Comments

CORPORATE CONSCIENCE: CHARITABLE DONATIONS

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Many corporations go to great lengths to further their image as having a true sense of public spirit. While it may be argued that the only motivation of a corporation is profit, very few corporations would strive to foster this belief; rather they seek to be identified as having a social conscience.[1] Arizona corporations certainly are no different and would be pleased to bear the burden of the public looking on them as being public spirited. One of the ways in which corporations have fostered this idea is through donations — to universities in the form of scholarships, to organized charities, or to many other types of non-profit organizations.

It is unfortunate that under the present state of Arizona law it is not clear whether an Arizona corporation has the authority to make any type of charitable donation. This problem is merely one of many which points out the tremendous void which exists in the Arizona statutory and case law concerning corporations and the uncertainty in many areas of Arizona corporate affairs.

In our current society there is a definite need for corporations to be able to meet their generally recognized social and moral obligations. A great part of the wealth of the nation is under corporate control. Society bestows substantial advantages on business enterprises which are allowed to use the corporate form of doing business; in terms of balance sheet morality corporations should be obligated to respond to some extent by means of charitable donations and other public service works. This may sound of heresy to corporate stockholders and the argument can be made that in undertaking public service activity the corporation is forcing the shareholder to contribute to certain social needs without any choice in the matter, passing the benefits of the use

[1] A.P. Smith Mfg. Co. v. Barlow, 13 N.J. 145, 98 A.2d 581, 584 (1953):
> Control of economic wealth has passed largely from individual entrepreneurs to dominating corporations, and calls upon the corporation for reasonable philanthropic donations have come to be made with increased public support. In many instances such contributions have been sustained by the courts within the common-law doctrine upon liberal findings that the donations tended reasonably to promote the corporate objectives.

For an historical treatment of the public service actions of a corporation see Union Pac. R.R. v. Trustees, Inc., 8 Utah 2d 101, 329 P.2d 398 (1958).

of his capital to others without his consent. It should be noted that the shareholder always retains the right to influence the management of the corporation and can change this management by the elective process.[2] Balance sheet morality can be used to show that that which improves society as a whole will ultimately benefit each of us, including the corporate shareholder.

The federal[3] and Arizona[4] tax statutes provide for deductions by a corporation for charitable donations. This tax advantage undoubtedly combines with social conscience in motivating charitable donations.

Advertising plays an important part in the affairs of a corporation; presently much of the advertising dollar is spent on establishing a corporate image, rather than selling particular corporate products. It is often part of the corporate image that the corporation has donated large amounts to charity, is providing scholarships, is furnishing on the job training for the underprivileged, and is taking part in community improvement programs. What better form of advertising is there than this?

THE POWER TO DONATE

Many jurisdictions have enacted statutes expressly authorizing corporations to make charitable donations. This has had limited effect in Arizona as savings and loan associations are the only Arizona corporations expressly granted the power to make charitable donations.[5] However, Arizona, by constitutional provision, has established that a corporation may *not* contribute to political causes.[6]

Arizona law allows broad powers to be conferred on a corporate board of directors by the articles of incorporation.[7] The question has not been litigated in Arizona but if the articles provide for the power to make charitable donations it seems that the corporation should have this power.[8]

The Arizona Corporation Commission in a rate hearing involving Arizona Public Service did not expressly rule on whether an Arizona corporation had the power to make charitable donations but concluded

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[2] ARIZ. REV. STAT. ANN. § 10-271 (1956) (provides for cumulative voting in director elections).

[3] 26 U.S.C. § 170 (1964).

[4] ARIZ. REV. STAT. ANN. § 43-123 (q) (1956).

[5] *See* 6A W. FLETCHER, PRIVATE CORPORATIONS § 2938 (rev. vol. 1950); H. HENN, CORPORATIONS § 185, at 281 (1961). ARIZ. REV. STAT. ANN. § 6-404 (Supp. 1968) (provides for charitable donations by savings and loan associations).

[6] ARIZ. CONST. art. 14, § 18.

[7] ARIZ. REV. STAT. ANN. § 10-152 (1956): "In addition to the powers granted to corporations by law, they may . . . establish by-laws and make rules and regulations deemed expedient for the management of their affairs not inconsistent with law."

[8] 6A W. FLETCHER, PRIVATE CORPORATIONS § 2938, at 664 (rev. vol. 1950).

that such donations in so far as they were reasonable were an expense of operation.[9] This opinion could be construed as an implied holding that such donations are authorized and the Arizona tax statute[10] allowing a deduction for charitable donations strengthens this implication.

The majority of decisions is to the effect that an ordinary business corporation has no common-law power in the absence of charter or statutory authorization to make gifts of its property or assets.[11] The general rule is that a gift of corporate assets is in violation of the rights of the shareholders and beyond the authority of the corporation, however worthy of encouragement or aid the object of the gift may be.[12]

This general rule must be qualified by the implied powers of corporations. Corporations normally have implied powers to do those things which are reasonably necessary to enable them to carry out their purposes, *e.g.*, to borrow,[13] to loan corporate funds,[14] to hold securities in other corporations,[15] and to reacquire the corporation's own shares.[16] In some cases the courts have found implied power to contribute to charity where there was some benefit which would accrue to the corporation.[17] It would seem that there would always be some benefit to a corporation from a charitable act but this benefit may not be very direct. Absent a direct benefit to the corporation it might be more difficult to convince an Arizona court that there was an implied power to make charitable donations.[18]

In some of the more recent cases the courts have taken the position

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[9] Ariz. Corp. Comm. Opinion and Order 39150, at 24-25 (Sept. 8, 1967).

[10] ARIZ. REV. STAT. ANN. § 43-123(q) (1956).

[11] 6A W. FLETCHER, PRIVATE CORPORATIONS § 2938 (rev. vol. 1950); R. STEVENS, CORPORATIONS §§ 52-54 (2d ed. 1949); Annot., 39 A.L.R.2d 1192 (1955).

[12] *But see* note 7 *supra*.

[13] ARIZ. REV. STAT. ANN. § 10-152(6) (1956): "Make contracts, acquire and transfer property, possessing the same power in such respects as private individuals enjoy."

[14] Sun Oil Co. v. Redd Auto Sales, Inc., 339 Mass. 384, 159 N.E.2d 111 (1959); Wasserman v. National Gypsum Co., 335 Mass. 240, 139 N.E.2d 410 (1957); Ketcham v. Mississippi Outdoor Displays, Inc., 203 Miss. 52, 33 So. 2d 300 (1948).

[15] H. HENN, CORPORATIONS § 185, at 280 (1961); *see* ARIZ. REV. STAT. ANN. § 10-152(6) (1956).

[16] H. HENN, CORPORATIONS § 185, at 281 (1961):

> While at one time it was questionable whether or not a corporation had implied power to purchase or otherwise reacquire its own shares, modern statutes expressly empower corporations to do so.
>
> Probably the power to do so exists today apart from statute and any provision in the articles of incorporation.

See ARIZ. REV. STAT. ANN. § 10-152 (1956).

[17] Annot., 39 A.L.R.2d 1192 (1955). This annotation points out that the early cases which found an implied power on the part of corporations to make charitable donations based this power on a benefit being realized by the corporation from the donation.

[18] *See* Lurie v. Arizona Fertilizer & Chem. Co., 101 Ariz. 482, 421 P.2d 330 (1966) (corporation has only such powers as are expressly or impliedly conferred by its charter); Trico Elec. Co-op v. Ralston, 67 Ariz. 358, 196 P.2d 470 (1948) (corporation has incidental powers only as are reasonably necessary to accomplish the purpose for which the corporation was organized).

that there is an implied power in corporations to make charitable contributions without requiring that there be a direct benefit to the corporation or placing very little emphasis on the benefit aspect of the contribution.[19] The reasoning of the New Jersey court in *A.P. Smith Mfg. Co. v. Barlow*,[20] articulates a common-law implied power to make charitable donations. This case involved a declaratory judgment action to determine the validity of a corporate donation to a university. The New Jersey court stated:

> [W]e have no hesitancy in sustaining the validity of the donation by the plaintiff. There is no suggestion that it was made indiscriminately or to a pet charity of the corporate directors in furtherance of personal rather than corporate ends. On the contrary, it was made to a preeminent institution of higher learning, was modest in amount and well within the limitations imposed by statutory enactment,[21] and was voluntarily made in the reasonable belief that it would aid the public welfare and advance the interests of the plaintiff as a private corporation and as part of the community in which it operates. We find that it was a lawful exercise of the corporation's implied and incidental powers under common-law principles and that it came within the express authority of the pertinent state legislation.[22]

WHAT IS A PROPER DONATION?

Even if a corporation is found to have the power to make charitable contributions the problem arises as to what are proper donations. The *A.P. Smith* case shows that courts might not look with favor upon donations made indiscriminately, to a pet charity of the corporate directors, or to further personal rather than corporate ends.[23] It has been held that it was not beyond the authority of a corporation to purchase land to erect a factory and homes for the workers, contribute toward a school, church, library, and public baths, and build streets and sewers, as this might reasonably be expected to insure the continued and faithful service of the employees.[24] It should be noted that this case did not involve an attempt to deduct these expenditures as donations for tax purposes. The *A.P. Smith* case approved donations modest in amount, voluntarily made, made with reasonable belief that they would aid the public welfare, and made with the belief that such donations would

[19] *See, e.g.*, Union Pac. R.R. v. Trustees, Inc., 8 Utah 2d 101, 329 P.2d 398 (1958). *See generally* Annot., 39 A.L.R.2d 1192 (1955).

[20] 13 N.J. 145, 98 A.2d 581 (1953). Noted in 39 CORNELL L.Q. 122 (1953); 67 HARV. L. REV. 343 (1953); 52 MICH. L. REV. 751 (1954); 28 TUL. L. REV. 491 (1954).

[21] The New Jersey legislature had passed a statute which granted to corporations the power to make charitable donations. This statute was held to be applicable to the A.P. Smith Mfg. Co.

[22] A.P. Smith Mfg. Co. v. Barlow, 13 N.J. 145, 98 A.2d 581, 590 (1953).

[23] A.P. Smith Mfg. Co. v. Barlow, 13 N.J. 145, 98 A.2d 581 (1953).

[24] Steinway v. Steinway & Sons, 17 Misc. 43, 40 N.Y.S. 718 (Sup. Ct. S.T. 1896).

further the interests of the corporation.[25] It seems clear that a donation made by corporate directors to a fund to protect themselves in their old age would not be a proper corporate donation.

The amount of such a donation is another area in which problems can arise. What is excessive for one corporation may not be for another. The amount can of course be related to the allowable tax deductions[26] but tax deductions alone probably would not be determinative of reasonableness of amount.

Liability for Unlawful Donations

It is important to note the possible result of a charitable donation being treated as beyond the corporate authority: ultra vires. If the courts refused to rule that there was implied power on the part of an Arizona corporation to make such contributions, liability could be imposed upon the board of directors for authorizing an ultra vires act[27] or upon the corporate officers for exceeding the powers of their office and the authority of the corporation.[28]

By traditional theories ultra vires acts of a corporation are deemed void, illegal, and a nullity.[29] The modern approach has been to treat such acts as being merely voidable in some circumstances and requiring the corporation to respond in damages in other circumstances.[30] A non-assenting shareholder may be allowed to recover from the agent responsible for an ultra vires act, at least where the agent was negligent in failing to ascertain the limitations upon corporate powers.[31] It is also possible for the state to enjoin ultra vires acts by *quo warranto* proceedings[32] and even to force corporate dissolution.[33]

If an ultra vires charitable donation were made by a corporate officer this act would probably be in violation of his duty to act intra vires and within his respective authority.[34] Unauthorized acts of officers

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[25] A.P. Smith Mfg. Co. v. Barlow, 13 N.J. 145, 98 A.2d 581 (1953).

[26] 26 U.S.C. § 170 (1964); Ariz. Rev. Stat. Ann. § 43-123(q) (1956).

[27] *See* Fagerberg v. Phoenix Flour Mills Co., 50 Ariz. 227, 71 P.2d 1022 (1937) (dealing in general with liability for ultra vires acts). *See generally* 3 W. Fletcher, Private Corporations §§ 1021-28 (rev. vol. 1965).

[28] *See* Tovrea Land & Cattle Co. v. Linsenmeyer, 100 Ariz. 107, 412 P.2d 47 (1966) (dealing with the authority of corporate officers and directors).

[29] *See* Trico Elec. Co-op. v. Ralston, 67 Ariz. 358, 196 P.2d 470 (1948) (ultra vires transaction is beyond the power of a corporation and is void). *See generally* H. Henn, Corporations § 186 (1961).

[30] H. Henn, Corporations § 186 (1961); R. Stevens, Corporations § 73 (2d ed. 1949).

[31] *See* O'Malley Inv. & Realty Co. v. Trimble, 5 Ariz. App. 10, 422 P.2d 740 (1967). *See generally* R. Stevens, Corporations § 155 (2d ed. 1949).

[32] *See* Big 4 Advertising Co. v. Clingan, 15 Ariz. 34, 135 P. 713 (1913); Duffield v. Ashurst, 12 Ariz. 360, 100 P. 820 (1909).

[33] Ariz. Rev. Stat. Ann. § 10-381(3) (1956).

[34] *See* Alderman v. Alderman, 178 S.C. 9, 181 S.E. 897 (1935) (failure to act intra vires will result in liability for loss from such action); Schwartz v. United

may be ratified by the board of directors, but such ratification is of no effect where the board of directors itself lacks the power to authorize the acts which are ratified.[35]

Directors are under a duty to act intra vires and within their authority.[36] The "Business Judgment Rule" will enable directors to escape liability for acts which are intra vires and involve the exercise of due care and compliance with applicable fiduciary duties.[37] This rule evolved to protect directors from liability for mere errors in judgment and would probably apply where the amount of a charitable conrtibution was in issue.[38] If charitable donations are in fact ultra vires then the "Business Judgment Rule" by definition would not protect the directors from liability.[39]

Majority shareholders occupy a fiduciary relationship to the minority shareholders.[40] This relationship gives rise to the possibility of a breach of duty if there is a shareholder ratification of a charitable donation made by the board of directors. If such a donation is in fact ultra vires then a ratification would be of no effect to protect the directors[41] but might give rise to liability being imposed on the assenting shareholders.

Merchants and Mfrs., Inc., 72 F.2d 256 (2d Cir. 1934) (duty of corporate officer to act intra vires). *See generally* Traver, *Arrogance of Corporate Power: a Study of the Violation of the Fiduciary Duty Owed by Management to the Corporation or its Shareholders,* 42 TUL. L. REV. 155 (1967).

[35] H. BALLANTINE, CORPORATIONS § 60 (1946).

[36] H. HENN, CORPORATIONS § 234, at 365 (1961):

> Directors and officers should not presume to act as such in behalf of their corporation in *ultra vires* transactions, or beyond the powers or authority of their respective positions.
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> For any loss to the corporation resulting from their engaging the corporation in an *ultra vires* transaction, they are, by one view, liable absolutely, and by another view, liable only when they have been negligent as to the scope of the corporate powers.

For a treatment of circumstances in which directors have been held liable to corporations see Comment, *The Doctrine of Corporate Opportunity: Has it Meaning in Arizona?,* 9 ARIZ. L. REV. 59 (1967).

[37] *See* Tovrea Land & Cattle Co. v. Linsenmeyer, 100 Ariz. 107, 412 P.2d 47 (1966) (acting in good faith and in best judgment within scope of corporation's ordinary business will excuse errors of judgment); Allied Freightways, Inc. v. Cholfin, 325 Mass. 630, 91 N.E.2d 765 (1950).

[38] H. HENN, CORPORATIONS § 233 (1961); Comment, *The Continuing Viability of the Business Judgment Rule as a Guide for Judicial Restraint,* 35 GEO. WASH. L. REV. 562 (1967).

[39] *See* Tovrea Land & Cattle Co. v. Linsenmeyer, 100 Ariz. 107, 412 P.2d 47 (1966); Foster v. Arata, 74 Nev. 143, 325 P.2d 759 (1958); New York Credit Men's Adjustment Bureau, Inc. v. Weiss, 305 N.Y. 1, 110 N.E.2d 397 (1953).

[40] Seagrave Corp. v. Mount, 212 F.2d 389 (6th Cir. 1954); Zahn v. Transamerica Corp., 162 F.2d 36 (3d Cir. 1947); Steinfeld v. Copper State Min. Co., 37 Ariz. 151, 290 P. 155 (1930); Heffern Co-op. Consol. Gold Min. & Mill Co. v. Gauthier, 22 Ariz. 67, 193 P. 1021 (1920). *See* Note, 7 ARIZ. L. REV. 130 (1965) (fiduciary duty owed to minority stockholder in sale of control).

[41] *See* Rogers v. American Can Co., 187 F. Supp. 532 (D.C.N.J. 1960); Eliasberg v. Standard Oil Co., 23 N.J. Super. 431, 92 A.2d 862 (Super. Ct. Ch. 1952), *aff'd mem.,* 12 N.J. 467, 97 A.2d 437 (1953); Berendt v. Bethlehem Steel Corp.,

Suits to enjoin ultra vires acts have been held to be a direct action by the shareholders[42] while actions to recover damages from consummated ultra vires acts have been held to be derivative suits.[43] It would appear that an action to recover for ultra vires charitable donations would be a derivative suit and subject to the requirements imposed upon the bringing of such an action.[44]

CONCLUSION

There is a definite need for corporations to be able to perform certain social and moral obligations. As the Arizona law currently stands rather than receive the praise which is deserved for an exercise of social conscience, a corporation may be subjected to judicial sanctions for ultra vires activities. The entire Arizona statutory law of corporations needs to be revised and upon such revision statutory authorization for charitable contributions should be included. Until there is such a revision of the statutes, authorization for charitable donations should be included in articles of incorporation.

If this issue ever comes before an Arizona court the ruling should be as favorable as possible toward the existence of an implied power for a corporation to make charitable donations.

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108 N.J. Eq. 148, 154 A. 321 (Ch. 1931); Comment, *Shareholder Validation of Directors' Frauds: The Non-ratification Rule v. the Business Judgment Rule,* 58 NW. U.L. REV. 807 (1964).

[42] *See* Swanson v. Traer, 354 U.S. 114 (1957); H. BALLANTINE, CORPORATIONS § 144 (rev. ed. 1946).

[43] *See* Swanson v. Traer, 354 U.S. 114 (1957); Morris v. Elyton Land Co., 125 Ala. 263, 28 So. 513 (1899); H. HENN, CORPORATIONS § 354 (1961).

[44] *See* Green v. Victor Talking Machine Co., 24 F.2d 378 (2d Cir. 1928); Dobry v. Yukon Elec. Co., 290 P.2d 135 (Okla. 1955); Shenberg v. DeGarmo, 61 Cal. App. 2d 326, 143 P.2d 74 (1943); Wells v. Dane, 101 Me. 67, 63 A. 324 (1905).

Before a derivative suit may be brought, generally there must be an exhaustion of the intracorporate remedies, Kowalski v. Nebraska-Iowa Packing Co., 160 Neb. 609, 71 N.W.2d 147 (1955), and a demand on the board of directors, Hawes v. City of Oakland, 104 U.S. 450 (1881); some jurisdictions require a demand upon the shareholders, Caldwell v. Eubanks, 326 Mo. 185, 30 S.W.2d 976 (1930).

For an Arizona case on the matter of shareholder suits see Rugee v. Hadley Products, Inc., 73 Ariz. 362, 241 P.2d 798 (1952).

Jurisdictions are uniform in holding that a shareholder must be such at the time of bringing the action, H. HENN, CORPORATIONS § 356 (1961); but there is a split of authority as to whether he must have been a shareholder at the time of the alleged ultra vires act. *Compare* Bank of Mill Creek v. Elk Horn Coal Corp. 133 W. Va. 639, 57 S.E.2d 736 (1950) (allowing subsequent shareholders to bring a derivative suit), *with* Home Fires Ins. Co. v. Barber, 67 Neb. 644, 93 N.W. 1024 (1903) (denying such a right). *See generally* H. HENN, CORPORATIONS § 359 (1961).