

STATE BANK OF NEW SOUTH WALES

RE STATE BUILDING SOCIETY

LIMITED

JOINT ADVICE

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Attn: Mr. J. O'Sullivan

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RE STATE BUILDING SOCIETY LIMITED

JOINT ADVICE

Our instructing solicitors act for the State Bank of New South Wales (the "Bank"). Our advice is sought concerning the construction and operation of certain provisions in the Co-operation Act, 1923 and concerning certain other matters.

We take the facts relevantly to be as follows:

1. The State Building Society Limited (the "Society") is a building society carrying on business in New South Wales. It was previously known as the Tamworth Building and Investment Society (up to 1976) and the Rural Building and Investment Society (from 1976 to 1982).
2. The Society, originally incorporated under the Building and Co-operative Societies Act, 1901, is a Society registered under the Co-operation Act: see s. 42 and the Second Schedule of that Act.
3. The Society has two classes of capital: fixed shares and withdrawable share capital: rule 7 of the Society's rules.

4. The Bank owns, either in its own name or beneficially, all the fixed capital shares in the Society. (From about September 1976 to mid 1982 the Bank beneficially owned slightly over 50% of the fixed capital. Since 1982 it has beneficially owned all such capital.)
5. Apart from other rights attaching to the fixed shares, the holding of at least 10 fixed shares is a necessary qualification for 4 of the members of the board.
6. Rule 91 of the rules of the Society provides that the board of the Society shall consist of at least 8 members:
 - (a) 4 of whom must hold at least 10 fixed shares and must be nominated for election by 2 members each holding at least 10 fixed shares; and
 - (b) 4 of whom must hold at least 1,000 withdrawable shares.
7. As the Bank controls all of the fixed shares, it is entitled to nominate for election the 4 directors who are required to hold fixed shares. However these 4 directors are elected by all members (being those holding fixed shares and those members of the public holding withdrawable shares) according to the franchise set out in the rules: see rule 85 especially.
8. At the present time the composition of the board of the Society is as follows:
 - (a) Mr. John O'Neill (Chairman), the managing director of the

Bank;

- (b) Mr. Alwyn Thomas (Deputy Chairman) a former director of the RSL Premier Permanent Building Society (which Society transferred its engagements to the Society in 1982);
- (c) Mr. Paul Kearns, a general manager of the Bank and its General Counsel;
- (d) Mr. Rob Thomas, a general manager of the Bank and the head of the Bank's Community Banking Group;
- (e) Mr. Rick Turner, the secretary of the Bank;
- (f) Mr. Ross Cribb, a director and the Chief General Manager of TNT Limited;
- (g) Mr. Warren Osmond, the State Secretary of the Returned Services League (N.S.W. Branch) and formerly a director of the RSL Premier Permanent Building Society;
- (h) Mr. Bruce Treloar, a former director and former fixed shareholder of the Society.

9. On 22 January 1988 the board of the Society unanimously resolved to appoint the Macquarie Bank Limited to advise the board as to possible options for the Society's future. One of those possible options was the merger, in some unspecified manner, of the Society with the Bank.

10. In April 1988 the Macquarie Bank Limited provided to the board a confidential report. Suffice it to say that this report viewed some merger with the Bank as a real possibility that could be advantageous for the members, depositors and borrowers of the Society, depending upon the content of any proposal to this end.

11. On 5 May 1988 the board of the Society unanimously resolved that "the Society open discussions with the State Bank to examine the possibility of a merger between the Bank and the Society and that the outcome of discussions be considered by the Board in due course in the light of the Macquarie Report and having regard to the interests of members generally, depositors, borrowers and staff". The persons referred to in sub-paragraphs 8 (a), (c), (d) and (e) above were present and voted at this board meeting.

12. By letter dated 11 May 1988, the Registrar of Co-operative Societies wrote to Mr. O'Neill regarding the participation of Messrs. O'Neill, Kearns, Thomas and Turner in the resolution referred to above. The terms of the Registrar's letter were relevantly as follows:

"The purpose of this letter is to request that you, and State Building Society directors who may in other capacities serve the State Bank of New South Wales, refrain from taking part in any negotiations with the Bank relating to a possible merger of the two organisations or in voting upon related resolutions when being considered by the Society's Board.

There is potential for conflicting duties and responsibilities for a person on the governing body of both organisations and this viewpoint can reasonably be extended to directors of the building society who are employees of the Bank.

It is my understanding that the four directors who are the holders of fixed shares comprise yourself, being a director of the State Bank, and employees of the Bank comprising Messrs. R.J. Thomas, P.W. Kearns and R.W. Turner. It appears from the draft minutes of the Board meeting held on 5 May, 1988 that all four voted on the resolution that the Society open discussions with the State Bank to examine the possibility of a merger. Although the minutes indicate that, the fixed capital shareholders were confident no conflict was involved, I do not believe they should have voted on the resolution in question.

Under the circumstances, I must seek the assurance outlined in the opening paragraph of this letter. A copy of this letter has been forwarded to the other 'fixed shareholder' directors with a similar request. I also ask that this letter be brought to the attention of all of the Society's directors."

13. Mr. O'Neill responded in writing to this letter the following day indicating that a considered response would be made in due course.

14. By letter dated 13 May 1988, the Registrar of Co-operative Societies wrote to Mr. O'Neill informing him that the Permanent Building Societies Advisory Committee proposed to consider whether a determination should be made under section 84AC (1) of the Co-operation Act. The terms of this letter were relevantly as follows:

"At a meeting of the Permanent Building Societies Advisory Committee held on 12 May, 1988 I was directed to inform you that the Committee proposes to consider whether a determination should be made under subsection (1) of Section 84AC of the Co-operation Act with respect to the State Bank of New South Wales of which you are a director.

The Committee wishes to consider this matter in the light of the Bank's likely activities and operations relating to possible merger proposals between the Bank and the Society, and which proposals give rise to conflicting responsibilities whilst merger proposals between the Society

and the Bank are under consideration.

In accordance with Section 84AC (2) (b) of the Act you will be given an opportunity to be heard by the Committee and a meeting of the Committee will be held on 3 June, 1988 for that purpose. You are invited to attend that meeting at 2.15 p.m. Should you wish to make a written submission beforehand I would arrange for it to be circulated prior to the meeting."

15. Messrs. O'Neill, Kearns, Thomas and Turner are happy to give the undertaking sought by the Registrar of Co-operative Societies and do not propose to take part in any negotiations with the Bank relating to a possible merger of the Bank and the Society nor to vote upon resolutions at meetings of the board of the Society relating to any such merger where they have a conflict of interest. Indeed, they propose that an independent committee of the Society's board be established to consider and negotiate any merger proposal that may be put to the Society by the Bank. This committee would not contain any of the directors holding fixed shares.

Our advice is sought in respect of the following questions:

- (a) Are Messrs. O'Neill, Kearns, Thomas and Turner "appointees" of the Bank for the purposes of sub-s. 84 (13) of the Co-operation Act?
- (b) Did the resolution of the board of directors of the Society on 5 May 1988 resolving to open discussions with the Bank to examine the possibility of a merger between the Bank and the Society involve any breach of sub-s. 84 (13) of the Act by the persons referred to in (a) above or of any duty that

they owed to the Society or its members in their capacity as directors of the Society?

- (c) Is it appropriate and proper for the directors of the Society (including the persons referred to in (a) above) to resolve to delegate to an independent committee of directors comprising, say, 3 of the directors of the Society not holding fixed shares powers of the board to consider and negotiate any merger proposal between the Bank and the Society?

As to the question in (a) above our answer is: No. Our reasons follow.

Sub-section 84 (13) of the Co-operation Act is relevantly in the following terms:

"... A director of a society shall not vote upon any question involving a matter in which he, or any body corporate of which he is the appointee, has, otherwise than as a member and in common with the other members of the society, any direct or indirect pecuniary interest and, if he does so vote, his vote shall not be counted."

Section 46 of the Co-operation Act deals with members in Part III Division 2 of that Act. Subsection 46 (7) deals with the appointment of natural person to represent a member which is a body corporate in respect of shares held by it. The terms of sub-ss. 46 (7) and (7A) are as follows:

- "(7) Subject to this section, and to any restriction imposed by the rules of the Society as to the entitlement of a person to represent a body corporate where a body corporate is a member of a Society it may, by instrument in writing, served

on the Society appoint a person to represent it in respect of the shares held by it.

(7A) An appointee under subsection (7) -

- (a) shall be entitled to receive notice of all meetings in the same manner as the members and shall be entitled to exercise the same rights to vote as a member; and
- (b) shall be eligible to be elected to the board of directors if the body corporate holds such qualifications, other than those relating to age, as may be requisite for holding office as a director.

A further fact which we take to be the case is that none of the directors of the Society who hold fixed shares has been appointed by an instrument in writing served on the Society to represent the Bank in respect of the shares held by it which would satisfy the terms of sub-s. 46 (7).

We are not aware of any provision of the Co-operation Act, apart from sub-s. 46 (7), which provides for the appointment of persons as representatives of the interests of corporate members.

The correct analysis in our view is that Messrs. O'Neill, Kearns, Thomas and Turner were nominated for election by the Bank and elected by all the members of the Society. Even if (contrary to our view) the word "appointee" in sub-s. 84 (13) is wider than the "appointee" envisaged by sub-ss. 46 (7) and (7A) and takes its ordinary meaning in English unaffected by those sub-sections, these persons are not appointees. They are not "ordered" or "assigned" or "nominated" to a position (cf Macquarie Dictionary). Rather they were each nominated for election and elected by the members.

As to question (b) above our view is: No. Our reasons are as follows.

As we have indicated above, we do not think that these persons are "appointees" for the purposes of sub-s. 84 (13). Even if they were we doubt whether the resolution of 5 May 1988 would in any event be a matter in which the Bank had an indirect pecuniary interest.

On the assumption that the Bank had an indirect pecuniary interest in seeing the resolution passed this fact did not prevent nor should it have prevented these persons voting on this resolution. This is said with one caveat, which almost goes without saying: that each must act bona fide in what he considers to be the interests of the Society. It is clear that as long as the directors consider the interests of the Society as a whole, they are entitled to reflect upon the interests of the shareholder who or which nominated them: Re Broadcasting Station 2GB (1965-6) NSWLR 1658; Berlei Hestia (NZ) Ltd. v. Fernyhough (1980) 2 NZLR 150. Further, as employees of the Bank, albeit very senior, they do not have any indirect pecuniary interest merely because the Bank does (on the assumption referred to above): Lapish v. Braithwaite (1926) AC 275, 278.

As to question (c) above, our view is that we see no reason why all the present directors of the Society cannot act in that fashion. Rule 106 (a) confers a power of delegation to a committee of directors. The only constraint which attends the exercise of this power is that, like any other power, it must be exercised in good faith and in what the directors consider to be in the interests of the Society.

Finally, we have also been requested to comment upon the proposed

consideration of Mr. O'Neill's position under s. 84AC of the Co-operation Act by the Permanent Building Societies Advisory Committee. Subsection 84AC (1) is relevantly in the following terms:

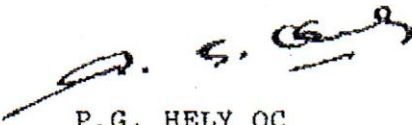
"Where a person, at the same time, a director of a non-terminating building society or a society mentioned in the Second Schedule and a director of another corporation (not being an association registered under this Act) the Permanent Building Societies Advisory Committee may, subject to this section, determine that, in its opinion, the activities and operations in which the corporation is engaged, are, or are likely to be, such that the person should not be a director of the society while he is a director of that corporation."

In our opinion the Committee in considering whether the precondition to the making of a determination under the section has occurred, and whether such determination should be made, is bound to take into account, and to give proper weight to the undertakings referred to earlier, and to the establishment of the independent committee.

On the assumption that the undertakings referred to earlier are given, and the independent committee established, we find it difficult to see how s. 84AC (1) could be reasonably applied to make a determination adverse to Mr. O'Neill.

CHAMBERS

19 May 1988


P.G. HELY QC


J.L.B. ALLSOP