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The Validity of Corporate Gifts

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I. Introduction

Scope of the Issue

As the number and scope of social programs in Canada increases, government alone cannot respond to the ever-growing demands of charitable organizations and, increasingly, the cost of providing such programs is falling on the private sector. This is in keeping with the current of conservatism that seems to be sweeping across the nation. There appears to be a growing tendency for Canadians to want less, not more, government involvement and, consequently, an expanded role for corporate philanthropy is being recognized and, in fact, demanded. In a 1960s article *Love and the Business Corporation,* B.S. Prunty, Jr. observed that:

> A noisy sector of the legal front is all but quiet... In the name of social need and institutional responsibility, the remnants of greed have been swept aside and the law has proclaimed that the business corporation may love mankind. Indeed it may express its love in a most practical way—with dollars.[1]

In 1980, Canadian corporations expressed their "love for mankind" to the tune of $196 million.[2] Statutory recognition of such behaviour leaves little doubt but that such "business" activity is perfectly legal. Section 110.(1)(a) of the *Income Tax Act*[3] provides:

110.(1) Other deducations permitted.—
For the purpose of computing the taxable income of a taxpayer for a taxation year, there may be deducted such of the following amounts as are applicable:

(a) **charitable gifts.**—the aggregate of gifts made by the taxpayer in the year (and in the 5 immediately preceding taxation years to the extent of the amount thereof that was not deducted in computing the taxable income of the taxpayer for any preceding taxation year) to

(i) registered charities, etc.

not exceeding 20% of the income of the taxpayer for the year...

Notwithstanding the strictly "legal" nature of corporate donations, there remains the issue of whether, within this legal framework, any of these payments is assailable on the grounds of corporate incapacity.

Incapacity, depending on how narrowly or broadly it is defined, might relate either to:

(i) *lack of corporate power:* an *ultra vires* act in the traditional sense of that term (i.e., a corporation is limited to acting for purposes for which it was formed, rendering *void ab initio* any transaction not expressly or by implication authorized by its stated objects or incorporating statutes[4]); or

(ii) *abuse of corporate power:* an act that can be challenged on the basis of its constituting a breach of fiduciary duty. In this case, the act is voidable provided that third party rights have not intervened and *restitutio in integrom* is possible.

It is imperative that these two matters be kept analytically distinct in order that the trends in the development of American, English, and our own law be properly understood.

It is worth noting at this point that there is a paucity of Canadian case law on the subject of the validity of corporate gifts. As indicated earlier, there is no question but that Canadian corporations are "giving" and the absence of litigation arising from this practice can only be indicative of the general acceptance by shareholders and the public alike of such socially responsible corporate behaviour. Surely, however, there must be limits to the extent of altruism that shareholders are willing to tolerate. At what point, if at all, will the law intervene to assist a shareholder who feels that the corporation is acting beyond the bounds of propriety, having regard to the interests of the company and hence its shareholders?

Depending on the size and profitability of any corporate donor, it is clear that every dollar of corporate philanthropy represents at least some fraction of a dollar being eliminated from the pool of resources that may or may not be distributed to shareholders. Because corporations exist primari-

ly to advance the economic objective (i.e., the production of profits for shareholders), what legal restraints, if any, exist to preclude the redirection of corporate assets to serve socially responsible ends?

II. The Profit Motive—Is It Being Eroded?

Any debate on the principles that should govern the validity of corporate gifts must have as its starting point a description of the corporate "raison d'être". It is only by having regard to the fundamental purpose of any corporation that one can assess critically the common law dealing with corporate gifts.

There are those who subscribe to the financial model, arguing that the powers granted to a corporation are necessarily, and at all times, exercisable only for the rateable benefit of all shareholders[5] or, as K.R. Gibson puts it:

> To be apologetic for making a maximum profit instead of an adequate profit is in reality reverting to Middle Ages mentality. The corporation was not created to serve the public as such. Although it does "service" the public, its goals should not be directed toward matters outside legitimate business concerns. Employee welfare programs, the arts, community affairs, etc., should not be the corporation's concern. If people desire these items, let *them* pay for them individually, but not ask all to pay. To allow such involves the corporation in areas it has no business in entering, such as social, political or religious matters ... Matters which do not directly involve the corporation's business should be given second priority. It is best not to give such welfare, social, political or religious activities a foothold in the corporate body.[6]

Proponents of the managerial model, on the other hand, assert that the business corporation is an economic institution which has a social-service as well as profit-making function.[7]

> ...Business must be accountable to interests both within and without it. The accountability is essential to corporate legitimacy and to the preservation of a society that is democratic in fact as well as in theory.[8]

In the United States at least, this debate seems to have been resolved in favour of the managerial model as evidenced by Jacobs J. in *Smith Manufacturing* v. *Barlow*:[9]

> Modern conditions require that corporations acknowledge and discharge social as well as private responsibilities as members of the communities within which they operate.

Within this framework, a corporate charitable donation to Princeton University was upheld as a valid exercise of corporate power.

While there has yet been no judicial pronouncement on this issue from a Canadian court of high authority, Berger J. in *Teck Corporation* v. *Millar* may have indicated a trend toward recognition of the validity of conduct which may be deemed to depart from the traditional aim of profit maximization:

> The classical theory is that the directors' duty is to the company. The company's shareholders are the company ... and therefore no interests outside those of the shareholders can legitimately be considered by the directors ... A classical theory that once was unchallengeable must yield to the facts of modern life. In fact, of course, it has ... I appreciate that it would be a breach of their duty for directors to disregard entirely the interests of a company's shareholders in order to confer a benefit on its employees: *Parke* v. *Daily News Ltd.* ... But if they observe a decent respect for other interests lying beyond those of the company's shareholders in the strict sense, that will not ... leave directors open to the charge that they have failed in their fiduciary duty to the company.[10]

Also worthy of note at this juncture is the decision of the Quebec Superior Court in *Hamilton* v. *Bank of Montreal* wherein it was held that:

> It is not beyond the powers of the directors of a bank to adopt resolutions granting certain sums to hospitals, the more so when such directors are acting in good faith and in accordance with a long established custom throughout the country.[11]

Even in those cases which appear to support the view that business corporations are integrally entwined in the social fabric of our society (thereby having a social as well as economic mandate), gratuitous dispositions are often rationalized on the basis that some benefit (albeit indirect and nebulous) inures to the socially responsible corporation. [12]

> But even if we confine ourselves to the terms of the common-law rule in its application to current conditions, such expenditures may likewise readily be justified as being for the benefit of the corporation; indeed, if need be the matter may be viewed strictly in terms of actual *survival of the corporation in a free enterprise system.*[13] (emphasis added)

Few would argue that the profit motive is alive and well and of paramount importance to Canadian corporations. However, the fact remains that business corporations are assuming a greater role in philanthropic endeavours. On what basis are these gifts justified? Is the apparent recogni-

tion of their validity a harbinger of the erosion of the profit motive so firmly entrenched in our understanding of the corporate raison d'être?

It is submitted that even where the courts have recognized the changing economic and social climate in which corporations must operate, the profit motive has not been rejected in a wholesale fashion. True, some American courts have suggested that corporate social responsibility is a legitimate end in and of itself.[14] An equally plausible interpretation of these judgments is that corporate gifts have been sustained (where challenged) because of a broader and more liberal definition of profits (e.g., goodwill as a "priceless" corporate asset[15]). This interpretation is credible and persuasive, especially in view of the fact that a ceiling of "reasonableness" seems to be imposed on all corporate giving:

> We think that a power once denied today may be implied under changed conditions and philosophies, and that in light of present day industrial and business exigencies, common sense dictates that included in the implied powers of a corporation, an authority should be numbered that allows contributions of *reasonable* amounts to selected charitable, scientific, religious or educational institutions, if they appear reasonably designed to assure a present or foreseeable benefit to the corporation; that *management decision in such matters should not be rendered impotent unless arbitrary and unreasonably indefensible,* or unless countermanded or eliminated by shareholders at a proper meeting. [16] (emphasis added)

It is unclear whether the courts have deviated from the profit motive by formally recognizing an independent corporate power to act as a socially responsible corporate citizen or whether the profit motive is still intact but with a much expanded definition of what constitutes a corporate asset. It is submitted, however, that any distinction along these lines is illusory at best. Regardless of how one construes recent judicial pronouncements, the fact remains that we have witnessed a departure in principle from the oft-quoted passage in the English case of *Hutton* v. *West Cork Railway Co.* wherein Bowen L.J. asserted:

> The law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company.[17]

As R.C. Mangrum argues, this must be perceived as a positive development in the law:

> Rather than acting as cold-calculating business school graduates with an accounting sheet forever in their minds, [corporate management] can internalize the moral responsibility of individuals generally and apply them to corporate circumstances.[18]

Directors are still precluded from acting with total disregard for the interests of their shareholders; however, there appears to have been an attitudinal transformation. Corporate management has long recognized that "short-term pain for long-term gain" can be in the best interests of the shareholders but, as our social climate changes, philanthropy is no longer necessarily equated with "pain" and the definition of "gain" has been expanded to include an improved public image.

III. Statutory Provisions Governing Corporate Capacity

Traditional Approach to Ultra Vires

Although occasionally used to describe any unauthorized activity undertaken by a corporation, it is perhaps most accurate to reserve the term *ultra vires* for a corporate act which is beyond the constitutional capacity of the corporation. Where corporate capacity has been abused in the sense that a corporate power has been exercised for an improper purpose, the impugned activity still can be challenged, but on different grounds (i.e., breach of fiduciary duty by a director). It is possible that a single act can be at one and the same time challenged on the basis of being both *ultra vires* and a breach of fiduciary duty; however, it is best to keep these grounds analytically distinct since there have been major legislative amendments affecting the doctrine of *ultra vires.*

Traditionally corporations as legal entities were not afforded the same treatment as individuals, in that their capacity was viewed as being limited. The objects of a given corporation were defined in its Memorandum of Association.[19] Any act inconsistent with the specified objects in the company's objects clause was considered to be void *ab initio* and was, by virtue of its being void, incapable of being rectified—even by 100 per cent of the shareholders. Over the years, the law developed in a manner that recognized the validity of acts taken pursuant to implied powers which were considered to be reasonably incidental to the carrying out of express objects. As L.C.B. Gower points out:

> ...[the] rule is to be applied reasonably, so that whatever is fairly incidental to the objects expressly authorised by the memorandum or statute, will unless expressly prohibited, be *intra vires*. But subject to that limitation, whatever is not expressly or impliedly authorised must be taken to be forbidden and cannot be undertaken even by the unanimous consent of all the members.[20]

An historical overview of the development of company law in the twentieth century reveals a recurrent tension between companies (seeking to ensure maximum flexibility in terms of their authorized activity) and the judiciary (seeking reasonably to limit the flexibility of companies so as to

afford maximum protection to creditors and shareholders concerned about how their funds would be deployed). The doctrine of *ultra vires* was a potentially useful tool in the courts' arsenal of weapons to restrict corporate activity to its express and implied objects and powers. However, corporate drafters, in their continuing quest to evade the doctrine, managed to develop various creative techniques to lessen its restrictive impact:

(i) *Creation of very extensive lists of corporate objects.* The courts responded to this by specifying one of the objects as being the "main" corporate object and subordinating all others to ancillary positions (i.e., objects which merely conferred powers to attain the main object);

(ii) *Insertion, as a final paragraph in the objects clause, of a statement to the effect that each object constituted a separate and independent object and should be construed in this manner.* The validity of such a statement was affirmed in the leading case of *Cotman* v. *Brougham,*[21] although the scope of the *Cotman* v. *Brougham* clause (as it has come to be known) has been restricted somewhat in *Re Introductions,* where, in the words of Harman LJ.:

> ...you cannot convert a power into an object merely by saying so.[22]

Alongside this development has been general acceptance of the "subjective objects clause" which essentially authorizes the carrying on of any business which the company or its directors think fit. The English Court of Appeal upheld such a clause in *Bell Houses Ltd.* v. *City Wall Properties Ltd.*[23]

What began originally as a fairly draconian application of the doctrine, gradually has been transformed and relaxed by creative draftsmanship; however the principle remains intact in those jurisdictions which have not altered the common law by statute. Absent statutory intervention, a company is precluded from engaging in activities beyond the objects and powers expressed and implied in its constitutional documents.[24] Unless the power to make corporate gifts can be construed as being an implied power (assuming it is not expressly provided for), such gifts are *ultra vires* in the traditional sense of that term and are subject to being set aside.

Statutory Modification of Ultra Vires

a) British Columbia

Section 2(1) of the *British Columbia Company Act*[25] (*BCCA*) and s. 15(1) of the *Canada Business Corporations Act*[26] (*CBCA*) confer on provincially and federally incorporated companies respectively, the powers and capacity of a natural person[27] (including presumably the power to make gifts). Specifically, s. 21(1) of the *BCCA* provides:

> Subject to subsection (2), a company has the power and capacity of a natural person of full capacity.

Similarly, s. 15(1) of the *CBCA* provides:

> A corporation has the capacity and, subject to this Act, the rights, powers and privileges of a natural person.

Of relevance too, are companies incorporated by letters patent under the *Canada Corporations Act*[28] (*CCA*). These companies have objects specified in their charters. Section 16 of the *CCA* gives such corporations broad incidental and ancillary powers to carry out the stated objects. Specifically, s.16(1)(e) provides a general power for corporations:

> ...to subscribe or guarantee money for charitable or benevolent objects, or for any exhibition or for any public, general or useful purpose.

This legislation applied to all federally incorporated business corporations before the *CBCA* took effect. This ancillary power could validate a charitable contribution provided that the express or implied objects could justify the making of such a gift.[29] In respect to companies still governed by letters patent legislation (as in some of the Atlantic provinces), it is submitted that they are in much the same position as most American corporations. (See "United States", p. 40.)

With respect to federally and provincially incorporated companies, both the *CBCA* and *BCCA* recognize that a company still may be restricted from carrying on certain activities by virtue of restrictions in its constitutional documents. Section 22(2) of the *BCCA* provides:

> No company shall exercise a power that it is restricted from exercising by its memorandum, or exercise any of its powers in a manner inconsistent with the restrictions in its memorandum.

A similar (although not identical) provision is found in s.16(2) of the *CBCA*.[30] Notwithstanding these provisions, both the *BCCA* (in s. 22(3)) and the *CBCA* (in s.16(3)) provide protection to parties affected by a corporation's undertaking restricted activities. For example, s. 22(3) of the *BCCA* provides:

> No act of a company, including a transfer of property to or by a company, is invalid by reason only that the act contravenes subsection (1) or (2).

Consistent with these provisions is the abolition of constructive notice in s. 26 and s. 17 of the *BCCA* and *CBCA* respectively.

On the basis of the foregoing, it would appear that federally and provincially incorporated companies engaging in philanthropic activity cannot have their gifts set aside on the basis of the doctrine of *ultra vires*. For all intents and purposes, *ultra vires* has been put to rest in British Columbia. Even where gratuitous dispositions of the company's assets are expressly restricted by its constitutional documents, it would appear that a payment already executed could not be recovered by the company. However, if the payment has not actually been made, an interested party could apply to the courts under s. 27(a) of the *BCCA* and s. 240 of the *CBCA* for an order restraining the company from acting in a constitutionally restricted manner. Section 25(a) of the *BCCA* provides:

> Where a company contravenes, or is about to contravene section 22(1) or (2), the Court may, on application by a member, a receiver, a receiver manager, a liquidator or a trustee in bankruptcy of a company, restrain the company from doing an act or transferring or receiving property.

Notwithstanding the virtual elimination of *ultra vires* as a ground for rendering void a gratuitous disposition, such activity is not completely immune from attack. Where the impugned gift constitutes a restricted activity, or is of an unreasonably large amount, it is submitted that a director may be found to have breached his fiduciary duty to the company and may be liable pursuant to s. 151(1)(f) of the *BCCA* to compensate the company for any loss sustained as a result. Section 151(1)(f) provides:

> Directors of a company who vote for, or consent to, a resolution authorizing an act contravening section 22 in respect of which the company has paid compensation to any person, are jointly and severally liable to the company to make good any loss or damage suffered by the company as a result.

However, the court does have the discretionary authority to relieve a director (found to be in breach of his fiduciary duty) of his or her liability, pursuant to s. 226 of the *BCCA* which provides:

> In any proceeding against a director ... if it appears to the court that the director ... is or may be liable in respect of ... breach of duty ..., but has acted honestly or reasonably and ought fairly to be excused, the court shall take into consideration all the circumstances of the case, ... and may relieve him, either wholly or partly, from his liability, on the terms the court considers necessary.

The statutory scheme in the *CBCA* is slightly different. The duty of care imposed on directors is defined in s. 117(1). Sections 117(2) and (3) go on to state that:

(2) Every director and officer of a corporation shall comply with this Act, the regulations, articles, by-laws and any unanimous shareholder agreement.

(3) ...no provision in a contract, the articles, the by-laws or a resolution relieves a director or officer from the duty to act in accordance with this Act or the regulations or relieves him from liability for a breach thereof.

Clearly therefore, if a director engages in a restricted activity (assuming the making of charitable donations is so restricted), he will be deemed to have breached his statutory duty of care. It would appear from s. 117(3) that a majority of shareholders could not ratify this breach so as to deprive a dissenting minority of the right to bring a derivative action to fix the director with personal liability; however, a special majority of the shareholders could prospectively effect an alteration to the articles so as to eliminate such a restriction, thereby validating a corporate gift in an *a priori* manner.

b) United States

With the increased acceptance of all-purpose clauses and corporate powers equivalent to those of a natural person, as well as the abolition of constructive notice, there remains little scope for the doctrine of *ultra vires.*[31] Section 4(m) of the United States *Model Business Corporation Act* (*MBCA*) expressly empowers a company to make charitable donations and the defence of *ultra vires* is expressly abolished in section 52. Similar legislation can be found in the *Corporation Law of Delaware* where s. 122(9) empowers every corporation to:

> Make donations for the public welfare or for charitable, scientific or educational purposes, and in time of war or other national emergency in aid thereof.

Also, with respect to *ultra vires,* s. 124 provides:

> No act of a corporation and no conveyance or transfer of real or personal property to or by a corporation shall be invalid by reason of the fact that the corporation was without capacity or power to do such act or to make or receive such conveyance or transfer ...

It is also worthy of note that s. 2.01(c) of the American Law Institute's recommended Draft No. 2 on *Corporate Governance*[32] provides:

> 2.01 The Objective and Conduct of the Business Corporation
>
> A business corporation should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain, except that, whether or not corporate profit and shareholder gain are thereby enhanced, the corporation, in the conduct of its business

(c) May devote a reasonable amount of resources to public welfare, humanitarian, educational, and philanthropic purposes.

It is submitted, therefore, that insofar as statutory modification of the doctrine of *ultra vires* is concerned, the American position is not unlike that of Canadian federally and provincially incorporated companies described earlier. Arguably, the power to make charitable donations in the United States is slightly more entrenched by virtue of the fact that enabling statutes expressly empower a corporation to make such dispositions regardless of whether a corporate benefit will accrue, e.g., section 14A:3-4 of the New Jersey statute empowers a corporation to make such gifts "irrespective of corporate benefit". This is to be contrasted with the predecessor provision which authorized charitable gifts such as, in the judgment of the directors, "will contribute to the protection of the corporate interests."[33]

The *CBCA* and *BCCA* give corporations the powers and capacity of the natural person but do not go so far as to say that directors may act in a manner that does not advance the economic objective. Presumably, the directors' common-law fiduciary duty precludes such activity. In the United States, it would appear that this common-law fiduciary duty is statutorily modified to the extent that charitable donations are expressly authorized even where no benefit inures to the corporation.

c) England

Section 235(3) of the *Companies Act 1985* (*CA*) requires that charitable and political donations in excess of £200 (aggregate amount) must be disclosed to members in the directors' report. This is an implicit recognition of the legality of such dispositions; however, these gifts are still subject to restraints imposed by vestiges of the doctrine of *ultra vires*, more visibly present in the United Kingdom than in either the United States or Canada. Except to the extent that it is modified by s. 9(1) of the *European Communities Act* (re-enacted with minor amendments as s.35(1) of the *CA*), the doctrine of *ultra vires* remains in full force. Section 35 of the *CA* provides:

35(1) In favour of a person dealing with a company in good faith, any transaction decided on by the directors is deemed to be one in which it is within the capacity of the company to enter into, and the power of the directors to bind the company is deemed to be free of any limitation under the memorandum or the articles.

(2) A party to a transaction so decided on is not bound to inquire as to the capacity of the company to enter into it or as to any such limitation on the powers of the directors, and is presumed to have acted in good faith unless the contrary is proved.

Whereas this legislation protects a limited class of persons dealing with the company, it seems to fall short of abolishing altogether the doctrine of *ultra vires.* As pointed out by Farrar, "dealing normally predicates reciprocity and is capable of limitation to commercial transactions".[34] Therefore, a gratuitous disposition would appear to be excluded from consideration under s.35 of the *CA,* and, notwithstanding this statutory provision, could still be challenged on the basis of *ultra vires* in the traditional sense. It is worthy of note as well that the doctrine of constructive notice has not been abolished in England,[35] therefore the validity of a corporate gift in England must still be determined by reference to the constitutional objects of the company.

The company's objects are capable of change, as s. 2(2) of the *CA* expressly authorizes alterations "in the mode and to the extent for which express provision is made by this act". However, as illustrated by s. 4 of the *CA* (which specifies seven purposes for which the objects clause can be altered), a company seems to have unrestricted powers to abandon objects but only restricted powers to adopt new objects.[36] For this reason, a company deemed incapable of making corporate gifts would have great difficulty amending its objects clause so as to permit such activity. A purported gift would therefore fail unless the company could argue that the gift attracted the operation of s. 35 of the *CA.* As indicated earlier, this would be difficult to achieve since corporate giving is rarely a reciprocal activity.

d) Summary: *Ultra Vires* and Gratuitous Dispositions

Because of the probable retention in England of the doctrine of *ultra vires* with respect to the gratuitous disposition of corporate assets, English case law has grown up quite distinct from American jurisprudence on the subject. It is submitted that because of the virtual abolition of *ultra vires* in British Columbia, our law is most closely aligned with that of the United States. Essentially, *ultra vires* as a grounds for assailing the validity of a corporate gift has been eliminated; however this type of activity is not completely immune from attack. Where it can be shown that directors, in authorizing such a gift, have acted in breach of their fiduciary duty (i.e., the gift is unreasonably large, is predicated on an improper purpose, or is an expressly restricted activity), the directors themselves may be liable to the company for any resulting damages. As pointed out by Dr. Slutsky:

> Professor Wedderburn has observed [that] "the principles of *ultra vires* and of directors' duties frequently become co-terminous when improper distributions of the corporate assets takes place". It is submitted that strict enforcement of the statutory and fiduciary obligations of directors will go a long way towards filling any possible "void" in shareholder and creditor protection resulting from the virtual demise of *ultra vires.*[37]

To reinforce the opinion that superfluous protection is afforded by the doctrine of *ultra vires,* D.H.J. Cohen notes:

> *ultra vires* is an unnecessary extra protection the only possible effect of which will be to enable a small number of diehards to frustrate the will of the majority.[38]

IV. Evolution Of Common Law On Corporate Gifts

a) United States

The law seems to attribute to every shareholder the right to expect that the affairs of the corporation will be conducted in such a manner as to maximize the return on his investment. Bowen L.J. stated very emphatically in the English case, *Hutton* v. *West Cork Railway Co.:*

> ... as it seems to me charity has no business to sit at boards of directors qua charity.[39]

On the basis of this line of reasoning, a gratuitous payment by the corporation to certain of its retiring directors was declared to be *ultra vires.* In applying the letter of the law, Bowen L.J. did acknowledge that:

> ... the directors in this case have done, it seems to me, nothing at all wrong ... Not only have they done nothing wrong, but I confess I think the company have done what nine companies out of ten would do, and do without the least objection being made. They have paid, perhaps liberally, perhaps not at all too liberally, persons who have served them faithfully. But that, of course, does not get rid of the difficulty. As soon as a question is raised by a dissentient shareholder, or by a person standing in the position of a dissentient, sympathy must be cut adrift, and we have simply to consider what the law is.[40]

In the United States, nowhere is the strict adherence to the profit maximization motive stated more clearly and convincingly than in *Dodge* v. *Ford Motor Co.,* where Ostrander C.J. asserted that

> A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of the directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes. [41]

Against this backdrop, American jurisprudence has evolved gradually, chipping away at this strict view, to the point where today, virtually any reasonable corporate gift (in the judgment of the directors) will be sus-

tained. How has this transformation come about? Let us look briefly at the highlights in this development.

In keeping with the tone of the British court in *Hutton*, many American cases leading up to, and including, *Dodge*, adopted a view that precluded the use of corporate resources for anything other than a corporate wealth-enhancing purpose. *Worthington* v. *Worthington* involved a donation to Columbia University of equipment for a hydraulic engineering laboratory (as a memorial to his father) by the president of a company engaged in the manufacture and sale of hydraulic equipment. The president was held liable to account to the company for the cost of this equipment on the basis that the evidence disclosed an intention to make a personal gift. In so holding, McLaughlin J. stated:

> ... there is nothing in the record which would justify a finding that any action was taken by the corporation which could be construed into its giving the materials and making the expenditure as a gift. Indeed, *it might well be doubted whether the corporation had power to do so, even if it had made the attempt.*[42] (emphasis added)

Similarly, in *Brinson Ry. Co.* v. *Exchange Bank of Springfield*, the hardline approach was followed. The impugned act in this case was a donation by a railroad company toward the construction of a public school, in an effort to build up the town in which the school was situated and, ultimately, to increase travel on the railroad. It was held in that case that:

> It was beyond the powers of the president of a railway company incorporated under the general laws of Georgia as a common carrier, *either with or without the consent of its board of directors*, to donate funds belonging to the corporation ... for the erection of a public school, or for the purpose of building up or promoting the town in which the school is situated, even though the school or town be located on the line of the company's railway and its transportation business might thereby be increased.[43] (emphasis added)

However, it must be noted that the courts did recognize the validity of charitable donations in instances where there was a direct benefit to the company of an identifiable nature. Thus it was held that a charitable contribution was a valid corporate act in *Whetstone* v. *Ottawa University*,[44] where the direct and proximate tendency of the donation was to build up the town and thereby enhance the value of remaining corporate property. In *Steinway* v. *Steinway & Sons*, Beekman J. upheld a charitable donation and said:

> It is a question, therefore, in each case, of the logical relation of the act to the corporate purpose expressed in the charter. If that act is one which is lawful

> in itself, and not otherwise prohibited, is done for the purpose of serving corporate ends, and *is reasonably tributary to the promotion of those ends, in a substantial, and not in a remote or fanciful sense,* it may fairly be considered within charter powers.[45] (emphasis added)

Beekman J. seemed to recognize that changing socio-economic conditions argued for an expanding field of impliedly authorized corporate activity; however, he did stop short of abandoning the "direct benefit" test altogether.

In contrast to the strict application of the "direct benefit" test in the *Brinson* case, the District Court of New York upheld the validity of corporate charitable donations to university endowment funds in *Armstrong Cork Co.* v. *Meldrum.* It was held that:

> ... it would in all probability inure to the future advantage of the company to be able to secure employees trained and skilled in corporate business ...[46]

In the early part of the twentieth century, courts demonstrated cautious reluctance to validate a corporate gift absent some corporate benefit. Modern cases have escaped the rigours of the "direct benefit" test in one of two ways:

(i) In one line of authority the courts have held that a contribution ostensibly made for the general welfare of society will be deemed to result in fact, in profit maximization (i.e., socially responsible behaviour creates goodwill [47]). They have even gone so far as to respect the business judgment of directors and have stated their preference not to interfere with a business decision (presumably promulgated on the profit motive) in the absence of an allegation of fraud or illegality. In the *Union Pacific* case, Justice Henriod observed:

> There seems to be no good reason to challenge the convictions of these men, the bona fides of their support for the contribution in question or their belief that it was for the best interests of the company and its shareholders. If their personal judgment was unsound, it is not reflected in their record, in the expressed national and state legislative encouragement of such practice, in the expressed opinions and thinking of members of legal groups concerned with the matter, nor by the mushrooming statistics dating from 1940 that clearly reflect an ever-increasing belief on the part of those who manage and run institutions flying a corporate ensign that *it is sound business to contribute to agencies fostering charity, church, science and school.*[48] (emphasis added)

(ii) An alternative line of authority supports the view that corporate philanthropy is a legitimate end in and of itself,[49] subject however to a

limit of "reasonableness". Reasonableness is generally assessed by having regard to the customary level of such expenditures by companies of like worth, and the strength of the link between the use of corporate resources and the corporation's business.[50] Typical of this line of reasoning are the words of Justice Jacobs who indicated in *Smith* v. *Barlow:*

> ... there is now widespread belief throughout the nation that free and vigorous non-governmental institutions of learning are vital to our democracy and the system of free enterprise and that withdrawal of corporate authority to make such contributions *within reasonable limits* would seriously threaten their continuance ... [A]ppellants ... ought not be permitted to close their eyes to present-day realities and thwart the long-visioned corporate action in recognizing and voluntarily discharging its high obligations as a constituent of our modern social structure.[51]

In addition to this common-law recognition of the validity of reasonable corporate gifts, most jurisdictions in the United States expressly empower corporations to make such dispositions by statute:

> And since in our view, the corporate power to make reasonable charitable contributions exists under modern conditions, even apart from express statutory provision, its enactments simply constitute helpful and confirmatory declarations of such power, accompanied by limiting safeguards.[52]

The value of statutory recognition of charitable donations is described by Vice-Chancellor Marvel in *Theodora Holding* v. *Henderson:*

> I conclude that the test to be applied in passing on the validity of a gift such as the one held in issue is that of reasonableness, a test in which the provisions of the Internal Revenue Code pertaining to charitable gifts by corporations furnish a helpful guide.[53]

In summary, American jurisprudence has evolved to the point where, absent personal gain or bad faith, the business judgment rule generally will validate a decision by directors to make a reasonable corporate gift by finding it to be in the best interests of the company.[54] The question remains open however, whether the courts would be as liberal and tolerant of corporate philanthropy when there was no possibility that any benefit at all could accrue to the corporation (e.g., if once the corporation ceased to be a going concern, it purported to make some last-minute gratuitous disposition).

b) England

Because of the failure of English legislators to follow the lead of their American and Canadian counterparts by putting the doctrine of *ultra vires*

finally to rest, it continues to play a very prominent role in their assessment of the validity of corporate gifts. Consequently, the state of English common law on this subject, until recently, was extremely confused as the questions of corporate incapacity, abuse of corporate capacity, and minority shareholder remedies had become hopelessly intertwined.

Again, the relevant starting point for this discussion must be *Hutton*, where it was held, rather unequivocally, that the power to make corporate gifts was *ultra vires* the company.[55]

In the much criticized judgment of Eve J. in *Re Lee, Behrens & Co. Ltd.*, he stated:

> But whether [ex gratia payments] be made under an express or implied power, all such grants involve an expenditure of the company's money, and that money can only be spent for purposes reasonably incidental to the carrying on of the company's business, and the validity of such grants is to be tested, ... by the answers to three pertinent questions:
>
> (i) Is the transaction reasonably incidental to the carrying on of the company's business?
>
> (ii) Is it a bona fide transaction? and
>
> (iii) Is it done for the benefit and to promote the prosperity of the company?[56]

Although the *Lee Behrens* test was relied on to strike down proposed payments (as being *ultra vires*) in *Parke* v. *Daily News*[57] and *Re W & M Roith Ltd.*,[58] it was finally rejected by Pennycuick J. in *Charterbridge Corp. Ltd.* v. *Lloyd's Bank Ltd.*[59] (In the *Lee Behrens* case, Eve J. created some confusion by purporting to make his three-pronged test applicable to both express and implied powers. He did not properly distinguish between the doctrine of *ultra vires* and breach of fiduciary duty, as evidenced by his statement that:

> ... authority from the shareholders in a meeting convened for that purpose would have ratified the transaction.[60]

(As pointed out earlier, an act deemed to be *ultra vires* is void *ab initio* and incapable of being ratified by even 100 per cent of the shareholders.)

On the basis of the *Charterbridge* decision it would appear that so long as the transaction is undertaken pursuant to an express substantive object in the company's constitution (as opposed to pursuant to an ancillary power), the third aspect of the *Lee Behrens* test (i.e., the inquiry into whether the transaction is for the best interests of the company) is inappropriate. It therefore becomes necessary to distinguish between "express substantive

objects" and "express ancillary powers". In several subsequent decisions, courts have engaged in the unfortunate hair-splitting exercise of deciding whether a given activity is properly characterized as a "substantive object" or an "ancillary power". In respect to the latter; however, the validity of the act remains subject still to an assessment of whether it was exercised "genuinely". That is, to be a valid exercise of that power, an activity must not be promulgated on an improper purpose. If, as was found to be the case in *Re Halt Garage Ltd.*,[61] the exercise of the express ancillary power is not genuine, (i.e., it is no more than a colourable attempt at making an invalid gift to a shareholder), the exercise of that power will be deemed to have been a breach of the director's fiduciary duty to the company and, on that basis, subject to being set aside.

In *Re Halt*, the company was expressly empowered to remunerate its directors and, pursuant to this express ancillary power, it purported to compensate Halt's wife (even though she did not provide any services to the company from the onset of an illness). It was held, because she had been so inactive during the relevant period, that a part of her fees was not "genuine" and therefore it was deemed to be *ultra vires* in the broad sense.

At issue in *Re Horsely & Weight Ltd.* was the validity of a pension policy for a director and employee. It was held by Buckley L.J. that:

> ... the power to grant a pension in clause 3(o) of the memorandum of association was a substantive object of the company and not merely an ancillary power; that since it was a substantive object, it was immaterial whether the exercise of the expressed power benefited and promoted the prosperity of the company.[62]

In keeping with this reasoning, Buckley L.J. went on to say:

> The objects of a company do not need to be commercial; they can be charitable or philanthropic; indeed they can be whatever the original incorporators wish, provided that they are legal. Nor is there any reason why a company should not part with its funds gratuitously or for non-commerical reasons if to do so is within its declared objects.[63]

The final word on this matter came in the case of *Rolled Steel Products* v. *British Steel Corp.*[64] which has done much to clarify the law in this area. It was stressed in the Court of Appeal that a distinction must be drawn between acts that are truly *ultra vires* and those that are merely a breach of fiduciary duty. In this regard, attention must be paid to the proper construction of the memorandum to determine whether a particular provision is a "substantive object" or an "ancillary power". Where a director exercises an ancillary power for an improper purpose (so that the act is in es-

sence a breach of fiduciary duty), a third party without notice will not be affected by the director's abuse of capacity.

To summarize, where the authority to make a gratuitous disposition is expressly stated in the company's memorandum, it would appear that an impugned gift made pursuant to this authority will be sustained on any challenge that it is *ultra vires* (in the traditional sense of the term). Whether or not it can be attacked on the basis of its being a breach of a director's fiduciary duty will depend on how the courts characterize the gift. Assuming it is characterized as a substantive object (as Buckley L.J. did in *Re Horsely & Weight Ltd.*), no further inquiry into whether it will affect the prosperity of the company will be necessary. The gift will be unassailable on the grounds of its being either *ultra vires* or an abuse of the company's capacity. On the other hand, the power to make gifts may be characterized as an ancillary one. Where this is the case and an attacker can demonstrate that it will have an adverse effect on the company's prosperity, presumably a director may be held liable to account to the company for what, in effect, is an invalid gift. It is important to note however, that so long as the power to make a gift is expressly stated in the memorandum, no third party will be adversely affected (i.e., the gift will never be set aside).

If there is no express provision empowering a company to make gratuitous dispositions, the validity of the gift will turn on whether the courts interpret this power as being one that is reasonably incidental to the stated objects of the company. If it is not found to be reasonably incidental, the gift will be *ultra vires* (in the traditional sense) and may be set aside. Again, where it is held that such a power is reasonably incidental to the company's stated objects, the validity of the gift will be determined according to the propriety of the exercise of the director's discretionary powers.

V. Shareholder Protection

As can be seen from the foregoing, corporations responding to social demands are increasingly participating in philanthropic activity. So long as directors act in good faith (and do not engage in restricted activity), charitable donations appear to be virtually unrestricted by law. The absence of any clearly defined policies regarding who is a deserving beneficiary of these corporate funds, and what constitutes a reasonably sized gift, may result in inadequate protection to individual shareholders.

> If businessmen do have a social responsibility other than making profit for stockholders, how are they to know what it is? Can self-selected private individuals decide what the social interest is? Can they decide how great a burden they are justified in placing on themselves or their stockholders to serve that social interest? Is it tolerable that these public functions of taxation, ex-

penditure and control be exercised by the people who happen at the moment to be in charge of particular enterprises, chosen for those posts by strictly private groups?[65]

As proponents of greater social responsibility have argued (with apparent judicial support), modern conditions are such that failure to respond to such demands is actually tantamount to *not* acting in the best interests of the company. As one author has argued:

> To permit one stockholder to thwart the corporation's desire to accept the varied responsibilities demanded of modern corporations, and thus lessen the corporation's chances of producing an eventual profit, seems to defeat the very purpose of its existence.[66]

However, given the opportunity for abuse, a more effective means of regulating such activity seems to be warranted. Shareholders should be given some input into this corporate decision-making power. To achieve this end, it has been recommended[67] that, at a minimum, the corporation's articles should provide:

(i) a set ceiling on funds generally available for charitable donations;

(ii) a set ceiling on funds available for a charitable donation to any given institution;

(iii) a requirement that any gift in excess of these set amounts be approved by the shareholders in general meeting;

(iv) a prohibition on any prospective shareholder donee from voting his shares on any such resolution;

(v) public disclosure requirements with respect to all charitable donations;

(vi) well-defined guidelines governing charitable donations.

It is submitted that such provisions would go a long way towards removing the potential for abuse and would assist in taking the wind out of the sails of those who would argue that the potential for abuse justifies no corporate giving at all.

VI. Conclusion

> ... [I]t would be nice if we lived in a world where, in the long run, self-interest were perfectly congruent with the social interest. But there are choices to be made.[68]

Historically, the doctrine of *ultra vires* was invoked to set aside gratuitous dispositions in the belief that such activity could only frustrate the corporate objectives. Not only has our appreciation of the corporate role in

modern society been transformed but, in British Columbia, the legislature appears to have recognized the limited usefulness of *ultra vires* by putting it to rest for most purposes. Corporations seem to have a statutory green light as far as corporate philanthropy is concerned and the only residual means of challenging such activity is to base an attack on a breach of fiduciary duty by directors. Given the rationale for the doctrine of *ultra vires* in the first place (i.e., to protect a shareholder's investment from the capricious whims of a corporate director), it is submitted that this must be viewed as a positive development in the law. By transforming the analysis to one based on fiduciary duty, the courts have left open the possibility of ratification of the breach by a majority of the shareholders. If this constituency is satisfied that the directors' breach nevertheless advances the economic interests of the corporation, why should a dissenting minority be entitled to frustrate the will of the majority? Properly drafted articles with built-in safeguards, as well as statutory protection for minority shareholders (e.g., oppression and appraisal remedies), eliminate the potential for abuse. As one comment notes:

> The stockholder desires today, as he did 70 years ago, the largest return possible on his investment; the corporation is still devoted to that end, but modern social pressure demands that different means be used to achieve it. When the law required a direct benefit for corporate expenditures, it did so with the corporate end and stockholders' interests in view. Circumstances have so altered the picture that a blind adherence to that restriction frustrates rather than furthers the professed goal.[69]

In recognizing the validity of a corporation's "love for mankind", the courts are, in effect, minimizing the incongruity between self-interest and social conscience. Difficult choices are becoming easier to make. It is encouraging indeed to witness a progression in the law, whereby corporate philanthropy is increasingly being viewed as a legitimate conduit to the attainment of the corporation's larger, more fundamental, economic objectives.

FOOTNOTES

1. B.S. Prunty, Jr., *Love and the Business Corporation,* (1960), 46 Virg. L.R. 467, at 467.
2. C.R. Webster, *Public and Private Philanthropy in the Eighties,* (1984), 4 Philanthrop. No. 1, at 38.
3. S.C. 1970-71-72, c. 63 as amended.
4. B.V. Slutsky, *Ultra Vires—The British Columbia Solution,* (1973), 8 U.B.C.L.R. 309, at 319.

5. D.E. Schwartz, *Objective and Conduct of the Corporation—Defining the Corporate Objective: Section 2.01 of the A.L.I.'s Principles,* (1984), 52 Geo. Wash. L.R. 4 & 5 511, at 521.
6. K.R. Gibson, *Corporate Social Responsibility: Antithesis of Classical Capitalism,* (1985), 10 Okla. City U.L.R. 343, at 389.
7. *Supra* footnote 5.
8. E.M. Epstein, *Societal, Managerial and Legal Perspectives on Corporate Social Responsibility—Product and Process,* (1979), 30 Hast.L.J. 1287, at 1304.
9. (1953), 98 A.2d. 581 (N.J.S.C.), at 586.
10. (1972), 33 D.L.R. (3d) 288 (B.C.S.C.), at 313.
11. (1929), 67 Que.S.C. 539, at 539.
12. *Sorenson* v. *Chicago Ry. Co.* (1924), 199 N.W. 534 (Nebr. S.C.); *Smith* v. *Barlow, supra* footnote 9; *Union Pacific* v. *Trustees* (1958), 329 P.2d. 398 (Utah S.C.); *Theodora Holding* v. *Henderson* (1969), 257 A.2d. 398 (Del.Ch.C.).
13. *Supra,* footnote 9, at 586.
14. *Supra,* footnote 12.
15. *Union Pacific* v. *Trustees, supra,* footnote 13, at 400.
16. *Ibid.,* at 402.
17. (1883), 23 Ch.D. 654, at 673.
18. R.C. Mangrum, *In Search of a Paradigm of Corporate Social Responsibility,* (1983/84), 17 Creigh.L.R. 21, at 70.
19. [A member of the Award Panel notes: that the law developed differently for corporations formed by letters patent. See *Bonanza Creek Gold Mining Co.* v. *The King,* [1916], A.C. 566 (P.C.). Several provinces still form corporations by letter patent.]
20. L.C.B. Gower, *Modern Company Law,* 4th ed., (1979), at 165.
21. [1918] A.C. 514.
22. [1970] Ch. 199 at 210.
23. [1966] 2 All E.R. 674.
24. [But, see comment of Award Panel member, *supra* footnote 19.]
25. R.S.B.C. 1979, c. 59 as amended.
26. S.C. 1974-76, c. 33 as amended.
27. Subject to some limitations in s. 21(2) of the *BCCA* which are not relevant in a discussion of corporate capacity to make gratuitous dispositions.
28. R.S.C. 1970, c. C-32 as amended.
29. J.P. Boyer, *Legal Aspects of the Corporate Political Contribution in Canada,* (1979), 3 Can.Bus.L.J. 161, at 169.
30. Section 16(2) of the *CBCA* provides:

    A corporation shall not carry on any business or exercise any power that it is restricted by its articles from carrying on or exercising, nor

shall the corporation exercise any of its powers in a manner contrary to its articles.

31. H.G. Henn and J. Alexander, *Corporations*, 3rd ed., (1983), at 478.
32. American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations*, Tentative Draft No. 2, April 13, 1984.
33. M.A. Eisenberg and W.L. Cary, *Corporations—Cases and Materials*, 5th ed., at 44.
34. J.H. Farrar, *Company Law*, (1985), at 91.
35. *Supra*, footnote 20, at 182.
36. *Supra*, footnote 34, at 94.
37. *Supra*, footnote 4, at 319.
38. D.H.J. Cohen, *Gratuitous Payments to Employees and the Ultra Vires Doctrine*, (1984), 134 New L.J. 716, at 728.
39. *Supra*, footnote 17, at 673.
40. *Ibid.*, at 670.
41. (1919), 170 N.W. 668, at 684. (Interestingly, A.F. Conrad has speculated in his article *Response: The Meaning of Corporate Social Responsibility—Variations on a Theme of Edwin M. Epstein*, (1979), 30 Hast.L.J. 1321, at 1323, that the altruistic motives attributed to Henry Ford may be inaccurate in view of certain historical facts. He states that:

    Two of Ford's principal shareholders, the Dodge brothers, had recently decided to graduate from making parts for Ford to making whole automobiles for themselves. Henry's dividend reduction cut the subsidy the Ford dividends were providing to the Dodges, and his price reduction made it more difficult for the Dodges to meet Ford's competition.

42. (1905), 91 N.Y.Supp. 443 (N.Y.S.C. App.Div), at 445.
43. (1915), 85 S.E. 634 (Geo.C.A.), at 635.
44. (1874), 13 Kan. 320 (Kan.S.C.).
45. (1896), 40 N.Y.Supp. 718 (N.Y.S.C.), at 720.
46. (1922), 285 Fed. 58 (N.Y.D.C.), at 58. A similarly broad interpretation of "direct benefit" is made in *Metropolitan Life Insurance* v. *Hotchkiss* (1909), 120 N.Y.Supp. 649 (N.Y.S.C. App.Div), where Justice Kellogg states at 651 (in reference to a company's purchase of a hospital for the care and treatment of its employees afflicted with tuberculosis):

    The duties of the employer to the employe[e] have been enlarged in recent years, and are not merely that of the purchaser of the employe[e]'s time and service for money ... The reasonable care of its employe[e]s, according to the enlightened sentiment of the age and community, is a duty resting upon it, and the proper discharge of that duty is merely transacting the business of the corporation.

47. *Shlensky* v. *Wrigley* (1968), 237 N.E. 2d. 776 (Ill.C.A.); *Union Pacific* v. *Trustees, supra,* footnote 11; *Kelly* v. *Bell* (1970), 266 A.2d. 878 (Del.); *Sylvia Martin Foundation* v. *Swearingen* (1966), 260 F.Supp. 231 (S.D.N.Y).
48. *Union Pacific* v. *Trustees, supra,* footnote 11, at 401.
49. *Supra,* footnote 12.
50. *Corporate Charitable Donations: Shareholder Protection and Public Disclosure,*, (1969), 52 Col.J. of L.Soc.Prob. 99.
51. *Supra,* footnote 9, at 590.
52. *Ibid.*
53. *Supra,* footnote 12, at 405.
54. *Supra,* footnote 18.
55. *Supra,* footnote 17.
56. [1932] 2 Ch. 46, at 51.
57. [1962] Ch. 927.
58. [1967] 1 All E.R. 427.
59. [1970] Ch. 62.
60. *Supra,* footnote 56, at 53.
61. [1982] 3 All E.R. 1016.
62. [1982] Ch. 442, at 442.
63. *Ibid.,* at 450.
64. [1984] B.C.L.C. 466 (C.A.)
65. D.L. Engel, *An Approach to Corporate Social Responsibility,* (1979/80), 32 Stan. L.R. 1.
66. *Corporate Donations: Common Law, Statutory and Constitutional Implications,*, (1953/54), 29 Ind.L.J. 295, at 306.
67. *Supra,* footnote 50.
68. *Ibid.,* at 91.
69. *Supra,* footnote 66, at 305.

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