Approved Clyde D. Graeber March 2,
Date

MINUTES OF THE HOUSE COMMITTEE ON Commercail & Financial Institutions.

The meeting was called to order by Clyde D. Graeber at
Chairperson

3:30 ~~a~~/p.m. on February 21, 1989 in room 527-S of the Capitol.

All members were present except: Representatives Norman Justice, L. V. Roper, Debara Schauf, George Teagarden and Lawrence Wilbert

Committee staff present: Bill Wolff, Research Department
Myrta Anderson, Research Department
Bruce Kinzie, Revisor of Statutes
June Evans, Secretary

Conferees appearing before the committee: Jim Turner, President, Kansas League of Savings Institutions

Representative Green moved and Representative Eckert seconded the minutes of the February 16 meeting be approved. The motion carried.

The Chairman stated there were two bills that had been requested, i.e., 9 RS 1098, an Act relating to taxation and 9 RS 1060, an Act providing for certificates of title for vessels.

9 RS 1098 is an act relating to taxation; concerning counties taking possession of Personal Property and the selling of said property to satisfy delinquent personal property taxes.

9 RS 1060 is an act providing for certificates of title for vessels which means any watercraft designed to be propelled by machinery, oars, paddles or wind action upon a sail for navigation on the water and is 17 feet or longer in length.

Representative Shallenburger moved and Representative Eckert seconded that 9 RS 1060 be introduced for legislation.

After discussion regarding 9 RS 1098, Representative King moved and Representative Ensminger seconded that 9 RS 1098 be introduced into legislation.

The Chairman opened the hearing on Senate Bill 47, an Act relating to liability of officers and directors of certain financial institutions; amending K.S.A. 17-5412 and repealing the existing section; also repealing K.S.A. 17-5812., to require proof of "willful or negligent" misconduct by a director who votes for declaration of a dividend when the capital of the association is impaired and removes language that makes such action a felony. Further, new language is added to this statute granting a director the right to seek contribution from other directors if a claim is made and to seek subrogation against persons who received the unlawful dividend.

Jim Turner, President, Kansas League of Savings Institutions testified in favor of Senate Bill 47 stating the bill pertains to the liability of officers and directors of state-chartered savings and loan associations. The bill would correct an inequity that exists relative to federally chartered associations.

Sections 2 and 3 allow directors to assert a defense if decisions are based upon a good faith reliance on the books of account or reports made to the board by the officers, independent CPA or appraiser.

New Section 4 will apply comparative negligence rules under K.S.A. 60-258(a) to actions against savings and loan directors and officers.

A new Section 5 was added by the Senate Committee to apply the protections of the bill to commercial banks. (See Attachment #1).

MINUTES OF THE HOUSE COMMITTEE ON Commercial & Financial Institutions

room 527-S Statehouse, at 3:30 ~~a.m.~~/p.m. on February 21, 19~~89~~

Gerald L. Goodell, Attorney and Harold Stones both stated that they supported Senate Bill 47.

The hearing was closed on Senate Bill 47.

The Chairman stated the Committee would not meet on Thursday but would meet both Tuesday and Thursday of next week.

The meeting adjourned at 4:00 P.M.

Date: 2/21/89

GUEST REGISTER

COMMERCIAL AND FINANCIAL INSTITUTIONS

NAME	ORGANIZATION	ADDRESS
Gerald Goodell	KS League of Savings	Topeka
JEFF SONNICH	KLSI	TOPEKA
Jim James	KLSI	Topeka
Kathy Taylor	Kans Bankers Assn	Topeka
Harold Stones	"	"
Jim McBride	Observer	Topeka

KLSI Kansas League of Savings Institutions

JAMES R. TURNER, President • Suite 512 • 700 Kansas Ave. • Topeka, KS 66603 • 913/232-8215

February 21, 1989

TO: HOUSE COMMITTEE ON COMMERCIAL AND FINANCIAL INSTITUTIONS

FROM: JIM TURNER, KANSAS LEAGUE OF SAVINGS INSTITUTIONS

RE: S.B. 47, DIRECTOR LIABILITY-STATE CHARTERED INSTITUTIONS

The Kansas League of Savings Institutions appreciates the opportunity to appear before the House Committee on Commercial and Financial Institutions in support of the passage of S.B. 47 pertaining to the liability of officers and directors of state-chartered savings and loan associations. The bill would correct an inequity that exists relative to federally chartered associations.

Senate Bill 47 amends K.S.A. 17-5412 and repeals K.S.A. 17-5812 to give officers and directors of state chartered savings and loan associations the same protection given to other officers and directors under the general corporation code, K.S.A. 17-6301(e). The bill includes the following changes:

Section 1 amends K.S.A. 17-5412 to require proof of "willful" and "negligent" misconduct by a director who votes for declaration of a dividend when the capital of the association is impaired. Section 1 repeals the felony penalty, but retains a civil penalty equal to the unlawful dividend. Section 1 grants a director the right to seek contribution from other directors if a claim is made and the right of subrogation against persons who received the unlawful dividend. (The language relating to contribution in subrogation is based upon K.S.A. 17-6424 which applies to corporations generally).

New Sections 2 and 3 allow directors to assert a defense if decisions are based upon a good faith reliance on the books of account or reports made to the board by the officers, independent CPA or appraiser. (This is based upon K.S.A. 17-6301(e) and K.S.A. 17-6422 which applies to corporations generally). The bill was amended by the Senate COmmittee to clarify application to savings and loan associations.

Atch #1

New Section 4 will apply comparative negligence rules under K.S.A. 60-258(a) to actions against savings & loan directors & officers.

A new Section 5 was added by the Senate Committee to apply the protections of the bill to commercial banks.

This bill will correct problems represented by the Kansas Supreme Court decision in FSLIC v. Huff. We have enclosed a KTLA Journal article on this issue that will be of interest to the committee. In conclusion, S.B. 47 would establish the same duties and fiduciary responsibilities for state-chartered savings and loan associations that presently apply to federal savings and loans, corporations, and commercial banks. Absent such equity it will be extremely difficult in the future to secure and retain directors for state-chartered associations.

We would appreciate the committees' earliest attention to reporting S.B. 47 favorably for passage.

James R. Turner
President

JRT:bw

Encl.

Commercial Law

Crisis in the Board Room/The Impact on Savings and Loan Management After *FSLIC v. Huff.*

By Robert S. Jones

Holding a seat on the Board of Directors of a corporation has traditionally been viewed as an honor and distinction. However, the exposure assumed in accepting such an appointment, particularly on boards of financial institutions, is fraught with peril. In fact, since the Kansas Supreme Court's ruling in *FSLIC vs. Huff,*[1] serving on such a board may be hazardous to your health.

To understand the impact of the *Huff* decision it is helpful to review the basic rule in Kansas concerning officer and director liability for breach of common law or statutory fiduciary duties.

Corporate officers and directors are uniformly held to owe various fiduciary duties to the corporation and its stockholders. The Kansas Supreme Court generally expressed these duties in *Sampson v. Hunt,*[2] as follows:

> "A strict fiduciary duty is imposed on officers and directors of a corporation to act in the best interests of the corporation and the stockholders. The duty imposed by this position of trust requires an officer or director to work for the general interests of the corporation. *Newton v. Hornblower, Inc.,* 224 Kan. 514; *Parsons Mobile Products, Inc. v. Remmert,* 216 Kan. 256, Syl. 2, 531 P2d 428 (1975); 18 Am. Jur. 2d, Corporations, S-497. The standard of duty by which the conduct of a director of a corporation is to be judged should be that measure of attention, care and ability which the ordinary director and officer of corporations of a similar kind would be reasonably and properly expected to bestow upon the affairs of the corporation. *Speer v. Dighton Grain, Inc.,* 229 Kan. 272, 276, 624 P2d 952 (1981). Directors and officers are liable to the corporation and the stockholders for losses resulting from their malfeasance, misfeasance or their failure or neglect to discharge the duties imposed by their offices."

Kansas has always imposed a more strict fiduciary duty than other jurisdictions. This was recognized in the recent case of *Delano v. Kitch.*[3] In that case, the Circuit Court of Appeals indicated that it was apparent from an examination of the Kansas decisions that the prevailing rule in Kansas sets a higher and stricter fiduciary standard of directors and officers of corporations than in other jurisdictions. This stricter standard has been clear since our Supreme Court in the 1887 case of *Thomas v. Sweet,*[4] first applied the rule.

To assist officers and directors in Kansas, however, in complying with these stricter standards, the legislature and the Courts have developed criteria for officers and directors to follow when carrying out their duties. One such statute is found at K.S.A. 17-6301 (e) where it provides:

> "A member of the board of directors or governing body of any corporation, or a member of any committee designated by the board of directors or governing body, shall be fully protected in the performance of such member's duties in relying in good faith upon the books of account or reports made to the corporation by any of its officers, or by any appraiser selected with reasonable care by the board of directors or by any such committee, or in relying in good faith upon other records of the corporation."

The Courts have further insulated officers and directors of commercial corporations through the development of what is commonly referred to as the "Business Judgement Rule."

Under this rule, which was first clearly enunciated in Kansas in the cases of *Darling and Co. v. Petri,*[5] and *Noll v. Boyle,*[6] and more recently applied and approved in the case of *Newton v. Hornblower,*[7] and *Sampson v. Hunt,*[8] the directors of a commercial corporation may take chances, the same kind of chances that a person would take in his or her own business without liability. Because officers and directors are given this latitude, the law will generally not hold directors liable for honest errors or mistakes of judgment as long as they act in good faith and without a corrupt motive. An honest mistake will not normally result in any liability to an officer or director. This is even true for gross errors in judgment. The error in judgment may be so bad as to demonstrate the unfitness of the directors to manage the corporate affairs but as long as made honestly and without any corrupt intent no liability will generally attach. The basis for this rule is the wide latitude that directors of a corporation must generally be given in the management of its affairs provided always that their judgment is unbiased and reasonably exercised by them. The Business Judgment Rule was adopted by the Courts and exists to protect and promote the full and free exercise of the power of management given to the directors.[9]

Even given these protections, however, the legislature has gone even further to provide protection when in its 1987 session it codified the essence of the Business Judgment Rule in K.S.A. 17-6002 (b) (8).[10]

With these things in mind, one may come to the conclusion that directors and officers of corporations are amply protected from suit. To the extent that we are discussing ordinary for profit corporations, the conclusion would be well founded. The case of *FSLIC v. Huff,* established for the first time in Kansas that officers and directors of Savings and Loan Associations are not blessed with the same protections as their counterparts in ordinary commercial corporations. The impact of this decision has created substantially greater exposure to those persons who serve as directors and officers of Savings and Loan Associations in Kansas. The issues before the Court in Huff were, essentially, whether or not K.S.A. 60-258A (the comparative negligence statute) was applicable as a defense to directors of a Savings and Loan Association for breach of their fiduciary duties. In ruling that the comparative negligence statute is not available as a defense against such individual officers and directors, the Court found that the statutory law and public policy of Kansas required joint and several liability rather than proportional fault be applied

Continued on next page

to causes of action against officers and directors of Savings and Loans for breach of fiduciary duty.

In arriving at this decision, the Court specifically made mention of the provisions heretofore set forth at K.S.A. 17-6301(e). Our Court in analyzing this provision of the General Corporation Code looked first to the Savings and Loan Code (K.S.A. 17-5101 et. seq.) to determine whether there was any comparable provision giving officers and directors of Savings and Loans similar protection. In that review, the Court found that although there was a provision under the Savings and Loan Code comparable to K.S.A. 17-6301(a) which is found at K.S.A. 17- 5311,[11] there was no exception comparable to that found at K.S.A. 17-6301(e) or K.S.A. 17-6422.[12] The Court ruled therefore that the exception in K.S.A. 17-6301 (e) was not available to directors of a savings and loan. The effect of the rule makes officers and directors of savings and loans virtual insurers of the corporation.

The *Huff* decision appears to represent a policy statement.[13] The Court by its decision intends to hold officers and directors of Savings and Loans responsible individually for all losses sustained by the Savings and Loan as a result of mismanagement or even an honest mistake. That mistake does not even have to be the directors own. Responsibility would seem to exist for the mismanagement or mistakes of other officers or directors. The Business Judgment Rule heretofore set forth as well as the statutory law that was once believed to provide protection with respect to decision making by officers and directors in such institutions no longer will provide insulation from liability. Although the Court does not come directly out in the *Huff* decision and say that it is abrogating the Business Judgment Rule as it relates to Savings and Loans in Kansas, it seems hard to imagine how that rule could be applied in the face of a decision that prohibits a director of a Savings and Loan from relying in good faith upon the books or reports of the corporation, the reports of management, the opinions of qualified appraisers or other corporate information. Therefore, honest errors or mistakes of judgment made in good faith probably, in view of the *Huff* decision, will no longer be available as a defense to insulate the decisions of directors of such institutions. It, likewise, does not seem that the legislature's 1987 amendment of K.S.A. 17-6002 will have application since the analysis in *Huff* makes it clear that the provision in the General Corporation Code would not apply to the Savings and Loan Code.

FSLIC v. Huff *established . . . that officers and directors of Savings and Loan Associations are not blessed with the same protections as their counterparts in ordinary commercial corporations.*

The effect of *Huff* on the board room of Savings and Loan Associations in Kansas is devastating. The officers and directors of such institution have exposure substantially greater than other officers or directors. Under the rule of *Huff*, if an officer of the Association fraudulently or even criminally misappropriates corporate assets without the knowledge of the other directors, those directors could nevertheless be held liable for that misappropriation and/or criminal conduct. No right of contribution, subrogation or comparison exists.[14] No director receiving an appraisal from a qualified appraiser hired after reasonable inquiry and investigation can rely upon that appraisal. No director may rely upon statements of the managing officers nor may they rely upon the books and records of the Association for other records of the Association in forming any judgment or making any decision.

From a practical standpoint, this gives Plaintiff's attorneys a substantial advantage in bringing actions against officers and directors of Savings and Loan Associations for breach of fiduciary duties. Since the officer and/or director may not rely upon his honest judgment, he is accountable for his good faith mistakes or those of his fellow board members or even of management.

In conclusion, therefore, the Supreme Court's 1985 decision of *FSLIC v. Huff*, has created a crisis in the Savings and Loan board rooms. With the almost unlimited liability for mistakes and errors in judgments on the part of officers and directors any person who formally found it to be an honor to have been asked to join such boards of directors are now finding it to be a substantial economic burden. Although a boon to the Plaintiff's bar, the Court by virtue of its decision in *Huff* may well have caused more of a problem than it sought to solve. Although it is without question that the potentiality of harm to Kansas citizens exists from the mismanagement of a Savings and Loan it is suggested however that the potentiality for harm and mismanagement increases when qualified persons refuse to become involved in these institutions because of their almost unlimited liability for mistakes, errors in judgments or even the misconduct of others. Whether applying such a strict standard will reduce the incident of mismanagement as intended or serves only to cause a stampede to the exit of the board room will depend on the future decisions of the Court and upon legislative reaction to the situation. The legislature may certainly act to provide protection if the Courts apply the holding of Huff literally. This may be necessary particularly if qualified persons cannot be found to serve and if the Courts refinement of *Huff* under differing fact situations is not forthcoming. As it stands now, however, it may not be wise to return the call that asks one to serve on such a board. □

Robert S. Jones is a partner in the firm of Norton, Wasserman, Jones and Kelly, Salina, Kansas. He graduated with honors from Washburn Law School, and has been a member of the Board of Governors of KTLA since 1984.

FOOTNOTES

1. 237 Kan. 873, 704 P2d 372 (1985)
2. 233 Kan. 572, 665 P28 743 (1983)
3. 542 Fed 550, 554 (10th Circ. 1976)
4. 37 Kan 183, 14 Pac. 545 (1887)
5. 138 Kan. 666, 27 P2d 255 (1933)
6. 140 Kan. 252, 255, 36 P2d 330 (1934)
7. 224 Kan. 506, 514, 582 P2d 1136
8. 233 Kan. 572, 665 P2d 743 (1983)
9. See *Treco, Inc. v. Land of Lincoln Savings and Loan, Rosenblatt v. Getty Oil Co.*, 493 A2d 929 applying Delaware law; *Unocal Corp. v. Mesa Petroleum*, 493 A28 946, applying Delaware law.
10. For complete text of new K.S.A. 17-6002 (b) (8), see 1987
11. K.S.A. 17-5311 provides. "The business of the association shall be managed by a board