SB
343

HOUSE COMMITTEE REPORT

(7)

Date referred: 4/22/88

FURTHER REFERRALS:

DATE: May 4, 1988

The Judiciary Committee has considered CSSB 343(Jud)

"An Act relating to the liability of directors of corporations."

RECOMMENDS:

[✓] replace with HCS CSSB343(L+C)

[ ] attached amendment(s)

[✓] do pass

[ ] do not pass

[ ] no recommendation

[ ] individual recommendations

[ ] additional referral to the ______ Committee

[✓] the same title

[ ] a new title

ADOPTS: [ ] ______ letter of intent

ATTACHES NEW FISCAL NOTE(s):

[ ] fiscal impact

[ ] zero fiscal note

[ ] zero with analysis

[ ] same as previous fiscal note published ______

[✓] same as previous zero fiscal note published 2/23/88

SIGNING DO PASS:

[signatures]

SIGNING OTHER RECOMMENDATIONS:

Chairman's signature

STATE OF ALASKA
THE LEGISLATURE

POUCH Y · STATE CAPITOL
JUNEAU, ALASKA 99811
907-465-3800

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May, 1988

Copies of minutes listed below were originally included in this file. The minutes are available on the STAIRS database CMPR. In order to save space copies of minutes have not been left in the files.

Mary Van Nimwegen

H. JUD. 5-4-88 1:30p.m.

Alaska State Legislature

SENATOR
ARLISS STURGULEWSKI
Chairman, Senate Community and Regional Affairs Committee
Vice-Chairman, Senate Judiciary Committee
Member, Senate Resources Committee

2957 SHELDON JACKSON STREET
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While in Juneau
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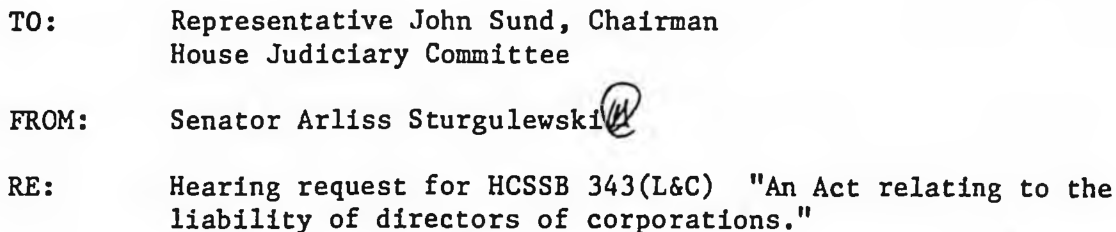
Senate

MEMORANDUM

April 22, 1988



TO: Representative John Sund, Chairman
House Judiciary Committee

FROM: Senator Arliss Sturgulewski

RE: Hearing request for HCSSB 343(L&C) "An Act relating to the liability of directors of corporations."

This legislation addresses the question of limiting or eliminating a director's personal monetary liability to the corporation or its shareholders for breach of his or her fiduciary duty of care to the corporation. It requires a vote of the shareholders to amend the articles of incorporation to allow for the limiting or eliminating of liability. In this sense, the legislation is permissive only. This is a national problem as more suits are brought by shareholders against directors. Many states have adopted these provisions because of the high cost of directors insurance or in some cases prohibitive costs. It does not eliminate liability for wrong doing. It does not address suits brought against the directors from outside the corporation.

The following is a brief explanation relating to the origin of each section of the bill. A sectional analysis from legal services is also attached.

Sec. 1. Business Corporations. Originally the bill as first introduced only applied to profit corporations. The problem of directors liability was brought to my attention at Fish Expo in Seattle last October. Washington state has adopted the limitation legislation following Delaware and several other states. This legislation was introduced in order to encourage the incorporation of businesses in Alaska and for Alaska to remain competitive with other states as a location for incorporation.

Sec. 2. Native Corporation Voting Requirements. This section was suggested by Sealaska Corporation. The corporation statute dealing with amendments to articles of incorporation (AS 10.05.276) requires a two-thirds vote of the shareholders to amend the articles of any corporation. Sealaska asked that this requirement for Native corporations be reduced to a majority vote since they have in excess of 16,000 shareholders. This reduction would apply only to the question of director

liability and not to other issues of the Native corporations. (See attached letter from Birch, Horton, Bittner)

Sec. 3. Cooperative Corporations. This section was added at the request of John Abbott, Chairman of the Alaska Code Revision Commission to bring conformity to corporation statutes and for the same reasons that liability relief is needed in other corporate forms.

Sec. 4. Non-profit Corporations. This section was added at the request of the Alaska State Chamber of Commerce for the same reasons that apply to profit corporations and cooperatives. In addition, it was noted that it is increasingly difficult to find people to serve on the boards of volunteer organizations because of the growing risk of law suits and the personal financial exposure that exists.

This legislation is supported by the Director of Banking and Securities and by all others who testified.

I would appreciate your consideration of this bill in the House Judiciary Committee. Thank you.

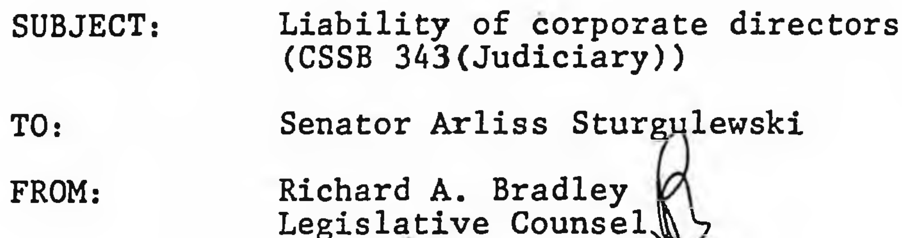
Attachments: HCSSB 343 (L&C)
Sectional Analysis
Fiscal Note - Zero
Directors and Officers Liability Insurance - Feb. 1987
by Rollins Budick Hunter
Memo: Joe Plesha, Trident Seafood, Nov. 11, 1987
Legislative Briefs - Similar legislation in other states
Letter Birch, Horton, Bittner - Feb. 17, 1988

STATE OF ALASKA
THE LEGISLATURE

POUCH Y STATE CAPITOL
JUNEAU, ALASKA 99811
907 465-3800

LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM February 22, 1988



SUBJECT: Liability of corporate directors (CSSB 343(Judiciary))

TO: Senator Arliss Sturgulewski

FROM: Richard A. Bradley
Legislative Counsel

You have requested a sectional analysis of the above described bill.

The main effect of the bill, apart from sec. 2, discussed below, is to address the liability relationship between the directors of the corporation and the corporation itself (or its stockholders or shareholders derivatively, if it has stockholders or shareholders).

The bill applies to the widely-used general types of corporations that may be established under state law: business corporations (AS 10.05), cooperative corporations (AS 10.15), and nonprofit corporations (AS 10.20). Corporations not included in the bill are electric and telephone cooperatives (AS 10.25), cemetery associations (AS 10.30), religious corporations (AS 10.40), and professional corporations (AS 10.45).

Section 1 of the bill amends AS 10.05.255, the section establishing the contents of the articles of incorporation for business corporations. It permits a corporation to add a provision "eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for the breach of fiduciary duty as a director."

The provisions of the section establish certain public policy areas where a corporation may not agree to waive liability. The section also provides that the elimination

or limitation of liability is only prospective from the time the amendment takes effect.

An existing business corporation may amend its articles under AS 10.05.270 and following.

Section 2 of the bill amends AS 10.05.276, a section establishing the "procedure to amend articles of incorporation." It provides that a corporation incorporated under AS 10.-05.005 (regional Native corporations and those village corporations that incorporate as business corporations) may take advantage of the provisions of section 1 of the bill. The main purpose of sec. 2 of the bill is to permit the Native corporation to adopt the amendment by lower thresholds than the existing provisions of law provide.

Section 3 of the bill amends AS 10.15.350, the section establishing the contents of the articles of incorporation for cooperative corporations. It permits a corporation to add a provision "eliminating or limiting the personal liability of a director to the corporation or its members for monetary damages for the breach of fiduciary duty as a director."

The provisions of the section establish certain public policy areas where a corporation may not agree to waive liability. The section also provides that the elimination or limitation of liability is only prospective from the time the amendment takes effect.

An existing cooperative corporation may amend its articles under AS 10.15.365 and following.

Section 4 of the bill amends AS 10.20.151, the section establishing the contents of the articles of incorporation for nonprofit corporations. It permits a corporation to add a provision "eliminating or limiting the personal liability of a director to the corporation for monetary damages for the breach of fiduciary duty as a director." Nonprofit corporations have neither stockholders nor members.

The provisions of the section establish certain public policy areas where a corporation may not agree to waive liability. The section also provides that the elimination or limitation of liability is only prospective from the time the amendment takes effect.

An existing nonprofit corporation may amend its articles under AS 10.20.171 and following.

If I may be of further assistance, please advise.

RAB:bb
wkb3/017

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April 12, 1988

Representative John Sund
Chair, House Judiciary Committee
P. O. Box V
Juneau, Alaska, 99811

Re: CSSB 343 (Judiciary)

Dear John:

Sealaska Corporation has been closely following CSSB 343 (Judiciary), which we expect to be heard in the House Labor and Commerce Committee in the near future. The legislation authorizes shareholders to agree to limit director liability in shareholder suits under certain conditions. When the bill arrives in House Judiciary, Sealaska is hoping to receive a hearing at your committee's earliest convenience.

To that end, I am enclosing a report which our firm has prepared for the House Labor and Commerce Committee on the legislation, so that your staffs can get a head start on the bill.

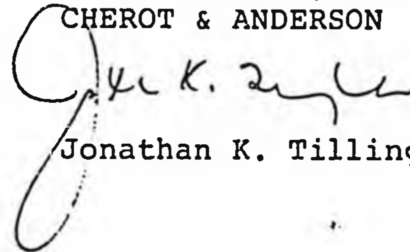
Birch, Horton, Bittner, Pestinger and Anderson
A PROFESSIONAL CORPORATION

April 12, 1988

On behalf of Sealaska, I want to thank you in advance for your consideration of this legislation, and I look forward to working with you, and your staff, when the bill arrives in your committee. If you have any questions or comments, please feel free to call.

Sincerely,

BIRCH, HORTON, BITTNER
CHEROT & ANDERSON



Jonathan K. Tillinghast

JKT/jm
cc: Robert Loescher
Chris McNeil

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February 17, 1988

Senator Arliss Sturgulewski
P. O. Box V
Juneau, Alaska 99811

Re: SB 343

Dear Senator Sturgulewski:

On Thursday, February 18, the Senate Judiciary Committee will revisit SB 343 -- a bill that would allow corporations, with shareholder approval, to limit their directors' liability for simple negligence. On behalf of Sealaska, I wanted to explain the purpose of an amendment to SB 343 that will be considered by the Committee in the form of a proposed Committee Substitute. That amendment would allow corporations formed under the Alaska Native Claims Settlement Act to amend their articles of incorporation with respect to directors' liability by a majority shareholders' vote, rather than the two-thirds vote otherwise required.

There are four sound public policy reasons for adopting the amendment. The proposal does not represent a "special deal" for Alaska Natives; rather, it recognizes that there are some fundamental differences between ANCSA corporations on the one hand, and general Alaska business corporations on the other, that must be addressed if the legislation is to achieve its intended goal. These considerations include:

1. Virtually all Alaska corporations have only a handful of shareholders. Indeed, in a typical situation the

only shareholders will be the directors themselves. As a result, obtaining a super-majority (or even unanimity) on this issue among shareholders would be an easy task. Typical of other regional corporations, however, Sealaska has 16,000 shareholders -- spread from southcentral Alaska to the lower 48. It is hard enough for corporations with such dispersed ownership to obtain a quorum; obtaining a two-thirds vote on any matter -- no matter how non-controversial -- is a virtual impossibility;

2. Normally, a corporation's directors hold large (and often controlling) blocks of shares in the company. As a result, they stand to realize substantial and direct profits from the corporation's business activities. This prospect of large personal gain compensates for the risk of liability that a director might suffer, and makes that potential for liability seem equitable. Native corporation directors, however, have no prospect of direct and substantial economic gain. They hold no more shares than any shareholder; and, as a result, directorship on a Native corporation is often viewed more as a form of community service than as an avenue of personal enrichment. The equitable symmetry of gain on the upside, and exposure on the downside, doesn't exist in the Native corporate context, and director liability legislation ought to recognize this substantial difference;

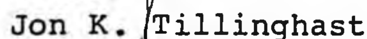
3. In the normal business setting, venturers voluntarily embark upon the corporate form in the expectation of gain. They voluntarily assume the risk, and they are usually familiar with the standard of care demanded of business men. Alaska's Natives, on the other hand, had the corporate form imposed upon them by Congress. They were told to administer their lands through a business organization with which -- particularly at the village level -- they were unfamiliar. Had the lands been administered through the Tribe, these same Native leaders would have performed essentially the same functions under the cloak of Tribal immunity. Moreover, they are not, by and large, familiar with the latest New York Court of Appeals cases defining permissible director conduct. It is perfectly proper for the state to be a bit sensitive in imposing personal liability for administering land entitlements through a form that is unfamiliar and, to a large extent, involuntarily; and

4. The purpose of the legislation is to encourage the formation of new corporations in Alaska. For new corporate ventures, a liability provision will be inserted in the initial articles of incorporation. Shareholders will, quite frankly, never read those articles. I will confess to never having reviewed the articles of incorporation of any company in which I have purchased stock. If, however, I receive a proxy solicitation from a company in which I own shares, asking me to accept limited director liability, I would probably give the matter some scrutiny. The point, of course, is that even majority shareholder approval for existing corporations will result in substantially broader scrutiny than that attendant the formation of new companies.

For these reasons, I believe the Judiciary Committee will be on firm footing in concluding that the sound philosophy behind SB 343 would be better served by acknowledging important differences between ANCSA and other business corporations. If I can be of any further assistance, or if you have any reservations about Sealaska's amendment, please do not hesitate to call.

Sincerely,

BIRCH, HORTON, BITTNER
PESTINGER & ANDERSON



Jon K. Tillinghast

JKT/jrm

NOVEMBER 11, 1987

MEMO

TO: CHUCK BUNDRANT
BART EATON

FROM: JOE PLESHA

RE: LIMITATION OF DIRECTOR LIABILITY UNDER DELAWARE LAW

INTRODUCTION

On July 1, 1986, a new law became effective in Delaware which permits a Delaware corporation to include in its certificate of incorporation a provision which limits or eliminates a director's personal monetary liability to the corporation or its stockholders for breach of his or her fiduciary duty of care to the corporation.[1]

BACKGROUND

Delaware law has generally permitted a Delaware corporation to purchase insurance on behalf of its directors and officers against liability incurred in their corporate capacity, regardless of whether the corporation would have the power to indemnify the director against such liability under Delaware law.[2] The market for directors' and officers' liability insurance has, however, changed dramatically over the past several years. Despite the statutory authorization of Delaware corporations to purchase and maintain directors' liability insurance, many corporations have have reportedly experienced difficulties in obtaining or maintaining sufficient coverage at a reasonable cost. As a result, may corporations have been forced to accept insurance with lower dollar limits of coverage, higher deductible amounts, and broader policy exclusions at a significantly higher cost.[3]

The insurance crisis for directors may be exacerbated by the courts increasing tendency to scrutinize the decisions of a director, even when the director acted in good faith and not out

[1] Indemnification of directors and officers, and limitation or elimination of director liability as authorized by the new Delaware law, are separate and distance concepts. Alaska law already provides that directors can be indemnified for actions under certain circumstances. Alaska Stat. § 10.05.101.

[2] Del. Code Ann. tit. 8, § 145(g) (Supp. 1986) (amended 1986) provides:

> A corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent to the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership , joint venture, trust or other enterprise against any liability asserted against him 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 such liability under this section.*

[3] *See* Hilder, *Liability insurance is Difficult to Find Now for Directors, Officers.* Wall St. J., July 10, 1985, at 1, col. 6.

of self interest. For example, the court in the case of *Smith v. Van Gorkom* [4] found that the board of directors of Trans Union Corporation breached their fiduciary duty of due care in approving a proposed cash merger and the court held members of the board personally liable for the resulting damages.

The expense of defending these lawsuits and the inevitable uncertainties with respect to application of the business judgment rule (the rule by which corporate directors actions are judged) may impact upon an individual's willingness to serve as director of a corporation. In addition, such uncertainty could cause directors to act defensively out of concern over costly litigation and potential personal liability, rather than acting to manage the business in the best interest of the corporation. For these reasons, Delaware adopted legislation in 1986 which would permit a corporation to limit or eliminate the director's personal monetary liability to the corporation or its stockholders for breach of his or her fiduciary duty of care to the corporation.

ANALYSIS OF NEW DELAWARE LAW

Title 8, §102(b)(7) of the Delaware General Corporation Law enables a Delaware corporation to include in its articles of incorporation a provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of their fiduciary duty as a director. In addition, § 102(b)(7) states that no such provision can eliminate or limit a director's liability (i) for breach of the director's *duty of loyalty* to the corporation or its stockholders; (ii) for acts of omissions *not in good faith or involving intentional misconduct or a knowing violation of law*; (iii) for willful or negligent conduct *paying dividends or repurchasing stock out of other than lawfully available funds*; or, (iv) for any transaction from which the director derives an *improper personal benefit.*

Section 102(b)(7) is an enabling provision only. Amendment of the corporate articles of incorporation, therefore, is required to include the provision authorized by this section before it is an effective limitation of personal liability for a corporation's directors. The ultimate determination as to the propriety of limiting the opportunity of a corporation or its stockholders to seek monetary damages from the directors rest with the stockholders of the corporation who vote on any amendments to the articles of incorporation. As a practical note, it can be argued that a board which proposes an amendment pursuant to this law is an "interested party," since the individual directors of the board will benefit from the elimination of monetary liability which they otherwise may be required to pay. Obtaining the required stockholder approval after full disclosure of all material facts, however, eliminates any conflict of interest which might otherwise arise.

Section 102(b)(7) does not preclude or limit damages in actions instituted by third parties. In addition, it can be argued that §102(b)(7) permits limitation or elimination of monetary liability only for directors acting as directors. Actions taken by a majority stockholder in his capacity as such cannot be exempted from liability. Finally, §102(b)(7) does not permit limitation or elimination of liability arising under other laws or regulations. A director's potential liability under state and federal securities laws, for example, is unaffected by this section

[4] 488 A.2d 858 (Del. 1985). The court found the board grossly negligent in that the directors had failed to fully inform themselves of "all material information reasonably available to them," and had acted hastily in approving the proposed merger, after two hours' consideration. *id.* at 872.

Fiduciary Duty
Directors are charged with the fiduciary duty of *due care* and *loyalty* to the corporation. Loyalty basically requires that a director, in making a business decision, act in good faith and in the honest belief that the action taken is in the best interest of the corporation. Under the new Delaware law, a director can still be found to be personally liable for monetary damages where they violate the fiduciary duty of loyalty by acting in their own "self-interest," and not in the best interest of the corporation.[5] (For example, by usurping a corporate opportunity for their own personal benefit or competing with the corporation.)

The official legislative synopsis of §102(b)(7) notes that this provision permits a corporation to protect its directors from monetary liability only from liability for breach of the *fiduciary duty of due care*.[6] It is clear that if a director negligently or with gross negligence (want of even scant care, or failure to exercise even that care which a careless person would use) disregarded his fiduciary duty of due care, they could be protected from monetary liability under the new Delaware law.

In is not clear, however, whether §102(b)(7) exempts directors from liability for reckless (actions that fall somewhere between gross negligence and intentional wrongdoing) disregard for the fiduciary duty of due care. It could be argued that to the extent that the recklessness involves conscious disregard for a known risk, such conduct is not taken in good faith and therefore, would not be a liability subject to limitation under §102(b)(7)(ii). To the extent recklessness encompasses merely inattention to duty by the directors, however, I believe that such conduct should be labeled "gross negligence" and therefore any liability resulting from it would be subject to limitation.

§102(b)(7), however, does not *eliminate* a director's fiduciary duty to act with due care, it merely insulates directors from personal *monetary* liability for failure to satisfy that duty. A director's conduct would, therefore, still be subject to injunctive or rescissory relief. A stockholder can institute an action to enjoin completion of a board's action or to rescind a completed action if such action involves violations of the duty of care. This may be relevant in proxy contest, elections, resignations, etc.

In conclusion, Delaware's new law only allows for a corporation to limit or eliminate the monetary damages a corporation or its shareholders can receive from its directors for a breach of the director's fiduciary duty of due care. It does not limit damages that can be awarded for a directors breach of their fiduciary duty of loyalty, or violations of law, or any transaction from which a director derives an improper personal benefit. In addition, the corporation or shareholder can still seek equitable remedies, such as recession or injunctive relief for a directors breach of their fiduciary duty of due care.

WASHINGTON & ALASKA LAW

Like Delaware, Washington State and Alaska law provide that a corporation may purchase insurance on behalf of its directors and officers to protect against personal liability incurred

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5 Del. Code Ann. tit. 8, § 102(b)(7)(i).

6 The synopsis notes: "[t]his provision enables a corporation in its original certificate of incorporation or an amendment thereto validly approved by stockholders to eliminate or limit personal liability of members of its board of directors or governing body for violations of a director's fiduciary duty of care."

in their corporate capacity, regardless of whether the corporation would have the power to indemnify against such liability under the relevant state law.[7]

Di Washington recently enacted legislation similar to Delaware's which would allow for a Washington corporation limit the monetary liability of directors for a breach of their fiduciary duty of due care to the corporation.[8] I am having a copy of the new provision sent to me. Alaska has not yet enacted such legislation.

I have attached the rele ant portions of the Delaware, Alaska and Washington State law.

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[7] Nearly identically to Delaware law, Wash. Rev. Code § 23A.08.025(11) (1980) provides:

> A corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent to the corporation, or is or was serving at the request of the corporation as a officer, employee or agent of another corporation, partnership , joint venture, trust or other employee benefit plan against any liability asserted against him 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 such liability under this section.*

The Alaska Statutes §10.05.015(g) (1970) provide that:

> A corporation may purchase and maintain insurance on behalf of a person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership joint venture, trust or other enterprise against any liability asserted against hem and incurred by the person in such a capacity, or arising out of the person's status as such, *whether or not the corporation would have the power to indemnify the person against the liability under the provisions of this section.*

[8] S.B. 6048, effective July 26, 1987.

fact that most major banks are reporting their most profitable year in history for 1986."

LEGISLATIVE BRIEFS

Arizona: SB 1103, limiting the release by the state of information contained in annual reports filed by corporations with the state, has been introduced. The information may not be released "unless it is in statistical form that prevents identification of particular corporations." Further, the bill provides that the information may be used as evidence in judicial proceedings or certain hearings, may be released to the state department of revenue for tax purposes, or may be released to a state or federal agency upon written request.

• HB 2082, SB 1087, and SB 1096, providing that directors and officers of nonprofit corporations are immune from personal liability for actions taken in good faith within the scope of their authority, have been introduced. Further, a "customary level of corporate indemnification" must have been obtained under §10-10005.

Georgia: HB 219, permitting a corporation to limit or eliminate directors' personal liability for breaches of fiduciary duty through its articles of incorporation, has been introduced. A limiting provision may not restrict a director's liability for breach of the duty of loyalty or for acts not done in good faith or that involve intentional misconduct or a knowing violation of the law. The bill also would amend indemnification provisions for directors.

Kansas: SB 26, amending Kansas corporation law to permit shareholders to limit directors' liability through a charter amendment or provision in the original certificate of incorporation, has been introduced. The bill permits elimination of directors' personal liability for breaches of fiduciary duty of care, but not for breaches of the duty of loyalty, failure to act in good faith, intentional misconduct, knowingly violating a law, paying an illegal dividend or approving an illegal stock repurchase, or obtaining an improper personal benefit. The bill would also eliminate provisions in the corporate law prohibiting indemnification by a corporation of officers and directors who have been found liable for negligence or misconduct. Shareholders may not limit directors' liability retroactively.

• HB 2107, limiting liability of directors or officers of a charitable organization, has been introduced. The bill provides that directors or officers may not be individually liable or the board as a whole may not be liable in a civil damages action for acts or omissions "unless such conduct constitutes willful or wanton misconduct or intentionally tortious conduct, but only to the extent the directors and officers are not required to be insured by law or are not otherwise insured against such acts or omissions."

Maryland: HB 242, permitting corporations to adopt provisions in the articles of incorporation that permit limitations on directors' personal liability, has been introduced. A director would only be liable if the person fails to perform the duties of a director in accordance with the statutory standard and the conduct amounts to willful misconduct or deliberate recklessness, or if the director received an improper benefit or voted for an illegal dividend.

• HB. 233, which would permit only limited liability for directors or officers of a voluntary organization where the organization obtains insurance with certain minimum coverage, has been introduced.

Minnesota: SB 7, which would repeal current securities regulation provisions and basically adopt the Uniform Securities Act of 1985 as issued by the National Conference of Commissioners on Uniform State Laws, has been introduced.

• HB 141, which would make directors or trustees of organizations that are exempt from state income tax immune from most civil suits if the directors or trustees acted in good faith and were not reckless, has been introduced. The director or trustee also must have been acting within the scope of the person's responsibilities as director or trustee.

Mississippi: HCR 62 and SCR 550, calling for an amendment to the Mississippi Constitution of 1980 that would repeal provisions that give all stockholders the right to vote their shares cumulatively for a single candidate for the board of directors or to vote shares of stock for all directors to be elected, have been introduced. The current constitutional provision also permits the issuance of preferred stock without voting rights.

• HB 1050, amending provisions dealing with a corporate director's duties to the corporation, has been introduced. The bill would amend §79-3-91, Mississippi Code of 1972, to state that a director must discharge directorial duties in accordance with the director's good faith business judgment of the best interests of the corporation. Unless a director has special knowledge, a director is entitled to rely on information, reports, or statements prepared by other officers or employees that the director believes to be reliable and competent; legal counsel or public accountants, or a committee of the board of directors, if certain conditions are met. A director is not personally liable for actions taken as a director if the director performs the duties of the office in compliance with subsection 79-3-91.

• SB 2574, permitting a corporation to include provisions in its articles of incorporation limiting a director's personal liability for breaches of fiduciary duty, has been introduced.

• SB 2501, limiting the liability of charitable and nonprofit organizations and their directors in certain cases, has been introduced.

Montana: HB 182, which would impose escrow requirements on securities issues to a promoter while a corporation is in a promotional or developmental stage, has been introduced.

• SB 49, abolishing individual liability of officers and directors or nonprofit corporations except in in-

stances of willful or wanton misconduct, has been introduced.

Nebraska: LB 650, which would permit the Nebraska Director of Banking and Finance to impose a fine of up to $25,000 for violations of the Nebraska Securities Act or rules or regulations under the Act, has been introduced. Failure to pay the fine and investigative costs would constitute a forfeiture of the violator's right to do business in the state under the Nebraska Securities Act.

• LB 425, permitting a corporation to amend its articles of incorporation to eliminate or limit the personal liability of a director to the corporation or its stockholders for breaches of fiduciary duty in certain cases, has been introduced.

Nevada: SB 52 and 58, permitting limitations on directors' liability in articles of incorporation, have been introduced. The limitation may not cover breaches of loyalty by a director.

New York: SB 830, which would provide for greater regulation of commodity contracts trading, has been introduced. The bill would provide a statutory definition of commodity and commodity contract, and would permit the attorney general to prosecute persons charged with commodity fraud where exclusive jurisdiction is not within the Commodity Futures Trading Commission. The bill also would give the attorney general authority to bring an action for either legal or injunctive relief in federal court to enjoin a fraudulent practice, or to enforce compliance with the Commodity Exchange Act or CFTC rules. For persons registered under the CEA other than floor brokers or registered futures associations, the attorney general may bring an action under the CEA in state court. The attorney general also is given certain investigative authority under the bill.

Ohio: HB 156 and SB 50, which would provide that authority conferred on corporations to grant options with conditions that preclude shareholders of a certain percentage of outstanding common shares from exercising the options applies only to companies that have shares listed on a national securities exchange or that are regularly quoted in an over-the-counter market by members of a national or affiliated securities association, have been introduced.

• HB 155, clarifying when shareholders may not authorize directors to amend a merger or consolidation agreement, has been introduced.

Oklahoma: HB 1038, permitting corporations to limit personal liability of directors through provisions in the articles of incorporation, has been introduced. Under the bill, a liability-limiting provision may not limit liability for breach of a director's duty of loyalty, for acts not in good faith or involving intentional misconduct or a knowing violation of the law, or for transactions from which the director derived an improper personal benefit. The provision also may not excuse a director from liability under §1053 of Section 6, Chapter 292, O.S.L. 1986. The bill also would provide that a director's or officer's right to indemnification continues even though the person has ceased to be a director or officer, and that the right inures to the estate of a former director or officer.

Oregon: SB 145, adopting the Oregon Commodity Code, has been introduced. The bill would prohibit certain commodity contracts, grant the corporation commissioner authority to enforce the Act, and punish violations of the Act by a maximum of 10 years imprisonment and a $100,000 fine.

South Dakota: SB 98, which would excuse directors and officers of tax- exempt, nonprofit corporations from personal liability unless there was willful or wanton misconduct, has been introduced.

Texas: HB 403, which would permit a corporation to amend its articles of incorporation to eliminate or limit a director's personal liability for breaches of fiduciary duty, has been introduced. The provision could not eliminate liability for breaches of the duty of loyalty, or for an act not done in good faith or that involved intentional misconduct.

REGULATORY BRIEFS

Florida: A trial court should have compelled parties in a securities law and fraud dispute to arbitrate their claims due to an arbitration clause in a franchise agreement between the parties, the Florida District Court of Appeal determines. Carol McCrory and Linda Kline brought a complaint with five causes of action against Doctors Associates, Inc. The complaint contained Florida securities law, franchise misrepresentation, common law fraud, and civil theft claims. The trial court granted a motion to compel arbitration under a franchise agreement only for the Florida securities law claim. The appeals court says that the trial court should have compelled arbitration of each count. Judge Monterey Campbell III relies on *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Melamed*, 453 So.2d 858 (FlaDistCtApp 1984), in reversing, and ordering arbitration of all claims (*Doctors Associates, Inc. v. McCrory*, Case No. 86-1151, FlaDistCtApp, 1/21/87).

Maine: New rules governing investment adviser registration in Maine took effect Feb. 1. The Securities Division of the Maine Bureau of Banking proposed the rules last August, and the comment period closed Sept. 26, 1986. The rules cover applications for licensing, amendments to an adviser's licensing file, renewal applications, custody of clients' securities and funds, statements of financial condition, and recordkeeping by advisers.

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STATE OF ALASKA
1988 LEGISLATIVE SESSION

BILL VERSION: CSSB 343 (Jud.) 2/18/88
PUBLISH DATE:

FISCAL NOTE

REQUEST:

Revision Date:
Title: Relating to the liability of directors of corporations
Sponsor: Sturgulewski, Uehling, Fahrenkamp and Kelly
Requester: XXXXXXX

Agency Affected: Commerce & Econ. Dev.
BRU: Banking, Securities & Corporations
Components:

EXPENDITURES / REVENUES : (Thousands of Dollars)

OPERATING	FY 88	FY 89	FY 90	FY 91	FY 92	FY 93
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	-0-	-0-	-0-	-0-	-0-	-0-

	FY 88	FY 89	FY 90	FY 91	FY 92	FY 93
CAPITAL	-0-	-0-	-0-	-0-	-0-	-0-
REVENUE	-0-	-0-	-0-	-0-	-0-	-0-

FUNDING: (Thousands of dollars)

	FY 88	FY 89	FY 90	FY 91	FY 92	FY 93
GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	-0-	-0-	-0-	-0-	-0-	-0-

POSITIONS:

	FY 88	FY 89	FY 90	FY 91	FY 92	FY 93
FULL-TIME	-0-	-0-	-0-	-0-	-0-	-0-
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary.)

Prepared by: Willis F. Kirkpatrick, Director
Phone: 465-2521
Division: Banking, Securities and Corporations
Date: 2-18-88

Approved by Commissioner: J. Anthony Smith, Commissioner
Date: 2-18-88
Agency: Department of Commerce and Economic Development

Distribution (by preparer):
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page ___ of ___

0644D-7/21888c

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April 12, 1988

Representative Dave Donley
Alaska House of Representatives
P. O. Box V
Juneau, Alaska 99811

Re: CSSB 343 (Judiciary)
Our File No. 600,100.644

Dear Representative Donley:

This letter is written on behalf of Sealaska Corporation in support of CSSB 343 (Judiciary). The legislation is patterned after Delaware's model director liability statute. The bill would allow a corporation's shareholders to agree to limit the liability of their directors for simple negligence in actions by these shareholders or the corporation itself. The bill has no impact whatsoever on directors' liability to creditors or other third parties.

In the past two years, 38 states have enacted legislation authorizing limitations of liability that are either identical to the provisions of SB 343 or substantially broader. *See* Attachment 1, Exhibit A. Our sister states have acted in response to rapidly increasing shareholder-related D&O liability litigation -- a situation that has discouraged qualified people from serving as corporate directors, and that has caused D&O liability insurance premiums to increase by about 1,000% in three years. Without this legislation, Alaska will remain far behind the

curve in responding to the situation, and its corporate code will remain a disincentive to incorporating in Alaska. 1/

The most visible manifestation of the current crisis are the well publicized, multi-million dollar settlements that have been obtained against directors and officers in the past few years. Banks have been particularly hard hit by these settlements -- for example, five former officers and directors of Seafirst Corp. agreed to a $110 million settlement of litigation arising out of the bank's participation in energy loans. In Attachment 2, director liability expert Dan A. Bailey lists 16 such settlements -- ranging from $13.9 million to $200 million. Id. at 2-5.

The problem, however, goes far beyond occasional horror stories. There has been, in fact, a "virtual explosion of litigation against corporate managers within the last five to seven years . . ." Attachment 2 at 1. The Wyatt Company has performed a comprehensive survey both of the increase in D&O litigation, and its impact upon available insurance coverage. The company reports that the frequency of D&O claims has been increasing "in the range of 15% to 20% per year." Attachment 3 at 12.

Among corporations other than banks, about 40% of claims against directors and officers are brought by shareholders. Id. at 28. These are the only claims that would be affected by CSSB 343. 2/ The statistics strongly suggest

---

1/ A disincentive to local incorporation will, in many cases, also serve as a disincentive to doing business in our state. For example, if a corporation expects to earn a profit in Alaska, it will want to form an Alaska subsidiary so that Alaska earnings are not included in other states' income tax base. If, however, creation of an Alaska subsidiary carries with it exposure to an outdated, minority approach on director liability, the price of doing business here may be just too high.

2/ For banks, over 50% of the claims are brought by
(Footnote Continued)

that a large number of shareholder claims are, in fact, nuisance suits. Between 1977-85, 90% of the shareholder suits sought damages in excess of $1 million. Id. at 29. However, fully 74% of the cases closed during that period resulted in no payment to shareholders at all. Id.

If a large number of shareholder claims are ultimately shown frivolous, why the crisis? The answer, of course, are in the substantial defense costs associated with shareholder litigation -- whether meritless or not. Between 1977 - 85, the median attorneys' fee associated with shareholder actions against directors was $275,000.00 per claim. Id., at 30. 3/

D&O litigation's increasing popularity among shareholders has had a predictable impact on D&O insurance premiums. The firm of Heidrick & Struggles, for example, found that D&O liability insurance premiums increased an average of 506% in 1986, and that in 20% of the cases, the annual increase was over 1,000%. Attachment 4. Similarly, the Wyatt Company found in excess of a 1,000% increase in D&O premiums between 1984 and 1987. Attachment 3 at 91. In that same period, the average deductible for claims subject to corporate reimbursement increased from $46,511.00 (1984) to $649,947.00 (1987). Id. at 76. Policy limits during that period decreased from between 14.9% and 41.7%, depending upon the size of the company. Id. at 57. The substantial increase in premiums, ccupled with the decline in coverage, has put D&O insurance out of the reach of many small corporations. For example, in 1974, 70% of American corporations with assets under $10 million were covered by D&O liability insurance; by 1987, that percentage had shrunk to 29%. Id. at 51.

(Footnote Continued)
customers, while 12 to 16% are brought by shareholders. Id. Customer claims would not be affected by CSSB 343.

3/ For all D&O claims, the legal fees for claims that were dropped by claimants altogether averaged $130,340.00. Id at 25.

The crisis has had a significant effect on the ability of corporations to keep and retain outside directors, and it threatens the quality of corporate decision making:

> These problems have left many businesses facing a difficult choice: A company can go without insurance, which may expose the personal assets of directors to the risk of liability judgments; or the company can utilize one of the alternatives to traditional insurance -- alternatives which may be challenged in court, and which may in themselves be a source of litigation.
>
> The loss of talented directors can affect the success of a company and this consequence must be included in coverage decisions. Outside directors can most easily leave and they are frequently considered to be the representatives of non-management shareholders. Their resignation may be viewed as a significant loss by the shareholders. Even when directors remain on an uninsured board, the need to avoid litigation may adversely effect their decisions. 4/

Available statistics also indicate that the crisis has, in fact, caused a decline in the number of outside directors. For example, in 1975, 63.2% of the directors of America's largest companies were "outsiders," while that number decreased to 57.5% in 1986. Attachment 4 at 2. Obviously, without the large personal stake possessed by a major shareholder/manager, the potential personal risks to an outside director will more and more outweigh the benefits of serving the company. In fact, almost one-third of the directors surveyed in a 1986 Touche Ross survey "have considered retiring from their boards because of the increased liability to which they are exposed." Attachment 6 at 2.

4/ Rollins Burdick Hunter, "Directors and Officers Liability Insurance: Challenge and Alternatives," February, 1987 at 2 (Attachment 5).

As a result, the director liability crisis will likely have, in the long run, precisely the opposite effect that shareholder activists might have expected. It is likely to cause directorships to be more tightly held by the corporation's major shareholders -- who may still have the financial incentive to take the increasing risk. Boards of Directors are likely to become more closed, and more defensive. In economic terms, corporations are likely to become less aggressive.

Out of economic self-interest, as well as fairness, most states, other than Alaska, have responded to this crisis by enacting legislation authorizing a limitation on director liability to their shareholders in limited cases. As Mr. Bailey has observed:

> The single most important development in D&O liability during the last two years has been the enactment by most of the states of various forms of remedial legislation which attempts to address the D&O liability and insurance crisis. These legislative efforts are significant not only because of the additional protections which they afford directors (and sometimes officers), but also because they evidence the concerns which the state legislators and presumably the public have toward preserving an environment in which directors, particularly outside directors, are willing to serve.

Attachment 1 at 1.

The benchmark legislation is Delaware's, on which CSSB 343 is patterned. Under the Delaware approach, and CSSB 343, a director's liability may be limited (e.g., in monetary terms) or eliminated for simple negligence. The liability limitations, however, apply <u>only</u> to actions against the director by the corporation or its stockholders, and do not apply in the case of a breach of the director's duty of loyalty, or for intentional misconduct. Further, liability can be limited <u>only</u> if the shareholders agree to amend the corporation's Articles of Incorporation to so provide.

20 states (including Delaware, California, and Oregon) have enacted substantially similar legislation.

Attachment 1, Exhibit A. Three additional states have adopted the Delaware approach, but have extended its protections to corporate officers (Louisiana, Maryland and New Jersey). Id. 12 other states (including Indiana, New York and Ohio) have gone further. Typical of the more comprehensive approach is Indiana's statute, which makes directors liable only for reckless or willful misconduct (or violations of federal securities laws,), and which is self-executing -- that is, it does not require shareholder approval. See Attachment 1 at 4-5. In all, five states have enacted "self-executing" legislation.

Director liability legislation is as important in Alaska as in any other state. Indeed, directors of Alaska corporations hardly fit the mold of corporate "fat cats" who have: (1) the kind of personal fortunes necessary to withstand personal liability; and (2) the expectation of extraordinary personal gain that might, in other circumstances, make personal liability more appropriate. This is particularly true, for example, of Alaska's Native corporations. At the village, and even the regional level, the corporations' directors generally serve on the board as a matter of community service, and have no disproportionate expectation of personal gain.

The willingness of a state to adapt its corporate code to present realities provides a strong indication of that state's general business climate. Enactment of CSSB 343 would bring Alaska in line with its sister states, and would send a strong signal that the state is willing to strike a reasonable balance in its commercial laws.

Sincerely,

BIRCH, HORTON, BITTNER
CHEROT & ANDERSON

Jonathan K. Tillinghast

JKT/jrm
encs.

HOUSE COMMITTEE REPORT

(7)

Date referred: 3/2/88 FURTHER REFERRALS: Judiciary

DATE: 4/21/88

The Labor & Commerce Committee has considered CSSB 343(Jud)

"An Act relating to the liability of directors of corporations."

RECOMMENDS:

[X] replace with HCS CSSB 343(L&C) [X] the same title

[ ] attached amendment(s) [ ] a new title

[X] do pass

[ ] do not pass

[ ] no recommendation

[ ] individual recommendations

[ ] additional referral to the ______________ Committee

ADOPTS: [ ] __________ letter of intent

ATTACHES NEW FISCAL NOTE(s):

[ ] fiscal impact

[ ] zero fiscal note

[ ] zero with analysis

[ ] same as previous fiscal note published ______________

[X] same as previous zero fiscal note published 2/23/88

SIGNING DO PASS:

SIGNING OTHER RECOMMENDATIONS:

Chairman's signature