

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 86/2

892 SCOMM32: AK GENERAL STOCK OWNERSHIP CORP. 1979-80

James Allen were able to create and fund the Economic and Development Corporation, a separate Swiss company, and pay \$750,000 to Dr. Hubert Weisbrod, a Swiss attorney, to stimulate West German jet sales without the knowledge of the board or, apparently, other senior executives.

At 3M, chairman Bert Cross and finances vice president Irwin Hansen ordered the company insurance department to pay out \$509,000 for imaginary insurance and the bookkeeper to fraudulently record the payments as a "necessary and proper" business expense for tax purposes. Although the transactions lacked required documentation, they were approved by both departments and later "verified" by Haskins and Sells, the outside auditor.

Ashland Oil Corporation's chief executive officer, Orwin E. Atkins, involved at least eight executives in illegally generating and distributing \$801,165 in domestic political contributions, also without question. Not only was the board not informed until the Special Prosecutor's Office and Internal Revenue Service compelled Atkins to dribble out details of the misappropriation of funds, but Ernst and Ernst, Ashland's accountants, did not effectively investigate any of half a dozen separate accounts it discovered that suggested Ashland's illegal course of action.

The Legal Basis of Management Power

The legal basis for such a consolidation of power in the hands of the corporation's chief executive is the proxy election. Annually the shareholders of each publicly held corporation are given the opportunity of either attending a meeting to nominate and elect directors or returning proxy cards to management or its challengers signing over their right to vote. Few shareholders personally attend meetings. Sylvan Silver, a Reuters correspondent who covers over 100 Wilmington annual meetings each year, described representative 1974 meetings in an interview: At Cities Service Company, the 77th largest industrial corporation with some 135,000 shareholders, 25 shareholders actually attended the meeting; El Paso Natural Gas with 125,000 shareholders had 50 shareholders; at Coca Cola, the 69th largest corporation with 70,000 shareholders, 25 shareholders

attended the annual meeting; at Bristol Meyers with 60,000 shareholders a like 25 shareholders appeared. Even "Campaign GM," the most publicized shareholder challenge of the past two decades, attracted no more than 3,000 of General Motors' 1,400,000 shareholders, or roughly two-tenths of one percent.

Thus, corporate directors are almost invariably chosen by written proxies. Yet management so totally dominates the proxy machinery that corporate elections have come to resemble the Soviet Union's euphemistic "Communist ballot"—that is, a ballot which lists only one slate of candidates. Although federal and state laws require the annual performance of an elaborate series of rituals pretending there is "corporate democracy," in 1973, 99.7 percent of the directorial elections in our largest corporations were uncontested.

Of the 6,744 corporations required to file data with the Securities and Exchange Commission, incumbent management retained control in at least 6,734 companies, or 99.9 percent. In the 500 largest industrial corporations—corporations which account for some 66 percent of the sales of all industrial corporations in the United States—no incumbent management was even challenged in 1973. One-sided as these results are, they are entirely typical for the largest business corporations. During the 18 years for which data are available, 1956-73, management has won 99.9 percent of all proxy solicitations in 10 out of 18 years.

THE BEST DEMOCRACY MONEY CAN BUY

The key to management's hegemony is money. Effectively, only incumbent management can nominate directors—because it has a nearly unlimited power to use corporate funds to win board elections while opponents must prepare separate proxies and campaign literature entirely at their own expense.

There is first management's power to print and post written communications to shareholders. In a typical proxy contest, management will "follow up" its initial proxy solicitation with a bombardment of five to ten subsequent mailings. As attorneys Edward Aranow and Herb Einhorn explain in their treatise, *Proxy Contests for Corporate Control*:

SOURCE: TAMING THE GIANT CORPORATION

NADER, GREEN, AND SELIGMAN

Perhaps the most important aspect of the follow-up letter is its role in the all-important efforts of a soliciting group to secure the *latest-dated* proxy from a stockholder. It is characteristic of every proxy contest that a large number of stockholders will sign and return proxies to one faction and then change their minds and want to have their stock used for the opposing faction.

The techniques of the Northern States Power Company in 1973 are illustrative. At that time, Northern States Power Company voluntarily employed cumulative voting, which meant that only 7.2 percent of outstanding shares was necessary to elect one director to Northern's 14-person board. Troubled by Northern's record on environmental and consumer issues, a broadly based coalition of public interest groups called the Citizens' Advocate for Public Utility Responsibility (CAPUR) nominated Ms. Alpha Snaby, a former Minnesota state legislator, to run for director. These groups then successfully solicited the votes of over 14 percent of all shareholders, or more than twice the votes necessary to elect her to the board.

Northern States then bought back the election. By soliciting proxies a second, and then a third time, the Power Company was able to persuade (or confuse) the shareholders of 71 percent of the 2.8 million shares cast for Ms. Snaby to change their votes.

Larger, more experienced corporations are usually less heavy-handed. Typically, they will begin a proxy campaign with a series of "build-up" letters preliminary to the first proxy solicitation. In Campaign GM, General Motors elevated this strategy to a new plateau by encasing the Project on Corporate Responsibility's single 100-word proxy solicitation within a 21-page booklet specifically rebutting each of the Project's charges. The Project, of course, could never afford to respond to GM's campaign. The postage costs of soliciting GM's 1,400,000 shareholders alone would have exceeded \$100,000. The cost of printing a document comparable to GM's 21-page booklet, mailing it out, accompanied by a proxy statement, a proxy card, and a stamped return envelope to each shareholder might have run as high as \$500,000.

Nor is it likely that the Project or any other outside shareholder could match GM's ability to hire "professional" proxy solic-

tors such as Georgeson & Company, which can deploy up to 100 solicitors throughout the country to personally contact shareholders, give them a campaign speech, and urge them to return their proxies. By daily tabulation of returned proxies, professional solicitors are able to identify on a day-by-day basis the largest blocks of stock outstanding which have yet to return a favorable vote.

Management's "army" in a proxy contest will also include attorneys to prepare necessary documents for the SEC and distract the opposition with costly litigation; accountants and statisticians to prepare the most self-serving financial analysis allowable; and public relations advisors to prepare advertisements for trade journals and the financial section of major newspapers. In the past 25 years there have been no more than a dozen instances in which insurgents have been able to match management expenses in a major proxy fight. Over the past decade, only the MGM proxy contest of 1967 has seen insurgents match management expenses in a large corporation's proxy contest for control.

A second advantage—and one that no outsider can match—is management's ability to use corporate personnel on its own behalf. Clerical help and clerical facilities including printing presses, photocopying machines, and addressing machines are invariably employed. Salespersons skilled in talking to customers are frequently assigned to the telephones to answer inquiries and to supplement the professional proxy solicitors by making direct calls to shareholders. Moreover, senior executives can be assigned to telephone particularly important shareholders who may be impressed by the personal call of a top executive.

State corporations law has done nothing to correct this inequality of corporate resources. Although leading cases in Delaware and New York have engaged in much gnashing of teeth about limiting management expenditures to: (a) proxy contests involving a "policy" issue, (b) expenditures necessary to inform shareholders about the "policy" issue, and/or (c) "reasonable" expenses—no decision since 1907 in either jurisdiction has denied management the power to expend corporate funds or use corporate personnel exactly as management chooses. Even such seemingly "unreasonable"

expenditures as public relations counsel, "entertainments," chartered airlines, limousines, and the indirect cost to the corporation of using officers and employees on behalf of an incumbent director slate have survived judicial scrutiny. By contrast, state courts have firmly established the rule that insurgents, unlike management, are not entitled to reimbursement of any campaign expenses as a matter of right. Challengers must defray all their own expenses, with the single slim hope of later being reimbursed *if* they are successful and the stockholders approve.

MANAGEMENT CONTROL OF INFORMATION

Management's grip on corporate power is tightened by its authority to print and distribute annual, quarterly, and other reports to shareholders. Besides the formal proxy statement, these reports usually embody the only detailed information shareholders receive about their corporation.

Neither state nor federal law places any meaningful restrictions on the amount of money management may spend reporting to shareholders. SEC Proxy Rules *do* require certification of financial statements. The report, however, "may be in any form deemed suitable by the management" and is not subject to the same standards of truthfulness that the text of a proxy solicitation is subjected to. Consequently, though every word of an insurgent shareholder's communications with other shareholders may be challenged if it is arguably "false or misleading," most management reports are subject to no textual regulation whatever.

Unfortunately, management reports are frequently "false and misleading." They are often written in an upbeat public relations jargon which emphasizes "positive" aspects of the past business year while rationalizing or ignoring management mistakes, financial losses, corporate or executive criminal violations, or civil actions successfully prosecuted against the corporation. Frequently, as much as half of the text of an annual report is represented by oversized charts, colored illustrations, and kindred public relations gimmicks.

There is often little difference between the text of a failing corporation's annual report and a healthy corporation's report. For ex-

ample, although subsequent congressional testimony made clear that Lockheed would have gone bankrupt unless it received an emergency loan guarantee from the federal government, Lockheed's 1969 annual report managed to ignore the prominent debate in Congress over whether the federal government should "bail out" the firm. Instead shareholders read the following:

It is disappointing to have to record a net loss for the year. Yet setbacks like this are singularly possible in an industry so dependent upon government policy and the ebb and flow of domestic and international developments.

We have experienced them before and in each case have emerged stronger than ever. We are confident this will be so again. We say this not out of easy optimism but from the knowledge that we have many broadly based defense and commercial programs with high business potential and that we are expending much technical effort to meet the nation's future needs.

The report then spent six pages suggesting that Lockheed's financial difficulties were primarily the result of contractual misunderstandings with the federal government. It strongly suggested that the federal government would compromise in these disputes. It was only *after* the Senate voted an Emergency Loan Guarantee by the razor-thin margin of 49-48 in August 1971 that Lockheed reported to its shareholders that without this congressional subsidy the corporation would have collapsed.

A similar lack of veracity appeared in the 1973 Annual Report of the Franklin New York Corporation, whose principal subsidiary was the Franklin National Bank, the largest state bank ever to fail in the United States. Just a few months before the Comptroller declared the Franklin National Bank insolvent, the corporation's management reported to its shareholders that "In 1973 Franklin crossed an important threshold so that it is now in a position to move forward in establishing itself as a major worldwide financial institution and a leading money center banking operation." Nowhere in the report was any mention made of the foreign currency speculation or improvident real estate loans which four months later caused the bank's demise. This was a serious omission, for the preponderance of financial loss caused by Franklin's collapse was

absorbed by the shareholder-readers of this report, not the management or the public relations firm which wrote it. These shareholder-readers were given absolutely no warning of what was coming, no opportunity to exert their prerogative to change management or to vote a more timely dissolution.

Nor can insurgent shareholders obtain much additional information from their own corporation when they prepare for a proxy challenge. They lack the legal tools to gain access to live interviews with corporate executives, board meetings, or memoranda which could document internal debate, management error, derogations of law, sloppy execution of policy, or even the content of management's policy formulations.

All of which is a bizarre commentary on the Securities and Exchange Commission. The federal security laws emphasize disclosure. The Commission has claimed that its Proxy Rules "represent an effective contribution to corporate democracy" because disclosure enables individual investors to exercise some measure of control over the management of their corporation. Although the Securities and Exchange Act of 1934 authorizes the SEC to require annual and quarterly reports, including the authority to prescribe "the items or details to be shown in the balance sheet and the earnings statement . . .," shareholders can not compel their corporation to give a product line or division accounting so as to uncover unprofitable operations. Specific management mistakes may thus be submerged in consolidated financial reports. Shareholders may wish to know whether executives are using expense accounts improperly or are being indemnified for certain civil or criminal liabilities. They cannot find out. They may wish to read minutes of the meetings of corporate directors—whom they elect—or reports of decisions by executives respecting corporate property—which shareholders own. Under federal securities laws, they have no legal rights to do so.

Under state statutory law, shareholders theoretically have broad rights to examine corporate records. State statutes typically authorize inspection of shareholder lists—without which a shareholder could not even begin a proxy solicitation—and "other books and records." But this access is circumscribed by legal require-

ments of "good faith," "proper purpose," and minimum share ownership, as well as ample opportunities for management to delay compliance with legitimate shareholder demands by forcing expensive court tests.

Almost invariably shareholders prevail in court battles to secure a shareholder list, for, as a leading Pennsylvania decision put it, ". . . the right to examine the stockholders' list is a basic privilege of every stockholder of a corporation and should be given the widest recognition as fundamental to corporate democracy." But the courts are reluctant to enforce shareholder demands for other information. Doctrinally, this has been rationalized as deterring excessive "stockholder agitation." The Supreme Court of Minnesota rather melodramatically explained why in the leading case of *State Ex rel. Pillsbury v. Honeywell*:

In terms of the corporate norm, inspection is merely the act of the concerned owner checking on what is in part his property. In the context of the large firm, inspection can be more akin to a weapon in corporate warfare. The effectiveness of the weapon is considerable: "considering the huge size of many modern corporations and the necessarily complicated nature of their bookkeeping, it is plain that to permit thousands of shareholders to roam at will through their records will render impossible not only any attempt to keep their records efficiently, but the proper carrying on of their business." . . . Because the power to inspect may be the power to destroy, it is important that only those with a bona fide interest in the corporation enjoy the power. . . .

Alarming as the specter of "thousands of shareholders roaming at will" through once efficient corporations may be, it can only be conjured up by courts so cunning as to overlook their inherent judicial power to restrict any shareholder access to corporate data to reasonable numbers of shareholders at reasonable times and reasonable places. Yet phantom or not, this rationale has been employed in recent decisions to deny one A&P shareholder access to the minutes of board meetings and information relevant to store closings; to deny Ralston Purina shareholders access to monthly profit analyses employed by management; and to deny shareholders of Gulf Sulphur Corporation information concerning a firm with which Gulf proposed to merge.

MANAGEMENT CONTROL OF THE LAW

Management power is further entrenched by three significant legal advantages.

First, in approximately 90 percent of all large industrial corporations, cumulative voting is not required. In these corporations, a minority of shareholders—even a minority as substantial as 49.9 percent—may be precluded from electing even one director to the board.

Under cumulative voting, each shareholder is entitled to votes equal to the number of his or her shares multiplied by the number of directors to be elected. The shareholder may cast all his or her votes for a single candidate or distribute them among two or more candidates as he or she sees fit. Cumulative voting, therefore, helps to protect the *financial* interest of minority shareholders by assuring them voice on the board of directors. And it protects the *political* interest of minority shareholders. For without cumulative voting, the tendency of large industrial corporations to perpetuate one-party rule is powerfully enhanced. As Professor Charles M. Williams demonstrated after analyzing proxy contests for the years 1943-1948, corporations with cumulative voting were more than twice as likely to have proxy contests as those without.

Because of these benefits, cumulative voting has enjoyed considerable popularity. From 1870, when Illinois became the first state to require cumulative voting, until 1955, 23 states had established absolute requirements for cumulative voting. Additionally, federal law requires cumulative voting for over 5,000 banks subject to the Federal Banking Act of 1933 (although the intent of this law has often been frustrated by bank holding company structures); and the Securities and Exchange Commission has consistently required cumulative voting for corporations subject to the Public Utility Holding Act of 1935 and corporations undergoing reorganization under Chapter X of the Bankruptcy Act. As an attorney snapped in 1950 in frustration at Wisconsin's refusal to enact cumulative voting, "Cumulative voting is so obviously in accord with our basic political philosophy of group representation and the party system that it is difficult to understand the legisla-

ture's repeated rejection of it, except in terms of a response to the pressure of corporate management's interest."

Unfortunately, "the pressure of corporate management's interest" often does prevail in state corporation law. Between 1955 and 1972, five states dropped mandatory cumulative voting. In 1973, Michigan changed from mandatory to permissive cumulative voting; in 1974 both California and Ohio considered—but did not enact—similar legislation. Today, in Delaware, as well as 32 other states, cumulative voting is not required. True, in most of these states, cumulative voting is permitted. In practice, however, permissive cumulative voting offers little but an illusory right. Studies by Professor Williams in 1951 and the Conference Board in 1973 indicate that only about 15 percent of the corporations in states with permissive cumulative voting have provided for this right.

And even in those few corporations which voluntarily institute cumulative voting, most states provide ample devices to subvert it. Although cumulative voting aims to prevent a simple majority from maintaining absolute corporate control, Delaware permits a simple majority to amend the corporate charter to repeal cumulative voting. And Delaware and some 42 other jurisdictions allow the "classification" of the board of directors. This device reduces to one third or one half the number of directors required to stand for election annually and thus increases the minimum vote necessary to elect a director.

Management's second legal edge is its power to issue nonvoting stock or classes of stock with unequal voting rights. For example, prior to December 1, 1955, there were three classes of stock in Ford Motor Company: common, Class A, and Class B. Only the Class B shares (4.94 percent of total equity), all of which were owned by Ford family interests, were entitled to vote.

Only Illinois and a few other states forbid the issuance of classes or series of stock without voting rights. But the refusal of both the New York Stock Exchange and the American Stock Exchange to list corporations with nonvoting stock has substantially reduced the number of corporations which may totally eviscerate shareholder suffrage, although neither exchange actively enforces equal voting rights.

The third statutory device for impairing shareholder suffrage

rights is a provision common to the law of Delaware and apparently every other jurisdiction requiring the submission of proxy materials only to *shareholders of record*. This innocent sounding requirement effectively disenfranchises approximately 50 percent of the beneficial owners of corporate stock in the largest industrial corporations. For approximately 50 percent of the stock in the 1,800 companies traded on the New York Stock Exchange is held by mutual funds, life insurance or property and casualty insurance companies, private pension funds (usually administered through commercial bank trust departments), state and local pension funds, foundations, university endowment funds or other institutional investors. The result is a mockery of shareholder democracy: *Approximately 50 percent of the votes in our largest industrial corporations are cast by financial intermediaries—not the real owners.*

These institutional shareholders provide virtually no check to corporate management. Most financial institutions, according to the SEC's 1971 *Institutional Investor Study*, follow what is known as "The Wall Street Rule": An investment in a business corporation is considered an investment in that corporation's management; if the financial institution ceases to like what management is doing, the institution sells the stock. By examining the voting practices of 215 large institutions between January 1, 1967 and September 30, 1969, the SEC determined that approximately 30 percent of these institutions *always* voted for management (in elections other than votes for directors). For the remaining institutions, both voting against management and abstention were found "to be a relatively infrequent phenomenon." For example, in only 26 instances did any of the 215 institutions vote against an acquisition favored by management, "a miniscule fraction of such transactions."

The SEC conducted its study before the proliferation of shareholder proposals directed at social issues and precipitated by Campaign GM. In the past five years, some financial institutions have established formal procedures to consider shareholder public policy or ethical proposals. According to newsletters published by the Council on Economic Priorities and the Investor Responsibility Research Center, a small number of church-related funds, foundations, and universities have supported shareholder proposals respecting disclosure of political contributions; withdrawal from

South Africa, Rhodesia, or Namibia; opposition to military production; or review of corporate safety, environment, occupational discrimination, or community programs. Since most institutional shares are voted by banks, insurance companies, and mutual funds, and these financial institutions have shown only a negligibly greater willingness to oppose management, the overall pattern of institutional voting has changed little in the past five years.

MANAGEMENT CONTROL OF OTHER FUNDAMENTAL DECISION-MAKING

Historically, shareholders controlled the business corporation not only through the election of directors but also through shareholders' power to initiate and vote upon all fundamental changes in the character of the corporation. Management's ability to initiate change was carefully circumscribed by requiring two-thirds or three-fourths affirmative votes for charter amendments, bylaw changes, mergers, sales of assets, stock issuance, recapitalization, or dissolution and was further limited by shareholder appraisal and preemptive rights.

Under Delaware's General Corporation Law, shareholders have lost nearly all power to initiate corporate change. Only the board of directors may propose charter amendments, a merger, or a sale of assets. The SEC Proxy Rules complement Delaware's corporation law by denying shareholders opportunity to communicate opposition to management proposals or to suggest modifications in management's formal proxy proposals.

This rout has been substantially replicated in all other leading chartering states. Indeed, the trend of recent revisions to state corporation law has been to attempt to deny the shareholder any vote at all! Modern corporate draftsmen invariably write short, purely formal certificates of incorporation and then place most of a corporation's actual governing rules in its bylaws, which the certificate establishes can be revised by the corporation's directors without any shareholder vote. For example, when ITT reincorporated in Delaware in 1967, it did so by creating a Delaware corporation called the "DeLitt Corporation" and by then merging ITT, previously a Maryland corporation, into DeLitt. The certificate of incorporation of DeLitt was only 1½ pages long. It reads in toto:

CERTIFICATE OF INCORPORATION
OF
DELITT CORPORATION

Article 1

The name of the corporation is Delitt Corporation (hereinafter called the "Corporation"). The name and mailing address of its incorporators are as follows:

NAME	MAILING ADDRESS
John J. Navin	320 Park Avenue, New York, N.Y. 10022
William J. Donovan	320 Park Avenue, New York, N.Y. 10022
DeForest Billyou	320 Park Avenue, New York, N.Y. 10022

Article 2

The address of the registered office of the Corporation in the State of Delaware is No. 100 West Tenth Street, in the City of Wilmington, County of New Castle. The name of its registered agent at such address is The Corporation Trust Company.

Article 3

The purpose of the Corporation is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of Delaware.

Article 4

The total number of shares of stock which the Corporation has authority to issue is 100 shares of capital stock of the par value of \$100 per share.

Article 5

Whenever the vote of stockholders at a meeting thereof is required or permitted to be taken for or in connection with any corporate action by any provision of the General Corporation Law of Delaware, the meeting and vote of stockholders may be dispensed with if the holders of stock having not less than the minimum percentage of the vote required by statute for the proposed corporate action shall consent in writing to such corporate action being taken, provided that prompt notice must be given to all stockholders of the taking of such corporate action without a meeting and by less than unanimous written consent.

Article 6

In furtherance and not in limitation of the powers conferred by law, the Board of Directors is expressly authorized:

(a) To make, alter, amend or repeal the By-Laws of the Corporation.

(b) To direct and determine the use and disposition of any annual net profits or net assets in excess of capital; to set apart out of any of the funds of the Corporation available for dividends a reserve or reserves for any proper purpose; and to abolish any such reserve in the manner in which it was created.

(c) To establish bonus, profit-sharing, stock option, retirement or other types of incentive or compensation plans for the employees (including officers and directors) of the Corporation and to fix the amount of the profits to be distributed or shared and to determine the persons to participate in any such plans and the amounts of their respective participations.

(d) From time to time to determine whether and to what extent, and at what time and places and under what conditions and regulations, the accounts and books of the Corporation (other than the stock ledger), or any of them, shall be open to the inspection of the stockholders; and no stockholder shall have any right to inspect any account or book or document of the Corporation, except as conferred by statute or authorized by the Board of Directors or by a resolution of the stockholders.

(e) To authorize, and cause to be executed, mortgages and liens upon the real and personal property of the Corporation.

Article 7

The corporation reserves the right to amend, alter, change or repeal any provision contained in this Certificate of Incorporation, in the manner now or hereafter prescribed by statute, and all rights conferred upon stockholders herein are granted subject to this reservation.

The key sentence is contained in Article 6: "In furtherance and not in limitation of the powers conferred by law, the Board of Directors is expressly authorized: (a) To make, alter, amend or repeal the By-Laws of the corporation. . . ." What ITT tried to do, as so many other giant Delaware corporations have tried to do, was to totally shut shareholders out of the governing process except in those rare instances in which the Delaware General Corporation Law explicitly requires a shareholder vote—which is not very often.

True, technically, section 251(c) grants shareholders a vote on management merger proposals. But this, in fact, is a mere snare

for the dim-witted. Only a small minority of corporate fusions actually trigger this shareholder vote. The overwhelming majority employ one of three conventional loopholes (discussed in the Sources).

Similarly, section 271 limits shareholder suffrage in a sale, lease, or exchange of assets to transactions involving "all or substantially all" of a corporation's property and assets. Since most large industrial corporations are highly diversified, this provision effectively insures their shareholders will never vote. For example, General Motors could sell an automobile division such as Pontiac or Cadillac and not require a vote. It could liquidate hundred-million-dollar plants which manufacture refrigerators, diesel engines, and trucks or auction off all of its Detroit real estate and relocate in the Peoples Republic of China, and shareholders would have no choice in the matter. Only if GM sold *all* assets used to manufacture "automotive products" (about 75 percent of the corporation) would a sale of assets require a shareholder vote.

Moreover, section 271 is the only Delaware statute concerning corporate divisions. A Delaware corporation may create and fund new subsidiary corporations, regardless of size; liquidate these subsidiaries or comparable divisions and distribute assets to shareholders; or spin-off new corporations altogether without any shareholder vote. As business corporations have evolved these new forms, Delaware and other principal chartering states have deliberately not kept pace. Corporate executives have not hesitated to take advantage of this laxity. In the past three years many Delaware corporations have "gone private" and bought up minority shareholdings at bargain prices during a depressed stock market. This will allow favored shareholders or the firm itself to reap the profits when the company's stock price rises. Other senior managements have used the merger provisions to prevent take-over bids—which can benefit all shareholders—by requiring super-majorities, such as 75 or 90 percent, to consent to any consolidation or sale of the companies' assets.

Whither/Wither the Board of Directors?

But does not the board of directors with its sweeping statutory mandate "to manage the business and affairs of every corporation"

provide an internal check on the power of corporate executives? No. Long ago the grandiloquent words of the statutes ceased to have any operative meaning. "Directors," William O. Douglas complained in 1934, "do not direct." "[T]here is one thing all boards have in common, regardless of their legal position," Peter Drucker has written. "*They do not function.*" In Robert Townsend's tart analysis, "[M]ost big companies have turned their boards of directors into nonboards. . . . In the years that I've spent on various boards I've never heard a single suggestion from a director (made as a director *at* a board meeting) that produced any result at all."

Recently these views were corroborated by Professor Myles Mace of the Harvard Business School, the nation's leading authority on the performance of boards of directors. In *Directors—Myth and Reality*, Mace summarized the results of hundreds of interviews with corporate officers and directors.

Directors do not establish the basic objectives, corporate strategies or broad policies of large and medium-sized corporations, Mace found. Management creates the policies. The board has a right of veto but rarely exercises it. As one executive said, "Nine hundred and ninety-nine times out of a thousand, the board goes along with management. . . ." Or another, "I can't think of a single time when the board has failed to support a proposed policy of management or failed to endorse the recommendation of management."

The board does not select the president or other chief executive officers. "What is perhaps the most common definition of a function of the board of directors—namely, to select the president—was found to be the greatest myth," reported Mace. "The board of directors in most companies, except in a crisis, does not select the president. The president usually chooses the man who succeeds him to that position, and the board complies with the legal amenities in endorsing and voting his election." A corporate president agreed: "The former company president tapped me to be president, and I assure you that I will select my successor when the time comes." Even seeming exceptions such as RCA's 1975 ouster of Robert Sarnoff frequently turn out to be at the instigation of senior operating executives rather than an aroused board.

The board's role as disciplinarian of the corporation is more apparent than real. As the business-supported Conference Board conceded, "One of the most glaring deficiencies attributed to the corporate board . . . is its failure to monitor and evaluate the performance of the chief executive in a concrete way." To cite a specific example, decisions on executive compensation are made by the president—with perfunctory board approval in most situations. In the vast majority of corporations, Professor Mace found, the compensation committee, and the board which approves the recommendations of the compensation committee, "are not decision-making bodies."

Directors do not even ask discerning questions. It is considered "discourteous," a breach of "corporate manners" for directors to "challenge" the president or other corporate officers. This can be a very expensive form of decorum, as the Penn Central's shareholders painfully discovered. At the time of its collapse in June 1970, Penn Central was the largest railroad in the country and the sixth largest industrial corporation overall. Within a two-year period, shareholders witnessed the decline of their shares from \$86.50 to \$2.75.

Why? "The board was definitely responsible for the trouble," recounted outside director E. Clayton Gengras. "They took their fees and they didn't do anything. Over a period of years, people just sat there. That poor man from the University of Pennsylvania [University President Gaylord P. Harnwell], he never opened his mouth. They didn't know the factual picture and they didn't try to find out." As the Penn Central rushed towards its monumental crack-up, the board routinely approved every proposal forwarded by management. Although Penn Central was desperate for capital, the directors paid out nearly \$100 million in dividends. The board never saw a capital expenditures budget. It never understood the inaccuracies published in Penn Central's annual reports. Just six hours before the corporation filed its bankruptcy petition, the board routinely approved new contracts for eight corporate executives, apparently unaware even then of the dimensions of the Penn Central's crisis. "All of this raises the serious question as to whether giant corporations affecting the everyday lives of our population . . . should continue to be governed in the traditional fash-

ion or whether a new system of corporate directorships should be devised," concluded the House Banking and Currency Committee.

Yet boards will continue to be dysfunctional as long as they remain the creature of the corporate chief executive. For it is the chief executive who, like the family owner-manager in a small corporation, selects new members of the board. And it is the chief executive who de-selects existing board members when nominations for the board are necessary for annual shareholders' meetings.

Our own survey of the boards of the 200 largest industrial corporations found that the average board had a total of 14.49 directors, including 7.93 "outsiders" (that is, directors who were not employees of the corporation) and 6.56 insiders (or employee directors). Some 69 percent of the outside directors were fellow corporate executives; 6 percent were investment bankers; 7 percent were lawyers. Only 2 percent were women; a lesser percentage were black. Hence over 90 percent of the directors of our largest corporations either worked for the corporate chief executive or were fellow corporate executives, corporate bankers, or corporate lawyers.

Most "outside" directors appear to be chosen because of their status. "Presidents and chairmen of large and respected companies," one corporate president observed, "enjoy the prestige of serving on similar large and respected company boards. They are identified with their peers. They find the experience socially satisfying. Outside directorships provide a few more lines in their *Who's Who*, and it is a little bit like being knighted to say 'I'm a director of General Motors, or General Electric, or AT&T.'" Frequently, the chief executive chooses his friends, or individuals known to be "sympathetic" or "congenial," to be directors. "You certainly don't want anyone on your board who even slightly might be a challenge on a question of your tenure, so you pick personal friends with prestige titles and names," a corporate president explained. Another executive agreed: "What would you do if you were president? You control the company and you control the board. You want to perpetuate this control. . . . You sure as hell are not going to ask Ralph Nader. . . ."

At its worst, the outside director system degenerates into a private club, as the president of a west coast company explained:

You've got to remember that the outside directors of large national and regional companies are members of a sort of club. To be considered for admission you must have the title as president or chairman of a respectable and respected organization. This is what some young people call the establishment. But these are the people you do business with, travel around with, serve on community projects with—and it has to be a group the members of which get along together. Regionally each area has its elite. Sometimes many will in fact be members of the same golf or social club. Here in Los Angeles you will find a great number of directors with membership in the Los Angeles Country Club; in Cleveland the same is true of the Union Club—each city has its hard core members of the club group.

Exceptions to this pattern become news events. In reporting on General Motors' 1971 annual shareholders' meeting, the *Wall Street Journal* noted that, "The meeting's dramatic highlight was an impassioned and unprecedented speech by the Rev. Leon Sullivan, GM's recently appointed Negro director, supporting the Episcopal Church's efforts to get the company out of South Africa. It was the first time that a GM director had ever spoken against management at an annual meeting." Now Rev. Sullivan is an unusual outside director, being General Motors' first black director and only "public interest" director. But what makes Leon Sullivan most extraordinary is that he was the first director in any major American corporation to come out publicly against his own corporation when its operations tended to support apartheid.

Yet as lethargic as outside directors usually are, employee directors tend to be even less effective. The typical vice president/inside-director is in a very precarious position at a board meeting. Unwilling to say anything in disagreement with his boss, he usually sits quietly and waits until he is called upon to speak. Disagreements with other corporate executives are invariably resolved out of the board room. The effect is to present outsiders with a "united front": to make the corporate chief executive's decisions seem inevitable.

So staffed, board meetings in most large industrial corporations have become formalized into a monthly or bimonthly ritual, usually lasting about one to three hours. Much of this time is consumed by perhaps a 30-minute to an hour review of operations for the last period (month or quarter) by the president or vice president

of finance. This is followed by board approvals of capital appropriations and of the actions of the executive committee taken since the last meeting. The meeting often concludes after senior executives have described a new research development or a major operations program. Usually the entire meeting—which is closed to shareholders—is choreographed by the corporate chief executive. He chooses which officers shall speak. He writes the agenda. When he wants to be asked about a particular issue, he plants the relevant question.

The impossibility of so infrequent or so circumscribed meetings of the board enabling directors to effectively "manage" their corporation was sardonically illustrated by the congressional testimony of H. O. Havemeyer, a corporate chieftain of an earlier day:

- Q. As a member of that board, what else have you done?
 A. *Oh, I have convened and talked.*
 Q. You have convened and talked?
 A. *And adjourned.*
 Q. Well, you have convened and talked?
 A. *And adjourned.*
 Q. Well, what have you talked about?
 A. *Statistics.*

This testimony was given in 1887 when outside directors were typically the "tools" or "dummies" of the controlling corporate president or bank. A popular gag on Wall Street was that the role of an outside director was to receive his five-dollar gold piece at the start of each meeting and then obediently fall asleep. Directorial lassitude is not so obvious today. Yet considering that the size and complexity of corporate enterprise has significantly increased since 1887 while the frequency and length of directors' meetings has not, it is a fair assumption that the outsiders who obediently nod through ceremonial board meetings today are little better informed than their brethren who slept before them.

Certainly directors' sources of information remain as much subject to management control today as they did 90 years ago. After resigning from TWA's board, former United States Supreme Court Justice Arthur Goldberg had this complaint: "What the typical board of directors gets is a recommendation which seems mono-

lithic. . . . It's not like a court, where a judge can order a brief from both sides." Recently the *quantity* of preparatory information available to outside directors has significantly increased. Yet the thickened reports and whirlwind plant tours are still only what the corporate chief executive wants outsiders to see. "In many corporations," found Professor Melvin Eisenberg, "the executives go so far as to wholly deny the board—supposedly entrusted with supreme power over the corporation—access to certain categories of information." For instance, a 1971 survey found that only 17 percent of 474 industrial firms sent manufacturing data to directors prior to board meetings, only 21 percent sent marketing data, and 11 percent sent no data at all.

And outside directors have little personal incentive to doubt management. A 1973 survey of 378 manufacturing corporations with assets of \$50 million or more showed that outside directors received median annual fees of approximately \$5,900, while inside directors generally are not paid at all. On top of the \$100,000+ incomes typically earned by outside directors, who are corporate chief executives or vice presidents, leading investment bankers, or law firm partners, such annual retainers or meeting fees seem like peanuts. The result is counterproductive. Outside directors rationalize not doing very much by the fact they are not paid very much.

How, then, can one reconcile the grand imperative, "The business and affairs of every corporation . . . shall be managed by or under the direction of . . . a board of directors" with the reality of this "non decision-making body"? The fashionable response is that the board is a legal fiction. Management control has overwhelmed the rule of law.

This widely held view is only half right. Management has deposed the board of directors—but it has done so under color of law. No rule within the modern corporation statutes prohibits management from nominating and serving as directors. Corporation law has abrogated directional independence by omission. Moreover, even if the statutes provided structural safeguards to maintain the independence of the board, these could not undo the effect of two provisions found in most state corporation laws.

The first provision is exemplified by a Delaware Corporation Law section which provides that a director shall "be fully protected in relying in good faith upon . . . reports made to the corporation by any of its officers." The meaning of this provision is very simple. Directors have no duty to know. "Unless something occurs to put them on suspicion that something is wrong, directors are entitled to rely on the honesty and integrity of [management]," held the leading case of *Graham v. Allis-Chalmers Manufacturing Company*. Directors are not required to "put into effect a system of watchfulness." They need not anticipate problems nor verify the accuracy of reports upon which they rely.

A second provision of the Delaware General Corporation Law accomplishes the same result by allowing the board to *formally* delegate responsibility for most corporate business to a committee dominated by inside directors. Our survey of the 200 largest industrial corporations indicates that approximately two-thirds of the corporations had withdrawn directorial powers from the full board—typically a majority of whose members were outsiders—to an executive committee at least half of whose members were insiders.

A much smaller number of corporations accomplish a comparable result by delegating authority to an insider-dominated finance committee. In our survey of the 200 largest industrial corporations, we found that 16 corporations had delegated authority to a finance committee, half or more of whose members were insiders.

Examples of the delegation of the board's authority to either an insider-dominated executive or finance committee have been well described by attorney John A. McMullen:

At IBM—four directors, all top level officers of the corporation, control the all-important executive and finance committees; in addition, three of them are members of the powerful Corporate Office. At GM, four or five men, all inside directors of the company, dominate the executive and finance committees of the board as well as the administration committee comprised of key officers and directors. . . . DuPont's executive committee consists of the company's chairman of the board, president, and six senior vice presidents. Each of these men is entirely relieved of day-to-day functional responsibilities; each operates jointly with his fellow committee

members to set overall corporate policy, and acts only as an advisor to the operating department from which he originally derived his skills, training, and experience.

Yet, whether or not the board formally resolves to delegate operational authority to an executive committee between board meetings, the actuality is that employee directors or other senior executives invariably exercise the powers of initiation. It does not matter whether key corporate decisions are initiated by a single corporate autocrat or a board committee or a committee operating out of the office of the president. Senior executives call the shots. This is what Berle and Means meant by their insightful descriptions of "management control." This is why state corporation law is moribund. Not only is it written by corporate management's representatives, it is also hopelessly inaccurate. In appreciating the law of corporate governance, one rule above all others must be followed: *Concentrate on the omissions*. Where state law does not require directors to be, corporate executives inevitably are.

The Limitations of Shareholder Litigation

STATE LAW: THE NON-DUTY OF CARE

The erosion of shareholder authority within the corporation would be less serious if shareholders were able to oppose the abuses of corporate management in court. In theory, civil litigation remains the shareholder's ultimate check. The problem is that, except for certain limited claims under the federal securities laws, it rarely works. Long ago judicial doctrines reduced the state shareholder action to a trivial value.

Earliest was the judicial rejection of the principle of *ultra vires* action. In its classical form, the doctrine of *ultra vires* envisioned the corporate charter as a contract between the state, corporate management, and the shareholders. Corporations were prohibited from performing certain acts, not because they were illegal but because neither the state nor the shareholders had agreed to them. Shareholders could enjoin corporate officers and directors from engaging in actions "beyond their powers." Accordingly, in a leading 1867 case, a single shareholder blocked a railroad from extending

its railway to a more distant point than that specified in the charter because that was not the enterprise he had bargained for.

With the rise of the corporate enabling acts, the principle of *ultra vires* declined. Shareholder limitations were overridden through court discoveries of "implied" or "auxiliary" powers. In the 1896 case of *Jacksonville M. P. Ry. & Nav. Co. v. Hopper*, for example, the United States Supreme Court held that the Florida railway company might engage in leasing and running a resort hotel, on the curious logic that "to maintain cheap hotels or eating houses . . . would not be so plainly an act outside the powers of a railway company as to compel a court to sustain the defense of *ultra vires*. . . ." By 1931, *Fletcher's Cyclopedia of Corporations* could proclaim, "the theory that a corporation can do no acts beyond its authority [has been] discarded by a majority of the courts in the country."

Paralleling the decline of *ultra vires* has been the universal refusal of state courts to hold corporate directors or officers liable for negligence. Because they are vested with great power over other people's property, the law has always nominally required, in the language of the present New York statute, that "Directors and officers shall discharge the duties of their respective positions in good faith and with that degree of diligence, care, and skill which ordinarily prudent men would exercise under similar circumstances in like positions."

In practice, the typical judicial or statutory formulation of the duty of care is too vague to require much of anything. As Yale Law School's Professor Joseph Bishop concluded after an extensive review of the case law:

The search for cases in which directors of industrial corporations have been held liable . . . for negligence uncomplicated by self-dealing is a search for a very small number of needles in a very large haystack. Few are the cases in which the stockholders do not allege conflict of interest, still fewer those among them which achieve even such partial success as denial of the defendant's motion to dismiss the complaint.

In all, Professor Bishop was able to find only four recent cases in which a state court held that a shareholder had alleged a good cause of action for negligence uncomplicated by self-dealing. In only one

of these cases did a state court rule on the merits that a corporate officer was liable for negligence. And in that case, the word "negligence" had been used as a euphemism for dishonesty.

This result is primarily the fault of statutory draftsmen. They have refused to identify *how* a corporate officer meets his duty of care. They have never identified what specific actions he must perform; what specific responsibilities are his. In the absence of a clear standard from the legislature, state courts have refused to guess.

At most, state courts will hold corporate directors or executives liable for conduct involving obvious self-enrichment such as fraud, misapplication of funds, diversion of corporate business opportunities, or causing the corporation to make excessive payment for the purchase of their property. Yet even in these types of cases, where the actions of corporate officers amount to simple and obvious theft, the procedural rules of state corporation law have been skewed to discourage shareholder suits.

The most onerous bars to shareholder litigation are the so-called "security for expenses" provisions enacted by New York, New Jersey, Pennsylvania, Michigan, California, and 13 other states. These provisions require a complaining shareholder owning less than a stated amount of stock—typically 5 percent of the stock or shares worth less than \$50,000—to "give security for the reasonable expenses, including attorney's fees, which may be incurred" by both the corporation and the parties defendant in a shareholder action. Since the cost of defendants' legal fees may amount to hundreds of thousands of dollars, the security for expense provision, when enforced, presents a formidable barrier to shareholder action.

The rules respecting attorneys' fees pose a second procedural pitfall for shareholder actions. Nearly every jurisdiction provides that only shareholders whose suits are successful may be reimbursed by the corporation for attorneys' fees. This rule seeks to discourage attorneys from bringing nonmeritorious suits. Several states, however, further provide that attorneys' fees may be awarded only if a substantial monetary benefit is conferred upon the corporation. As a practical matter, this standard precludes shareholder litigation in all cases except those of overreaching where a monetary benefit—the amount taken—is readily apparent.

In all other cases it is normally cheaper to sell the stock than to compel the corporation to obey the law.

FEDERAL SECURITIES LAW: "TAKING OVER THE UNIVERSE GRADUALLY"?

To some extent, federal securities law—and federal court decisions—have compensated for the atrophy of state shareholder protection.

In 1968, the influential Second Circuit Court of Appeals handed down its celebrated *S.E.C. v. Texas Gulf Sulphur* decision which revolutionized the case law interpreting Rule 10b-5 under the 1934 Securities and Exchange Act. Rule 10b-5 provides that it is unlawful for any person to employ a fraudulent scheme, to make any untrue statement, or to fail to state a pertinent fact when purchasing or selling a security. *Texas Gulf* substantially broadened this antifraud rule by holding that corporate directors, officers, and employees violated 10b-5 when they purchased company stock knowing of a huge mineral strike before this fact was generally known or communicated to the public.

A federal district court, also in 1968, ruled in *Escott v. Bar Chris*—a decision some commentators initially believed would have even greater effect on directorial behavior than *Texas Gulf*. In *Bar Chris* security holders asserted that a bowling alley construction company that had sold them convertible debentures had filed a registration statement prior to the sale of the bonds which contained false statements and omissions. After concluding that the registration statement did, indeed, contain numerous inaccuracies, the district court stunned Wall Street by holding all nine directors who signed the prospectus—including two new to the board—liable. In summing up their liability, the court seemed to move far toward creating a federal duty of care, at least with respect to registration statements:

Section 11 imposes liability in the first instance upon a director, no matter how new he is. He is presumed to know his responsibility when he becomes a director. He can escape liability only by using that reasonable care to investigate the facts which a prudent man would employ in the management of his own property. In my opinion, a prudent man would not act in an important matter without any knowledge of the relevant facts, in sole

reliance upon representations of persons who are comparative strangers and upon general information which does not purport to cover the particular case. To say that such minimal conduct measures up to the statutory standard would, to all intents and purposes, absolve new directors from responsibility merely because they are new. This is not a sensible construction of section 11, when one bears in mind its fundamental purpose of requiring full and truthful disclosure for the protection of investors.

The cumulative result of these and other federal securities law decisions led the *Wall Street Journal* to exclaim in early 1973, "[D]irectors of corporations now face more perils than Pauline ever did!" In a similar vein, Harvard Law School's securities expert, Professor Louis Loss, observed in 1969 that "the great Rule 10b-5," which had emerged as the principal basis of liability under the federal securities laws, "seems to be taking over the universe gradually."

In retrospect, both views seem overstated. The basic reason the securities laws will neither "take over the universe" nor seriously "imperil outside directors" is that they are restricted to a discrete set of securities transactions. Although present securities laws do require corporate officers to file with the SEC accurate periodic financial reports and securities registration statements, not make false and misleading statements in proxies, nor defraud outsiders in connection with their own securities purchases or sales, the securities laws do not, emphasized the Supreme Court in 1971, reach transactions which otherwise involve "internal corporate mismanagement."

And in late 1973, the Second Circuit Court of Appeals held in *Lanza v. Drexel* that only corporate officers who recklessly or deliberately defrauded shareholders could be held liable for money damages under Rule 10b-5. In refusing to follow the reasoning of the district court in the *Escott v. Bar Chris* case, the appeals court made plain that an outside director who was "merely negligent" in his participation in a fraudulent securities transaction had little to fear.

The consequence of *Lanza* and similar recent decisions has been to leave federal securities law in a crazy quilt pattern. The federal securities laws, for example, will not reach a deliberate though not self-enriching decision of corporate executives to engage in an unprofitable line of business unless there has been an accom-

panying failure of disclosure. Nor will they reach decisions which *do* enrich corporate officers unless they involve security transactions. Liability seems so haphazard and fortuitous that former SEC Chairman William Cary was moved to complain:

There is no justification for a federal law disciplining or holding a tippee liable for misusing inside information concerning management decisions but not monitoring the misconduct of management itself. . . . It is absurd that a corporate transaction, clearly unfair though perhaps not fraudulent, should be subject to attack in the federal courts only upon the ground that it has not been disclosed to shareholders rather than because of its inherent inequity.

NULLIFY THE JUDGMENT: INDEMNIFICATION INSURANCE

Not only is it difficult for shareholders to successfully sue their companies, but even successful judgments often can be nullified. Seventeen states today permit corporations to purchase indemnification insurance for their directors and officers against, in the words of a typical policy, any "wrongful act [committed] . . . in their capacities as directors or officers." A 1974 survey of the Fortune 500 list found that 80 percent of these companies carried indemnification insurance. A similar sample of corporations listed on the New York Stock Exchange found that 76.1 percent carried such insurance. Since indemnification insurance was virtually unknown as recently as a dozen years ago, and most insurance policies were purchased within the past five to seven years, it is a fair assumption that nearly every large industrial corporation permitted by state law will carry indemnification insurance within a short time.*

* One reason for the enormous leap in the number of corporations carrying indemnification insurance has been the scare tactics employed by the insurance companies. The general tenor of their approach is illustrated by an advertisement on page six of the *Wall Street Journal*, March 21, 1968, featuring a composite photograph of a board of directors presided over by a stuffed duck and the explanatory text, "As a corporate officer or director, you may be a sitting duck for a shareholder or third party liability suit." A similar ad appears on page nine of the same issue wherein a sullen looking stockholder announces that he "might just sue every company director reading this newspaper," and reminds the presumably panicking directors that he is just one of "24 million potential enemies."

There is, to be sure, a persuasive case for indemnifying corporate directors against the costs of nonmeritorious legal claims. If innocent directors had to settle such suits because they lacked the resources to hire competent attorneys, responsible men and women would be discouraged from becoming directors. But current indemnity statutes are not limited to the purpose of protecting innocent officers from the costs of nonmeritorious suits. They also protect guilty officers from accountability for their wrongs and reduce incentives for lawful conduct.

Delaware's statute exemplifies this overbreadth. It allows a corporation

to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation . . . against any liability asserted against him and incurred by him in any such capacity, or arising out of his status as such, whether or not the corporation would have the power to indemnify him against any such liability under the provisions of this section.

As written, this provision permits the corporation to insulate its officers from *all* potential liabilities. Officers may be insured against any negligence, self-dealing, looting the corporation or embezzlement, all conflicts of interest, and deliberate statutory violations. They may be reimbursed for violations of federal safety, civil rights, environmental, tax, or antitrust laws. They may even be insured against the same judgments in derivative actions that an earlier provision of the same statute provided a corporation could not indemnify directly.

Delaware defends such insurance as a form of compensation, arguing that the corporation could make a larger compensation arrangement with the executive and let him pay for the insurance himself. But the question is not how much officers' compensation should be, but rather whether wrongful acts *should* be indemnified at all. Why should an executive of a drug company be indemnified for the costs of a criminal fine if he is convicted of allowing a harmful drug to injure several thousand people when the same act as a private individual would send him to jail? An untenable double standard has been created. The more powerful an executive becomes, the less likely he is to pay for an abuse of power.

Conflicts of Interests

In almost every primary economic relation of the industrial corporation—to competing corporations, to banks, to suppliers, to distributors, to investors—the law now permits (in many instances, encourages) the most blatant division of loyalties.

Most threatening is the anticompetitive practice of *interlocking directorates*. A philosophic cornerstone of American business is that vigorous competition will enable firms to have comparable access to capital, supplies, distributors, and markets, and thus an equal chance to succeed or fail on the merits. But if competing corporations place directors on each other's boards, there is opportunity to conspire on price or territory. If corporate officers sit on the boards of their banks or suppliers or distributors, there arises the obvious temptation to obtain preferential treatment based on favor and friendship. Then the race is not to the swift, but to the well-connected. Louis Brandeis saw the problem early in this century:

The practice of interlocking directorates is the root of many evils. It offends laws human and divine. Applied to rival corporations, it tends to the suppression of competition and to violation of the Sherman law. Applied to corporations which deal with each other, it tends to disloyalty and to violation of the fundamental law that no man can serve two masters. In either event it leads to inefficiency; for it removes incentive and destroys soundness of judgment. It is undemocratic, for it rejects the platform: "A fair field and no favors"—substituting the pull of privilege for the push of manhood.

With Brandeis as a major proponent, Congress in 1914 enacted the Clayton Act, section 8 of which expressly forbids any person from serving on the boards of two or more competing corporations. Until recently, however, section 8 had not been enforced. Through 1952, some 38 years after the enactment of the Clayton Act, the Department of Justice had not litigated a single case to a decision by a court. Through December 1975, the Department had instituted a total of 15 cases. The Federal Trade Commission, which has concurrent enforcement responsibilities, had filed only 13 complaints under section 8 of the Clayton Act through January 1965. Only one of these complaints resulted in a cease and desist order; the remainder were dismissed when the directors involved discon-

tinued the prohibited relationship. As Chairman Emanuel Celler's House Antitrust Subcommittee concluded in 1965 after a lengthy study of interlocks among competitors: enforcement had been neither "prompt nor vigorous."*

Shortly after Celler's study was released, economist Peter Dooley calculated that there were a total of 4,007 directorships held by the directors of the 200 largest nonfinancial corporations and the 50 largest financial corporations. "While most of these directors sat on a single board, 562 sat on two or more boards: Five men held six directorships each. In all, 1,404 directorships were held by multiple directors." Two hundred and thirty-three of the 250 corporations had at least one director who sat on the board of at least one other of the largest corporations. Most significantly, fully 297 interlocks involved companies which were competitors. "While illegal under the Clayton Act," observed Professor Dooley, "the law has not been effectively enforced, so that the institution of interlocking directorates continues to provide a vehicle for restricting competition. . . ."

Our own more recent survey of the boards of directors of the 50 largest industrial corporations identified eight apparent instances of illegal interlocks. John T. Connor, for example, is both a director of General Motors and Chairman of Allied Chemical, though Allied Chemical produces seat belts, shoulder harnesses, and airbags, all of which GM either presently manufactures or potentially could. Dean McGee is a director of General Electric and Chairman of Kerr-McGee, though both sell nuclear fuels. Henry S. Wingate is a director of both U.S. Steel and International Nickel Company of Canada, both of which mine nickel, iron ore, and other competing metals.

Even beyond inadequate enforcement of its provisions, section 8 only forbids interlocks among competitive corporations. Interlocks among corporations which provide services, supplies,

* In the past three years the Federal Trade Commission has begun to enforce the Act, bringing three major actions, the most important of which required seven directors common to the boards of 12 competing oil and gas corporations to resign. More recently the Justice Department awoke from its long slumber and brought an action in 1975 against the Bank of America holding company and certain insurance companies which allegedly competed in providing designated services.

funding, or distribution for each other equally violate the fundamental law that no man can serve two masters. They are also far more numerous. In 1974, the Center for Science in the Public Interest analyzed interlocking directorates and advisory committee connections of the eighteen largest United States oil corporations. They found 460 interlocking connections in all, including 132 interlocks with banks, 31 interlocks with insurance companies, 12 interlocks with utilities, 15 interlocks with transportation corporations, and 224 interlocks with manufacturing and distribution corporations. Oil company ties with banks (which supply capital), insurance companies (which provide an underwriting service), distribution companies (which distribute oil company products), and utilities, transportation, and manufacturing corporations (which purchase oil products) inevitably diminish the arm's length atmosphere in which effective competition thrives.

Such clubbishness, however, is typical of this nation's largest corporations. Our survey of the 50 largest industrial corporations and 10 largest commercial banks found that the 50 largest industrialists had 54 interlocks with the 10 leading commercial banks and 24 interlocks among themselves. Our survey also established that it has become a common practice for the leading commercial banks to bring together competitors on their boards of directors. For example, on its board Chase Manhattan unites directors from competing companies in four industries: industrial chemicals (Allied Chemical, Celanese, and Commercial Solvents Corporation); drugs (Pfizer and Squibb); paper goods (Celanese and International Paper); and oil (Exxon, Royal Dutch Petroleum, and Standard Oil of Indiana). Continental Illinois brings together leading agricultural equipment producers Caterpillar Tractor and International Harvester; food producers Esmark and Kraftco; and railroads Chicago-Milwaukee and Illinois Central.

When interlocks are viewed on a city-by-city basis, it becomes clear that there are substantial social costs as well—as in the case of Minneapolis-St. Paul. In January 1971, Richard Gibson, a methodical staff reporter for the *Minneapolis Star*, described the social structure of a major industrial city by examining the boards of the 20 or so leading Twin City industrial corporations and eight leading banks. What he found was a tight little net or what he

called swapping: Burlington Northern placed its executive on the board of General Mills, and General Mills reciprocated by placing an executive on the board of Burlington Northern. Honeywell, Pillsbury, 3M, and Dayton Hudson just placed executives everywhere, as did the leading banks.

But Gibson went beyond the statistics and examined the personalities involved. He found that the boards of the 30 leading corporations in a major metropolitan area of some two million people were dominated by 19 men. Eight served on three or more boards; five men served on four boards; six served on five boards or more. Crucially, these were the men that served as chairman or led the key committees. All but one of these men, Professor Walter Heller, was a corporate executive. Fourteen of the 19 were corporate chief executives. Examined in social terms, the economy of Minneapolis looks like an oligarchy.

Certainly no one would argue that all interlocks, whether among competitors, in financing, supply, or distribution relations, direct or indirect, lead to collusive behavior. But it is unnecessary that any interlock occur. There are sufficient directors available so that each board may be staffed by disinterested persons. The costs of interlocks—favoritism, joint price or output actions, discouragement of entrepreneurs—must be weighed against what are at best negligible advantages.

Conflict of interests can also occur when large industrial corporations invite their investment banker or outside counsel to serve on their boards. For the investment banker, especially, this creates a stark division of loyalty. In addition to underwriting security offerings and related corporate financial services, he typically does investment counseling, employs brokers, and administers mutual funds. He is just as likely to perceive his primary obligation to run to his investment clients as to the shareholders of the corporation he directs. As one top executive explained, "As soon as you have an investment banker [on the board], you put yourself in a position where one group of shareholders might be favored at the expense of other shareholders."

A worse situation occurs when the investment banker is favored at the expense of *all* shareholders. J. M. Juran and J. Lou-

den, authors of the American Management Association's study, *The Corporate Director*, cited instances where investment bankers have been guilty of guiding the company into a poor acquisition to create a need for selling securities. Investment banker-directors have insisted on being involved—for a fee—when the corporation seeks to borrow money from an insurance company or other lender. And when a corporation has an investment banker on its board, it becomes very difficult to transact business with other investment bankers. "Having a senior partner of an investment banking firm on our board is notice to the world that we are his captive client," said one corporate president. "Of course this is the main reason investment bankers want to be on so many boards. They think of board membership as a very good way of assuring that the business of the company goes only to them. It's a sort of Operation Stakeout. It tags the company as belonging to one particular firm."

A similar division of loyalties occurs when corporate counsel serves on the board. Attorneys have a financial interest to increase the corporation's law bills, rather than economize for its shareholders. This inability of lawyer-directors to give disinterested counsel has led some law firms to discourage partners from serving on clients' boards. For example, New York City's Debevoise, Plimpton, Lyons and Gates will not permit a partner to go on a board without the approval of the firm as a whole. Skadden, Arps, Slate, Meagher and Flom, also of New York, flatly prohibits partners from becoming directors "except in extenuating cases." Nonetheless, an exhaustive 1971-72 study of some 12,000 companies, which filed information statements with the SEC, found that approximately one in six employs an attorney from the company's outside counsel as a director.

Aggravating the costs to shareholders of these structural conflicts of interest is the tolerance by modern corporate law of self-enriching executive conduct. As early as an 1846 Supreme Court opinion, the rule was well established that any contract between an interested director and his corporation was voidable at the mere insistence of the corporation or any of its shareholders regardless of the fairness or unfairness of the transaction. Professor Harold Marsh explained why:

Under this rule it mattered not the slightest that there was a majority of so-called disinterested directors who approved the contract. The courts stated that the corporation was entitled to the unprejudiced judgment and advice of all of its directors and therefore it did no good to say that the interested director did not participate in the making of the contract on behalf of the corporation. . . .

By 1880, this principle "appeared to be impregnable. . . . It was stated in ringing terms by virtually every decided case, with arguments which seemed irrefutable, and it was sanctioned by age." One scholar termed this the "fundamental law of morals and of human nature" and identified its Biblical origin: "No man can serve two masters." "Fraud is too cunning and evasive," reasoned a New Jersey court, "for courts to establish a rule that invites its presence."

Today this principle is dead. The Delaware General Corporation Law not only tolerates interested conduct by corporate officers and directors; it has made self-dealing the norm.

Under current Delaware law, the chief executive of a corporation and other senior corporate executives may serve on the board of directors or compensation committee which: (1) sets executive salaries; (2) sells or purchases property from corporate executives; (3) loans money—on a secured or unsecured basis; with or without interest—to corporate executives; and (4) establishes pension plans, profit sharing plans, stock bonuses, retirement, benefit, incentive, and compensation plans (including "phantom stock"—a risk-free, cost-free stock option plan), trusts; health insurance; or deferred income plans for such corporate officers or their dependents.

Not only may corporate officers engage in such self-dealing but shareholders under Delaware law are nearly powerless to minimize the amount of corporate largess top executives pay themselves. Any contract or transaction between the corporation and an interested executive is permissible as long as it is "fair." But, in Delaware, fairness is presumed. Professor Ernest Folk, the leading commentator of Delaware's General Corporation Law, explains that "Given Delaware's presumption of sound business judgment with respect to board decisions, the courts will try to determine whether the decision can be attributed to any rational business pur-

pose, and if so, there will be no judicial preemption of the decision."

There seem to be few practical limits to this doctrine. For example, if a corporate chief executive were so graceless as to embezzle \$500,000, there is little question that even in Delaware he would be required to return the money and would be subject to criminal prosecution. Yet if that same corporate executive raised his salary \$500,000 and received the approval of a board of directors he selected, there is equally little question that a Delaware court would term this "fair"—so long as the chief executive could point to similar salary increases in his industry or received the \$500,000 through an "incentive bonus" or profit participation plan.

In the absence of judicial limitations, excessive remuneration has become the norm. In 1974 the executive compensation (salary, bonus, deferred income, and directors' fees) of the highest paid executive at the 50 largest industrial corporations was approximately \$400,000—or about as much in one year as many of their employees earn in a lifetime and two and one-half times the average executive compensation of \$145,000 earned by the highest paid executive at the 50 largest industrial corporations in 1963.

Contrary to the conventional wisdom, top executive salaries do not generally decrease in response to a decline in corporate sales or profits. In the recessionary years 1970–1973, Professor Wilbur Lelwellen, a leading authority on executive compensation, found that the "mean" salary for the top executive at 50 large manufacturing corporations increased steadily from \$251,867 in 1970, to \$287,759 in 1971, \$323,802 in 1972, and \$389,277 in 1973.

But salary, bonus, and deferred income are only the most obvious benefits appropriated by corporate chieftains. Equally important is ownership income. Nearly every large industrial corporation offers its top executives stock options. These options allow executives to buy shares of stock in their corporation at a fixed price at any time or at specified times—often with the help of company-secured low interest loans or interest-free loans—and subsequently sell them.

From the shareholder's point of view, the result is a classic case of "heads we lose, tails you win." Over time, executives are

able to build up a substantial fortune in corporate stock without personal risk. The more they do so, the more they dilute the value of other stockholders' shares.

We examined the stock holdings of the highest paid executives at the 50 largest industrial corporations to get some indication of the extent of executive stock holdings. From the start, we eliminated from consideration the seven highest paid chief executives whose stock holdings were either largely inherited or largely "founder's shares": Henry Ford II (Ford Motors), Robert Sarnoff (RCA), Brooks McCormick (International Harvester), Willard Rockwell (Rockwell International), Armand Hammer (Occidental Petroleum), Sanford McDonnell (McDonnell Douglas) and J. P. Grace (W. P. Grace). The 43 remaining chief executives were "employee" executives. Yet each owned an average of \$1,566,009 of his corporation's stock, according to the most recent proxy statements filed with the SEC and the closing stock prices of October 1, 1975.*

This crude figure illustrates three points. First, primarily at shareholder expense, the top executives of our largest corporations can, and often do, build up million-dollar fortunes in corporate stock on top of their substantial cash and deferred compensation. Second, the income of top executives is significantly increased each year by dividends from their corporate stock. Using our 43 top executives as an example again, each received an average of \$60,382 in dividend income in 1974 above and beyond a \$400,000 salary. Third, each top executive will further be enriched by increases in the price of the stock. Professor Lewellen has determined that a similar list of chief executives at the fifty largest industrial corporations (after deleting "extreme values" such as inherited or founder's stockholdings) averaged \$220,087 per year in capital gains income for the four years 1960-63.

* This figure is admittedly a very crude approximation of ownership income. On the one hand, it does not distinguish the shares the executives purchase with their own money from those the company gave them through stock options, stock bonuses, or loan arrangements. On the other hand, it understates the amount of ownership income of these executives by making no allowance for the fact that corporate chief executives frequently sell stock they own in their own corporation and put their money in other investments.

Additionally, pension or retirement benefits have swollen. McKinsey and Company's 1975 Executive Compensation Survey found that all but one of 577 major U.S. corporations studied had a pension or profit-sharing retirement plan to pay former executives a fixed income each year after they retire. Almost half of the companies provide either a thrift or savings plan or a profit-sharing plan in addition to the pension plan. Our own survey found that the 21 chief executives of the 50 largest corporations who disclosed their estimated annual retirement benefits anticipated an income of \$133,910 per year after they retire. And corporate executives also enjoy other benefits such as life and medical insurance; free medical service; educational grants for their children; indemnification insurance; company apartments; country club membership; luncheon or dinner club membership; chauffeur-driven cars; free legal and tax counseling; personal financial counseling; expense accounts, and other amenities. This myriad of stock bonus, insurance, and benefit programs increases the income of corporate chiefs by approximately 50-75 percent above their \$400,000 direct remuneration to an actual income of approximately \$600,000 to \$700,000 per year.

Yet if excessive remuneration were a conflict of interest confined to the corporate chief executive, it would seem small once it was divided by the total number of shares in most large industrial corporations. What makes the executive compensation conflict truly expensive is that the corporate chief executive not only sets his own salary but also determines the remuneration of other executives all the way down the line. It is clearly in the corporate chief executive's personal interest to seek the greatest possible rewards for his subordinates as well as himself. For a corporate chief who can "deliver" high salaries increases the personal loyalty of his subordinates. And the higher his subordinates' income, the higher the chief executive's income must be.

A good illustration of this is General Electric, where in 1974 Reginald Jones, the chairman, received a compensation of \$501,200. Walter Dance, Jack Parker, and Herman Weiss, the next three highest paid executives, received \$400,750; \$400,500; and \$400,000, respectively. The next 107 highest paid officers averaged direct compensation of \$121,240. Aggregate figures for "executive group 1" at the other 50 largest industrial corporations were approx-

imately the same. In the average corporation, the 31 or so officers ranked immediately below the five highest paid executives received an average of \$99,256 in direct remuneration, which would equal approximately \$150,000 imputing the present value of stock bonus programs, retirement benefits, insurance, and other perquisites.

A compensation system is obviously askew when a private business corporation must pay a chief executive compensation and benefits of over \$600,000 when this is 15 times the \$40,000 or so the United States government must pay its highest ranking general, regulator, or Senator. Or when it must pay its next 20-100 senior executives an average of \$150,000 each when the federal government expends a maximum of \$38,000 per year to hire its highest ranking civil servants, and California, this nation's largest state, pays its governor \$49,000.

This is not to deny that the entrepreneur or corporate founder who, at substantial risk, introduces a new or better good or service should not be given a substantial incentive to make an unusual personal contribution to society. But we are concerned here with the administrators of large industrial corporations who, at minimal personal risk, serve as the bureaucrats of private industry. These individuals receive their staggeringly large salaries and stock options by rising through executive ranks—in exactly the same way that government's civil servants rise through civil service ranks—and by then exploiting the laxity of state corporate laws that their predecessors helped write.

Remedies

REVAMPING THE BOARD

The modern corporation is akin to a political state in which all powers are held by a single clique. The senior executives of a large firm are essentially not accountable to any other officials within the firm. These are precisely the circumstances that, in a democratic political state, require a separation of powers into different branches of authority. As James Madison explained in the *Federalist* No. 47:

The accumulation of all powers, legislative, executive, and judiciary, in the same hands, whether of one, a few or many, and whether hereditary,

self-appointed, or elective, may justly be pronounced the very definition of tyranny. Were the federal constitution, therefore, really chargeable with this accumulation of power, or with a mixture of powers, having a dangerous tendency to such an accumulation, no further arguments would be necessary to inspire a universal reprobation of the system.

A similar concern over the unaccountability of business executives historically led to the elevation of a board of directors to review and check the actions of operating management. As a practical matter, if corporate governance is to be reformed, it must begin by returning the board to this historical role. The board should serve as an internal auditor of the corporation, responsible for constraining executive management from violations of law and breach of trust. Like a rival branch of government, the board's function must be defined as separate from operating management. Rather than pretending directors can "manage" the corporation, the board's role as disciplinarian should be clearly described. Specifically, the board of directors should:

- establish and monitor procedures that assure that operating executives are informed of and obey applicable federal, state, and local laws;
- approve or veto all important executive management business proposals such as corporate by-laws, mergers, or dividend decisions;
- hire and dismiss the chief executive officer and be able to disapprove the hiring and firing of the principal executives of the corporation; and
- report to the public and the shareholders how well the corporation has obeyed the law and protected the shareholders' investment.

It is not enough, however, to specify what the board should do. State corporations statutes have long provided that "the business and affairs of a corporation shall be managed by a board of directors," yet it has been over a century since the boards of the largest corporations have actually performed this role. To reform the corporation, a federal chartering law must also specify the manner in which the board performs its primary duties.

First, to insure that the corporation obeys federal and state laws, the board should designate executives responsible for compliance with these laws and require periodic signed reports describing the effectiveness of compliance procedures. Mechanisms to administer spot checks on compliance with the principal statutes should be created. Similar mechanisms can insure that corporate "whistle blowers" and nonemployee sources may communicate to the board—in private and without fear of retaliation—knowledge of violations of law.

Second, the board should actively review important executive business proposals to determine their full compliance with law, to preclude conflicts of interest, and to assure that executive decisions are rational and informed of all foreseeable risks and costs. But even though the board's responsibility here is limited to approval or veto of executive initiatives, it should proceed in as well-informed a manner as practicable. To demonstrate rational business judgment, the directorate should require management "to prove its case." It should review the studies upon which management relied to make a decision, require management to justify its decision in terms of costs or rebutting dissenting views, and, when necessary, request that outside experts provide an independent business analysis.

Only with respect to two types of business decisions should the board exceed this limited review role. The determination of salary, expense, and benefit schedules inherently possesses such obvious conflicts of interest for executives that only the board should make these decisions. And since the relocation of principal manufacturing facilities tends to have a greater effect on local communities than any other type of business decision, the board should require management to prepare a "community impact statement." This public report would be similar to the environmental impact statements presently required by the National Environmental Policy Act. It would require the corporation to state the purpose of a relocation decision; to compare feasible alternative means; to quantify the costs to the local community; and to consider methods to mitigate these costs. Although it would not prevent a corporation from making a profit-maximizing decision, it would require the corporation to minimize the costs of relocation decisions to local communities.

To accomplish this restructuring of the board requires the institutionalization of a new profession: the full-time "professional" director. Corporate scholar frequently identify William O. Douglas' 1940 proposal for "salaried, professional experts [who] would bring a new responsibility and authority to directorates and a new safety to stockholders" as the origin of the professional director idea. More recently, corporations including Westinghouse and Texas Instruments have established slots on their boards to be filled by full-time directors. Individuals such as Harvard Business School's Myles Mace and former Federal Reserve Board chairman William McChesney Martin consider their own thoroughgoing approach to boardroom responsibilities to be that of a "professional" director.

To succeed, professional directors must put in the substantial time necessary to get the job done. One cannot monitor the performance of Chrysler's or Gulf's management at a once-a-month meeting; those firms' activities are too sweeping and complicated for such ritual oversight. The obvious minimum here is an adequate salary to attract competent persons to work as full-time directors and to maintain the independence of the board from executive management.

The board must also be sufficiently staffed. A few board members alone cannot oversee the activities of thousands of executives. To be able to appraise operating management, the board needs a trim group of attorneys, economists, and labor and consumer advisors who can analyze complex business proposals, investigate complaints, spot-check accountability, and frame pertinent inquiries.

The board also needs timely access to relevant corporate data. To insure this, the board should be empowered to nominate the corporate financial auditor, select the corporation's counsel, compel the forwarding and preservation of corporate records, require all corporate executives or representatives to answer fully all board questions respecting corporate operations, and dismiss any executive or representative who fails to do so.

This proposed redesign for corporate democracy attempts to make executive management accountable to the law and shareholders without diminishing its operating efficiency. Like a judi-

ciary within the corporation, the board has ultimate powers to judge and sanction. Like a legislature, it oversees executive activity. Yet executive management substantially retains its powers to initiate and administer business operations. The chief executive officer retains control over the organization of the executive hierarchy and the allocation of the corporate budget. The directors are given ultimate control over a narrow jurisdiction: Does the corporation obey the law, avoid exploiting consumers or communities, and protect the shareholders' investment? The executive contingent retains general authority for all corporate operations.

No doubt there will be objections that this structure is too expensive or that it will disturb the "harmony" of executive management. But it is unclear that there would be any increased cost in adopting an effective board. The true cost to the corporation could only be determined by comparing the expense of a fully paid and staffed board with the savings resulting from the elimination of conflicts of interest and corporate waste. In addition, if this should result in a slightly increased corporate expense, the appropriateness must be assessed within a broader social context: should federal and state governments or the corporations themselves bear the primary expense of keeping corporations honest? In our view, this cost should be placed on the corporations as far as reasonably possible.

It is true that an effective board will reduce the "harmony" of executive management in the sense that the power of the chief executive or senior executives will be subject to knowledgeable review. But a board which monitors rather than rubber-stamps management is exactly what is necessary to diminish the unfettered authority of the corporate chief executive or ruling clique. The autocratic power these individuals presently possess has proven unacceptably dangerous: it has led to recurring violations of law, conflicts of interest, productive inefficiency, and pervasive harm to consumers, workers, and the community environment. Under normal circumstances there should be a healthy friction between operating executives and the board to assure that the wisest possible use is made of corporate resources. When corporate executives are breaking the law, there should be no "harmony" whatsoever.

ELECTION OF THE BOARD

Restructuring the board is hardly likely to succeed if boards remain as homogeneously white, male, and narrowly oriented as they are today. Dissatisfaction with current selection of directors is so intense that analysts of corporate governance, including Harvard Law School's Abram Chayes, Yale political scientist Robert Dahl, and University of Southern California Law School Professor Christopher Stone, have each separately urged that the starting point of corporate reform should be to change the way in which the board is elected.

Professor Chayes, echoing John Locke's principle that no authority is legitimate except that granted "the consent of the governed," argues that employees and other groups substantially affected by corporate operations should have a say in its governance:

Shareholder democracy, so-called, is misconceived because the shareholders are not the governed of the corporations whose consent must be sought. . . . Their interests are protected if financial information is made available, fraud and overreaching are prevented, and a market is maintained in which their shares may be sold. A priori, there is no reason for them to have any voice, direct or representational, in [corporate decision making]. They are no more affected than nonshareholding neighbors by these decisions. . . .

A more spacious conception of 'membership,' and one closer to the facts of corporate life, would include all those having a relation of sufficient intimacy with the corporation or subject to its powers in a sufficiently specialized way. Their rightful share in decisions and the exercise of corporate power would be exercised through an institutional arrangement appropriately designed to represent the interests of a constituency of members having a significant common relation to the corporation and its power.

Professor Dahl holds a similar view: "[W]hy should people who own shares be given the privileges of citizenship in the government of the firm when citizenship is denied to other people who also make vital contributions to the firm?" he asks rhetorically. "The people I have in mind are, of course, employees and customers, without whom the firm could not exist, and the general

public, without whose support for (or acquiescence in) the myriad protections and services of the state the firm would instantly disappear. . . . Yet Dahl finds proposals for interest group representation less desirable than those for worker self-management. He also suggests consideration of codetermination statutes such as those enacted by West Germany and ten other European and South American countries under which shareholders and employees separately elect designated portions of the board.

From a different perspective, Professor Stone has recommended that a federal agency appoint "general public directors" to serve on the boards of all the largest industrial and financial firms. In certain extreme cases such as where a corporation repeatedly violates the law, Stone recommends that the federal courts appoint "special public directors" to prevent further delinquency.

There are substantial problems with each of these proposals. It seems impossible to design a general "interest group" formula which will assure that all affected constituencies of large industrial corporations will be represented and that all constituencies will be given appropriate weight. Even if such a formula could be designed, however, there is the danger that consumer or community or minority or franchisee representatives would become only special pleaders for their constituents and otherwise lack the loyalty or interest to direct generally. This defect has emerged in West Germany under codetermination. Labor representatives apparently are indifferent to most problems of corporate management that do not directly affect labor. They seem as deferential to operating executive management as present American directors are. Alternatively, federally appointed public directors might be frozen out of critical decision-making by a majority of "privately" elected directors, or the appointing agency itself might be biased.

Nonetheless, the essence of the Chayes-Dahl-Stone argument is well taken. The boards of directors of most major corporations are, as CBS's Dan Rather criticized the original Nixon cabinet, too much like "twelve grey-haired guys named George." The quiescence of the board has resulted in important public and, for that matter, shareholder concerns being ignored.

An important answer is structural. The homogeneity of the board can only be ended by giving to each director, in addition to a

general duty to see that the corporation is profitably administered, a separate oversight responsibility, a separate expertise, and a separate constituency so that each important public concern would be guaranteed at least one informed representative on the board. There might be nine corporate directors, each of whom is elected to a board position with one of the following oversight responsibilities:

1. Employee welfare
2. Consumer protection
3. Environmental protection and community relations
4. Shareholder rights
5. Compliance with law
6. Finances
7. Purchasing and marketing
8. Management efficiency
9. Planning and research

By requiring each director to balance responsibility for representing a particular social concern against responsibility for the overall health of the enterprise, the problem of isolated "public" directors would be avoided. No individual director is likely to be "frozen out" of collegial decision-making because all directors would be of the same character. Each director would spend the greater part of his or her time developing expertise in a different area; each director would have a motivation to insist that a different aspect of a business decision be considered. Yet each would simultaneously be responsible for participating in all board decisions, as directors now are. So the specialized area of each director would supplement but not supplant the director's general duties.

Although not a symmetrical analogy, the most successful precedent for dividing the representative responsibilities and constituencies is, of course, the Constitution of the United States. There, too, a basic question was one of motivation: How to design a political administration which would retain an equal respect for the rights of all of its citizens. Only by arranging "ambition . . . to counteract ambition" did the Federalists believe such respect would endure. By granting the President, the two houses of Congress, and the judiciary different geographic constituencies, different

terms, and different duties, the various factions of the nation's citizens were most likely to be insured some representation within the government. "Hence a double security arises to the rights of the people. The different governments will control each other, at the same time that each will be controlled by itself," explained Madison in *Federalist No. 51*.

In recent years, some business corporations have also perceived the advantages of creating constituent voices within the structure of the firm. Reverend Leon Sullivan, the only black director on General Motors' board, has made plain that he considers it his special responsibility to advance the interests of GM's black employees and dealers. His representation, among other things, has led to an increase in the number of blacks being trained to be GM executives. Gillette's Vice President for Product Integrity, Robert Giovacchini, is said to perform a similar role. Although not a member of the board, Mr. Giovacchini has been given the authority to recall any Gillette product, quash any advertising claim, or order any packaging change he feels is necessary to protect the company's consumers.

Only by institutionalizing the duties and power that individuals like Reverend Sullivan and Robert Giovacchini hold can responsible corporate government be brought to each large firm.

For in most giant corporations, no specific executive official or board member is responsible for protecting the interests of employees, consumers, the environment, or local communities. No one outside of senior management reviews the most important business decisions to assure their compliance with law, financial integrity, efficiency, or long-term corporate goals. Because these concerns become everybody's general interest, they become nobody's particular interest—and often go unattended.

To maintain the independence of the board from the operating management it reviews also requires that each federally chartered corporation shall be directed by a purely "outside" board. No executive, attorney, representative, or agent of a corporation should be allowed to serve simultaneously as a director of that same corporation. Directorial and executive loyalty should be furthered by an

absolute prohibition of interlocks. No director, executive, general counsel, or company agent should be allowed to serve more than one corporation subject to the Federal Corporate Chartering Act.

Several objections may be raised. First, how can we be sure that completely outside boards will be competent? As elaborated subsequently, corporate campaign rules will be redesigned to emphasize qualifications. This will allow shareholder voters to make rational decisions based on information clearly presented to them. It is also a fair assumption that shareholders, given an actual choice and role in corporate governance, will want to elect the men and women most likely to safeguard their investments.

A second objection is that once all interlocks are proscribed and a full-time outside board required, there will not be enough qualified directors to staff all major firms. This complaint springs from that corporate mentality which, accustomed to 60-year-old white male bankers and businessmen as directors, makes the norm a virtue. In fact, if we loosen the reins on our imagination, America has a large, rich, and diverse pool of possible directorial talent from academics and public administrators and community leaders to corporate and public interest lawyers.

But directors should be limited to four two-year terms so that boards do not become stale. And no director should be allowed to serve on more than one board at any one time. Although simultaneous service on two or three boards might allow key directors to "pollinize" directorates by comparing their different experiences, this would reduce their loyalty to any one board, jeopardize their ability to fully perform their new directorial responsibilities, and undermine the goal of opening up major boardrooms to as varied a new membership as is reasonable.

The shareholder electoral process should be made more democratic as well. Any shareholder or allied shareholder group which owns 1 percent of the common voting stock in the corporation or comprises 100 or more individuals and does not include a present executive of the corporation, nor act for a present executive, may nominate up to three persons to serve as directors. This will exclude executive management from the nomination process. It also increases the likelihood of a diverse board by preventing any one or

two sources from proposing all nominees. To prevent frivolous use of the nominating power, this proposal establishes a minimum shareownership condition.

Six weeks prior to the shareholders' meeting to elect directors, each shareholder should receive a ballot and a written statement on which each candidate for the board sets forth his or her qualifications to hold office and purposes for seeking office. All campaign costs would be borne by the corporation. These strict campaign and funding rules will assure that all nominees will have an equal opportunity to be judged by the shareholders. By preventing directorates from being bought, these provisions will require board elections to be conducted solely on the merit of the candidates.

Only the actual or "beneficial" owners of stock should be eligible to vote. Financial intermediaries shall be required to "pass through" voting rights in approximately the same manner that present New York and American Stock Exchange rules require broker-dealers to "pass through" proxies and corporate reports to shareholders owning stock in street name accounts. Already a number of major firms, including Sears, Roebuck, General Motors, McDonnell Douglas, and United States Steel, "pass through" voting rights to hundreds of thousands of employees holding stock in joint pension funds.

Finally, additional provisions will require cumulative voting and forbid "staggered" board elections. Thus any shareholder faction capable of jointly voting approximately 10 percent of the total number of shares cast may elect a director.

A NEW ROLE FOR SHAREHOLDERS

The difficulty with this proposal is the one that troubled Juvenal two millennia ago: *Quis custodiet ipsos custodes*, or, Who shall watch the watchmen? Without a full-time body to discipline the board, it would be so easy for the board of directors and executive management to become friends. Active vigilance could become routinized into an uncritical partnership. The same board theoretically elected to protect shareholder equity and internalize law might instead become management's lobbyist.

Relying on shareholders to discipline directors may strike many as a dubious approach. Historically, the record of share-

holder participation in corporate governance has been an abysmal one. The monumental indifference of most shareholders is worse than that of sheep; sheep at least have some sense of what manner of ram they follow. But taken together, the earlier proposals—an outside, full-time board, nominated by rival shareholder groups and voted on by beneficial owners—will increase involvement by shareholders. And cumulative voting insures that an aroused minority of shareholders—even one as small as 9 or 10 percent of all shareholders—shall have the opportunity to elect at least one member of the board.

But that alone is hardly sufficient. At a corporation the size of General Motors, an aggregation of 10 percent of all voting stock might require the allied action of over 200,000 individuals—which probably could occur no more than once in a generation. To keep directors responsive to law and legitimate public concerns requires surer and more immediate mechanisms. In a word, it requires arming the victims of corporate abuses with the powers to swiftly respond to them. For only those employees, consumers, racial or sex minorities, and local communities harmed by corporate depredations can be depended upon to speedily complain. By allowing any victim to become a shareholder and by permitting any shareholder to have an effective voice, there will be the greatest likelihood of continuing scrutiny of the corporation's directorate. Shareholder involvement can be further enhanced by the disclosures discussed in the next chapter, by the opportunity to attend periodically scheduled directors' meetings to ask questions or present grievances, and by reform of the shareholder derivative action so that any investor who identifies a corporate violation of law may bring lawsuit without risk of financial loss.

For the purpose of motivating the board to perform its intended role, however, it is appropriate to inject shareholders further into corporate governance wherever they have a financial or other incentive to perform effectively.

Six weeks before a vote on any fundamental transaction—which can be defined as executive proposals involving the purchase, sale, lease, merger, consolidation, financing, refinancing, dissolution, or liquidation of assets equal to, say, 10 percent of the corporation's total assets or over \$100 million, or the authorization

of corporate securities in any amount—the board should forward a written statement to the shareholders explaining the transaction, the vote by which the transaction was approved by the board, the reasons why members of the board approved the transaction, the reasons why other members opposed it, and the foreseeable costs and risks of implementing the proposal. This provision would provide for shareholder votes on all business decisions above a certain minimum size, however named. By requiring directors to publicly elaborate their reasoning—reasoning which may be judged not only during this vote but also during subsequent board elections or mismanagement suits—there would be a powerful incentive for directors to police themselves.

A complementary provision should allow any shareholder or allied shareholder group holding stock equal to a minimum of one percent of all outstanding stock to simultaneously publish a dissenting view or, at any time, to propose amendments to the corporate charter or bylaws.

AFFECTED COMMUNITIES

Shareholders are not the only ones with an incentive to review decisions of corporate management; nor, as Professors Chayes and Dahl argue, are shareholders the only persons who should be accorded corporate voting rights. The increasing use by American corporations of technologies and materials that pose direct and serious threats to the health of communities surrounding their plants requires the creation of a new form of corporate voting right. When a federally chartered corporation engages, for example, in production or distribution of nuclear fuels or the emission of toxic air, water, or solid waste pollutants, citizens whose health is endangered should not be left, at best, with receiving money damages after a time-consuming trial to compensate them for damaged property, impaired health, or even death.

Instead, upon finding of a public health hazard by three members of the board of directors or 3 percent of the shareholders, a corporate referendum should be held in the political jurisdiction affected by the health hazard. The referendum would be drafted by the unit triggering it—either the three board members or a designate of the shareholders. The affected citizens by majority vote

will then decide whether the hazardous practice shall be allowed to continue. This form of direct democracy has obvious parallels to the initiative and referendum procedures familiar to many states—except that the election will be paid for by a business corporation and will not necessarily occur at a regular election.

What would happen to the local community if it voted to close a dangerous plant? Three answers seem reasonable. First, the board of directors should have the opportunity to modify the local plant to reduce the health hazard. If the board chooses to do so, it should be allowed to submit its modification plan as a subsequent referendum for community approval. Second, if the corporation chooses to leave after the vote, it should be required to immediately repay the local community for all damages to its health and property by the outlawed activity. This valuation proceeding should occur in federal district court. If the corporation chooses to leave before the referendum vote, it should additionally be required to pay its local employees salaries for a reasonable interim period. Third, the referendum voting procedure should be flexible. Local communities should be given the opportunity to vote upon an initiative calling for the corporation to remedy a specific health hazard by a designated date as an alternative to one calling for immediate closing of a plant. Similarly, the board should be given the opportunity to submit a plan of modification simultaneously with the initial referendum vote.

This type of election procedure is necessary to give enduring meaning to the democratic concept of "consent of the governed." To be sure, this proposal goes beyond the traditional assumption that the only affected or relevant constituents of the corporation are the shareholders. But no longer can we accept the Faustian bargain that the continued toleration of corporate destruction of local health and property is the cost to the public of doing business. In an equitable system of governance, the perpetrators should answer to their victims.

ARTICLES OF INCORPORATION OF SEALASKA CORPORATION

The undersigned natural persons, all of whom are above the age of 19 years, appointed by authority of the Central Council of the Tlingit & Haida Indians of Alaska, acting as incorporators of a corporation under the provisions of the Alaska Business Corporation Act (hereinafter referred to as the "Corporation Act"), and the Alaska Native Claims Settlement Act of December 18, 1971, 85 Stat. 588 (hereinafter referred to as the "Settlement Act"), do hereby adopt the following Articles of Incorporation:

Article I

NAME

The name of the Corporation is SEALASKA CORPORATION.

Article II

DURATION

The Corporation shall have perpetual existence.

Article III

PURPOSES AND POWERS

The purposes of the Corporation are to be the regional corporation authorized by section 7 of the Settlement Act for the Natives of the Southeastern Alaska region; to secure and administer the benefits of said Act for the Natives enrolled in said region pursuant to section 5 thereof; and to engage in any and all lawful enterprises, businesses, undertakings and activities permitted or not denied corporations under the Corporation Act or the Settlement Act.

Subject to these Articles, the Corporation shall have and may exercise any and all powers that are permitted or not denied corporations under the Corporation Act or the Settlement Act.

Article IV

SHARES

- A. Subject to section 7(g) of the Settlement Act, the aggregate number of shares that the Corporation shall have authority to issue is two million. Such shares shall be common stock of a single class, shall be without par value, and shall be deemed fully paid and non-assessable upon issuance.

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- B. Until December 18, 1991, shares issued by the Corporation, inchoate rights thereto, and any dividends paid or distributions made with respect thereto may not be sold, pledged, subjected to a lien or judgement execution, assigned in present or future, or otherwise alienated, except pursuant to a court decree of separation, divorce or child support.
 - C. Shares issued by the Corporation shall:
 - 1. Except as provided in paragraph D of this Article, carry a right to vote in elections for the board of directors and on such other matters as are presented to the shareholders;
 - 2. Subject to the provisions of paragraph E of this Article, permit the holders to receive dividends and other distributions from the Corporation; and
 - 3. Vest in the holders all rights of a shareholder in a business corporation organized under the laws of the State of Alaska.
 - D. Upon the death of a shareholder ownership of his shares shall be transferred in accordance with his last will and testament or under the applicable laws of intestacy, except that:
 - 1. Until December 18, 1991, such shares shall carry voting rights only if the holder thereof through inheritance is a Native; and
 - 2. In the event a deceased shareholder fails to dispose of his shares by will and has no heirs who are natural persons under the applicable laws of intestacy, such shares shall escheat to the Corporation.
 - E. When funds are distributed among Village Corporations in the Southeastern Alaska region pursuant to the provisions of the Settlement Act, an amount computed as follows shall be distributed as dividends, subject to the provisions of said Act, exclusively to the shareholders of the Corporation who are non-residents of those villages whose Corporations are distributees. The amount so distributed as dividends exclusively to such shareholders shall bear the same ratio to the amount distributed among the Village Corporations that the number of shares registered on the books of the Corporation in the names of such shareholders bears to the number of shares registered in the names of residents of such villages.
 - F. On January 1, 1992, all stock previously issued by the Corporation shall be deemed to be cancelled, and shares will be issued which shall not be subject to the restrictions set forth in paragraph B or in subparagraph 1 of paragraph D of this Article.

Article V

COMMENCING BUSINESS

If so restricted by law, the Corporation will not commence business until consideration of the value of at least \$1,000 has been received.

Article VI

PREEMPTIVE RIGHTS

Except as may otherwise be provided by the Board of Directors, no stockholder of the Corporation shall have any pre-emptive rights to purchase, subscribe for or otherwise acquire any shares of stock of the Corporation now or hereafter authorized, or any securities exchangeable for or convertible into such shares, or any warrants or other instruments evidencing rights or options to subscribe for, purchase or otherwise acquire such shares.

Article VII

MANAGEMENT

The management of the Corporation shall be vested in a Board of Directors. Subject to the provisions of section 7(f) of the Settlement Act respecting the qualifications of Directors, the number, terms, and method of election of Directors shall be as prescribed in the Bylaws of the Corporation.

Article VIII

ARBITRATION

In the event of disagreement between the Corporation and a Village Corporation or Village Corporations over the provisions of a plan or plans formulated pursuant to section 7(l) of the Settlement Act, the issues in disagreement shall be submitted to arbitration before a panel of three arbiters, of whom one shall be chosen by the Corporation, one by the Village Corporation or Corporations involved in the disagreement, and one by the two so chosen by the parties. The arbitration shall be subject to the Alaska Uniform Arbitration Act.

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Article IX

OFFICE AND AGENT

The address of the Corporation's initial registered office is:

114 South Franklin Street
Juneau, Alaska 99801

The name of the Corporation's initial registered agent at that address is:

John Borbridge, Jr.

Article X

INITIAL BOARD OF DIRECTORS

The initial Board of Directors shall be composed of fifteen persons who shall serve until the first annual meeting of shareholders or until their successors are elected and qualified. The names and addresses of the members of the initial Board of Directors are:

Name	Address
John Borbridge, Jr.	Juneau, Alaska
Bertrand C. Campbell, Jr.	Ketchikan, Alaska
Robert David, Sr.	Haines, Alaska
Sam L. Demmert	Yakutat, Alaska
Cyril W. George, Sr.	Angoon, Alaska
Gilbert Gunderson	Wrangell, Alaska
Aaron T. Isaacs, Jr.	Craig, Alaska
Clarence Jackson, Sr.	Kake, Alaska
Mark Jacobs, Jr.	Sitka, Alaska
Marlene Johnson	Hoonah, Alaska
Leonard Kato	Klawock, Alaska
Richard Kito	Petersburg, Alaska
Robert Lang	Juneau, Alaska
Byron Mallott	Juneau, Alaska
Charles Nelson	Ketchikan, Alaska

Article XI

INCORPORATORS

The names and addresses of the incorporators are:

Name	Address
John Borbridge, Jr.	Juneau, Alaska
Clarence Jackson, Sr.	Kake, Alaska
Marlene Johnson	Hoonah, Alaska
Leonard Kato	Klawock, Alaska
Richard Kito	Petersburg, Alaska

Article XII

AMENDMENT

Subject to section 7(e) of the Settlement Act, these Articles may be amended, restated or repealed from time to time in accordance with the Corporation Act.

In witness whereof the undersigned incorporators have hereunto set their hands and seals this 13th day of June, 1972.

John Corbridge Jr. (SEAL)

Charles Jackson Jr. (SEAL)

Maureen Johnson (SEAL)

Leonard Hob (SEAL)

Richard K. S. (SEAL)

VERIFICATION

CITY OF WASHINGTON)
) ss
DISTRICT OF COLUMBIA)

I, the undersigned, a Notary Public duly commissioned to take acknowledgements and administer oaths in the District of Columbia, do hereby certify that on the 13th day of June, 1972, personally appeared before me John Borbridge, Jr., Clarence Jackson, Sr., Marlene Johnson, Leonard Kato, and Richard Kito, who, being by me first duly sworn, declared that they are the incorporators referred to in the foregoing Articles of Incorporation, that they signed the Articles as such that the statements contained herein are true.

Nancy L. Love
NOTARY PUBLIC, D. C.

My Commission Expires March 31, 1977.

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APPROVED

this 14th day of June, 1972,
in accordance with section 7(e)
of the Alaska Native Claims
Settlement Act of December 18, 1971
(85 Stat. 688).

Harrison Speech
ASSISTANT SECRETARY OF THE INTERIOR

BYLAWS OF SEALASKA CORPORATION

Article I

IDENTIFICATION

- A. Name. The name of the Corporation is SEALASKA CORPORATION.
- B. Office and Agent. The address of the registered office of the Corporation is 114 South Franklin Street, Juneau, Alaska 99801; and the name of the registered agent at this address is John Borbridge, Jr.
- C. Seal. The seal of the Corporation shall be in such form as the Board of Directors shall prescribe.
- D. The fiscal year of the Corporation shall be as prescribed by the Board of Directors.

Article II

TEMPORARY LIMITATIONS OF POWERS

Notwithstanding the recitations contained in Article III of the Articles of Incorporation relating to the powers of the Corporation, prior to completion of the roll required by section 5 of the Alaska Native Claims Settlement Act of December 18, 1971, 85 Stat. 688 (hereinafter referred to as the "Settlement Act"), the issuance of shares as provided by section 7(g) of the Settlement Act, and the holding of the first annual meeting of shareholders thereafter, the powers of the Corporation shall be subject to the limitations hereafter set forth, except that, with the approval of the Secretary of the Interior, the Corporation may act beyond such limitations.

- A. The Corporation shall not borrow funds in excess of the aggregate amount of \$1,200,000.
- B. The Corporation shall not expend or commit funds in excess of the aggregate amount of \$1,200,000; nor for purposes other than organizational and to assemble and analyze data pertinent to land selections and related responsibilities; nor for more than one year in advance.
- C. The Corporation shall not invest funds distributed under the Act for periods in excess of one year, provided that the Corporation may invest funds in readily marketable securities qualified for the investment of trust funds having maturities beyond one year.

- D. The Corporation shall not make land selections.

Article III

SHAREHOLDERS

- A. Annual Meeting. The annual meeting of shareholders, unless for compelling reasons the Board of Directors otherwise provides for particular years, shall be held within three months of the close of the fiscal year of the Corporation at such time as the Board of Directors shall prescribe.
- B. Special Meetings. Special meetings of the shareholders may be called by the Board of Directors, the Chairman of the Board of Directors, the President, or the holders of not less than one-tenth of all shares entitled to vote at the meeting. Only such business shall be conducted at a special meeting as is specified in the notice thereof.
- C. Place of Meetings. Unless otherwise provided by the Board of Directors, all meetings of shareholders shall be held at the registered office of the Corporation.
- D. Notice of Meetings. Written notice stating the place, day, and hour of the meeting and, in case of a special meeting, the purpose or purposes for which the meeting is called, shall be delivered not less than 10 nor more than 50 days before the date of the meeting, either personally or by mail, by or at the direction of the President, the Secretary, or the officer or persons calling the meeting, to each registered holder entitled to vote at such meeting. If mailed, such notice shall be deemed to be delivered when deposited in the United States mail postage prepaid addressed to the registered holder at his address as it appears on the stock transfer books of the Corporation. Waiver by a shareholder in writing of a notice of a shareholders' meeting shall be equivalent to the giving of such notice, whether in person or by proxy, at a shareholders' meeting shall constitute a waiver of notice of the meeting.
- E. Quorum. A majority of the shares entitled to vote, represented in person or by proxy, shall constitute a quorum at a meeting of shareholders. The shareholders present at a duly organized meeting may continue to do business until adjournment, notwithstanding the withdrawal of enough shareholders to leave less than a quorum.
- F. Closing of Transfer Books and Fixing Record Date. For the purpose of determining shareholders entitled to notice of or to vote at any meeting of shareholders, or any adjournment thereof, or entitled to receive payment of any dividend, or in order to make a determination of shareholders for any other

proper purpose, the Board of Directors of the Corporation may provide that the stock transfer books shall be closed for a stated period but not to exceed, in any case, 50 days. If the stock transfer books shall be closed for any purpose of determining shareholders entitled to notice of or to vote at a meeting of shareholders, the books shall be closed for at least 10 days immediately preceding the meeting. In lieu of closing the stock transfer books, the Board of Directors may fix in advance a date as the record date for any such determination of shareholders, such date, in any case, to be not more than 50 days and, in case of a meeting of shareholders, not less than 10 days prior to the date on which the particular action, requiring this determination of shareholders, is to be taken. If the stock transfer books are not closed and no record date is fixed for the determination of shareholders entitled to notice or to vote at a meeting of shareholders or shareholders entitled to receive payment of a dividend, the date on which notice of the meeting is mailed or the date on which the resolution of the Board of Directors declaring the dividend is adopted, as the case may be, shall be the record date for the determination of shareholders. When a determination of shareholders entitled to vote at any meeting of shareholders has been made as provided in this paragraph, the determination shall apply to any adjournment thereof, except where the determination has been made through the closing of the stock transfer books and the stated period of closing has expired.

- G. List of Shareholders. At least ten days before each meeting of shareholders, the officer or agent having charge of the share transfer book for shares of the corporation shall make a list of the shareholders entitled to vote at the meeting or an adjournment of the meeting, arranged in alphabetical order, with the address of and the number of shares held by each. The list shall be kept on file at the registered office of the corporation and is subject to inspection by a shareholder at any time during usual business hours for a period of 10 days prior to the meeting. The list shall also be produced and kept open at the time and place of the meeting and be subject to the inspection of a shareholder during the meeting. Failure to comply with the requirements of this paragraph does not affect the validity of the action taken at the meeting.
- H. Voting. At any meeting of the shareholders every shareholder having the right to vote shall be entitled to vote in person, or by proxy appointed by an instrument in writing subscribed by such shareholder or his authorized attorney in fact, and bearing a date not more than eleven months prior to said meeting. Until after the first election of directors following completion by the Secretary of the Interior of a roll of Natives, pursuant to section 5 of the Settlement Act, only Natives enrolled in the southeastern Alaska region, pursuant to the Act, may be appointed as proxies. At an election for directors every shareholder entitled to vote may vote, in person or by proxy, the number of shares owned by him for as many persons as there are directors to be elected, or may cumulate his votes by giving one candidate as many votes as the number of directors to be elected multiplied by the number of his shares equals, or by distributing these votes on the same principle among any number of candidates.

- I. Action Without A Meeting. Any action required to be taken at a meeting of the shareholders of the Corporation, or any action that may be taken at a meeting of the shareholders, may be taken without a meeting if a consent in writing setting forth the action so taken shall be signed by all of the shareholders entitled to vote with respect to the subject matter thereof.

Article IV

BOARD OF DIRECTORS

- A. Composition. The business, affairs and property of the Corporation shall be managed by a Board of Directors composed of fifteen members. The terms of members, except those of members elected prior to and at the first annual meeting of shareholders held after the completion of the roll required by section 5 of the Settlement Act, shall be three years; five members to be elected at each annual meeting of shareholders as hereinafter prescribed. The terms of members of the initial board and of any successor board elected prior to the completion of such roll and the first annual meeting of shareholders held thereafter shall be one year, or until such first annual meeting of shareholders, whichever first occurs, and until their successors are elected and qualified. Members of the Board of Directors elected at and after such first annual meeting of shareholders shall be shareholders of the Corporation over the age of eighteen years.
- B. Election. At the first annual meeting of shareholders held after completion of the roll, fifteen members shall be elected to the Board of Directors in three classes, each consisting of five members. The term of office of the directors of the first class shall expire at the first annual meeting of shareholders held after their elections. The term of office of the directors of the second class shall expire at the second annual meeting of shareholders held after their elections. The term of office of the directors of the third class shall expire at the third annual meeting of shareholders held after their elections. At each annual meeting after the first, five directors shall be elected whose terms shall expire at the third annual meeting of shareholders held after the meeting at which they are elected. Each director shall hold office for the term for which he is elected and until a successor is elected and qualified.
- C. Removal. A director may be removed from office by majority vote of the shares eligible to vote, with or without cause, at any annual meeting of shareholders or at a special meeting called for that purpose.
- D. Vacancies. A vacancy occurring in the Board of Directors may be filled by the vote of a majority of the remaining directors though the majority is less than a quorum of the Board. A director elected to fill a vacancy is elected for the unexpired term of his predecessor. A directorship to be filled by reason of an

increase in the number of directors shall be filled by election at an annual meeting of shareholders or at a special meeting of shareholders called for that purpose.

- E. Place of Meetings. Meetings of the Board of Directors, annual, regular and special may be held at any place designated by the Board, or, in the case of a special meeting, at any place designated by the authority calling the meeting, either within or without the State of Alaska.
- F. Annual Meetings. The Board of Directors shall meet each year immediately after the annual meeting of the shareholders for the purposes of election of a Chairman, organization, election of officers of the Corporation, and the consideration of any other business that may properly be brought before the meeting. No notice of any kind of this meeting shall be necessary either to old or new members of the Board of Directors. The Chairman shall preside at meetings of the Board of Directors and shall supervise the execution of actions taken by it.
- G. Regular Meetings. The Board of Directors may from time to time provide for the holding of subsequent or regular meetings. No notice of any kind need be given to any members of the Board of Directors of any such meetings.
- H. Special Meetings. Other meetings of the Board of Directors may be held upon notice by letter, telegram, cable, or radiogram, delivered for transmission not later than during the third day immediately preceding the day for the meeting, or by word of mouth, telephone or radiophone received not later than during the second day immediately preceding the day for the meeting, upon the call of the Chairman of the Board, the President of the Corporation, or a majority of the members of the Board of Directors then in office, at any place within or without the State of Alaska. Notice of any meeting of the Board of Directors may be waived in writing signed by the person or persons entitled to the notice, whether before or after the time of the meeting. Neither the business to be transacted at, nor the purpose of, any meeting of the Board of Directors need be specified in the notice or waiver of notice of the meeting.
- I. Acting Without Assembling. Any action that may be taken at a meeting of the Board of Directors or of a committee thereof may be taken without a meeting if a consent in writing, setting forth the action to be taken, shall be signed by all of the Directors or all of the members of the committee, as the case may be. Without assembling the members of the Board of Directors or of a committee thereof can conduct a meeting by communicating simultaneously with each other by means of conference telephones or similar communications equipment.

- J. Executive Committee. When the Board of Directors is not meeting, the powers of the Board may be exercised by an Executive Committee, consisting of the Chairman and four other members designated by the Board. In its exercise of the authority of the Board in the management of the Corporation, the Executive Committee, except as otherwise provided by resolutions of the Board, may do anything that the Board itself might lawfully do, except that it may not take any action contrary to or inconsistent with any action taken by the Board.
- K. Transactions in Which Directors Have an Interest. Any contract or other transaction between the Corporation and one or more of its directors, or between the Corporation and any firm of which one or more of its directors are members or employees, or in which they are interested, or between the Corporation and any corporation or association of which one or more of its directors are shareholders, members, directors, officers, or employees, or in which they are interested, shall be valid for all purposes, notwithstanding the presence of the director or directors at the meeting of the Board of Directors of the Corporation that acts upon, or in reference to, the contract or transaction, and notwithstanding his or their participation in the action, if the fact of such interest shall be disclosed or known to the Board of Directors and the Board of Directors shall, nevertheless, authorize or ratify the contract or transaction, the interested director or directors to be counted in determining whether a quorum is present and to be entitled to vote on such authorization or ratification. This section shall not be construed to invalidate any contract or other transaction that would otherwise be valid under the common and statutory law applicable to it.

Article V

OFFICERS

- A. Titles and Tenure. The officers of the Corporation shall be a President, a Vice President, a Secretary, and a Treasurer, each of whom shall be elected by the Board of Directors at such times, in such manner, and upon and for such terms as it shall prescribe. In addition to the above officers, the Board of Directors may designate and elect or appoint such other officers, assistant officers, and agents as it deems necessary at such times, in such manner, and upon and for such terms as it shall prescribe. Two or more offices may be held by the same person, except the offices of President and Secretary. No officer or agent of the Corporation need be a shareholder of the Corporation or a member of the Board of Directors. All officers and agents of the Corporation shall serve at the pleasure of the Board of Directors and may be removed by the Board or the

Executive Committee whenever in its judgment the best interests of the Corporation will be served. Removal is without prejudice to the contract rights of the person removed, but election or appointment of an officer or agent by the Board of Directors, regardless of whether for a stated term, does not of itself create contract rights.

- B. Duties. Officers and agents of the Corporation shall have and perform such duties as are prescribed from time to time by the Board of Directors.

Article VI

CERTIFICATES

- A. Certificates Representing Shares. The shares of the Corporation shall be represented by certificates signed by the President or Vice President and the Secretary or an Assistant Secretary of the Corporation, and may be sealed with the seal of the Corporation or a facsimile of the seal. The signatures of the President or Vice President and the Secretary or Assistant Secretary upon a certificate may be facsimiles if the certificate is countersigned by a transfer agent, or registered by a registrar, other than the Corporation itself or an employee of the Corporation. If an officer who has signed or whose facsimile signature has been placed upon such certificate ceases to be an officer before the certificate is issued, it may be issued by the Corporation with the same effect as if he were an officer at the date of its issue.
- B. Information To Be Stated on Face of Certificates. Each certificate representing shares shall state upon the face:
1. That the Corporation is organized under the laws of Alaska, subject to the provision of the Alaska Native Claims Settlement Act of December 18, 1971, P.L. 92-203 (85 Stat. 688);
 2. The name of the person to whom issued;
 3. The number of shares it represents; and
 4. That the shares are without par value.
- C. Additional Information. The Board of Directors may provide for the setting out on the face or back of each certificate such additional statements about the provisions of the Settlement Act as it believes would be helpful to the holder, including statements about restrictions upon alienation, and about variations in voting and dividend rights depending upon whether the holder is a Native or a non-Native or a resident or a non-resident of a village for which a Village Corporation is organized pursuant to the Settlement Act.

- D. Regulations. The Board of Directors may make such rules and regulations as it deems appropriate to govern the issue, transfer, registration and replacement of certificates.

Article VII

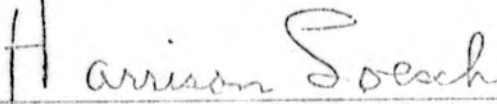
AMENDMENTS

These Bylaws may be amended, repealed or restated by majority vote of the shares eligible to vote at any annual meeting of shareholders, or at any special meeting of shareholders called for that purpose, or by the Board of Directors, except that for a period of five years from the date of filing of the Articles of Incorporation of the Corporation the following provisions shall not be amended without the approval of the Secretary of the Interior:

- A. Article II (Temporary Limitation of Powers);
- B. Paragraph H (Voting) of Article III (Shareholders); and
- C. Paragraphs A (Composition) and B (Election) of Article IV (Board of Directors).

APPROVED

this 14th day of June, 1972,
in accordance with section 7(e)
of the Alaska Native Claims
Settlement Act of December 18,
1971 (85 Stat. 688).


ASSISTANT SECRETARY OF THE INTERIOR

Federal Credit Unions

Chapter 14 of Title 12 of the United States Code, as amended to April 19, 1977

§ 1751

Short Title.—This chapter may be cited as the "Federal Credit Union Act". (June 26, 1934, § 1, 48 Stat. 1216; Sept. 22, 1959, § 1, 73 Stat. 628.)

Act of June 26, 1934, cited to the text was entitled "An Act to establish a Federal Credit Union System, to establish a further market for securities of the United States and to make more available to people of small means credit for provident purposes through a national system of cooperative credit, thereby helping to stabilize the credit structure of the United States."

Subchapter I—General Provisions

§ 1752

Definitions.—As used in this chapter—

(1) the term "Federal credit union" means a cooperative association organized in accordance with the provisions of this chapter for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes;

(2) the term 'Administrator' means the Administrator of the National Credit Union Administration;

(3) the term 'Administration' means the National Credit Union Administration; and

(4) the term 'Board' means the National Credit Union Board.

* (4) The terms 'member account' and 'account' (when referring to the account of a member of a credit union) mean a share, share certificate, or share deposit account of a member of a credit union of a type approved by the Administrator which evidences money or its equivalent received or held by a credit union in the usual course of business and for which it has given or is obligated to give credit to the account of the member, and, in the case of a credit union serving predominantly low-income members (as defined by the Administrator), such terms (when referring to the account of a nonmember served by such credit union) mean a share, share certificate, or share de-

§ 101

posit account of such nonmember which is of a type approved by the Administrator and evidences money or its equivalent received or held by such credit union in the usual course of business and for which it has given or is obligated to give credit to the account of such nonmember, and such terms mean those accounts of nonmember credit unions and nonmember units of Federal, State, or local governments and political subdivisions thereof in which payments are received by a credit union pursuant to section 107(6) of this Act;

(5) The terms 'State credit union' and 'State-chartered credit union' mean a credit union organized and operated according to the laws of any State, the District of Columbia, the several territories and possessions of the United States, the Panama Canal Zone, or the Commonwealth of Puerto Rico, which laws provide for the organization of credit unions similar in principle and objectives to Federal credit unions;

(6) The term 'insured credit union' means any credit union the member accounts of which are insured in accordance with the provisions of title II of this Act, and the

*Definitions of terms "member account" and "account" were added as paragraph (1) notwithstanding the existence of a paragraph (4) defining the term "Board."

term 'noninsured credit union' means any credit union the member accounts of which are not so insured;

(7) The term 'Fund' means the National Credit Union Share Insurance Fund; and

(8) The term 'branch' includes any branch credit union, branch office, branch agency, additional office, or any branch place of business located in any State of the United States, the District of Columbia, the several territories and possessions of the United States, the Panama Canal Zone, or the Commonwealth of Puerto Rico, at which member accounts are established or money lent.

(As amended Mar. 10, 1970, Pub.L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub.L. 91-468, 84 Stat. 1015; Apr. 19, 1977, Pub.L. 95-22, 91 Stat. 49).

§ 1752a

§ 102

Creation of Administration

(a) There is hereby established in the executive branch of the Government an independent agency to be known as the National Credit Union Administration (hereinafter referred to as the 'Administration'). The Administration shall consist of a National Credit Union Board (hereinafter referred to as the 'Board'), and an Administrator of the National Credit Union Administration (hereinafter referred to as the 'Administrator').

(b) The Administrator shall be appointed by the President, by and with the advice and consent of the Senate. He shall be the chief executive officer of the Administration and shall serve at the pleasure of the President.

(c) The Board shall consist of a Chairman and one member from each of the Federal credit union regions to be appointed by the President, by and with the advice and consent of the Senate. The Chairman shall be appointed from the country at large and shall serve at the pleasure of the President. In making appointments to the Board, the President shall appoint persons of tested credit union experience.

(d) The term of office of each member of the Board, other than the Chairman, shall be six years. However, the initial terms of the members first taking office shall expire as follows: one on December 31, 1970, and one at the end of each succeeding calendar year thereafter. Of the members so appointed,

the President shall designate one to serve as Vice Chairman for a term expiring upon the expiration of his term as a member, or upon the expiration of the then current term of the Chairman, whichever is earlier. The Vice Chairman shall act as Chairman in the absence or disability of the Chairman. Any member of the Board may continue to serve as such after the expiration of his term of office until his successor has been appointed and has qualified.

(e) The President shall call the first meeting of the Board, and thereafter the Board shall meet on a quarterly basis, and at such other times as the Chairman or the Administrator may request, or whenever one-third of the members so request. The Board shall adopt such rules as it may see fit for the transaction of its business and shall keep permanent and complete records and minutes of its acts and proceedings. A majority of the voting members of the Board shall constitute a quorum. The Administrator shall seek the advice, counsel, and guidance of the Board with respect to matters of policy relating to the activities and functions of the Administration under this Act. The Administrator shall make an annual report to the President for submission to the Congress summarizing the activities of the Administration and making such recommendations as he deems appropriate. Such report shall be made after full consultation with the Board and shall contain any recommendations or comments submitted by the Board for inclusion in the report. The members of the Board shall be entitled to receive compensation at the rate of \$75 for each day engaged in the business of the Administration pursuant to authorization by the Chairman, and shall be allowed travel expenses including per diem in lieu of subsistence as authorized by section 5703 of title 5 of the United States Code for persons in the Government service employed intermittently.

(f) The financial transactions of the Administration shall be audited by the General Accounting Office in accordance with the principles and procedures applicable to commercial corporate transactions and under such rules and regulations as may be prescribed by the Comptroller General of the United States. The audit shall be conducted

at the place or places where the accounts of the Administration are kept.

(As amended Mar. 10, 1970, Pub.L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub.L. 91-468, 84 Stat. 1015).

§ 1753

§ 103

Federal credit union organization.—Any seven or more natural persons who desire to form a Federal credit union shall subscribe before some officer competent to administer oaths an organization certificate in duplicate which shall specifically state—

(1) the name of the association;

(2) the location of the proposed Federal credit union and the territory in which it will operate;

(3) the names and addresses of the subscribers to the certificate and the number of shares subscribed by each;

(4) the par value of the shares which shall be \$5 each;

(5) the proposed field of membership, specified in detail;

(6) the term of the existence of the corporation which may be perpetual; and

(7) The fact that the certificate is made to enable such persons to avail themselves of the advantages of this Act.

Such organization certificate may also contain any provisions approved by the Administrator for the management of the business of the association and for the conduct of its affairs and relative to the powers of its directors, officers, or stockholders. (June 26, 1934, § 3, 48 Stat. 1217; June 29, 1948, § 2, 62 Stat. 1091; Sept. 22, 1959, § 4, 73 Stat. 628, Mar. 10, 1970, Pub.L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub.L. 91-468, 84 Stat. 1015).

§ 1754

§ 104

Approval of organization certificate.—The organization certificate shall be presented to the Administrator for approval. Before any organization certificate is approved, an appropriate investigation shall be made for the purpose of determining (1) whether the organization certificate conforms to the provisions of this chapter; (2) the general character and fitness of the subscribers thereto; and (3) the economic advisability of

establishing the proposed Federal credit union. Upon approval of such organization certificate by the Administrator it shall be the charter of the corporation, and one of the originals thereof shall be delivered to the corporation after the payment of the fee required therefor. Upon such approval the Federal credit union shall be a body corporate and as such, subject to the limitations herein contained, shall be vested with all the powers and charged with all of the liabilities conferred and imposed by this chapter upon corporations organized hereunder. (June 26, 1934, § 4, 48 Stat. 1217; June 29, 1948, § 2, 62 Stat. 1091; Sept. 22, 1959, § 5, 73 Stat. 629, Mar. 10, 1970, Pub.L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub.L. 91-468, 84 Stat. 1015).

§ 1755

§ 105

Fees.—For the purpose of paying the costs incident to the ascertainment of whether an organization certificate should be approved, the subscribers to any such certificate shall pay, at the time of filing their organization certificate, the amount prescribed by the Administrator, which shall not exceed \$20 in any case; and on the approval of any organization certificate they shall also pay a fee of \$5. Not later than January 31 of each calendar year, each Federal credit union shall pay to the Administration, for the preceding calendar year, a supervision fee in accordance with a graduated scale prescribed by regulation on the basis of assets as of December 31 of such preceding year, but such fee shall in no event be less than \$10 nor more than the applicable amount specified in the following table:

Total assets	Maximum fee
\$500,000 or less	30 cents per \$1,000.
Over \$500,000 and not over \$1,000,000	\$150, plus 25 cents per \$1,000 in excess of \$500,000.
Over \$1,000,000 and not over \$2,000,000	\$275, plus 20 cents per \$1,000 in excess of \$1,000,000.
Over \$2,000,000 and not over \$5,000,000	\$475, plus 15 cents per \$1,000 in excess of \$2,000,000.
Over \$5,000,000	\$925, plus 10 cents per \$1,000 in excess of \$5,000,000.

All such fees shall be deposited with the Treasurer of the United States for the account of the Administration and may be expended by the Administrator for such administrative, supervisory, and other expenses incurred in carrying out the provisions of this chapter as he may determine to be proper, the purpose of such fees being to defray such expenses as far as practicable. No annual supervision fee shall be payable by the Federal credit union with respect to the year in which its charter is issued, or in which final distribution is made in its liquidation or the charter is otherwise canceled. (June 26, 1934, § 5, 48 Stat. 1217; June 29, 1948, § 2, 62 Stat. 1091; April 17, 1952, § 1, 66 Stat. 63; Sept. 22, 1959, § 5, 73 Stat. 629, Mar. 10, 1970, Pub.L. 91-206, 84 Stat. 49, Oct. 19, 1970, Pub.L. 91-468, 84 Stat. 1015).

§ 1756

Reports and examinations.—Federal credit unions shall be under the supervision of the Administrator, and shall make financial reports to him as and when he may require, but at least annually. Each Federal credit union shall be subject to examination by, and for this purpose shall make its books and records accessible to, any person designated by the Administrator. The Administrator shall fix a scale of examination fees to be paid by Federal credit unions, giving due consideration to the time and expense incident to such examinations, and to the ability of Federal credit unions to pay such fees, which fees shall be assessed against and paid by each Federal credit union promptly after the completion of such examination. Examination fees collected under the provisions of this section shall be deposited to the credit of the special fund created by section 105, and shall be available for the purposes specified in such section. (June 26, 1934, § 6, 48 Stat. 1218; Dec. 6, 1937, § 1, 51 Stat. 4; June 29, 1948, § 2, 62 Stat. 1091; Sept. 22, 1959, § 6, 73 Stat. 629, Mar. 10, 1970, Pub.L. 91-206, 84 Stat. 49, Oct. 19, 1970, Pub.L. 91-468, 84 Stat. 1015).

§ 1757

Powers.—A Federal credit union shall have succession in its corporate name during its existence and shall have power—

§ 106

- (1) to make contracts;
- (2) to sue and be sued;
- (3) to adopt and use a common seal and alter the same at pleasure;
- (4) to purchase, hold, and dispose of property necessary or incidental to its operations;
- (5) to make loans, the maturities of which shall not exceed twelve years except as otherwise provided herein, and extend lines of credit to its members, to other credit unions, and to credit union organizations and to participate with other credit unions, credit union organizations, or financial organizations in making loans to credit union members in accordance with the following:

(A) Loans to members shall be made in conformity with criteria established by the board of directors: *Provided, That*—

(i) a residential real estate loan which is made to finance the acquisition of a one-to-four-family dwelling for the principal residence of a credit union member, the sales price of which is not more than 150 per centum of the median sales price of residential real property situated in the geographical area (as determined by the board of directors) in which the property is located, and which is secured by a first lien upon such dwelling, may have a maturity not exceeding thirty years, subject to the rules and regulations of the Administrator;

(ii) a loan to finance the purchase of a mobile home, which shall be secured by a first lien on such mobile home, to be used by the credit union member as his residence, or for the repair, alteration, or improvement of a residential dwelling which is the residence of a credit union member shall have a maturity not to exceed fifteen years unless such loan is insured or guaranteed as provided in subparagraph (iii);

(iii) a loan secured by the insurance or guarantee of the Federal Government, of a State government, or any agency of either may be made for the maturity and under the terms and conditions specified in the law under which such insurance or guarantee is provided;

(iv) a loan or aggregate of loans to a director or member of the supervisory or credit committee of the credit union making

the loan which exceeds \$5,000 plus pledged shares, be approved by the board of directors;

(v) loans to other members for which directors or members of the supervisory or credit committee act as guarantor or endorser be approved by the board of directors when such loans standing alone or when added to any outstanding loan or loans of the guarantor or endorser exceeds \$5,000;

(vi) the rate of interest not exceed 1 per centum per month on the unpaid balance inclusive of all service charges;

(vii) the taking, receiving, reserving, or charging of a rate of interest greater than is allowed by this paragraph, when knowingly done, shall be deemed a forfeiture of the entire interest which the note, bill, or other evidence of debt carries with it, or which has been agreed to be paid thereon. If such greater rate of interest has been paid, the person by whom it has been paid, or his legal representatives, may recover back from the credit union taking or receiving the same, in an action in the nature of an action of debt, the entire amount of interest paid; but such action must be commenced within two years from the time the usurious collection was made;

(viii) a borrower may repay his loan, prior to maturity in whole or in part on any business day without penalty;

(ix) loans shall be paid or amortized in accordance with rules and regulations prescribed by the Administrator after taking into account the needs or conditions of the borrowers, the amounts and duration of the loans, the interests of the members and the credit unions, and such other factors as the Administrator deems relevant.

(B) A self-replenishing line of credit to a borrower may be established to a stated maximum amount on certain terms and conditions which may be different from the terms and conditions established for another borrower.

(C) Loans to other credit unions shall be approved by the board of directors.

(D) Loans to credit union organizations shall be approved by the board of directors and shall not exceed 1 per centum of the paid-in and unimpaired capital and surplus of the credit union. A credit union organization means any organization as determined

by the Administrator, which is established primarily to serve the needs of its member credit unions, and whose business relates to the daily operations of the credit unions they serve.

(E) Participation loans with other credit unions, credit union organizations, or financial organizations shall be in accordance with written policies of the board of directors: *Provided*. That a credit union which originates a loan for which participation arrangements are made in accordance with this subsection shall retain an interest of at least 10 per centum of the face amount of the loan.

(6) to receive from its members, from other credit unions, from an officer, employee, or agent of those nonmember units of Federal, State, or local governments and political subdivisions thereof enumerated in section 207 of this Act and in the manner so prescribed, and from nonmembers in the case of credit unions serving predominately low-income members (as defined by the Administrator) payments on shares which may be issued at varying dividend rates, and payments on share certificates which may be issued at varying dividend rates and maturities, subject to such terms, rates, and conditions as may be established by the board of directors, within limitations prescribed by the Administrator.

(7) To invest its funds (A) in loans exclusively to members; (B) in obligations of the United States of America, or securities fully guaranteed as to principal and interest thereby; (C) in accordance with rules and regulations prescribed by the Administrator, in loans to other credit unions in the total amount not exceeding 25 per centum of its paid-in and unimpaired capital and surplus; (D) in shares or accounts of savings and loan associations or mutual savings banks, the accounts of which are insured by the Federal Savings and Loan Insurance Corporation or the Federal Deposit Insurance Corporation; (E) in obligations issued by banks for cooperatives, Federal land banks, Federal intermediate credit banks, Federal home loan banks, the Federal Home Loan Bank Board, or any corporation designated in section 846 of Title 31 as a wholly owned Government corporation; or in obligations, participations, or other instruments of or issued

by, or fully guaranteed as to principal and interest by, the Federal National Mortgage Association or the Government National Mortgage Association; or in mortgages, obligations, or other securities which are or ever have been sold by the Federal Home Loan Mortgage Corporation pursuant to Section 305 or Section 306 of the Federal Home Loan Mortgage Corporation Act; or in obligations or other instruments or securities of the Student Loan Marketing Association; (F) in participation certificates evidencing beneficial interests in obligations, or in the right to receive interest and principal collections therefrom, which obligations have been subjected by one or more Government agencies to a trust or trusts for which any executive department, agency, or instrumentality of the United States (or the head thereof) has been named to act as trustee; (G) in shares or deposits of any central credit union in which such investments are specifically authorized by the board of directors of the Federal credit union making the investment; and (H) in shares, share certificates, or share deposits of federally insured credit unions; (I) in the shares, stocks, or obligations of any other organization, providing services which are associated with the routine operations of credit unions, up to 1 per centum of the total paid in and unimpaired capital and surplus of the credit union with the approval of the Administrator: *Provided, however,* That such authority does not include the power to acquire control directly or indirectly, of another financial institution, nor invest in shares, stocks or obligations of an insurance company, trade association, liquidity facility or any other similar organization, corporation, or association, except as otherwise expressly provided by this Act:

(8) to make deposits in national banks and in State banks, trust companies, and mutual savings banks operating in accordance with the laws of the State in which the Federal credit union does business, and for Federal credit unions or credit unions authorized by the Department of Defense operating suboffices on American military installations in foreign countries or trust territories of the United States to maintain demand deposit accounts in banks located in those countries or trust territories, subject to such

regulations as may be issued by the Administrator and provided such banks are correspondents of banks described in this paragraph;

(9) to borrow, in accordance with such rules and regulations as may be prescribed by the Administrator, from any source, in an aggregate amount not exceeding 50 per centum of its paid-in and unimpaired capital and surplus: *Provided,* That any Federal credit union may discount with or sell to any Federal intermediate credit bank any eligible obligations up to the amount of its paid-in and unimpaired capital;

(10) to levy late charges, in accordance with the bylaws, for failure of members to meet promptly their obligations to the Federal credit union;

(11) to impress and enforce a lien upon the shares and dividends of any member, to the extent of any loan made to him and any dues or charges payable by him;

(12) in accordance with rules and regulations prescribed by the Administrator, to sell to members negotiable checks (including travelers checks) and money orders, and to cash checks and money orders for members, for a fee which does not exceed the direct and indirect costs incident to providing such service;

(13) in accordance with rules and regulations prescribed by the Administrator, to purchase, sell, pledge, or discount or otherwise receive or dispose of, in whole or in part, any eligible obligations (as defined by the Administrator) of its members and to purchase from any liquidating credit union notes made by individual members of the liquidating credit union at such prices as may be agreed upon by the board of directors of the liquidating credit union and the board of directors of the purchasing credit union, but no purchase may be made under authority of this paragraph if, upon the making of that purchase, the aggregate of the unpaid balances of notes purchased under authority of this paragraph would exceed 5 per centum of the unimpaired capital and surplus of the credit union;

(14) to sell all or a part of its assets to another credit union, to purchase all or part of the assets of another credit union and to assume the liabilities of the selling credit

union and those of its members subject to regulations of the Administrator; and

(15) to exercise such incidental powers as shall be necessary or requisite to enable it to carry out effectively the business for which it is incorporated.

(June 26, 1934, § 7, 48 Stat. 1218; Dec. 6, 1937, § 2, 51 Stat. 4; July 31, 1946, § 1, 60 Stat. 744; June 29, 1948, § 2, 62 Stat. 1091; Oct. 25, 1949, § 1, 63 Stat. 890; May 13, 1952, 66 Stat. 70; Sept. 22, 1959, § 7, 73 Stat. 630; July 2, 1964, § 1, 78 Stat. 269; May 24, 1966, § 7, 80 Stat. 167; July 3, 1967, §§ 2, 3, 81 Stat. 110; July 5, 1968, § 1, 82 Stat. 284; Aug. 1, 1968, § 80, 82 Stat. 545; Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1017; June 23, 1971, Pub. L. 92-318, 86 Stat. 270; Aug. 22, 1974, Pub. L. 93-383, 88 Stat. 739; Oct. 29, 1974, Pub. L. 93-495, 88 Stat. 1500; Dec. 31, 1974, Pub. L. 93-569, 88 Stat. 1866; Apr. 19, 1977, Pub. L. 95-22, 91 Stat. 49).

§ 1758

§ 108

Bylaws.—In order to simplify the organization of Federal credit unions the Administrator shall from time to time cause to be prepared a form of organization certificate and a form of bylaws, consistent with this chapter, which shall be used by Federal credit union incorporators, and shall be supplied to them on request. At the time of presenting the organization certificate the incorporators shall also submit proposed bylaws to the Administrator for his approval. (June 26, 1934, § 8, 48 Stat. 1219; June 29, 1948, § 2, 62 Stat. 1091; Sept. 22, 1959, § 9, 73 Stat. 631; Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015).

§ 1759

§ 109

Membership.—Federal credit union membership shall consist of the incorporators and such other persons and incorporated and unincorporated organizations, to the extent permitted by rules and regulations prescribed by the Administrator, as may be elected to membership and as such shall each, subscribe to at least one share of its stock and pay the initial installment thereon and a uniform entrance fee if required by

the board of directors, except that Federal credit union membership shall be limited to groups having a common bond of occupation or association, or to groups within a well-defined neighborhood, community, or rural district. Shares may be issued in joint tenancy with right of survivorship with any persons designated by the credit union member, but no joint tenant shall be permitted to vote, obtain loans, or hold office, unless he is within the field of membership and is a qualified member. (June 26, 1934, § 9, 48 Stat. 1219; July 31, 1946, § 2, 60 Stat. 744; June 29, 1948, § 2, 62 Stat. 1091; Sept. 22, 1959, § 10, 73 Stat. 631; Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015; Aug. 22, 1974, Pub. L. 93-383, 88 Stat. 739).

§ 1760

§ 110

Members' meetings.—The fiscal year of all Federal credit unions shall end December 31. The annual meeting of each Federal credit union shall be held at such time during the following January, February, or March and at such place as its bylaws shall prescribe. Special meetings may be held in the manner indicated in the bylaws. No member shall be entitled to vote by proxy, but a member other than a natural person may vote through an agent designated for the purpose. Irrespective of the number of shares held by him, no member shall have more than one vote. (June 26, 1934, § 10, 48 Stat. 1219; Sept. 22, 1959, § 11, 73 Stat. 631; Oct. 17, 1963, § 1, 77 Stat. 270; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015).

§ 1761

§ 111

Management.—The business affairs of a Federal credit union shall be managed by a board of not less than five directors, and a credit committee of not less than three members, all to be elected at the annual members' meeting by and from the members, and by a supervisory committee of not less than three members nor more than five members, one of whom may be a director other than the treasurer, to be appointed by the board. Any vacancy occurring in the supervisory committee shall be filled in the same manner as original appointments to such committee. All members of the board

and of such committees shall hold office for such terms, respectively, as the bylaws may provide. A record of the names and addresses of the members of the board and such committees and of the officers of the credit union shall be filed with the Administration within ten days after their election or appointment. No member of the board or of either such committee shall, as such, be compensated: *Provided, however,* That reasonable health, accident, and similar insurance protection shall not be considered compensation under regulations promulgated by the Administrator. (June 26, 1934, § 11, 48 Stat. 1219; June 29, 1948, § 2, 62 Stat. 1091; Sept. 22, 1959, § 12, 73 Stat. 632; July 2, 1964, § 2, 78 Stat. 269; Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015; Oct. 29, 1974, Pub. L. 93-495, 88 Stat. 1500).

§ 1761a

§ 112

Officers.—At their first meeting after the annual meeting of the members, the directors shall elect from their number a president, one or more vice presidents, a secretary, and a treasurer, who shall be the executive officers of the corporation. No executive officer, except the treasurer, shall be compensated as such. The offices of secretary and treasurer may be held by the same person. The duties of the officers shall be as determined by the bylaws. Before the treasurer shall enter upon his duties he shall give bond with good and sufficient surety, in an amount and character to be determined by the board of directors in compliance with regulations prescribed from time to time by the Administrator, conditioned upon the faithful performance of his trust. (June 26, 1934, § 11, 48 Stat. 1219; June 29, 1948, § 2, 62 Stat. 1091; Aug. 24, 1954, § 1, 68 Stat. 792; Sept. 22, 1959, § 13, 73 Stat. 632; Oct. 17, 1963, § 2, 77 Stat. 270; Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015).

§ 1761b

§ 113

Directors.—The board of directors shall meet at least once a month and shall have the general direction and control of the affairs of the corporation. Minutes of all such meetings shall be kept. Among other things they shall act upon applications for member-

ship; require any officer or employee having custody of or handling funds to give bond with good and sufficient surety in an amount and character to be determined by the board of directors in compliance with regulations prescribed from time to time by the Administrator, and authorize the payment of the premium or premiums therefor from the funds of the Federal credit union; fill vacancies in the board and in the credit committee until successors elected at the next annual meeting have qualified; have charge of investments other than loans to members, except that the board may designate a committee of not less than two to act as an investment committee, such investment committee to have charge of making investments under rules and procedures established by the board of directors; determine from time to time the maximum number of shares and share certificates and the classes of shares and share certificates that may be held; subject to the limitations of this chapter, determine the interest rates on loans, the security, and the maximum amount which may be loaned or provided in lines of credit; subject to such regulations as may be issued by the Administrator, authorize an interest refund to members of record at the close of business on the last day of any dividend period in proportion to the interest paid by them during the dividend period; and provide for compensation of necessary clerical and auditing assistance requested by the supervisory committee, and of loan officers appointed by the credit committee. The board may appoint an executive committee of not less than three directors to exercise such authority as may be delegated to it subject to such conditions and limitations as may be prescribed by the board. Such executive committee or one or more membership officers appointed by the board from among the members of the credit union, other than the treasurer, an assistant treasurer, or a loan officer, may be authorized by the board to approve applications for membership under such conditions as the board may prescribe; except that such committee or membership officer so authorized shall submit to the board at each monthly meeting a list of approved or pending applications for membership received since the previous monthly

meeting, together with such other related information as the bylaws or the board may require. If a membership application is denied, the reasons therefor shall be furnished in writing to the person whose application is denied, upon written request. (June 26, 1934, § 11, 48 Stat. 1219; July 31, 1946, § 3, 60 Stat. 745; June 29, 1948; § 2, 62 Stat. 1091; June 30, 1954; § 1, 68 Stat. 335; Aug. 24, 1954, § 2, 68 Stat. 792; Sept. 22, 1959, § 14, 73 Stat. 632; July 2, 1964, § 3, 78 Stat. 269; July 5, 1968, § 1, 82 Stat. 284; Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015; Aug. 22, 1974, Pub. L. 93-383, 88 Stat. 739; Apr. 19, 1977, Pub. L. 95-22, 91 Stat. 49).

§ 1761c

Credit Committee.—The credit committee shall hold such meetings as the business of the Federal credit union may require and not less frequently than once a month to consider applications for loans and lines of credit. Reasonable notice of such meetings shall be given to all members of the committee. Except for those loans or lines of credit required to be approved by the board of directors in section 107(5) of this Act, approval of an application shall be by a majority of the entire committee and by all members of the committee who are present at the meeting at which the application is considered; except that the credit committee may appoint one or more loan officers, and delegate to him or them the power to approve loans and lines of credit. Each loan officer shall furnish to the credit committee a record of each application approved or not approved by him within seven days of the date of the filing of the application therefor. All applications not approved by a loan officer shall be acted upon by the credit committee. No individual shall have authority to disburse funds of the Federal credit union with respect to any loan or line of credit for which the application has been approved by him in his capacity as a loan officer. Not more than one member of the credit committee may be appointed as a loan officer. Applications for loans and lines of credit shall be made on forms prepared by such

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committee, which shall set forth the security, if any, and such other data as may be required. No loan may be made to any member if, upon the making of that loan, the member would be indebted to the Federal credit union upon loans made to him in an aggregate amount which would exceed 10 per centum of the credit union's unimpaired capital and surplus. For the purposes of this section an assignment of shares or the endorsement of a note shall be deemed security and, subject to such regulations as the Administrator may prescribe, insurance obtained under Title 1 of the National Housing Act shall be deemed adequate security. (June 26, 1934, § 11, 48 Stat. 1219; June 15, 1940, 54 Stat. 398; July 31, 1946, §§ 4, 5, 60 Stat. 745; Oct. 25, 1949, § 2, 63 Stat. 890; Sept. 22, 1959, § 15, 73 Stat. 633; July 2, 1964, § 4, 78 Stat. 269; Dec. 13, 1967, § 1, 81 Stat. 567; July 5, 1968, § 1, 82 Stat. 284; Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015; Apr. 19, 1977, Pub. L. 95-22, 91 Stat. 49).

§ 1761d

Supervisory committee.—The supervisory committee shall make or cause to be made an annual audit and shall submit a report of that audit to the board of directors and a summary of the report to the members at the next annual meeting of the credit union; shall make or cause to be made such supplementary audits as it deems necessary or as may be ordered by the Administrator, and submit reports of the supplementary audits to the board of directors; may by a unanimous vote suspend any officer of the credit union or any member of the credit committee or of the board of directors, until the next members' meeting, which shall be held not less than seven nor more than fourteen days after any such suspension, at which meeting any such suspension shall be acted upon by the members; and may call by a majority vote a special meeting of the members to consider any violation of this chapter, the charter, or the bylaws, or any practice of the credit union deemed by the supervisory committee to be unsafe or unauthorized. Any member of the supervisory committee may be suspended by a majority vote of the board of directors. The members

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shall decide, at a meeting held not less than seven nor more than fourteen days after any such suspension, whether the suspended committee member shall be removed from or restored to the supervisory committee. The supervisory committee shall cause the passbooks and accounts of the members to be verified with the records of the treasurer from time to time, and not less frequently than once every two years. As used in this section, the term "passbook" shall include any book, statement of account, or other record approved by the Administrator for use by Federal credit unions. (June 26, 1934, § 11, 48 Stat. 1219; July 31, 1946, §§ 3-6, 60 Stat. 745; June 29, 1948, § 2, 62 Stat. 1091; Sept. 22, 1959, § 16, 73 Stat. 633; July 5, 1968, § 1, 82 Stat. 284; Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015; Aug. 22, 1974, Pub. L. 93-383, 88 Stat. 739).

§ 1762

§ 116

Reserves.—(a) At the end of each accounting period the gross income shall be determined. From this amount, there shall be set aside, as a regular reserve against losses on loans and against such other losses as may be specified in regulations prescribed under this Act, sums in accordance with the following schedule:

(1) A credit union in operation for more than four years and having assets of \$500,000 or more shall set aside (A) 10 per centum of gross income until the regular reserve shall equal 4 per centum of the total of outstanding loans and risk assets, then (B) 5 per centum of gross income until the regular reserve shall equal 6 per centum of the total of outstanding loans and risk assets.

(2) A credit union in operation less than four years or having assets of less than \$500,000 shall set aside (A) 10 per centum of gross income until the regular reserve shall equal 7½ per centum of the total of outstanding loans and risk assets, then (B) 5 per centum of gross income until the regular reserve shall equal 10 per centum of the total of outstanding loans and risk assets.

(3) Whenever the regular reserve falls below the stated per centum of the total of outstanding loans and risk assets, it shall

be replenished by regular contributions in such amounts as may be needed to maintain the stated reserve goals.

(b) The Administrator may decrease the reserve requirement set forth in subsection (a) of this section when in his opinion such a decrease is necessary or desirable. The Administrator may also require special reserves to protect the interests of members either by regulation or for an individual credit union in any special case.

(As amended Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1017; Apr. 19, 1977, Pub. L. 95-22, 91 Stat. 49).

§ 1763

§ 117

Dividends.—At such intervals as the board of directors may authorize, and after provision for required reserves, the board may declare, pursuant to such regulations as may be issued by the Administrator, a dividend to be paid at different rates on different types of shares and at different rates and maturity dates in the case of share certificates. Dividend credit may be accrued on various types of shares and share certificates as authorized by the board of directors. (June 26, 1934, § 13, 48 Stat. 1221; Sept. 22, 1959, § 18, 73 Stat. 634; Dec. 13, 1967, § 2, 81 Stat. 567; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015; Aug. 22, 1974, Pub. L. 93-383, 88 Stat. 739; Apr. 19, 1977, Pub. L. 95-22, 91 Stat. 49).

§ 1764

§ 118

Expulsion and withdrawal.—A member may be expelled by a two-thirds vote of the members of a Federal credit union present at a special meeting called for the purpose, but only after an opportunity has been given him to be heard. Withdrawal or expulsion of a member shall not operate to relieve him from liability to the Federal credit union. The amount to be paid a withdrawing or expelled member by a Federal credit union shall be determined and paid in the manner specified in the bylaws. (June 26, 1934, § 14, 48 Stat. 1221; Sept. 22, 1959, § 19, 73 Stat. 634; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015).

§ 1765

Minors.—Shares may be issued in the name of a minor or in trust, subject to such conditions as may be prescribed by the by-laws. When shares are issued in trust, the name of the beneficiary shall be disclosed to the Federal credit union. (June 26, 1934, § 15, 48 Stat. 1221; Sept. 22, 1959, § 20, 73 Stat. 634, Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015).

§ 1766

Certain powers of the Administrator.—

(a) The Administrator may prescribe rules and regulations for the administration of this chapter (including, but not by way of limitation, the merger, consolidation, and dissolution of corporations organized under this chapter).

(b) (1) The Administrator may suspend or revoke the charter of any Federal credit union, or place the same in involuntary liquidation and appoint a liquidating agent therefor, upon his finding that the organization is bankrupt or insolvent, or has violated any of the provisions of its charter, its bylaws, this chapter, or any regulations issued thereunder.

(2) The Administrator, through such persons as he shall designate, may examine any Federal credit union in voluntary liquidation and, upon his finding that such voluntary liquidation is not being conducted in an orderly or efficient manner or in the best interests of its members, may terminate such voluntary liquidation and place such organization in involuntary liquidation and appoint a liquidating agent therefore.

(3) Such liquidating agent shall have power and authority, subject to the control and supervision of the Administrator and under such rules and regulations as the Administrator may prescribe, (A) to receive and take possession of the books, records, assets, and property of every description of the Federal credit union in liquidation, to sell, enforce collection of, and liquidate all such assets and property, to compound all bad or doubtful debts, and to sue in his own name or in the name of the Federal credit union in liquidation, and defend such actions as may be brought against him as liquidating agent or against the Federal credit union; (E) to receive, examine, and pass

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upon all claims against the Federal credit union in liquidation, including claims of members on member accounts; (C) to make distribution and payments to creditors and members as their interests may appear; and (D) to execute such documents and papers and to do such other acts and things which he may deem necessary or desirable to discharge his duties hereunder.

(4) Subject to the control and supervision of the Administrator and under such rules and regulations as the Administrator may prescribe, the liquidating agent of a Federal credit union in involuntary liquidation shall (A) cause notice to be given to creditors and members to present their claims and make legal proof thereof, which notice shall be published once a week in each of three successive weeks in a newspaper of general circulation in each county in which the Federal credit union in liquidation maintained an office or branch for the transaction of business on the date it ceased unrestricted operations; except that whenever the aggregate book value of the assets and property of a Federal credit union in involuntary liquidation is less than \$1,000, unless the Administrator shall find that its books and records do not contain a true and accurate record of its liabilities, he shall declare such Federal credit union in liquidation to be a "no publication" liquidation, and publication of notice to creditors and members shall not be required in such case; (B) from time to time make a ratable dividend on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction and, after the assets of such organization have been liquidated, make further dividends on all claims previously proved or adjudicated, and he may accept in lieu of a formal proof of claim on behalf of any creditor or member the statement of any amount due to such creditor or member as shown on the books and records of the credit union; but all claims not filed before payment of the final dividend shall be barred and claims rejected or disallowed by the liquidating agent shall be likewise barred unless suit be instituted thereon within three months after notice of rejection or disallowance; and (C) in a "no publication" liquidation, determine from all sources available to him, and within the limits of available funds of the Federal

credit union, the amounts due to creditors and members, and after sixty days shall have elapsed from the date of his appointment distribute the funds of the Federal credit union to creditors and members ratably and as their interests may appear.

(5) Upon certification by the liquidating agent in the case of an involuntary liquidation, and upon such proof as shall be satisfactory to the Administrator in the case of a voluntary liquidation, that distribution has been made and that liquidation has been completed, as provided herein, the Administrator shall cancel the charter of such Federal credit union; but the corporate existence of the Federal credit union shall continue for a period of three years from the date of such cancellation of its charter, during which period the liquidating agent, or his duly appointed successor, or such persons as the Administrator shall designate, may act on behalf of the Federal credit union for the purpose of paying, satisfying, and discharging any existing liabilities or obligations, collecting and distributing its assets, and doing all other acts required to adjust and wind up its business and affairs, and it may sue and be sued in its corporate name.

(c) After the expiration of five years from the date of cancellation of the charter of a Federal credit union the Administrator may, in his discretion, destroy any or all books and records of such Federal credit union in his possession or under his control.

(d) The Administrator is authorized and empowered to execute any and all functions and perform any and all duties vested in him hereby, through such persons as he shall designate or employ; and he may delegate to any person or persons, including any institution operating under the general supervision of the Administration, the performance and discharge of any authority, power, or function vested in him by this chapter.

(e) All books and records of Federal credit unions shall be kept and reports shall be made in accordance with forms approved by the Administrator.

(f) (1) The Administrator is authorized to make investigations and to conduct re-

searches and studies of the problems of persons of small means in obtaining credit at reasonable rates of interest, and of the methods and benefits of cooperative saving and lending among such persons. He is further authorized to make reports of such investigations and to publish and disseminate the same.

(2) (A) The Administrator is authorized to conduct directly, or to make grants to or contracts with colleges or universities, State or local educational agencies, or other appropriate public or private nonprofit organizations to conduct, programs for the training of persons engaged, or preparing to engage, in the operation of credit unions, and in related consumer counseling programs, serving the poor. He is authorized to establish a program of experimental, developmental, demonstration, and pilot projects, either directly or by grants to public or private nonprofit organizations, including credit unions, or by contracts with such organizations or other private organizations, designed to promote more effective operation of credit unions, and related consumer counseling programs, serving the poor.

(B) In carrying out his authority under this paragraph, the Administrator shall consult with officials of the Office of Economic Opportunity and other appropriate Federal agencies responsible for the administration of projects or programs concerned with problems of the poor. The development and operation of programs and projects under this paragraph shall involve maximum feasible participation of residents of the areas and members of the groups served by such programs and projects, with community action agencies established under the provisions of the Economic Opportunity Act of 1964 serving, to the extent feasible, as the means through which such participation is achieved.

(C) In order to carry out the purposes of this paragraph, there is authorized to be appropriated, as a supplement to any funds that may be expended by the Administrator pursuant to section 105 and 106 for such purposes, not to exceed \$300,000 for the fiscal year ending June 30, 1970, and not to exceed \$1,000,000 for the fiscal year ending June 30, 1971.

(g) Any officer or employee of the Administration is authorized, when designated for the purpose by the Administrator, to administer oaths and affirmations and to take affidavits and depositions touching upon any matter within the jurisdiction of the Administration.

(h) The Administrator is authorized, empowered, and directed to require that every person appointed or elected by any Federal credit union to any position requiring the receipt, payment, or custody of money or other personal property owned by a Federal credit union, or in its custody or control as collateral or otherwise, give bond in a corporate surety company holding a certificate of authority from the Secretary of the Treasury under the Act approved July 30, 1947 (6 U.S.C. secs. 6-13), as an acceptable surety on Federal bonds. Any such bond or bonds shall be in form approved by the Administrator with a view to providing surety coverage to the Federal credit union with reference to loss by reason of acts of fraud or dishonesty including forgery, theft, embezzlement, wrongful abstraction, or misapplication on the part of the person, directly or through connivance with others, and such other surety coverages as the Administrator may determine to be reasonably appropriate or as elsewhere required by this chapter. Any such bond or bonds shall be in such an amount in relation to the money or other personal property involved or in relation to the assets of the Federal credit union as the Administrator may from time to time prescribe by regulation for the purpose of requiring reasonable coverage. In lieu of individual bonds the Administrator may approve the use of a form of schedule or blanket bond which covers all of the officers and employees of a Federal credit union whose duties include the receipt, payment, or custody of money or other personal property for or on behalf of the Federal credit union. The Administrator may also approve the use of a form of coverage bond whereby a Federal credit union may obtain an amount of coverage in excess of the basic surety coverage.

(i) In addition to the authority conferred upon him by other sections of this Act, the Administrator is authorized in carrying out his functions under this Act—

(1) to appoint such personnel as may be necessary to enable the Administration to carry out its functions;

(2) to expend such funds, enter into such contracts with public and private organizations and persons, make such payments in advance or by way of reimbursement, and perform such other functions or acts as he may deem necessary or appropriate to carry out the provisions of this Act; and

(3) to pay stipends, including allowances for travel to and from the place of residence, to any individual to study in a program assisted under this Act upon a determination by the Administrator that assistance to such individual in such studies will be in furtherance of the purposes of this Act.

(June 26, 1934, § 16, 48 Stat. 1221; Dec. 6, 1937, § 3, 51 Stat. 4; July 31, 1946, § 8, 60 Stat. 745; June 29, 1948, § 2, 62 Stat. 1091; June 30, 1954, § 2, 68 Stat. 336; Aug. 24, 1954, § 3, 68 Stat. 792; Sept. 22, 1959, § 21, 73 Stat. 635; July 5, 1968, § 2, 82 Stat. 285; Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015; Apr. 19, 1977, Pub. L. 95-22, 91 Stat. 49).

§ 1767

§ 121

Fiscal agents and depositories.—Each Federal credit union organized under this chapter, when requested by the Secretary of the Treasury, shall act as fiscal agent of the United States and shall perform such services as the Secretary of the Treasury may require in connection with the collection of taxes and other obligations due the United States and the lending, borrowing, and repayment of money by the United States, including the issue, sale, redemption, or repurchase of bonds, notes, Treasury certificates of indebtedness, or other obligations of the United States; and to facilitate such purposes the Administrator shall furnish to the Secretary of the Treasury from time to time the names and addresses of all Federal credit unions with such other available information concerning them as may be requested by the Secretary of the Treasury. Any Federal credit union organized under this chapter, when designated for that purpose by the Secretary of the Treasury, shall

be a depository of public money, except receipts from customs, under such regulations as may be prescribed by the Secretary of the Treasury. (June 26, 1934, § 17, 48 Stat. 1222; June 29, 1948, § 62 Stat. 1091; Sept. 22, 1959, § 22, 73 Stat. 637; Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015).

§ 1768

Taxation.—The Federal credit unions organized hereunder, their property, their franchises, capital, reserves, surpluses, and other funds, and their income shall be exempt from all taxation now or hereafter imposed by the United States or by any State, Territorial, or local taxing authority; except that any real property and any tangible personal property of such Federal credit unions shall be subject to Federal, State, Territorial, and local taxation to the same extent as other similar property is taxed. Nothing herein contained shall prevent holdings in any Federal credit union organized hereunder from being included in the valuation of the personal property of the owners or holders thereof in assessing taxes imposed by authority of the State or political subdivision thereof in which the Federal credit union is located; but the duty or burden of collecting or enforcing the payment of such a tax shall not be imposed upon any such Federal credit union and the tax shall not exceed the rate of taxes imposed upon holdings in domestic credit unions. (June 26, 1934, § 18, 48 Stat. 1222; Dec. 6, 1937, § 4, 51 Stat. 4; Sept. 22, 1959, § 23, 73 Stat. 637; Oct. 14, 1970, Pub. L. 91-468, 84 Stat. 1015).

§ 1769

Partial invalidity; right to amend.—(a) If any provision of this chapter or the application thereof to any person or circumstance, is held invalid, the remainder of the chapter, and the application of such provision to other persons or circumstances, shall not be affected thereby.

(b) The right to alter, amend, or repeal this chapter or any part thereof, or any charter issued pursuant to the provisions of this chapter, is expressly reserved. (June 26, 1934, § 20, 48 Stat. 1222; Sept. 22, 1959, §

24, 73 Stat. 637; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015).

§ 1770

Space in Federal Buildings.—Upon application by any credit union organized under State law or by any Federal credit union organized in accordance with the term of this chapter, at least 95 per centum of the membership of which is composed of persons who either are presently Federal employees or were Federal employees at the time of admission into the credit union, and members of their families, which application shall be addressed to the officer or agency of the United States charged with the allotment of space in the Federal buildings in the community or district in which such credit union does business, such officer or agency may in his or its discretion allot space to such credit union if space is available, without charge for rent or services. (June 26, 1934, § 21, added July 9, 1937, 50 Stat. 487; Sept. 22, 1959, § 25, 73 Stat. 638; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015).

§ 1771

Conversion from Federal to State credit union and from State to Federal credit union.—(a) A Federal credit union may be converted into a State credit union under the laws of any State, the District of Columbia, the several Territories and possessions of the United States, the Panama Canal Zone, or the Commonwealth of Puerto Rico, by complying with the following requirements:

(1) The proposition for such conversion shall first be approved, and a date set for a vote thereon by the members (either at a meeting to be held on such date or by written ballot to be filed on or before such date), by a majority of the directors of the Federal credit union. Written notice of the proposition and of the date set for the vote shall then be delivered in person to each member, or mailed to each member at the address for such member appearing on the records of the credit union, not more than thirty nor less than seven days prior to such date. Approval of the proposition for conversion shall be by the affirmative vote of a majority of the members, in person or in writing.

§ 124

§ 125

§ 122

§ 123

(2) A statement of the results of the vote, verified by the affidavits of the president or vice president and the secretary, shall be filed with the Administration within ten days after the vote is taken.

(3) Promptly after the vote is taken and in no event later than ninety days thereafter, if the proposition for conversion was approved by such vote, the credit union shall take such action as may be necessary under the applicable State law to make it a State credit union, and within ten days after receipt of the State credit union charter there shall be filed with the Administration a copy of the charter thus issued. Upon such filing the credit union shall cease to be a Federal credit union.

(4) Upon ceasing to be a Federal credit union, such credit union shall no longer be subject to any of the provisions of this chapter. The successor State credit union shall be vested with all of the assets and shall continue responsible for all of the obligations of the Federal credit union to the same extent as though the conversion had not taken place.

(b) (1) A State credit union, organized under the laws of any State, the District of Columbia, the several Territories and possessions of the United States, the Panama Canal Zone, or the Commonwealth of Puerto Rico, may be converted into a Federal credit union by (A) complying with all State requirements requisite to enabling it to convert to a Federal credit union or to cease being a State credit union, (B) filing with the Administration proof of such compliance, satisfactory to the Administrator, and (C) filing with the Administration an organization certificate as required by this chapter.

(2) When the Administrator has been satisfied that all of such requirements, and all other requirements of this chapter, have been complied with the Administrator shall approve the organization certificate. Upon such approval, the State credit union shall become a Federal credit union as of the date it ceases to be a State credit union. The Federal credit union shall be vested with all of the assets and shall continue responsible for all of the obligations of the State credit

union to the same extent as though the conversion had not taken place. (Added Sept. 22, 1959, § 26, 73 Stat. 638; Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015).

§ 1772

Territorial application of chapter.—The provisions of this chapter shall apply to the several States, the District of Columbia, the several Territories, including the trust territories, and possessions of the United States, the Panama Canal Zone, and the Commonwealth of Puerto Rico. (June 26, 1934, § 22, added July 31, 1946, § 7, 60 Stat. 745; May 8, 1952, 66 Stat. 55; Sept. 22, 1959, § 27, 73 Stat. 639; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015; Aug. 22, 1974, Pub. L. 93-383, 88 Stat. 739).

§ 1772a

Gifts.—The Administrator is authorized to accept gifts of money made unconditionally by will or otherwise for the carrying out of any of the functions under this chapter. A conditional gift of money made by will or otherwise for such purposes may be accepted and used in accordance with its conditions, but no such gift shall be accepted which is conditioned upon any expenditure not to be met therefrom or from income thereof unless the Administrator determines that supplementation of such gift from the fees he may expend pursuant to sections 1755 and 1756 of this title or from any funds appropriated pursuant to section 1756(f)(2)(C) of this title for the purpose of making such expenditure will not adversely affect the sound administration of this chapter. Any such gift shall be deposited in the Treasury of the United States for the account of the Administration and may be expended in accordance with section 105 or as provided in the preceding sentence. (July 5, 1968, § 3, 82 Stat. 285; Nov. 10, 1970, Pub. L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015).

§ 126

§ 127

§ 1773

District of Columbia credit unions; conversion to Federal status.—Any credit union organized under the District of Columbia Credit Unions Act, as amended, may apply for conversion into a Federal credit union by filing with the Administrator of the National Credit Union Administration (hereinafter referred to as the Administrator), pursuant to a resolution adopted by a majority of its directors, an organization certificate meeting the requirements of section 1753 of this title. (Pub. L. 88-395, § 1, Aug. 1, 1964, 78 Stat. 377; Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 48).

§ 1774

Approval of certificate; assets and obligations of applicant credit union.—The Administrator shall approve any such organization certificate meeting such requirements. Upon such approval, the applicant credit union shall become a Federal credit union, and shall be vested with all of the assets and shall continue responsible for all of the obligations of such applicant credit union to the same extent as though the conversion had not taken place. (Pub. L. 88-395, § 2, Aug. 1, 1964, 78 Stat. 377; Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49).

§ 1775

Conditions upon conversion to Federal status.—Any District of Columbia credit union

converting into a Federal credit union in accordance with section 1773-1775 of this title shall thereupon be subject to the limitations, vested with the powers, and charged with the liabilities conferred and imposed by this chapter upon credit unions organized thereunder, except that—

(1) no fee shall be imposed upon a credit union converting pursuant to sections 1773-1775 of this title as an incident to its conversion;

(2) any loan or investment made by a credit union converting pursuant to sections 1773-1775 of this title in conformity with the District of Columbia Credit Unions Act prior to its conversion, which does not conform to the requirements of this chapter and is still outstanding at the time of conversion, shall be liquidated at or before its maturity or, if it has no maturity date, in a prudent manner and within a reasonable period of time;

(3) a credit union converting pursuant to sections 1773-1775 of this title shall submit proposed bylaws to the Administrator for his approval after its conversion, but not later than thirty days following its next annual meeting or six months after August 1, 1964, whichever is later: Provided, that any existing bylaw inconsistent with any other requirements of this chapter shall be deemed null and void.

(Pub. L. 88-395, § 3, Aug. 1, 1964, 78 Stat. 377; Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49).

BYLAWS

Federal Credit Union, Charter No. _____

(A corporation chartered under the laws of the United States)

Article I. Name—Purposes

SECTION 1. The name of this credit union is as stated in section 1 of the charter (approved organization certificate) of this credit union.

SEC. 2. The purpose of this credit union is to promote thrift among its members by affording them an opportunity to accumulate their savings, and to create for them a source of credit for provident or productive purposes.

Article II. Qualifications for Membership

SECTION 1. The field of membership of this credit union is limited to that stated in section 5 of its charter.

SEC. 2. Applications for membership from persons eligible to membership under section 5 of the charter shall be signed by the applicant on forms approved by the board. Upon approval of such an application by a majority of the directors or a majority of the members of a duly authorized executive committee or by a membership officer and upon his subscription to at least one share of this credit union and the payment of the initial installment thereon, and the payment of any uniform required entrance fee, the applicant is admitted to membership. The board may by resolution reduce the required entrance fee for members under 16 years of age.

SEC. 3. A number shall be assigned to each member as a means of identifying his account with the credit union.

SEC. 4. A member who withdraws all of his shareholdings thereby ceases to be a member. The board may by resolution require persons readmitted to membership to pay another entrance fee.

SEC. 5. The membership of members who are no longer within the field of membership on the day this bylaw is effective or thereafter, is terminated immediately: *Provided, however,* That the board may resolve that such members may retain membership if they meet certain reasonable minimum standards established by the board.

Article III. Shares of Members

SECTION 1. The par value of each share shall be \$5. Subscriptions to shares are payable at the time of subscription, or in installments of at least 25 cents per month.

SEC. 2. The maximum amount of shares which may be held by any one member shall be established from time to time by resolution of the board.

SEC. 3. The shareholdings of a member who fails to complete payment of one share within 2 years of his admission to membership, or of a member who reduces his share balance below \$5 and does not increase the balance to at least \$5 within 2 years of the reduction, may be absorbed by a late charge upon authorization of the board.

SEC. 4. Shares may be transferred only from one member to another, by written instrument

in such form as the board may prescribe. Such transfer shall carry dividend credits with it. The board may require payment of a fee not to exceed \$1 for each such transfer and, if so required, such fee shall apply to all transfers.

SEC. 5. Money paid in on shares or installments of shares may be withdrawn as provided in these bylaws on any day when payment on shares may be made: *Provided, however, That—*

(a) The board shall have the right, at any time, to require members to give, in writing, not more than 60 days notice of intention to withdraw the whole or any part of the amounts so paid in by them.

(b) The board may determine that if shares are paid in under an accumulated payroll deduction plan, as prescribed in the *Accounting Manual for Federal Credit Unions*, they may not be withdrawn until credited to members' accounts.

(c) No member may withdraw shareholdings that are pledged as required security on loans without the written approval of the credit committee or a loan officer, except to the extent that such shares exceed the member's total primary and contingent liability to the credit union.

(d) No member may withdraw any shareholdings below the amount of his primary or contingent liability to the credit union if he is delinquent as a borrower, or if borrowers for whom he is comaker, endorser, or guarantor are delinquent, without the written approval of the credit committee or a loan officer.

(e) The share account of a person whose membership is terminated in accordance with article II, section 5, of these bylaws and the share account of a deceased member (other than one held in joint tenancy with another member) may be continued until the close of the dividend period in which the membership terminated, after which it shall be transferred to an account payable: *Provided, however, That* the shares may not be withdrawn or transferred below that person's primary or contingent liability to the credit union without the approval of the credit committee or a loan officer. Such shares may be retained as such until the close of the dividend

period in which the member's liability to the credit union is liquidated.

"Required security," as used in this section, refers to shares which are in existence at the time the loan is made and specifically required to be pledged as security as part of a secured loan transaction.

Article IV. Receipting for Money— Passbooks

SECTION 1. Money paid in or paid out on account of shares, loans, interest, entrance and transfer fees, or late charges shall be evidenced by an appropriate voucher or receipt or by entries in a member's passbook which shall also identify the person acting on behalf of this credit union. The member's official permanent record for all transactions shall be the entries in the passbook or a statement of account when such a plan is used as prescribed in the *Accounting Manual for Federal Credit Unions*.

SEC. 2. If a passbook is lost or stolen, immediate notice of such fact shall be given to the treasurer, and written application shall be made for the payment of the amount due the member as represented by said passbook or for the issuance of a duplicate passbook. The board may require the filing of an adequate bond to indemnify this credit union against any loss or losses resulting from the issuance of such duplicate passbook. The board may also require payment to this credit union of a reasonable charge to cover the cost of issuing a duplicate passbook.

Article V. Meetings of Members

SECTION 1. The annual meeting of the members shall be held within the period authorized in the Act, in the county in which the office of the credit union is located or within a radius of 100 miles of such office, at such time and place as the board shall determine and announce in the notice thereof.

SEC. 2. At least 7 days before the date of any annual or special meeting of the members, the secretary shall cause written notice thereof to

be handed to each member in person, or mailed to each member at his address as the same appears on the records of this credit union; except that if the annual meeting is to be held during the same month as that of the previous annual meeting and if this credit union maintains an office that is readily accessible to members and wherein regular business hours are maintained, and the board so determines, notice of the annual meeting may be given by posting the notice thereof, in a conspicuous place in the office of this credit union where it may be read by the members, at least 14 days prior to such meeting. Any meeting of the members, whether annual or special, may be held without prior notice, at any place or time, if all the members entitled to vote thereat who are not present at such meeting shall in writing waive notice thereof, before, during, or after the meeting.

Notice of any special meeting shall state the purpose for which it is to be held, and no business other than that related to this purpose shall be transacted at the meeting.

SEC. 3. Special meetings of the members may be called by the president or by the supervisory committee as provided in these bylaws, and may be held at any location permitted for the annual meeting. A special meeting shall be called by the president within 30 days of the receipt of a written request of 25 members or 5 percent of the members as of the date of the request, whichever number is larger: *Provided, however,* That a request of no more than 200 members shall be required for such meeting. The notice of such special meeting shall be given as provided in section 2 of this article.

SEC. 4. The order of business at annual meetings of members shall be—

- (a) Ascertainment that a quorum is present.
- (b) Reading and approval (or correction) of the minutes of the last meeting.
- (c) Report of directors.
- (d) Report of the treasurer or the manager.
- (e) Report of the credit committee.
- (f) Report of the supervisory committee.
- (g) Unfinished business.
- (h) New business other than elections.

(i) Elections.

(j) Adjournment.

The members assembled at any annual meeting may suspend the above order of business upon a two-thirds vote of the members present at the meeting.

SEC. 5. Except as hereinafter provided, at annual or special meetings, 15 members shall constitute a quorum. If no quorum is present, an adjournment may be taken to a date not fewer than 7 nor more than 14 days thereafter; and the members present at any such adjourned meeting shall constitute a quorum, regardless of the number of members present. The same notice shall be given for the adjourned meeting as is prescribed in section 2 of this article for the original meeting, except that such notice shall be given not fewer than 5 days previous to the date of the meeting as fixed in the adjournment.

Article VI. Elections

SECTION 1. At least 30 days prior to each annual meeting, the president shall appoint a nominating committee of not fewer than 3 members. It shall be the duty of the nominating committee to nominate at least one member for each vacancy, including any unexpired term vacancy, for which elections are being held.

SEC. 2. After the nominations of the nominating committee have been placed before the members, the president shall call for nominations from the floor. When nominations are closed, tellers shall be appointed by the president, ballots shall be distributed, the vote shall be taken and tallied by the tellers, and the results announced. All elections shall be determined by plurality vote, and shall be by ballot except where there is only one nominee for the office.

SEC. 3. Nominations shall be in the following order:

- (a) Nominations for directors.
- (b) Nominations for credit committee members.

Elections may be by separate ballots following the same order as the above nominations or, if preferred, may be by one ballot for all offices.

SEC. 4. No member shall be entitled to vote by proxy, but a member other than a natural person may vote through an agent designated in writing for the purpose. A trustee, or other person acting in a representative capacity, shall not, as such, be entitled to vote.

SEC. 5. Irrespective of the number of shares held by him, no member shall have more than one vote.

SEC. 6. The names and addresses of members of the board, executive officers, executive committee, and members of the credit and supervisory committees shall be forwarded to the Administration in accordance with the Act and regulations in such manner as may be required by said Administration.

SEC. 7. The board may establish by resolution a minimum age, not greater than 16 years of age, as a qualification for eligibility to vote at meetings of the members, or to hold elective or appointive office, or both.

Article VII. Board of Directors

SECTION 1. The board shall consist of _____ members, all of whom shall be members of this credit union. The number of directors may be changed to an odd number not fewer than 5 nor more than 15 by resolution of the board. No reduction in the number of directors may be made unless corresponding vacancies exist as a result of deaths, resignations, expiration of terms of office, or other actions provided by these bylaws. A copy of the resolution of the board covering any increase or decrease in the number of directors shall be filed with the official copy of the bylaws of this credit union.

SEC. 2. Regular terms of office for directors shall be for periods of either 2 or 3 years as the board shall determine: *Provided, however,* That all regular terms shall be for the same number of years and until the election and qualification of successors. The regular terms shall be so fixed at the beginning, or upon any increase or decrease in the number of directors, that approximately an equal number of regular terms shall expire at each annual meeting.

SEC. 3. 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 any unexpired terms shall be filled by vote of the members, and until the qualification of their successors. Members of the supervisory committee so appointed shall hold office until the first regular meeting of the board following the next annual meeting of members at which the regular term expires and until the appointment and qualification of their successors.

SEC. 4. A regular meeting of the board shall be held each month at the time and place fixed by resolution of the board. The president, or in his absence the ranking vice president, may call a special meeting of the board at any time; and shall do so upon written request of a majority of the directors then holding office. Unless the board prescribes otherwise, the president, or in his absence the ranking vice president, shall fix the time and place of special meetings. Notice of all meetings shall be given in such manner as the board may from time to time by resolution prescribe.

SEC. 5. The board shall have the general direction and control of the affairs of this credit union and shall be responsible for performing all the duties customarily performed by boards of directors. This shall include but not be limited to the following:

(a) Directing the affairs of the credit union in accordance with the Act, these bylaws, the rules and regulations and sound business practices.

(b) Establishing programs to achieve the purposes of this credit union as stated in article I, section 2, of these bylaws.

(c) Establishing and supervising a loan collection program and authorizing the chargeoff of uncollectible loans.

(d) Determining that all persons appointed or elected by this credit union to any position requiring the receipt, payment or custody of money or other property of this credit union, or in its custody or control as collateral or otherwise, are

properly bonded in accordance with the Act and regulations.

(e) Performing such additional acts and exercising such additional powers as may be required or authorized by applicable law and regulations.

SEC. 6. A majority of the number of directors (inclusive of any vacancies) shall constitute a quorum for the transaction of business at any meeting thereof; but fewer than a quorum may adjourn from time to time until a quorum is in attendance.

SEC. 7. If a director or a credit committee member fails to attend regular meetings of the board or credit committee, respectively, for 3 consecutive months, or otherwise fails to perform any of the duties devolving upon him as a director or a credit committee member, his office may be declared vacant by the board and the vacancy filled as herein provided. The board may remove any executive officer from office for failure to perform the duties thereof, after giving the officer reasonable notice and opportunity to be heard.

When any executive officer, membership officer, or executive committee member is absent, disqualified, or otherwise unable to perform the duties of his office, the board may by resolution designate another member of this credit union to act temporarily in his place. The board may also, by resolution, designate another member or members of this credit union to act on the credit committee when necessary in order to obtain a quorum.

SEC. 8. Any member of the supervisory committee may be suspended by a majority vote of the board of directors. The members of this credit union shall decide, at a special meeting held not fewer than 7 nor more than 14 days after any such suspension, whether the suspended committee member shall be removed from or restored to the supervisory committee.

Article VIII. Executive Officers, Executive Committee and Management Staff

SECTION 1. The executive officers of this

credit union shall be a president, one or more vice presidents, a treasurer, and a secretary, all of whom shall be elected by the board and from their number. If more than one vice president is elected, the board shall determine their rank as first vice president, second vice president, et cetera. The offices of treasurer and secretary only may be held by the same person. Unless sooner removed as herein provided, the officers elected at the first meeting of the board shall hold office until the first meeting of the board following the first annual meeting of the members and until the election and qualification of their respective successors.

SEC. 2. Officers elected at the meeting of the board next following the annual meeting of the members, which shall be held not later than 7 days after the annual meeting, shall hold office for a term of 1 year and until the election and qualification of their respective successors: *Provided, however,* That any person elected to fill a vacancy caused by the death, resignation, or removal of an officer shall be elected by the board to serve for the unexpired term of such officer and until his successor is duly elected and qualified.

SEC. 3. The president shall preside at all meetings of the members and at all meetings of the board, unless disqualified through suspension by the supervisory committee. He shall countersign all notes of this credit union, and all checks, drafts, and other orders for disbursement of its funds as prescribed in article XV, section 2, of these bylaws. The president shall also perform such other duties as customarily appertain to the office of president or as he may be directed to perform by resolution of the board not inconsistent with the Act and regulations and these bylaws.

SEC. 4. The ranking vice president available shall have and exercise all the powers, authority, and duties of the president during the absence of the latter or his inability to act.

SEC. 5. The treasurer shall be the manager of this credit union under the control and direction of the board unless the board has employed a separate manager. Subject to such limitations,

controls and delegations as may be imposed by the board, he shall:

(a) Have custody of all funds, securities, valuable papers and other assets of this credit union.

(b) Sign all notes of this credit union, and all checks, drafts, and other orders for disbursement of its funds.

(c) Provide and maintain full and complete records of all the assets and liabilities of this credit union in accordance with forms and procedures prescribed in the Accounting Manual for Federal Credit Unions or otherwise approved by the Administration.

(d) Within 7 days after the close of each month, prepare and submit to the board a financial statement showing the condition of this credit union as of the end of the month, including a summary of delinquent loans. He shall promptly post a copy of such statement in a conspicuous place in the office of this credit union where it will remain until replaced by the financial statement for the next succeeding month.

(e) Prepare and forward to the Administration such financial and other reports as the Administration may require.

(f) If so authorized by the board and within standards and limitations prescribed by the board, employ tellers, clerks, bookkeepers, and other office employees, and have the power to remove such employees.

(g) Perform such other duties as customarily appertain to the office of treasurer or as he may be directed to perform by resolution of the board not inconsistent with the Act and regulations and these bylaws.

The treasurer may be compensated for his services to such extent as may be determined by the board.

The board may employ one or more assistant treasurers, none of whom may also hold office as president or vice president, and may authorize them, under the direction of the treasurer, to perform any of the duties devolving on the treasurer, including the signing of checks. When designated by the board, any assistant treasurer may also act as treasurer during the temporary absence of the treasurer or in the event of his temporary inability to act.

SEC. 6. The board may employ a manager who shall not be a member of the board and who shall be under the direction and control of the board or of the treasurer as determined by the board. The manager may be assigned any or all of the responsibilities of the treasurer described in section 5 of this article.

The board may employ one or more assistant managers, none of whom shall be a member of the board. The board may authorize assistant managers under the direction of the manager, to perform any of the duties devolving on the manager, including the signing of checks. When designated by the board, any assistant manager may also act as manager during the temporary absence of the manager or in the event of his temporary inability to act.

SEC. 7. The board shall employ, fix the compensation, and prescribe the duties of such employees as may in the discretion of the board be necessary, and have the power to remove such employees, unless it has delegated these powers to the treasurer or manager; except that neither the board, the treasurer, nor the manager shall have the power or the duty to employ, prescribe the duties of, or remove any loan officer appointed by the credit committee, or necessary clerical and auditing assistance employed or utilized by the supervisory committee.

SEC. 8. The secretary shall prepare and maintain full and correct records of all meetings of the members and of the board, which records shall be prepared within 7 days after the respective meetings. The secretary shall promptly inform the Administration in writing of any change in the address of the office of this credit union or the location of its principal records. He shall give or cause to be given, in the manner prescribed in these bylaws, proper notice of all meetings of the members, and shall perform such other duties as he may be directed to perform by resolution of the board not inconsistent with the Act and regulations and these bylaws.

The board may employ one or more assistant secretaries, none of whom may also hold office as president, vice president, or treasurer, and may authorize them under direction of the secretary

to perform any of the duties devolving on the secretary.

SEC. 9. The board may appoint an executive committee of not fewer than three directors to serve at its pleasure, to act for it with respect to specifically delegated functions authorized by the Act and regulations. The board may also authorize such executive committee or a membership officer appointed by the board to serve at its pleasure from among the members of this credit union other than a person authorized to disburse funds, to approve applications for membership under such conditions as the board and these bylaws may prescribe. No executive committee member or membership officer may be compensated as such.

Article IX. Credit Committee

SECTION 1. The credit committee shall consist of _____ members. All the members of the credit committee shall be members of this credit union. The number of members of the credit committee may be changed to not fewer than 3 nor more than 7 by resolution of the board. No reduction in the number of members may be made unless corresponding vacancies exist as a result of deaths, resignations, expiration of terms of office, or other actions provided by these bylaws. A copy of the resolution of the board covering any increase or decrease in the number of committee members shall be filed with the official copy of the bylaws of this credit union.

SEC. 2. Regular terms of office for credit committee members shall be for periods of either 2 or 3 years as the board shall determine: *Provided, however,* That all regular terms shall be for the same number of years and until the election and qualification of successors. The regular terms shall be so fixed at the beginning, or upon any increase or decrease in the number of committee members, that approximately an equal number of regular terms shall expire at each annual meeting.

SEC. 3. The credit committee shall choose from their number a chairman and a secretary.

The secretary of the committee shall prepare and maintain full and correct records of all actions taken by it, and such records shall be prepared within 3 days after the action. The offices of chairman and secretary may be held by the same person.

SEC. 4. The credit committee may, by majority vote of its members, appoint one or more loan officers to serve at its pleasure, and delegate to him or them the power to approve loans, share withdrawals, releases and substitutions of security, within limits specified by the committee. Not more than one member of the committee may be appointed as a loan officer. Each loan officer shall furnish to the committee a record of each transaction approved or not approved by him within 7 days of the date of the filing of the application or request, and such record shall become a part of the records of the committee. All applications or requests not approved by a loan officer shall be acted upon by the committee. No individual may disburse funds of this credit union for any loan or share withdrawal which he has approved as a loan officer.

SEC. 5. The credit committee shall hold such meetings as the business of this credit union may require, and not less frequently than once a month. Notice of such meetings shall be given to members of the committee in such manner as the committee may from time to time, by resolution, prescribe.

SEC. 6. The credit committee or a loan officer shall inquire carefully into the character and financial condition of each applicant for a loan and his sureties, if any, to ascertain their ability to repay fully and promptly the obligations incurred by them and to determine whether the loan sought is for a provident or productive purpose and will be of probable benefit to the borrower. The credit committee shall endeavor diligently to assist applicants in solving their financial problems.

SEC. 7. No loan shall be made unless approved by the committee or a loan officer in accordance with applicable law and regulations.

SEC. 8. Subject to the limits imposed by applicable law and regulations, these bylaws, and

the general policies of the board, the credit committee, or a loan officer, shall determine the security required for each loan, if any, and the terms upon which it shall be repaid. The security furnished shall be adequate in quality and character and consistent with sound lending practices. When funds are not available to make all the loans for which there are loan applications, preference shall be given, in all cases, to the applications for smaller loans if the need and credit factors are nearly equal.

Article X. Supervisory Committee

SECTION 1. The supervisory committee shall be appointed by the board from among the members of this credit union, one of whom may be a director other than the treasurer. The board shall determine the number of members on the committee, which shall not be fewer than 3 nor more than the maximum number permitted by the Act. No member of the credit committee or any employee of this credit union may be appointed to the committee. Regular terms of committee members shall be for periods of 1, 2, or 3 years as the board shall determine: *Provided, however,* That all regular terms shall be for the same number of years and until the appointment and qualification of successors. The regular terms shall expire at the first regular meeting of the board following each annual meeting.

SEC. 2. The supervisory committee members shall choose from among their number a chairman and a secretary. The secretary of the supervisory committee shall prepare, maintain, and have custody of full and correct records of all actions taken by it. The offices of chairman and secretary may be held by the same person.

SEC. 3. The supervisory committee shall make, or cause to be made, such audits, and to prepare and submit such written reports, as are required by the Act and regulations. The committee may employ and use such clerical and auditing assistance as may be required to carry out its responsibilities prescribed by this article, and may request the board to provide compensation

for such assistance. It shall prepare and forward to the Administration such reports as may be required.

SEC. 4. The supervisory committee shall, from time to time and not less frequently than as required by the Act and regulations, cause the passbooks and accounts of all members to be verified with the records of the treasurer. The committee shall maintain a record of such verification.

SEC. 5. By unanimous vote the supervisory committee may suspend until the next meeting of the members any director, executive officer, or member of the credit committee. In the event of any such suspension, the supervisory committee shall call a special meeting of the members to act on said suspension which meeting shall be held not fewer than 7 nor more than 14 days after such suspension. The chairman of the committee shall act as chairman of the meeting unless the members select another person to act as chairman.

SEC. 6. By the affirmative vote of a majority of its members, the supervisory committee may call a special meeting of the members to consider any violation of the provisions of the Act, the regulations, or of the charter or the bylaws of this credit union, or to consider any practice of this credit union which the committee deems to be unsafe or unauthorized.

Article XI. Organization Meeting

SECTION 1. At the time application is made for a Federal credit union charter, the subscribers to the organization certificate shall meet for the purpose of electing a board of directors and a credit committee. Failure to commence operations within 60 days following receipt of the approved organization certificate (charter) shall be cause for revocation of the charter unless a request for an extension of time has been submitted to and approved by the Regional Director.

SEC. 2. The subscribers shall elect a chairman and a secretary for the meeting. The subscribers shall then elect from their number, or from those eligible to become members of this credit union, a board of directors and a credit committee, all to hold office until the first annual meeting of the members and until the election and

qualification of their respective successors. If not already a member, every person elected under this section or appointed under section 3 of this article, must qualify within 30 days by becoming a member. If any person elected as a director or committee member or appointed as a supervisory committee member does not qualify as a member within 30 days of such an election or appointment, his office shall automatically become vacant and shall be filled by the board.

SEC. 3. Promptly following the elections held under the provisions of section 2 of this article, the board shall meet and elect the executive officers who shall hold office until the first meeting of the board of directors following the first annual meeting of the members and until the election and qualification of their respective successors. The board shall also appoint at this meeting a supervisory committee as provided in article X, section 1, of these bylaws. The members so appointed shall hold office until the first regular meeting of the board following the first annual meeting of the members and until the appointment and qualification of their respective successors.

Article XII. Loans to Members

SECTION 1. Loans to individuals shall be made only to members, and shall be made for provident or productive purposes in accordance with applicable law and regulations. Loans to a member other than a natural person shall not be in excess of its shareholdings in this credit union.

SEC. 2. Within the limitations prescribed by applicable law and regulations, the board shall fix from time to time the interest rates on loans, the rate of interest refund, if any, to be made to members, the maximum maturities and terms of payment or amortization of loans to members, and the maximum amount that may be loaned with and without security, to any member. When, by action of the board, the interest rates on future loans are reduced, similar action may be taken with regard to interest rates on unpaid balances of existing loans.

SEC. 3. The aggregate amount of loans to any member and the terms and conditions of such

loans shall not exceed the limits permitted by applicable law and regulations.

SEC. 4. Any loan made to a director or member of the credit or supervisory committee and the aggregate of such loans shall be in compliance with the Act and regulations. No director or member of the credit or supervisory committee shall act as comaker, endorser or guarantor for borrowers from this credit union.

SEC. 5. A borrower may repay his loan prior to maturity, in whole or in part, on any business day.

SEC. 6. Applications for loans shall be on forms prepared and furnished by the credit committee and shall in each case set forth the purpose for which the loan is desired, the security, if any, and such other data as may be required by the committee or by applicable law and regulations.

SEC. 7. Subject to the limitations of applicable law and regulations, any member whose loan is delinquent for a period of 1 week or more may be required by the board to pay a late charge of 20 percent of the interest due, with a minimum of not less than 5 cents.

Article XIII. Reserves

SECTION 1. All entrance fees, transfer fees, late charges, and such other amounts as shall be required by the Act and regulations, shall be set aside as a regular reserve: *Provided, however,* That when the regular reserve thus established shall reach the minimum balance required by the Act and regulations, no further transfers except fees and late charges shall be required except up to such amounts permitted by law and as may be needed to maintain such minimum balance. Amounts in excess of the above requirements may be transferred to the regular reserve by authorization of the board. The regular reserve shall be used only for losses on loans to members (including unrecovered collection costs) and such other losses as are authorized by applicable law and regulations.

SEC. 2. In addition to the regular reserve, special reserves to protect the interests of members shall be established in accordance with the

Act and regulations. The board may also authorize the establishment of any additional reserves which it deems necessary.

Article XIV. Dividends

SECTION 1. The board shall establish dividend periods and declare dividends as permitted by the Act and in accordance with the following:

(a) The board shall establish annual, semi-annual, or quarterly dividend periods or other dividend periods permitted by the Act in such a way that the last dividend period in any calendar year ends on December 31.

(b) The board may change the established dividend periods, such change to take effect after the close of the current dividend period, and shall take reasonable action to notify the members of the change; *except that* the change may be applied to the current period if the members are notified a reasonable time prior to the end of such period.

(c) Dividends may be declared by the board, for an established dividend period, from earnings available after provision for reserves required by the Act and regulations, only during the last month of the period or the first month following the close of the period.

(d) Within the limitations of the Act, the board shall determine the number of days from and including the first day of the month during which shares may be fully paid up and earn dividend credit for the entire month. Dividend credit may not be earned for a fraction of a month.

SEC. 2. No dividend shall be declared or paid at a rate in excess of 6 percent per annum.

SEC. 3. A member shall be deemed to have one fully paid share for each \$5 paid in, regardless of the number of shares for which he has subscribed.

Article XV. Deposit and Disbursement of Funds—Investments and Borrowing

SECTION 1. All funds of this credit union, except for petty cash and cash change funds

authorized by section 3 of this article, shall be deposited in such qualified depository or depositories from among those authorized by applicable law and regulations as the board may from time to time by resolution designate; and shall be so deposited not later than the second banking day after their receipt: *Provided, however,* That receipts in the aggregate of \$300 or less may be held as long as 1 week before they are deposited.

SEC. 2. All disbursements of funds of this credit union shall be made by checks or other written instruments signed by the treasurer, manager, assistant treasurer, or an assistant manager, and countersigned by the president, or in his absence or inability to serve, by the ranking vice president: *Provided, however,* That the board may by resolution eliminate the requirement of countersigning: *And provided further,* That the board may by resolution determine that disbursements may be made in cash in accordance with procedures prescribed in the *Accounting Manual for Federal Credit Unions* or otherwise approved by the Administration.

SEC. 3. A cash fund may be authorized by the board by resolution for the purpose of making change, and for such other purposes as prescribed in the *Accounting Manual for Federal Credit Unions*.

The board may authorize by resolution the establishment of a petty cash fund for postage, and for defraying other expense items in amounts of less than \$10.

SEC. 4. The funds of this credit union shall be invested only as authorized by applicable law and regulations.

SEC. 5. The board may authorize borrowing and discounting operations on behalf of this credit union within the limitations prescribed by applicable law and regulations.

Article XVI. Expulsion and Withdrawal

SECTION 1. A member may be expelled only in the manner provided by the Act. Expulsion or withdrawal shall not operate to relieve a member of any liability to this credit union. All

amounts paid in on shares by expelled or withdrawing members, prior to their expulsion or withdrawal, shall be paid to them in the order of their withdrawal or expulsion, but only as funds become available and only after deducting therefrom any amounts due from such members to this credit union.

Article XVII. Minors

SECTION 1. Shares may be issued in the name of a minor, or in trust therefor. When shares are so issued in trust, the trustee must be a member of this credit union in his own right, and the name of the beneficiary must be stated.

Article XVIII. Definitions

SECTION 1. When used in these bylaws the terms:

(a) "*Act*" means the Federal Credit Union Act, as amended.

(b) "*Administration*" means the National Credit Union Administration.

(c) "*Administrator*" means the Administrator of the National Credit Union Administration.

(d) "*Regulation*" or "*regulations*" means rules and regulations issued by the Administrator of the National Credit Union Administration.

(e) "*Applicable law and regulations*" means the Federal Credit Union Act and rules and regulations issued thereunder or other applicable Federal statutes and rules and regulations issued thereunder as the context indicates (such as The Higher Education Act of 1965).

(f) "*Net earnings*," for a given period, means the balance remaining after deducting from the gross income of this credit union actually received during such period all expenses paid or payable during such period, and any losses sustained therein (as determined by the board) for which no specific reserve has been set aside. Amounts set aside during such period as a reserve shall not be deemed items of expense.

(g) "*Paid in and unimpaired capital*," as of a given date, means the balance of the paid-in shares account as of such date, less any losses that may have been incurred for which there is

no reserve or which have not been charged against undivided earnings.

(h) "*Surplus*," as of a given date, means the credit balance of the undivided earnings account on such date, after all losses have been provided for and net earnings or net losses have been added thereto or deducted therefrom, as the case may be. Reserves shall not be considered as a part of the surplus.

SEC. 2. If included in the definition of the field of membership in the organization certificate (charter) of this credit union, the terms or expressions:

(a) "*Members of their immediate families*" includes grandparents, parents, husband, wife, children, grandchildren, brothers, and sisters, living under the same roof and in the same household.

(b) "*Organizations of such persons*" means an organization or organizations composed exclusively of persons who are within the field of membership of this credit union.

Article XIX. General

SECTION 1. All power, authority, duties, and functions of the members, directors, officers, and employees of this credit union, pursuant to the provisions of these bylaws, shall be exercised in strict conformity with the provisions of applicable law and regulations, and of the charter and the bylaws of this credit union.

SEC. 2. The officers, directors, members of committees, and employees of this credit union shall hold in confidence all transactions of this credit union with its members and all information respecting their personal affairs, except to the extent deemed necessary by the board in connection with the making of loans and the collection thereof.

SEC. 3. Notwithstanding any other provisions in these bylaws, any director, committee member, officer, or employee of this credit union may be removed from office by the affirmative vote of a majority of the members present at a special meeting called for the purpose, but only after an opportunity has been given him to be heard.

SEC. 4. No director, committee member, officer, agent, or employee of this credit union shall in any manner, directly or indirectly, participate in the deliberation upon or the determination of any question affecting his pecuniary interest or the pecuniary interest of any corporation, partnership, or association (other than this credit union) in which he is directly or indirectly interested. In the event of the disqualification of any director respecting any matter presented to the board for deliberation or determination, such director shall withdraw from such deliberation or determination; and in such event the remaining qualified directors present at the meeting, if constituting a quorum with the disqualified director or directors, may exercise with respect to this matter, by majority vote, all the powers of the board. In the event of the disqualification of any member of the credit committee or the supervisory committee, such committee member shall withdraw from such deliberation or determination.

SEC. 5. Copies of the organization certificate of this credit union, its bylaws and any amendments thereof, and any special authorizations by the Administration shall be preserved in a place of safekeeping. Returns of nominations and elections and proceedings of all regular and special meetings of the members and directors shall be recorded in the minute books of this credit union. The minutes of the meetings of the members, the board, and the committees shall be signed by their respective chairmen or presiding officers and by the persons who serve as secretaries of such meetings.

SEC. 6. All books of account and other records of this credit union shall at all times be available to the directors and committee members of this credit union. The charter and bylaws of this credit union shall be made available for inspection by any member.

SEC. 7. Each member shall keep the credit union informed about his current address. In the event a member fails to do this, a charge may be made to the member's share account for the actual cost of necessary locator service incurred in determining such address: *Provided, how-*

ever, That such charge shall not exceed \$5. Such charge shall be made only for amounts paid to a person or concern normally engaged in providing such service, and shall be made against the account or accounts of any one member not more than once in any 12-month period.

Article XX. Operations Following an Attack on the United States

SECTION 1. In the event of an attack upon the United States, the officers and employees of the credit union shall continue to conduct the affairs of the credit union under such guidance from the directors as may be available and subject to conformance with any governmental directives during the emergency.

SEC. 2. In the event of an attack upon the United States of sufficient severity to prevent the conduct and management of the affairs and business of the credit union by its regularly elected directors, officers, and properly constituted committees as contemplated by these bylaws, any three available members of the then incumbent board of directors shall constitute a quorum of the board of directors for the full conduct and management of the affairs and business of the credit union including the approval of loans to members if the regularly elected credit committee is not available. In the event of the unavailability at such time of three members of the board, the vacancies, in order to provide a quorum of three, shall be filled as follows:

(a) If the regularly elected president or a regularly elected vice president is not available, the available person who is highest on the succession list for president last authorized by the board of directors shall automatically become an acting director if he is not a member of the board and acting president.

(b) If the regularly elected treasurer is not available, the available person who is highest on the succession list for treasurer last authorized by the board of directors shall automatically become an acting director if he is not a member of the board and acting treasurer.

(c) If a third director is necessary to make a quorum, he shall be the next highest available

person on the succession list for president or upon the exhaustion of such list, the next highest available person on the succession list for treasurer.

The quorum of the board of directors as regularly constituted or as constituted above shall appoint additional directors as necessary to provide for a full board of five members, provided that: If there is available an even number of regularly elected directors in excess of five, the board shall appoint one additional director, in which case, a quorum shall then be a majority of the full board thus constituted. Persons selected as provided in this section shall hold office only until their successors are elected at the next annual meeting or at a special meeting called for that purpose and until the qualification of their successors; provided that the person selected pursuant to subsection (a) shall hold office as acting president and as acting director only until the regularly elected president or a regularly elected vice president becomes available; and that the person selected pursuant to subsection (b) shall hold offices as acting treasurer and as acting director only until the regularly elected treasurer becomes available. This bylaw shall be subject to implementation by resolutions by the board of directors passed from time to time for that purpose, and any

provisions of these bylaws (other than this section) and any resolutions which are contrary to the provisions of this section or to the provisions of any such supplementary resolutions shall be suspended until a regularly constituted board of directors can be obtained.

SEC. 3. In the event that the office of the credit union becomes unusable, as a result of an attack upon the United States, the credit union shall, if possible, establish temporary substitute quarters. The office of this credit union shall be established as soon as practicable thereafter at a suitable permanent location within the limits permitted by the charter of this credit union.

Article XXI. Amendments of Bylaws and Charter

SECTION 1. Amendments of these bylaws may be adopted and amendments of the charter requested by the affirmative vote of two-thirds of the authorized number of members of the board at any duly held meeting thereof if the members of the board have been given prior written notice of said meeting and the notice has contained a copy of the proposed amendment or amendments. No amendment of these bylaws or of the charter shall become effective, however, until approved in writing by the Administrator.

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PROCEDURE FOR ADOPTING AMENDMENTS TO BYLAWS

The attached certification forms are for use of the board of directors in adopting the amendments to the bylaws made available by the enactment of HR 3365.

The amendments have been approved in advance by the Administrator and may be placed in effect immediately by the credit union when the following actions are taken:

1. Adoption of the amendment by the board of directors at a meeting held in accordance with Article XXI, section 1 of the bylaws;
2. Execution of the Certificate of Resolution in triplicate;
3. Filing of the original of the Certification of Resolution with the credit union's official bylaws; and,
4. Mailing of two completed sets (Pages 1-6) of the Certification of Resolution to your NCUA regional office.

(NOTE: This Procedure Applies For Adopting Change #4)

CERTIFICATION OF RESOLUTION OF BOARD OF DIRECTORS

ADOPTING AMENDMENT TO BYLAWS

We, the undersigned, president and secretary of the _____
_____ Federal Credit Union,
Charter No. _____, _____ hereby certify:
(city, state)

That by affirmative vote of two-thirds of the members of the board at a
duly held meeting thereof on _____, _____ the
following resolution was adopted:

BE IT RESOLVED: That the following amendments of this credit union's bylaws
are hereby adopted, as set forth below and approved in advance by the
Administrator, National Credit Union Administration, to be effective immedi-
ately:

CERTIFICATE

Article II, Section 2, of the bylaws shall be amended to read as follows:

"Applications for membership from persons eligible to membership under
section 5 of the charter shall be signed by the applicant on forms approved
by the board. Upon approval of such an application by a majority of the
directors or a majority of the members of a duly authorized executive com-
mittee or by a membership officer and upon his/her subscription to at least
one share of this credit union and the payment of the initial installment
thereon, and the payment of a uniform entrance fee if required by the board,
the applicant is admitted to membership. If a membership application is
denied, the reasons therefor shall be furnished in writing to the person
whose application is denied, upon written request."

Article III, Section 5, of the bylaws shall be amended to read as follows:

"Money paid in on shares or installments of shares may be withdrawn as
provided in these bylaws or regulation on any day when payment on shares
may be made: Provided, however, That

(a) The board shall have the right, at any time, to require members
to give, in writing, not more than 60 days notice of intention to withdraw
the whole or any part of the amounts so paid in by them.

(b) The board may determine that if shares are paid in under an
accumulated payroll deduction plan, as prescribed in the Accounting Manual