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## Article

### THE RIGHTS OF SHAREHOLDERS IN AUTHORIZING CORPORATE PHILANTHROPY

JOHN A. PEARCE II\*

#### I. CORPORATE PHILANTHROPY IN THE UNITED STATES

Corporate philanthropy is on the rise as United States corporations donated an estimated \$20.1 billion to charities in 2013.<sup>1</sup> This record level of charitable donations seems to dispute the notion that a corporation exists “primarily for the profit of stockholders.”<sup>2</sup> Despite any misimpressions to the contrary, corporate statutes do not dictate that directors have a singular duty to pursue profit-maximizing activities.<sup>3</sup> Instead, corporate statutes specify activities for which directors are able to use corporate profits, including provisions allowing corporate donations for social goals.<sup>4</sup> In determining whether a public company’s board of directors has acted in its shareholders’ best interests, courts scrutinize directors’ decisions based on the directors’ fiduciary duties and thus apply the “business judgment” rule, which accords directors very deferential treatment.<sup>5</sup> The business

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1. See ATLAS OF GIVING, U.S. CHARITABLE GIVING: 2013 RESULTS & INITIAL 2014 FORECAST 1, 8 (2013), available at <http://www.atlasofgiving.com/cye>.

2. See *Dodge v. Ford Motor Co.*, 170 N.W. 668, 684 (Mich. 1919) (expressing position that profits should be primary goal of managers); see also A.L.I., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01(a) (1994) (“[A] corporation should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain.” (citation omitted)).

3. See Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 763 (2005) (profiling discretion directors are allowed in refraining from profit-maximizing activities).

4. See *id.* (“To the contrary, every state has enacted a corporate statute giving managers explicit authority to donate corporate funds for charitable purposes.”).

5. See Ashley Schoenjahn, Note, *New Faces of Corporate Responsibility: Will New Entity Forms Allow Businesses to Do Good?*, 37 J. CORP. L. 453, 457 (2012) (discussing business judgment rule in context of past precedent).

judgment rule prevents courts from finding directors at fault if they relied on “any rational business purpose” when making their decision.<sup>6</sup>

A corporation contributes to nonprofit organizations as a way to expand its marketing, create positive public relations, serve community needs in the hope of generating consumer loyalty, provide tax benefits for the corporation, and elicit “the applause and approval of business peers and local philanthropic elites.”<sup>7</sup> The most direct economic benefits that companies reap from corporate philanthropy are the tax incentives that the United States Internal Revenue Service (IRS) allows.<sup>8</sup> These tax allowances reduce a corporation’s taxable base or provide the corporation with state and local government tax credits to reduce a company’s tax liability.<sup>9</sup> To claim a tax deduction, the IRS requires that a company’s board of directors authorize the charitable contribution.<sup>10</sup> Presumed benefits of corporate philanthropy that do not produce direct economic benefits—and cannot prove their worth as direct line items—can cause consternation among a corporation’s shareholders and may prompt shareholder demands for reconsideration of the corporation’s charitable donations.<sup>11</sup>

In certain circumstances, directors are able to donate their company’s philanthropic funds in personally beneficial ways.<sup>12</sup> The public profiles of board members and company executives are raised frequently by news media appearances that praise corporate philanthropy, while simultaneously increasing their personal stature, fame, recognition, and board seats.<sup>13</sup> In light of the discretion given to boards of directors in determining corpo-

6. See R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, *DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS* § 4.19(A) (3d ed. 2014) (citing *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971)) (explaining business judgment rule).

7. See Jayne W. Barnard, *Corporate Philanthropy, Executives’ Pet Charities and the Agency Problem*, 41 N.Y.L. SCH. L. REV. 1147, 1164 (1997) (quoting Joseph Galaskiewicz, *Corporate Contributions to Charity: Nothing More than a Marketing Strategy?*, in *PHILANTHROPIC GIVING: STUDIES IN VARIETIES AND GOALS* 251, 252 (Richard Magat ed., 1989)) (internal quotation marks omitted) (identifying five predominant reasons corporations participate in philanthropy).

8. See, e.g., I.R.C. § 170 (2012) (providing deductions for certain allowable charitable contributions and gifts under Internal Revenue Code).

9. See, e.g., *North Dakota’s Income Tax Credit*, N.D. CMTY. FOUND., <http://www.ndcf.net/Information/NDtaxCredit.asp> (last visited Jan. 30, 2015) (providing tax credit for specific gifts to North Dakota charities under senate bill 2160); see also IDAHO CODE ANN. § 63-3029A (West 2014) (providing tax credit limit of fifty percent of contributions and up to ten percent of total income or tax liability).

10. See I.R.C. § 170(a)(2)(A).

11. Of the four major tax choices available for domestic and international corporate philanthropy—direct corporate giving, company foundation grants, donor-advised fund grants, and promotional or marketing expenses—direct corporate giving was chosen as the focus of this Article to help improve clarity and thoroughness.

12. See Barnard, *supra* note 7, at 1148 (commenting on notion of corporate directors using corporate funds to subsidize “pet projects”).

13. See *id.* at 1160–64 (supporting notion that philanthropic actions carried out by corporate executives are highlighted from many angles).

rate philanthropic donations of stockholder funds, this research was conducted to understand board powers and the legal constraints in place to protect shareholder rights and interests.

### A. *An Overview of Extant Law*

Before the mid-1950s, the prevailing law did not grant corporations the authority to make philanthropic contributions unless the contributions were directly related to the purposes of the corporation.<sup>14</sup> Currently, all fifty states have statutes providing for corporate authority to make philanthropic contributions.<sup>15</sup> Additionally, the American Bar Association Committee on Business Corporations passed a resolution “empowering corporate donations to charitable, scientific, religious and educational institutions.”<sup>16</sup> Authorized contributions include corporate donations to promote goodwill for the company<sup>17</sup> and charities, which are important to the welfare of the communities where the donor does business.<sup>18</sup>

Most states have enacted statutes that provide guidelines specifying whose interests directors must consider in making corporate philanthropic decisions.<sup>19</sup> While some states require directors to place disproportionate weight on shareholder interests, other states require directors to consider additional interested parties, such as employees, suppliers, customers, and local communities.<sup>20</sup> For instance, Delaware directs boards of directors to consider primarily shareholders’ interests or to make deci-

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14. See William O. Brown, Eric Helland & Janet Kiholm Smith, *Corporate Philanthropic Practices*, 12 J. CORP. FIN. 855, 861 (2006) (describing corporate philanthropy laws prior to mid-1950s). See generally Faith Stevelman Kahn, *Pandora’s Box: Managerial Discretion and the Problem of Corporate Philanthropy*, 44 UCLA L. REV. 579 (1997).

15. See Brown, Helland & Smith, *supra* note 14, at 859 (“Twenty-four states, including Delaware, have adopted phrasing that enables corporations ‘to make donations for the public welfare or for charitable, scientific or educational purposes.’ Nineteen have a two-provision statute that allows contributions for either ‘furthering the business affairs of the corporation’ or for ‘charitable purposes.’ The remaining seven authorize contributions ‘irrespective of corporate benefits.’”).

16. *Union Pac. R.R. Co. v. Trustees, Inc.*, 329 P.2d 398, 400 (Utah 1958).

17. See *Greene Cnty. Nat’l Farm Loan Ass’n v. Fed. Land Bank of Louisville*, 57 F. Supp. 783, 789 (W.D. Ky. 1944) (finding it well-established that substantial contributions meant to promote goodwill of company are permitted), *aff’d*, 152 F.2d 215 (6th Cir. 1945).

18. See *A. P. Smith Mfg. Co. v. Barlow*, 98 A.2d 581, 585–86 (N.J. 1953) (discussing importance of corporate philanthropy efforts to better communities in which those corporations conduct business).

19. See Brown, Helland & Smith, *supra* note 14, at 859 (acknowledging states now provide guidelines for whose interests must be considered during decision making process).

20. See *id.* at 859–60 (“Delaware imposes a ‘shareholder primacy’ criterion on managers (managers must place shareholders’ interests first). Other states allow managers to consider broader constituencies . . .”).

sions about charitable donations in accordance with the business judgment rule.<sup>21</sup>

Shareholders rarely have opportunities to provide input on corporate philanthropy decisions.<sup>22</sup> There are no laws that expressly allow or require shareholders to receive disclosures of corporate donations or to participate in the decision making process such that they would be able to help choose the recipient organizations and the amounts donated.<sup>23</sup>

### B. *Tax Policy*

The United States government supports corporate philanthropy through its tax policy.<sup>24</sup> In 1935, Congress encouraged corporate contributions to “eleemosynary causes” by allowing a tax deduction for such donations.<sup>25</sup> This encouragement is codified in section 170 of the Internal Revenue Code.<sup>26</sup> The federal policy is also reflected in the tax deductions at the state level; since 1955, over eighty percent of states also allow charity-related tax deductions.<sup>27</sup>

## II. SUBSTANTIVE REVIEW OF CASE LAW

Four cases are especially relevant to corporate philanthropic activities.<sup>28</sup> These cases provide examples of shareholders’ views and arguments in attempting to overrule management’s decisions on corporate philanthropy.

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21. *See id.* at 860 (“[T]here are three different formulations currently in place: Delaware’s shareholder primacy statute, Connecticut law, which *requires* consideration of non-shareholder interests, and ‘other constituency statutes,’ which indicate whose interests may be considered. The latter states give broad discretion to consider non-shareholder interests, and are used in 26 states. The remaining 22 states have not enacted specific laws, but instead follow the ‘business judgment rule,’ which holds that directors’ decisions are presumed to be informed decisions, made in good faith, and in the belief that they are in the interest of the shareholders.”).

22. *See id.* at 861–62 (discussing how many managers and directors will conceal philanthropic activity, evidencing that many shareholders are not given opportunities to participate in these decisions).

23. *See id.* at 861 (“There is no legal requirement for firms to disclose their charitable giving.”).

24. *See* I.R.C. § 170 (2012) (providing tax statute supporting corporate philanthropy).

25. *See* Revenue Act of 1935, Pub. L. No. 74-407, 49 Stat. 1014, 1016 (providing statutes applying to tax deduction considerations for charitable donations).

26. *See* I.R.C. § 170.

27. *See* *Union Pac. R.R. Co. v. Trustees, Inc.*, 329 P.2d 398, 400–01 (Utah 1958).

28. *See generally* *Kahn v. Sullivan*, 594 A.2d 48 (Del. 1991); *Theodora Holding Corp. v. Henderson*, 257 A.2d 398 (Del. Ch. 1969); *A. P. Smith Mfg. Co. v. Barlow*, 98 A.2d 581 (N.J. 1953); *Union Pac. R.R. Co.*, 329 P.2d 398.

## A. A. P. Smith Manufacturing Co. v. Barlow

The A. P. Smith Manufacturing Company (“A. P. Smith”), a New Jersey company incorporated in 1896, engaged in the manufacture and sale of valves, fire hydrants, and special equipment, mainly for the water and gas industries.<sup>29</sup> Over the years, A. P. Smith made regular contributions to the local community chest and occasionally to Upsala College and Newark University.<sup>30</sup> In July 1951, “[A. P. Smith’s] board of directors adopted a resolution which set forth that it was in [A.P. Smith’s] best interests to join with others in the 1951 Annual Giving to Princeton University . . . .”<sup>31</sup> The board of directors appropriated the sum of \$1,500 to be contributed to Princeton University for its maintenance.<sup>32</sup>

A. P. Smith’s stockholders questioned this donation and sought a declaratory judgment, leading to a trial.<sup>33</sup> During the trial, A. P. Smith’s president explained that the contribution at issue was a “sound investment” because the public expected corporations to donate money to philanthropic and benevolent institutions. In return, corporations receive community goodwill and a favorable environment in which to conduct business.<sup>34</sup> Princeton University’s President also testified to the benefit of donations to private institutions.<sup>35</sup>

The shareholders did not dispute A. P. Smith’s testimony on the importance of donating to private higher learning institutions, such as Princeton, and did not object to the legislation and public policy in favor of corporate contributions.<sup>36</sup> However, the shareholders argued that A. P. Smith’s certificate of incorporation did not expressly authorize contribu-

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29. *See A. P. Smith Mfg. Co.*, 98 A.2d at 582. The company was located in East Orange and Bloomfield, New Jersey, and it had approximately 300 employees. *See id.*

30. *See id.* Upsala College was located in East Orange and Newark University is now a part of Rutgers, the State University. *See id.*

31. *Id.* (discussing board resolution relating to Annual Giving to Princeton University).

32. *See id.* (noting amount of contribution given to Princeton University).

33. *See id.* (recounting procedural history).

34. *See id.* at 582–83 (quoting A. P. Smith president’s testimony on contributions to Princeton). Additionally, A. P. Smith’s president stated that by “contributing to liberal arts institutions, corporations were furthering their self-interest in assuring the free flow of properly trained personnel for administrative and other corporate employment.” *Id.* at 583. Moreover, the chairman of the board of the Standard Oil Company of New Jersey testified that “corporations are expected to acknowledge their public responsibilities in support of the essential elements of our free enterprise system.” *Id.* In addition, he indicated that disappointing reasonable and justified public expectations was a bad business practice, as was “tak[ing] substantial benefits from their membership in the economic community while avoiding the normally accepted obligations of citizenship in the social community.” *Id.*

35. *See id.* (providing Princeton President’s testimony arguing for need to maintain non-governmental sources of knowledge and philanthropic aid).

36. *See id.* (noting that shareholders did not object to testimony presented on public policy reasons for corporate contributions).

tions and that, under common law, A. P. Smith did not possess any implied or incidental power to make philanthropic contributions.<sup>37</sup> Further, the shareholders argued that the New Jersey statutes expressly authorizing contributions did not apply to A. P. Smith because the company was formed before the statutes were enacted.<sup>38</sup> The trial court ruled for A. P. Smith, stating that the company's decision to donate was within its corporate power, *intra vires*, and the shareholders appealed.<sup>39</sup>

The appellate court agreed, finding that A. P. Smith's authority to make charitable donations was valid.<sup>40</sup> The court held that A. P. Smith was permitted to make donations when the activity supported by the gift promoted the goodwill of the corporation's business.<sup>41</sup> The appellate court stated that A. P. Smith's modest donation to a preeminent institution of higher learning was well within the limitations imposed by the statute, and the donation was voluntarily made with reasonable belief that it would aid the public welfare and advance the company's interest as a private corporation in the community in which the company operated.<sup>42</sup>

#### B. Union Pacific Railroad Co. v. Trustees, Inc.

Plaintiff Union Pacific Railroad Co. ("Union Pacific") was incorporated in 1897 to operate a railroad.<sup>43</sup> Union Pacific's charter "gave no express power of contribution, there was no legislation authorizing it, and none existed until and unless it was provided by the 1955 legislation."<sup>44</sup> In 1955, four shareholders challenged Union Pacific's authority to make charitable contributions from corporate funds and threatened to commence litigation.<sup>45</sup> The next day, Union Pacific filed a lawsuit seeking a declaratory judgment against these four shareholders.<sup>46</sup>

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37. *See id.* (providing shareholders' first position in challenging A. P. Smith's contribution).

38. *See id.* (presenting shareholders' second argument against A. P. Smith's contribution).

39. *See id.* at 582.

40. *See id.* at 590 (presenting holding of court in A. P. Smith's favor).

41. *See id.* at 584. Under New Jersey law, corporations can make charitable donations, provided that the contributions are not made to donee institutions that own more than ten percent of the voting stock of the donor and that the contributions do not exceed one percent of capital and surplus, unless one of these prohibited donations are authorized by the stockholders. *See* N.J. STAT. ANN. § 14A:3-4(1) (West 2014) (authorizing contributions by corporations and providing requirements).

42. *See A. P. Smith Mfg. Co.*, 98 A.2d at 590 (providing court's additional reasoning in finding A. P. Smith's contribution valid).

43. *See* Union Pac. R.R. Co. v. Trustees, Inc., 329 P.2d 398, 400 (Utah 1958).

44. *Id.* (discussing Union Pacific's authority to make philanthropic donations).

45. *See id.* (explaining shareholders' desire to "test" donation by filing suit before Union Pacific filed declaratory judgment suit).

46. *See id.* (stating Union Pacific's declaratory judgment appeared "to have been one of the speediest, most understanding corporate responses to benevolent shareholder belligerency on record").

During the hearing, Union Pacific's directors testified that the new concept of corporate responsibility through philanthropy was "conceived in a shifting socio-economic atmosphere[,] was born of new corporate business policy, [and] . . . seems to be nurtured by legislative, corporate and judicial thinking."<sup>47</sup> They further stated that "[a] reasonable percentage of corporate income . . . should be earmarked for worthy [philanthropic] causes, as a necessary and proper item of business expense . . . ."<sup>48</sup> The chairperson of Union Pacific's board of directors testified that corporate donations are beneficial to the shareholders in the long run, and that the public expects businesses to support worthwhile local and national causes.<sup>49</sup>

The lower court ruled that Union Pacific's resolution authorizing a \$5,000 contribution of corporate funds to its foundation—a non-profit corporation organized by Union Pacific and dedicated to charitable, scientific, religious, and educational purposes—was *ultra vires*.<sup>50</sup> Further, the lower court stated that Union Pacific did not have the statutory authority to make contributions of corporate funds for public welfare or for charitable, scientific, religious, or educational purposes.<sup>51</sup>

On appeal, the Supreme Court of Utah concluded that the corporation made the donation in the best interest of the shareholders and the company.<sup>52</sup> The court found that such a corporate contribution should rest on the "sound discretion of management" and was a legitimate exercise of "implied authority in the ordinary course of the company's business."<sup>53</sup> The court stated that the implied powers of a corporation provide

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47. *Id.* at 401 (providing context for Union Pacific's decision to make philanthropic donation).

48. *Id.* (quoting testimony to lend further policy support for corporate giving).

49. *See id.* (emphasizing donation decision was made with shareholders in mind). Other directors testified that corporate donations create goodwill in the community and positive reflection from the public to corporate generosity. *See id.* (discussing other benefits of corporate donations). The court echoed this testimony by recognizing the goodwill benefit received by Union Pacific when it shipped 1,600 carloads of food and material, contributed \$200,000 in cash, and evacuated a quarter of a million people at no charge following the San Francisco earthquake in 1906. *See id.* at 400 (highlighting this act as illustrative of implied corporate power that, although not profitable, was not "priceless" due to resulting community goodwill).

50. *See id.* at 399 (providing procedural background of case).

51. *See id.* (summarizing lower court's finding that precluded Union Pacific from making philanthropic donation absent authority).

52. *See id.* at 401 ("If [directors'] personal judgment was unsound, it is not reflected in this 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.").

53. *Id.* at 401–02 (likening donation to sponsoring baseball teams, subsidizing students with intent to hire them later, giving to community chests, paying public



the authority to contribute "reasonable amounts to selected charitable, scientific, religious or educational institutions, if they appear reasonably designed to assure a present or foreseeable future benefit to the corporation . . . ." <sup>54</sup> The court also held that in making a charitable contribution, the management's decisions "should not be rendered impotent unless arbitrary and unreasonably indefensible, or unless countermanded or eliminated by action of the shareholders at a proper meeting." <sup>55</sup>

### C. Theodora Holding Corp. v. Henderson

The Theodora Holding Corporation ("Theodora") was formed in 1967 as a holding company of Alexander Dawson, Inc. <sup>56</sup> Theodora's shareholder filed a derivative action against the corporation and the corporation's president, who was also a majority shareholder, seeking an appointment of a liquidating receiver. <sup>57</sup> The shareholder alleged that, through several separate transactions, the president mismanaged the corporation and engaged in several expenditures for his own benefit and to the corporation's detriment. <sup>58</sup> The lawsuit demanded an accounting by individual defendants for losses allegedly sustained and improper gains received by the defendants because of certain transactions, such as the purchase of a seat on the New York Stock Exchange and the donation of monies to a charitable trust. <sup>59</sup>

Theodora donated stock, valued in excess of \$525,000, to the charitable trust. <sup>60</sup> The court stated that the donated amount was within the limits of federal tax provisions pertaining to deductible corporate gifts under sections 170(b)(2) and 545(b)(2) of the Internal Revenue Code of 1954. <sup>61</sup> The court also stated that the charitable trust was legitimate, as it operated exclusively in the fields of religious, charitable, scientific, literary, or edu-

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relations salaries, sponsoring newspaper or television programs, or conducting advertising programs).

54. *Id.* at 402 (finding directors' decision rooted in common sense).

55. *Id.*

56. *See* Theodora Holding Corp. v. Henderson, 257 A.2d 398, 399 (Del. Ch. 1969) ("Theodora G. Henderson[ ] is the holder of record of 11,000 of the 40,500 issued and outstanding shares of common stock of the defendant Alexander Dawson, Inc.").

57. *See id.* ("[T]he basic relief sought by plaintiff after trial is the appointment of a liquidating receiver for the corporate defendant, such application being based on the alleged wrongs suffered by the corporate defendant at the hands of the individual defendants, which wrongs, according to plaintiff, if permitted to continue, threaten the very existence of such corporation.").

58. *See id.* at 399-400 (noting plaintiff's argument that such wrongs threatened existence of Alexander Dawson, Inc.).

59. *See id.* at 399 ("[T]he basic relief sought by plaintiff after trial is the appointment of a liquidating receiver . . .").

60. *See id.* at 402 (noting that donations had been made to Alexander Dawson Foundation since 1957, and shareholders had unanimously approved all gifts including tract of land worth \$467,750).

61. *See id.* at 404-05 (framing gift as percentage of revenue).

cational purposes.<sup>62</sup> Before rendering its decision, the court considered contemporary decisions from other jurisdictions—which recognized a corporation’s obligations to philanthropic, educational, and artistic causes—and current statutory law supporting the same.<sup>63</sup> The court held that a reasonableness test should apply to philanthropic donations and that the Internal Revenue Code should furnish a helpful guide pertaining to charitable gifts by corporations.<sup>64</sup>

The court denied the request for a receiver and stated that none of the separate transactions “demonstrate gross mismanagement or a threat to [Theodora’s] existence as a viable business entity . . . .”<sup>65</sup> Although the gift of \$528,000 was significant, Theodora’s total income was \$19.1 million, thus placing the donation well within the federal deduction limitation, which was five percent of a corporation’s income pursuant to the Internal Revenue Code of 1954.<sup>66</sup> Accordingly, the court held that the shareholders in this case failed to prove that Theodora’s transactions, separately or cumulatively, demonstrated corporate perversion or self-dealing, but instead showed reasonable corporate acts within the business judgment rule.<sup>67</sup>

This case signifies court adoption of the reasonableness standard for corporate philanthropic donations and the use of the Internal Revenue Code to decide if a donation is in fact reasonable.<sup>68</sup> In this decision, the court limited shareholders’ rights to challenge corporate donations by validating corporate donations as long as they are reasonable in amount, regardless of the total dollar figure donated, and follow the standards prescribed by tax statutes.<sup>69</sup> This case also expressly extended the applica-

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62. *See id.* at 404 (citing DEL. CODE ANN. tit. 8, § 122) (finding that, under Delaware law, “Every corporation . . . shall have the power to . . . make donations for the public welfare or for charitable, scientific or educational purposes . . .”).

63. *See id.* (citing *A. P. Smith Mfg. Co. v. Barlow*, 98 A.2d 681 (N.J. 1953)) (emphasizing *A. P. Smith Mfg. Co.* court’s holding that corporate gifts must be reasonable in amount and purpose).

64. *See id.* at 405 (noting cost to shareholders per contribution dollar was only fifteen cents because of favorable tax provisions).

65. *See id.* at 406 (explaining that liquidation should only be forced upon showing of “a failure of corporate purpose, a fraudulent disregard of the minority’s rights, or some other fact which indicates an imminent danger of great loss resulting from fraudulent or absolute mismanagement”).

66. *See id.* at 405.

67. *See id.* at 406.

68. *See* Henry N. Butler & Fred S. McChesney, *Why They Give at the Office: Shareholder Welfare and Corporate Philanthropy in the Contractual Theory of the Corporation*, 84 CORNELL L. REV. 1195, 1195 (1999) (“Courts largely have resolved the legal issue in favor of allowing corporate management wide latitude in making philanthropic contributions.”).

69. *See id.* at 1205 (noting that while shareholders could make those contributions on their own, firm can do so at lower cost).

tion of the business judgment rule to corporate philanthropic activities.<sup>70</sup> Finally, the decision signifies the extension of previously established precedent and the power of a corporation to make charitable donations.<sup>71</sup>

#### D. Kahn v. Sullivan

Occidental Petroleum Corporation ("Occidental") was a Delaware corporation with corporate headquarters located in Los Angeles, California that had approximately 290 million shares of stock outstanding and 495,000 shareholders at the time of the case.<sup>72</sup> Armand Hammer, Occidental's chief operating officer and chairman of its board of directors, was an art collector at the time of his death. Both personally and with his foundation, Hammer owned three major collections of art valued at \$300 to \$400 million.<sup>73</sup> For many years, Occidental's board of directors determined that it was in the corporation's best interest to support and promote the acquisition and exhibition of the art collection.<sup>74</sup> Occidental's financial support and sponsorship allowed the art collection to be loaned to sponsors in more than twenty-five American cities and at least eighteen foreign countries, the majority of which were countries where Occidental had business "operations or was negotiating business contracts."<sup>75</sup> Occidental's annual report described the "benefits and good will which [the art collection] attributes to the financial support that Occidental has provided for the Art Collection."<sup>76</sup>

The Los Angeles County Museum of Art (LACMA) had an ongoing relationship with Hammer, through which he donated numerous paintings and funds to LACMA for the purchase of additional art.<sup>77</sup> For his contributions, LACMA named one of its wings after Hammer.<sup>78</sup> For nearly twenty years, Hammer expressed his intention to donate the art collection to LACMA, but neither party entered into an agreement to that

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70. *See id.* (explaining that protection of business judgment rule allows company, instead of its shareholders, "to take the lead in choosing the objects and amounts of corporate charity").

71. *See id.* (noting that *Theodora* court explained that there could be instances when certain philanthropic actions add more utility to manager than firm, which might not fall within this role).

72. *See Kahn v. Sullivan*, 594 A.2d 48, 51 (Del. 1991) (providing general information about company).

73. *See id.* ("The Art Collection, valued at \$300–\$400 million included: 'Five Centuries of Art,' more than 100 works by artists such as Rembrandt, Rubens, Renoir and Van Gogh; the *Codex Hammer*, a rare manuscript by Leonardo da Vinci; and the world's most extensive private collection of paintings, lithographs and bronzes by the French satirist Honore Daumier.").

74. *See id.*

75. *See id.* (explaining that more than six million people have viewed collection in total).

76. *Id.*

77. *See id.* at 51–52 (describing relationship that spanned several decades).

78. *See id.* at 52 ("Nevertheless, LACMA named one of its buildings the Frances and Armand Hammer Wing in recognition of Dr. Hammer's gifts.").

effect.<sup>79</sup> Occidental approved Hammer's decision to display the art collection permanently at LACMA and made "substantial financial contributions to facilitate that display."<sup>80</sup> When LACMA and Hammer attempted to formalize the donation through a binding agreement, the negotiations broke down, and Hammer concluded that he would make arrangements for permanent display of the art collection at a place other than LACMA.<sup>81</sup>

Consequently, Hammer proposed to Occidental that the company construct a museum for the art collection.<sup>82</sup> Occidental's executive committee decided that it was in the corporation's best interest to accept the proposal, approving the construction of the art museum on the corporate premises.<sup>83</sup> In its annual report, Occidental informed its shareholders of the preliminary plans to construct the art museum.<sup>84</sup>

Prior to approving the proposal, the board of directors conducted and participated in multiple due diligence processes.<sup>85</sup> First, the board hired outside legal and accounting firms to examine all issues relevant to the final proposal for the museum.<sup>86</sup> These external professional firms rendered their opinions pertaining to the museum proposal.<sup>87</sup> Second, the board appointed a special committee comprised of eight independent directors to review the proposal.<sup>88</sup> After deliberating and relying on the

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79. *See id.* (explaining that Hammer presented LACMA with thirty-nine page proposed agreement, but they were unable to agree on terms).

80. *See id.* (providing example of Occidental's \$2 million payment to expand and refurbish the Hammer wing at LACMA in 1982).

81. *See id.* (noting Hammer had stated in letter that he "'decided to create [his] own museum to house'" collection).

82. *See id.* (explaining plan to use space of existing employee parking lot for museum).

83. *See id.* (noting executive committee approved negotiations for design and construction of museum after discussing company's history with art collection).

84. *See id.*

85. *See id.*

86. *See id.* (noting that one law firm was retained to examine proposal and address issues relevant to board's consideration, and another law firm was retained to represent newly formed entity that would be necessary for museum proposal).

87. *See id.* (explaining that law firm examining proposals relevant to board's consideration "provided each member of the Board with a ninety-six page memorandum," which "contained a definition of the Museum proposal and the anticipated magnitude of the proposed charitable donation by Occidental"). The memorandum:

[R]eviewed the authority of the Board to approve such a donation and the reasonableness of the proposed donation" and "included an analysis of the donation's effect on Occidental's financial condition, the potential for good will and other benefits to Occidental, and a comparison of the proposed charitable contribution by Occidental to the charitable contributions of other corporations.

*Id.* at 52–53. The second law firm also provided a tax opinion. *See id.* at 53 ("The presentation reviewed again the directors' standard of conduct in considering the Museum proposal, as well as the financial and tax consequences to Occidental as a result of the donation.").

88. *See id.* (listing board members, who collectively accounted for approximately eighty years of service on Occidental's board).

reports prepared by outside legal and accounting consultants, the special committee concluded that establishing the museum on Occidental's corporate property would provide benefit to the corporation and would establish a "new cultural landmark for the City of Los Angeles."<sup>89</sup> As a result, the special committee unanimously approved the museum proposal subject to several conditions, which required additional substantial expenditures and numerous procedural compliances.<sup>90</sup>

After Occidental reported its approval of the museum proposal to its shareholders via a proxy statement, three shareholder lawsuits challenged the Occidental board's actions to make charitable donations to construct

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89. *See id.* at 54 (describing decision-making process as including many questions, extensive discussions, and reliance on expert opinions).

90. *See id.* at 54–55. The proposal approved by the Special Committee included the following provisions:

- (1) Occidental would construct a new museum building, renovate portions of four floors of its adjacent headquarters for use by the Museum, and construct a parking garage beneath the museum for its own use for a total cost of approximately \$50 million.
- (2) Occidental would lease the Museum building and the four floors of its headquarters to the Museum rent-free for a term of thirty years. Occidental would continue to pay the property taxes, and the Museum would pay the utilities and maintenance expenses;
- (3) Occidental would purchase a thirty-year annuity at an estimated cost of \$35.6 million to provide for the funding of the Museum's operations during its initial years;
- (4) Occidental would grant the Museum an irrevocable option to purchase the Museum building, the parking garage, and the Occidental headquarters building in thirty years for \$55 million;
- (5) Dr. Hammer and the Foundation would transfer the Art Collection entirely to the Museum;
- (6) The Museum would be named for Dr. Hammer—The Armand Hammer Museum of Art and Cultural Center.
- (7) Occidental would have representation on the board of directors of the Museum;
- (8) Occidental would receive public recognition for its role in establishing the Museum, for example, by the naming of the courtyard, library, or auditorium for Occidental and Occidental would have the right to use the Museum, and be entitled to "corporate sponsor" rights.

*Id.* at 54. Additionally, the approval of the proposal was subject to the following conditions:

- (1) The incorporation of the Museum as a non-profit corporation under Delaware law;
- (2) The determination by the Internal Revenue Service that the Museum would be a tax-exempt entity under the Internal Revenue Code;
- (3) The receipt of supplementation of the [ ] opinion letters to reflect tax issues discussed at the meeting, including the question of self-dealing; and
- (4) The execution of the necessary documents relating to (a) the lease of the Museum facilities, (b) the Museum's option to purchase Occidental's headquarters, (c) Occidental's lease-back rights if the option was exercised, and (d) an agreement for the transfer of the Collection from the Foundation and Dr. Hammer to the Museum, including a full inventory of the art.

*Id.* at 54–55.

and fund an art museum.<sup>91</sup> Occidental's board, by unanimous written consent, delegated full authority to a special committee to settle the shareholder litigation.<sup>92</sup> One group of shareholders agreed to a settlement of their class and derivative actions, subject to approval by the Court of Chancery.<sup>93</sup> After Occidental's special committee authorized the settlement, the shareholders in the other two lawsuits objected and decided to challenge the proposed settlement.<sup>94</sup>

The Court of Chancery concluded that under the circumstances of this litigation, the terms of the settlement were fair and reasonable, and it

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91. *See id.* at 50, 55 (describing timeline of Kahn, Sullivan, and Stepak actions).

92. *See id.* at 56 (reviewing process of special committee drafting agreement).

93. *See id.* at 50, 56–57. The Settlement and Release Agreement presented to the Court of Chancery provided for the following:

(1) The Museum building shall be named the "Occidental Petroleum Cultural Center Building" with the name displayed appropriately on the building.

(2) Occidental shall be treated as a corporate sponsor by the Museum for as long as the Museum occupies the building.

(3) Occidental's contribution of the building shall be recognized by the Museum in public references to the facility.

(4) Three of Occidental's directors shall serve on the Museum's Board (or no less than one-third of the total Museum Board) with Occidental having the option to designate a fourth director.

(5) There shall be an immediate loan of substantially all of the art collections of Dr. Hammer to the Museum and there shall be an actual transfer of ownership of the collections upon Dr. Hammer's death or the commencement of operation of the Museum—whichever later occurs.

(6) All future charitable contributions by Occidental to any Hammer-affiliated charities shall be limited by the size of the dividends paid to Occidental's common stockholders. At current dividend levels, Occidental's annual contributions to Hammer-affiliated charities pursuant to this limitation could not exceed approximately three cents per share.

(7) Any amounts Occidental pays for construction of the Museum in excess of \$50 million and any amounts paid to the Foundation upon Dr. Hammer's death must be charged against the agreed ceiling on limitations to Hammer-affiliated charities.

(8) Occidental's expenditures for the Museum construction shall not exceed \$50 million, except that an additional \$10 million may be expended through December 31, 1990 but only if such additional expenditures do not enlarge the scope of construction and if such expenditures are approved by the Special Committee. Amounts in excess of \$50 million must be charged against the limitation on donations to Hammer-affiliated charities.

(9) Occidental shall be entitled to receive 50% of any consideration received in excess of a \$55 million option price for the Museum property or 50% of any consideration the Museum receives from the assignment or transfer of its option or lease to a third party.

(10) Plaintiffs' attorneys' fees in the *Sullivan* action shall not exceed \$1.4 million.

*Id.* at 57.

94. *See id.* at 50, 57 (noting that Kahn, Stepak, and California Public Employees Retirement System ("CalPERS") appeared to oppose settlement).

approved the settlement.<sup>95</sup> Specifically, the court concluded that the shareholders' claims were likely to be dismissed before or after the trial.<sup>96</sup> The court also stated that the benefit to be received from the settlement "was meager" and that "it was adequate considering all facts and circumstances" surrounding this litigation.<sup>97</sup>

An appeal followed in which the shareholders contended that the Court of Chancery abused its discretion in approving the settlement.<sup>98</sup> Specifically, the shareholders presented three arguments.<sup>99</sup> First, shareholders argued that the court "erred in holding that it was 'highly probable' that the protection of the business judgment rule would successfully apply to the actions taken by the directors of Occidental who had been named as defendants."<sup>100</sup> Second, the shareholders argued that the court abused its discretion in finding that "plaintiffs' claims of corporate waste were weak."<sup>101</sup> Third, the shareholders stated that the court "abused its discretion in approving the settlement because the consideration for the settlement was inadequate in view of the strength of the claims" against the defendant.<sup>102</sup>

After reviewing the facts and law underlying this action, the Supreme Court of Delaware affirmed the Court of Chancery's decision and held against the objecting shareholders.<sup>103</sup> As to the shareholders' first argument, the Delaware Supreme Court affirmed the lower court's conclusion that "it was highly probable in deciding a motion to dismiss, a motion for summary judgment, or a post-trial motion, the actions of 'the Special Committee would be protected by the presumption of propriety afforded by the business judgment rule.'"<sup>104</sup> The Delaware Supreme Court agreed with the Court of Chancery regarding its conclusion that the record of Occidental's actions, relying on outside and independent directors to make informed decisions regarding the approval of charitable donations, supported the disposition of the lawsuit.<sup>105</sup>

As to the shareholders' second argument accusing Occidental of corporate waste, the court affirmed the dismissal of that claim, finding that Occidental acted within the bounds of Delaware law and that the corpora-

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95. *See id.* at 51, 58 (noting that in reviewing settlement, Chancery Court was bound by business judgment rule in determining reasonableness).

96. *See id.* at 58, 61 (describing reasoning in approving settlement).

97. *See id.* at 58.

98. *See id.* at 51 (stating California Public Employees Retirement System was permitted to intervene as shareholder plaintiff and appeared in opposition to proposed settlement).

99. *See id.* (introducing objectors' arguments).

100. *See id.*

101. *See id.*

102. *See id.*

103. *See id.* at 63 (affirming Court of Chancery's approval of settlement).

104. *See id.* at 61 (restating Court of Chancery's reasoning as to shareholders' first argument).

105. *See id.*

tion was expressly authorized by law to make charitable contributions.<sup>106</sup> The donation was reasonable, permissible, and not excessive given Occidental's net worth, net income before taxes, and the tax benefits received because of the donation.<sup>107</sup> As a result, the court agreed with the Court of Chancery's determination that the objecting shareholders' claim of waste would fail.<sup>108</sup> Finally, the court held that the lower court's determination as to the strength of the objecting shareholders' claim was appropriate.<sup>109</sup>

### III. CURRENT LAW APPLICABLE TO CORPORATE PHILANTHROPY

#### A. *Federal Law*

While the United States Securities and Exchange Commission (SEC) does not require companies to disclose information about charitable contributions, other governing organizations—like the New York Stock Exchange (NYSE), the National Association of Securities Dealers Automated Quotations (NASDAQ), and the IRS—regulate this area. In 2002, the NYSE and NASDAQ requested that the SEC comment on certain rules the exchanges wished to adopt.<sup>110</sup> These rules require independence from the companies registered on the respective exchanges to deal with potential conflicts of interest when boards make charitable contributions to non-profits.<sup>111</sup> The SEC approved these rules on November 4, 2003.<sup>112</sup>

Specifically, the SEC approved NYSE Section 303A, which requires that listed NYSE companies have a board of directors that is composed in the majority of "independent" directors.<sup>113</sup> In defining "independent," the NYSE excludes directors who are now or within the past three years have been employees or whose family members are now or have been executive directors of companies that receive payments from the listed company of the greater of \$1 million or two percent of the listed company's consolidated gross revenues.<sup>114</sup>

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106. *See id.* (affirming authorization of Occidental to make charitable donations).

107. *See id.* (endorsing Court of Chancery's waste analysis).

108. *See id.* (affirming Court of Chancery's finding that "it was 'reasonably probable' that plaintiffs would fail on their claim of waste").

109. *See id.* (holding this determination "the product of an orderly and logical deductive process").

110. *See* Sarita Venkat, *Director Independence and Charitable Giving*, FOUND. NEWS & COMMENTARY, May/June 2005, available at <https://web.archive.org/web/20060720172457/http://www.foundationnews.org/CME/article.cfm?ID=3269> (reporting request for comment on rules).

111. *See id.* (outlining rules).

112. *See* Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the New York Stock Exchange, Inc. Relating to Corporate Governance, 68 Fed. Reg. 19,051-01 (Apr. 17, 2003) (approving the NASD and NYSE proposed rules); Notice of Filing of Proposed Rule Change Relating to Proposed Amendments to NASD Rules 4200 and 4350, 68 Fed. Reg. 14,451-01 (Mar. 25, 2003).

113. *See* NYSE LISTED COMPANY MANUAL § 303A.02 (2013) (setting forth rules for listed companies on independent boards of directors).

114. *See id.* (defining exclusions for independent directors).



The SEC approved very similar NASDAQ rules concerning the requirement for a majority of the board of directors of a listed company to be independent.<sup>115</sup> The NASDAQ rules are slightly stricter, however, and disqualify a director from being classified as independent if the director or a family member is an executive officer of a charitable organization and receives the greater of \$200,000 or five percent of its revenues from the listed company.<sup>116</sup>

Companies make cash or non-cash contributions directly to charitable organizations, or indirectly through company-run foundations.<sup>117</sup> If a company wishes to contribute through a private foundation, it needs to establish the foundation as a separate legal entity to operate as a section 501(c)(3) organization.<sup>118</sup> The IRS requires the disclosure of the amount and purpose of a corporate foundation's contributions to a non-profit company.<sup>119</sup> This requirement, however, provides an exception whereby a corporation can avoid disclosure by giving directly to the non-profit and then deducting that amount from its taxable federal income under the Internal Revenue Code.<sup>120</sup> While the IRS requires board of director approval before a company can deduct such contributions, it does not require disclosure.<sup>121</sup> In the pharmaceutical context, the United States federal government has imposed regulations on corporate philanthropy to curb widespread abuses in "continuing education" grants.<sup>122</sup> In response to calls for industry-wide disclosure and regulation of charitable and educational contributions, the Patient Protection and Affordable Care Act integrated the Physician Payment Sunshine provision, which requires public

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115. See NASDAQ LISTING RULES § 5605(D) (outlining board of director requirements).

116. See *id.* § 5605(a)(2)(D) (defining independent).

117. See *What Is the Difference Between a Company-Sponsored Foundation and a Corporate Direct Giving Program?*, GRANTSPACE, <http://www.grantspace.org/Tools/Knowledge-Base/Funding-Resources/Corporations/Corporate-foundations-vs-giving-programs> (last visited Jan. 30, 2015) (outlining how corporations can support non-profit organizations).

118. See SIMPSON THATCHER & BARTLETT LLP, FREQUENTLY ASKED QUESTIONS ABOUT COMPANY FOUNDATIONS AND CORPORATE GIVING 15 (May 23, 2006), available at [http://www.stblaw.com/docs/default-source/cold-fusion-existing-content/news/news527\\_1.pdf?sfvrsn=2](http://www.stblaw.com/docs/default-source/cold-fusion-existing-content/news/news527_1.pdf?sfvrsn=2) (explaining structure of company foundation governance for charitable giving).

119. See *Private Foundations*, IRS, <http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Private-Foundations> (last visited Jan. 30, 2015) (describing 501(c)(3) exclusions); see also *Form 990-PF, Part XV*, IRS, available at <http://www.irs.gov/pub/irs-pdf/f990pf.pdf> (requiring disclosure of information about disbursements for charitable purposes).

120. See I.R.C. § 170 (2012) (prescribing charitable giving).

121. See *Private Foundations*, *supra* note 119 (discussing tax deduction requirements).

122. See Lance K. Stell, *Opposing View: Physician Payments Sunshine Act's Expensive*, USA TODAY (Feb. 27, 2012, 9:30 PM), <http://usatoday30.usatoday.com/news/opinion/story/2012-02-27/Physician-Payments-Sunshine-Act/53276506/1>.

disclosure of funds provided to physicians and teaching hospitals, including charitable donations.<sup>123</sup>

Beginning on May 31, 2013, all applicable manufacturers<sup>124</sup> that pay out any sum of money or transfer other value to a covered recipient<sup>125</sup> must disclose the name of the recipient, the value of the payment or transfer, the date of payment, and a description of the nature of the payment to the Secretary of Health and Human Services.<sup>126</sup> The failure to report could result in fines of up to \$150,000 annually, and up to \$1 million annually if the violations are intentional failures.<sup>127</sup> The information reported to the Department of Health and Human Services is publicly displayed on a website.<sup>128</sup>

Since federal regulations on corporate philanthropy present in the Physician Payment Sunshine provision pertain only to pharmaceutical firms, the federal government has yet to address disclosure requirements on charitable contributions in all other industries, despite the similar potential for conflicts of interest in directors' decision making.

### B. *State Laws*

Both public and non-public companies look to their state-specific corporation laws to determine what constitute legal business activities, including the power to make charitable donations; but across states, there are generally three distinct charitable giving provisions:

1. Nineteen states authorize donations under two provisions:
  - (a) to further the business and affairs of the corporation, and
  - (b) for "charitable purposes."<sup>129</sup>

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123. See 42 U.S.C. § 1320a-7h (2012).

124. See *id.* § 1320a-7h(e)(2) (defining "applicable manufacturer" as "a manufacturer of a covered drug, device, biological, or medical supply which is operating in the United States, or in a territory, possession, or commonwealth of the United States").

125. See *id.* § 1320a-7h(e)(6) (defining "covered recipient" as either physician or teaching hospital, but providing exception for physicians who are employees of applicable manufacturer).

126. See *id.* § 1320a-7h(a) (defining payments and transfers of value).

127. See *id.* § 1320a-7h(b)(1) (providing that each reporting failure shall result in fine between \$1,000 and \$10,000, but total amount of such payments shall not exceed \$150,000 annually); *id.* § 1320a-7h(b)(2) (providing that each knowing reporting failure shall result in fine between \$10,000 and \$100,000, but total amount of such payments shall not exceed \$1 million annually). The term "knowingly" is given the same meaning as that found in section 3729(b) of title 31, United States Code. See 31 U.S.C. § 3729(b) (2012).

128. See 42 U.S.C. § 1320a-7h(c)(1)(C) (guaranteeing information that is received from applicable manufacturers will be communicated clearly to public via website).

129. See Brown, Helland & Smith, *supra* note 14, at 859 ("[N]ineteen [states] have a two-provision statute that allows contributions for either 'furthering the business affairs of the corporation' or for 'charitable purposes.'").

2. Twenty-four states, including Delaware and Texas, only authorize “donations for the public welfare or for charitable, scientific, or educational purposes.”<sup>130</sup>
3. Seven states, including California and New York, authorize donations “irrespective of corporate benefits.”<sup>131</sup>

These state law provisions complicate corporate philanthropy by failing to provide unambiguous guidelines for donations and contribution limits. When assessing a company’s particular contributions, courts apply a reasonableness standard.<sup>132</sup> The reasonableness standard is constructed around the Internal Revenue Code’s provisions relating to charitable contributions.<sup>133</sup> In interpreting the reasonableness of a contribution, a court considers factors such as whether the contribution fell within the tax deduction limitations of the Internal Revenue Code and the associated tax considerations.<sup>134</sup>

### C. *Fiduciary Duties of Directors*

In reviewing whether directors have fulfilled their fiduciary duties with respect to a decision, courts will apply the business judgment rule, which presumes “that in making a business decision, the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company.”<sup>135</sup>

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130. *See id.*

131. *See id.* (“The remaining seven [states] authorize contributions ‘irrespective of corporate benefits.’”).

132. *See, e.g., Kahn v. Sullivan*, 594 A.2d 48, 61 (Del. 1991) (citing *Theodora Holding Corp. v. Henderson*, 257 A.2d 398, 405 (Del. Ch. 1969)) (holding test to be applied when considering whether contribution was “waste” is reasonableness standard similar to that used in Internal Revenue Code).

133. *See id.*; *see also* I.R.C. § 170 (2012) (providing Internal Revenue Code standard).

134. *See Theodora Holding Corp.*, 257 A.2d at 405 (articulating “test to be applied in passing on the validity of a [charitable] gift”).

135. 3A FLETCHER CYC. CORP. § 1036 (2014) (detailing history and precedents of business judgment rule generally); *see, e.g., CAL. CORP. CODE* § 207(e) (West 2014) (granting corporations power to “[m]ake donations, regardless of specific corporate benefit, for the public welfare or for community fund, hospital, charitable, educational, scientific, civic, or similar purposes”); *DEL. CODE ANN.* tit. 8, § 122(9) (2013) (granting corporations power to “[m]ake donations for the public welfare or for charitable, scientific or educational purposes, and in time of war or other national emergency in aid thereof”); *N.Y. BUS. CORP. LAW* § 202(a) (12) (McKinney 2014) (granting corporations power “[t]o make donations, irrespective of corporate benefit, for the public welfare or for community fund, hospital, charitable, educational, scientific, civic or similar purposes, and in time of war or other national emergency in aid thereof”); *TEX. BUS. ORGS. CODE ANN.* § 2.101(18) (West 2014) (granting domestic entities power to “make donations for the public welfare or for a charitable, scientific, or educational purpose”).

This rule serves to insulate directors from personal liability for losses suffered by the corporation because of their decisions.<sup>136</sup>

The business judgment rule introduces a rebuttable presumption, which places a burden on the agent of change in the business's operations to rebut the presumption that the rationale for the status quo is true.<sup>137</sup> For example, if a board of directors makes charitable donations from a corporation's profits, the contributions are presumed by the court to be truly in the corporation's best interest. If some stockholders (plaintiffs) want the board to stop making these donations, they face the difficult requirement of proving that the donations are not in the best interest of the corporation.

If the plaintiffs succeed in discrediting the presumption, the responsibility shifts to the board to prove that the decision to make the donations was entirely fair to the shareholders.<sup>138</sup> The defendant's need to prove entire fairness rests on two elements: fair price and fair dealing.<sup>139</sup> To reach a determination on fair price, a court looks at all financially related aspects of the decision.<sup>140</sup> In determining fair dealing, a court looks at issues of disclosure, structure, negotiation, and timing.<sup>141</sup>

State laws generally govern the fiduciary duties of directors of corporations. However, because more than half of the publicly traded companies in the United States, and more than sixty percent of the Fortune 500 companies, are incorporated in Delaware, the laws affecting United States corporations in general can often be best understood by focusing on Delaware law.<sup>142</sup> In Delaware, a director of a corporation owes several fiduciary duties to the corporation, including the duty of obedience, the duty of loyalty, the duty of care, and the duty of good faith.<sup>143</sup>

The duty of obedience requires directors not to engage in external illegal acts or in *ultra vires* acts, such as acts that they cannot perform

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136. See 3A FLETCHER CYC. CORP., *supra* note 135, § 1036 n.10 (discussing benefits of business judgment rule).

137. See BALOTTI & FINKELSTEIN, *supra* note 6, § 419(B)(1).

138. See, e.g., *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 52 (Del. 2006) (describing burden-shifting).

139. See BALOTTI & FINKELSTEIN, *supra* note 6, § 4.19(B)(1) (describing what defendants must establish to prove donation decision was entirely fair).

140. See *id.* ("Directors with the burden of proving fairness have two elements to prove—fair price and fair dealing—but the test 'is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness.'" (quoting *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983))).

141. See *id.*

142. See *Why Businesses Choose Delaware*, STATE OF DEL., [http://corplaw.delaware.gov/eng/why\\_delaware.shtml](http://corplaw.delaware.gov/eng/why_delaware.shtml) (last visited Jan. 30, 2015) (reporting state incorporation statistics).

143. See *In re Walt Disney Co.*, 906 A.2d at 47 (describing fiduciary duties).

under the company's bylaws and articles of incorporation.<sup>144</sup> The duty of loyalty requires directors to act on behalf of the corporation and not engage in acts that constitute self-dealing or benefiting improperly from their positions, to the detriment of shareholders.<sup>145</sup> The duty of loyalty also mandates that directors avoid conflicts of interest, which can be a basis for shareholder action against directors when they contribute to charities with which the directors are affiliated.<sup>146</sup> The duty of care requires that a director perform duties in good faith, as a reasonably prudent person, and in a manner perceived to be in the best interests of the corporation.<sup>147</sup> It also demands that directors use corporate assets in a way that is not wasteful—a requirement that shareholders can use in litigating claims against directors for the charitable contributions that they sponsor.<sup>148</sup>

In 2011, a shareholder derivative action brought in Delaware alleged that nine members of Goldman Sachs's board of directors were neither independent nor disinterested because the Goldman Sachs Foundation contributed to charities with which the directors were affiliated.<sup>149</sup> For example, one of the Goldman directors, John Bryan, was a trustee for the University of Chicago, and in that capacity, he engaged in fundraising campaigns to raise money for donations to the University.<sup>150</sup> Goldman donated at least \$200,000 to the University over a two-year period.<sup>151</sup> However, the shareholders failed to prove that the amounts Goldman donated influenced Bryan's decision making process.<sup>152</sup> The shareholders made similar accusations against the other eight directors.<sup>153</sup> However, because of a lack of proof that the financial contributions caused the directors to become "disinterested," the allegations were dismissed as to those claims.<sup>154</sup>

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144. See Alan R. Palmiter, *Duty of Obedience: The Forgotten Duty*, 55 N.Y.L. SCH. L. REV. 457, 458 (2010) (discussing duty of obedience and its history in Delaware courts).

145. See *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939) (articulating fiduciary duty of loyalty).

146. See *id.* ("The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest.").

147. See *Smith v. Van Gorkom*, 488 A.2d 858, 873 (Del. 1985) (discussing duty of care of directors).

148. See *id.* (clarifying duty toward shareholders and responsibilities owed to corporation).

149. See *In re Goldman Sachs Grp., Inc. S'holder Litig.*, No. 5215-VCG, 2011 WL 4826104, at \*8–12 (Del. Ch. Oct. 12, 2011) (describing shareholders' allegations).

150. See *id.* at \*9 (providing shareholders' concerns about lack of independence).

151. See *id.* (describing defendant's donations to University of Chicago).

152. See *id.* (noting that University affiliate did not receive salary for his "philanthropic roles").

153. See *id.* at \*9–12 (outlining shareholders' remaining allegations).

154. See *id.* at \*8–12.

## IV. PROPOSED LEGISLATION

For stockholders who are not absolutely opposed to corporate philanthropy, one approach to addressing their concerns is to allow shareholder participation in the board's decision to donate money and provide shareholders with information about the donations. Spurred by this idea, the House Committee on Commerce asked the SEC to study the feasibility of two related bill proposals in 1997.<sup>155</sup> The bills would apply to public companies, corporate issuers, and investment companies, such as mutual funds.<sup>156</sup>

Under the legislation, the SEC would have the authority to adopt rules granting exemptions from disclosure requirements and permitting shareholder participation.<sup>157</sup> The potential exemptions may also apply to gifts of tangible personal property, such as products produced by the company, gifts to public or private nonprofit educational institutions, and gifts to local charities.<sup>158</sup>

A. *Corporate Disclosure*

House of Representatives Bill 944 (H.R. 944) introduced on March 5, 1997, by Representative Paul Gillmor, sought to amend the Securities and Exchange Act of 1934 (Exchange Act) to require improved disclosure of corporate charitable contributions.<sup>159</sup> H.R. 944 would allow the SEC to enhance the level of disclosure required for charitable donations, requiring such disclosures to include the name of the recipient and the amount of the donation.<sup>160</sup> It would also provide for certain exemptions such as "gifts of tangible personal property, gifts to public or private nonprofit educational institutions, and gifts to local charities, consistent with the public interest, [and] the protection of investors . . . ."<sup>161</sup> On March 14, 1997, H.R. 944 was referred to the House Subcommittee on Finance and Hazardous Materials, but the bill never made it out of the subcommittee.<sup>162</sup>

B. *Shareholder Participation*

House of Representatives Bill 945 (H.R. 945), introduced on March 5, 1997, sought to amend the Exchange Act to allow shareholders the oppor-

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155. See *Revised Invitation for Comments: Charitable Giving by Public Companies*, SEC (Nov. 24, 1997), <http://www.sec.gov/rules/other/chgive.htm> (explaining two bills and their potential impact).

156. See *id.* (describing effect of bills on corporations).

157. See *id.* (outlining content of H.R. 945, 105th Cong. (1997)).

158. See *id.* (describing types of gifts affected by bill).

159. See H.R. 944, 105th Cong. (1997) (describing intent and scope of bill).

160. See *id.* (highlighting changes to corporate disclosure requirements).

161. See *id.* (listing rule exceptions).

162. See *Bill Summary & Status 105th Congress (1997-1998): H.R. 944*, LIB. OF CONG., <http://thomas.loc.gov/cgi-bin/bdquery/z?d105:h.r.00944>: (last visited Jan. 21, 2015) (providing major actions taken on H.R. 944).

tunity, on the basis of their proportional number of shares, to participate in deciding the recipients of charitable donations.<sup>163</sup> H.R. 945 would not limit the authority of management to designate additional recipients for charitable donations, but it would provide access to the process for interested shareholders.<sup>164</sup>

### C. *Corporate Charitable Disclosure Acts*

Several "Charitable Disclosure Acts" have been proposed but have not passed through Congress. The Corporate Charitable Disclosure Act of 2002 (CCDA) was referred to the House Committee on Financial Services. It called for the disclosure of both the amount and the beneficiary of charitable donations by those companies required to report under the Exchange Act or the Investment Company Act of 1940.<sup>165</sup> The CCDAs of 2003,<sup>166</sup> 2005,<sup>167</sup> and 2007<sup>168</sup> all died in the House Committee on Financial Services.

### D. *Sarbanes-Oxley Act*

An early version of the Sarbanes-Oxley Act, discussed in the House of Representatives, would have required disclosure of the interrelationships of directors and their affiliations with non-profit companies, specifically if any directors or their family members were board members or executives of non-profits.<sup>169</sup> This version would have also required disclosure of company contributions and contributions of company officers to non-profits in excess of \$10,000.<sup>170</sup> This dollar limit provision was dropped in the final bill, and the provisions relating to corporate disclosure on insider trading were reduced to a prohibition on loans to executives, as well as enhanced disclosures of transactions between management and principal stockholders.<sup>171</sup> The philanthropic disclosure provisions were removed

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163. See H.R. 945, 105th Cong. (1997) (presenting rule allowing heightened shareholder participation in corporate charitable decision-making).

164. See *Bill Summary & Status 105th Congress (1997-1998): H.R. 945*, LIB. OF CONG., <http://thomas.loc.gov/cgi-bin/bdquery/z?d105:h.r.00945>: (last visited Jan. 30, 2015) (providing major actions taken on H.R. 945).

165. See Corporate Charitable Disclosure Act of 2002, H.R. 3745, 107th Cong. (calling for tightened charitable disclosure rules for certain corporations).

166. See Corporate Charitable Disclosure Act of 2003, H.R. 275, 108th Cong.

167. See Corporate Charitable Disclosure Act of 2005, H.R. 543, 109th Cong.

168. See Corporate Charitable Disclosure Act of 2007, H.R. 1208, 110th Cong.

169. See Improvements in Reporting on Insider Transactions and Relationships, H.R. 3763, 107th Cong. § 7(a)(2) (2002) (stating bill objectives of providing transparency to investors); see also Venkat, *supra* note 110, at 2 (describing earlier version of Sarbanes-Oxley Act).

170. See H.R. 3763 (introducing disclosure threshold).

171. See H.R. 3763 ENR, 107th Cong., §§ 402-03 (1st Sess. 2002) (amending original requirements).

after the House of Representatives' Sarbanes-Oxley bill was reconciled with the Senate's Sarbanes-Oxley bill.<sup>172</sup>

## V. PROVEN SOLUTIONS AND BEST PRACTICES

Corporations commonly face dilemmas posed by the decision to engage in corporate philanthropy. Thus, in making their decision, boards can often glean insights from the approaches that other firms have already taken. Such a search for best practices can produce an option that represents the wisest course of action for a particular company. In this section, two illustrative approaches are discussed: new corporate governance models and modifications to existing governance structures.

### A. *New Corporate Governance Models*

Because corporations, through their boards of directors, have discretion in deciding when, how much, and to whom charitable donations will be given, some corporations have espoused new models of corporate governance to deal with the philanthropic issues. Two high profile models originated at Google.org and Berkshire Hathaway.

#### 1. *Google.org*

Google Inc. created a philanthropic arm of its public company to “develop[ ] technologies to help address global challenges and support[ ] innovative partners through grants, investments and in-kind resources.”<sup>173</sup> Named Google.org, this arm of the company was started with a grant of \$2 billion in Google Inc. shares during Google’s initial public offering.<sup>174</sup> Google.org runs the Google Foundation, which has the main responsibility for Google Inc.’s philanthropic efforts, as a for-profit division of Google Inc.<sup>175</sup> Google Inc.’s for-profit philanthropy model allows it to avoid many conflict of interest issues by completely disclosing all of its grants and investments.<sup>176</sup> Simultaneously, the model allows Google Inc.’s directors to fulfill their fiduciary duties by investing in social projects that might have future economic value for shareholders.<sup>177</sup> The fiduciary duties of loyalty and care are met because Google Inc.’s directors are protected by the def-

172. See H.R. 3763 EAS, 107th Cong. (2d Sess. 2002).

173. See *About*, GOOGLE.ORG, <http://www.google.org/%2Fabout.html> (last visited Jan. 30, 2015).

174. See Kevin J. Delaney, *Google: From 'Don't Be Evil' to How to Do Good*, WALL ST. J. (Jan. 18, 2008, 11:59 PM), <http://online.wsj.com/articles/SB120058125428197687> (describing assets set aside for Google.org philanthropy).

175. See Dana Brakman Reiser, *For-Profit Philanthropy*, 77 FORDHAM L. REV. 2437, 2439–40 (2009) (discussing Google.org’s innovative impact on corporate philanthropy).

176. See *id.* at 2468 (explaining disclosure “provides Google Inc. a strong defense to any claim that Google.org breaches protections for investors”).

177. See *id.* (summarizing “traditional responses” with which Google could “easily defend[ ]” itself against shareholder opposition).



erential standard of the business judgment rule and need only to be informed and act in good faith.<sup>178</sup>

Google.org accepts considerable risk for a slight chance at great rewards because it invests in businesses with social missions.<sup>179</sup> For example, Google.org invests in renewable energy research, climate change, health analytics companies, and social development initiatives.<sup>180</sup> It also makes grants to non-profits, such as funding groups that track diseases in developing countries.<sup>181</sup> Google.org also has access to Google Inc.'s proprietary technology and resources, which it employs on its projects.<sup>182</sup> For example, Google.org gives in-kind grants to non-profit organizations that seek to advertise on the Google.com search page by listing them on its site for a period free of charge.<sup>183</sup>

The Google for-profit model does not allow for the favorable charitable tax treatment that is normally afforded tax-exempt 501(c)(3) organizations.<sup>184</sup> However, by not seeking tax-exempt status, Google.com has greater flexibility in making investments and in going outside of its stated purpose, including making political contributions.<sup>185</sup> By not seeking tax-exempt status, and instead keeping an in-house, for-profit business division, Google Inc. removes many of the legal challenges that would interfere with its social mission.<sup>186</sup> This freedom to operate is necessary for Google.org because of the legal limitations of: (1) self-dealing between a tax-exempt organization and a contributor (e.g., Google Inc.), (2) the limited ability to invest in varied companies without worrying if it is outside its tax-exempt purpose, and (3) lobbying efforts by tax-exempt organizations that would not apply to Google.org.<sup>187</sup> For these reasons, the for-profit

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178. See *id.* at 2469 (noting business judgment rule “would generally protect decisions by for-profit directors and managers to pursue social ends”).

179. See *id.* at 2451 (describing how Google initiatives “target areas of operation to maximize philanthropic impact”).

180. See GOOGLE.ORG, <http://www.google.org/> (last visited Jan. 30, 2015); see also Jameson Berkow, *Google Spent US \$1.4 Billion on 2011 Acquisition Spree, So Far*, FIN. POST (Oct. 27, 2011, 10:20 AM), [http://business.financialpost.com/2011/10/27/google-spent-us1-4-billion-on-2011-acquisition-spree-so-far/?\\_\\_lsa=517d-8d82](http://business.financialpost.com/2011/10/27/google-spent-us1-4-billion-on-2011-acquisition-spree-so-far/?__lsa=517d-8d82).

181. See GOOGLE.ORG, PREDICT AND PREVENT: AN INITIATIVE TO HELP PREVENT LOCAL OUTBREAKS OF EMERGING DISEASE FROM BECOMING PANDEMICS (Oct. 14, 2008), available at [http://www.google.org/Predict\\_Prevent\\_Brief.pdf](http://www.google.org/Predict_Prevent_Brief.pdf) (describing Google.org initiative on emerging diseases).

182. See Reiser, *supra* note 175, at 2458 (describing Google.org's access to Google resources and technology).

183. See *Google for Non-Profits*, GOOGLE.COM, <http://www.google.com/nonprofits/> (last visited Jan. 30, 2015) (compiling Google resources for nonprofits).

184. See Reiser, *supra* note 175, at 2453–54 (exploring tax advantages of using non-profit entities for philanthropy and noting Google chose for-profit model).

185. See *id.* at 2459–62 (discussing obstacles Google would have faced to engage in political activities with non-profit model).

186. See *id.* at 2452 (listing Google.org's for-profit benefits, including “greater freedom to invest, direct access to Google Inc.'s resources, and more ability to engage in political activities”).

187. See *id.* at 2453–62 (generalizing advantages of for-profit model).

model of Google.org can operate in ways a tax-exempt organization cannot, thereby expanding the options available to Google Inc. to achieve success for its shareholders.<sup>188</sup>

In summary, if a corporation is willing to forego an opportunity for major tax deductions, the Google model is a viable way for a for-profit company to be transparent in its charitable giving while satisfying its board of directors' fiduciary duties.<sup>189</sup>

## 2. *Berkshire Hathaway*

In 1981, Berkshire Hathaway instituted a program that allowed shareholders of Berkshire Class A shares to choose up to three charities to receive donations.<sup>190</sup> Each shareholder's vote was multiplied on a per share basis.<sup>191</sup> The Berkshire Hathaway board had no control over where the money was donated.<sup>192</sup> This program was in force until 2003 and donated over \$197 million to approximately 3,500 charities.<sup>193</sup>

The program was dismantled soon after Berkshire Hathaway acquired The Pampered Chef in 2002.<sup>194</sup> The Pampered Chef faced harsh criticism and the threat of a boycott because of Berkshire's charitable donations to pro-choice organizations.<sup>195</sup> Pressured by The Pampered Chef's CEO, the CEO and Chairman of Berkshire Hathaway, Warren Buffett, made the decision to end the program.<sup>196</sup>

This innovative program could be a model for other companies, but the pressure from special interest groups shows an important vulnerability in any system that discloses the recipients of corporate philanthropy and the amounts that they receive.<sup>197</sup>

### B. *Modifications to Existing Governance Structures*

Both shareholder proposals and executive-initiated action supported by the board of directors can initiate modifications to a corporation's governance structure. A shareholder proposal is a document that is formally submitted to a publicly traded company requesting a shareholder vote at

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188. *See id.*

189. *See id.* at 2469 (discussing how for-profit companies can defend against claims that philanthropic activities violate fiduciary duties).

190. *See* Press Release, Berkshire Hathaway (July 3, 2003), *available at* <http://www.berkshirehathaway.com/news/jul0303.pdf> (announcing termination of "shareholder-designated contributions program").

191. *See id.*

192. *See id.*

193. *See id.*

194. *See id.*

195. *See* Charles Storch, *Feeling the Heat, Warren Buffett Gives in on Giving*, CHI. TRIBUNE (July 25, 2003), [http://articles.chicagotribune.com/2003-07-25/features/0307250164\\_1\\_pampered-chef-warren-buffett-planned-parenthood](http://articles.chicagotribune.com/2003-07-25/features/0307250164_1_pampered-chef-warren-buffett-planned-parenthood).

196. *See id.*

197. *See id.* (describing interest group reaction to and effective campaign against philanthropic activities they opposed).

the company's annual meeting on a specific course of action. The public vote, which is often non-binding, is designed by change agents to persuade management to accept an action that they may be otherwise inclined to oppose.

### 1. *Shareholder Proposals*

Shareholder proposals are a vehicle by which shareholders can amend their corporation's governance to ensure disclosure of the company's charitable contributions.<sup>198</sup> They allow shareholders to propose amendments to a company's articles of incorporation or bylaws at an annual meeting.<sup>199</sup> Rule 14a-8 governs shareholder proposals, and it is the first SEC rule to be created in a question and answer format to ensure that shareholders can easily understand its contents.<sup>200</sup> For companies that are required to register with the SEC under the Exchange Act, Rule 14a-8 provides that a security holder of either \$2,000 or 1% of a company's voting stock may make a shareholder proposal at an annual meeting.<sup>201</sup> The proposer must follow the individual company's bylaws, articles of incorporation, and proxy statement.<sup>202</sup> The company must receive the proposal 120 days prior to its annual meeting.<sup>203</sup> In addition, under Rule 14a-8, a company has the power to exclude a shareholder proposal, if:

1. It is improper under state law because the proposal is not "a proper subject for action by shareholders,"
2. It lacks relevance because it relates "to operations which account for less than 5 percent of the company's total assets," or importantly,
3. It deals with a very broad category of management functions that relates to "the company's ordinary business operations."<sup>204</sup>

The National Legal and Policy Center (NLPC) sponsored shareholder proposals that would have required PepsiCo to disclose its charitable donations and provide a business rationale for each donation.<sup>205</sup> The

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198. See Shareholder Proposals, 17 C.F.R. § 240.14a-8 (2014) (defining shareholder proposal).

199. See *id.* (describing procedure for shareholder proposals).

200. See *id.* (presenting thirteen questions and answers addressing common shareholder inquiries).

201. See *id.* § 240.14a-8(b) (providing shareholder eligibility to make proposals).

202. See *id.* § 240.14a-8(i) (providing that failure to comply with such requirements warrants grounds for exclusion).

203. See *id.* § 240.14a-8(e) (providing proposal submission deadline).

204. See *id.* § 240.14a-8(i) (outlining bases for excluding shareholder proposals from annual meeting).

205. See Peter Flaherty, *Pepsi's Politicized Charitable Giving Again Under Fire*, NAT'L LEGAL & POL'Y CTR., (Apr. 26, 2009, 8:31 PM), <http://nlpc.org/stories/>

NLPC's proposals were in response to PepsiCo's decision to fund activist groups that promoted gay marriage.<sup>206</sup> Shareholder proposals have been a very popular route for shareholders to attempt to require disclosure of philanthropic contributions, as companies such as General Electric,<sup>207</sup> Home Depot,<sup>208</sup> Starbucks,<sup>209</sup> Target,<sup>210</sup> and Wells Fargo<sup>211</sup> have received such proposals. Companies excluded several such shareholder proposals from their annual meetings under the very broad management function exclusion in Rule 14a-8.<sup>212</sup> However, shareholder proposals directed solely at disclosure of charitable contributions are "extraordinary in nature," and the SEC will allow them to be voted on at an annual meeting.<sup>213</sup> Once a shareholder proposal reaches the annual meeting and passes by a majority vote of shareholders, it is still within the discretion of the board of directors to decide whether to implement the proposal.<sup>214</sup> While most shareholder proposals have been unsuccessful, they are one of the main routes for activist shareholders who want to force the disclosure

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2009/04/26/pepsi%E2%80%99s-politicized-charitable-giving-again-under-fire (describing backlash by opponents of gay marriage rights).

206. *See id.*

207. *See* GEN. ELEC., *Shareowner Proposals*, in GE 2007 PROXY STATEMENT (2007), available at <http://www.ge.com/ar2006/proxy/sprop6.htm>.

208. *See* HOME DEPOT, *Shareholder Proposal Regarding Charitable Contributions*, in PROXY STATEMENT 30 (2012), available at [http://www.sec.gov/Archives/edgar/data/354950/000119312512146086/d277811ddef14a.htm#toc277811\\_17](http://www.sec.gov/Archives/edgar/data/354950/000119312512146086/d277811ddef14a.htm#toc277811_17) (asking for disclosure of charitable contributions over \$6,000, which Home Depot's board of directors did not recommend be passed).

209. *See* Starbucks Corp., SEC No-Action Letter (Dec. 16, 2009), available at <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2009/physicianscommittee121609-14a8.pdf> (allowing exclusion of shareholder proposal, which called for disclosure of charitable contributions since 2004, because it related to Starbucks's ordinary business operations).

210. *See* Target Corp., SEC No-Action Letter (Mar. 31, 2010), available at <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2010/physicianscommittee033110-14a8.pdf> (allowing exclusion of shareholder proposal, which called for disclosure of charitable contributions since 2004, because it related to Target's ordinary business operations).

211. *See* Wells Fargo & Co., SEC No-Action Letter (Feb. 19, 2010), available at <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2010/humanlife021910-14a8.pdf> (disallowing exclusion of shareholder proposal, which called for disclosure of charitable contributions over \$5,000 to be listed on company website, because it is "matter of corporate policy which is extraordinary in nature and beyond a company's ordinary business operations").

212. *See, e.g.*, Starbucks Corp., SEC No-Action Letter, *supra* note 209.

213. *Compare* 17 C.F.R. § 240.14a-8(i)(7) (2014) (providing companies may exclude shareholder proposals that "deal[ ] with a matter relating to the company's ordinary business operations"), *with* Wells Fargo & Co., SEC No-Action Letter, *supra* note 211 (disallowing exclusion of shareholder proposal, which called for disclosure of charitable contributions over \$5,000 to be listed on company website, because it is "matter of corporate policy which is extraordinary in nature and beyond a company's ordinary business operations").

214. *See* Chris Chi & Rachel Posner, *Shareholder Proposals—Getting Ready for 2011*, GEORGESON (Nov. 29, 2010) (on file with author) (describing board's discretion to implement proposals).

of charitable contributions, and they have been used more than twenty-three times since 2006.<sup>215</sup>

## 2. *Executive-Initiated Action*

When a company's top management team is intent on controlling the firm's charitable giving, including retaining the ability to conceal its list of philanthropic recipients and the amounts they receive, it can institute public governance provisions in their company's articles of incorporation or bylaws.<sup>216</sup> Such provisions, which require the support of the company's board of directors, can serve as evidence to shareholders that there are internal controls on corporate philanthropy.<sup>217</sup>

Companies can create a hierarchical approach to reaching decisions on corporate philanthropy.<sup>218</sup> The internal procedure can categorize contributions according to dollar amount thresholds and require different approvals for each category.<sup>219</sup> Companies can also establish a cap on the total amount of charitable contributions they can make annually. For example, Automatic Data Processing, Inc. (ADP) has such a cap, which limits the ADP donation of a board member who is an employee, officer, or director of the charity to the "lesser of \$100,000 or one percent of the total contributions the [recipient] non-profit receives annually" in donations.<sup>220</sup>

## VI. FORTIFYING CORPORATE PHILANTHROPY INITIATIVES

For stockholders who hold intermediate positions on the desirability of corporate philanthropy, it may be helpful to gauge the impact of charitable contributions on the giver and the recipients. There are three approaches to evaluating "work hardened" charitable activities that may enable stockholders to feel better informed and more comfortable with boards of directors managing a part of their personal giving: strategic philanthropy, measuring achievement, and leveraging donations by contributing "what we do."

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215. See PROXYMONITOR, <http://www.proxymonitor.org> (last visited Jan. 30, 2015) (using "Advanced Search" tab, using "Show Advanced Filter", using "Proposal Types", using "Social Policy", selecting "Other", viewing results, searching "Title" column using Ctrl+F search function for "charitable contributions").

216. See Kahn, *supra* note 14, at 604 (describing how modern state corporation law accords corporate directors "extraordinary power and discretion" over charitable contributions).

217. See *id.*

218. See SIMPSON THATCHER & BARTLETT LLP, *supra* note 118, at 11 (explaining that companies may structure authority for charitable giving).

219. See *id.* (suggesting approval process wherein grants above \$250,000 must be approved by committee, grants between \$100,000 and \$250,000 can be approved by two officers and then ratified by committee, and grants below \$100,000 can be delegated to staff, and then ratified by committee).

220. See Venkat, *supra* note 110.

### A. *Strategic Philanthropy*

One widespread justification for corporate philanthropy appeals to “moral and social obligations” arising from “the notion of the corporation as a ‘member’ of society . . . .”<sup>221</sup> It follows that corporations are privileged entities that owe something special in return for those privileges, with corporate philanthropy being a primary means by which they can meet their obligations.<sup>222</sup>

The increase in corporate philanthropy speaks to its rise in both the popularity of satisfying these obligations and its importance to the consumer. Corporate philanthropy is a factor in how a firm is viewed by potential customers. A survey for the Boston College Center for Corporate Community Relations reported that more than seventy-five percent of respondents evaluate a company’s philanthropic record when deciding whether to do business with it, and eighty percent of respondents said they had decided to do business with a company because of its involvement in community improvement activities.<sup>223</sup> Some corporations, in turn, use philanthropy as a form of investment in public relations and advertising or an approach to branding through cause-related marketing.<sup>224</sup> Empirical academic research provided some early evidence of the increase in popularity of cause-related marketing by showing that United States corporate spending on cause-related marketing increased from \$125 million in 1990, to an estimated \$828 million in 2002.<sup>225</sup> The belief underlying this philanthropy is that it blends economic and social goals, thereby helping to assure the long-term survival of the firm.<sup>226</sup>

### B. *Measuring Achievement*

The relative benefits of corporate philanthropy—compared to saving the money to distribute to shareholders, thereby allowing shareholders to make independent charitable donations using the increased returns—depend on the strength of the connections between the donor and the charity. Research suggests that measuring this strength can be beneficial for all parties.<sup>227</sup> First, when the corporate donor works directly with the re-

221. Victor Brudney & Allen Ferrell, *Corporate Charitable Giving*, 69 U. CHI. L. REV. 1191, 1205 (2002).

222. See *id.* (exploring concept of corporation as “specially privileged entity”).

223. See Richard Barnes, *Americans Value Businesses’ Philanthropic Performance*, 13 CHRON. PHILANTHROPY 1 (1995) (discussing Boston College’s Center for Corporate Community Relations research).

224. See Brudney & Ferrell, *supra* note 221, at 1193 (describing corporate practice of making charitable contributions to improve public image).

225. See Michael E. Porter & Mark R. Kramer, *The Competitive Advantage of Corporate Philanthropy*, HARV. BUS. REV., Dec. 2002, available at <https://hbr.org/2002/12/the-competitive-advantage-of-corporate-philanthropy> (charting increase in corporate spending on cause-related marketing).

226. See *id.*

227. See *id.* (stressing importance of monitoring results of collective corporate philanthropy).

cipient, the charity should become measurably more effective for an extended period.<sup>228</sup> Second, charitably engaged corporate representatives bring a diverse set of expertise that the charity would be unable to secure for itself, creating the opportunity for the charitable organization to access sophisticated services at measurably reduced costs.<sup>229</sup> Third, companies engaged in philanthropic activities in multiple settings are capable of transferring knowledge among their recipients to help improve the operations of the charitable organizations in measurable ways.<sup>230</sup>

By measuring the benefits of their philanthropy periodically and systematically, supporters and detractors can come to an improved agreement on the merits of corporate contributions.<sup>231</sup> Such an assessment can provide often-elusive evidence to the process of improving charitable engagements.

### C. Contributing "What We Do"

Corporations have three basic options when making philanthropic contributions.<sup>232</sup> Traditionally, they have donated cash.<sup>233</sup> Alternatively, they contribute goods that they normally produce for commercial sale.<sup>234</sup> Known as in-kind contributions, the donated items may include overruns, items specially produced for the charity with inputs normally used for commercial products, inventory that is nearing its expiration date, end-of-season items, or production and computer related access.<sup>235</sup> Alternatively, corporations have collaborated with non-profit organizations that they can benefit by providing employee expertise, time, and talent.<sup>236</sup>

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228. See *id.* (discussing impact of corporate donors closely working with specific charities on effectiveness).

229. See *id.* (discussing sophisticated "nonmonetary assistance," including expertise, that corporations can provide charities at reduced cost).

230. See *id.* (discussing examples of coordinated corporate philanthropic activities across multiple charities).

231. See Eric Thurman, *Performance Philanthropy: Bringing Accountability to Charitable Giving*, 28 HARV. INT'L REV., Spring 2006, at 19 (2006) (advocating treating philanthropy as "form of investment" with performance expectations).

232. See John A. Pearce II & Jonathon P. Doh, *The High Impact of Collaborative Social Initiatives*, 46 MIT-SLOAN MGMT. REV., Spring 2005, at 32 (2005) (contrasting methods of corporate philanthropy: detached, narrow donation of resources versus active corporate social mission).

233. See M. Todd Henderson & Anup Malani, *Corporate Philanthropy and the Market for Altruism*, 109 COLUM. L. REV. 571, 573 (2009) ("The conventional, narrow definition of corporate philanthropy is cash donations by corporations to non-profit organizations, which then use the cash to help others.").

234. See Linda Sugin, *Encouraging Corporate Charity*, 26 VA. TAX REV. 125, 156 (2006) (describing incentives for corporations to give in-kind donations).

235. See *id.* at 158 (discussing in-kind donation of drugs by pharmaceutical companies as one of most popular forms of corporate in-kind donations).

236. See Pearce & Doh, *supra* note 232, at 32–33 (discussing collaborative model, which draws on expertise and resources of corporation in working with charity to meet common goals).

Philanthropic donations of cash are the most popular option for corporations.<sup>237</sup> Although money can be used to address a wide spectrum of needs, donations of products or expertise can be far more valuable because they could be almost prohibitively expensive for charitable organizations to access in the marketplace.<sup>238</sup> When donors contribute “what we do,” they contribute the benefits of their competitive proficiency, which is difficult for any charity to duplicate and very expensive to purchase in the marketplace.<sup>239</sup> For example, America’s Second Harvest relies heavily on corporate donors like ConAgra Foods, Inc. to volunteer the use of extremely high-cost refrigeration trucks to make its food deliveries possible.<sup>240</sup> These are important donations because the high cost of purchasing and maintaining such trucks would require America’s Second Harvest to eliminate other priority programs.<sup>241</sup>

Therefore, when corporations share with the charity the core capabilities that make the corporations’ operations successful, the corporations are able to leverage their donations, thereby increasing the positive effects of philanthropy. Such contributions maximize the benefits of the company’s contributions with minimal disruption to its commercial operations, much to the likely approval of shareholders.

## VII. THE LAW SUPPORTS CORPORATE PHILANTHROPY

The reality that not all stockholders view corporate philanthropy as a close substitute for personal giving complicates the decision about its desirability. Consequently, boards of directors can reasonably expect some stockholders to support corporate philanthropy and others to prefer to make individual charitable donations, ostensibly from their investment gains.<sup>242</sup> In line with this theory, an empirical study focused on investor preferences for corporate philanthropy relative to personal private charity.<sup>243</sup> The study concludes that if a “non-negligible fraction” of investors consider corporate social responsibility and private charity as imperfect

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237. See Kahn, *supra* note 14, at 588 (“Cash predominates as the most popular currency for corporate contributions. Cash transfers have typically constituted more than 80% of the total value of corporate contributions, with the remainder representing donations of products, property, and equipment.”).

238. See Pearce & Doh, *supra* note 232, at 34 (contending corporate donations of products and services “maximize” benefits of corporate philanthropy).

239. See *id.*

240. See *id.* at 35, 37 (discussing ConAgra’s philanthropic collaboration with America’s Second Harvest).

241. See *id.*

242. See David P. Baron, *Corporate Social Responsibility and Social Entrepreneurship*, 16 J. ECON. & MGMT. STRATEGY 683 (2007) (discussing how “social satisfaction” from corporate giving varies among shareholders); Markus Kitzmueller & Jay Shimshack, *Economic Perspectives on Corporate Social Responsibility*, 50 J. ECON. LIT. 51, 61 (2012) (discussing different attitudes toward corporate giving among shareholders).

243. See Joshua Graff Zivin & Arthur Small, *A Modigliani-Miller Theory of Altruistic Corporate Social Responsibility*, 5 TOPICS ECON. ANALYSIS & POL’Y (2005) (discuss-



substitutes, a positive level of corporate philanthropy is necessary to maximize shareholder value.<sup>244</sup> This conclusion is bolstered by research that indicates that, “[w]hen corporate social giving is an imperfect substitute for personal giving, firms that practice [corporate social responsibility] have a lower market value than profit-maximizing firms.”<sup>245</sup>

Thus, while stockholder and board of director support for philanthropy is mixed, and its benefits are uncertain, the law on corporate giving is clear. Corporate law does not restrict corporate philanthropy that promotes corporate goals, even if there is no evidence of direct and immediate economic benefits to the corporation. Furthermore, there are only a few major requirements placed on the donor corporation when it seeks a tax benefit from its giving. Namely, the recipient must be a qualified non-profit charitable organization,<sup>246</sup> the corporate donor cannot deduct contributions in excess of ten percent of its taxable income, and, in the case of an international donation, the recipient must have been created and organized in the United States.<sup>247</sup> With very few exceptions and limitations, when a corporation’s board of directors, duly elected by the shareholders, agrees on philanthropic donations, the law exists to support their decisions.

However, legal might can be a problematic basis for resolving a corporation’s internal disagreements. Fortunately, to reduce the level of dissenting stockholder antagonism in response to corporate philanthropy, corporate leaders have meaningful options. As discussed in this Article, new corporate governance models can facilitate investor input into philanthropic decisions, as the approaches of Google.org and Berkshire Hathaway have shown. Alternatively, legal modifications to governance structures introduced through shareholder proposals and executive-initiated action can formalize the inclusion of shareholders in existing decision making processes on corporate charity, to facilitate stockholder participation and corporate transparency. Finally, corporate leaders can optimize the benefits of philanthropic initiatives and thereby attempt to lower resistance to the redirection of stockholder funds in three ways. Boards of directors and their corporate executives can demonstrate the economic utility of philanthropy by providing evidence of its strategic value, by measuring its benefits to recipients, and by maximizing the leveraging potential of their contributions through donations of goods and services generated by its operations and loans of their productive resources rather than cash.

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ing how shareholder views of corporate charity may impact share prices and efficacy of charity).

244. *See id.*

245. Baron, *supra* note 242, at 685.

246. *See* I.R.C. § 170(c) (2012).

247. *See id.* § 170(c)(2)(A).