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# Philanthropy and the Business Corporation, Existing Guidelines—Future Policy

COVINGTON HARDEE

*Clark, Carr & Ellis*

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PHILANTHROPY may exist in many forms, as the work of the National Bureau of Economic Research and of this conference amply demonstrates. Historically, philanthropy begins with the individual acting privately and under the compulsion of a variety of drives—some of which may appear to contain more altruism than others. A later development is the institutionalization of aid by means of the private foundation which the law recognizes as an entity separate from its creator. The foundation may be simple or highly organized as the circumstances and the donor's wishes determine; it may take the form of a trust or of a nonprofit corporation. Traditionally foundations have been employed where large amounts of capital are to be devoted to charitable purposes and where the donor intends that the income from invested capital or, in the case of self-liquidating foundations, income and part principal over a period of years, be used to carry out his philanthropic aims. More recently philanthropic individuals have come to realize that the private foundation offers tax and other advantages for even the small donor.

The charitable foundation is a unique creation of private enterprise capitalism in the United States. The encouragement which our polity has given to the creation and development of this institution, through tax incentives, has resulted in the accumulation of significant amounts of capital devoted to bettering the conditions of human life in our society. The significance and substantiality of this wholly private, non-

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governmental activity is little understood outside the North Atlantic capitalist community. If more time and effort were spent in informing alien cultures of the connection between private enterprise capitalism and the philanthropic activities carried on by U.S. private foundations abroad, a more favorable image of our social system could be developed.

Some students, such as Frank Dickinson, consider that another form of philanthropy is public philanthropy. Just which governmental activities should be so classified is to some extent an exercise in semantics. It should be remembered that the labels we pin on things affect our thinking about them, and the way we think in turn affects our acts. The notion that governmental activity of any sort may be properly termed "philanthropy" seems to some observers quite erroneous. It is certainly true that the government distributes social benefits which are paid for in most cases by taxpayers other than the recipients. Such benefits, however, are generally distributed pursuant to legislation enacted because the legislators think that the recipients are *entitled* to them. Thus, Social Security benefits, to the extent that they are not paid for by the workers, should be regarded as representing a Congressional decision concerning the *proper* distribution of the fruits of private enterprise. This is certainly not philanthropy in the ordinary usage of that term. It might be better subsumed under the heading of "social justice." Whether one agrees with the propriety of the system or the quantum of the benefits is, of course, beside the point.

Beyond these more or less traditional forms of philanthropy or social welfare we come to the newest type—corporation philanthropy. Like individual philanthropy, it may be conducted by the corporation itself or through a separate legal entity—either a trust or a corporation. The growth of company giving over the past two decades warrants considerable study. We need to examine the why, the wherefore and especially the whither. We need to know what motivates management in directing part of the fruits of private enterprise in this or that direction. We need to know whether the decision-making is good or bad, whether the trend is more or less favorable to the good society, whether these activities should be encouraged or discouraged. The purpose of this paper is to lay the groundwork for a discussion directed to these questions.

It has recently been pointed out that:

A noisy sector of the legal front is all but quiet. Where the clamor was, was little more, for this small war was less than a battle, and its spoils more

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form than substance. 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.<sup>1</sup>

While it is true that litigation involving corporate power to make charitable contributions is rare (indeed, such power has seldom been invalidated in this century), it would be a great mistake to assume that management is free from constraint in such matters. This may be demonstrated by a study of the steps taken by the Union Pacific Railroad Company to insure that its corporate contribution program was placed not only beyond the realm of successful legal attack, but indeed beyond the range of responsible criticism.

In 1953 the Board of Directors of the Union Pacific Railroad Company began to consider the question of putting its contributions program on an expanded basis. Over the years, the Company had been making contributions to organizations which had a close tie-in with railroad operations, such as Travelers' Aid and Red Cross. Corporate power to make such contributions was never questioned and would doubtless be sustained under the common-law test of validity—direct benefit to the corporation. This test was laid down in the 19th century in the famous old case of *Hutton v. West Cork Railway*, 23 Ch. Div. 654 (1893). The Board of Union Pacific concluded, however, that in its traditional contributions the Company may not have been fully discharging its responsibility as a corporate citizen. Many felt that Union Pacific could and should do more to strengthen and expand educational, welfare and cultural activity in the areas it serves. To this end, a special committee of the Board was created to give thought to the matter and report to the full Board its recommendations for action.

The report of the Contributions Advisory Committee of the Board was rendered in June 1954. It was supported by counsel's opinion noting the absence of statutory or case law in Utah, the state from which the company derived its corporate powers, concerning corporate power to make charitable contributions. The Committee and counsel jointly suggested a course of action designed to supply the needed legitimacy. This would encompass: first, the preparation and proposal of legislation adding charity to the list of powers possessed by Utah corporations; second, the formation of the Union Pacific Railroad Foundation as a nonprofit corporation under the laws of Utah; third,

<sup>1</sup> B. S. Prunty, Jr., "Love and the Business Corporation," *Virginia Law Review*, April 1960, p. 467.

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a modest contribution to the Foundation by the Company; fourth, a contribution by the Foundation to an eleemosynary institution; fifth, a test case in the Utah courts establishing the legality of the foregoing under the Utah law.

The preparation of legislation was not difficult since the Company's counsel had available the work of a very fine committee of the American Bar Association, which had prepared a model statute expressly granting to corporations the power to make philanthropic contributions. The strong public-interest flavor of the legislation and its eminent sponsorship made it easy to develop the necessary political support for it. The bill was passed in the 1955 session of the Utah legislature and promptly approved by the Governor. It provided that corporations organized under the laws of Utah "shall have the power . . . to make donations for the public welfare or for charitable, scientific, religious or educational purposes."<sup>2</sup>

The Union Pacific Railroad Foundation was organized May 13, 1955 as a membership corporation under Utah law; that is, instead of stockholders, the corporation has members. No stock is ever issued. The membership is a self-perpetuating body, vacancies being filled by the remaining members. The duty of the membership is to elect annually a Board of Trustees, who in turn decide on policy and select the executive officers. The membership of the Union Pacific Railroad Foundation is restricted by its charter to persons who are also directors of the Union Pacific Railroad Company. The trustees of the Foundation are in practice Board members of the Union Pacific Railroad Company or its subsidiaries. Provisions in the charter for electing a minority of outside or public trustees have never been exercised.

When organization was complete, the test contributions were made; \$5,000 by the Company to the Foundation and \$4,000 by the Foundation to Brigham Young University, an institution operated by the Church of Jesus Christ of Latter Day Saints. The latter gift was earmarked one-half to current income and one-half to capital requirements of the university. The stage was thus set for the litigation testing the validity of the Company's actions. The gifts were made with the provision that, if judicially invalidated, they were required to be returned.

The test litigation which ensued was patterned on the well-known case of *A. P. Smith Co. v. Barlow*, which established the validity of charitable contributions by corporations organized under the laws of

<sup>2</sup> Utah Code Annotated (1953), Ch. 16-2-14(8).

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New Jersey. That case held that a gift by a company to Princeton University was valid under the recently passed New Jersey statute and would have been valid even without statutory sanction by reason of judicial expansion of the notion of what constitutes "benefit" to the corporation—the traditional requirement of the common law deriving from the *Hutton* case referred to above.

To set the stage for the litigation it was necessary to find some stockholder members of what might be called a loyal opposition. Stockholders were found who were willing to write to the company stating their opposition to the Company's program under the existing Utah law. Thereupon, the Company commenced action against the complaining stockholders, requesting the Utah courts to declare that the Company's activities were valid under the Utah statute and would have been valid even if the statute had not been enacted. Depositions were taken from various Union Pacific directors as to the reasons for the Board's action. John Watson of the National Industrial Conference Board testified to the growth and importance of corporate philanthropy in the United States. The trial court decided that the Company had acted improperly, that Utah corporations lacked power under the common law to make gifts to charity and that the statute could not apply to a corporation organized prior to its effective date.

Nothing daunted by this unfavorable, and somewhat irrational, decision, the Company's attorneys appealed. They informed the management that the result in the trial court merely confirmed the advisability of proceeding with utmost caution. Fortunately, the Supreme Court of Utah reversed the trial court. The decision on appeal, though gratifying as to result, was unsatisfactory in its reasoning. Union Pacific's activities were upheld under the common law, but the Court refused to pass on the applicability of the statute, on the grounds that the statute itself made no mention of applicability to pre-existing corporations. This omission was remedied in 1961 when a new business corporation law was passed, reenacting the charitable power and making all provisions of the new law applicable to pre-existing corporations.

The time and effort expended by Union Pacific in establishing the legitimacy of its charitable efforts is a graphic illustration, I believe, of the importance management attributes to being above criticism in the touchy area of giving away "other people's money." Fear of an attack based on *ultra vires* (exceeding authorized powers) is not the only constraint upon management's judgment. The outer limits on the quantum of giving are controlled by statute in some states and, as

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a practical matter, by the federal income tax laws, which limit to 5 per cent of taxable income the amount of charitable giving which is deductible for tax purposes.

The acts of directors of corporations are controlled in another important way as well. Directors are required to exercise reasonable business judgment in all of their decisions. Existence of a corporate power to make contributions is not license to give any amount to any donee. An undefined perimeter exists, measured by what seems reasonable under the circumstances (reasonableness being determined by the courts upon shareholder challenge). Directors exceeding these bounds do so at peril of being held liable for wasting company assets. This is an effective sanction even though no recent cases have been found where directors have been held liable for straying beyond the permitted territory. Indeed, since litigation itself is expensive and involves unfavorable publicity, the existence of the barrier tends to make management lean over backward to be safe from attack. We cannot, therefore, expect company-sponsored foundations to engage in the kind of experimental programming and subsidization of work on the frontiers of sociology, which are and must remain the prized preserve of private foundations in our pluralistic order.

The fact that certain boundaries and limitations on managerial discretion exist does not mean that we should be complacent about the developing role of company-sponsored foundations. The funds devoted to these purposes are bound to grow as more and more companies join in corporate philanthropy and as the unexpended capital increases. We should, therefore, direct our attention to the question: what can be done to improve the usefulness of these entities to our society? One suggestion will be advanced here; it is hoped that others may be developed in colloquy.

The encouragement of professionalism in management is a phenomenon of twentieth century capitalism. That same attitude, which is responsible for the wide acceptance of business schools, conference boards, management associations, and company-sponsored executive training programs, should be applied to corporate philanthropy. Far from deriding the "philanthropoid," companies should welcome the role of the professional giver. Private foundations, the training ground for professionalism in philanthropy, should expect and indeed look forward to some raiding of their ranks for the importation of trained personnel into company-sponsored foundations. To some extent this has already begun, but it must be encouraged and increased.

The fact that company-sponsored foundations must pursue a more

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cautious course than private foundations is no excuse for turning over their funds, as is sometimes done, to the company public-relations department. The company foundation should be thought of as tied to the company's objectives but with some degree of independence in reaching them. It should have a fully developed and trained staff without other company duties or responsibilities. Existing means for exchanging views between companies and for developing sound philanthropic policy should be strengthened. Exchange of views should not be limited to such questions as respective opinions of the X charitable organization, or whether to support a particular appeal.

Where the company foundation is too small to permit the development of its own professional staff, outside help should be sought. Already there exist men of national repute in the field, whose services are available on a consultative basis. Sound policy-making and programming is available to even small company-sponsored foundations through this means. Attendance at various meetings and conferences on corporate philanthropy, such as those conducted from time to time by the National Industrial Conference Board and biennially by New York University, is another way for the small-company foundation to participate in the development of sound objectives and attitudes for corporate philanthropy.

As professionalism increases and becomes more accepted, we may even look forward to the development of case-method teaching materials in this area. The introduction of courses in college departments of sociology and in the business schools would be of great assistance in attracting the talent and ability of young intellectuals and thus creating a professional cadre for this important work.

Those who believe in having numerous power centers in our society will welcome the growth of institutionalized philanthropy. The sound development of these private entities acts as a counterweight to the growth and importance of the welfare activities of the state. Private enterprise capitalism should therefore lend all support to the growing trend towards professionalism in private philanthropic activity.

The charitable foundation, whether sponsored by an individual or by a company, is an American institution of great and growing importance. This product of the capitalist society, which distributes some of the rewards of capital to cultural and humanitarian activities, is a tangible result of the realization by property owners and managers of duties and responsibilities over and above those imposed by law. It is likewise a refutation of the dogma that American culture is

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purely materialistic. The new awakening, whether motivated by love of man or fear of the consequences of non-action, is a powerful force for good in our order. It remains for us to make certain that the new image of enlightened capitalism is carried to the rest of the world, presently struggling with the outmoded concept of capitalism as a rapacious, dog-eat-dog system with values measured purely by self-interest.