NATIONAL CREDIT UNION ADMINISTRATION
WASHINGTON, D.C. 20456

July 1, 1991

Ann M. Seward, Esq.
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PriMerit Bank Center
3320 West Sahara Avenue
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Re: Conflict of Interest - Nevada Federal Credit Union (Your May 15, 1991 Letter)

Dear Ms. Seward:

This responds to your letter to NCUA General Counsel Robert Fenner. You asked several questions concerning a possible conflict of interest of one of the directors of Nevada Federal Credit Union ("NFCU") and various alternatives for dealing with the situation. Your individual questions are discussed below.

Background

The Supervisory Committee of NFCU suspended a member of the board of directors, who was then removed from office at a special meeting of the members. Approximately two months before the suspension and removal, a slate of candidates for election to the board of directors had been distributed to the membership in anticipation of the upcoming annual meeting and election. The slate included the director in question. The director was reelected to the board at the annual meeting, one and one half months after his suspension and re-

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moval. The director instituted suit against NFCU and the supervisory committee members after the suspension and before the reelection.

At present, the director is still a member of NFCU's board. Although he has not been allowed to participate in any discussions pertaining to his lawsuit against NFCU and the supervisory committee, he does take part in other credit union matters. You are concerned about the director's knowledge of NFCU business and financial information, and suggest that there is a conflict of interest between the director's interest in using such information to his advantage in the lawsuit, and his duty to NFCU.

Analysis

1. May a previously removed and subsequently reelected director, who is suing the credit union, act on any matter before the board of directors?

Neither the Federal Credit Union Act, 12 U.S.C. Section 1751 et seq. (the "Act"), nor NCUA's Rules and Regulations, 12 C.F.R. Part 700 et seq. (the "Regulations"), addresses this issue. The only qualifications for a director imposed by the Act are that he be a member of the federal credit union (Section 111(a), 12 U.S.C. §1761(a)), and that he not have been convicted of a crime involving dishonesty or breach of trust, (or, if he has been convicted of such a crime, that the NCUA Board has waived that prohibition) (Section 205(d), 12 U.S.C. §1785(d)). Nothing in your letter indicates that the director in question does not meet these qualifications. Therefore, the Act and Regulations do not preclude the director from serving on the board and participating in board business.

The real issue is whether the director's fiduciary duty to NFCU requires that he not take part in any matters before the board because of his current law suit. The only NCUA provision that may bear upon this question is Article XIX, Section 4 of the Standard Federal Credit Union Bylaws (the "Bylaws") which, as you know, requires a director to disqualify himself from any deliberation or vote on matters affecting his pecuniary interest of the pecuniary interest of any corporation, partnership or association in which he is directly or indirectly interested. That provision is obviously limited in scope, and does not cover the precise situation presented in

your letter. Even assuming that Article XIX, Section 4 is relevant to the instant case, it does not implement law or regulation, and a court seeking to apply it to the NFCU situation would therefore look to state corporate common law for guidance. We suggest that you review Nevada corporate common law to determine whether Article XIX, Section 4, principles of fiduciary responsibility, or any other principle of law would be interpreted to preclude the director from acting on any matters before the board.

2. May, or should, a previously removed and subsequently re-elected director, who is suing the credit union, be excluded or suspended from the board of directors while the suit is in progress?

Again, neither the Act nor the Regulations addresses this exact question. Of course, the supervisory committee has the power to suspend a director pursuant to Section 115 of the Act, 12 U.S.C. §1761d, and Article X, Section 5 of the Bylaws. However, such suspension is valid only until the next meeting of the members, which must be held in not less than seven or more than fourteen days from the suspension. Should the members choose not to suspend or remove the director at that meeting, he would return to his position on the board.

As with the previous question, you should look to state corporate common law to determine whether NFCU's particular fact situation is sufficient to warrant the director's exclusion or suspension from the board of directors during the pendency of his suit.

3. May, or should, a previously removed and subsequently re-elected director, who is suing the credit union, be removed from directorship?

Article VII, Section 7 of the Standard Federal Credit Union Bylaws empowers a federal credit union's board of directors to remove a director who "fails to attend regular meetings of the board . . . for 3 consecutive months, or otherwise fails to perform any of the duties devolving upon him/her as a director" by declaring the director's seat vacant and filling the vacancy. A board's removal power is interpreted according to state common law, and traditionally has been narrowly construed. The general rule is that the removal power of a board of directors is exceptional and limited, because the

ultimate power and responsibility for selection and removal of directors lies with voting stockholders, in this case, the credit union members. Whether a given director's actions rise to the level of failure to perform his duties is a fact question to be resolved in accordance with state corporate common law.

Article XIX, Section 3 of the Bylaws permits a federal credit union's members to remove a director at a special meeting called for that purpose, after affording the director notice and opportunity to be heard. This is in keeping with general corporate common law principles. However, you should consult Nevada corporate common law for guidance on whether the members must have cause for the removal and, if so, whether there is cause to remove the director in question.

We note that it has long been our policy not to become involved in bylaw disputes unless there are issues related to the Act or Regulations, or the alleged bylaw violation poses a threat to the safety and soundness of the federal credit union in question. Neither the Act, the Regulation, nor safety and soundness is at issue here. Moreover, this matter involves the Bylaws only tangentially. Essentially, this is an internal problem that should be resolved within NFCU or by a court, and we do not believe that it would be appropriate for NCUA to insert itself into this dispute. Please be advised that it is our policy not to issue formal opinions in matters of this nature. We are enclosing a copy of an advisory letter issued to NFCU by NCUA's Region VI Office, for your information.

You also asked whether NCUA has previously taken investigation and/or removal action in situations similar to that at NFCU. Although you refer to 12 U.S.C. Section 1758 for NCUA's investigation and removal authority, we assume that you intended to cite Section 206(g) of the Act, 12 U.S.C. §1786(g), which allows the NCUA Board to suspend and/or remove individuals from office or prohibit their participation in credit union affairs, under certain circumstances. The mere fact that a director has filed a law suit against the

federal credit union on whose board he serves is not a sufficient basis for his removal from office under Section 206(g), and NCUA has neither investigated nor removed a director on such grounds.

Sincerely,

James J. Engel
Deputy General Counsel

Enclosure

GC/MRS:sg
SSIC 3700
91-0521

March 14, 1990

Mr. Bradley W. Beal
President
Nevada Federal Credit Union
P.O. Box 15400
Las Vegas, Nevada

Re: Removal of Directors

Dear Mr. Beal:

You have raised several questions relating to the removal of four of Nevada Federal Credit Union's (the "FCU") directors and the FCU's upcoming annual election. We have consulted with NCUA's Office of General Counsel in answering your questions. The Office of General Counsel has also been in contact with Robert Kolesar, the credit union's attorney. Your questions and our responses are set forth below.

BACKGROUND

During a special membership meeting, four of the FCU's seven directors were removed from the board. One additional director resigned the following day. Two directors remain. The terms of the two remaining directors expire in March 1990.

The FCU's regular annual election is in process. Mail ballots were distributed to all members in early January and must be returned by March 23, 1990, to be included in the tally. Based on previous years' experience, you believe that the FCU has already received the vast majority of ballots containing votes to be cast in the regular election.

Three board seats were up for election prior to the removals and resignation. Of the three seats, two are held by the two remaining directors. Five candidates have been nominated. One of the candidates is one of the directors removed by the membership at the special meeting.

ANALYSIS

Your questions and our responses are as follows:

1. Are the two remaining directors empowered to conduct the affairs of the FCU?

No. Article VII, Section 6 of the Standard FCU Bylaws provides that:

> A majority of the number of directors (inclusive of any vacancies) shall constitute a quorum for the transaction of business at any meeting thereof.... (Emphasis added.)

Therefore, in order for your credit union to conduct business, there must be four directors.

This does not mean, however, that the two remaining directors can't appoint temporary board members to fill vacancies. We do not view such action as constituting the transaction of credit union business. Section 111 of the FCU Act (12 U.S.C. 1761) provides in part:

> . . . Any vacancy occurring on the board shall be filled until the next annual election by appointment by the remainder of the directors. (Emphasis added.)

This provision is incorporated into Article VII, Section 3 of the Standard FCU Bylaws, which provides:

> Any vacancy on the board, credit committee, or supervisory committee shall be filled by vote of a majority of the directors then holding office. Directors and credit committee members so appointed shall hold office only until the next annual meeting, at which time any unexpired terms shall be filled by vote of the members, and until the qualification of their successors. . . . (Emphasis added.)

It is our opinion that the board must fill the vacancies as directed by the FCU Act and Article VII, Section 3 of the bylaws in order to permit the FCU to continue operations.

2. Should the FCU pay the legal fees of the four removed directors, (and the director who resigned), incurred beyond the date of the special membership meeting? We anticipate that these directors may file a lawsuit or take other legal measures due to their removal. This issue is somewhat affected by an indemnity provision previously approved by the NCUA and included in our bylaws.

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Your FCU's bylaws provide for indemnification of directors, including former directors, in accordance with the laws of Nevada. While we cannot provide you with advice regarding Nevada law, that is a matter that should be reviewed by the FCU's attorney, we can offer the following comments. In our view, indemnity is provided in those cases were an official is found liable to third parties for actions taken when properly performing the duties of his or her official position. Indemnification would not be proper, for example, to cover the expenses of an ousted official who files suit against the FCU's board or supervisory committee. Rather, indemnification would be available to the board or committee members for expenses incurred in defending their actions if those actions meet the test of state law. It would be up to the appropriate tribunal to determine whether the challenging official is entitled to recover expenses.

3. The bylaws state that any appointed directors serve until the next membership meeting. If the present two board members appoint directors to fill the current vacancies, when would the terms of those appointees expire? At the March 28, 1990, annual meeting, or at the 1991 annual meeting? If the terms expire on March 28, 1990, what is the procedure to fill those seats at that time?

Both the FCU Act and the Standard FCU Bylaws provide that directors appointed to fill a vacancy hold office only until the next annual membership meeting. In your case, there is not sufficient time before the upcoming annual meeting for nominations to be made for the vacancies created by the removals and resignation.

We believe that the FCU Act can be interpreted to permit the appointed directors to hold office until the 1991 annual meeting since the FCU has already begun its 1990 election process. This would result in three elected directors and four appointed directors.

We also understand that the FCU is considering reducing its board size from seven to five. One alternative being considered by the FCU is to have the current two directors appoint three directors, and then, by board resolution, reduce the board size to five. At the March 28 meeting, the five nominees running for office could be declared elected pursuant to Article VI, Section 2 of the FCU Standard Bylaw Amendments. We would pose no objection to such action.

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4. If Mr. Dube (one of the removed directors) is successful in the regular 1990 election currently in process, would he be returned to the board, or would this week's removal action take priority resulting in his disqualification in the election currently in process? This question is somewhat complicated because, based on previous years experience, our anticipation is that we have already received the vast majority of votes expected to be cast in the regular election.

The fact that a director has been removed from office does not disqualify him from later running for office. The problem in your case is that the members who have already cast their mail ballots may have voted to reelect Mr. Dube before he was removed from office, and may have voted differently if they had known of the removal at the time they voted for his reelection. Neither the FCU Act nor NCUA's Regulations would make this a basis for negating Mr. Dube's election. Your attorney has determined that this is also not a sufficient basis for disqualification under state law.

Another alternative that may be considered is for the board, including the appointed board members, to declare the election now in process as void due to intervening circumstances, reschedule the annual meeting and call for a new election. The appointed board members would continue to hold office until that time in accordance with Article VII, Section 3 of the bylaws.

Sincerely,

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Foster C. Bryan
Regional Director

BC/JJE/JT:sg/tjm

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