

STATE BUILDING SOCIETY LIMITEDREPORT ON ADMINISTRATIVE CHANGES TO THE
SOCIETY DURING WEEK ENDING 6 MAY, 1988PREAMBLE

At the request of the Registrar we visited the Society's Head Office on 6 May, 1988 in order to interview certain officers and directors concerning major administrative changes that had been reported by the media following an extraordinary Board meeting held on the previous day.

The society's chairman was unavailable for interview on 6 May. The following officers were interviewed:-

Leonard Thompson	-	Deputy General Manager
Paul Gibbeson	-	Secretary
Fiona Toose	-	Assistant Secretary
Denis Cleary	-	former General Manager (in the presence of Paul Gibbeson and Fiona Toose)
Anthony Howarth	-	General Manager (formerly Assistant General Manager, Corporate & Financial Institutions, State Bank).

Certain major administrative changes were reported in the evening news that day and in the press the following day.

The major events are summarised as follows:-

- Mr. K. G. Dennewald, Chairman, resigned.
- Mr. J. A. O'Neill was appointed Chairman, and Mr. A.C. Thomas was appointed Deputy Chairman. Mr. R.W. Turner was appointed as a Director to fill the casual vacancy created by the resignation of Mr. Dennewald and the transfer of his 10 fixed capital shares to the State Bank.
- Mr. D.C. Cleary's appointment as a Director was terminated.
- The tabling of a report by the Macquarie Bank on the Society's future direction, which according to the minutes concluded that a merger with the State Bank or another large financial institution was desirable.
- The termination of Mr. D.C. Cleary's employment contract as General Manager of the society, effective immediately.
- Appointment of Mr. Anthony Howarth as General Manager.

A copy of the draft minutes of the meeting are attached (tabled "A"). These minutes have yet to be formally confirmed as a true record by the next meeting of the Board.

We met on 9 May, 1988 at the Head Office of the State Bank with the following Society directors (their positions in the State Bank are shown in brackets):-

- Mr. John O'Neill, Chairman (Managing Director, State Bank).
- Mr. Robert Thomas (Chief General Manager, State Bank).
- Mr. Paul Kearns (General Counsel, Executive General Manager, State Bank).

The three people named above are referred to as "the Bank related Directors" in the remainder of this report.

In late 1987 a legal settlement was reached between the State Bank and the Commonwealth Bank of Australia and part of this outcome was that the State Bank was now allowed to operate a savings bank in New South Wales.

At a Board Meeting held on 22 January, 1988, the Society decided to commission the Macquarie Bank Limited to prepare a report on the future direction of the Society. One of the options under the terms of reference was to consider the relationship between the Society and the Bank and whether the Society should become the Savings Bank arm of the State Bank.

According to the General Manager, Mr. Howarth, the Bank has been contemplating the idea of a merger with the Society since 1976.

Comment on Rules regarding Directors

The society's rules provide for a Board of up to 9 Directors made up of 4 directors holding 10 fixed shares, 4 directors holding at least 1,000 withdrawable shares and the ninth director being the Society's Chief Executive Officer (if he is nominated by the Board and elected by members at a general meeting).

The State Bank holds all the fixed share capital in the society (\$3,049,075) and transfers this share capital to persons (usually Bank Executives) as it sees fit under a Deed of Trust, thereby making those persons eligible for appointment to the society's Board. Approximately 15 people each currently hold 10 x \$5 fixed shares in the society.

Rule 91(b) states:-

"(b) Four of the directors shall each hold at least ten (10) fixed shares and they shall be nominated for election by two members each holding at least ten (10) fixed shares."

This rule enables only existing Board members with fixed shares to nominate further directors with fixed shares should a vacancy occur amongst the four fixed share directors.

Major items in Board Minutes dated 5 May, 1988

1. Mr. Dennewald's Resignation and Mr. Turner's Appointment

According to the Bank related Directors, Mr. Dennewald was originally appointed to the Society's Board in 1983 when he was an employee of the State Bank and was recently requested to step down by the Bank's Chairman, Mr. R. Watson. This Mr. Dennewald agreed to do and tendered his resignation to the Board meeting held on 5 May, 1988. The transfer of Mr. Dennewald's fixed shares to the Bank also occurred at that meeting.

The wording of Mr. Dennewald's resignation letter (tabbed "B") raised initial suspicion that he may have been forcibly removed from the Board by the Bank withdrawing his fixed shares. The minutes of the Board meeting held on 5 May, 1988 record Mr. Dennewald resigning as Chairman of the Society although his resignation letter states "...At the Bank's request I am resigning from the Board of the Society... and I believe my resignation will facilitate this course of action".

According to Mr. O'Neill, Mr. Dennewald saw himself as being on the society's Board at the Bank's request and he agreed to step down quite amicably. In a subsequent telephone discussion, Mr. Dennewald supported Mr. O'Neill's explanation and suggested that it would be preferable for a current employee of the bank to oversight any negotiations with the State Bank (Mr. Dennewald is no longer an employee of the Bank).

The transfer of shares from Mr. Dennewald to the Bank made him ineligible to remain a director under Rule 101(e). This is how it was recorded in the minutes, and enabled Richard Turner to be appointed forthwith under rule 97 to fill the casual vacancy created by Mr. Dennewald.

The minutes also record that the Chairman would make appropriate arrangements, through the State Bank, for payment of a suitable gratuity to Mr. Dennewald. The society's rule 98 prevents payment of such gratuities by the society unless a minimum of 10 cumulative years have been served as a director.

2) Mr. O'Neill's Appointment as Chairman and Mr. A.C. Thomas' Appointment as Deputy Chairman

Clause 20(a) of the society's Agency Agreement with the Bank empowers the Bank to nominate which of the society's Directors are to be Chairman and Deputy Chairman.

Accordingly, the appointment of Messrs. O'Neill and A. Thomas as Chairman and Deputy Chairman was essentially a formality. (Mr. A. Thomas is not a Bank related director/fixed shareholder).

3) Mr. Cleary's Removal as a Director

Rule 91(d) empowers the Board to terminate the Chief Executive Officer's appointment as a Director.

The minutes of 5 May, 1988 record a resolution for Mr. Cleary's removal pursuant to this rule.

According to the Bank related Directors, Mr. Cleary was opposed to any proposal to merge the Society with the Bank and had continually opposed the Board on this issue. Additional material in the Board minutes record "...that Mr. Cleary had repeatedly usurped the function of the Board in matters of policy and seemed unable to differentiate between his duties as a Director and those of General Manager... Previous counselling of Mr. Cleary and previous assurances which had been given were raised...".

Five directors (Messrs O'Neill, R. Thomas, A. Thomas, Turner & Kearns) voted for Mr. Cleary's removal while the remaining four (Messrs Osmond, Treloar, Cribb and Cleary) voted against.

4) Macquarie Bank Report on Society's Future Direction

This report was tabled and discussed at the Board meeting. The Board resolved to open discussions with the Bank to examine the possibility of a merger. We requested a copy of the Report and Mr. Cleary's overview to be supplied to the Registrar at the earliest opportunity. This request was complied with on Monday 9 May, 1988.

5) Conflict of Interest

The question of whether the four directors holding fixed share capital have a conflict of interest in considering and/or voting on matters that jointly affect the Bank's interests and society's interests occupied lengthy discussion with the Bank related Directors. Messrs O'Neill, R. Thomas and Kearns are all qualified Solicitors. They did not seek independent legal advice on this issue but relied on their own skill and knowledge in formulating their opinion that they were not engaged in a conflict of interest and all were confident that the decisions they made were in the best interests of the society, because they did not consider that they had a pecuniary interest in the previously mentioned resolution. Further, they did not see themselves as "appointees" of the State Bank for the purpose of Section 84(13) of the Co-operation Act. We have found no documentation which could serve to demonstrate that they were appointed by the Bank, notwithstanding that for all practical purposes the Bank can effectively influence who serves as fixed share directors.

We drew their attention to a report dated 26 April, 1988 by Messrs Mallesons Stephen Jaques, Solicitors, which pointed out that Bank related Directors would be in direct conflict of interest if they voted on a proposal being put to the Board involving a transfer of the control of the society to the Bank. All three Bank related directors expressed surprise at the existence of this report, claiming that they were unaware of its existence and denied having requested it. They said they would study the advice contained in this report. The Bank related Directors clearly stressed that they have only voted to enter into discussions with the Bank and that if a proposal was put forward it would need the approval of members as well as the Government. (The abovementioned advising appears to be based on the assumption that the bank related directors are bank appointed whereas those directors would no doubt claim that they are not appointees in terms of S.84(13) of the Act.)

The minutes record that the motion to enter discussions with the Bank was carried unanimously. In a telephone discussion, director Bruce Treloar (who lives in Tamworth) stated that although he agreed to the Society entering into "discussions" with the Bank, he was totally opposed to any merger proposal. The Northern Daily Leader newspaper of 9 May, 1988, pages 1 and 2 quotes Mr. Treloar as stating that he will oppose the merger proposal. Mr. Treloar had not yet seen the draft minutes of the 5 May, 1988 meeting but he indicated that some other directors shared similar views to his.

6) Mr. Cleary

The minutes record Mr. Cleary's dismissal as Chief Executive but do not state the reasons in that segment of the minutes. The dismissal is recorded as being "carried unanimously" which is surprising because of the opposition to the earlier proposal to have Mr. Cleary removed as a director.

Mr. Treloar indicated to us that he went along with the dismissal because he was outnumbered in opposing it and wanted to ensure that Mr. Cleary received maximum termination benefits with minimal obstruction. He also indicated that otherwise dissident directors shared the same view. (Mr. Treloar asked that his comments be treated confidentially).

Mr. Cleary himself was still quite shaken by the events that occurred at the Board meeting when he was interviewed on the morning of 6 May, 1988. Since his employment was terminated at 5:00 p.m. on 5 May, he was not longer an officer of the Society, and he was interviewed on the Society's premises in the presence of the Secretary, Paul Gibbeson and Assistant Secretary, Fiona Toose. Mr. Cleary volunteered very little information concerning the proposed talks with the State Bank and the impression was gained that he did not wish to jeopardise his negotiations for payment of termination benefits.

7. Mr. Howarth's Appointment as General Manager

Immediately following Mr. Cleary's dismissal, the Board appointed Mr. Tony Howarth as General Manager. Mr. Howarth previously held the position of Assistant General Manager, Corporate and Financial Institutions, with the State Bank up until his appointment and he is holding the position of General Manager on a secondment arrangement from the Bank (i.e., he remains on the bank payroll).

Mr. Howarth informed us that he will try to convince staff and members that a merger with the Bank will be in their best interests. He feels that the Society will be subjected to a possible takeover attempt from other sources (e.g. interstate) if the society does not merge with the State Bank.

CONCLUSION

Having reviewed the matters set out in the Board Minutes of 5 May, 1988 we were unable to detect any breaches of the society's rules.

The Crown Solicitor, in an advising dated 9 May, 1988 did not feel that a breach of Section 84(13) of the Co-operation Act, 1923 had yet occurred, based on the information before him.

However, the Crown Solicitor also felt that persons who are directors of the Society and employees of the Bank ought to refrain from voting and negotiating on merger proposals. This view was expressed by the Registrar in writing to the Bank related directors in his letter dated 11 May, 1988.

It is obvious that the directors holding fixed shares had planned their actions well in advance for the Board meeting of 5 May, 1988. The new General Manager, Mr. Howarth, began occupying Mr. Cleary's office the next day. The remaining directors were not aware of Mr. Dennewald's resignation until the commencement of the Board meeting.

Division 6 of the Permanent Building Societies Act, 1967 would apply to any merger proposal involving the society and the bank and will require the approval of at least 75% of votes cast in a postal ballot (provided that at least 20% of eligible members have voted in that ballot). As at 5 May, 1988, 126,964 members were eligible to vote in terms of the society's rules. Mr. P. Kearns was of the view that the State Bank Act, 1981, will also require amendment to permit such a merger to proceed.

B. McDonald

 Barry McDonald
 Senior Inspector - Field
 16 May, 1988

D. Bussman

 David Bussman
 Manager, Advisory Services
 16 May, 1988

TO: Mr. R.R. Baker
 Registrar.