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3 4 3

Original sponsors: Sturgulewski, Uehling,
Fahrenkamp and Kelly

1 IN THE SENATE

BY THE LABOR AND
COMMERCE COMMITTEE

2 CS FOR SENATE BILL NO. 343 (L&C)

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 FIFTEENTH LEGISLATURE - SECOND SESSION

5 A BILL

6 For an Act entitled: "An Act relating to the liability of directors of
7 corporations."

8 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9 * Section 1. AS 10.05.255 is amended by adding new subsections to read:

10 (c) In addition to the matters required to be set out in the
11 articles of incorporation by (a) of this section, the articles of
12 incorporation may also contain a provision eliminating or limiting the
13 personal liability of a director to the corporation or its stock-
14 holders for monetary damages for the breach of fiduciary duty as a
15 director. The articles of incorporation may not eliminate or limit
16 the liability of a director for

17 (1) a breach of a director's duty of loyalty to the corpo-
18 ration or its stockholders;

19 (2) acts or omissions not in good faith or that involve
20 intentional misconduct or a knowing violation of law;

21 (3) wilful or negligent conduct involved in the payment of
22 dividends or the repurchase of stock from other than lawfully avail-
23 able funds; or

24 (4) a transaction from which the director derives an im-
25 proper personal benefit.

26 (d) The provisions of (c) of this section do not eliminate or
27 limit the liability of a director for an act or omission that occurs
28 before the effective date of the articles of incorporation or of an
29 amendment to the articles of incorporation authorized by (c) of this

1 section.

2 * Sec. 2. AS 10.20.151 is amended by adding new subsections to read:

3 (d) In addition to the matters required to be set out in the
4 articles of incorporation by (a) of this section, the articles of
5 incorporation may also contain a provision eliminating or limiting the
6 personal liability of a director to the corporation for monetary
7 damages for the breach of fiduciary duty as a director. The articles
8 of incorporation may not eliminate or limit the liability of a direc-
9 tor for

10 (1) a breach of a director's duty of loyalty to the corpo-
11 ration;

12 (2) acts or omissions not in good faith or that involve
13 intentional misconduct or a knowing violation of law; or

14 (3) a transaction from which the director derives an im-
15 proper personal benefit.

16 (e) The provisions of (d) of this section do not eliminate or
17 limit the liability of a director for an act or omission that occurs
18 before the effective date of the articles of incorporation or of an
19 amendment to the articles of incorporation authorized by (d) of this
20 section.
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FISCAL NOTE

REQUEST:

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

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-

CAPITAL	-0-	-0-	-0-	-0-	-0-	-0-
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REVENUE	-0-	-0-	-0-	-0-	-0-	-0-
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FUNDING: (Thousands of dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	-0-	-0-	-0-	-0-	-0-	-0-

POSITIONS:

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: _____
Approved by Commissioner: J. Anthony Smith, Commissioner Date: 1-26-88
Agency: Department of Commerce and Economic Development

Distribution (by preparer):

- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)

STATE OF ALASKA
1988 LEGISLATIVE SESSION

BILL VERSION: SB 343
PUBLISH DATE: _____

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Division: Banking, Securities and Corporations

Phone: 465-2521
Date: January 21, 1988

Approved by Commissioner: D. Anthony Smith, Commissioner
Agency: Department of Commerce and Economic Development

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page _____ of _____

**Issues Facing U.S.
Corporate Directors**
December 1986

Touche Ross

An opinion survey of directors of major U.S. corporations on the consequences of increased director's liability and other issues that affect the work of the board: the U.S. economy, foreign trade pressures, and the outlook on corporate America's future.



Are directors of large U.S. corporations concerned about their ability to make the right decisions in their work on the board? What do they think about foreign trade pressures, intense merger and acquisition activity, and access to capital markets? As directors, how do they deal with increased personal liability? Do they foresee problems recruiting qualified board candidates in the future?

These and other issues critical to the future of business in America were explored in a nationwide survey of corporate directors conducted by Touche Ross in the fall of 1986. More than 1,100 directors participated in the survey; nearly three-quarters of them serve on boards of companies with annual sales (or the equivalent in assets) of \$1 billion dollars or more, and 81 percent have more than five years of board experience.

Highlights

Directors' Issues

- Almost one-third of the directors surveyed say they have considered retiring from their boards because of the increased liability to which they are exposed.
- Ninety-three percent of the directors polled believe increased liability will make it more difficult to recruit talented, experienced people to serve on boards in the future.
- More than 80 percent of the directors surveyed believe today's directors, in general, are more effective than they were twenty years ago.

Corporate and Economic Issues

- Nearly half the directors surveyed believe merger and acquisition activity has hurt the U.S. economy. Nevertheless, when the survey was conducted in September and October of 1986, some 45 percent of the directors polled believed that merger and acquisition activity would remain at the same level, and 27 percent said it would increase, over the next twelve months.

- While half of the directors say foreign trade has adversely affected earnings of companies of which they are a board member, the large majority of all directors polled do *not* think Congress should pass legislation to protect U.S. business from foreign competition.
- Eighty-one percent of the directors polled do not believe that, over the next year, Third World debt will have an adverse effect on the balance sheets of companies where they serve on the board.
- Almost one-third of the directors surveyed think the bankruptcy rate for companies with sales of \$1 billion or more will increase in the coming year.
- Directors divide evenly in their opinion on whether corporate America's investment in capital equipment will increase, decrease, or continue at the same level in the next twelve months. However, 77 percent believe investment in capital *plant* will decrease or remain the same. The vast majority agree that corporate America will increase its investments in technology and in research and development in the next year.

Directors' Issues

Most survey participants are highly experienced board directors who serve major U.S. corporations: 71 percent of the respondents serve on at least one board of a business whose annual sales equal or exceed \$1 billion; 76 percent serve on more than one board; and 58 percent have ten or more years of board experience.

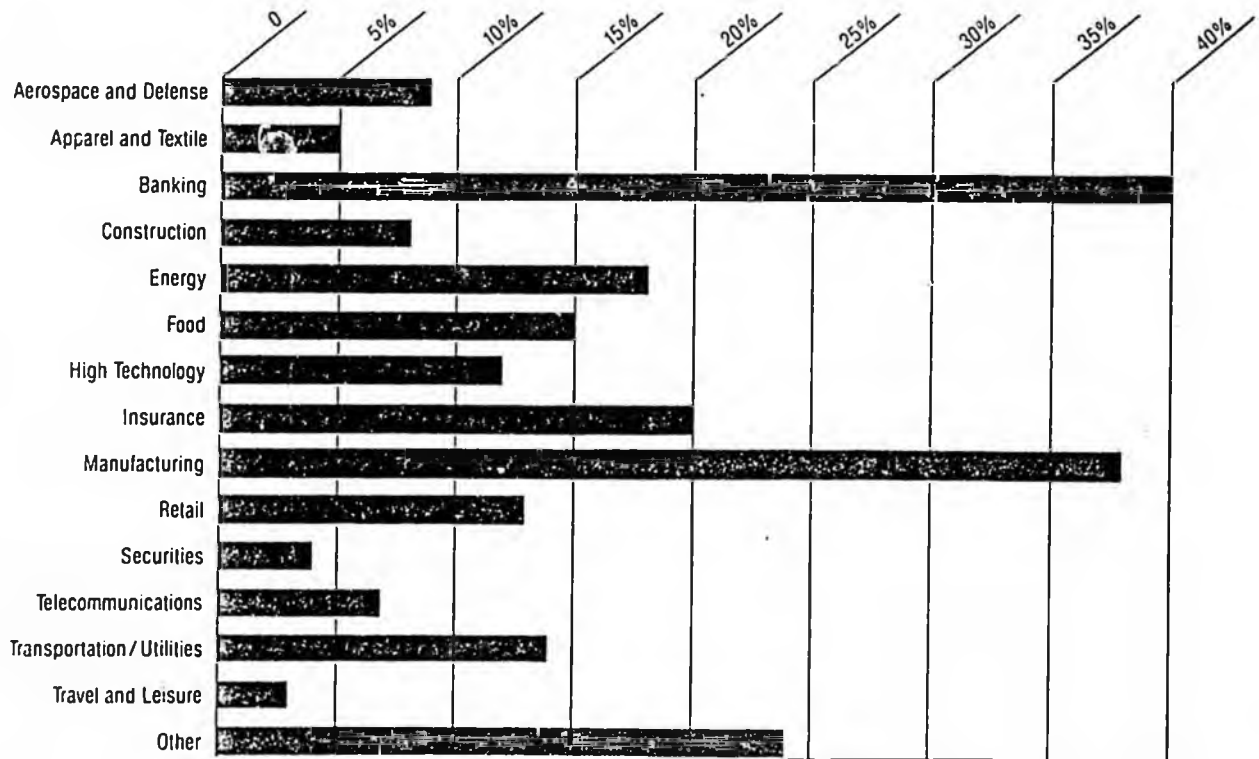
Participants in the Survey

The directors surveyed serve on a wide diversity of boards of large businesses and industries: 71 percent serve on at least one board of a business that has annual sales of \$1 billion (or the equivalent in assets) or more; 41 percent serve on at least one board of a company that has annual sales of \$500 million to \$999 million; and 45 percent serve on at least one board of a business that has annual sales of under \$500 million.

Of the directors surveyed, 24 percent serve on one board only; 26 percent serve on two boards; 21 percent serve on three boards; 13 percent serve on four boards; and 16 percent serve on five or more boards. Thus, most participants in the survey have extensive board experience.

This fact is supported by the amount of time the respondents have served as directors: less than one-fifth of the respondents have been directors for less than five years; 23 percent have five to nine years of

Industries Served by Survey Respondents



Note: Percentages total more than 100 percent because nearly three-quarters of the directors surveyed serve on more than one board.

experience; 23 percent have ten to fourteen years of experience; 15 percent have served as board members for fifteen to nineteen years; and 20 percent have served for twenty years or more. Eighty-one percent of the total respondents have at least five years of board experience, and 58 percent have served ten or more years. The majority of respondents, then, are widely experienced board directors who serve large U.S. businesses.

Nearly three-quarters of the respondents are officers of one or more companies where they serve on the board:

- 26% are Chief Executive Officers
- 9% are Chief Operating Officers
- 9% are Chief Financial Officers
- 6% are Executive Vice Presidents
- 9% are Senior Vice Presidents or Vice Presidents
- 4% are Chairmen
- 4% are Vice Chairmen
- 6% are Presidents, Legal Counsels, Secretaries, and other officers.

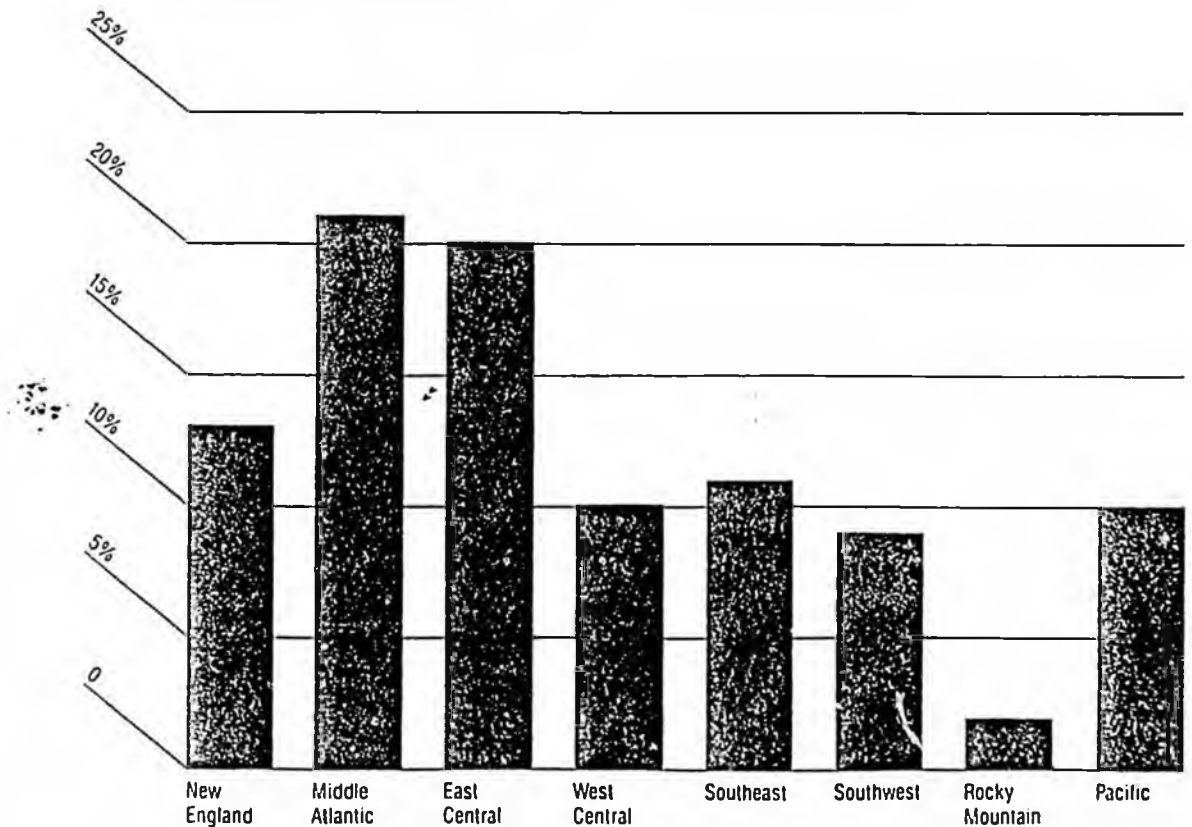
Eighty-eight percent of the outside directors were recruited by the chief executive officer; 7 percent by another officer of the company; 4 percent by an executive search firm; and 10 percent by others.

Twenty-three percent of the respondents are officers or retired officers of other companies, and 20 percent have special business experience or skills. Only 2 percent represent a special, external constituency.

Internal directors serving their board(s) tend to have the least board experience—both in number of years served and in number of boards served on. Predictably, the more years directors have served, the more likely they are to be officers or retired officers of another company, or to have special business-related experience or skills. However, directors who have served on a board for twenty years or more are *three times* more likely to be major stockholders of the company(ies) served than directors serving less than twenty years.

Nearly three-quarters of the directors surveyed are officers of one or more companies where they serve on the board. Of those who are outside directors, 88 percent were recruited by the chief executive officer.

Regions of the United States in Which Survey Participants Live



Some 93 percent of the directors surveyed believe that increased directors' liabilities will make it more difficult to recruit talented, experienced people in the future. The directors imply, then, that increased liability will create boards whose members will be less qualified or less effective than today's.

Ninety percent of the directors surveyed serve on board committees, and most serve on a number of these committees. Predictably, those who do not serve on committees have less than five years of board experience or serve on only one board. Directors who are officers of at least one company on whose board they serve are most likely to sit on the executive committee (64 percent), followed by the compensation committee (43 percent), the audit committee (40 percent), and the budget committee (11 percent). Thirteen percent of these directors serve on no board committees.

Outside directors—defined here as directors who are not officers of any company on whose board they serve—are most likely to serve on the audit committee (75 percent), followed by the compensation committee (63 percent), the executive committee (58 percent), and the budget committee (8 percent). Only 2 percent of these directors serve on no board committees.

Forty percent of the directors who are not officers of any company on whose board they serve sit on other committees, as do 25 percent of those directors who are officers of at least one company on whose board they serve. These committees include the nominating, contribution, social responsibility, public policy, and foundation committees.

The Challenge of Increased Liability

One-third of the directors surveyed say they have considered retiring from one or more of their board seats because of the increased liabilities to which they are exposed. In fact, the longer that directors have served on boards, the more likely they are to think of retiring because of increased liabilities. Only 16 percent of all the directors polled who have less than five years of board experience think of retiring, while the percentage more than doubles for directors who have five or more years of experience.

While 41 percent of the directors who are not officers of any company where they serve on the board have considered retiring because of increased liability, 36 percent of CEOs also say they have considered doing

so. Some 36 percent of committee members, regardless of the committee(s) on which they serve, have considered retiring, while only 16 percent of non-committee members of the board have considered doing so. Thus, directors who have the least experience as measured by length of time served, and those who are not involved with board committees are the least concerned about increased liabilities.

Given the pace of change affecting the business community and the responsibilities of corporate directors, 35 percent feel only "somewhat confident" in exercising their responsibilities as a director and 4 percent feel "unsure." Overall, 62 percent of board members feel "confident." CEOs feel more confident than any other board members, with 66 percent saying so. Fifty-nine percent of CFOs express confidence in today's board environment, as do 60 percent of the other officers who serve on boards and 60 percent of those directors who are not officers of any companies where they serve on the board. The least confident in exercising their responsibilities are board members who serve on no board committees and who have, perhaps, the least "hands-on" experience.

Although the less-experienced directors worry the least about increased liabilities, it is not really a contradiction that they are the least confident in dealing with board matters. The survey results imply that, while they are aware that they lack knowledge of areas which are brought before the board, they may not be aware—precisely because they know less—of the extent to which increased directors' liabilities can affect them.

An overwhelming 93 percent of the directors surveyed believe that increased liability will make it more difficult to recruit talented, experienced people in the future. This percentage holds for all directors, regardless of length of board service, their involvement in committee work, and whether they are officers of any company on whose board they serve. Do the findings imply that increased liability will create boards whose members will be less qualified or less effective than current board members?

A great majority of the directors surveyed (83 percent) believe that today's directors are more effective than those of twenty years ago. Eighty-five percent of the directors serving on boards for twenty or more years (and who can, therefore, compare their earlier experience to their present experience), and 86 percent of the directors serving on three or more boards, find today's directors more effective than do those serving on fewer boards and with fewer years of experience.

Directors' Influence on Their Board(s)

When asked how much influence they have on their board(s), 39 percent of the respondents say their influence is great. Sixty percent claim moderate influence, and only 6 percent believe their influence is small. These responses and percentages hold true for both internal and outside directors.

Directors with less than five years of board experience and directors who sit on only one board feel they have the least influence. The more boards that directors serve on, the greater they believe their influence to be: 54 percent of directors serving on more than five boards say their influence is great, the largest percentage of all directors surveyed to say so. Directors who have served on a board(s) for twenty years or more are also likely (44 percent) to think they have great influence.

The directors' responses also reflect the particular board committees on which they serve. Fifty-two percent of directors serving on the budget committee believe their influence on the board is great, as do 47 percent of those who sit on the compensation committee, 43 percent of those on the executive committee, 38 percent of audit committee members, and 36 percent who serve on other committees. Nearly 20 percent of directors who do not serve on any committees say their influence is small.

Directors' Influence on the Chief Executive Officer

While 90 percent of the directors who are not officers of any company on whose board they serve were recruited by CEOs, only 28 percent believe they have great influence on the CEO(s). Directors serving on more than five boards feel they have the greatest influence (35 percent), followed by or including those who sit on board committees. Twenty-nine percent of the directors serving on compensation committees feel they have great influence on the CEO, followed by those serving on the audit committee (28 percent), the budget committee (27 percent), and the executive committee (24 percent).

Interestingly, 90 percent of the outside directors surveyed who are not officers of any company where they serve on the board were recruited by the chief executive officer—yet only 28 percent believe they have great influence on the chief executive officer.

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 reportedly experienced difficulties in obtaining or maintaining sufficient coverage at a reasonable cost. As a result, many 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 distinct 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.

It 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

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

On 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 relevant portions of the Delaware, Alaska and Washington State law.

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.

STATE OF ALASKA
1988 LEGISLATIVE SESSION

BILL VERSION: SB 343
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REVENUE	-0-	-0-	-0-	-0-	-0-	-0-
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Division: Banking, Securities and Corporations

Phone: 465-2521
Date: January 21, 1988

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