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VIA E-MAIL: regcomments@ncua.gov

Ms. Mary Rupp
Secretary of the Board
NATIONAL CREDIT UNION ADMINISTRATION
1775 Duke Street
Alexandria, VA 22314-3428

Re: Comments Concerning Proposed Rule 701.3, Member Inspection of Credit Union Books, Records, and Minutes ("Proposed Rule")

Dear Ms. Rupp:

Our office is responding to the NCUA's request for comments on the Proposed Rule. Our comments are provided from the perspective of attorneys representing more than 350 federal and state chartered credit unions. Based on our experience, we believe that a number of our credit union clients will be affected by the Proposed Rule.

We applaud the NCUA in its efforts to address and improve the standards for member inspection rights and understand the concerns of the NCUA in this area. Even so, we believe that there are certain sections of the Proposed Rule that the NCUA should reconsider. Our comments are set forth below.

1. **Proposed Rule 701.3(a)**

The Proposed Rule indicates that member inspection rights are limited to "non-confidential" portions of a credit unions books, records and minutes. The crux of the matter will be the determination of "confidential" as opposed to "non-confidential" books, records and/or minutes.

We understand and appreciate NCUA's stated interest in providing a consistent standard regardless of an FCU's location. However, we suggest that NCUA may wish to carefully consider whether it should discard its longstanding practice of relying on the state corporation law where the FCU is located with respect to shareholder inspection rights. The courts and legislatures of the various states have dealt with shareholder inspection rights for quite some time and we raise the issue of whether NCUA should entangle itself

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in this area. As to a determination of which state law should apply, many corporations (not just credit unions) must address this situation typically by determining the location of the principal executive office of the corporation.

With respect to the issue of whether the financial interests of FCU members should be analogized to those of depositors in a mutual savings bank, we support NCUA's rejection of such a conclusion. Notwithstanding anything else, NCUA's specific determination on this issue should prove beneficial to a judicial interpretation of credit union law in a future matter (not only for FCUs but, perhaps, also for state chartered credit unions).

2. **Proposed Rule 701.3(d)**

We concur with the corollary that NCUA has drawn to 12 CFR §552.11 ("OTS Rule"). However, we also note that the OTS Rule is simple and straightforward in limiting shareholder access to "non-confidential" information under §552.11(b) and information that is specifically excluded at §552.11(d).

Section 552.11(b) of the OTS Rule states:

> "Any stockholder of a group of stockholders of a Federal stock association, holding of record the number of voting shares of such association specified below, upon making written demand stating a proper purpose, shall have the right to examine, in person or by agent or attorney, at any reasonable time or times, non-confidential portions of its books and records of account, minutes and record of stockholders and to make extracts therefrom."

A cursory review of the OTS Rule reveals several significant items. Initially, the OTS Rule was implemented without any limiting language on member access to books and records and minutes. However, in 1997, the word "non-confidential" was added as a limitation on information accessible to shareholders. With one exception (§552.11(d)), OTS did not choose to define non-confidential information. That is, in general, it appears that OTS has left the determination of "confidential" information to common law.

With this in mind, Section 552.11(d) of the OTS Rules states:

> "(d) Notwithstanding any provision of this section or common law, no stockholder or group of stockholders shall have the right to obtain, inspect or copy any portion of any books or records of a Federal stock association containing:

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(1) A list of depositors in or borrowers from such association;
(2) Their addresses;
(3) Individual deposit or loan balances or records; or
(4) Any data from which such information could be reasonably constructed [emphasis provided]."

Note that the above noted exception, at §552.11(d) was adopted prior to the passage of the Gramm-Leach-Bliley Act ("GLB") in 1999 and covers limited information which appears to fall within the definition of "non-public personal information" under GLB.

Even so, perhaps the most important aspect of §552.11(d), for our purposes, is the language which states: "Notwithstanding any provision of this section or common law [emphasis provided]." Such language does not appear to exclude provisions under common law which would protect confidential information. Rather, it merely suggests that any inconsistency with common law or any other provisions of §552.11 is to be resolved in protecting the confidentiality of the information specified under §552.11(d).

Accordingly, the use of such language at §552.11(d) and the use of the added term "non-confidential" under §552.11(b), OTS clearly did not limit the scope of the term "confidential" information. Nor did OTS seek to provide an exhaustive or exclusive definition of the term "confidential information." Again, OTS preserved the application of common law to determine "confidential" information. We suggest NCUA consider such an approach as opposed to attempting the exclusive approach set forth at Proposed Rule 701.3(d).

3. **Proposed Rule 701.3(d); Other Considerations**

The Supplementary Information to the Proposed Rule raises a number of complex issues and sets forth a number of remarkable statements concerning NCUA Proposed Rule 701.3(d) which merit comment and further consideration by NCUA.

a. Trade Secrets

The "other considerations" portion of the Supplemental Information to the Proposed Rule addresses Trade Secrets as follows:

> "This proposal, like the OTS Rule, has no confidentiality provisions related to internal memoranda or trade secrets for several reasons. First, credit unions do not generally have trade

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> secrets, that is, secret formulas or technology on which the success of the organization is dependent, and cases that deal with confidential internal correspondence generally do not provide a standard by which confidentiality can be measured. Second, it is unlikely that, given the narrow interpretation of "books and records of account" intended by the Board, any materials deserving of confidentiality would appear among those materials subject to inspection. Third, even if confidential materials appear among the materials subject to this rule, requested materials must be relevant to the petitioners' stated business purpose before they become subject to inspection [emphasis provided]." 72 Fed. Reg. No. 77 at Page 20065.

Initially, we do not concur with NCUA's statement that the OTS Rule does not contain confidentiality provisions for internal memoranda or trade secrets. As noted above, while OTS does not explicitly address internal memoranda or trade secrets, it does preserve common law and other statutory protections which do protect such information.

Beyond this, we are surprised that the Supplementary Information to the Proposed Rule suggests that "credit unions do not generally have trade secrets." Respectfully, our experience is such that this statement is factually inaccurate and certainly not in the best interests of credit unions. Indeed, it would be exceedingly unfortunate to have NCUA's statement quoted against a credit union asserting a trade secret against a third party.

In considering this comment, we believe the problem may be with NCUA's understanding of a trade secret. For example, we note that Black's Law Dictionary defines "trade secret" as "a formula, process, device, or other business information that is kept confidential to maintain an advantage over competitors." See BLACK'S LAW DICTIONARY (8th ed. 2004). Given this broad definition, it is difficult to understand a supposition that trade secrets are somehow limited to "secret formulas or technology."

Our experience and observation is that a number of credit unions do in fact develop their own processes, formulas and technology. Moreover, such information can easily overlap with other processes and procedures to protect confidentiality of member information and ensure safety and soundness (e.g., internal controls; procedures and practices required under NCUA Rule 748).

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In sum, we recommend that the NCUA amend the Proposed Rule to recognize that credit unions can and do have trade secrets which must remain confidential.

b. Attorney-Client Privilege

With respect to privileged information, the Proposed Rule states:

> "The Board believes member-owners with a proper purpose should have access to relevant FCU information. Accordingly, and like the OTS Rule, this proposal does not include confidentiality protection for privileged information, but that does not mean that privileged material will automatically be subject to inspection [emphasis provided]." 72 Fed. Reg. 77 at Page 20065.

The NCUA purports to base its position on an analysis of the OTS Rule and several state law cases.

As noted above, OTS Rule §552.11(b) merely states that a stockholder, upon a showing of proper purpose, is allowed access to nonconfidential portions of a Federal stock association's books and records. There is nothing in the OTS Rule which suggests that the OTS has concluded that privileged information is not confidential. Nor is there any analysis in the NCUA's Supplementary Information which supports the NCUA's suggestion that the OTS Rule does not include confidentiality protection for privileged information.

While the case law relating to the OTS Rule is limited, our office contacted the OTS and spoke with an OTS attorney in an effort to better understand the view of OTS on their Rule 552.11 and its relation to confidential information such as attorney-client privileged information. Our call was on a "blind basis" without reference to a specific financial institution or even reference to the NCUA's Proposed Rule. Even so, when questioned about the meaning of "nonconfidential," the OTS attorney advised that there was no official OTS definition as to the term. Further, he understood "nonconfidential" to mean "not rising to the level of confidential business information." He further stated that he believed the term to be analogous to information that was not privileged and suggested that "common sense would dictate that under §552.11, privileged information would not be accessible." Finally, the OTS attorney indicated that while §552.11 is often a secondary issue in a dispute, he has observed the issue of shareholder inspection rights and confidential information contested in court and subject to a judicial determination.

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The above analysis and informal input from the OTS suggests that NCUA should reconsider its statement that the OTS Rule does not include a confidentiality protection for privileged information. It also suggests that NCUA may wish to reconsider its view of the accessibility of privileged information.

c. Comparison of Rules on Privileged Information

In examining privileged information, NCUA's Supplementary Information continues as follows:

> "The NCUA Board also considered if privileged information, that is, exempt from discovery in court cases, should be withheld from members. Case law on the corporate shareholder's right to inspect privileged information differs by jurisdiction. In California, for example, shareholders lack the right to inspect corporate books and records covered by the attorney-client privilege." 72 Fed. Reg. 77 at Page 20065.

We concur with the NCUA's analysis of the California Rule. Indeed, the California Evidence Code unambiguously provides that the attorney-client privilege can be limited only by statutory exception. Dickerson v. Ferrito, 135 Cal. App.3d, 93, 93 (1982). Thus, there is no shareholder exception to the corporate attorney-client privilege in California. National Football League Properties, Inc. v. Oakland Raiders, 65 Cal. App.4th 100, 107 (1998).

The NCUA Supplementary Information continues by indicating that, "In other jurisdictions, however, shareholders who are concerned with corporate mismanagement may inspect attorney-client privileged documents [emphasis provided]." 72 Fed. Reg. 77 at Page 20065.

The NCUA cites to, among others, Garner v. Wolfinbarger, 430 F.2d 1093, (5th Cir. 1970) and suggests that stockholders could inspect communications between an attorney and corporate management under some circumstances. The Supplementary Information continues by stating "member-owners with a proper purpose should have access to relevant information" and continues with the above noted statement "Accordingly, and like the OTS Rule, this proposal does not include confidentiality protection for privileged information [emphasis provided]." 72 Fed. Reg. at Page 20065.

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With the NCUA's comments in mind, a closer examination of the Garner case reveals a detailed analysis as to circumstances under which shareholders may inspect corporate records. The analysis begins with the Federal Rules of Evidence §501 which provide, in pertinent part:

> "Except as otherwise required by the Constitution of the United States or provided by Act of Congress or in rules prescribed by the Supreme Court pursuant to statutory authority, the privilege of a witness, person, government, State, or political subdivision thereof shall by governed by the principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience [emphasis provided]."

Based this Federal Rule of Evidence, in the absence of an exception under the Constitution or by statute (or a rule of the Supreme Court) the scope of the attorney client privilege is governed by common law. Following this analysis, the Garner court indicates that as long as shareholders can demonstrate "good cause" for disallowing a privilege, the communications are not privileged. Garner v. Wolfinbarger, 430 F.2d 1093, 1103-1104 (5th Cir. 1970).

Pursuant to this analysis, the Garner court listed nine factors which it believed should be considered in determining whether good cause exists. Those factors are as follows:

(1) The number of shareholders and the percentage of stock they represent;

(2) The bona fides of the shareholders;

(3) The nature of the shareholders' claim and whether it is obviously colorable;

(4) The apparent necessity or desirability of the shareholders having the information and the availability of it from other sources;

(5) Whether, if the shareholders claim is of wrongful action by the corporation, it is of action criminal or illegal or not criminal but of doubtful legality;

(6) Whether the communications relate to past or prospective actions;

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(7) Whether the communications are of advice concerning the litigation itself;

(8) The extent to which the communication is identified versus the extent to which the shareholders are blindly fishing; and

(9) The risk of revelation of trade secrets or other information in whose confidentiality the corporation has an interest for independent reasons.

While the Garner Rule set forth these criteria, it did not purport to create an exhaustive list of elements necessary to a finding of good cause, but rather it set forth "indica that may contribute to a decision of presence or absence of good cause." See Garner at Page 1104. Subsequent case law suggests that a party opposing the attorney-client privilege is not required to "satisfy" every Garner factor. Under the Garner Rule courts should implement a balancing test, applying the Garner factors, to determine if a party can show sufficient "good cause" to warrant the dismissal of the attorney-client privilege.

Given this context, we do not necessarily disagree with NCUA's statement in the Supplementary Information that "shareholders who are concerned with corporate mismanagement may inspect attorney-client privileged documents [emphasis provided]." However, the mere fact that the Garner decision allows for shareholder access to privileged information in cases of good cause is not a compelling basis for NCUA's conclusion that there is no confidentiality protection for privileged information at all. With this in mind, we would suggest that the NCUA revisit the Proposed Rule and consider applying the Garner Rule as an appropriate standard in determining disputes concerning confidentiality of attorney communications with credit union management.

Indeed, we believe that the Garner Rule presents an excellent standard in balancing shareholders (members) inspection rights against corporate (credit union) interests in protecting privileged information. Accordingly, we recommend that the NCUA adopt the standard set forth in the Garner Rule in the final draft of the Proposed Rule.

d. Applying the Garner Rule

In considering application of the Garner Rule, we suggest two typical scenarios which might involve a request to inspect privileged information: 1) a matter requiring a decision of the members; and 2) class action litigation.

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The first scenario would involve an instance where the members of a credit union are faced with an important decision such as the election or removal of directors, a merger, conversion from federal to private account insurance, conversion from a federal to a state charter, conversion to a mutual savings bank or voluntary liquidation. In such situations, to the extent any such communications form the basis of the matter to be considered by the members, and do not relate to a trade secret, an application to the factors under Garner Rule suggests there should be very little information that is protected by the attorney-client privilege.

The second scenario involves a class of credit union members asserting a violation of a consumer protection statute such as, for example, Regulation "Z." This situation raises significant concerns as to whether there is a proper purpose (not addressed here) in addition to the process of determining whether the information sought is privileged. An application of the factors under the Garner Rule suggests a conclusion that attorney communications with credit union management should remain privileged and should not be readily accessible to the members.

The above illustrations (and the analysis thereon) are by no means exhaustive but do serve to show that the Garner Rule provides a framework to consider the context of a member information request and provides a solid guideline for a court or the NCUA to follow in determining whether there is "good cause" to permit member inspection of attorney communications with credit union management and officials.

We appreciate the opportunity to provide these nonexhaustive comments and look forward to NCUA implementation of a revised Member Inspection Rule which will properly balance the interests of credit unions and their members. Of course, if NCUA has any questions on our comments, please do not hesitate to contact our office.

Sincerely,

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William J. Adler

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