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BILL ANALYSIS

Senate Fiscal Agency

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LEGISLATIVE COUNCIL

Senate Bill 445 (Substitute S-5 as reported)**Sponsor: Senator Michael J. O'Brien****Committee: Commerce and Technology****Date Completed: 3-10-88****RATIONALE**

In response to concerns that corporate directors and officers could be held personally liable for erroneous decisions that were made honestly and in good faith, and to avoid the consequent loss of individuals willing to serve in these capacities, the Legislature enacted Public Acts 1 and 170 of 1987, which limit the personal liability of directors of for-profit and nonprofit corporations, and broaden the authority of corporations to indemnify directors and officers for claims made against them. The same concerns apply to directors of financial institutions, so Senate Bills 39 and 643 (currently pending before the House Judiciary Committee) propose similar changes in regard to the liability of directors and officers of banks and safe and collateral deposit companies and savings and loan associations. In order to achieve parity between financial institutions, it has been suggested that analogous changes be made for credit unions.

CONTENT

The bill would amend the Credit Union Act to limit the personal liability of directors, officers, employees and agents of credit unions.

Specifically, the bill would require directors and officers of credit unions to discharge their duties "in good faith and with that degree of diligence, care, and skill which an ordinarily prudent person would exercise under similar circumstances in a like position". In discharging their duties, directors and officers would be able to rely upon the opinion of the credit union's legal counsel, reports of independent appraisers selected by the board and financial statements of the credit union that are said to be correct by the credit union's general manager or officer in charge of the credit union's books of account or that are prepared by a certified public accountant or other professionally qualified individual pursuant to a comprehensive audit or other audit of the credit union.

A credit union's certificate of organization could contain a provision that a director was not personally liable to a credit union or its shareholders for monetary damages for breach of the director's fiduciary duty. This provision, however, would not eliminate or limit the director's liability for any of the following:

- A breach of the director's duty of loyalty to the credit union or its shareholders.
- Acts or omissions not in good faith or that involve intentional misconduct or knowing violation of law.
- A transaction from which the director derived an improper personal benefit.

- The loss of principal or interest of an uninsured deposit or share account resulting in an action brought by a shareholder as a depositor or owner of a share account.
- Breach of fiduciary duty resulting in an action brought by a shareholder as a consumer of services other than depository or share account services.
- An act or omission occurring before March 1, 1988.

Any director or officer who knowingly violated or assented to a violation of the bill or of the rules of the Commissioner of the Financial Institutions Bureau promulgated under the authority of the bill would be held personally and individually liable for all damages sustained by the credit union, any shareholder or any other person as a consequence of the violation.

An action against a director or officer for failure to perform his or her duties would have to commence within three years after the cause of action occurred or within two years after the cause of action was discovered, or should reasonably have been discovered, by the complainant, whichever occurred sooner.

A credit union could indemnify a director, officer, employee, or agent of the credit union or a person serving at the request of the credit union in such a capacity for another credit union, corporation, or other enterprise against legal expenses actually and reasonably incurred in an action, lawsuit, or proceeding, whether civil, criminal, administrative or investigative and informal or formal, including actions or suits by or in the right of the credit union to procure a favorable judgment, if he or she acted in good faith and not in a manner opposed to the best interests of the credit union or its shareholders and, if the action were a criminal action, the person had no reasonable cause to believe that his or her conduct was unlawful.

The termination of any action, suit or proceeding by judgment, order, conviction, settlement or plea of nolo contendere could not create a presumption that the person did not act in good faith and in a manner believed to be in the best interests of the credit union and its shareholders or that the person had cause to believe that his or her conduct was unlawful.

Indemnification could not be made for any claim, issue, or matter in which the person had been found liable to the credit union unless and only to the extent that the court in which the action or suit was brought determined that the person was fairly and reasonably entitled to indemnity for expenses the court considered proper.

S.B. 445 (3-10-88)

Unless ordered by a court, indemnification could be made by a credit union only upon the determination that the person to be indemnified met the applicable standard of conduct. The determination could be made in any of the following ways:

- By a majority vote of a quorum of directors who were not parties to the action.
- By a majority vote of a committee of directors who were not parties to the action. The committee would not have to consist of not less than two disinterested directors.
- By independent legal counsel in a written opinion.
- By the shareholders.

If a person were entitled to indemnification for only a portion of the expenses incurred in an action or proceeding, the credit union could indemnify the person for that portion.

The credit union could pay expenses incurred in defending a civil or criminal action before final disposition of the action provided the director, officer, employee or agent agreed to repay the expenses if it were ultimately determined that he or she was not entitled to indemnification.

The indemnification and advancement of expenses could not be considered exclusive of any other rights to which those seeking indemnification or advancement of expenses were entitled. The total amount of expenses advanced or indemnified from all sources combined could not exceed the amount of actual expenses incurred by the person seeking indemnification or advancement of expenses. Indemnification would continue for a person who ceased to be an officer, director, employee or agent and would inure to the benefit of the heirs, executors and administrators of the person.

The term "credit union" would include all other credit unions which become related to the credit union by a consolidation or merger and the resulting or continuing credit union, and indemnification would cover directors, officers, employees and agents of the other credit unions as well.

The bill would take effect July 1, 1988.

Proposed MCL 490.9a-490.9f

FISCAL IMPACT

The bill would have no fiscal impact on State or local government.

ARGUMENTS

Supporting Argument

Like banks, deposit companies, and other corporations, credit unions need to obtain and retain their directors, officers, and "outside directors" who are not employees but are recruited from the public and private sectors. These persons may be reluctant to serve on boards if they feel exposed to personal liability. As a result, the quality of governance of a credit union's affairs may be reduced by its inability to recruit competent persons. In addition, the State's economic climate may be damaged if these institutions are discouraged from locating in Michigan. The bill would address these concerns by proposing changes parallel to those of Senate Bill 39, Senate Bill 643 and Public Acts 1 and 170 of 1987. At the same time, the bill would retain existing provisions that define the fiduciary relationship between directors or officers and their association, and protect the interests of members as depositors and consumers.

Supporting Argument

Although credit unions already may purchase liability insurance for their directors and officers, this type of coverage is becoming increasingly scarce and prohibitively expensive. Another method of protecting these individuals must be found. Broadened indemnification is needed to protect individual assets, and limited liability is needed for a credit union to recruit and keep qualified directors who want to avoid the negative exposure of a lawsuit.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.