

**HB**

**92**

# Alaska State Legislature

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## **Representative Mike Kelly** *House District 7*

### **MEMORANDUM**

**To:** Senator Dyson, Chair, Health, Education and Social Services Committee  
**From:** Rep. Mike Kelly *Mike Kelly by DM*  
**Date:** January 24, 2006  
**Re:** Committee Hearing Request – CSHB 92(JUD)

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Attached you will find the bill packet for CSHB 92(JUD) - "*An Act relating to the purchase of interests in corporations, including limited liability companies, by the University of Alaska.*" The packet contains the following:

- Current version of the bill
- Sponsor Statement
- Fiscal Note
- Testimony of University of Alaska Associate General Counsel Mary E. Greene
- Questions & Answers, Associate General Counsel Mary E. Greene
- Memorandum by Craig Dorman, Vice President for Research and Academic Affairs
- Background information

In addition, I have provided written testimony from Meg Greene - acting General Counsel for the University of Alaska, written testimony from Dr. Craig Dorman - Vice President of Research for the University of Alaska and reference material.

Thank you for your time and attention to this request. If I can provide any other relevant information or answer any immediate questions you might have, feel free to contact me directly at extension 4976 or my staff, Derek Miller at extension 6890.

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## Member

House Finance Committee

## Representative Mike Kelly

House District 7

### CSHB 92(JUD)

*"An Act relating to the purchase of interests in nonprofit corporations by the University of Alaska."*

The University of Alaska has proven to be a valuable tool in Alaska's economic development. In a desire to allow the university to continue and expand its vital role in this area, we propose a much needed change in Alaska's corporate liability laws intended to protect the university from liability arising from "piercing the corporate veil".

"Piercing the corporate veil" is "a judicial process whereby the court will disregard the usual immunity of corporate entities from liability for wrongful corporate activities perpetrated fraud. The doctrine which holds that the corporate structure with its attendant limited liability of stockholders may be disregarded and personal liability imposed on stockholders, officers, and directors in the case of fraud or other wrongful acts done in the name of the corporation."<sup>1</sup> Generally, we believe this is a sound policy intended to protect consumers from fraudulent corporate abuses and encourage good corporate citizenship. However, in the university context the application of this theory has the unintended consequence of discouraging university investment in new corporate endeavors resulting from intellectual property generated by faculty research.

The university cannot support various types of economic development initiatives or associate with public groups through nonprofit corporations without the fear of liability arising from "piercing the corporate veil". As described above, the university could become liable for the tort obligations of a corporate entity it may start up, where the entity was not adequately capitalized or insured.

In one such immediate example the university rejected a 501 (c)(3) nonprofit corporation to lead the business enterprise institute because of potential corporate veil liability. Likewise, the university has not been supportive of efforts by faculty members with intellectual property to start up corporations, recognizing that if liability were incurred by such a corporation, there would be substantial risk that such liability could pass on to the university. The most recent version of the bill stipulates that instances of fraud or other malfeasance committed by the university will not protect it under the corporate veil. This is positive change to the original bill that clarifies that while the Legislature wants to encourage responsible university investment intended to advance its research mission, it also wants to guarantee ongoing protections to the general public.

Our intent with HB 92 is to specifically define a university/corporate liability structure intended to encourage new university investment in nonprofit corporations resulting from research-generated intellectual property or companies created and managed on university lands. The University of Alaska is a valuable component to Alaska's economic engine and this bill will go to great lengths to expand its ability to increase economic development in our state.

<sup>1</sup> Nolan, J.R., & Nolan-Haley, J. M. (1990) Piercing the corporate veil In *Black's Law Dictionary*, (pp. 1147-1148) St. Paul, MN: West.

# FISCAL NOTE

**STATE OF ALASKA**  
**2005 LEGISLATIVE SESSION**

Fiscal Note Number: 1  
 Bill Version: CSHB 92(EDU)  
 (H) Publish Date: 4/18/05

Revision Date/Time (Note if correction): \_\_\_\_\_ Dept. Affected: University of Alaska  
 Title University of Alaska and Corporations RDU \_\_\_\_\_  
 Component \_\_\_\_\_  
 Sponsor Representative Kelly \_\_\_\_\_  
 Requester \_\_\_\_\_ Component No. \_\_\_\_\_

**Expenditures/Revenues** (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
<b>TOTAL OPERATING</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

<b>CAPITAL EXPENDITURES</b>						
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<b>CHANGE IN REVENUES ( )</b>						
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**FUND SOURCE** (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
<b>TOTAL</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

Estimate of any current year (FY2005) cost: 0.0  
 Mark this box (X) if funding for this bill is included in the Governor's FY 2006 budget proposal:

**POSITIONS**

Full-time						
Part-time						
Temporary						

**ANALYSIS:** (Attach a separate page if necessary)  
 The bill limits the university's legal liability to the amount that the university invested into a separate corporation for the purpose of advancing the public purpose of the university. This bill would create no additional cost for the University.

Prepared by: Pat Pitney Phone 450-8191  
 Division University of Alaska Date/Time 4/15/05 1:53 PM  
 Approved by: Pat Pitney Date 4/15/2005CS  
 Agency University of Alaska

TESTIMONY OF MARY E. GREENE  
ASSOCIATE GENERAL COUNSEL  
UNIVERSITY OF ALASKA

I appreciate the opportunity to present a fuller explanation of some of the questions posed by members to me during the meeting held April 5, 2005, at 5:30 p.m.

One of the questions raised concerned why the University of Alaska should be treated differently than other corporations. There are several reasons. First, unlike most corporations, the University is a constitutional corporation created in Article VII, section 2 of the Alaska Constitution. That makes the University a part of the state unlike other corporations. The property of the State and the University is owned by the people of Alaska, not by a few shareholders. The University's mission is to serve the public interest, not provide dividends to investors like other corporations. Public money and public assets would be tapped if a plaintiff was able to pierce the corporate veil and reach University assets in addition to the money the University invested as a shareholder.

The effort of the University to avoid potential liability beyond those funds it voluntarily invests in a corporation is very much like the state's actions when it creates a state corporation or authority and refuses to pledge the credit of the state. That says to creditors of the authority or state corporation that they can only look to the assets the legislature has placed in the authority or corporation to pay the debts of the authority or corporation. The legislature has frequently used this tool to protect state assets while at the same time promote economic development or create a service that serves the public interest. For example, the legislature refused to pledge the credit of the state in the creation of the Alaska Railroad Corporation (AS 42.40.690), the Alaska Housing Finance Corporation (AS 18.56.170), corporations organized under the Business and Industrial Development Corporation Act (AS 10.10.190), the Alaska Student Loan Corporation (AS 14.42.260), the Alaska Medical Facility Authority (AS 18.26.150), Regional Electrical Authorities (AS 18.57.110), the Knik Arm Bridge and Toll Authority (bonds) (AS 19.75.241), state and municipal port authorities (AS 29.35.640), Regional Resource Development Authorities (bonds) (AS 30.13.090), Adak Reuse Authority (bonds) (AS 30.17.240), the Alaska Natural Gas Development Authority (AS 41.41.400), Alaska Energy Authority (bonds) (AS 44.83.130), the Alaska Municipal Bond Bank Authority (bonds and notes) (AS 44.85.130), and the Alaska Industrial Development and Export Authority (bonds) (AS 44.88.120). HB 92, if enacted, would do no more for University investments than the legislature has done in these instances. It would allow the University to voluntarily invest funds where the Board of Regents authorizes the investment AND the investment advances a public purpose. Those voluntarily invested funds would, of course, not be protected. They would be available for the payment of the corporation's debts. But a clever plaintiff would not be able to go beyond that corporation's assets to the other assets of the University. That is, the University would not have to pledge its credit by investing in a project that advances a public purpose.

If granted this protection, the University could help its faculty develop their research ideas into marketable goods and promote the economic development of Alaska. It could participate in worthwhile non-profit corporations that meet a public purpose. It could do so without risking the public's money that is invested in the University.

Thank you.

Mary E. Greene

Associate General Counsel

## **QUESTIONS & ANSWERS**

### **ASSOCIATE GENERAL COUNSEL MARY E. GREENE**

#### **5 examples of UA or any university's investment in a corporation that worked well.**

*THE UNIVERSITY GENERALLY DOES NOT INVEST IN CORPORATIONS. ONE OF THE REASONS IT DOES NOT, IS THAT, AS A DEEP POCKET, IT IS VERY CONCERNED ABOUT LIABILITY IF THE CORPORATE VEIL IS PIERCED.*

#### **5 reasons why UA would invest in a corporation, and what the benefits of UA investment would be to UA and to the venture.**

##### *KT-UP CORPORATIONS WITH FACULTY MEMBER:*

- 1. PROMOTE ECONOMIC DEVELOPMENT BY TURNING A RESEARCH PRODUCT INTO A MARKETABLE PRODUCT;*
- 2. FOSTER BETTER RELATIONSHIPS WITH RESEARCH FACULTY;*
- 3. ENHANCE REPUTATION OF UNIVERSITY THROUGH MARKETABLE PRODUCT (LIKE UNIV. OF FL WITH GATORADE) OR INVENTIVE PRODUCT ( LIKE SOME OF THE MAPPING PROGRAMMING THAT IS GOING ON HERE)*

##### *NON-PROFIT COOPERTIVE CORPORATION WITH OTHER UNIVERSITIES OR RESEARCHERS:*

- 1. CHANCE TO WORK WITH OTHERS TO SOLVE LARGE IMPORTANT ISSUES*
- 2. ASSIST OTHERS IN ADDRESSING ISSUES OF PUBLIC CONCERN*

#### **Is there in-kind investment that results in equity? How would that be structured?**

*THERE ARE IN START-UPS. NORMALLY WHAT UNIVERSITIES DO IS TO CONTRIBUTE THEIR INTEREST IN PATENTS OR OTHER INTELLECTUAL PROPERTY TO THE CORPORATION. OTHERS ARE MORE WILLING TO LEND MONEY TO A START-UP IF THE WHOLE IP IS PORPERTY OF THE CORPORATION. IT DOES NO HARM, NO MONEY IS INVESTED, BUT IT HELPS THE START-UP. I CANNOT GIVE SPECIFICS, BUT IT IS COMMON IN RESEARCH UNIVERSITIES TO DO SOMETHING LIKE THIS. MOST DO NOT MAKE MONEY FOR THE CORPORATION, BUT DO GET THINGS TO MARKET. I SPOKE WITH ONE OF THE ATTORNEYS FROM THE UNIVERSITY OF CHICAGO ABOUT THEIR PROGRAM AT A CONFERENCE A WHILE AGO. THEY HAD SEVERAL START-UPS. NONE HAD EVER PAID OFF IN DOLLARS, BUT ALL THOUGHT IT STILL TO BE A GOOD IDEA.*

#### **3 examples of lost opportunities for UA under current liability law.**

- 1. BUSINESS ENTERPRISE INSTITUTE WANTED TO ORGANIZE AS A NON-PROFIT WITH UNIVESITY PARTICIPATION INSTEAD OF AS A DEPARTMENT OF THE UNIVERSITY. GENERAL COUNSEL WOULD NOT ALLOW BECAUSE OF THE DEEP POCKET/CORP. VEIL ISSUE.*
- 2. WE HAVE HAD OFFERS TO PARTICIPATE IN START-UPS WITH FACULTY MEMBERS, BUT I DO NOT KNOW THE SPECIFICS.*

**Arguments for eliminating lawsuit options against UA, in the face of the loss of protection the current law may give non-UA stockholders of the spin-off company, or any member of the public that may be harmed by the spin-off.**

1. THE CREDITORS OF THE CORP AND OTHER PARTICIPANTS WOULD BE TREATED JUST THE SAME AS THE LAW NORMALLY WOULD TREAT THEM. EVERY INVESTOR WOULD LOSE ITS SHARE OF THE MONEY INVESTED. THE CREDITORS OF A CORPORATION CAN NORMALLY NOT COLLECT MONEY OWED BY THE CORPORATION FROM AN INVESTOR. THAT IS THE WHOLE REASON TO INCORPORATE IN MANY INSTANCES. AN INVESTOR CAN PROTECT HIS OR HER ASSETS WHILE STILL INVESTING IN THE BUSINESS.

2. THE ONLY THING THAT WOULD BE LOST TO CREDITORS/OTHER INVESTORS IS THE POSSIBILITY OF GOING AFTER THE DEEP POCKET OF THE UNIVERSITY BY ATTEMPTING TO PIERCE THE CORPORATE VEIL. THERE ARE PRECAUTIONS THAT THE UNIVERSITY CAN TAKE, BUT THE TEST IN ALASKA IS NOT BLACK/WHITE. IT IS A BALANCING TEST. IF THE PLAINTIFF WAS SYMPATHETIC, THERE IS ENOUGH WIGGLE ROOM IN THE LAW FOR A JURY THAT WAS SO INCLINED TO HELP OUT THE SYMPATHECTIC PARTY BY ZAPPING THE UNIVERSITY. THE UNIVERSITY CANNOT RISK THE PUBLIC'S ASSETS BY RISKING A DETERMINATION THAT WE WERE TOO INVOLVED TO KEEP CORPORATE PROTECTIONS GIVEN TO ALL, AND THUS ARE LIABLE FOR THE CORPORATION'S DEBTS.

**Would UA investments typically be temporary?**

I DOUBT IT. HOWEVER, IF A START-UP IN FACT TOOK OFF AND A LARGER CORPORATION WANTED TO BUY IT, THE UNIVERSITY WOULD LIKELY SELL SO AS NOT TO BLOCK THE DEAL. WITH NON-PROFITS, NORMALLY THERE IS LITTLE OR NO WAY OUT ONCE YOU INVEST FROM A PRACTICAL PERSPECTIVE. I AM GOING TO FORWARD THIS TO DIANNE MCLEAN WHO DOES IP FOR THE UNIVERSITY. SHE MAY HAVE SOME KNOWLEDGE ABOUT START-UP OR OTHER OPPORTUNITIES THE UNIVERSITY HAS MISSED.

## MEMORANDUM

**DATE:** 6 April 2005

**TO:** House Education Committee, Chair Mark Neuman

**FROM:** Craig Dorman, Vice President for Research and Academic Affairs,  
University of Alaska Statewide System

**RE:** Comments re HB92 from

Thank you for the opportunity to testify briefly last evening on the proposed change to AS 14.40.458, University Corporate Relations. Per your request, I will briefly reiterate my points:

The authorization requested is limited to ownership of stock, or membership in a corporation, that would "advance the mission of the University of Alaska, pursuant to the policies of the Board of Regents". Thus, such ownership or membership would be undertaken only to advance the instructional and research responsibilities of the university, and not principally as a money-making enterprise.

The motivation for participation in ownership of a corporation derives basically from PL- 96-517 of 1980 (and amendments in PL 98-620 of 1984), commonly referred to as the Bayh-Dole Act. This Act permits universities to elect ownership of inventions made under federal funding, and to become directly involved in the commercialization process. In the quarter century since its enactment, this Act has fundamentally changed university-industrial relationships, and has resulted in the introduction of many new technologies into public use. While there are a variety of ways that universities can transfer their technology to industry, the incubation of new small businesses has proven very successful in enhancing local, state and national economic development, particularly in the vicinity of university campuses. As part of that incubation process, universities may encourage and even assist their faculty to take an equity interest in bringing one of their inventions or ideas into public use; and since under Bayh-Dole the ownership of the invention accrues to the university (with sharing rights as detailed in the testimony of Judge Greene), universities may (and many do) elect to invest their non-general fund resources to encourage such activity. All such arrangements are conducted as business arrangements with full review by University General Counsel, and the proposed provision in AS 14.40 seeks to limit the University's liability to the obligations specified in those agreements.

The university is seeking this provision at this time because of recently enhanced emphasis on support of state needs, and in particular our interest in supporting diversified economic development in the state. As I have stated in earlier testimony to the House and Senate Finance Committees, nationally, industry conducts 70% of R&D, and universities conduct 14%. In Alaska, UA conducts

55% of R&D, and industries only 10%. This disparity suggests the need for even greater diligence on the part of UA than is typical for universities, in taking an active role in the development and incubation of new business. Recent actions to this end include both external and internal reviews of our technology transfer procedures, the formation of the Business Enterprise Institute (BEI) at the College of Business and Public Policy at UAA, the establishment of the Office of Electronic Miniaturization and search for a Vice Chancellor for Research and Economic Development at UAF, and UAF collaboration with local groups in Fairbanks in the establishment of the "NanookTech Technology Accelerator".

BEI and NanookTech are examples of entities that may evolve into non-profit corporations in which the university may wish to participate. As with stock ownership, the intent of the proposed change to AS 14.40 is to limit the university's liability to those obligations to which it explicitly agrees as a condition of its membership. Another example, which I briefly mentioned during my oral testimony, is the Alaska Ocean Observing System (AOOS), one of a number of such regional systems around the U.S., as recommended by the U.S. Commission on Ocean Policy. AOOS is designed to support safety of life at sea, improved weather forecasting, fisheries, and safety of marine transportation, and the University has played a leading role in its establishment and development. As AOOS and the associated national associations and federal funding mechanisms mature, it will likely become a 501(c)(3) corporation, and again the University would like to be able to continue to participate without the fear of liability reaching beyond its explicit obligations as a member.

## **SPIN-OFF COMPANY MODELS FOR UNIVERSITIES: *Hands Off, Hands On, or Up-to-Your-Neck***

**Prepared by:**

K. Diane McLean

Director, Intellectual Property & Licensing  
Deputy Director, Office of Sponsored Programs  
University of Alaska Fairbanks

Universities that are able to accept equity in start-up businesses, usually accept the equity in lieu of up-front licensing fees. Most universities have policies dictating whether or not the university will accept a seat on the start-up's board and define triggers for stock divestiture. Many universities try to hold the stock for as short a time as is reasonable. The desired technology is licensed to the start-up for reasonable commercial terms. Sometimes the inventing faculty member is given a leave of absence during the new business' startup phase. Agreements are often made that allow the start-up access to university facilities.

There are typically three approaches used by universities to spin-off companies: Hands Off (U. of Washington uses this one.), Hands On, or the Up-to-Your-Neck approach. The Hands off Approach requires the faculty member to develop his/her own business plan, find venture funding and pay all other start-up costs. The university negotiates with a representative of the company (not the faculty member to avoid conflict of interest) for the technology license. Typically, the deal has a low or no up-front fee that is balanced by higher than usual royalties down the road and the university receiving equity in lieu of the up-front money. In that case, the university's costs are the patenting and maintenance fee payments while waiting on a royalty stream to begin.

With the Hands on Approach the university may review the faculty member's business plan, go with them to help acquire venture capital, and maybe provide a little funding. Otherwise it would be the same as the Hands Off Approach.

With the Up-to-Your-Neck approach the university puts together the business management team or provides a business incubator. The university provides substantial funding and other start-up support for the business.

Typically universities that regularly enter into start-ups or have ownership in other corporations use a research foundation/corporation as the intermediary. These foundations come in all sorts of flavors. Some universities run all their research awards through the foundation. Others use the foundation to handle IP, development and entrepreneurial activities, etc.

Universities that handle start-ups thoughtfully and well attract high energy, innovative faculty who, in turn, attract top-notch students. (Students often tend to settle near communities where they attended school.) Start-ups can provide training grounds for students and valuable collaborators for university faculty, as well as economic development opportunities. There are a number of successful models for handling start-ups.



Health, Education, and Social Services Committee  
Alaska State Senate

MEMORANDUM

To: Senator Ben Stevens, President  
Alaska State Senate

From: Senator Fred Dyson, Chair  
Senate H.E.S.S. Committee

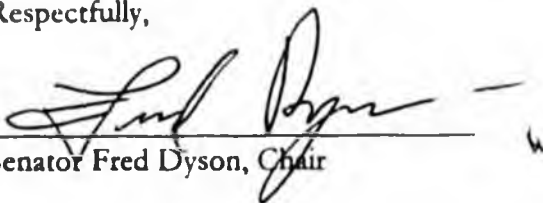
Date: February 3, 2006

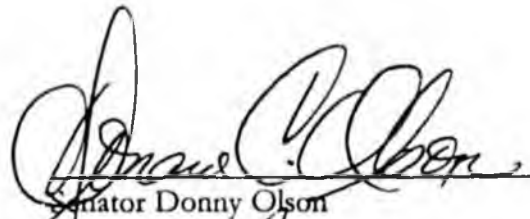
Re: HB 92—" An Act relating to the purchase of interests in nonprofit corporations by the University of Alaska."

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The Senate Health, Education, and Social Services Committee respectfully requests that HB 92 be waived from the H.E.S.S. Committee and instead, be referred to the Labor & Commerce or Judiciary Committee for consideration.

Respectfully,

  
\_\_\_\_\_  
Senator Fred Dyson, Chair

  
\_\_\_\_\_  
Senator Donny Olson

\_\_\_\_\_  
Senator Lyda Green

  
\_\_\_\_\_  
Senator Kim Elton

  
\_\_\_\_\_  
Senator Gary Wilken