CORPORATE CITIZENSHIP

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I. INTRODUCTION

In the early nineteenth century the typical North American corporation was a small owner-operated, locally based business that was closely intertwined with the community in which it operated. Later in the century, technological changes made it increasingly necessary for companies to specialize in markets that were developing on a larger geographical scale. The national markets that developed in those years have in turn been replaced in this century by international markets.

In the early stages of this development, the interests of the corporation and the community in which it was based were largely identical, and the business men of the day provided civic leadership. However, the growth of corporations into national markets was accompanied by their disengagement from civic affairs. Neil Chamberlain writes: "The resident managers of branches of national corporations were incapable and unwilling to assume the civil positions vacated by the old-family business elite."[1] The results have been seriously detrimental for many communities. Chamberlain continued:

> The rise of the national corporation, autonomous in its actions under a philosophy of private initiative intended originally for persons . . . has made communities--like the physical environment--something to be exploited for pecuniary advantage.[2]

In effect, corporations have begun to look upon communities as exploitable colonies.

Chamberlain's thesis underlines a fundamental difference in the perception of different corporations by the

public-at-large. Smaller companies are rarely subjected to the demands for greater civic or social responsibility made on the larger companies. A small company generally has sunk deep roots in a community because its goodwill within the community is often the very foundation of its viability, and it must be a "good citizen" in order to retain the goodwill whereby it maximizes its profits. Large comapnies, on the other hand, frequently maximize their profits through mobility, by being able to locate in those places where the cost of production and transportation to market combined will be least.

Companies have grown spurred on by technological change, and this in turn has led to internal dissatisfaction as production-line workers increasingly lost control over their tasks and the quality of the final product. Job alination in turn has led to consumer dissatisfaction. These are also areas in which greater "corporate social responsibility" has been urged by various interested groups.

Another result of corporate growth has been the divorce of two attributes of ownership--the provision of the risk-capital and the ultimate management of the enterprise, the ownership and the control--in the large corporations.[3] Berle points out that the nature of capital in a "mature" corporation is fundamentally different from the original pooling of savings on which corporations were founded, and the expectations that are placed on this capital are different:[4]

> Since corporations legally have perpetual life, this process [of reinvesting the undistributed earnings] can continue indefinitely. The result has been that more that 60 per cent of capital entering a particular industry is "internally generated" or, more accurately, "price-generated" because

> it is collected from the customers. Another 20 per cent of the capital the corporation uses is borrowed from banks chiefly in anticipation of this accumulative process. The corporations in aggregate do indeed tap individual "savings," but for only a little less than 20 per cent of their capital, and mainly through the issuance of bonds to intermediate savings-collecting institutions (life insurance companies, trust funds, pension trusts and savings banks).

Means continues:

> The corporation becomes the legal "owner" of the capital thus collected and has complete decision-making power over it; the corporation runs on its own economic steam. On the other hand, its stockholders, by now grandsons or great-grandsons of the original "investors" or (far more often) transferees of their transferees at thousands of removes, have and expect to have through their stock the "beneficial ownership" of the assets and profits thus accumulated and realized, after taxes, by the corporate enterprise. Management thus becomes, in an odd sort of way, the uncontrolled administrator of a kind of trust having the privilege of perpetual accumulation. The stockholder is the passive beneficiary, not only of the original "trust," but of the compounded annual accretions to it.

Furthermore, the wider the distribution of shares in a public corporation, the more difficult it becomes for the shareholders to assert any influence on the management and direction of the corporation. Indeed, in a panel discussion on new voices in the corporation Professor Alfred F. Conard remarked, "An effective voice for shareholders might be as new as any other"[5] in making management more responsible. We should keep this comment in mind, since greater protection of shareholder rights would lead to a more accurate reflection of the corporation's "conscience".

Shareholders, however, are not the only--nor, indeed, the primary--group calling for management to show greater "social responsibility" for the interests that they represent.

In fact, the premise that a company's profits should accrue to the shareholders alone is being challenged on the basis that the public at large indirectly contributes to the wealth of corporations:[6]

> Under the recent tax reduction, the federal government presently taxes corporate profits above $25,000 at the rate of about 50 per cent. This virtually makes the state an equal partner as far as profits are concerned. Factually, though silently, the process recognizes a fundamental and entirely demonstrable economic premise. Corporations derive their profits partly indeed from their own operations, but partly also from their market position and increasingly from techniques resulting from state expenditures of taxpayers' money. In this sense, the American state is an investor in practically every substantial enterprise; without its activity, the enterprise, if it could exist at all, would be or would have been compelled to spend money and effort to create position, maintain access to market, and build technical development it currently takes for granted. Under these circumstances, there is little reason or justification for assuming that *all* profits should automatically accrue to stockholders. Put differently, stockholders—not having created the entire enterprise—are no longer the sole residuary legatees (after production costs and depreciation) of all the profits of an industrial progress, much of which is derived from state outlay.

Berle advances another argument for limiting the exclusive property rights that shareholders as a collective presently possess. He maintains, along with Paul Harbrecht,[7] that the present system of share-holding and share-trading has created a "circulating

> . . . circulating 'property-wealth' system, in which the wealth flows from passive wealth-holder to passive wealth-holder, without significantly furthering the functions of capital formation, capital application, capital use or risk-bearing. Yet these functions were the heart of the nineteenth-century 'capitalist' system.[8]

He concludes:

> Privilege to have income and a fragment of wealth without a corresponding duty to work for it cannot be justified except on the ground that the community is better off—and not unless most members of the community share it. A guaranteed annual wage for all, a governmentally assured minimum income, a stockholder's share in the United States distributed to every American family—these are all different ways of giving Americans capacity to settle their own lives rather than having their lives settled for them by blind economic forces, by compulsions of poverty or by regulations of a social-work bureaucracy.
>
> Wide distribution of stockholdings is one way of working toward this.

With this canvas as a background, a number of assertions have been made about big business. Neil H. Jacobi has organized contemporary criticism into five principal theses;[10]

Big business corporations are alleged to:

(1) Exercise concentrated economic power contrary to the public interest.

(2) Exercise concentrated political power contrary to the public interest.

(3) Be controlled by a self-perpetuating, irresponsible "power elite".

(4) Exploit and dehumanize workers and consumers.

(5) Degrade the environment and the quality of life.

Each of these "theses" in turn is broken down into a number of common assertions, which--in their specificity--need not concern us here.

Jacobi's theses are all premised on discontent with hig business. Similar criticism has not generally been levelled at small business. We must bear this in mind as we consider the position of companies in Alberta. Less that

two per cent of all companies incorporated under the present Alberta Companies Act are public companies. The majority of Alberta companies would fall into the small business category. There is, however, a question whether the distinction between "public" and "private" companies should stand. "Private" companies can be very large indeed, and, because of the present disclosure requirements, can operate under an almost perfect veil of secrecy. The Watkin's report on Foreign Ownership deals at length with the problem of "private" companies as wholly-owned subsidiaries being used to maximize the profit of the parent or of the global operations of the parent, although this may be distinctly detrimental to the interests of the host jurisdiction.[11] British Columbia has tried to lift the veil by adopting the concept of "reporting company", which enforces public disclosure on designated private companies.

II. DEFINING CORPORATE CITIZENSHIP

The Committee for Economic Development in the United States wrote in its policy statement on Social Responsibilities,[12] that

> The great growth of coproations in size, market power and impact on society has naturally brought with it commensurate growth in responsibilities; in a democratic society, power sooner or later begets equivalent accountability.

Several questions arise. To whom should the corporation be accountable and for what duties? Furthermore, should corporations, as an incident of the right of incorporation, have placed on them specific duties beyond those attached to an individual? Should corporations operate as instruments of public policy, and if so, how?

Within the term "corporate social responsibility" two broad but distinct areas are discernible. The first area involves proposals for "restructuring" large corporations to make their management more responsive to the voices of the various groups that claim to have a particular interest affected by the operations of the corporation. A model for implementing such structural changes exists and will be discussed later in this paper. With few exceptions, the structural changes have come about because of statutory enactments and are not voluntary implementations by the corporations under existing law. Henry G. Manne rejects the idea that this can represent corporate social responsibility:[13]

> None of these ideas is consistent with the definition of corporate social activity being discussed in this paper. They lack both the elements of voluntarism and charitable intent.

Manne is of the opinion that:[14]

> Any working definition of the idea of corporate social responsibility must begin with the idea that the expenditure or activity be one for which the marginal returns to the corporation are less than the returns available from some alternative expenditure. That is not to say that the company must in absolute terms, lose money but simply that it makes less money than would otherwise be the case. Without this feature as a starting point we are left with nothing significantly different from Adam Smith's unseen hand, which, by virtue of selfish individual behaviour, guides all economic resources to their socially optimal use.

Manne adds to his definition,

> . . . that the activity must be that of the corporation, not that of an individual. Meaningful 'corporate' social behaviour must

> connote something different from individual contributions being made through a corporate conduit.[15]

This leads him to the paradox that "We can only denote as corporate charity corporate expenditures that do not have the approval of all shareholders."[16]

Apart from Manne's restrictive definition, no useful definition of either the term "corporate social responsibility" or of "good corporate citizenship" has been given. Dow Votaw sets out some of the associations that the term "corporate social responsibility" evokes:[17]

> The term is a brilliant one; it means something but not always the same thing, to everybody. To some it conveys the idea of legal responsibility or liability; to others it means socially responsible behaviour in an ethical sense; to still others the meaning transmitted is that of "responsible for," in a causal mode; many simply equate it with "charitable contributions"; some take it to mean socially "conscious" or "aware"; many of those who embrace it most fervently see it as a mere synonym for "legitimacy," in the context of "belonging" or being proper or valid; a few see it as a sort of fiduciary duty imposing higher standards of behavior on businessmen then on citizens at large. Even the antonyms, socially "irresponsible" and "nonresponsible," are subject to multiple interpretations.

As Votaw has written elsewhere, the primary problem is "How one perceives the social system as a whole and the relationship between the whole social system and its subsystems. . . .";[18]

> Anyone who is disturbed by the bewildering array of definitions and conceptions with which the subject of "social responsibility" is burdened should seek his peace, not in the principles and practices of lexicography, but in the basic assumptions on which each author builds his perceptions of this slippery concept. Differing perceptions of social responsibility are not the primary cause of the problem; instead, the many divergent perceptions of the context within which the issue of social responsibility is raised is the issue. How one perceives the social system as a whole and

> the relationship between the whole social system and its subsystems and among those subsystems is the primary variable. Depending on these perceptions, social responsibility might be seen, for example, as an imposition, an opportunity, an act of charity, a liability, a subterfuge, an exercise in public relations, an excuse, an ideology, an historical imperative, a biological phenomenon, an impossibility, a social expectation, a means of communication between system and subsystem, a search for respectability or legitimacy, a part of the process by which the technostructure attributes social purpose to its own goals, the performance of basic chores, a subversive doctrine, a mode of conduct, the conscience of business (or of society), an adjustment mechanism for change, social consciousness or awareness, enlightened self-interest, a duty to maximize profits or protect shareholders, an expedient response to temporary social change, propaganda, a manifestation of status anxiety, or a part of a cultural revolution.

Henry c. Wallich, who takes a position opposite to Manne's, has attempted to formulate a broader definition of "corporate responsibility":[19]

> I take "responsibility" to mean a condition in which the corporation is at least in some measure a free agent. To the extent that any of the . . . objectives are imposed upon the corporation by law, the corporation exercises no responsibility when it implements them. Even so, compliance with the law can be generous or niggardly; there are borderlines and grey areas where the corporation can make decisions and exercise responsibility.

The "definition" is really too vague a statement. More important is Wallich's assertion that the corporation should exercise its discretion in a number of areas listed below with responsible concern not only for the benefit of the corporation but also for society at large:[20]

1. efficiency in the use of resources,
2. adequate expansion to provide growth of output and jobs,
3. research and development,
4. safe and economical product design,
5. socially desirable location of new plants,
6. protection of the environment,
7. conservation of resources,

8. employment and training of minority and handicapped labor,
9. civil rights and equal opportunity,
10. urban renewal,
11. medical care,
12. education, and
13. cultural pursuits.

A similar list of corporate "activities to improve society" was presented by the Committee for Economic Development, stating that "each company must select those activities which it can pursue most effectively" (Appendix 1). This statement, however, in view of the activities listed, makes it difficult to distinguish what amounts to "corporate social responsibility" from an ordinary business decision designed to earn maximal profits for the company over a given period of time. In fact, this represents the views of a number of business executives. The Conference Board, in its report on Social Responsibility and the Smaller Company: Some Perspectives presents the following opinion by the anonymous president of an electrical equipment manufacturer:[21]

> I do not believe that you can separate social responsibility from the performance of any company as a profit-making organization. It has become a subject which a well-run company must be concerned with in order to continue to succeed in its neighbourhood, to be respected by its employees and to conform to legislation being developed by the local, state and Federal governments. All of these are interwoven with its desire to continue as a profit-making organization.

The American writers approach the concept of social responsibility from a predominantly domestic viewpoint, considering only marginally the international impact of a company's operations. The only official guidelines on corporate social responsibility published in Canada are

understandably much more concerned with the performance of foreign-controlled firms in a manner demonstrating its responsibility as a Canadian company. In 1966 the Federal Department of Trade and Commerce published the following "Guiding Principles of Good Corporate Behaviour in Canada":[22]

1. Pursuit of sound growth and full realization of the company's productive potential, thereby sharing the national objective of full and effective use of the nation's resources.

2. Realization of maximum competitiveness through the most effective use of the company's own resources; progressively achieving appropriate specialization of product development within the international group of companies.

3. Maximum development of export opportunities.

4. Extension of processing of natural resource products to the economically practicable maximum.

5. Pricing policies aimed at assuring a fair and reasonable return to the company and to Canada for all goods and services sold abroad, including sales to the parent company and other affiliates.

6. To search out and develop economic sources of supply of parts and materials within Canada.

7. To develop, as an integral part of the Canadian operation wherever practicable, the capability for technological research and design necessary to pursue product development programs and thus to take full advantage of market opportunities domestically and abroad.

8. Retention of sufficient earnings to give appropriate financial support to expansion of the Canadian operation while ensuring fair return to shareholders.

9. To work toward a Canadian outlook within management, through purposeful training programs, promotion of qualified Canadian personnel and inclusion of a major proportion of Canadian citizens on its Board of Directors.

10. To achieve a financial structure which provides opportunity for equity participation by Canada.

11. Periodically to publish information on financial position and operations.

12. To give appropriate attention and support to recognized national objectives and established government programs designed to further Canada's economic development; to encourage and support Canadian institutions directed toward intellectual, social and cultural advancement.

The first eight of these guidelines are specifically designed to encourage companies operating in Canada to do so in a manner that harmonizes with Canadian economic interests rather than heeding solely the imperatives of foreign-based parent companies. In effect, the guidelines encourage subsidiaries to operate as if they were independent Canadian companies.

Guideline #9 envisages a greater degree of "Canadian outlook" at the management and directoral level through the inclusion of Canadian personnel. This objective has been partially supersided by s. 100(3) of the Canada Business Corporations Act, which provides that a majority of the directors of a corporation shall be "resident Canadians".

Guideline 10 encourages Canadian input at the shareholder level. However, the wording is very vague, does not specify whether voting shares are contemplated as a means of direct shareholder input on the operations of the company, or whether it simply envisages a means of allowing "Canada" (are individuals or government bodies contemplated?) to participate in the profits of the company.

Guideline 11 envisages greater disclosure by foreign-controlled corporations, while Guideline 12 encourages the companies to become more broadly involved in non-business activities of the Canadian community, activities that we would normally consider under the heading of "charitable donations".

How effective these guidelines have been is a matter of speculation. Certainly the federal government felt the need to exert more stringent controls on the entry of foreign capital into Canada[23] and to make at least a token gesture on the residence requirement for directors. On

the guidelines themselves, no follow-up study appears to have been done.

Clearly, in many respects the issues raised by these definitions, guidelines, and goals of "corporate social responsibility" are beyond the scope of legislation enacted to enable incorporation as a matter of right. Furthermore, the inability of academic writers to arrive at a workable definition of the terms "social responsibility" and "good corporate citizenship" would seem to indicate that there is considerable difficulty in formulating these terms--either generally or more specifically with reference to the various areas of activity proposed--as duties in law. The paper on Company Law Reform presented to the British Parliament in July 1973 by the Secretary for Trade and Industry also clearly acknowledges this difficulty:[24]

> The other kind of responsibility, a more general and moral kind, is much more difficult to specify and define in terms that can assist any board to decide in any particular situation just where that responsibility leads them, or that can be translated into law.

The problem of defining these terms raises the basic question of whether the law should impose duties on corporations that it does not impose on private persons other than laws and regulations affecting every person, whether an individual or a corporation, in a certain class. Some writers consider that the concentration of economic power represented by large corporations should attract commensurate responsibility as a legal or quasi-legal obligation. This, however, leads to further questions: How should "socially responsible" performance be measured, and to what kind of corporation should it attach? The so-called "social audit" has been suggested as a means of measuring corporate performanc in living up to its social responsibility. This concept will be discussed later. As to the other question, the idea that

"corporate social responsibility", in the sense of legal obligations above those attaching to private individuals in the same field of endeavour which arise from great concentration of economic power in the corporation, implicitly excepts smaller, less potent companies. Nonetheless, the Report of the Conference Board on Social Responsibility and the Smaller Company: Some Perspectives suggests that there are some valid areas for smaller companies to exercise social responsibility without, however, suggesting that this should be legal obligation.

III. ADVOCATES OF A POSITIVE DUTY OF SOCIALLY RESPONSIBLE CORPORATE BEHAVIOUR

Surprisingly, many of the advocates of socially responsible corporate behaviour are closely allied to the operational business world as teachers of business administration, and even as directors and officers of large corporations. Others are to be found in academic disciplines such as economics and political science. On the other hand, two of the more sceptical critics of the notion of corporate responsibility, Manne and Dickerson, are lawyers.

The most frequently advanced rationale for corporate social responsibility relates to its oldest form--corporate donations to charities and non-profit organizations--and can be described as "enlightened self-interest" in philanthropy. William J. Baumol has stated the rationale as follows:[25]

> Giving by corporations is in at least one respect a paradoxical phenomenon. The corporation owes its existence and its continued prosperity to the successful operation of the economy and the viability of the social arrangements. Since a significant segment of the institutions vital for the functioning of that society are financed largely on an eleemosynary basis, it is surely appropriate for the corporations to help to support the operations of these nonprofit groups. Gifts by private firms are

> justified not merely as a matter of their indebtedness to the nonprofit institutions for their past accomplishments, but also as a matter of self-interest, inasmuch as the deterioration of institutions such as universities and hospitals would no doubt have serious consequences for private enterprise.

Corporate philanthropy is thus really only a business judgment decision. This is clear from Baumol's conclusion:[26]

> As businessmen see more clearly and are able to show more effectively to their stockholders that the company's prosperity depends on the health of the communities in which it operates, it will become clearer that self-interest is indeed served by corporate contributions. The company pays a high price for operating in a region where education is poor, where living conditions are deplorable, where health is poorly protected, where property is unsafe, and where cultural activity is all but dead. As it grows clear to stockholders and others immediately concerned that these circumstances are all more expensive than corporate giving, the rationality of business philanthropy must become obvious.

Corporate philanthropy, if it goes beyond the point of being defensible as business judgment, affects the shareholders most directly by decreasing the amount available for distribution as dividends or for reinvestment in the company. The question of corporate philanthropy necessarily also raises two other questions, whether the corporation should be permitted to substitute the moral judgment of management for that of its shareholders, and whether controlling shareholders should be permitted to use a company as a conduit for what is essentially a private donation. Arguments have been advanced to get rid of corporate philanthropy on the basis of negative answers to these two questions, implicitly proposing that the only responsibility of a company is to its shareholders.

The second large group claiming that the company has a duty to be socially responsible to them is labour. However, the questions raised by labour relations are largely irrelevant in considering a companies statute: most questions concerning labour relations are better settled at the bargaining table pursuant to labour legislation. Nonethe less, employees, by virtue of long service or of ordering their lives and homes around their work, develop vested interests in the overall operation of a company. In europe this fact has been recognized by giving the employees a voice on the supervisory boards.

The other major groups claiming an interest in the social behaviour of corporations, are, broadly speaking, the advocates of consumer interests and the environmentalists. Here, too, specific legislation relating to environmental protection and product safety appears to be the most effective way of protecting the public. However, to ensure that corporations adhere to the spirit as well as the letter of such legislation, demands have been made by these groups for greater disclosure by companies as well as for public representatives on the boards of directors. There is no good support for these claims. However, a better case can be made for dealers and franchisers who are closely tied into and identified with the company.

Another group that has a special interest in the affairs of a company are its creditors. Although they are most directly affected by any changes in a company's financial position, relatively little has been said about granting them special consideration in respect to the structure of the company. This reflects the power of large lenders or suppliers at the time of contracting to get security or guarantees from the debtor company. On the whole, the

interests of creditors diverge markedly from those groups who would burden the company with responsibilities that might encroach on the company's maximal profit margin. Where large lending institutions have accepted seats on corporate boards, they do so as shareholders or as nominees of the shareholders.

The institutional shareholder represents a special group that can effectively temper the business decisions of corporations with moral considerations where the institutional stockholders are a large factor in the overall shareholding in the company. Yale University has published guidelines that it has adopted for its investment bodies. Chamberlain presents the Yale position in these words:[27]

> In brief, the "moral minimum" of the university is to take such action as it can to prevent or correct social injury by actions of any corporation in which it holds shares. An advisory committee of teachers and students, following guidelines, makes recommendations to the trustees, with whom final discretion lies. . . . The objective is not to champion social causes, but only to assume the responsibility of a part-owner in registering its views with respect to the desirable behaviour of companies in which it was invested . . . it will sell its holdings only as a last resort, when persuaded that its influence is without effect.

Other institutional investors are beginning to follow similar policies, although, as the following statements by William A. Loeb, Vice-President, Technological Investors Management Corporation, New York, implicitly demonstrate, the purpose of these policies is to make sure that the companies are responsive to social pressures so that they will maintain their goodwill in the market place:[28]

Our current state of mind is then:

(1) Corporate managements must pay attention to and try to read the future, not just the past. They must take into account the pressures in areas of polution, consumer quality, equal opportunity, natural resources, poverty, health and housing. Its going to be in their own interests to do so. We think companies would do well to have public representation at the board level to help keep in touch with what's trending. It probably will shake them up on occasion, but in the long term the advantages may outweigh the disadvantages.

(2) As investors we will invest for financial gain but will avoid investing in "clearly socially bad" situations. We will not hold stocks of companies we deem to be substantially polluters or that make polluting products. We will look for good managements that are adjusting to the pressures.

(3) As stockholders we will vote for and will advise our clients to vote for constructive steps in line with the above.

The most important question to be resolved with respect to representation on corporate boards by persons representing interests other than those of the shareholders concerns the potential for conflicts of interests. We will return to this issue in a later section of this paper dealing with restructuring the board of directors.

IV. CORPORATE PHILANTHROPY

A. Statutes

While corporate philanthropy does not represent a new initiative in corporate reform and has been with us for many decades, it has been and continues to be a controversial subject since it involves the expenditure of money that

would otherwise have been distributable and taxable earnings of the company.

"Corporate Philanthropy" has always been justifiable as a legitimate business expense, that is, as a payment made for the benefit of the company and not only for the benefit of the recipient. This is explicitly recognized by the powers enumerated under s. 20(1) of the Alberta Companies Act, R.S.A. 1970, c. 60, as amended, in paragraph 19 particularly, and incidentally in paragraph 2. It is to be noted, however, that these powers are dependent on the objects of the company, and can be excluded from the memorandum of association:

> **20.** (1) For the purpose of carrying out its objects, a company other than a specially limited company has the following powers, except such of them as may be expressly excluded by the memorandum,
>
> 2. the power to construct, improve, maintain, develop, work, manage, carry out, or control any roads, ways, tramways, branches or sidings, bridges, reservoirs, watercourses, wharves, manufactories, warehouses, electric works, shops, stores, and other works and conveniences that may seem calculated, directly or indirectly, to advance the company's interests, and the power to contribute to. subsidize, or otherwise assist or take part in the construction, improvement, maintenance, working, management, carrying out, or control thereof,
>
> 19. the power to establish and support or aid in the establishment and support of associations, institutions, funds, trusts, and conveniences calculated to benefit employees or ex-employees of the company or its predecessors in business, or the dependants or connections of such persons, and the power to grant pensions and allowances, and to make payments towards insurance. and to subscribe or guarantee money for charitable or benevolent objects or for any exhibition, or for any public, general, or useful object,

The Ontario Business Corporations Act, R.S.O. 1970, c. 53, as amended, contains almost identical provisions in paragraphs 8 and 14 of s. 15 (see Appendix II).

In somewhat broader terms the American Model Business Corporations Act, revised 1969, has the following sections:

SECTION 3. PURPOSES

Corporations may be organized under this Act for any lawful purpose or purposes, except for the purpose of banking or insurance.

SECTION 4. GENERAL POWERS

Each corporation shall have power:

(m) To make donations for the public welfare or for charitable, scientific or educational purposes.

(n) To transact any lawful business which the board of directors shall find will be in aid of governmental policy.

(o) To pay pensions and establish pension plans, pension trusts, profit sharing plans, stock bonus plans, stock option plans and other incentive plans for any or all of its directors, officers and employees.

(q) To have and exercise all powers necessary or convenient to effect its purposes.

It should be noted that this statute does not make the powers under s. 4 dependent on the prupose of incorporation, and does not provide for any "opting-out" in the by-laws of the company.

The provisions of the Ghana Companies Act, 1963, are somewhat more complicated. Section 24 gives a company all the powers of a "natural person of full capacity" but

only "for the furtherance of its objects" and unless the comapny's Regulations otherwise provide. Prima facie this makes the power to make charitable donations permissive, but other limitations in respect to such gifts are imposed on the directors by s. 202.

> **24.** Except to the extent that a company's Regulations otherwise provide, every company registered after the commencement of this Code and every existing company which, pursuant to section 19 of this Code, adopts Regulations in lieu of its memorandum and articles of association shall have, for the furtherance of its objects and of any business carried on by it and authorised in its Regulations all the powers of a natural person of full capacity.

Gower recognized that his approach in drafting the Ghana Companies Act in effect affirmed the existing case law:[29]

> In the version of this section included in the Draft circulated for comments I had attempted to deal with the problem of how far companies may make gifts for charitable, political or other purposes. The comments on this attempt have convinced me that it would do more harm than good and that it is better to leave this vexed question with no clearer answer than is afforded by this section in its present form. The validity of such gifts will thereby depend on whether they can fairly be regarded as made " for the furtherance of any (authorised) business carried on by it ". This test seems in effect to be that laid down by the existing case-law; *see Hutton v. W. Cork Rly* (1883) 23 Ch. D. 654, C. A.; *Re George Newman Ltd.* [1895] 1 Ch. 674, C. A.; *Evans v. Brunner Mond & Co.* [1921] 1 Ch. 359; *Re Lee Behrens & Co.* [1932] 2 Ch. 46; *Parke v. Daily News* [1961] 1.W.L.R. 493. So far as charitable contributions are concerned this is perhaps a slightly anachronistic and cynical approach, but in fact companies do not seem to find it unduly restrictive. For the American approach *see Smith v. Barlow* 98 A. 2d 581 (1953).
>
> It should be noted that a later section (section 202) limits the powers of the *directors* to make gifts without the consent of the members in general meeting.

Section 202(1)(c) provides:

> **202.** (1) Notwithstanding subsection (3) of section 137 of this Code or any provision in the company's Regulations the directors of a company with shares shall not, without the approval of an ordinary resolution of the company—
>
> (c) make voluntary contributions to any charitable or other funds, other than pension funds for the benefit of employees of the company or any associated company, of any amounts the aggregate of which will, in any financial year of the company, exceed £G1,000 or 2 per cent of the income surplus of the company at the end of the immediately preceding financial year, whichever is the greater:

Gower's reasons for this subsection are quite simply based on the undesirability of giving directors unlimited powers to make charitable donations:

> **6.** Subsection (1) (*c*), follows section 293 of the Indian Act which, in turn, is based on similar sections in many of the American Acts; there is nothing comparable in the South African Act. The exact extent of the limits which should be imposed is a matter for debate, but I have no doubt that it is undesirable that directors should have unlimited power to give away the company's funds to charity.

While the Ghana Companies Act attempts to fetter the director's discretion to make charitable donations by providing for a monetary ceiling, the British Companies Act of 1967 (see Appendix III) took a different approach by requiring directors to disclose each donation of more than £50, by giving the name of the person and the purpose for which it was given, and if fiven for a political purpose, whether directly or indeirectly, the name of the party must also be provided. The section further defines "charitable purposes" according to the four heads set out by Lord Macnaghten in Income Tax Special Purpose Comrs. v. Pemsel [1891] A.C. 531. The application of the section is thereby somewhat restricted.

The newer Canadian legislation is less explicit on the subject of charitable donations. The new British Columbia Companies Act, S.B.C. 1973, c. 18, is silent on the matter. The Act simply gives the company "the power and capacity of a natural person of full capacity" under s. 23 subject by s. 24 to any restrictions in its memorandum of association:

> **23.** (1) Subject to subsection (2), a company has the power and capacity of a natural person of full capacity.
>
> (2) No company has the capacity
>
> (a) to operate a railway as a common carrier; or
>
> (b) to carry on the business of insurance, except as authorized by clause (d) of subsection (1) of section 35; or
>
> (c) to operate as a club, unless authorized in writing by the Attorney-General; or
>
> (d) to carry on a business that is trust business as defined in Schedule A of the *Trust Companies Act.*

> **24.** (1) No company shall carry on any business that it is restricted from carrying on by its memorandum.
>
> (2) No company shall exercise any power that it is restricted from exercising by its memorandum, or exercise any of its powers in a manner inconsistent with the restrictions in its memorandum.
>
> (3) No act of a company, including any transfer of property to or by a company, is invalid by reason only that the act contravenes subsections (1) or (2).

In the result, companies must be taken to have the power to make donations unless these are excluded by its memorandum. However, the second clause of s. 24(2) suggests that the exclusion may be implicit rather than explicit.

No guidance is to be had from the duties imposed upon the directors, which by virtue of s. 141(1)(a) and (b) are simply "to act honestly and in good faith and in the best interests of the company and to exercise the care, diligence and skill of a reasonably prudent person."

The new Canada Business Coporations Act (Bill C-29), uses similar language to the B.C. legislation to arrive at the same end.

The legislation canvassed above thus covers a broad range of options, from the inclusion of mandatory powers to make charitable donations, to controlled permissive powers to make such donations, to the existing Alberta legislation permitting such donations only if they are incidental to carrying out the objects of the company.

B. Case Law: British

The case law on charitable donations by companies evo in the 19th century. The leading case is Hutton v. West Cor Railway Co., a decision of the English Court of Appeal from 1883.[30] The railway company had sold its assets and was in

the process of winding up. A general meeting of the company resolved to pay £1050 to the paid officials of the company as compensation for lost employment and £1500 as remuneration to the directors for past services. There was no provision in the articles providing for remuneration of directors, and they had never been paid. The Court of Appeal held that, although the company could validly make such resolutions for the benefit of the business while it was a going concern, in the circumstances of winding-up, these payments could not be considered to be for the benefit of a business that no longer existed. The company continued to exist only for the purpose of winding-up. Bowen L.J. made the following observations, ending with his frequently quoted "cakes and ale" dictum:[31]

> Most businesses require liberal dealings. The test there again is not whether it is *bonâ fide*, but whether, as well as being done *bonâ fide*, it is done within the ordinary scope of the company's business, and whether it is reasonably incidental to the carrying on of the company's business for the company's benefit. Take this sort of instance. A railway company, or the directors of the company, might send down all the porters at a railway station to have tea in the country at the expense of the company. Why should they not? It is for the directors to judge, provided it is a matter which is reasonably incidental to the carrying on of the business of the company, and a company which always treated its employés with Draconian severity, and never allowed them a single inch more than the strict letter of the bond, would soon find itself deserted—at all events, unless labour was very much more easy to obtain in the market than it often is. The law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company.

His Lordship continued, touching directly on the question of corporate "charity" as charity:[32]

> Now that I think is the principle to be found in the case of *Hampson* v. *Price's Patent Candle Company* (1). The Master of the Rolls there held that the company might lawfully expend a week's wages as gratuities for their servants; because that sort of liberal dealing with servants eases the friction between masters and servants, and is, in the end, a benefit to the company. It is not charity sitting at the board of directors, because as it seems to me charity has no business to sit at boards of directors *quâ* charity. There is, however, a kind of charitable dealing which is for the interest of those who practise it, and to that extent and in that garb (I admit not a very philanthropic garb) charity may sit at the board, but for no other purpose.

As long as some sort of corporate self-interest can be found, the courts seem to be prepared to take a liberal view of charitable donations. This is illustrated by the case of Evans v. Brunner, Mond and Company, Ltd.[33] The defendant was a chemical manufacturer having ancilliary to its main object power to do "all such business and things as may be incidental or conducive to the attainment of the above objects, or any of them." An extraordinary meeting of the company passed a resolution authorizing the directors to distribute £100,000 out of the surplus reserve account to U.K. scientific institutions and universities "for the furtherance of scientific education and research." On an application for a declaration that the resolution was ultra vires and for an injunction, the court affirmed the validity of the resolution, despite a strong argument by the plaintiff that the money would be applied for education generally in a manner too remote to benefit the company directly, and even if it were applied in branches of sicnece in which the company has an interest, this expenditure would not secure to the company any advantage over its competitors. Eve J. acknowledged that this point caused him difficulty, yet nonetheless he found for the company on very liberal grounds:[34]

I confess I do feel some difficulty on these points. The furtherance of scientific education and research generally might certainly appear to sanction the application of this large fund in part to scientific education not necessarily useful or beneficial to the company, and in the absence of the evidence to which I am about to allude, I should have been disposed to think the terms of the resolution somewhat indefinite and wide and calculated to give rise to the suggestion that the advancement of science rather than the direct benefit of the company had dictated it. But it appears from the evidence of the chairman of the company, supported by the evidence of all the other directors, that the company is not aiming by this contribution at securing the education of scientific men as specialists in its business. What it desires is to encourage and assist men who will cultivate the scientific attitude of mind, and be prepared to devote their time and abilities to scientific study and research generally. According to the evidence that is the class of men for whom the company is constantly looking out, a class of men of which the supply is very inadequate but who when obtainable are readily capable of adapting themselves to the investigation research and scientific work of the company. It is not intended to impose on the universities and other institutions who may benefit under this grant any obligation to train men as specialists in the particular scientific work which the company undertakes. What is desired is to offer attractions to these who are prepared to take up science and to cultivate the scientific mind and scientific habits, and thereby to establish what one of the deponents speaks of as "a reservoir of trained experts" from which the company will be able to select the right men to instruct in the particular branches of scientific investigation necessary for the purposes of the company. The evidence establishes this much, that the company is in constant need of a reserve of scientifically trained men for the purpose of its business—that the business cannot be maintained if the supply of such men is deficient—that a deficiency is almost inevitable unless substantial inducements are forthcoming to attract men to scientific study and research—that the best agencies for directing these studies are the well-equipped universities and scientific institutions, and that the interest of the company does not require that the education and training should necessarily be confined to scientific work of the nature of that in which the company is solely interested. These considerations dispose I think of the objection raised to the wide and general nature of the reference in the resolution to scientific education and research;

> it is not intended to limit the application of the money to the special branches of science affecting the company's business but to promote the training and education calculated to produce the class of men qualified to assist in maintaining the company's business.

But even such liberal construction can only be resorted to where there is in fact some benefit reasonably incidental to the company's business. In Re Lee, Behrens and Company, Ltd.[35] Eve J. held that a deed of covenant for a pension of £500 per annum to the widow of a former managing director of the company five years after his death was ultra vires the company, even though the memorandum of association gave the company an express power to provide for the welfare of the company's former employees and their dependants:[36]

> It is not contended, nor in the face of a number of authorities to the contrary effect could it be, that an arrangement of this nature for rewarding long and faithful service on the part of persons employed by the company is not within the power of an ordinary trading company such as this company was, and indeed in the company's memorandum of association is contained (clause 3) an express power to provide for the welfare of persons in the employment of the company or formerly in its employment, and the widows and children of such persons and others dependent upon them by granting money or pensions, providing schools, reading rooms or places of recreation, subscribing to sick or benefit clubs or societies or otherwise as the company may think fit.
>
> But whether they be made under an express or implied power, all such grants involve an expenditure of the company's money, and that money can only be spent for purposes reasonably incidental to the carrying on of the company's business, and the validity of such grants is to be tested, as is shown in all the authorities, by the answers to three pertinent questions: (i.) Is the transaction reasonably incidental to the carrying on of the company's business? (ii.) Is it a bona fide transaction? and (iii.) Is it done for the benefit and to promote the prosperity of the company?

> If there were nothing more in the case than what I have just indicated, I should feel myself bound in the circumstances to support the liquidator's rejection of this lady's proof.

The Hutton and Lee, Behrens cases were applied by Wilberforce J. to enjoin the company and directors of the defendant in Parke v. Daily News Ltd.[37] from applying the proceeds from the sale of two newspapers (£2 million) to the benefit of the staff and pensioners of the Daily News by way of compensation for loss of pension rights, pension benefits and payments in lieu of notice. Since the company no longer had any undertaking, it was in the same position as the company in the Hutton case and these essentially gratuitous expenditures could not be of benefit for the company.

There has only been one decision in which a court has gone so far as to affirm that a company may be operated in a manner designed to benefit primarily not the company but other interests. It must be stated, however, that this decision, Miles v. Sydney Meat Preserving Co. (Ltd.),[38] a decision of the High Court of Australia, affirmed by the Judicial Committee of the Privy Council other grounds, is of dubious authority. The company had been formed by grazers as an ordinary stock company with provision for the payment of dividends, subject to the directors' discretion to form a reserve fund, but had in fact been operated for thirty years very much like a marketing board to assure stable prices to grazers generally. It had never paid a dividend and for a number of years was dependent upon voluntary contributions from grazers for its survival. At the time of the action, however, the company had built up a £60,000 reserve. The plaintiff director was the largest shareholder and applied for an injunction to restrain the company from operating in a manner otherwise than with a view to making

profits distributable among its members. Griffith C.J. accepted the facts alleged by the plaintiff:[39]

> The appellant's complaint is that it is the settled policy of the company to carry on its operations, not with a view to paying dividends to its members, but with a view to benefitting the pastoral industry in general, and incidentally such of the members as are interested in that industry, and that the conduct of the affairs of the company is in accordance with that policy. This may be taken to be established. The appellant contends that such conduct is ultra vires.

The Chief Justice refused to be swayed by the argument that a company must carry on business for the purpose of maximizing its own profits:[40]

> But, in my opinion, the law allows the members of a company to adopt what policy they please to guide them in carrying on its operations. If they think fit to accry them on with the collateral object of enabling another enterprise to be carried on with greater success than would otherwise be possible, I think that they are entitled to do so without any interference from the Court, provided that they do not expend the funds of the company upon any object not authorized by its constitution.
>
> The law does not require the members of a company to divest themselves in its management, of all altruistic motices, or to maintain the character of the company as a soulless and bowelless thing, or to extract the last farthing in its commercial dealings, or forbid them to carry on its operations in a way which they think conducive to the best interests of the community as a whole, or a substantial part of it, rather than in a way which they think detrimental to such interests, though more beneficial (in a pecuniary sense) to themselves. And if they desire to assist another enterprise, it is immaterial whether they are or are not personally interested in that enterprise.

The Privy Council affirmed this decision on the simple basis that the plaintiff had failed to make out his case. Lord Parker of Waddington, delivering the judgment of their Lordships, expressly refused to discuss the questions of law raised in the High Court:[41]

> Under these circumstances it is unnecessary to consider or decide the questions of law raised and discussed in the Court below. It must not, however, be understood that their Lordships assent to the view that if the plaintiff had established the case he set out to prove he would not have been entitled to relief. Without expressing an opinion on this or any other question of law, their Lordships are of the opinion . . . that the appeal failed. . . .

The case has not been judicially considered.

C. Case Law: American

In the United States the law has changed radically in this century. In the 1916 decision in Dodge v. Ford Motor Co.[42] the court ordered the defendant company, which was completely controlled by Henry Ford, to pay out as dividends a large portion of the earnings that had been retained to facilitate the further expansion of this fabulously successful company. By reason of ever-greater production and rationalization of costs, the price of the Model T had been reduced progressively from around $900 to $440, and a further reduction to $360 was planned. Henry Ford had made the following fateful statements:[43]

> "My ambition," said Mr. Ford, "is to employ still more men, to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes. To do this we are putting the greatest share of our profits back in the business."
>
> "With regard to dividends, the company paid sixty per cent. on its capitalization of two million dollars, or $1,200,000, leaving $58,000,000 to reinvest for the growth of the company. This is Mr. Ford's policy at present, and it is understood that the other stockholders cheerfully accede to this plan."

> He had made up his mind in the summer of 1916 that no dividends other than the regular dividends should be paid, "for the present."
>
> "Q. For how long? Had you fixed in your mind any time in the future, when you were going to pay— A. No.
>
> "Q. That was indefinite in the future? That was indefinite; yes, sir"

This convinced the court that the Board's actions were not in the best interest of the shareholders--particularly since the board was dominated by Henry Ford:[44]

> The record, and especially the testimony of Mr. Ford, convinces that he has to some extent the attitude towards shareholders of one who has dispensed and distributed to them large gains and that they should be content to take what he chooses to give. His testimony creates the impression, also, that he thinks the Ford Motor Company has made too much money, has had too large profits, and that, although large profits might be still earned, a sharing of them with the public, by reducing the price of the output of the company, ought to be undertaken. We have no doubt that certain sentiments philanthropic and altruistic, creditable to Mr. Ford, had large influence in determining the policy to be pursued by the Ford Motor Company—the policy which has been hereir referred to.

The court concluded:[45]

> The difference between an incidental humanitarian expenditure of corporate funds for the benefit of the employés, like the building of a hospital for their use and the employment of agencies for the betterment of their condition, and a general purpose and plan to benefit mankind at the expense of others, is obvious. There should be no confusion (of which there is evidence) of the duties which Mr. Ford conceives that he and the stockholders owe to the general public and the duties which in law he and his codirectors owe to protesting, minority stockholders. A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and

does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among stockholders in order to devote them to other purposes.

There is committed to the discretion of directors, a discretion to be exercised in good faith, the infinite details of business, including the wages which shall be paid to employés, the number of hours they shall work, the conditions under which labor shall be carried on, and the price for which products shall be offered to the public.

It is said by appellants that the motives of the board members are not material and will not be inquired into by the court so long as their acts are within their lawful powers. As we have pointed out, and the proposition does not require argument to sustain it, it is not within the lawful powers of a board of directors to shape and conduct the affairs of a corporation for the merely incidental benefit of shareholders and for the primary purpose of benefiting others, and no one will contend that, if the avowed purpose of the defendant directors was to sacrifice the interests of shareholders, it would not be the duty of the courts to interfere.

The Dodge v. Ford Motor Co. is somewhat anomalous because there was a distributable surplus of almost $30 million on a paid-up capital of only $2 million, with a constant income of over $60 million in profits per year! In these circumstances the court felt that a dividend of only $1.2 million per year was an arbitrary exercise of authority with which a court of equity could interfere.

In more reasonable circumstances, American courts have not hesitated to find that a company was legally entitled to make reasonable contributions to public causes.

The law seems to have been well advanced by the case of A. P. Smith Mfg. Co. v. Barlow.[46] In this case the plaintiff-appellant had for a number of years made donations to private universities. This was contested by shareholders on the grounds that the plaintiff's certificate of incorporation did not expressly authorize such contributions and that the company did not possess any implied or incidental

powers to make them under common-law principles. In its decision, the New Jersey Appellate Division acknowledged that twentieth century operations operate in a different climate from that in which the common-law principles relating to corporate charity evolved. Refering to Berle and Manns, The Modern Corporation and Private Property, Jacobs J. said:[47]

> During the 19th Century when corporations were relatively few and small and did not dominate the country's wealth, the common-law rule did not significantly interfere with the public interest. But the 20th Century has presented a different climate. Berle and Means, The Modern Corporation and Private Property (1948). Control of economic wealth has passed largely from individual entrepreneurs to dominating corporations, and calls upon the corporations for reasonable philanthropic donations have come to be made with increased public support. In many instances such contributions have been sustained by the courts within the common-law doctrine upon liberal findings that the donations tended reasonably to promote the corporate objectives.

Jacobs J. recognized the practical effects of the transfer of wealth:[48]

> With the transfer of most of the wealth to corporate hands and the imposition of heavy burdens of individual taxation, they [individuals] have been unable to keep pace with increased philanthropic needs. They have therefore, with justification, turned to corporations to assume the modern obligations of good citizenship in the same manner as humans do. Congress and state legislatures have enacted laws which encourage corporate contributions, and must has recently been written to indicate the crying need and adequate legal basis therefor.

And further:

> In actual practice corporate giving has correspondingly increased. Thus, it is estimated that annual corporate contributions throughout the nation aggregate over 300 million dollars, with over 60 million dollars thereof going to universities and other educational institutions. Similarly, it is estimated that local community chests receive well over 40% of their contributions from corporations; these contributions and those made by corporations to the American Red Cross, to Boy Scouts and Girl Scouts, to 4-H Clubs and similar organizations have almost invariably been unquestioned.

In the result, the court in an unanimous decision affirmed that "the corporate power to make reasonable charitable contributions exists under modern conditions, even apart from express statutory provision"[49] and continued:

> There is no suggestion that it was made indiscriminately or to a pet charity of the corporate directors in furtherance of personal rather than corporate ends. On the contrary, it was made to a preeminent institution of higher learning, was modest in amount and well within the limitations imposed by the statutory enactments, and was voluntarily made in the reasonable belief that it would aid the public welfare and advance the interests of the plaintiff as a private corporation and as part of the community in which it operates. We find that it was a lawful exercise of the corporation's implied and incidental powers under common-law principles and that it came within the express authority of the pertinent state legislation. As has been indicated, there is now widespread belief throughout the nation that free and vigorous non-governmental institutions of learning are vital to our democracy and the system of free enterprise and that withdrawal of corporate authority to make such contributions within reasonable limits would seriously threaten their continuance. Corporations have come to recognize this and with their enlightenment have sought in varying measures, as has the plaintiff by its

> contribution, to insure and strengthen the society which gives them existence and the means of aiding themselves and their fellow citizens. Clearly then, the appellants, as individual stockholders whose private interests rest entirely upon the well-being of the plaintiff corporation, ought not be permitted to close their eyes to present-day realities and thwart the long-visioned corporate action in recognizing and voluntarily discharging its high obligations as a constituent of our modern social structure.

D. Reform

Execept for more specific disclosure and requirements, the U.K. Companies Act of 1967 does not substantially alter the law on charitable donations by companies as it had been developed in the cases up to Parke v. Daily News. The principa requirement of such donations is that they be in some way good for business.

Gower, in writing about the duties of directors, notes that they are not required to act in detached altruism for the company, but that "it is apparently only the interests of the members, present and future, to which they are entitled to have regard; the interests of the employees, the consumers of the company's products or the nation as a whole are legally irrelevant."[50] However, he goes on to say:[51]

> This, it may be thought, is an increasingly anachronistic view. Directors habitually have regard to these interests; indeed it has become common form for them to declare that industry owes duties to employees, consumers and the nation, as well as to the shareholders.[38] Fortunately, so long as the company remains a going concern the members' interests will normally be served by having regard to the other interests; rebellious staff, hostile trade unions, dissatisfied customers and an aggrieved public or government are not conducive to the future prosperity of the company.[39] Hence it is generally possible to justify generosity to employees, charitable donations[40] and even political contributions,[41] though it seems that the onus will be on the directors to justify any gratuitous payments by showing positively that they were made bona fide for the benefit of the company.[42]

In his Draft Ghana Code Gower recognized that the fiduciary duty of directors to the "company as a whole" extends beyond the company either as an abstract entity distinct from its incorporators or as the sum of its incorporators. However, it is clear from his commentary that Gower is not entirely certain of how far a duty to interests other than those of the shareholders, should or could be placed on the directors. He asks:[52]

> Does it then mean that the directors should weigh the interests of the members, the employees, the consumers of the company's products and the nation as a whole? It has recently become almost a cliche for directors to declare that they owe duties to all these classes and the Companies Act of the German Federal Republic expressly declares that directors must act to the best interests of the employees and the country as a whole, as well as of the members. But the present English and Ghanaian law does not appear to support this. . . . On the other hand, the law shows signs of developing and in the U.S.A., for example, it is far from clear that as restricted a view would be taken: cf. Berle, The Twentieth Century Capitalist Revolution.

Gower's solution was to avoid the creation of a positive duty to other interests, but to permit directors to have regard to these other interests in determining whether a particular transaction is in the nest interests of the company. Section 203 of the Ghana Companies Act reads:

> **203. (1)** A director of a company stands in a fiduciary relationship towards the company and shall observe the utmost good faith towards the company in any transaction with it or on its behalf.
>
> **(2)** A director shall act at all times in what he believes to be the best interests of the company as a whole so as to preserve its assets, further its business, and promote the purposes for which it was formed, and in such manner as a faithful, diligent, careful and ordinarily skilful director would act in the circumstances.

(3) In considering whether a particular transaction or course of action is in the bes interests of the company as a whole a director may have regard to the interests of the employees as well as the members, of the company, and, when appointed by, or as representative of, a specia class of members, employees, or creditors may give special, but not exclusive, consideration t the interests of that class.

(4) No provision, whether contained in the Regulations of a company, or in any contract or in any resolution of a company shall relieve any director from the duty to act in accordance wit this section or relieve him from any liability incurred as a result of any breach thereof.

In effect, under this section a board of directors may defend themselves against a shareholder claim that disbursemen made for the benefit primarily of the company's employees are ultra vires the company without having to resort to a fiction that this was done in the best interests of the company's business. However, it does not seem that representatives of special interests can demand of the board that it consider their interests if the board refuses: there is no positive duty to consider interests other than those of the shareholders.

On the other hand, if a director represents special interests, he cannot act exclusively in the interests of that class: he has a larger duty to the "company as a whole".

Gower's permissive approach deems more sensible than the positive duty to act in the best interests of people and state had been taken by the German law on public stock companies. The 1937 Act contained the following section:[53]

> 70 The managing board is, on its own responsibility, to manage the corporation as the good of the enterprise and its retinue and the common weal of folk and realm demand.

Vagts points out that nothing at all is said here about the shareholders, and that the meaning of the section is confused by the use of "retinue", a word without exact meaning in a modern context, but replete with Nazi racial mysticism.

The clause was abolished in the revision of 1958 as "unnecessary because self-evident",[54] although the present German legislation still provides that a corporation may be dissolved for failure to heed the public interest.[55]

Vagts points out that 28 years (he was writing in 1966) had not led to the crystallization into meaningful guidelines of these sections. There was no case law, although there had been some commentary on the effect of these sections on specific corporate actions. However, it seems clear that this section also cannot be effectively used to compel decisions not otherwise dictated by the pursuit of shareholder interests, and at best serves to protect management on decisions otherwise open to shareholder attack in much the same way that the Ghana legislation protects directors who have regard to interests other than those of the shareholders.

Vagts further points out that the failure of s. 70 to have a noticeable effect on German corporate behaviour may be traced to a number of different social and political factors, including a more independent and authoritarian corporate management attitude, and greater state support of charities and cultural institutions that leaves little room for corporate intrusion in these fields. Corporate giving would be greeted by public distrust of the motives. Vagts' notes that only in the area of research beyond the government scope do corporations contribute significantly. Because of business involvement with the rise of Nazism, political contributs are subject to corrupt practice legislation and are no longer tax deductible.[56]

E. Should corporations be permitted to make charitable contributions?

The factors which are considered as limitations on corporate giving in Germany do not have any real significance in the very different social conditions which exist in Canada.

There are, however, two very important arguments that have been raised against permitting corporate charity in Canada.

(1) Corporations are economic institutions

It is a trite argument that corporations exist primarily to carry on business. Its principal role, it is argued, is to maximize its profits under existing market conditions. The pressures of the market place are the most effective controls in assuring that the corporation meets consumer demands as well as assuring continued prosperity for both its employees and its shareholders. Under this somewhat simplistic and idealistic model, an ineffective management which fails to meet market demands will be subject to shareholder unrest lowered stock prices and take-over bids. It is a model that Henry Manns proposes as the ultimate control of management's use of what he calls "discretionary" earnings (those sums which amount to the difference between the market value of a company's stock and the cost of a take-over bid).[57]

(2) Corporate donations further the private interests of management

It is contended that corporate charitable donations are less often made with the company's direct benefit in mind than with the personal aggrandisement in the community of the executive chiefly responsible for arranging the donation. Certainly, with small companies the interests of the sole or principal shareholder are identical with those of the company, and any corporate donation that results in goodwill for him personally may also result in goodwill towards the company. This is less clearly the case where large corporation are used as the source and conduit for donations made largely in the private interests of a member of management or of a director.[58]

(3) Large scale corporate donations are an intrusion on public policy without public accountability

Using Manne's model of "discretionary income" it is quite possible to imagine huge sums of money becoming available for distribution to non-shareholder interests essentially in order to satisfy the personal whims of management. These disbursements could be potentially very important in shaping the institutions of the nation. This was recognized by the court in A. P. Smith Co. Ltd. v. Barlow, in which one of the arguments went to the effect that company support of private collegs and universities was important in helping these institutions to survive, since they provided a quality of education different from that of state-funded institutions, and that the survival of private colleges was fundamental to the survival of the free-enterprise system and "freedom as we know it." On the other hand, the German example has shown that despite a positive duty to act in the national interest, corporate donations in a great many spheres are suspect precisely because they introduce on areas in which the state has asserted an interest. Governments at least are accountable at the polls, and its officials are publicly visible and subject to criticism. This cannot be said of corporate managements and corporate directors. It is for these reasons that Dickerson has taken a very negative attitude towards corporate charity:[59]

> . . . businessmen have no particular knowledge which would allow them to define social objectives in an acceptable way. Indeed, their outlook is apt to be too narrowly materialistic for that purpose. This is as it should be, because the proper job of corporate management is to maximize profits for the shareholders. But it is quite another thing to allow that group to apply that view to non-economic matters, and it is positively dangerous to allow such a powerful and influential group as corporation management, however benevolent its proclaimed intentions, to intrude where it does not belong. . .

> Despair as we may over the ineptitude of government, we should not want to change it for the cold-blooded efficiency of business. We should insist that the country's social decisions be made openly in Parliament, by people who, if they do not actively seek our opinion, might at least listen to us if we do have something to say....
>
> In the corporate state, things are very different. Decisions will be made behind boardroom doors by an anonymous collection of managers whom we do not know and cannot reach. If political and not market considerations govern the allocation of resources even a vote in the market place becomes worthless....
>
> Social responsibility foreshadows a coalescing of business and government. Social responsibility, in fact, is a recipe for fascism.

F. A reasonable approach to corporate charity

Dickerson's approach leads us back to the somewhat unsatisfactory situation under the present legislation. Corporations will continue to support causes favoured by its management or board and will do so without accounting for most of these donations since they will be made under the cynical guise of business expenses.

It appears that such "donations" are an accepted fact of corporate life, whether they be in money or money's worth. The question confronting us is how best to assure accountability and control of disbursements.

It will be recalled that Henry Manne considered as "corporate social responsibility" only such acts of the compan as were voluntary, altruistic, and resulted in a loss in the amount of money that would potentially have been available for distribution to the shareholders. In this sense we have looked at "corporate donations" in a broader sense than mere giving to charitable institutions. Except for the A. P. Smith Co. Ltd. case , the cases we have looked at have involved primarily a lessening of the shareholders'

profits for the benefit of the employees and consumers. This should be kept in mind in drafting any legislation dealing with corporate charity. It will be recalled that Gower included s. 203(3) in the Ghana Code to permit directors to heed such special interests in carrying out their duties. I am of the opinion that a similar provision may be validly included in a section dealing with corporate charity.

Gower's draft of the charitable donations section in the Ghana code is less useful: apart from the disclosure provisions elsewhere in the code, this section only codifies the common law in the same manner that present Alberta legislation does, by continuing to require a business justification for each contribution.

While newer American legislation based upon the Model Business Corporations Act does not go so far as to put the company under a duty of social responsibility, it does go quite far in vesting every company with the power to make such expenditures, whether they be charitable or for the purpose of furthering government policy. Under the Act these powers are a mandatory incident of incorporation. However, there would seem to be no justification for such mandatory powers under present conditions in Alberta. This would derogate unduly from the rights of the incorporators to restrict the scope of the company's activities. This also goes beyond the liberal reasoning in the A.P. Smith Co. Ltd. case, which only extended common law principles to imply such powers for companies where they were not expressly given. But nothing in the case suggested that incorporators could not expressly exclude such powers.

Therefore I am of the opinion that a section providing for"expenditures for non-profit purposes" should be drafted, and should:

(1) be an incident of incorporation unless expressly excluded or limited;
(2) extend to include indirect as well as direct contributions;
(3) unmask essentially charitable donations as such without permitting management to hide contributions to causes in which they are privately interested under the business judgment rule. This could well be a separate and mandatory section requiring disclosure, so that no recourse can be had to the business judgment rule as a shield against shareholder attack;

(4) include any expenditures on behalf of employees or consumers (such as assistance to consumer research organizations) which it was not under a legal duty to make;
(5) extend to include any amounts that represent an immediate loss of income to the company by the provision of goods or services to any non-profit organization for less than fair market value or where the value received is calculated in good-will;
(6) provide for full disclosure of each such sum above a minimum amount in every annual report. This would go a long way to controlling managerial whims and would also provide an information bank for "social audits";
(7) assure that such disbursements, whether authorized by the shareholders themselves or not, are reasonable and do not by themselves undermine the economic stability of the company.

A draft of such a section is appended as Appendix IV.

V. DISCLOSURE

As will be seen from the foregoing, I am of the opinion that greater and more detailed disclosure is esssential in order to retain shareholder control over expenditures made for non-profit purposes. While the shareholders would be the parties primarily interested, such disclosures, made available to government agencies, could be a useful instrument to help form guidelines and policies to channel these funds. This is also one area in which the financial and "social" audits overlap and can be reported to the shareholders with precision.

Audits

Audits affect the interests of the shareholders, the creditors, and potentially even other parties in the community that are in some way relying upon the welfare of the company. Yet it appears to be one of the most abused areas of corporate affairs. John Crispo maintains that the complexity of a company's financies has been used by management as a means of controlling the reported profits. He believes that persons in senior management who have not had training in the morality of financial reporting are apt to look for loopholes in the accounting standards to get the greatest advantage from the audit.[60] As a result, auditors get caught between the competing claims of management, which seeks the legal minimum of disclosure as being a full and proper presentation of the company's position, and the claims of shareholders, who might see such a legal minimum as being deceitful and misleading. Crispo quotes from a recent American judgment (not cited) which affirmed the shareholder position and imposed greater care on the accountant by giving a liberal interpretation of the phrase "present fairly" the position of a company, this being a matter separate and apart from presenting its position "in compliance with generally

accepted accounting principles."[61]

Implicit in these statements is the conviction that present "generally accepted accounting principles" are inadequate to give a "fair" presentation at all times. Crispo formulates this as the question: "Should the auditor tell all?" and replies in the affirmative. What "all" embraces and what should be disclosed is presented in excerpts from an article by Robert A. Kleckner, "Disclosure is the Weak Spot in Audits":[62]

> ■ Break down inventories according to the way in which they are expected to be sold....
> ■ Summarize fixed-asset acquisitions by year and depreciation method....
> ■ Disclose management's justification for the capitalization of major intangibles, such as research and development expense. Explain the basis for the realization period selected.
> ■ Provide a summary of the aging of account receivable at each balance sheet date.
> ■ Disclose certain nonaccounting information that could have drastic effects on future operations....
> ■ Present comparative industry statistics and management's commentary on them.
> ■ Present information on business segments. I suggest, as a partial solution to the present controversy surrounding the definitional aspects of this disclosure, that consideration be given to presenting the information according to the managerial units in which the enterprise conducts its business.[32]

The gist of these recommendations is to provide the shareholder and other parties legitimately interested in a company's operations with the detailed information that is necessary to make management truly accountable for the way it runs a business.

Audit Committees

Audit committees, constituted with a majority of outside directors, have been suggested as one way of disenaging the close relationships that have developed between

management and auditors and to assure a fairer presentation of the company's position. Such committees, with a majority of outside directors, are now required in companies having publicly held shares by s. 165 of the new Canada Business Corporations Act, S.C. 1974-75, c. 33, by s. 182 of the Ontario Business Corporations Act, R.S.O. 1970, c. 53 as amended, and by s. 208 of the B.C. Companies Act, S.B.C. 1973, c. 18 as amended.

The duties and responsibilities of such committees are not yet specifically outlined other than to review the financial statements and to submit them to the board of directors. No body of knowledge based on experience has yet been built up on how such committees should function or what their responsibilities and liabilities should be. However, it seems clear that such a committee, if the outside directors on it are not easily bluffed by managerial interference, can function as a useful watchdog to prevent management from hiding important information from the stockholders or any other interests that may be represented on the board, by assuring the auditor greater independence from management, and by fully using its powers to question the auditor about the state of the company. The effectiveness of these committees could be increased even more if, as Kleckner suggests, more detailed disclosure can be brought about in audits.

Corporate social responsibility audits

I have suggested that disclosure under the proposed "expenditures for non-profit purposes" section would be a useful adjunct to carrying out a "corporate social responsibility audit". This is an area where the audit committee of the company could also have a useful function, should the company feel the need to carry out such an audit.

This kind of audit does not seek to examine the financial position of the company, but rather the performance of the company with respect to norms of social behaviour that have been set either by its own directors or management, or by outside bodies (whether they be governmental bodies or special interest groups such as manufacturer's associations) in the form of guidelines.

However, it is clear that such audits must be voluntary on the part of the company. The area is still to vague and muddled. As Crispo says, the problems posed by corporate social audits are many and varied:[63]

> First and foremost there is the problem of accessibility to and quantification of pertinent data. Since a kind of cost-benefit analysis is called for no matter which aspect of social responsibility is to be examined, all the facts available must be mustered to avoid overly impressionistic appraisals. Related to this first problem is the issue of who is to conduct the audit. If it is to be insiders they will have the advantage of familiarity with the situation, but their views will naturally be suspect. In contrast, if outsiders are involved they will doubtless be less well-informed, although presumably more detached and objective. There is no easy answer to this dilemma except perhaps to assign a mixed group of insiders and outsiders to the job. Nor is there an obvious solution to the issue of whether the entire audit should be made public. If not at least partially made public, it may prove little more than an exercise in self-delusion. To make it all public, however, might prove not only embarrassing, but damaging from a competitive point of view. Perhaps it is best, therefore, to conclude this section by simply noting that there are many problems associated with corporate social responsibility audits, problems which go a long way towards explaining why they have not yet made much headway either qualitatively or quantitatively.

VI. BOARD REPRESENTATION OF NON-SHAREHOLDER INTERESTS

Much has been written in the past ten years about the possibility of introducting non-shareholder representation on the boards of large public companies. Employee representation has been most proposed, usually with consideration being given to the German experience in the area. There has also been some support given to the idea of "special interests" directors representing consumers and environmentalists, as well as for "public" directors generally representing the interests of the public at large in such corporations.

Apart from the massive change that this would entail in our present concept that the property of a corporation is that of the shareholders, and that they are entitled to control of that property -- an issue discussed at length by Berle and Means, the question of non-shareholder representation on corporate boards is fraught with potential conflict-of-interest problems since implicit in such representation is a duty to protect the interests of the special groups as well as those of the company as a whole. The German experience in this area suggests that (1) conflicts of interests in Germany are neither perceived nor regulated as stringently in Germany as in the United States[64] with reference to the fact that most of Germany's stock holding is legally in the hands of three major banks, whose representatives sit on many boards, including representation by the same bank in competing companies; (2) where worker representation is concerned, the board representatives are in conflict with their status as unionists, and their duties to the company, and that this is most frequently resolved by the workers' representatives adopting management's views.

However, the issue of broader board representation is one which bears consideration. Phillip I. Blumberg has identified five major factors behind the proposals to broaden the composition of the board of directors:[65]

> (1) *Corporate power.* Recognition of the large public corporation as a political and social institution of paramount dimensions in a society in crisis. Recognition of the power and role of the major corporation in American society inevitably leads to evaluation and review of its structure for governance.
>
> (2) *The social and environmental crisis.* We are living in a world undergoing profound and accelerating change, change in attitudes and values, and in institutions. Further, the intensity of the social and environmental crisis, the struggle for racial and social justice, the concern with the physical impact of industrial technology on the quality of life and on life itself inevitably leads to a reexamination of previously accepted institutions and relationships. The large corporation as a major influence in the society is, along with society, swept up in the process for change.
>
> Similarly, the acceptance of the as yet poorly defined concept of corporate social responsibility has given rise to a reconsideration of the basic objectives of the corporation, including its structure, especially board structure.
>
> (3) *Lack of accountability.* Management of the large public corporation lacks accountability. Although there is still argument to the contrary,[1] it is difficult not to conclude that with the separation of ownership and control resulting from the widespread distribution of shares, shareholders in the large corporation, generally speaking, no longer have an effective independent voice in the selection of the board or in other matters submitted for their consideration. Except in unusual cases, board members have become a self-perpetuating group, accountable only to themselves or perhaps to the chief executive officer who was responsible for their selection (who himself is accountable to no one). Further, management's ability to rule unchallenged by take-over threats from outsiders may rest on its continued ability to achieve minimally acceptable earnings per share.[2] In the typical case, however, management lacks accountability.
>
> (4) *Lack of legitimacy.* The corporation is no longer an enterprise that significantly involves only its owner-managers. It affects wide segments of the society. "Private" has become "public." In contrast, the social and economic groups whose lives and fortunes are profoundly

affected by the corporation have no role in its direction. Regulation through government in specified areas of conduct is regarded by some as only a limited and inadequate response. Such reform groups want the affected social and economic groups to participate in corporate decision making. They demand changes in the board because it is unrepresentative. Even if the board were not self-perpetuating and the stockholders possessed power of selection in realistic terms, the problem of legitimacy of a board of directors reflecting solely stockholder interests would remain.[3] The problem of accountability might be resolved, but the issue of legitimacy would still remain.

(5) *Rejection of the concept of managerialism.* This conviction that the interests of vitally affected groups are not receiving adequate consideration in the corporate decision-making process represents a rejection of the concept of managerialism. This is the concept that the board of directors acts as a trustee not solely for stockholders but for employees, consumers, the community, and other groups as well, and that the function of the board is to mediate among the legitimate claims of these conflicting groups. However, this view has little support in reality. Further, it runs directly contrary to the established legal principle that the board of directors owes single-minded loyalty to the advancement of the interests of stockholders.[4]

Employee Representation

Under German law, public stock companies have a two-level directorate. Under this system there is a management board, which is responsible for the daily operations of the company, and a supervisory board, which oversees the activities of the management and is responsible for their appointment. The two boards are strictly separated and there is no overlapping membership. Presently German law requires public stock companies as well as companies private in form but having over 500 employees, to reserve one-third of the seats on the supervisory board for employee representatives. In the coal and steel branches, the proportion is one-half of the seats.

While this model has found much favour with writers, largely because it demonstrates that business can continue to function effectively with non-shareholder participation in the control of the company, it seems that employees do not thereby get as significant a voice in the decision-making process as would at first appear. The managerial board, although subject to the appointment, scrutiny and dismissal of the supervisory board, is solely responsible for the active management of the business. The supervisory board cannot intervene directly in enterprise policy.[66] However, the supervisory board is responsible for appointing persons to the important company positions, and can thus indirectly shape the course of the company.[67] It is to be noted, though, that shareholders retain the majority of the votes and can effectively override objections by worker representatives. More direct control can be exercised at the level of the works' council , which in certain cases can veto decisions made by management. It should be clear, however, that under developing Canadian labour law there is a strong current to restrict residual management rights. Any further moves in this direction, if they are desired, might be better implemented through labour legislation than through a companies statute.

While German management seems to have come to live happily with the present concept of "co-determination", there is evidence that the workers themselves are less satisfied. The German experience seems to be, according to Simitis, that workers representatives have generally tended to support management even in large scale reconsiderations of enterprise policy that would substantially effect the workers.[68] Under the law, in any event, all members of a company board have the same rights and duties. The electing constituency is not

a factor. As a result, a worker representative could support the viewpoint of his constituency only if he was of the opinion that this was also in the best interests of the company. Vagts has pointed out that the position of employee representatives on company boards, particularly where this is a full-time, salaried position, has the effect of alienating the director from his constituency. Particularly where such representatives are in the minority on the board, and thus unable to decisively affect the work of the supervisory board, these positions are likely to become either sinecures, or-- as Vagts has suggested--a training ground for potential managers. Blumberg sums up the German experience in a less than fully positive manner:[69]

> The results of the German experience are mixed. In steel, iron, and coal, where labor representation includes one-half of the supervisory board as well as a veto power over the designation of the labor director on the managing board, full codetermination seems to have provided labor with an effective share of power, has apparently contributed to reduced labor strife, and generally has worked satisfactorily. In other industries, where labor representation is restricted to one-third membership on the supervisory board, or partial codetermination, labor representation generally has been regarded as not particularly meaningful. Power in fact has not been shared.
>
> Often, labor representation has not been taken seriously and has served as a source of sinecures for old faithful trade union officials, with management control essentially unimpaired.

Blumberg maintains that German labour is not antagonistic to the principle of co-determination, but in fact affirms it, pressing for the full extension of co-determination or one-half representation on all boards, rather than just in the coal, iron and steel works.[70]

Co-determination can be used to management's advantage in labour negotiations. Simitis writes:[71]

> Co-determination challenges, however, not only company law. Labour law is no less at stake. Once participation is introduced trade unions are no more confronted with enterprises pursuing a policy exclusively determined by the owners. The attitude of the management reflects on the contrary the consensus between capital and workers' representatives. Moreover trade unions can scarcely fight a policy adopted by persons who according to most models represent them too. Collective bargaining may thus prove extremely difficult." It loses, anyway, the importance it had as long as management and workers could be clearly distinguished.

Simitis concludes:[72]

> The implications for strikes are rather obvious. In fact if co-determination is understood not only as a right to participate in the decision-making process but also as a duty to accept and defend the results of this process, strike activites may prove more and more questionable, at least as long as they are motivated by claims directly connected with the enterprise. It is hardly conceivable to permit the employees to determine the guidelines of enterprise policy without at the same time restricting the use of an instrument permanently endangering the application of these guidelines.

As a result there does not yet seem to have been any interest expressed by North American unionism favouring the introduction of the German model of co-determination. In Britain, however, the debate has begun, and the Working Group of the Labour Party Industrial Policy Sub-Committee is adamant in its report that it accepts the proposition of labour representation on the board of companies only on the basis that "trade union participation

at the board level must be a supplement to, and not in any way detract from, the trade unions' position in collective bargaining."[73] Furthermore, the Working Group would not settle for less than 50% representation on the supervisory board:[74]

> We think there is no particular merit in having anything less than 50 per cent workers representation on the board if the intention is to produce a real improvement in industrial democracy. Anything less than 50 per cent would be likely, in fact, to be the equivalent of merely having a number of "observers" on the board. Where 50 per cent membership applies, the workers' representatives would be fully participating members with full responsibilities with the other members in decision taking (although see (e) Duties and Responsibility below). We therefore reject any proposal for worker representatives to have less than 50 per cent of Board seats. We are also of the view that a worker director may be but need not necessarily be an employee of the company. He could for example be a Trade Union official or even an outsider nominated by the Trade Union concerned.

If the British Labour Party Working Group is less than enthusiastic about any board involvement that would be less than worker parity, the British Confederation of Industry is completely unenthusiastic about any rapid changes in the corporate structure. They propose rather a type of council outside of the board meeting in which consultation with workders can take place before the decision-making process is implemented.[75] It is obvious that both of these positions must be considered as bargaining positions for the changes that will eventually come to British industry as a consequence of EEC membership.

Consumer Directors

Some support has been given to the idea that consumers of a company's products are entitled to be represented on its board. The idea has little appeal unless the concept of "consumer" is so severely restricted as to be limited only to the first purchaser in large quantities for resale of a

company's products -- so that effecitvely only dealers and franchisees of a company would have such representation. Serious consideration should be given to involving these persons in the corporate decision-making process because their own livelihood and the goodwill of their own businesses is totally dependant on the goodwill nurtured by the supplier company. However, it should be noted that in this case the constituency that such directors would represent is clearly defined, and all its members have an interest in the company that is analogous to a capital participation.

Environmentalists as Directors

Blumberg writes:[76]

> It is hard to take seriously proposals for environmentalists, economic conversion experts, investment bankers, etc., as directors, except as symbolic or quixotic gestures.

This area would be better left to regulatory legislation armed with sufficiently severe penalties to encourage compliance.

Public Directors

Robert Townsend has suggested that "public directors" charged with a quasi-trusteeship to represent public investors and the community at large sit on the boards of directors , and he would have these salaried by the corporation and provided with an independent staff.[77] The basic question

is who would be responsible for selecting and appointing these persons. If he is selected by the board, his appointment would not signify a change in the corporate structure. Another question raised by Blumberg is whether such a director, even if he had a public constituency outside, and even if he were provided with funds and staff, could function effectively on a board which was hostile to his presence. In such a case, the actual board decisions would probably be made in caucus prior to the meeting.[78] The obvious difficulty for making a case for broader representation on corporate boards if that of defining in any clear terms the constituencies that are to be represented, and, if that were possible, arriving at a reasonable method of selection that is democratic and representative of that constituency. But even before one could proceed to that point, one is faced by the almost insurmountable problem of defining the interest (and its relative weight for each member within the class) that these "constituencies" have in the corporation, and in which type of corporation they can apply.

Conflicts of Interest

As we have seen in the case of workers directors under the German system, there is an inherent conflict between representing the interests of one particular constituency and being under a legal duty to give his undivided loyalty to the corporation, rather than to his constituency. Under traditional company law a director owes his loyalty to the corporation and to the shareholders as a whole. Blumberg asks: "Would not the special interest director designated to represent the interests of the group responsible for his designation be confronted with a fundamental conflict of interest?"[79] As a possible solution to this problem

Blumberg puts forward the British solution of requiring labour directors on the boards of nationalized firms to divest themselves of all formal affiliations with the unions so that they come with a unionist perspective, but not as union representatives. Although Blumberg does not say so, this amounts to divesting such directors of their constituencies, and one has to wonder what continuing basis such a director would have for sitting on a board and participating in decisions affecting the company and his former constituency. On the other hand, if one were to permit special interest representatives as such on the board, one would need to set new fiduciary standards for directors to reflect the changed composition of the board and the revised objectives of the corporation.[80]

> Such standards would almost inevitably involve the realization that, except in the most unusual circumstances, special interest representatives would place loyalty to the group which designated them and which they represent above all other loyalties, whether to the enterprise as a whole, the community or the nation.
>
> The board would then function essentially as a political institution. There is a serious question whether such a board could effectively function . . .

The issues involved in the notion of "corporate citizenship" or "corporate social responsibilities" cannot be resolved until these terms can be adequately defined. WHO the company should be responsible to and for WHAT has not been discussed in a manner that gives any real meaning to these terms; there is not yet any consensus as to their meaning. The only approach to defining these terms has been through outlining areas of operations, as has been done by a number of writers, including academics and business men, but it is noteworthy that these are largely areas of general public concern in which the government has already intervened with some regulatory legislation--areas such as product safety, environmental protection and minority hiring. It has also been stated that "corporate social responsibility" relates to achieving nationally recognized objectives. This is almost as vague as the American constitutional objective--the pursuit of happiness. Guidelines such as those issued by the Federal Department of Indutry, Trade and Commerce in 1966 asking companies to adhere to "nationally recognized objectives" are no guidelines.

Implicit behind the call for greater corporate conscience, if that is not a metaphysical impossibility, is the idea that corporations, because they are reputedly bigger and richer than individuals, should be placed under a greater duty of good citizenship than an individual. The idea does not appear to have any foundation in logic and is incapable of application so long as the duty rem ains too vague to be defined. However, there is no reason why corporations should not reflect the moral values of the people who own it. The divorce ownership from control in the larger corporations has been an important factor in the public perception of corporations as autonomous, soulless entities accountable to no effective body. Therefore, in order to assure that the company reflects the moral values of the persons most directly interested in it--the shareholders, it is important that some links between ownership and control be reforged through a more detailed accounting of how these assets of the company are dealt with by management. This would involve a greater duty of

care for accountants and a more clearly defined responsibility of accountants and auditors to the shareholders rather than the management of a corporation.

The effective implementation of more stringent accountin standards is largely beyond the scope of this paper. However, I have indicated in the section dealing with "corporate charity disclosure of certain sums is possible and would provide an effective mechanism whereby the shareholders could exercise som control over management's disposition of "discretionary" funds. At the same time this would permit management a greater leeway with these funds--providing that the disposition reflects shareholder attitudes--than has been permitted under existing Alberta legislation. To this end, it may be useful to set som guidelines concerning the things a director may take into accou in managing the business--much in the same way that s. 203 of t Ghana Companies Act does.

However, the more radical calls for producing greater corporate social responsibility by changing the fundamental structure of the company at the directoral level seem to have little merit. If non-shareholder representation were implemented to share in the power of the corporation, it would be an illusion of power so long as directors representing capital interests remain in the majority on the board. The Working Gro of the British Labour Party recognized this in its report when it refused to consider board representation unless labour were to receive half the seats. Furthermore, in large corporations a great many of the important operational decisions that most directly affect the public either through their impact on the environment or on the market-place are made not at the full board level, but at a managerial level, or at best in board committees. It is unlikely that corporations would allow outsiders to participate in the decision-making process at these "lower," but very important levels.

In respect to smaller companies, of the type that represent the majority of incorporations in Alberta, there seems to be no intrinsic need to enforce greater social responsibility. In such companies control and ownership of the company are usually still in the same hands, and the companies operate in a market-place that demands reasonably harmonious relations with the community as a prerequisite of survival.

Much that has been written about social responsibility suffers from the very reason that it is attractive: it is exotic. While these suggestions for reform may be at home in other lands, in North America they are strange creatures. The conditions under which business is carried on are different, and there is no guarantee that such things as mandatory employee representation are adaptable to our situation. There is, however, a grave danger that such ideas carry with them the seeds for the destruction of other institutions and mechanisms that we have developed to serve our own peculiar needs. It may be better to leave them alone.

Economic Growth and Efficiency

- *increasing productivity in the private sector of the economy*
- *improving the innovativeness and performance of business management*
- *enhancing competition*
- *cooperating with the government in developing more effective measures to control inflation and achieve high levels of employment*
- *supporting fiscal and monetary policies for steady economic growth*
- *helping with the post-Vietnam conversion of the economy*

Education

- *direct financial aid to schools, including scholarships, grants, and tuition refunds*
- *support for increases in school budgets*
- *donation of equipment and skilled personnel*
- *assistance in curriculum development*
- *aid in counseling and remedial education*
- *establishment of new schools, running schools and school systems*
- *assistance in the management and financing of colleges*

Employment and Training

- *active recruitment of the disadvantaged*
- *special functional training, remedial education, and counseling*
- *provision of day-care centers for children of working mothers*
- *improvement of work/career opportunities*
- *retraining of workers affected by automation or other causes of joblessness*
- *establishment of company programs to remove the hazards of old age and sickness*
- *supporting where needed and appropriate the extension of government accident, unemployment, health and retirement systems*

Civil Rights and Equal Opportunity

- *ensuring employment and advancement opportunities for minorities*
- *facilitating equality of results by continued training and other special programs*
- *supporting and aiding the improvement of black educational facilities, and special programs for blacks and other minorities in integrated institutions*
- *encouraging adoption of open-housing ordinances*
- *building plants and sales offices in the ghettos*
- *providing financing and managerial assistance to minority enterprises, and participating with minorities in joint ventures*

Urban Renewal and Development

- *leadership and financial support for city and regional planning and development*
- *building or improving low-income housing*
- *building shopping centers, new communities, new cities*
- *improving transportation systems*

Pollution Abatement

- *installation of modern equipment*
- *engineering new facilities for minimum environmental effects*
- *research and technological development*
- *cooperating with municipalities in joint treatment facilities*
- *cooperating with local, state, regional and federal agencies in developing improved systems of environmental management*
- *developing more effective programs for recycling and reusing disposable materials*

Conservation and Recreation

- *augmenting the supply of replenishable resources, such as trees, with more productive species*
- *preserving animal life and the ecology of forests and comparable areas*
- *providing recreational and aesthetic facilities for public use*
- *restoring aesthetically depleted properties such as strip mines*
- *improving the yield of scarce materials and recycling to conserve the supply*

Culture and the Arts

- *direct financial support to art institutions and the performing arts*
- *development of indirect support as a business expense through gifts in kind, sponsoring artistic talent, and advertising*
- *participation on boards to give advice on legal, labor, and financial management problems*
- *helping secure government financial support for local or state arts councils and the National Endowment for the Arts*

Medical Care

- *helping plan community health activities*
- *designing and operating low-cost medical-care programs*
- *designing and running new hospitals, clinics, and extended-care facilities*
- *improving the administration and effectiveness of medical care*
- *developing better systems for medical education, nurses' training*
- *developing and supporting a better national system of health care*

Government

- *helping improve management performance at all levels of government*
- *supporting adequate compensation and development programs for government executives and employees*
- *working for the modernization of the nation's governmental structure*
- *facilitating the reorganization of government to improve its responsiveness and performance*
- *advocating and supporting reforms in the election system and the legislative process*
- *designing programs to enhance the effectiveness of the civil services*
- *promoting reforms in the public welfare system, law enforcement, and other major governmental operations*

Business Corporations Act, R.S.O. 1970, c. 53 as amended

15. (2) **Incidental powers.**—A corporation has power as incidental and ancillary to the objects set out in its articles,

8. to establish and support or aid in the establishment and support of associations, institutions, funds or trusts for the benefit of employees or former employees of the corporation or its predecessors, or the dependants or connections of such employees or former employees, and grant pensions and allowances, and make payments towards insurance or for any object similar to those set forth in this paragraph, and to subscribe or guarantee money for charitable, benevolent, educational or religious objects or for any exhibition or for any public, general or useful objects;

14. to construct, improve, maintain, work, manage, carry out or control any roads, ways, tramways, branches or sidings, bridges, reservoirs, watercourses, wharves, manufactories, warehouses, electric works, shops, stores and other works and conveniences that may advance the interests of the corporation, and contribute to, subsidize or otherwise assist or take part in the construction, improvement, maintenance, working, management, carrying out or control thereof;

19. Directors' report to include certain particulars of contributions for political or charitable purposes

(1) If a company (not being the wholly owned subsidiary of a company incorporated in Great Britain) has, in a financial year, given money for political purposes or charitable purposes or both, there shall (if it exceeded £50 in amount) be contained in the directors' report relating to that year, in the case of each of the purposes for which money has been given, a statement of the amount of money given therefor and, in the case of political purposes for which money has been given, the following particulars, so far as applicable, namely—

(*a*) the name of each person to whom money has been given for those purposes exceeding £50 in amount and the amount of money given;

(*b*) if money exceeding £50 in amount has been given by way of donation or subscription to a political party, the identity of the party and the amount of money given.

(2) The foregoing subsection shall not have effect in the case of a company which, at the end of a financial year, has subsidiaries which have, in that year, given money as mentioned in the foregoing subsection, but is not itself the wholly owned subsidiary of a company incorporated in Great Britain; but in such a case there shall (if the amount of money so given in that year by the company and the subsidiaries between them exceeds £50) be contained in the directors' report relating to that year, in the case of each of the purposes for which money has been given by the company and the subsidiaries between them, a statement of the amount of money given therefor and, in the case of political purposes for which money has been given, the like particulars, so far as applicable, as are required by the foregoing subsection.

(3) For the purposes of this section a company shall be treated as giving money for political purposes if, directly or indirectly,—

(*a*) it gives a donation or subscription to a political party of the United Kingdom or of any part thereof; or

(*b*) it gives a donation or subscription to a person who, to its knowledge, is carrying on, or proposing to carry on, any activities which can, at the time at which the donation or subscription was given, reasonably be regarded as likely to affect public support for such a political party as aforesaid.

(4) For the purposes of this section, money given for charitable purposes to a person who, when it was given, was ordinarily resident outside the United Kingdom shall be left out of account.

(5) In this section, "charitable purposes" means purposes which are exclusively charitable and "wholly owned subsidiary" shall be construed in accordance with section 150 (4) of the principal Act; and, as respects Scotland, "charitable" shall be construed in the same way as if it were contained in the Income Tax Acts.

NOTES

Sub-s. (1): Great Britain. See the note to s. 3, *ante*.

Sub-s. (4): United Kingdom. See the note to s. 3, *ante*.

Knowledge. There is authority for saying that, where a person deliberately refrains from making inquiries the results of which he might not care to have, this constitutes in law actual knowledge of the facts in question; see *Knox* v. *Boyd*, 1941 S.C. (J.) 82, at p. 86, and *Taylor's Central Garages (Exeter), Ltd.* v. *Roper* (1951), 115 J.P. 445, at pp. 449, 450, *per* Devlin, J.; and see also, in particular, *Mallon* v. *Allon*, [1964] 1 Q.B. 385; [1963] 3 All E.R. 843, at p. 394 and p. 847, respectively. Yet, mere neglect to ascertain what would have been found out by making reasonable inquiries is not tantamount to knowledge; see *Taylor's Central Garages (Exeter), Ltd.* v. *Roper* above, *per* Devlin, J.; but see also *Mallon* v. *Allon* above and *Wallworth* v. *Balmer*, [1965] 3 All E.R. 721.

Sub-s. (5): Exclusively charitable. Charity in its legal sense comprises four principal divisions: trusts for the relief of poverty, trusts for the advancement of education, trusts for the advancement of religion, and trusts for other purposes beneficial to the community not falling under any of the preceding heads; see *Income Tax Special Purposes Comrs.* v. *Pemsel*, [1891] A.C. 531; [1891–4] All E.R. Rep. 28, H.L., at p. 583 and p. 55, respectively, *per* Lord Macnaghten. It should be noted, however, that religious purposes are not necessarily charitable as they may lack the requisite element of public benefit; see, in particular, *Gilmour* v. *Coats*, [1949] A.C. 426; [1949] 1 All E.R. 848, H.L. See, further, on the meaning of "charitable" in particular, *Williams Trustees* v. *Inland Revenue Comrs.*, [1947] A.C. 447; [1947] 1 All E.R. 513; *National Anti-Vivisection Society* v. *Inland Revenue Comrs.*, [1948] A.C. 31; [1947] 2 All E.R. 217; *Gibson* v. *South American Stores (Gath & Chaves), Ltd.*, [1950] Ch. 177; [1949] 2 All E.R. 985, C.A.; *Oppenheim* v. *Tobacco Securities Trust Co., Ltd.*, [1951] A.C. 297; [1951] 1 All E.R. 31; *Re Coulthurst, Coutts & Co.* v. *Coulthurst*, [1951] Ch. 661; [1951] 1 All E.R. 774, C.A.; *Inland Revenue Comrs.* v. *Educational Grants Association, Ltd.*, [1967] 2 All E.R. 893, C.A.; and *Le Cras* v. *Perpetual Trustee Co., Ltd.*, [1967] 3 All E.R. 915, P.C.

Reports relating to pre-Act financial years. See the note to s. 16, *ante*.

Unregistered companies. See the note to s. 3, *ante*.

Offences. For offences connected with this section, see s. 23, *post*.

Accounts of oversea companies. See the note to s. 3, *ante*.

APPENDIX IV

LEGISLATIVE DRAFT

"Expenditures for non-profit purposes"

A. (1) Unless expressly prohibited by its articles, a company may make reasonable expenditures in support of public purposes or for purposes providing no direct or immediate benefit to the company, without limiting the generality of the foregoing, in such fields as

a) benevolent charities,

b) education,

c) research,

d) public affairs,

e) employee benefits.

(2) For the purposes of this section, "expenditure" means any expense to the company, whether in money, discounts, goods or services, which can be quantified and entered into the accounts of the company.

(3) What is a reasonable expenditure is a question of fact to be determined with regard, among other things, to the earnings of the company over the ____ [two?] fiscal years of the company immediately preceding.

(4) No such expenditure shall be made unless the company has paid a lawful dividend in each of the ___[two?] fiscal years immediately preceding.

(Quaere, whether this section should be even more restrictive to provide for a dividend to have been paid on the common stock?)

(5) Each such expenditure made in a fiscal year shall be reported to the shareholders at the next annual meeting, and the report shall specify the amount and the name of the recipient.

B. Each expenditure made by the company for the benefit of the enterprise to or on behalf of a non-profit organisation or to an individual for a consideration that is less than fair market value or for a consideration that is wholly or partly in the nature of good-will shall be reported to the shareholders at the next annual meeting, and the report shall specify the amount of the expenditure and the name of the recipient.

[1]Neil W. Chamberlain, The Limits of Corporate Responsibility (New York, Basic Books, 1974), pp. 123-4.

[2]Id. p. 126.

[3]Adolf Berle and Gardiner Means, The Modern Corporation and Private Property, Revised edition (New York: Harcourt Brace, 1968), p. viii.

[4]Id., p. xv.

[5]Alfred F. Conard in "The Corporate Machinery For Hearing and Heeding New Voices. A Panel Discussion", (1971) 27 Business Lawyer, 195 at 197.

[6]Berle and Means, supra, xvi.

[7]Berle present Harbrecht's views at p. xxii.

[8]Id., p. xxii.

[9]Id., p. xxiii.

[10]Neil H. Jacobi, Corporate Power and Social Responsibility (New York: Macmillan, 1973), p. 10.

[11]Foreign Ownership and the Structure of Canadian Industry. Report of the Task Force on the Structure of Canadian Industry (Ottawa: Queen's Printer, 1968), particularly at p. 169.

[12]Committee for Economic Development, Social REsponsibilities of Business Corporations (New York, 1971), p. 21.

[13]Manne and Wallich, The Modern Corporation and Social Responsibility (Washington D.C., 1972), p. 6.

[14]Id., p. 4.

[15]Id., pp. 6-7.

[16]Id., p. 7.

[17]Dow Votaw, "Genius Becomes Rare," in The Corporate Dilemma (Englewood Cliffs, N.J.; Prentice-Hall, 1973), p. 11.

[18]Dow Votaw, "The nature of Social Responsibility: You Can't get There from Here", Journal of Contemporary Business, vol. 2 (1973), p. 1. Quoted by John Crispo The Public Right to Know (Toronto: McGraw-Hill Ryerson, 1975), pp. 218-19.

[19]Manne and Wallich, supra, n. 13 at p. 40.

[20]Id., p. 43.

[21]James K. Brown, Social Responsibility and the Smaller Company: Some Perspectives, a Report from the Conference Board of New York, 1972), p. 6.

[22]Department of Trade and Commerce, Annual Report, 1966 (Ottawa: Queen's Printer 1966), pp. 18-20.

[23]See generally Foreign Direct Investment in Canada (Ottawa: Information Canada, 1972). The "Gray Report". Also Editors of the Canadian Forum, A Citizen's Guide to the The Gray Report (Toronto: New Press, 1971).

[24]Department of Trade and Industry, Company Law Reform (London: Her Majesty's Stationery Office, 1973), p. 19.

[25]Baumol et al., A New Rationale for Corporate Social Policy (Lexington: D. C. Heath, 1970), p. 3.

[26]Id., p. 19.

[27]Chamberlain, supra, n. 1 at pp. 193-194.

[28]Commercial Development Association, The Corporation and Social Responsibility (New York, 1972), p. 34.

[29]Final Report of the Commission of Enquiry into the Working and Administration of the present Company Law of Ghana (Accra: Government Printer, 1961), p. 42.

[30](1883) 23 Ch. 654 (C.A.).

[31]Id., at pp. 672-3.

[32] Id., p. 673.

[33] [1921] 1 Ch. 359.

[34] Id., at pp. 366-7.

[35] [193] 2 Ch. 46.

[36] Id., at pp. 52-53.

[37] [1961] 1 W.L.R. 493 (Ch.D.).

[38] [1913] 16 C.L.R. 50 (H.C. Sub.).

[39] Id., p. 63.

[40] Id., p. 66.

[41] [1914] 17 C.L.R. 639 (J.C.) at 644.

[42] 170 N.W. 668 (Mich. S.C.).

[43] Id., at p. 683

[44] Id., at pp. 683-4.

[45] Id.

[46] 98 A. 2d 581 (N.J.S.C.).

[47] Id., at 584.

[48] Id., at 586.

[49] Id. at 590.

[50] Gower, The Principles of Modern Company Law, 3rd ed., 522.

[51] Id.

[52] Ghana Draft Code, supra, n. 29, p. 145.

[53]Translation as per Detlev Vagts, German Corporate Perzpectives", (1966-67) 80 Harvard Law Rev. 23 at 40.

[54]Id., p. 40.

[55]Id., p. 41.

[56]Id., p. 45.

[57]Supra, n. 13, at p. 16ff. See also Manne's article "The Social Responsibility of Regulated Utilities", Corporate Practice Commentator, 1973-74 Annual 242 at 252-53.

[58]See Manne, supra, n. 13 at p. 20ff.

[59]Dickerson, "Social Responsibility and other Claptrap", a memorandum dated September 11, 1973, at pp. 8-11.

[60]Crispo, The Public Right to Know (Toronto, 1975), p. 161.

[61]Id.

[62]Crispo, supra, pp. 164-65. Quoted from Business Week, June 30, 1973.

[63]Id., p. 168.

[64]Detlev Vagts, "The European System", (1972) 27 Business Lawyer 165 at 169.

[65]Phillip I. Blumberg, "Reflections on Proposals for Corporate Reform Through Change in the Composition of the Board of Directors: 'Special Interest' or 'Public' Directors", The Unstable Ground: Corporate Social Policy in a Dynamic Society, S. Prakash Sethi, editor (Los Angeles: Melville Publishing, 1974), 112 at 113-114.

[66]S. Simitis, "Workers' Participation in the Enterprise--Transcending Company Law?" (1975) 38 Modern Law Rev. 1 at p. 8.

[67]Id.

[68]Id., p. 9.

[69]Blumberg, supra, n. 65, pp. 123-4.

[70]Id., p. 126.

[71]Supra, n. 66 at pp. 19-20.

[72]Id., p. 20.

[73]Working Group of the Labour Party Industrial Policy Sub-Committee, Green Paper. The Community and The Company: Reform of Company Law, 1974, p. 12.

[74]Id., p. 14.

[75]Company Affairs Committee, Report on the responsibilities of the British Public Company, Confederation of British Industry, 1973, p. 21.

[76]Supra, n. 65, p. 119.

[77]Id., pp. 121, 128.

[78]Id., p. 128.

[79]Id., p. 127.

[80]Id., p. 128.

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