



Mutual Alert

Plaintiffs Bring Class Action In Their Capacity As Members Challenging Merger Between Two Federal Mutuals Because of Capital Disparity, Naming Directors of Disappearing Bank as Defendants

In a case brought in Federal District Court, where a mutual board of a Federal savings bank with a significantly higher capital ratio than the acquirer agreed to merge into another mutual, two former members of the disappearing mutual have brought a class action against the former directors alleging a breach of fiduciary duty. The acquiring bank had a net worth ratio of 12.41% and the acquired bank had a 23.63% in late 2014 according to the complaint. The complaint alleges that the acquired bank had over \$25 million more capital than the acquirer. The case raises issues that may implicate the failure of the acquired bank to update its bylaw and charter language regarding member distributions. It also, by implication, puts pressure on the OCC to use its discretion to require a special member vote on a merger between two mutuals whenever the disappearing has a disproportionately high capital ratio.

The gravamen of the case is that the Board of the acquired bank should have explored other alternatives including a payout of the capital surplus to the members. This contention is in direct conflict with the historical legal position of the old FHLBB and OTS which treated any such distribution as inequitable as it would constitute a windfall. The OCC has followed that position but has made some exception regarding conversion/ mergers. There also have been some state approvals of member payouts. The good news for the defendants is that this case was brought after the merger was completed. It is doubtful that the plaintiffs have much leverage here and we expect the fundamental law to support the actions of the Board. However, failure to update the charter and bylaws regarding member distributions and /or OCC reluctance to support its approval and actions of the Board could prove troublesome. Suffice to say that the incidence of these lawsuits will increase if the OCC continues to allow conversion/ mergers or payouts by very small federal mutuals (\$25-\$75 Million in assets).

AMB will monitor this case closely and keep you advised of its progress.

Douglas Faucette
America's Mutual Banks
www.americasmutualbanks.com