a*) (*b*).

SUMMARY—*continued.*

No. of Recommendation.	Summary of Findings and Recommendations.	Page in Report.	Order of Reference Paragraph.
	The charges permissible should be clearly stated. A statement should be furnished annually to debenture-holders showing clearly particulars of charges and costs deducted, and giving debenture-holders sufficient information to enable a drift to be detected.		
	We recommend,—		
(59)	**That the maximum charges deductible by way of brokerage, administrative, and other charges on the sale of debentures shall be clearly stated as a percentage of the nominal value of debentures on every prospectus for debentures and on every debenture certificate.**	61	(2) (*a*) (*b*).
(60)	**That, when the dividend payable to debenture-holders is not a fixed sum but is a proportion of net income, the same obligation shall apply to costs and charges other than taxes deductible from the income received from the investments.**		
(61)	**That, when the dividend payable to debenture-holders is a proportion of the net profits, an investment trust shall be required to furnish annually to debenture-holders a report (audited by an auditor appointed on behalf of the debenture-holders), covering the following items :—** **(*a*) Nominal value of debentures sold.** **(*b*) Amount of cash or value of securities received in respect of such debentures.** **(*c*) Particulars of deductions therefrom in respect of brokerage, administration costs, or other charges.** **(*d*) Net amount available for investment, divided into—** **(1) Amount invested in securities at cost :** **(2) Amount represented otherwise [*specify*].** **Also :—** **(*a*) Total income from investments held in respect of each series of debentures.** **(*b*) Particulars of deductions by way of administration costs, taxes, or other charges.** **(*c*) Amounts carried to reserve.** **(*d*) Net amount distributed to debenture-holders.**		
	As the result of conditions outlined in Part IV of the report, it is possible, by the provision of a small share capital, for a small group of individuals to obtain control over a large volume of funds. Even if there is no " rake off " by way of brokerage, administration, or other charges, they may gain a very high rate of return without incurring any risk of loss of their own capital. There is no trustee to impose a check and no power of audit. There is nothing to prevent controllers of such companies from using the funds to their own advantage. This is facilitated by the use of subsidiary and affiliated companies. We consider that the law should be amended to make such conditions impossible, and force investment trusts in New Zealand to conform to the British type of trust. Share capital in a British trust is seldom less than the debenture capital. Such debenture capital is secured against the whole of the assets of the undertaking. Some New Zealand trusts are of the " contractual " type. The debenture-holder receives a stated proportion of the net profit from investment. He has no security over the share capital of the company and its assets, but only over the securities purchased with money provided by debenture-holders.	61	
	We recommend,—		
(62)	**That in no case shall investment trusts be permitted to issue debentures whether at a fixed rate of dividend or at a rate of dividend expressed as a percentage of net profits, of a nominal value exceeding twice the sum of the ordinary and preference-share capital of the company, which has been allotted and paid up in cash ; or three times the amount of ordinary share capital allotted and paid up in cash, whichever is the lesser.**	61	(2) (*a*) (*b*).
(63)	**That the term " cash " shall be interpreted as in recommendation No. (36), page 54.**		
(64)	**That all such debentures shall be secured against the whole of the assets of the undertaking.**		

SUMMARY—*continued.*

No. of Recommendation.	Summary of Findings and Recommendations.	Page in Report.	Order of Reference Paragraph.
	We recommend,—		
(65)	**That all existing investment trust companies other than those named in the Schedule to the Companies (Special Investigations) Act, 1934, shall within six months after the enactment of any provisions embodying the above recommendations, be required to apply to the Court for approval of an amended constitution and financial scheme bringing the company's capital and debenture constitution and terms into line with such enactment. If any such company does not, within the prescribed period, apply to the Court, or if, as a result of such application, its capital and debenture constitution and terms are not brought into conformity with the legislative requirements and standards, the Attorney-General may petition the Court for the winding-up of that company on the ground that it is just and equitable that it should be wound up. On any such petition for winding-up, the Court, in considering what is just and equitable, shall take into account such legislative standards, and failure to conform to those standards shall be deemed to be a sufficient ground for winding up the company.**	62	
	(*c*) *Investment Policy.*		
	(i) *Diversification.*—Diversification of investments should be a cardinal principle of the investment policy of investment trusts. Not more than a small proportion of the funds of an investment trust should be in any one security or in the securities of any one undertaking. An investment trust should not invest in more than a small proportion of the securities *issued* by any one company. Funds should be spread over a wide variety of undertakings, and types of security, and over securities issued in a number of countries. This is necessary if the prospects of comparatively high returns are to be associated with a reasonable assurance against loss through the depreciation in the value of particular securities or classes of securities. Certain New Zealand companies have provided that not more than 10 per cent. of the funds contributed shall be invested, *on completion of an issue* of debentures, in any one security. Adequate diversification may be avoided by the device of ensuring that the issue is never completed. The principle of diversification has been violated because large sums have been invested in a single speculative undertaking. Statements giving the spread of investment have been drawn up in such a form as to give the appearance of diversification, without ensuring that the principle is observed.	62	(2) (*a*) (*b*).
	We recommend,—		
(66)	**That in no case shall investments made by an investment company in the securities issued by any one company exceed one-twentieth of the combined subscribed share capital and debenture capital nor one-tenth of the subscribed share capital of such investment company, whichever is the less.**	64	(2) (*a*) (*b*).
(67)	**That in no case shall investments made either directly or indirectly by an investment company in the securities of all kinds issued by any company, exceed one-tenth of the aggregate market value of the securities of such issuing company at the time of purchase.**		
	(ii) *Publicity.*		
	Opinion differs as to whether or not an investment trust should give a detailed list of its investments from time to time. Certain British trusts publish such a list, others do not. We do not think it desirable to require by law that such lists should be published, but consider that the analysis of investments should be more exhaustive than is customary in New Zealand. A uniform system of analysis and presentation possesses advantages.		
	We recommend,—		
(68)	**That investment companies be required to include in their annual report to shareholders and/or debenture-holders an analysis of investments in the following classes, giving in respect of each class—**	64	(2) (*a*) (*b*).

SUMMARY—*continued.*

No. of Recommendation.	Summary of Findings and Recommendations.	Page in Report.	Order of Reference Paragraph.
	(*a*) Aggregate value of investments in each class expressed as a percentage of the total valuation of all investments. **(*b*) Number of securities in each class.** **(*c*) The percentage ratio of the valuation of the maximum investment in any one security in each class to the total valuation of all investments.** **Date of return.** **Aggregate valuation of securities as shown in balance-sheet.** **Classes of security :—** **Bonds, debentures, and debenture stock—** **Government and local-body.** **Industrial and commercial.** **Financial : Banks ; Insurance companies ; other.** **Preference and guaranteed stocks and shares—** **Industrial and commercial.** **Financial : Banks ; Insurance companies ; other.** **Ordinary shares and stocks—** **Industrial and commercial.** **Financial : Banks ; Insurance companies ; other.** **Geographical distribution : Domiciled in—New Zealand ; Australia ; Great Britain ; other.**		
	(iii) *Reserve and Dividend Policy.*		
	British trusts place capital profits resulting from the sale of securities at an enhanced price to reserve and do not distribute them as dividends. Some New Zealand companies credit the proceeds from the purchase and sale of securities to Profit and Loss Account and distribute them as interest or dividends. This militates against the creation of reserves, endangers security, and, on a rising market, misleads the investor as to the prospects of the enterprise. The policy is unsound and highly dangerous.	65	(2) (*a*) (*b*).
	We recommend,—		
(69)	**That all investment trusts raising capital by the issue of debentures or contracts in series be forbidden to distribute as dividends capital profits resulting from the sale of securities, and be required to place them to reserve.**	65	(2) (*a*) (*b*).
	(iv) *Non-investment Motives ; Speculation and the Device of Subsidiary, Affiliated, or Interlocking Companies.*	65	(2) (*a*) (*b*).
	The funds of debenture-holders have been used to enable directors or controllers of an investment trust to obtain control over other undertakings and to further their personal interests. The formation of subsidiary or affiliated companies has facilitated transactions directed to these ends, and enabled other investment trust principles such as investment diversification and the avoidance of speculative investment to be violated more readily. The dangers inherent in the use of subsidiary or affiliated companies include the following :—		
	(*a*) The limitation on investments in any one security nominally designed to ensure proper diversification may be evaded. Funds may be invested in two or more subsidiaries and then diverted to a particular purpose.	68	
	(*b*) Funds may be used to make speculative investments under such circumstances that the debenture-holders bear all the risk and those in control of the trust reap the speculative profit.		
	(*c*) Funds may be used to further the personal interests of those in control.		
	(*d*) Such companies may be used to enable controllers of the trust to obtain a controlling interest in other companies.		
	(*e*) They facilitate the deduction of excessive charges for brokerage, administrative, and other services.		
	(*f*) They enable debenture-holders' money to be diverted into the pockets of those who control the trust in other ways.		
	(*g*) They make it impossible to conduct an effective audit unless there is a common auditor to all such companies, or unless all their accounts are audited as at the same date with conference between the auditors.		

SUMMARY—*continued.*

No. of Recommendation.	Summary of Findings and Recommendations.	Page in Report.	Order of Reference Paragraph.
	We are seriously disturbed by the evils which may be encouraged and facilitated through the use of subsidiary or affiliate companies. The definition of such companies is difficult, but we attempt a definition on page 70 (*q.v.*).	69	
	We recommend,—		
(70)	**That the Corporate Investments Bureau be empowered to declare any company to be a company subsidiary to or affiliated with an investment trust when there is reason to believe that such company falls within the definition on page 70, and thereupon such relationship shall be deemed to exist, the investment trust to have a right of appeal to the Court against such declaration.**	70	(2) (*a*) (*b*).
(71)	**That, save with the permission of the Bureau, the aggregate of investments of an investment trust company in the securities of all such subsidiary or affiliated companies taken together shall in no case exceed at any time one-twentieth of the combined share and debenture capital of such investment trust company subscribed and paid up at that time; nor more than one-fortieth in any one such subsidiary or affiliated company.**		
(72)	**That an investment trust shall be required to include in its annual accounts the names of all subsidiary or related companies, together with (*a*) the maximum amount invested in each of such companies at any time during the preceding financial period; (*b*) the maximum number and nominal value of shares in any such company held by any director of the investment trust or his nominee or trustee during such financial period.**		
(73)	**That, whenever the relationship of subsidiary and parent shall exist between an investment trust and any other company or companies, the Corporate Investments Bureau may, of its own initiative, and shall, on being required so to do by any such company or the auditor of any such company affected thereby, fix a date common to both or all of such companies as the date at which its accounts shall be balanced and as at which its balance-sheet and revenue accounts shall be prepared and audited.**		
(74)	**That copies of the accounts and reports of each of such companies shall be forwarded to the auditors of the other company or of each of the other of such companies forthwith after they are completed and audited.**		
	(5) SCHEME OF CONTROL AND ADMINISTRATION.		
	In view of the existing and potential evils, the scheme of control is of considerable importance. In trusts of the contractual type operating in New Zealand the capital provided in cash by shareholders is small, but they have complete control. Debenture-holders provide all but an infinitesimal part of the capital, but they have no powers of control. Debenture-holders have no representation on the directorate, and no trustee is appointed to look after their interests. There is no provision for calling a meeting of debenture-holders. Debenture-holders have no power of audit or inspection. In such circumstances, the temptation to use debenture-holders' money to further the interest of controllers of the trust has not always been resisted.	70	(2) (*a*) (*b*).
	We recommend,—		
(75)	**That every investment company issuing debentures or contracts in series shall be required to appoint a trustee for debenture-holders.**	71	(2) (*a*) (*b*).
(76)	**That, in the case of such companies as do not at present have trustees, the first trustees shall be appointed by the Court from a panel selected by the company, such appointment to be made within a period of six months from the legislative adoption of these recommendations. If the company does not so apply within the period of six months, any debenture-holder may thereafter apply, and the Court may appoint such trustee as it thinks fit; the costs of this application to be borne by the company.**		

SUMMARY—*continued.*

No. of Recommendation.	Summary of Findings and Recommendations.	Page in Report.	Order of Reference Paragraph.
(77)	**That debenture-holders shall be given adequate powers in regard to the dismissal and election of trustees.**	71	
(78)	**That investment trusts shall, in their trust deeds, make adequate provision for the summoning and holding of meetings of debenture-holders and the exercise of voting-powers.**		
(79)	**That the debenture-holders in investment companies issuing debentures in series shall be entitled to elect at least one director.**		
(80)	**That trustees for debenture-holders in an investment company issuing debentures in series shall have full power to inspect the portfolio of investments at all times.**		
(81)	**That debenture-holders in such companies shall have power at a general meeting of debenture-holders to appoint an auditor for debenture-holders upon the terms and subject to the conditions on which shareholders may, under the Companies Act, 1933, appoint an auditor.**		
(82)	**That recommendation No. (17) (page 40) apply, with the necessary verbal alterations, to investment companies.**		
	PART V.—INVESTMENT *CUM* LOTTERY COMPANIES.		
	This is an ingenious type of company which combines the investment-trust idea with proposals to run a lottery in a foreign country.	73	(2) (*a*) (*b*).
	Promoters of such companies appear to be men of little financial reputation or substance, with little to lose. The financial schemes of such companies are unsound. They are adequately condemned on the grounds that they are incorporated in New Zealand to engage, in another country, in an undertaking which is unlawful in New Zealand.		
	We recommend,—		
(83)	**That no company incorporated in New Zealand shall be permitted to raise moneys in New Zealand or elsewhere for the pursuance in another country of any object which is unlawful in New Zealand; and any existing company having any such object may be wound up by the Court on the application of the Attorney-General.**	73	2 (*a*) (*b*).
	PART VI.—EMPLOYEE SHAREHOLDING COMPANIES.		
	At least one company has invited subscription for shares as a condition of employment. The company has wide powers to terminate the contract, subject only to arbitration in the event of dispute as to the interpretation of the contract.	74	(1) (*a*) to (*e*).
	Such a scheme is dangerous, unless controlled, because it may enable unscrupulous or over-sanguine promoters to obtain the small savings of workers, under conditions onerous to the workers, for investment in enterprises which may have little prospect of success.		
	We recommend,—		
(84)	**That all companies which invite subscription for shares as a condition of employment must obtain the approval of the Department of Labour to the schemes proposed.**	75	(1) (*a*) to (*e*).
	PART VII.—MISCELLANEOUS.		
	1. BROKERAGE AS DISTINCT FROM COMMISSION.		
	The Companies Act, 1933, has various provisions relating to commission payable to persons for subscribing or procuring subscriptions to shares in a company's capital. There are no corresponding provisions relating to brokerage.	75	(1) (*a*) (*c*) (*e*).
	The two are confused in the public mind and the distinction is not clear. We draw attention to the distinction in pages 75 and 76.		
	As our law stands at present, it requires the disclosure of amounts paid or agreed to be paid as commission, but requires no disclosure of amounts paid or agreed to be paid as brokerage. The dangers are obvious.		
	We recommend,—		
(85)	**That there be added to section 55 of the Companies Act, 1933, a new provision requiring that there be stated in every balance-sheet of a company a statement of all sums paid by way of brokerage (as distinct from commission) in respect of any shares or debentures issued by the company, and that brokerage on debentures shall be provided for out of share capital.**	76	(1) (*a*) (*c*) (*e*).

SUMMARY—*continued.*

No. of Recommendation.	Summary of Findings and Recommendations.	Page in Report.	Order of Reference Paragraph.
(86)	**That the matters required in the prospectus or statement in lieu of prospectus include all payments made or to be made by way of brokerage.**	76	
	2. AUDITING OF LIQUIDATORS' ACCOUNTS IN VOLUNTARY LIQUIDATIONS.		
	There is no provision in the Companies Act, 1933, providing for the audit of a liquidator's accounts in respect of a company in voluntary liquidation. Such an omission should be remedied— (*a*) As an ordinary business precaution; (*b*) To protect creditors and shareholders against the unnecessary dissipation of assets through an unduly prolonged liquidation.	76	(1) (*b*).
	We recommend,—		
(87)	**That there be added to section 228 of the Companies Act, 1933, a provision that the company in general meeting on appointing liquidators shall also appoint an auditor or auditors to audit the liquidators' accounts, and shall fix his remuneration.**	76	(1) (*b*).
	3. AUDITOR'S NAME ON PROSPECTUS.		
	Auditors may be named on prospectuses by promoters, but may not be appointed. If they are appointed, they may not be called in for a considerable period. In the meantime, the use of their names on a prospectus may have influenced investors.	76	(1) (*e*).
	We recommend,—		
(88)	**That every auditor named in the prospectus of a company shall have the rights given to the auditor of a company by subsections (2) and (3) of section 141 of the Companies Act, 1933, and shall, if and when required by the Corporate Investments Bureau, examine the books and records of the company and report on the same to the Bureau at the expense in all things of the company, or of the directors and promoters named in the prospectus.**	76	(1) (*e*).
	4. SIMILARITY IN NAMES OF COMPANIES.		
	Companies have been incorporated in Australia with the same name as, or one very similar to, the name of companies carrying on the same sort of business in New Zealand, and incorporated in New Zealand. This creates confusion and difficulty.	76	(1) (*a*).
	We recommend,—		
(89)	**That the Governments of the Australian States be approached and invited to reciprocate with the Dominion in legislation designed to meet this difficulty, and an administrative practice to make that legislation effective.**	76	(1) (*a*).
	5. ABUSE OF PROVISIONS RELATING TO PRIVATE COMPANIES.		
	Cases exist where a private company has been formed to take over a business. The vendors of the business have taken over mortgage debentures to the excess of assets over liabilities, and subscribe for a few shares, to comply with the provisions relating to memoranda of association. They become secured creditors. If the business proves unsuccessful, they exercise the ordinary rights of secured creditors and take over the assets. Current creditors may receive little or nothing.	77	(1) (*b*).
	We recommend,—		
(90)	**That a provision be included in the Companies Act, 1933, to the effect that no mortgage or charge fixed or floating shall be given by a private company except in respect of a *bona fide* cash advance by the mortgagees made contemporaneously with the execution of the mortgage.**	77	(1) (*b*).
	6. GENERAL PENAL CLAUSE.		
	There are some provisions in the Act requiring certain things to be done, but in respect of which there is no penalty if such things are not done.	77	(1) (*a*) to (*e*).
	We recommend,—		
(91)	**That there shall be added to the Act a general penal clause providing a penalty applicable where any such act or thing is required to be done and no penalty is fixed in relation to any failure or refusal to perform such act.**	77	(1) (*a*) to (*e*).

SUMMARY—*continued.*

No. of Recommendation.	Summary of Findings and Recommendations.	Page in Report.	Order of Reference Paragraph.
	7. EVASION OF LIABILITIES AND RATIFICATION OF IRREGULARITIES.		
	We have evidence of two objectionable devices, the first of which is designed to evade liabilities, the second to obtain ratification of invalid acts.	77	1 (*b*).
	These are especially likely to be used when control is in the hands of a small group with a common interest opposed to other interests in the company.		
	In pursuit of the former objective, directors may assign to a friend for valuable consideration all right of action which a company may possess against the directors or any one of them in relation to any act or omission of such directors or any of them.		
	In pursuit of the latter objective, directors obtain a general ratifying or "whitewashing" resolution in respect of previous transactions.		
	We recommend,—		
(92)	**That, whenever on any proceedings based upon or involving an inquiry into the alleged acts or omissions of promoters, directors, or officers of a company, a ratifying resolution of a meeting of directors or of a general meeting of the company shall be pleaded in bar of the proceedings, the Court shall have jurisdiction to inquire into the circumstances of the case; and, if it appears to the Court that the alleged acts or omissions affect the interests of any persons or any class of persons who were not present or represented at the meeting in question, the Court may thereupon inquire into such acts or omissions and adjudicate thereon as if such ratifying resolution had never been passed, whether the said resolution shall have been passed before or after this enactment.**	77	(1) (*b*).
(93)	**That, whenever on any such proceedings a prior assignment of all rights of action by the company shall be pleaded in bar of the proceedings, the Court may inquire into the circumstances in which such assignment was made; and if it appears to the Court that the said assignment is collusive only and designed to protect promoters, directors, or officers of the company, the Court shall have power to declare such assignment to be collusive and invalid and to set it aside accordingly.**	78	(1) (*b*).
	8. SECTION 50 OF THE COMPANIES ACT, 1933.		
	This section deals with the minimum subscription required to be stated in a prospectus, and provides that, if the minimum subscription is not obtained within four months from the date of issue of the prospectus, all moneys received from applicants for shares shall be forthwith repaid to them without interest.	78	(1) (*e*).
	Having in mind the present tendency towards the flotation of enterprises requiring large capitalization, we consider that the provisions may at times prove to be unduly restrictive.		
	We recommend,—		
(94)	**That, where after inquiry the Corporate Investments Bureau deems it to be in the public interest so to do, it may extend the period of four months to such longer period as the Bureau shall think fit, not exceeding eight months in all.**	78	(1) (*e*).
	11. TRUSTEE SHAREHOLDERS: A VULNERABLE POINT IN COMPANY LAW.		
	The Companies Act requires members of companies, as the price of the advantages of incorporation and limited liability, to disclose their identity in public registers.	78	1 (*a*). 1 (*e*).
	It also enunciates the principle that, on these registers, no notice of any trusteeships shall be entered, so that companies shall be excused from the onerous task of noting and protecting equitable interests.		
	This qualification of the principle of disclosure, by the conflicting principle of non-recognition of trusts lets in and protects the device of the "dummy" member. Round this device many nefarious practices gather and find sanctuary to the great detriment of the public interests and clean business ideals. The least of the evil is a denial of information; at its worst it is a positive deception.		
	The public interests may be fully protected without subtracting from the necessary safeguard for companies in the matter of trusts and equitable interests.		

SUMMARY—*continued.*

No. of Recommendation.	Summary of Findings and Recommendations.	Page in Report.	Order of Reference Paragraph.
	We recommend,—		
94A	**That section 106 of the Companies Act, 1933, be amended—**	78	1 (*a*) 1 (*e*).
	(i) So that every company shall keep an index of the names of its members :		
	(ii) To provide that (without prejudice to section 111) all trusts in relation to shareholdings in a company shall be notified to the company, and a minute of the same shall be entered opposite the shareholder's name in the index :		
	(iii) So that non-compliance with this provision shall be a punishable offence, and that any trusts not so notified shall be unenforceable at law or in equity.		
	PART VIII.—OPERATION OF THE PRESENT STATUTE GOVERNING THE CONSTITUTION AND REGISTRATION OF STOCK EXCHANGES IN NEW ZEALAND.		
	Certain conditions are necessary for the establishment of an efficient stock-exchange market :—	79 *et seq.*	(3).
	(*a*) There must be a sufficient number of members in contact to make for active buying and selling.		
	(*b*) Meetings on the exchange must be frequent enough to enable business to be practically continuous.		
	(*c*) The integrity and efficiency of the individuals who comprise the exchange must be such as to create a justifiable feeling of confidence among investors.		
	Under the present statute it is possible for stock exchanges to be formed in New Zealand which do not conform to these conditions.		
	Under the present Act the minimum membership required before an exchange can be registered is seven, without reference to their places of business. They may be located in seven different towns.	82	
	This number is too low. A body comprising only seven members is an exchange in name only. An exchange cannot operate as such if its members reside in different towns.		
	We recommend,—		
(95)	**That the minimum membership of any stock exchange registered in New Zealand shall be as follows :—**	83	(3).
	In towns with a population of not more than—		
	20,000 inhabitants .. .. 12 members.		
	50,000 inhabitants .. .. 15 members.		
	Over 50,000 inhabitants .. .. 20 members.		
(96)	**That, for the purpose of the computation of membership as above, the separate members of any firm or the employees thereof shall not be considered separately, but only one member shall be counted for each such firm.**	83	(3).
(97)	**That the members of any such exchange shall be resident within a twenty-mile radius of the post-office of the town in which the exchange is formed, and that their place of business shall be located in such town.**	83	(3).
(98)	**That all existing stock exchanges shall be required to conform to the above conditions within a period of six months from the passing of the Act embodying the above recommendations ; and that, failing compliance, registration shall be cancelled.**	83	(3).
	It is important that membership of an exchange should be effective and not nominal.		
	We recommend,—		
(99)	**That the secretary of an exchange shall keep a roll of members present at all calls of the exchange, as hereinafter provided for.**	83	(3).
(100)	**That any member who attends less than two-thirds of the calls in any financial year of an exchange of which he is a member shall forfeit membership, provided that the Stock Exchange Association of New Zealand may reinstate such member in cases where in its opinion a good and sufficient reason is shown.**	83	(3).
(101)	**That, where the membership of an exchange falls below the minimum numbers set out in recommendation No. (95) above, for a period of three consecutive months, the Corporate Investments Bureau shall have power to cancel the registration of such exchange.**	83	(3).

SUMMARY—*continued.*

No. of Recommendation.	Summary of Findings and Recommendations.	Page in Report.	Order of Reference Paragraph.
(102)	**That the Corporate Investments Bureau shall have power to cancel the registration of an exchange where the average attendance at calls falls below the following for any period of six months ended 31st December, and 30th June in any year :—** **In towns with a population of not more than—** **20,000 inhabitants. An average attendance of 8 members.** **50,000 inhabitants. An average attendance of 10 members.** **Over 50,000 inhabitants. An average attendance of 15 members.**	83	(3).
	In regard to calls and quotations,		
	We recommend,—		
(103)	**That every registered exchange shall have a regular place of meeting, the location of which shall be notified to the Corporate Investments Bureau.**	83	(3).
(104)	**That, at such place of meeting, calls or meetings shall be held at least once daily, save on such public holidays or other occasions as are prescribed in the rules of the exchange.**		
(105)	**That sales and quotations made at such calls or meetings shall be made available to the press for publication on the day during which the calls or meetings take place.**		
	Since quotations of the prices at which small parcels are sold may be misleading,		
	We recommend,—		
(106)	**That no sales be recorded save where the number or value of securities sold is equal to or greater than the following :—** **(*a*) Local-body debentures £200 face value.** **(*b*) New Zealand Government stock bonds or debentures—** **Where free of tax £500 face value.** **Where not free of tax £200 face value.** **(*c*) Other securities except mining shares : 100 shares or £100 worth, whichever is lower in value.** **(*d*) Mining shares—** **Up to 1s. quoted price .. .. 300 shares.** **Over 1s. to 2s. 6d. quoted price .. 200 shares.** **Over 2s. 6d. to 5s. quoted price .. 100 shares.** **Over 5s. quoted price .. .. 50 shares, or £50 worth.**		
	The organization and control of stock exchange and the statute governing brokers and stock exchanges in New Zealand are inadequate to protect the investing public and the reputation of reliable brokers and exchanges.	83	(3).
	The licensing of sharebrokers appears to have been regarded in the main as a formal matter.		
	There is little to prevent people from forming an exchange whose sole qualifications are that they have been granted a license according to a standard and practice which offers no assurance that they are men of high reputation and financial standing ; and wish to form an exchange.		
	In such circumstances undesirable practices may develop to the detriment of investors and reputable sharebrokers and exchanges. An exchange may, at present, be formed to further the interests of a particular group.	84	(3).
	More effective control over brokers and exchanges should be exercised.		
	We recommend,—		
(107)	**That the Stock Exchange Association of New Zealand be incorporated by statute as a society or association.**	84	(3).
(108)	**That all stock exchanges at present existing or hereafter established shall be affiliated to the Stock Exchange Association of New Zealand.**	84	(3).
(109)	**That the Stock Exchange Association of New Zealand shall prepare rules governing such matters as conditions of membership, the conduct of stock exchanges, and the infliction of fines or other penalties on affiliated stock exchanges, such rules before adoption to be approved by the Governor-General, on the recommendation of the Corporate Investments Bureau.**	84	(3).

SUMMARY—*continued.*

No. of Recommendation.	Summary of Findings and Recommendations.	Page in Report.	Order of Reference Paragraph.
(110)	**That the rules of all stock exchanges shall be approved, before adoption, by the Governor-General in Council on the recommendation of the Corporate Investments Bureau.**	84	(3).
(111)	**That, in the case of conflict between the rules of the Stock Exchange Association of New Zealand and of any stock exchange, the rules of the former shall override those of the latter.**	84	(3).
(112)	**That the control of the Stock Exchange Association of New Zealand shall be in the hands of a conference which shall meet at least once annually.**	84	(3).
(113)	**That each stock exchange shall be entitled to representation at such conferences on the basis of one representative for each ten members and each fraction thereof exceeding five but less than ten.**	84	(3).
(114)	**That there shall be an executive committee which shall be elected annually by the conference.**	84	(3).
(115)	**That every broker or salesman of shares or other securities shall be registered with the Corporate Investments Bureau.**	84	(3).
(116)	**That each broker or salesman of shares or other securities whose name is placed on the register shall be an individual, and in no case shall a limited-liability company be registered.**	84	(3).
(117)	**That every applicant for registration shall be required to apply in writing to the Corporate Investments Bureau, giving such particulars as are required by the Bureau.**	84	(3).
(118)	**That accompanying the application for registration there shall be required—** **(*a*) A certificate of approval from the Magistrate residing or exercising jurisdiction in the district in which the applicant resides :** **(*b*) Such financial guarantees as may be required from time to time by the Governor-General in Council.**	84	(3).
(119)	**That applications for membership of a stock exchange shall be approved by the Corporate Investments Bureau, and the applicant shall then be eligible for membership of such stock exchange, subject to election under its rules.**	84	(3).
(120)	**That power to cancel membership for a breach of its rules shall lie with a stock exchange in respect of its members, subject to the rules of such stock exchange.**	85	(3).
(121)	**That, subject to a right of appeal to the Court, the Corporate Investments Bureau shall have power to cancel the registration of any broker or salesman of shares or other securities, or to close any exchange.**	85	(3).
(122)	**That the Stock Exchange Association of New Zealand shall present an annual report to the Corporate Investments Bureau on such matters as are required by the Bureau, together with reports on such special matters as may be demanded from time to time.**	85	(3).
(123)	**That the Corporate Investments Bureau shall have power to veto the official listing of any security on any exchange.**	85	(3).
(124)	**That the proposed Act incorporating the Stock Exchange of New Zealand shall embody the foregoing recommendations.**	85	(3).
	PART III.		
	4. F. (2) AN ALTERNATIVE RECOMMENDATION, *i.e.*, TO THE ABOLITION OF THE BOND SYSTEM.		
	We have strongly urged the adoption of recommendations Nos. (18) and (19), which propose the abolition of the bond system of finance for land-utilization companies. Failing such adoption, we recommend that the provisions which follow be made applicable to all existing and future bond-issuing companies. These recommendations are not adequate to solve the problems with which we have been confronted. They leave many inherent defects and dangers for which we can find no satisfactory remedies. We have drawn attention to the uncertainty which exists as to whether or not an offer to the public to subscribe for bonds is an invitation falling within the definition of a prospectus. This uncertainty should be removed. For convenience, we repeat, in recommendation No. (20), the principles embodied in recommendation No. (4).	43	(1) (*a*) to (*e*).

SUMMARY—*continued.*

No. of Recommendation.	Summary of Findings and Recommendations.	Page in Report.	Order of Reference Paragraph.
	We recommend,—		
(20)	**That all provisions of the Companies Act, 1933, relating to prospectuses for shares and debentures proper be made applicable (as far as possible) to proposed issues of bonds, forestry and land-utilization contracts, and such instruments in series.**	43	(1) (*e*).
	The bondholder has no rights other than the performance of the contract between him and the company, or, in the alternative, an action for damages. Nevertheless, it is clear that an entirely illusory atmosphere of security has become associated with the instruments sold by land-utilization companies—an illusion engendered by effective sales talk and the special connotation of the term "bond" itself. The manner in which the bond contract is described in "prospectuses" is not calculated to dispel this illusion. The least that should be required is that the security behind "bonds" shall be prominently and unambiguously stated.	43	(1) (*b*) (*c*) (*e*).
	We recommend,—		
(21)	**That, in addition to all requirements under recommendation No. (20) above, every prospectus for bonds and every bond certificate should contain a definitive statement, in a prominent place, in large type, giving the nature and effect of the instrument and the security (if any).**	43	(1) (*e*).
	We have already recommended that the position of bondholders be strengthened by extending to them the power now exercisable by shareholders in the right to apply to the Court (under section 142) for an inspection of a company's affairs. For convenience we repeat the suggestion here.	43	(1) (*b*).
	We recommend,—		
(22)	**That the right to apply to the Court for an inspection of affairs be granted to shareholders by sections 142 to 145 (inclusive) of the Companies Act, 1933, be extended to bondholders.**	43	(1) (*b*).
	Certain land-utilization companies have contracted to pay interest on fully-paid-up bonds until the plantations mature. Except where income from catch-crops is available, the interest is paid out of capital—in effect, out of moneys provided by the bondholders themselves. This is objectionable, because it reduces the working capital available and, in effect, weakens the security of the bondholder by encroaching on maintenance funds.	43	(1) (*c*).
	We recommend,—		
(23)	**That payment of interest on bonds shall be prohibited if and to the extent to which it is paid out of the capital of the bonds.**	44	(1) (*c*).
	In some cases companies have not appointed trustees for bondholders. In others both the trustees and the trust fund are domiciled outside the jurisdiction of the Courts of New Zealand. This has weakened the position of bondholders in New Zealand and rendered it more difficult for a drift to be detected or to enforce a remedy in the event of default. In at least one case the power to invest the trust funds has been vested in the company and not in the trustee. Investments have been made to serve the interests of the company.		
	We recommend,—		
(24)	(*a*) **That all companies, whether registered within or outside of New Zealand, raising capital by the sale of bonds or other similar contracts in New Zealand, whether the lands in respect of which bonds are issued are located in New Zealand or elsewhere, shall be required to appoint a trustee or trustees domiciled in New Zealand to represent bondholders in New Zealand, and that all moneys allocated to the trust fund shall be invested by the trustee and not by the company.** (*b*) **That, where two or more series of bonds are issued by any company, a separate trust deed shall be drawn up in each case covering each such series.** (*c*) **That, in respect of such issues by a company incorporated outside New Zealand, a separate trust fund shall be established in New Zealand, the fund to be invested by the New Zealand Trustee.**	44	(1) (*a*) (*b*) (*c*).

SUMMARY—*continued.*

No. of Recommendation.	Summary of Findings and Recommendations.	Page in Report.	Order of Reference Paragraph.
	Payments into the trust fund are not usually made until bonds are fully paid up. We consider that the trust fund should be built up from payments by instalments as they are received. The proceeds from forfeited bonds invariably go to the company. The company commits itself to expenditure on the strength of subscriptions and incurs the risk that share capital will be lost if bonds are not sold. Bondholders bear a similar risk, because, if insufficient bonds are sold, the company may be unable to fulfil its contract with them. Since both share the risk both should share the proceeds.	44	
(25)	We recommend,— (*a*) **That, as money is received from the sale of bonds, not less than one-half of each payment received should be placed in the trust fund until an amount has been paid into the trust fund equal to the amount agreed upon in respect of each bond.** (*b*) **That the amount so received and placed in the trust fund in respect of any bonds which shall be subsequently forfeited should be paid by the trustee to the company to be expended by the company on its main utilization purposes, and the area or rights in such area so planted should vest in the trustee for the benefit of bondholders generally.**	44	(1) (*d*).
	Bondholders provide the greater part of the capital invested in land-utilization companies. They are intimately concerned with the manner in which bond-moneys are expended, because this has a bearing on their security and on the capacity of a land-utilization company to fulfil its contracts. They should receive adequate information concerning the expenditure of bond-moneys to enable them to detect a drift and to reveal to them the extent to which unconscionable profits may be obtained or charges incurred.	44	(1) (*c*).
(26)	We recommend,— **That within one month of its annual meeting every land-utilization company should be required to forward a copy of its annual accounts, duly audited, to every bondholder, accompanied by an audited analysis (under defined heads) of the expenditure of the bond-moneys received. We would suggest the following table of heads under which the analysis should be made :—** **Total payments out of bond-moneys in respect of—** (*a*) **Land ;** (*b*) **Brokerage ;** (*c*) **Other selling-costs ;** (*d*) **Plant and maintenance ;** (*e*) **Administration ;** (*f*) **Trust fund ; and** (*g*) **Other expenditure.**	44	(1) (*c*).
	The first trustees to watch over the interests of bondholders are invariably appointed by the land-utilization company. Such trustees may prove unsatisfactory to bondholders, but in many cases bondholders possess no power to remove or replace trustees.	44	(1) (*b*).
(27)	We recommend,— **That every trust deed shall include a provision enabling a stated proportion of the bondholders, not less than 20 per cent., to take the initiative by steps provided in the trust deed, to effect the removal and replacement of the existing trustee.**	44	(1) (*b*).
	Most trustees report annually to bondholders on the state of the plantations and the amount of the trust fund. The rights and duties of trustees in regard to inspection and report are not always clearly defined in trust deeds, nor their power to appoint independent experts to advise on the plantations. A report made on advice given by an expert employed by the company loses much of its value.	44	(1) (*b*).

SUMMARY—*continued.*

No. of Recommendation.	Summary of Findings and Recommendations.	Page in Report.	Order of Reference Paragraph.
	We recommend,—		
(28)	**That every trust deed shall contain provisions requiring and enabling the trustee to obtain and distribute to bondholders at stated intervals independent expert reports on the state of the plantations.**	44	
	From time to time situations arise which make it desirable that bondholders be consulted by the trustee and a decision made by them. Trust deeds do not always make proper provision for the calling of meetings of bondholders, or for the registering of a decision by them.	44	(1) (*b*).
	We recommend,—		
(29)	**That every trust deed shall contain provisions relating to the convening and holding of meetings of bondholders and defining voting-power and providing for its exercise.**	44	(1) (*b*).
	Since the trust deed embodies some of the terms of the contract between the company and the bondholders, and since it determines and limits the powers and duties of trustees, it becomes a document of first-rate importance. It should be readily available for inspection by hondholders or the general public.	44	(1) (*a*) (*b*) (*c*).
	We recommend,—		
(30)	**That a copy of every trust deed of a land-utilization company be deposited with the Registrar of Companies.**	44	(1) (*a*) (*b*) (*c*).
	APPENDIX I.—SCHEDULE OF STATISTICAL INFORMATION TO BE REQUIRED OF LAND-UTILIZATION COMPANIES OPERATING IN NEW ZEALAND.	115	
	APPENDIX II.—SCHEDULE OF STATISTICAL INFORMATION TO BE REQUIRED OF INVESTMENT TRUSTS OR FINANCE COMPANIES ISSUING DEBENTURES IN SERIES.	116	
	APPENDIX III.—REALIZATION OF ASSETS OF LAND-UTILIZATION COMPANIES.	117	
	Serious obstacles become apparent when the realization of planted areas by bondholders is contemplated and planned.		
	Trustees are an unsuitable body to have charge of, or administer, realization schemes. In most cases incorporation of bondholders is a necessary preliminary step.		
	The difficulties facing incorporation are insuperable under the present law, and it is necessary that they should be removed.		
	Appendix III includes a draft Bill designed to remove these difficulties by the incorporation of bondholders and the setting-up of a Commission to consider reconstruction and realization proposals.	118	
	Since some plantations are already sufficiently advanced to necessitate realization projects, the need for action is immediate and urgent.		
	APPENDIX IV.—THE DIRECTION OF SAVINGS AND THE ENCOURAGEMENT OF SMALL SAVINGS.	126	
	Our main report demonstrates the dangers which besets the investor, especially the small investor, because of the existence of companies whose financial schemes are unsound and whose promoters and directors are often unscrupulous or display an unduly imaginative optimism.		
	In addition to the need for restrictive and regulative measures to discourage and prevent undesirable practices, there is the need for positive measures to direct and encourage savings. The various aspects of this problem include—		
	(1) The direction of savings into commercially sound or socially desirable enterprises :		
	(2) The establishment of a new type of investment company with a view to providing small investors with an opportunity to invest in enterprises whose financial schemes are sound and whose operations are under some special form of control :		
	(3) Improvement in the method of directing investment into public issues :		
	(4) Improvement in the machinery of company flotation to enable large issues to be more readily taken up to and enhance the security.		
	We outline various proposals directed to these ends and commend them for further investigation. In these proposals we give strong support to the principle of combining public with private control.		

The findings in this report are unanimous.

INQUIRIES STILL IN PROGRESS.

As a result of our first interim report, Inspectors were appointed by Your Excellency to inquire into the affairs of a group of investment trust companies and their affiliates and to report the result of those inquiries to the Supreme Court and the Attorney-General.

As the result of our second interim report similar appointments were made for an investigation into the affairs of a group of afforestation and timber companies and their affiliates, and in the case of these companies also the report of the Inspectors is to be made to the Supreme Court and to the Attorney-General.

A Royal Commission of Inquiry into the matters concerning the affairs of the Investment Executive Trust of New Zealand, Limited, and other companies was appointed in Sydney, New South Wales, on the 8th August, 1934. That Commission has conducted its sittings in public, and at the time of writing it has not completed its inquiries. We have been supplied with printed official copies of the evidence taken before this Commission, and a complete set of this evidence will accompany this present report. A copy of the report of the New South Wales Commission will no doubt be made available to Your Excellency's Advisers.

There are, therefore, three separate inquiries proceeding, and the resultant reports will, together with supporting statements of evidence, be made available to Your Excellency's Attorney-General, and we have no doubt that any matters raised by these documents, as well as the results of the reports to the Supreme Court of New Zealand, will be considered by Your Excellency's Advisers in conjunction with the relative portions of the report which we now have the honour to present.

APPRECIATION OF EFFORTS OF STAFF.

We desire to place on record our high appreciation of the services of the staff which has been placed at out disposal by the Public Service Commissioner. The work has been done promptly and with intelligence, and the members of the staff have willingly and cheerfully responded to the necessities of the case when overtime was called for to cope with the work.

We desire to record also our sense of indebtedness to the Secretary of the Commission, Miss E. Storry. She has performed a difficult task to our complete satisfaction, and has greatly facilitated our work.

In witness whereof we, Your Excellency's most obedient servants, have hereunto set out hands and seals at Auckland, this 10th day of October, 1934.

[L.S.] JOHN S. BARTON, Chairman.

[L.S.] H. BELSHAW,

[L.S.] F. E. GRAHAM, } Members of Commission.

APPENDIX I.

ANNUAL SCHEDULE OF STATISTICAL INFORMATION TO BE REQUIRED OF LAND-UTILIZATION COMPANIES OPERATING IN NEW ZEALAND.

Name of company :

Date and place of incorporation :

Whether still operating or in liquidation :

Date of liquidation :

Main purpose :

Area owned :

Area planted (excluding replanting) :
During current year : acres in
Total area : acres in

Share capital—
(1) Nominal .. .. ..
(2) Subscribed .. .. ..
(3) Paid-up cash .. ..
(4) Other than cash .. ..
(5) Total (3) and (4) .. ..

[*Indicating different classes—if any—e.g.*, ordinary, deferred, preference, redeemable preference.]

If the use of bonds is to be permitted in the future.

CAPITAL OBTAINED BY WAY OF "BONDS," "DEBENTURES," OR PLANTING AND MAINTENANCE CONTRACTS OTHERWISE DESCRIBED.

Total number sold to date .. ..
Total number fully paid up to date ..
Total nominal value sold to date .. £
Total amount received to date .. £

Forfeiture.
Total number forfeited to date :
Total nominal value : £
Total amount received : £

Total number sold and total amount received therefrom—
In New Zealand : Number : . Amount received : £
In other countries [*State the countries*] : Number : . Amount received : £
Number : . Amount received : £
Number : . Amount received : £

Distribution of capital to date on—
Land and improvements .. .. £
Planting, maintenance, and administration .. .. £
Brokerage .. .. £
Selling-costs .. .. £
Trust funds .. .. £
Other .. .. £

APPENDIX II.

ANNUAL SCHEDULE OF STATISTICAL INFORMATION TO BE REQUIRED OF INVESTMENT TRUSTS OR FINANCE COMPANIES ISSUING DEBENTURES IN SERIES.

I. Name of company :

II. Date and place of incorporation :

III. Share capital :—

	Ordinary.	Preference.	Total.
(1) Nominal			
(2) Subscribed			
(3) Paid up, cash			
(4) Other than cash			
(5) Total (3) and (4)			

IV. Reserves :

V. "Debenture" Capital :—

(1) Nominal value per debenture .. .. £
(2) Total number sold to date .. ..
(3) Total number fully paid to date .. ..
(4) Total nominal value sold to date .. .. £
(5) Total amount received to date .. .. £
(6) Forfeitures—

Total number ..	..	..	..	..
Nominal value ..	..	..	..	..
Amount received ..	..	..	..	..

(7) Total number sold and amount received therefrom :—

In New Zealand .. Number : . Amount received : £

In other countries—

[*State the countries.*]
Number : . Amount received : £
Number : . Amount received : £
Number : . Amount received : £

VI. Investments—

Value of investments as appearing in latest balance-sheet—

Amount : £ . Date :

State basis of valuation :

Distribution of investments :—

	Valuation. £ s. d.	Per Cent. of Total Valuation.
(1) Type of undertaking—		
Government securities		
Local bodies		
Industrial and commercial ..		
Financial—		
Banks		
Other		
Total		

	Valuation. £ s. d.	Per Cent. of Total Valuation.
(2) Nature of security—		
Bonds, debentures, and debenture stocks		
Preference and guaranteed shares or stocks		
Ordinary shares or stocks ..		
Total		

	Valuation. £ s. d.	Per Cent. of Total Valuation.
(3) Geographical domicile—		
Securities domiciled in—		
New Zealand		
Australia		
Great Britain		
Other		
Total		

APPENDIX III.

REALIZATION OF ASSETS OF LAND-UTILIZATION COMPANIES.

It has been represented to us by the legal advisers and officers of several companies that serious obstacles become apparent when the realization of planted areas by bondholders is contemplated and planned.

It is generally agreed that trustees acting for bondholders are an unsuitable body to have charge of, or administer, working operations connected with the realization of forests or other plantations. Considerations governing their appointment and the exercise of their powers are different from those which would govern the appointments of directors or executives of a realization company. The incorporation of bondholders in a realization company is therefore, in most cases, a necessary preliminary to the realization of the assets.

The difficulties facing the establishment of such a company are insuperable under the present law, and it is urgently necessary that these difficulties should be removed. These may be stated as follows:—

(1) *The title* of the bondholder consists not in a claim to an individual acre per bond, but to an aliquot part of a large area which he holds *in common* with other bondholders in a series. In some companies provision is made in the trust deed that a [*specified*] majority decision of bondholders in respect of a realization policy shall be binding on all. In many companies this does not apply, and a unanimous vote is required before such a policy can be safely put into effect. Such a unanimous vote is practically impossible to get, because bondholders are scattered.

(2) If certain companies should seek to procure the adoption of schemes of conversion of bonds into shares by inviting the bondholders to subscribe for the necessary shares, the existing provisions of the Companies Act would operate to defeat the scheme. We refer to the provisions of section 50 of the Companies Act, 1933, which requires that 60 per cent. of the minimum subscription of shares offered by a prospectus or other invitation must be received *within four months* of the issue of the prospectus. The bondholders of some companies are so scattered that this time-limit represents a prohibition. This would be specially likely to occur if it were deemed necessary to raise additional capital, and not simply to obtain agreement to incorporate and convert bonds into shares.

(3) *The costs* involved in the incorporation of bondholders and the transfer of areas to bondholders may be heavy.

We have given considerable thought to this matter, and have concluded that it is impracticable to recommend a common formula applicable to all companies, because conditions differ so much in respect of different companies. We consider, also, that it would be unduly cumbersome if each company were required to have its own scheme incorporated in a private Act.

The position would best be met if provision were made for a common procedure along the lines indicated in the draft Bill given below.

There is at least one company which has taken an important preliminary step towards realization of its main asset for the benefit of its bondholders. A meeting of bondholders was held and it passed resolutions constituting and electing the members of a Realization Board. That Board is a trustee for all the bondholders, and all the trust funds and other assets of the bondholders are now vested in it as such trustee. Section 4 of the draft Bill is designed to meet the case of this company.

The innate conservatism of many bondholders and their suspicion of any suggestion to alter their rights and privileges would tend to make it impossible for the directors of a company to procure the necessary majority. The approval of the scheme by an independent statutory body would tend to remove this difficulty.

Since certain companies have now reached the stage when realization schemes must soon be put into operation, we would respectfully urge the need for early action.

[*Draft Bill.*]

THE LAND-UTILIZATION COMPANIES EMPOWERING BILL, 1934.

A BILL INTITULED

AN ACT to make Provision for the Incorporation in a Company of Persons who have taken up Bonds from Land-utilization Companies and for the Exchange of such Bonds for Shares in the Company so incorporated.

WHEREAS divers persons (hereinafter called "bondholders") have from time to time entered into contracts with land-utilization companies (as hereinafter defined) carrying on business in New Zealand, in terms of which contracts such land-utilization companies for the considerations expressed in such contracts undertake to procure or provide land and to plant the same with products (as hereinafter defined) and thereafter to care for and maintain the same for such period as is in the said contracts provided, or to procure or provide land on which such products are already growing, and to develop and thereafter care for and maintain the same as aforesaid; and, in either case, on or before the expiration of such period of maintenance to transfer or otherwise account for the whole or a part of the said land and the products thereof or the proceeds thereof or of the products of the said land or the proceeds of such products to such bondholders either individually or as tenants in common or to a trustee acting on their behalf: And whereas bondholders in New Zealand and abroad have subscribed large sums of money in pursuance of such contracts and certain trusts and trust funds have been established in connection therewith: And whereas, owing to the large numbers of such bondholders and to the fact that they are not an incorporated body or bodies and to the limited powers of the trustees acting on their behalf, difficulties have arisen or may arise in realizing or otherwise turning to account such lands or products: And whereas it is just and equitable in the circumstances and also in the public interest that power should be given to incorporate such holders of bonds into a company or companies in manner hereinafter appearing, and to provide that the provisions of this Act may in certain cases extend to bonds or bond contracts which have been extinguished:

BE IT THEREFORE ENACTED by the General Assembly of New Zealand in Parliament assembled, and by the authority of the same, as follows:—

1. This Act may be cited as the Land-utilization Companies Empowering Act, 1934.
2. In this Act, unless the context otherwise requires,—

"Land-utilization company" means and includes any person who has entered (or may hereafter enter) into a bond contract with a bondholder:

"Bond contract" means and includes any contract now or hereafter subsisting by whatever name called made between a land-utilization company and a bondholder upon terms (*inter alia*) that for the considerations on the part of such bondholder expressed in such contract such land-utilization company has undertaken or undertakes to procure or provide land and to plant the same with products and thereafter care for and maintain the same for such period as is in the said contract provided or to procure or provide land on which such products are already growing and to develop and thereafter care for and maintain the same as aforesaid; and, in either case, on or before the expiration of such period of maintenance to transfer or otherwise account for the whole or a part of the said land and the products thereon or the proceeds thereof or of the products of the said lands or the proceeds of such products to such bondholders either individually or as tenants in common or to a trustee acting on their behalf:

"Bondholder" means and includes any person who is the holder of a bond or bond contract and includes the executors, administrators, and assigns of any such holder, and any person who in the opinion of the Commission has authority to administer the estate of any such holder or any portion of his estate which includes such bonds or bond contracts, and whether as committee, manager, administrator, interim curator, *curator bonis*, or otherwise:

"Bond" means the unit, by whatever name called, representing one undivided interest in any group area and acquired by a bondholder under a bond contract:

"Group" means the bondholders entitled under bond contracts to undivided interests in the same group area, or in the products of such group area, or in the proceeds of such group area or products, and includes a land-utilization company and any person claiming through such land-utilization company in so far as and to the extent that it or he is entitled to share in such group area products or proceeds as aforesaid:

"Group Area" means the land and the products thereon allocated or to be allocated for the purpose of satisfying the obligations of a land-utilization company under bond contracts entered into with a group or the members thereof:

Provided that in any case where the bondholders under their bonds or bond contracts are entitled to share only in the products of the land the term "group area" shall mean such products only and shall not include the land on which such products are growing:

"Person" means and includes any person, firm, association of persons, body corporate, or incorporated company:

"The Commission" means "The Land-utilization Companies Commission" to be set up in pursuance of section seven of this Act:

"Trust deed" means any deed or other instrument whereby a trustee is appointed for or on behalf of any group or any part of a group:

"Trustee" means any person appointed trustee under a trust deed, and includes any substituted trustee and any person who with the express or the implied consent of a land-utilization company and of the bondholders in any group or part thereof purports to act as trustee for such group or part thereof as the case may be:

"Products" mean and include trees and plants used for the production of timber, wood pulp, tung oil, tobacco, citrus fruits, flax, or any other products of land which may be included by Proclamation made as provided by section six hereof or of any merchandise derived from such respective products.

3. (1) Notwithstanding the provisions of section four of this Act every land-utilization company carrying on business or any part of its business in New Zealand shall within three months after the coming into operation of this Act file with the Assistant Registrar of Companies at Wellington a statement headed "In the matter of the Land-utilization Companies Empowering Act, 1934", and containing the following particulars:—

(*a*) The name of the company:

(*b*) The situation of its registered office:

(*c*) The names and addresses of the secretary and of the directors of the company.

(*d*) The names and addresses of the trustees for its bondholders:

(*e*) The number and face value of the bonds and bond contracts issued by it, and the area of the lands affected thereby.

(2) Every such company shall supply such further information as may from time to time be required by the Commission by notice in writing addressed to the registered office of the company.

(3) If any land-utilization company fails to comply with or acts in contravention of the provisions of this section, then such company and the directors and secretary thereof shall each be liable on summary conviction to a fine not exceeding one hundred pounds.

4. (1) The Commission on the application either of any land-utilization company or of any trustee for the bondholders of such company may at any time order that this Act shall apply to such company and to the bond contracts of such company:

Provided that the Governor-General on the application of the Commission may at any time by Proclamation published in the *Gazette* order that this Act shall apply to any land-utilization company named in such Proclamation and to the bond contracts of such land-utilization company, notwithstanding that no application as aforesaid shall have been made to the Commission.

(2) The provisions of this Act shall apply to such company and to the bond contracts of such company from and after the date of such Order or Proclamation made as aforesaid.

(3) Provided, however, that on the joint application of any land-utilization company and the trustees for its bondholders the Commission, on being satisfied that it is in the best interests of the company and the bondholders or of any group so to do, may order that the provisions of this Act shall not apply to such company, its bonds and bond contracts, or to any group and group area thereof for such period not exceeding twelve months from the date of such application, and on such terms and conditions (if any) as to the Commission may seem just equitable and expedient.

5. The Commission, on the joint application of any land-utilization company and the trustee for its bondholders, may order that the provisions of this Act shall *mutatis mutandis* apply to such company and to the bonds and bond contracts of such company notwithstanding that such bonds or bond contracts have, prior to the coming into operation of this Act, been extinguished either wholly or in part by reason of the vesting of any group area trust funds or other assets in a trustee for the bondholders.

6. The Governor-General may on the application of any person at any time and from time to time by Proclamation published in the *Gazette* add to the definition of the term "Products" in section two hereof by including therein any products of land not now included therein.

PART I.

The Land-Utilization Companies Commission.

7. There shall be a Commission, to be called the Land-utilization Companies Commission, which shall have and may from time to time exercise the jurisdiction and powers conferred upon it by this Act.

8. (1) The Commission shall consist of three members. Such members may be appointed from time to time by the Governor-General, who may from time to time remove such members or any of them and may appoint other members to fill any vacancy.

(2) Every member of the Commission shall hold office for such period and subject to such conditions as to tenure and otherwise as may be determined by the Governor-General.

9. The Commission may from time to time appoint a clerk to the Commission and such other officers as may be necessary upon such terms and conditions as to remuneration and otherwise as may from time to time be determined by the Governor-General.

10. The Commission shall have a seal in such form as may be determined by the Chairman of the Commission. Such seal shall be judicially noticed in all Courts of judicature and for all purposes.

11. (1) There shall be established a fund to be called "The Land-utilization Companies Commission Fund", to which shall be paid all moneys receivable by the Commission under the provisions of this Act.

(2) The said fund shall be public money within the meaning of the Public Revenues Act, 1926, and shall be applied for the purpose of paying the remuneration and expenses of the Commission.

12. (1) There shall be paid to the Commission in respect of any application or other proceedings pursuant to the provisions of this Act by such party or parties to the proceedings, and in such manner and at such time or times as the Chairman of the Commission may from time to time direct, fees in accordance with a scale to be fixed from time to time by the Governor-General.

(2) In addition to the fees payable as provided in the preceding subsection the Commission may from time to time and at any time, being not more than one year from the passing of this Act, with the approval of the Governor-General make a levy or levies on the land-utilization companies to which this Act applies not exceeding in all the sum of one hundred pounds in the case of any one of such companies. Such levy or levies shall be paid and borne by such respective companies in such proportion as to the Commission may seem equitable.

13. Each member of the Commission shall receive as remuneration for each day or part of a day on which he is engaged on the business of the Commission according to a scale to be fixed from time to time by the Governor-General.

14. The Clerk to the Commission or other person appointed in that behalf by the Commission shall keep proper books in which shall be entered minutes of all proceedings before the Commission.

15. Subject to the provisions of this Act, the rules determining the practice and procedure of the Commission shall be such as may be made in that behalf from time to time by the Commission.

16. Any application made by any person in pursuance of this Act shall be forwarded by registered post or delivered to the Clerk of the Commission, and shall be in such form (if any) and shall contain such particulars (if any) as may be determined by the Chairman of the Commission.

17. Forthwith after any application or other proceeding under this Act has been so forwarded or delivered the Clerk shall notify the fact to the Chairman.

18. (1) The sittings of the Commission shall be held at such times and places as are from time to time fixed by the Chairman.

(2) It shall be the duty of the Clerk to the Commission to give to each member of the Commission and to all persons named by the Chairman at least fourteen clear days' previous notice of the time and place of each sitting.

19. At any sitting of the Commission the Chairman and any one member shall form a quorum.

20. Subject to the provisions of this Act the provisions contained in sections three to twelve (both inclusive) of the Commissions of Inquiry Act, 1908, shall apply to the Commission and to proceedings before the Commission as if the Commission were a Commission of Inquiry appointed under the said Act and the proceedings before it were an inquiry under the said Act.

21. The proceedings before the Commission shall not be open to the public or to the press and no report or account of the evidence or other proceedings before it shall be published save with the consent of the Commission. The breach of any of the provisions of this section shall be an offence and every person who commits such offence shall be liable on summary conviction to a fine not exceeding *one hundred pounds*.

22. (1) The Commission may act on any sworn testimony, and in the event of no direct personal evidence being available within the Dominion of New Zealand the Commission may act on any unsworn testimony, and the Commission may in either event receive as evidence any statement, document, information, or matter which in the opinion of the Commission may assist the Commission, to deal effectually with the matters before it whether the same would apart from this section be legally admissible evidence or not.

(2) Subject to the foregoing provisions of this section, the Evidence Act, 1908, shall apply to the Commission and to the members thereof and to all proceedings before the Commission in the same manner as if the Commission were a Court within the meaning of that Act.

23. In order that full effect may be given to the intent of this Act the Commission shall in every matter coming before it have full power and jurisdiction to deal with and determine such matter and all questions arising in connection therewith in such manner and to make such order not inconsistent with the provisions of this Act as it deems just and equitable under the circumstances of the case, notwithstanding that express provision in respect of such matter or questions is not contained herein.

24. (1) The decision of a majority (including the Chairman) of the members present at a sitting of the Commission or, if the members present are equally divided in opinion, then the decision of the Chairman shall be the decision of the Commission.

(2) The decision of the Commission shall in every case be signed by the Chairman and shall be delivered by him. No dissenting opinion shall be announced in any case.

25. (1) Whether the Commission at any sitting thereof is duly constituted as required by the provisions of this Act or has been duly convened for such sitting are matters to be determined by the Chairman whose decision thereon shall be final and conclusive, and shall not be questioned in any proceedings before the Commission or in any Court.

(2) The fact that a sitting of the Commission has been held shall be conclusive evidence of a decision by the Chairman that the Commission was duly constituted at and was duly convened for that sitting.

Part II.

Incorporation of Company.

26. Each land-utilization company to which this Act applies shall within three months after the date on which this Act is made to apply to such company or within such further or extended time as may be granted by the Commission apply to the Commission for an order that a company be incorporated for the purposes and in the manner hereinafter appearing. If any land-utilization company fails to make such application within the period above-mentioned, then such application may thereafter be made at any time by any bondholder who has entered into a bond contract with such land-utilization company or by any trustee for such bondholder:

Provided, however, and notwithstanding anything herein contained to the contrary, the Commission may at any time in such cases as it thinks fit and whether before or after the periods above mentioned, give notice in writing to any such company that it intends to proceed as if such application had been made to it by such company, and such company shall thereupon for all purposes be deemed to have applied to the Commission under the foregoing provisions of this section.

27. Without in any way limiting the power of the Commission by its order to approve of and include such additional powers and objects as it may think fit, the objects of the company shall include either or both of the following objects as may be determined by the Commission:—

(*a*) The acquisition of all bonds and bond contracts issued by the land-utilization Company so applying; or

(*b*) The acquisition of all group areas affected by all bonds and bond contracts issued by such land-utilization company or of any specified interest therein as determined by the Commission.

28. In this Part and in Part III of this Act the words "the company" mean a company incorporated or to be incorporated under the provisions of this Part of the Act.

29. Subject to the provisions of this Act, the following provisions shall apply to the company:—

(*a*) The shares in the company shall be divided into classes equal in number to the number of groups whose bonds and bond contracts or group areas are to be acquired by the company. Where the bondholders or other persons interested in any group are entitled to differing rights, then such classes shall be further subdivided into such subclasses as may in the opinion of the Commission be expedient to enable an equitable adjustment to be made of the rights of the members of the group:

(*b*) One of each such classes of shares subdivided where necessary into subclasses as provided in the preceding paragraph of this section shall be allocated to each group to the intent that the holders of each such class or subclass of shares shall as one body be entitled as against the company and the other holders of shares in the company to the aggregate of all rights to which the holders of that class or subclass were entitled under their bonds, bond contracts, or other interests in the group area :

(*c*) The shares so allocated to each class or subclass shall be divided amongst the members of such group to the intent that each such member shall retain as nearly as may be the same proportionate interest in the property and rights allocated as aforesaid to such class or subclass of shares :

(*d*) The amount unpaid on the shares to be so allocated to any member of a group shall not exceed the amount (if any) unpaid on the bonds or bond contracts held by him and in respect of which such shares are so allocated :

(*e*) The calls on any partly unpaid shares issued as aforesaid to any member of a group shall as nearly as may be be made in the manner at the times and in the amounts provided in the bonds or bond contracts in respect of which such shares are allocated :

(*f*) Any holder of such partly unpaid shares shall have the same rights (if any) of or in respect of the surrender of such shares so allocated to him as he had of or in respect of the surrender of the bonds or bond contracts for which such shares are allotted :

(*g*) The foregoing provisions of this section shall apply, *mutatis mutandis*, to a case where only one group is incorporated in the company.

30. (1) The Commission may on any such application, subject to the provisions of the Companies Act, 1933, at any time and from time to time, by order, determine—

(*a*) The name of the company :

(*b*) Its memorandum of association and the signatories thereto :

Provided, however, that if and in so far as any method or methods shall have been prescribed by a bond, bond contract, or trust deed for the maintenance, realization, or disposition of a group area, the same shall with such variations, modifications, or additions as the Commission considers expedient be incorporated as an object or objects in such memorandum unless the Commission otherwise orders :

(*c*) Its articles of association, including, but without limiting the powers of the Commission to include all other provisions it may deem expedient, the provisions relating to the rights of voting to the appointment of directors to the method of division of profits and losses both while the company is a going concern and on winding-up, and to the variation or abrogation of the rights of any class or subclass of shareholders :

(*d*) In accordance with and subject to the provisions of the preceding section,—

(i) The amount of its share capital and the classes or subclasses into which the same shall be divided or subdivided :

(ii) The number nominal value and amounts to be deemed paid up on the shares in any class or subclass :

(iii) The division of the shares in each class or subclass of shares amongst the persons entitled thereto. If any question arises as to whether or not any person is entitled to be treated as a bondholder, such question shall be settled and determined by the Commission, which shall have exclusive power and jurisdiction so to do :

(*e*) The property and rights to be acquired by the company in respect of the bonds or bond contracts :

(*f*) The directors of the company :

(*g*) That the trustee or trustees of any trust fund or funds established in relation to any bond contracts or group areas to be taken over by such company shall advance from such trust fund or funds to the company at such time, and upon such terms and conditions as to repayment and otherwise as the Commission may think fit, such sums by way of loan as the Commission may deem necessary or expedient to provide for the promotion and incorporation of the company and matters preliminary or incidental thereto and for any other matters or things determined by the Commission, and such trustee or trustees is or are hereby authorized and directed to make such advances accordingly :

(*h*) That the company shall repay to the person who has incurred such expenditure the whole or any part of any expenditure incurred by such person, whether before or after the passing of this Act, for the purpose of investigating the possibilities of marketing or otherwise turning to account any group area or products of such group area or for purposes in the opinion of the Commission beneficial or at the time of such expenditure likely to be beneficial for such marketing or turning to account or for the protection of the interests of the bondholders or of any assets affected by their bonds, bond contracts, or trust deeds :

(*i*) That in default of any agreement thereto relating between the land-utilization company and the company the land-utilization company shall pay to the company such sum (if any) at such times and upon such terms and conditions as to the Commission may seem equitable by way of allowance for any reduction which may be made in the cost to it of collecting instalments owing on bonds or bond contracts taken over by the company, by reason of such taking-over:

(*j*) The registered office of the company:

(*k*) Generally, all questions arising out of the provisions of the last preceding section and all matters necessary to enable the company to be incorporated.

(2) When in the opinion of the Commission the above matters or any of them should not be finally determined it may make such interim order or orders and such provision for the later variation thereof as it may deem expedient.

31. Upon the making of any order or interim order as is referred to in section thirty hereof, and upon compliance with such of the provisions of such order or interim order as are to be complied with prior to registration, such order or interim order shall be filed with the Registrar of Companies by such person and in such place as may be determined by the Commission, and upon compliance with the provisions of the Companies Act, 1933, in that behalf and the issue of a certificate of incorporation the company shall be deemed to be duly registered.

32. (1) Upon the making of any order by the Commission as to the persons entitled to shares in the company the persons named in such order shall forthwith be registered in the Register of Members of the Company as proprietors of the shares as stated in such order.

(2) The provisions of paragraph (*b*) of subsection one and of subsection two of section fifty-three of the Companies Act, 1933, shall not apply to any allotment of shares made in pursuance of an order made by the Commission under this Act.

33. Notwithstanding anything to the contrary expressed or implied in the memorandum of association of any company or in any trust deed, will, or other instrument, any company trustee, administrator of the estate of a deceased bondholder, or any person having authority to administer the estate of a bondholder or any part thereof, whether as committee, manager, administrator, interim curator, assignee, or otherwise, or any other person, may lawfully accept any shares issued under the foregoing provisions of this Act and may hold the same in the same manner and upon the same terms as it or he was entitled to hold the bonds, bond contracts, or other interests in respect of which such shares are issued.

34. (1) If so ordered by the Commission in any order made under the provisions of this Act such group area and bonds and bond contracts, or any of them, or any specified interest therein or relating thereto, shall vest in such company so incorporated as aforesaid at the times and in the manner ordered by the Commission without conveyance or assignment for the estate and interest of such persons as may be determined in such order. No stamp duty shall be payable in respect of any order so made by the Commission or of any agreement entered into in pursuance of paragraph (*d*) of subsection two of section thirty-six of this Act or of any conveyance, transfer, or other instrument executed for the purpose of giving effect to such order or agreement. On production by the company to the Registrar of Deeds or to the District Land Registrar, as the case may require, of a sealed copy of any order made or purporting to be made under the authority of this section, such Registrar of Deeds or District Land Registrar shall enter the name of the company on the folium or folia of the register-book in which such group area is registered or recorded as the registered proprietor of the estate or interest therein specified in such order.

(2) If so determined in such order any bonds and bond contracts and any documents evidencing the same and the title-deeds or other documents of title to any land or property affected by such vesting order shall forthwith be surrendered to the company by the persons holding the same upon demand.

(3) Such vesting as is in subsection one of this section provided shall be subject to all charges, encumbrances, or other estates or interests then affecting the same and all the contracts, engagements, debts, liabilities, and powers of the former holders of such bonds, bond contracts, group areas, or interests therein so vested as aforesaid, as the case may be, shall become the contracts, engagements, debts, liabilities, and powers of the company:

Provided, however, that the provisions of this subsection shall not apply—

(*a*) To any charges, encumbrances, or other estates or interests or to any contracts, engagements, debts, or liabilities entered into by the former holders of such bonds or bond contracts for the purpose of securing any loan or other obligation incurred by any such former holder on his personal behalf. If any question at any time arises as to whether any loan or other obligation has been incurred by any such holder on his personal behalf the same shall be determined by the Commission:

(*b*) Save as may be otherwise ordered by the Commission, to any charges, encumbrances, or other estates or interests or to any contracts, engagements, debts, liabilities, rights, or powers of the land-utilization company under such bonds, bond contracts, or trust deed.

35. Any charges, encumbrances, or other estates and interests then affecting any bonds or bond contracts in respect of which shares are issued as hereinbefore provided and which are not assumed by the company in accordance with the provisions of the preceding section shall continue to apply to the shares so issued, and for such purpose shall be as valid as if such charges, encumbrances, or other estates and interests had been originally created in respect of such shares instead of in respect of such bonds or bond contracts.

PART III.

Realization of Group Areas.

36. (1) The directors of the company may at any time or times apply to the Commission for the approval of any proposals made by them for realizing or otherwise turning to account any of the group areas acquired or to be acquired by the company or any part thereof.

(2) On any such application the Commission, after hearing the applicants and any other persons who may apply to the Commission to be heard and appear to the Commission to be interested in the application, and after calling such meetings (if any) of the shareholders and conducting such postal ballots (if any) as the Commission may think fit, may by order provide for all or any of the following matters:—

(*a*) For the variation or abrogation of the rights of the holders of any class or subclass of shares or for the combination of any such classes or subclasses of shares in so far as such variation, abrogation, or combination is in the opinion of the Commission expedient for the purposes of realizing or turning to account any property of the company and upon such terms as the Commission may consider equitable:

(*b*) For the termination of any trusts relating to any group area:

(*c*) For the discharge of any trustee, and thereupon, after a period of twelve months from the making of such order, no claim shall be made against such trustee in respect of any breach of trust alleged to have been committed by such trustee:

(*d*) That any agreement approved by the directors of the land-utilization company and the directors of the company as to either or both of the following matters:—

(i) The disposal or vesting of any funds or assets held under any trust deed; or

(ii) Any variation to be made in contracts taken over by the company and made with such land-utilization company or as to the substitution of a new contract therefor shall be carried into effect, and shall be binding upon all persons interested in the subject-matter thereof:

(*e*) For the partition and allocation to a trustee or to a company as determined by the Commission of portions of the group areas taken over by the company and of any trust fund relating thereto proportionate to the shares held by any shareholders who desire to be excluded from the said company; and on any such partition to provide for the surrender of shares by such dissenting shareholders and for the reinstatement of the bonds and bond contracts (if any) in respect of which such shares were issued and for such variations as may be necessary in the terms of any trust deed, bond, or bond contract or other document to give effect to such partition and to place such dissenting shareholders in as nearly as may in the opinion of the Commission be practicable the same position and with the same rights and obligations as before the company was incorporated and acquired the same:

(*f*) That the provisions of sections fifty and three hundred and forty-three of the Companies Act, 1933, shall not apply to an issue of shares or debentures made by the company to shareholders in the company for the purpose of raising capital for maintaining, realizing, or turning to account any property of the company:

(*g*) That the company may pay interest on share capital and may charge the sum so paid by way of interest to capital as part of the cost of construction of a work or building or the provision of plant, subject to the provisions contained in section sixty-six of the Companies Act, 1933, save that the words "The Land-utilization Companies Commission" shall be deemed to be substituted for the words "the Court" wherever the same occur in the said section:

(*h*) Generally and without limitation by the foregoing provisions of this section for the effectual carrying into operation of any method of realization or turning to account approved by the Commission and for all matters which the Commission may consider necessary or incidental thereto.

37. (1) Any order made by the Commission under the provisions of this Act shall be signed by the Chairman and sealed with the seal of the Commission.

(2) Any order made by the Commission under this Act shall be final and conclusive and binding on all parties in any way interested in the subject-matter of such order, and shall not be subject to review by any Court and the provisions of sections seventy-three and one hundred and fifty-nine of the Companies Act, 1933, shall not apply thereto.

38. The company shall within one month after the making of any order by the Commission under the provisions of this Part of this Act, if so ordered by the Commission, forward a copy of the same to the Registrar of Companies.

39. Notwithstanding anything to the contrary in the Companies Act, 1933, or in the memorandum or articles of association of any land-utilization company to which this Act applies, it shall be lawful for such company without complying with the provisions of the Companies Act, 1933, relating to the alteration of the memorandum or articles of companies, to do all or any of the following things, that is to say:—

(*a*) To take up, hold, and dispose of in any manner as the directors may think fit any shares in a company formed under the provisions of this Act whether such shares are fully or partly paid or are issued in exchange for such land-utilization company's interest in any group area or for cash or otherwise:

(*b*) The directors of such land-utilization company may advance moneys to any company formed under the provisions of this Act, or, for the purpose of taking up additional shares in such company, to any shareholder in such company so formed either with or without security and upon such terms as to repayment and otherwise as the directors of such land-utilization company may think fit:

(*c*) The directors of such land-utilization company may agree with the directors of a company formed under the provisions of this Act upon any variation to be made in any bonds or bond contracts taken over by the company and made with such land-utilization company, or in any trust deed or other instrument relating to such bonds or bond contracts, or as to the substitution of a new contract trust deed or other instrument therefor, and any such variation or substituted contract, trust deed, or other instrument, as the case may be, shall when approved by the Commission in manner hereinbefore provided be binding upon the land-utilization company and the company and upon all persons interested in the subject-matter thereof.

40. For the purposes of paragraph (*b*) of subsection one of section four of the Land and Income Tax Amendment Act, 1930, the cost of any timber or flax growing upon the lands acquired by the company in pursuance of the foregoing provisions of this Act shall be deemed to be the total of the amounts deemed to be paid up on the shares for which bonds or bond contracts or group areas were exchanged as aforesaid at the time of such exchange, less the then unimproved value as appearing on the district valuation roll of such company's interest in such lands, plus any capital expenditure subsequently made by the company thereon or in connection therewith.

41. (1) Notwithstanding anything in the Companies Act, 1933, or any rule of law to the contrary, it shall be lawful for the company at any time or times within a period of two years from the date of the incorporation of the company to accept from any of its shareholders for the purposes of subsection (*f*) of section twenty-nine and of paragraph (*e*) of subsection two of section thirty-six of this Act and in accordance with the provisions hereinafter contained the surrender of any shares held by them in the company and to pay for the shares so surrendered out of the assets of the company in manner hereinafter provided.

(2) Any shares so surrendered may be reissued by the company to any person in the same manner as if they had not been previously issued.

(3) The surrender of any shares may be accepted by the company in pursuance of the foregoing provisions from any shareholder who agrees or is ordered by the Commission to surrender the same, and in such case there shall be payable to such shareholder out of the assets of the company such amount or such asset or assets as is agreed upon between the company and such shareholder, or as is ordered by the Commission by way of consideration for such surrender.

APPENDIX IV.

THE DIRECTION OF SAVINGS AND THE ENCOURAGEMENT OF SMALL SAVINGS.

I. Introductory.

In our main report we have demonstrated the dangers which beset the investor, especially the small investor, because of the existence of companies whose financial schemes are unsound and whose promoters and directors are often unscrupulous or display an unduly imaginative optimism. These dangers are distinct from and additional to the danger that the investment may be lost because the venture eventually proves to be commercially unsound.

The problem of directing and encouraging savings is a complex one, and has several aspects. The main aspects are as follows:—

(1) The proper regulation and control of investment in private enterprise through amendments to the law, supplemented by the creation of a body with limited and defined discretionary powers. (This problem has been dealt with in our main report.)
(2) The direction of savings into commercially sound or socially desirable enterprises.
(3) The establishment of new types of investment company with a view to providing small investors with an opportunity to invest in enterprises whose financial scheme is sound and whose operations are under some special form of control. (These we shall describe as "*popular investment companies.*")
(4) Improvements in the methods of directing investment into public issues of the Government or local bodies.
(5) Improvements in the machinery of company flotation to enable large issues to be more readily taken up, and to enhance the security.

II. Matters Warranting further Investigation.

Our main task has been to investigate tendencies connected with the promotion, administration, and control of private or public companies operating under conditions of private enterprise, and to make recommendations relating to such companies. We have been unable to devote adequate time or attention to the matters now discussed to justify our making detailed recommendations, and in any case such matters do not fall completely within our Order of Reference. Nevertheless, we deem them to be of such economic and social importance as to require us to deal with them briefly.

1. *National Investment Board.*—We refer above to the direction of savings into commercially sound or socially desirable enterprises as one aspect of the problem of investment. We regard our terms of reference as limiting us to the financial and administrative aspects of investment, and have regarded consideration of the extent to which the State may determine the economic purposes to which investment may be put as beyond our province. Proposals directed to this latter purpose usually envisage a *National Investment Board*, with powers to pass judgment on the economic and social merits of different propositions, and direct savings into those channels deemed to be advantageous on national grounds as distinct from grounds of private profit. A recent exposition of the functions of such a Board is as follows:—

> "My suggestion then is a National Investment Board, which should have control by license over all issues of capital other than issues of British Government stock. That control should extend also to private loans of a capital character, but not to loans made in the course of ordinary banking business. The Board itself should be provided out of public funds with such capital as is at present required by an issuing house for the carrying-on of its business—the margin of capital required by a financial institution, not, of course, capital for permanent investment in industry. It should have power to act as an issuing house, underwriting issues and promoting companies. It should raise money by the issue of its own stock, which might be of several classes according to the risks involved in different classes of investment. With the savings of the community, collected in the form of that stock, it should act in effect as an investment trust on national lines, purchasing securities and making advances as required. It should have power to take over securities in satisfaction of debts due to the Crown and to requisition foreign securities, held in England, so far as may be necessary for the control of foreign exchange. It should take over the duties of the Public Works Loan Commissioners in lending public money for the purposes of national benefit. Lastly, it should have power to control or prohibit stock-exchange or other dealing in any security or class of securities. A National Investment Board, so empowered, would be in a position to serve as a co-ordinating financial authority for the industries of the country to avoid the waste at present involved in the promotion of companies and in stock-exchange speculation, and, above all, to use the savings of the community in the public interest and in accordance with a planned economy—not, as they are used at present in this and other countries, to secure private profits without regard to the advantage or disadvantage to the community at large of the purpose for which they are employed."*

* Cole and others, "What Everybody wants to know about Money," pp. 312–313.

The above proposals clearly envisage a monopoly control over the funds offered for investment and over the direction of such funds into economic enterprise. It would be possible to devise an organization possessing less complete control, which new or existing enterprises might use as an issuing or underwriting house or as a source of long-term capital; but such an organization would still involve a judgment on the economic and social merits of particular enterprises as distinct from their schemes of finance or systems of control.

Since the National Investment Board is the subject of discussion in this and other countries, we have considered it necessary to outline the purpose of such a body and draw a distinction between its objects and those covered by our Order of Reference.

Such a proposal raises the whole issue of economic planning and involves questions of public policy which we do not consider it to be our function to traverse. The matter is, however, of sufficient importance to warrant further consideration.

2. *A Popular Investment Company.*—Our main report has established the fact that an enormous volume of investment has gone into certain types of company, particularly land-utilization companies and investment trusts, during the past ten or twelve years. Certain deductions may be drawn from this. The first is that there is a considerable volume of saving available for investment in small units. The second is that the savings are of a type which is not normally or easily directed into ordinary industrial or commercial securities or Government bonds. The main reasons are probably the smallness of the units of saving available for investment and the lack of knowledge or experience of the investors. The third conclusion is that such small investors are attracted by the promise of a higher rate of return than would be obtained from leaving moneys on deposit, and that they are willing to invest these amounts in such a manner that they are not capable of being immediately withdrawn.

Our description of land-utilization companies and investment trusts and their operations shows that the security is frequently imperilled by the methods adopted and that the financial schemes of such companies are conducive to the reaping of unconscionable profits by those in control.

In addition, we believe that much investment has been of a type which is economically wasteful because the funds collected have been unwisely directed and the enterprises have been commercially unsound.

We believe that our recommendations in regard to companies of the above types should do much to safeguard the investor. In particular, we believe that, if properly controlled in the ways suggested, investment trusts should offer a valuable service to the investor, always providing that they are honestly administered.

Nevertheless, we think that there is scope for a type of investment trust in the form of a quasi-public concern in which the small investor may purchase shares or debentures with a prospect of reasonable profits and of a measure of security which is as complete as it is possible to make it. Such an institution might be established by statute. The general principle of joint public and private control adopted in the constitution of the Reserve Bank might be followed with advantage. The capital composition and conditions as to diversification of investments, accumulation of reserves, payment of dividends, presentation of accounts, and audit should be prescribed. Provision might be made to enable small investors to purchase shares or debentures by instalments. It should not be impossible to devise a scheme whereby substantial sums might be accumulated by means of small individual units of saving.

The advantages of such a proposal are as follows:—

(1) As far as is humanly possible, security of investment would be assured by the manner in which directors were appointed, by provision in regard to the diversification of securities, by the absence of subsidiaries, and by public audit. There would be less chance of loss through excessive costs or mismanagement than in a small investment trust under private enterprise.

(2) Small investors would be able to purchase securities in any one of the three classes by instalments, and would be placed on an equal footing with large investors as regards security, diversification, and return on their investment.

(3) There could be no reason why the securities of such a trust should not be listed on the stock exchange, and they would then possess a ready market.

(4) In general terms, small savings would be encouraged and a useful volume of funds rendered available for investment in Government or company securities.

Two objections might be raised against such a proposal:—

(1) The company would be in competition with private enterprise. This is true, and may be a valid objection from the point of view of the investment trust operating entirely under private enterprise. It is not a valid objection from the point of view of the investor or the community at large. In any case, there remains ample scope for properly conducted trusts, and the same objection applies equally to many enterprises already existing.

(2) The State might be held responsible if anything went wrong. We do not think that this objection carries much weight. In the matter of management the concern would be independent within the limits laid down by statute. In any case, the same criticism would apply to the Public Trust, the State Fire Insurance, and other public concerns competing with private enterprise, so that there is no new principle invoked. In other words, the principle is already accepted. The argument should not stand in the way of any proposal which is highly desirable on other grounds.

We recommend the above proposal to the favourable consideration of Your Excellency's advisers.

3. *Investment in Public Securities.*—We have had presented to us by Mr. G. S. Crimp, of Hamilton, a proposal for improving the conditions relating to local-body loans. The proposal is to establish a Local Body Finance Corporation of substantial strength and size, dealing only in local-body loans. This corporation would issue debentures to the public along the lines followed by agricultural mortgage credit banks, and use the proceeds to advance moneys to local authorities on table mortgage, repayment in this form replacing the method of repayment by sinking funds. Loans would be spread over local bodies of different types scattered throughout New Zealand. By virtue of its size and the spreading of risk in the above manner debentures would be readily marketable, and if proper care were exercised in the constitution of the board of directors the debentures would be accepted as trustee securities.

Since a corporation of this sort would be in a better position to assess the extent of the risk, a small but sound local authority would be able to issue loans at a cheaper rate than would otherwise be likely. The debentures of such a local authority are not likely under present conditions to be freely quoted on the stock exchange, and this is a factor affecting the rate at which they can be issued.

Debentures in such a corporation would be readily marketable, and since the corporation, when well established, would have sufficient resources (in the form of reserves made up by amortization payments or in other ways) to redeem its debentures at par or thereabouts, an investor who was forced to realize would have smaller risk of loss through depreciation in the value of his security than in the case of debentures in a small local authority for which there was only a limited market.

If such a corporation were successfully established, it would prove of great benefit in marshalling the finance available for smaller local bodies, and in stabilizing and equalizing interest-rates. It would replace a variety of securities with different degrees of risk and marketability by a standardized security which should be readily marketable. It would provide a secure and reasonably remunerative avenue for investment to individuals and institutions.

In the formation of such a corporation due regard should be paid to the national character of its operations, and we feel strongly that it should be incorporated by special Act and should be established as a quasi-public concern. In short, the principles of control by a joint board of Government and shareholders' representatives should be followed. We would strongly recommend that the proposal be the subject of further consideration and report.

4. *Enhancement of Security and Improvement in the Machinery of Company Flotation.*—We now refer briefly to a number of related suggestions made by a group of individuals amongst whom Mr. J. D. Macmillan, of Auckland, and Mr. G. S. Crimp, of Hamilton, are prominent. The central ideas around which these proposals are grouped are—

(1) To provide machinery for encouraging industrial and commercial development by improving the basis of security and therefore of confidence:
(2) To improve the basis of mortgage finance and at the same time liquefy mortgage securities which are at present frozen:
(3) To provide improved machinery for company promotion and flotation by establishing a substantial and reputable concern which will be in a position to underwrite large issues.

The individuals interested in the above proposal formed a syndicate, which then floated a company known as "The New Zealand Development Company, Ltd." This is comprised of groups of shareholders in various centres, each shareholder holding a small number of shares. The main object of the company is to promote the formation of companies embodying the ideas outlined above. It does not appear as if the promoting company itself is expected to be a profit-making concern. No doubt the promoters of this company will expect some return for their efforts if the companies embodying their main ideas are successfully established, but we gained the impression that their proposals were genuinely designed to further the economic welfare of the Dominion.

It is proposed that a company known as the "National Guarantee Company of New Zealand, Ltd.," should be incorporated by statute. The capital suggested is £250,000, to be raised by public subscription.

The purpose of the company is to give a limited guarantee in respect of interest, say, 5 per cent. for a stated period, say, three years. This, it is argued, will have a threefold purpose in stimulating investment in (*a*) secured investment, (*b*) the reorganization and development of existing undertakings, (*c*) new undertakings.

The objects are stated more specifically as follows:—

(*a*) To influence the investment of capital in approved undertakings by guarantee of such capital (against suitable security to the company), and/or by guarantee of interest only thereon for a limited period (with or without security to the company) on a basis of profit.
(*b*) To act as an organized national instrument to effect reconstruction and development of industrial (including rural and mining) undertakings of national importance.
(*c*) To pay special regard to the employment of men in guaranteed undertakings thereby relieving the State from its present unemployment obligations and assisting generally in national recovery.
(*d*) To provide a responsible organization capable of inviting and giving direction to British capital in the development of New Zealand industry.

The funds of the company, out of which guarantees must be met, will be held in liquid securities.

The draft scheme suggests a Board of Governors comprised of a member of the Dairy-export Control Board, a member of the Meat Producers Board, a nominee of the Associated Banks, a member of the Unemployment Board, a representative of the Government, a representative of organized labour,

a representative of secondary industries, and representatives of law and accountancy. Advisory panels in the fields of research, finance, law, accountancy, engineering, and architecture are suggested.

Profits of the undertaking are to be derived from—(*a*) Payments for examining and sponsoring enterprises, (*b*) payments in consideration of guarantees, (*c*) payments as agents for an insurance company or companies.

It is hoped that the company may obtain the co-operation of the Unemployment Board, which may assist financially in certain cases by making a limited guarantee in respect of wages.

The above proposal is in line with modern developments towards what the authors of the Liberal Industrial Report* describe as the public concern—a type of organization in which all or a greater part of the capital is provided by private investors, but in which the profit-making motive is subservient to broader considerations of public policy, and in which, in consequence, there is a greater measure of public regulation or control.

In some measure such a company would perform the functions of a National Investment Board, because it would exercise a directive influence on industry through its selection of the enterprises to be guaranteed. In addition it might be instrumental at the present time in encouraging new enterprises or the development of existing concerns, because in some measure it would promote greater confidence through the limited guarantee.

A related proposal consists in the "liquefaction" of mortgages. It is suggested that the gurantee company, or a mortgage company specially formed for the purpose, should agree to take over existing mortgages up to a safe proportion of current valuation, issuing debentures in their place. Whereas existing mortgages may be of little value as collateral and are practically unsaleable, such debentures would possess a ready market and would be readily acceptable as collateral. It will be apparent that such a proposal raises complicated and difficult issues, more especially in regard to the policy to be adopted with the balance of mortgages in excess of the value converted into debentures.

A proposal related to the formation of the National Guarantee Company of New Zealand, Ltd., is the establishment of an underwriting company to be known as "New Zealand Underwriters, Ltd." The suggested capital is £125,000, the ordinary shares, totalling £25,000, to be held by members of stock exchanges and selected outside brokers. Such brokers will be underwriters, to whom will be attached sub-underwriters. These will be preference shareholders, holding £100,000 in 4-per-cent. cumulative preference shares of £1. The company proposes to accept underwriting contracts and apportion them among its ordinary shareholders, who will further distribute them among the preference shareholders. By means of such an organization it should be possible to undertake the flotation of large capital issues for which the machinery is lacking at the present time.

We deem it unnecessary to discuss the above proposals in any detail, and think it sufficient to commend them for further investigation.

---

* *Cf.* "Britain's Industrial Future," page 63.

APPENDIX V.

LIST OF COMPANIES AND WITNESSES.

1. LIST OF COMPANIES IN RELATION TO WHICH EVIDENCE HAS BEEN TENDERED TO THE COMMISSION.

NOTE.—The numerical order in this list does not correspond with the company numbers given in the report.

Name of Company.	Evidence-book, commencing at Page No.
Auckland Tobacco Growers, Ltd., and Empire Tobacco Corporation, Ltd.	99, 114
Australasian Forestry Bondholders Trust Co., Ltd., and New Zealand Perpetual Forests, Ltd.	61
British and Dominion Investment Trust, Ltd.	389, 391
*Dominion Executive Trust, Ltd.	512
Empire Tobacco Corporation and Auckland Tobacco Growers, Ltd.	99, 114
Empire Wood Oil (N.Z.), Ltd.	347
Existing Forests, Ltd.	414
Financial Publications, Ltd.	569
*Flaxgrowers Pulp and Cellulose Products of New Zealand, Ltd.	481
Forestry Development, Ltd.	4, 15, 30, 282
*Gold and General Investment Trust, Ltd.	506
Hemplands Bondholders Association (Australian and New Zealand Investments, Ltd.)	41
Investment Executive Trust of New Zealand, Ltd.	46, 54, 110, 208, 331
Kaingaroa Plantations, Ltd.	316
Mamaku Forests, Ltd.	386
Mutual Bond Deposits, Ltd.	275
New Zealand Investment Trust, Ltd.	222, 225, 226, 227, 469.
New Zealand Perpetual Forests, Ltd.	61, 175, 367.
New Zealand Redwood Forests, Ltd.	132, 134, 146, 148, 153, 309, 312, 325, 531, 574, 577
New Zealand Tung Oil Corporation, Ltd.	33
Northern Tung Oil, Ltd.	244
Pacific Exploration Co., Ltd.	558
*Parenga (N.Z.) Tung Oil, Ltd.	500
Provident Bonds, Ltd.	463
Putaruru Pine and Pulp Co., Ltd.	345
Selwyn Timber Co., Ltd.	1, 356
State Forestry Department	Separate book as Appendix VII.
Stock Exchange matters	288, 293, 301, 306, 405, 408
Timberlands Woodpulp, Ltd.	422, 423
*Tobacco Growers (N.Z.), Ltd.	475
Transport Mutual and General Insurance Co., Ltd.	336, 339, 341, 552
Transport Mutual and General Insurance Co., Ltd., and Trustees Executors and Agency Co. of New Zealand, Ltd.	580
Tung Oil Debenture Trust, Ltd.	189, 261
V. B. McInnes, Ltd.	331
Zealandia Packing Co., Ltd.	348
*Dominion Investment and Banking Association	595 *et seq.*
*Northern Co-operative Investment Trust, Ltd.	595 *et seq.*
*Northern Co-operative Building Society	595 *et seq.*

2. LIST OF WITNESSES.

[*Not for publication.*]

* Witnesses did not appear personally, but supplied statements in answer to Commission's questionnaire.

APPENDIX VI.

LIST OF COMMISSION'S FILES.

File No.	Title.
	Timber Companies.
1	New Zealand Redwood Forests, Ltd.
2	Redwood Selwyn Group
3	Selwyn Timber Co., Ltd.
4/1	New Zealand Perpetual Forests, Ltd., and Australasian Forestry Bondholders Trust Co., Ltd. (search notes, forms of questionnaire, &c.)
4/2	New Zealand Perpetual Forests, Ltd. (communications from ——).
4/3	New Zealand Perpetual Forests, Ltd. (communications from ——).
5	Smith, Wylie, and Co.
6	Timberlands Woodpulp, Ltd.
7	Putaruru Pine and Pulp Co. (N.Z.), Ltd.
8	Commercial Pine Forests, Ltd. Nukuroa Trustee Co., Ltd. Putaruru Forests, Ltd.
9	Waitane Sawmilling and Afforestation, Ltd.
10	Afforestation Ltd.
11	Kaihu Valley Perpetual Afforestation Co., Ltd.
12	Afforestation (Aust.) Proprietary, Ltd.
13	Nelson Pine Forests Afforestation Co., Ltd.
14	Matahina Forests, Ltd.
15	Morton Mains Afforestation, Ltd.
16	Australian Plantations, Ltd.
17	Forests, Farms, and Products, Ltd.
18	Taneatua Afforestation, Ltd.
19	Hawke's Bay Forests, Ltd.
20	North Canterbury Forests, Ltd.
21	Monterey Pines, Ltd. Matakana Radiata. New Zealand Pinelands Proprietary, Ltd. Matakana Afforestation Development Co., Ltd. — Matakana Island Companies.
22	Auckland Milling and Afforestation Co. (see Australian and New Zealand Investments, Ltd.).
23	New Zealand Timberlands, Ltd.
24	Forestry Bonds Exchange, Ltd.
25	Forestal Timber Co., Ltd.
26	Forestry Development, Ltd.
27	Maoriland Forests, Ltd.
28	Pacific Forests, Ltd. Waratah Paper and Pulp Co., Ltd.
29	Kaingaroa Plantations, Ltd. Kaingaroa Bond Co., Ltd.
30	Existing Forests, Ltd.
31	Mamaku Forests, Ltd.
32	General matters: Afforestation companies.
33	Forestry Department's map (showing afforestation statistics prepared for Commission).
	Tung-oil Companies.
34	New Zealand Tung Oil Corporation, Ltd.
35	Tung Oil Debenture Trust, Ltd.
36	Parenga (N.Z.) Tung Oil, Ltd.
37	Tung Oil Securities (N.Z.), Ltd.
38	Tung Oil Plantations (N.Z.), Ltd.
39	Northern Tung Oil, Ltd.
40	Empire Tung Oil Products, Ltd.
41	Natural Products (N.Z.), Ltd. Company Finance, Ltd.
42	Empire Wood Oil (N.Z.), Ltd.
43	Tung Oil Corporation of Australia, Ltd.

File No.	Title.
	Tobacco Companies.
44	Empire Tobacco Corporation, Ltd. Southern Land Co., Ltd. Auckland Tobacco Growers, Ltd. Reliance Loan, Mortgage, and Discount Corporation, Ltd. — Connected.
45	New Zealand Tobacco Co., Ltd., taken over by New Zealand Tobacco Plantations, Ltd.
46	Tobacco Growers (N.Z.), Ltd. (in liquidation).
47	Tobacco Producers Trust, Ltd. New Zealand Incorporated Tobacco, Ltd.
48	Pacific Tobacco Industries (Australasia), Ltd.
49	Union Tobacco Company of New Zealand, Ltd.
50	Tauranga Tobacco and Citrus Co., Ltd.
51	Standard Tobacco Co., Ltd. Amalgamated Tobacco Manufacturers, Ltd. United Tobacco Corporation of Tauranga, Ltd.
	Flax Companies.
52	Australian and New Zealand Investments, Ltd. (in liquidation). Hemplands Bondholders Association.
53	Provincial Flaxgrowers and Millers' Association. Flaxgrowers Pulp and Cellulose Products of New Zealand, Ltd.
54	New Zealand Flax Securities, Ltd. Matata Flax, Ltd. Flax Products, Ltd.
55	Flax Corporation of Australia, Ltd. Flax Industries, Ltd. New Zealand Fibre Corporation, Ltd.
56	Flaxlands Development, Ltd. Northern Flaxlands, Ltd. Flaxlands, Ltd.
57	New Zealand Flax Fibre Co. New Zealand Flax Investments, Ltd. New Zealand Flax Plantations, Ltd.
58	The Wellington Flax Growers' Corporation, Ltd.
59	South Auckland Flax Growers, Ltd.
60	Hauraki Flax Growers and Hemp Producers, Ltd.
61	F. Seifert Co., Ltd.
	Land Companies.
62	North Auckland Land Development Corporation, Ltd.
63	New Zealand and Australian Land Co., Ltd.
	Investment Trusts, Banking and Finance Companies, and Building Society Companies.
64	New Zealand Investment Trust, Ltd.
65/1	Investment Executive Trust of New Zealand, Ltd., and subsidiaries: Search notes, forms of questionnaire, &c.
65/2	Investment Executive Trust of New Zealand, Ltd., and subsidiaries: Correspondence, statements by intending witnesses, &c.
65/3	Investment Executive Trust of New Zealand, Ltd., and subsidiaries: Documents and information received from ——, of ——.

LIST OF COMMISSION'S FILES—*continued.*

File No.	Title.
	Investment Trusts, &c.—continued.
65/4	Investment Executive Trust Group: Statement "X" and matters leading up to first interim report.
65/5	Investment Executive Trust Group: Correspondence after passing of Companies (Special Investigations) Act.
65/6	Investment Executive Trust of New Zealand, Ltd.: Urgent correspondence from Mr. ——, after passing of Special Investigations Act.
65/7	Southern British National Trust,Ltd.
65/8	Transport Mutual and General Insurance Co., Ltd., and Trustees, Executors, and Agency Co. of New Zealand, Ltd.
65/9	Confidential reports received from Australia *re*— South British National Trust. Investment Executive Trust of New Zealand, Ltd. Transport and General Insurance Co., Ltd. British National Investment Trust, Ltd.
65/10	Special search notes made by Chairman in Auckland. Special search notes made by Chairman in Australia.
65/11	Alcorn, Trower, and Co. Lucerne Ltd. Lucerne Bondholders Trust, Ltd.
66	New Zealand Financial Times, Ltd.
67	Provident Bonds, Ltd.
68	Mutual Bond Deposits, Ltd.
69	Gold and General Investment Trust, Ltd.
70	Dominion Executive Trust, Ltd.
71	British and Dominion Investment Trust, Ltd.
72	Apex Investment Trust, Ltd.
73	Dominion Investment and Banking Association.
74	Australian and New Zealand Banking Corporation, Ltd.
75	Multiple Systems, Ltd. Continuity Investments, Ltd. Security Trust and Investment Co., Ltd. Craig Investment Co., Ltd. Campbell Investment Trust, Ltd. General Trust and Investment Co., Ltd. Avalon Investment Co., Ltd. Ocean Investment Trust (N.Z.), Ltd. Amalgamated Investment (N.Z.), Ltd. First National Mortgage Bond Corporation, Ltd.
76	Perpetual Bonds, Ltd. Associated Investment Underwriters, Ltd. New Zealand Brokers and Investments, Ltd. New Zealand Trust Co., Ltd. The Wellington Investment and Trustee Agency Co., Ltd. Permanent Building Society of New Zealand, Ltd.

File No.	Title.
	Investment Trusts, &c.—continued.
77	Northern Co-operative Investment Trust, Ltd.
78	Northern Co-operative Terminating Building Society.
	Sugar-growing Companies, and Passion-fruit and Citrus Plantations.
79	Papuan Rural Products, Ltd.
80	Imperial Sugar Industries, Ltd.
81	New Zealand Citrus Plantations, Ltd.
82	Passion-fruit Plantations, Ltd.
	Canning Companies.
83	Zealandia Packing Co., Ltd.
84	Northland Canneries, Ltd.
	Dairy Company.
85	New Zealand Co-operative Dairy Co., Ltd.
	Stock Exchange Matters; Sharebroking.
86	Stock Exchange matters (various).
87	Dominion Stock Exchange.
	Proposed Corporation.
88/1	National Guarantee Co. of New Zealand. Ltd. (G. S. Crimp's Proposals). General Finance, Ltd.
88/2	The New Zealand Development Co., Ltd.
	Gold-mining Companies.
89	New Guinea Exploitation, Ltd.
90	Golden Terrace Gold-dredging Co., Ltd.
91	Dawn of Hope Gold-mines (N.Z.), Ltd. (formerly Lucky Shot Gold-mine).
92	Coromandel Gold-mines.
93	Golden Mount Mine.
94	Several Gold-mining companies. (Correspondence with ——.)
	Other Companies.
95	Okarito Harbour Co., Ltd.
96	Blue Star Bus Co., Ltd.
	General Matters.
97	Land Transfer Office: Search notes of afforestation, tung-oil, flax, and tobacco companies.
98	——: Search notes of afforestation, tung-oil, flax, and tobacco companies.
99	Notes taken from Treasury file No. 40/471.
100	Notes taken from Industries and Commerce General File.
101	Prohibition proceedings against Commission. Employment of counsel to assist Commission.
102	Report on Chairman's visit to South Island.

APPENDIX VII.

BOOK OF EVIDENCE GIVEN BY OFFICERS OF THE STATE FOREST SERVICE.

[*Detached. Bound in separate volume.*]

(Not printed.)

Approximate Cost of Paper.—Preparation, not given; printing (1,650 copies), including graph, £185.

By Authority: G. H. Loney, Government Printer, Wellington.—1934.

Price 2s. 6d.]