February 20, 2008

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

Re: Comments on Advanced Notice of Proposed Rulemaking for Parts 708a and 708b (Mergers, Conversion from Credit Union Charter, and Account Insurance Termination)

Dear Ms. Rupp:

In the U.S., corporate organizational law has generally been a matter of state jurisdictional purview in contrast to credit union oversight which has generally been a matter of NCUA regulatory prerogative. Although credit unions have long-maintained themselves as cooperative organizations, recent case law decisions, and regulatory actions, in the context of member access, have gingerly advanced a comparison of the status of credit union "members" as more analogous to that of bank customers or depositors. Such comparison creates a separation from the notion of shareholder status for bank owners and signals consideration of whether or not credit union members (as "members" and not as "shareholders") should be legally entitled to a pro-rata distribution of funds in any context other than that of a liquidation. Declaring the status of credit union members in the context of customers rather than owners raises some interesting issues of litigation and jurisdiction not the least of which is that denying credit union "members" ownership status comparatively denies them rights and privileges typically associated with "shareholder" status, such as the inspection of books and records, notice-date voting requirements, and pro-rate dividend declarations. Each of these rights and privileges are an integral component of the conversion/merger options prospectively available to credit union boards.

Case law decisional discussions are currently creating the inference that the appropriate context within which to assess and evaluate credit union governance (especially as it might concern

merger transactions) is state corporate law and not federal regulatory provisions. Were state corporate law to apply to mergers of non-federally-chartered credit unions, and were credit union members to be considered more as cooperative customers and not as cooperative owners, the full panoply of state law would, arguably, trump NCUA initiatives such as the one proposed to create a uniform standard for the definition of director due care. The fact that state corporate law can vary from one state to another and is haphazard in its application is hardly a defensible basis upon which the NCUA can choose to assert its authority in derogation of decades of state decisional law that has crafted workable standards for director due care and due diligence.

An NCUA uniform standard of director due care would, by definition, elevate the responsibilities of directors under some state laws while simultaneously decreasing responsibilities of directors under other state laws. Given the comparative uncertainty that an NCUA imposed standard of care would engender relative to state law requirements it is likely that significant issues of credit union director liability, both individually and collectively as a board, will be threatened by critics on both sides of a proposed merge or conversion. Derogating well-defined standards of director liability under existing state law concepts of director due care, both within and without the business judgment rule, could expose credit union directors to significant personal liability well beyond applicable bonding and bylaw provisions. Concerns over enhanced liability exposure could very well prompt an exodus of directors who are unwilling to sacrifice their personal assets in defense of credit union board actions. Such an exodus would leave credit union members bereft of experienced leadership at one of the most critical junctures of a credit union's organizational life, i.e., consideration of a merger or conversion proposal. Further, it must be understood that although judgment liability for each individual director is of concern here, of even more concern is the prospect of significant legal bills incurred by each director for his or her personal defense. It is doubtful that many credit unions currently have adequate provisions in place for director indemnification in the event of them being personally sued in conjunction with credit union business.

An exodus of directors concerned about personal liability would not be unlike that experienced in the corporate world in the wake of the Sarbanes-Oxley Act of 2002 (SOX). And, as the corporate world has since discovered, the compliance costs associated with the implementation of SOX are well beyond what anyone had expected. Are credit unions willing to absorb the increased costs for assurance that boards will demand in order to satisfy concerns over a NCUA mandated standard of due care that might well vary from existing state law? The definition of "due care" in the light of an impending merger or conversion can mean many things to many different people regardless of what the NCUA might otherwise anticipate. For smaller credit unions unfamiliar with internal audit procedures, or unaccustomed to certified audits, or unfamiliar with merger valuation standards, the documented support required to sustain director conduct sufficient to withstand a due care attack by dissident members could be formidable.

Given the voracious appetite of commercial banks for new members; given the dearth of capital formation alternatives for credit unions just as intent as commercial banks for growth; and, given the huge pools of venture capital moneys available to banks eagerly searching for an inexpensive acquisition of new depositors to whom a diversified array of consumer goods and services can be profitably packaged, it would be wise for the NCUA to reconsider its intention to impose a uniform standard of director care in the context of an impending merger or conversion. Market standards have been dealing with these kinds of corporate organizational matters far longer than the relatively recent, and fairly infrequent, incidents in the credit union universe. Although topically alarmist in some credit union circles, the actual number of credit union mergers and conversions to date has been few. And, those that have transpired appear to reflect more of a natural organizational evolution than the result of predatory practices. Existing market mechanisms, regulations, and industry practices, although seemingly insufficient, are actually permitting the market alternatives to function as credit unions each assess their competitive position in the light of a rapidly evolving financial services industry. Increasing regulatory burdens only serves to restrict the options available to credit union boards intent upon serving the bests interests of their members. The traditionally-formed credit union may well serve the interests of some; but, given the economics of the marketplace today NCUA attempts to disrupt the natural evolution of credit unions opting for alternative forms of organization is an unwarranted interference in this process fraught with the very real possibility of significant legal challenge.

Sincerely,

Prof. Gregory J. Naples
Dept. of Business Law and Accounting
Marquette University