One of the central questions in corporate law and policy is about the purpose of the corporation. For whose benefit should the corporation be run? Should the corporation be run for the primary benefit of its shareholders? Or should corporations be run with the goal of benefiting society overall? In short, what is the purpose of the corporation? The answer to these questions can lead to different conclusions about corporate decision making.

This chapter introduces you to the debate over the corporation’s place in society. First, we lay out the debate, which basically pits those who see the corporation as a set of contractual/property interests against those who see the corporation as a social institution with responsibilities to its many constituents. Then, we look at how the debate has played out in two different contexts – the allocation of firm profits and charitable giving by modern corporations. Finally, we consider the role of directors and corporate lawyers faced with issues of CSR – specifically, the choices that directors face in a corporate takeover and the legal/ethical dilemmas faced by multinational corporations.

A. Who Does the Corporation Serve?

The debate over the purpose of the corporation has dominated corporate law since the aftermath of the “Great Crash” of 1929 and the economic depression that followed. During the early 1930s, Congress held a series of hearings about the role of the corporation. Testimony focused on the major scandals of that era and leading scholars debated the appropriate role of corporate law, policy, and power. Then and now, the debate has been framed by two polar views, which generally have come to be labeled “shareholder primacy” and “corporate social responsibility,” or CSR.

1. Corporation as Private Property

Adolf Berle, a Wall Street lawyer and law professor, developed the early version of the shareholder primacy view during the early 1930s. He argued in an influential law review article that corporate powers were held in trust “at all times
exercisable only for the ratable benefit of all the shareholders.” During the following two decades, Berle modified some of his views, and economist Milton Friedman emerged as the leading proponent of shareholder primacy.

Friedman argued that the only social responsibility of a corporation is to maximize profits for its shareholders within the confines of the law. According to Friedman, private for-profit corporations had developed a proven ability to maximize shareholder wealth, and he argued that they should pursue this specialty. In his view, “there is one and only one social responsibility of business: to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition, without deception or fraud.”

Friedman was not opposed to social responsibility. But he argued that social responsibility was for individuals and government, not corporations. If individual shareholders wanted to be socially responsible by contributing their own money to social causes, that was fine. Friedman favored government intervention to resolve market failures, to provide important public services, and to protect and enforce contract and property rights. But those responsibilities were not the job of business corporations. (We look in the next section at *Dodge v. Ford*, a case that considers whether corporate profits can be used to benefit employees and consumers, at the expense of shareholders.)

Over time, many academics and financial leaders have come to share Friedman’s view that the corporation exists primarily to generate shareholder wealth. They have explained that other corporate constituencies, such as employees and creditors, are protected by contracts with the corporation. They have seen other constituencies’ interests as incidental and subordinate to the goal of maximizing shareholder wealth. Delaware Chancellor William Allen labeled this view the “property” model, because it envisions the corporation as a form of privately held property. Delaware Chancellor William Allen labeled this view the “property” model, because it envisions the corporation as a form of privately held property. They have seen other constituencies’ interests as incidental and subordinate to the goal of maximizing shareholder wealth. Delaware Chancellor William Allen labeled this view the “property” model, because it envisions the corporation as a form of privately held property. (We consider in the next section the situation where interests of employees and creditors conflict with the interests of shareholders in a corporate takeover.)

Notice that the property model explicitly assumes the corporation is run for the benefit of sharehold-
ers rather than employees. It is the bedrock of capitalism. Karl Marx argued that capitalism’s driving force was the exploitation and alienation of labor. Many commentators find it ironic that corporate law focuses on contributors of capital (shareholders) instead of contributors of labor (employees), who typically are much more involved in and dependent on the success of the corporation. Whereas shareholders can diversify their exposure to risk in the corporation, employees—both officers and more junior employees—cannot. Others argue that employee interests are best served by a free market for labor and any employee protections should come from government rules and contractual negotiations, not corporate law. In this debate, it is important to recognize that some employees do better than others. We devote an entire chapter to the issue of executive compensation and the widening gap between the compensation of senior officers and lower-level employees.

2. Corporation as Social Institution

The leading 1930s proponent of the contrary view, which later became known as corporate social responsibility, was E. Merrick Dodd. A year after Berle published his influential pro-shareholder article, Dodd countered that the business corporation should be viewed as something far more significant than merely a shareholder profit maximizer. Dodd contended that the business corporation was properly seen “as an economic institution which has a social service as well as a profit making function.”

Dodd’s view spread widely. It appealed to people who found the notion of corporate citizenship and responsibility attractive, and the business community endorsed the economic case for corporate social responsibility. Many corporate executives came to see shareholders as too short-sighted, with no real stake in the long-term health of the corporation. Those shareholders wrongly viewed the corporation as their private property, when the superior view was that direc-
tors should focus on the corporation’s long-term interests as an economic entity, including attention to non-shareholder constituencies. In this view, the directors owed duties to the corporation itself as an entity, not merely to the corporation’s shareholders. Chancellor Allen labeled this competing view the “entity” model.

More recently, support for CSR has been driven by demand from consumers and other corporate stakeholders, who have pressed corporations to consider issues of ethics and sustainability. Social awareness initiatives and socially responsible investing have led to some pressure on corporations to behave responsibly. Several prominent corporate leaders have argued that corporations should do more than merely maximize shareholder value. And many leading academics have argued that the notion of maximizing shareholder value is logically inconsistent, because of the differences among shareholders and the fact that corporations raise funds through internal sources and by issuing securities other than common shares (such as preferred shares, hybrid securities, and debt – we discuss these in greater detail in Chapter 10). They instead favor the corporate objective of maximizing “firm value,” which includes the value of all corporate securities, not just common shares.

Other commentators have argued that CSR has spread, not because managers naturally want to pursue a social responsibility agenda, but instead because such an agenda is good public relations. Cynics argue that some corporations implement CSR policies to distract the public from ethical questions posed by their core operations. Many corporations have explicitly supported CSR, but only to the extent CSR actually helps the company maximize profits. Most large public corporations have CSR-related links on their home pages. You might take a few minutes now to pick a public corporation you find interesting, and check to see what CSR initiatives they have posted.

**Take Note!**

Part of the CSR movement has been the adoption of voluntary standards and programs by many large companies on environmental stewardship, workplace standards, and sustainability initiatives. One of the leading groups, Ceres, was formed in 1989 in response to the Exxon-Valdez oil spill. It promotes social well-being and environmental protection by bringing together investors and other stakeholders to encourage companies to adopt CSR-based reporting, decision making and business activities. See [http://www.ceres.org](http://www.ceres.org).

**Go Online!**

Many students find the film “The Corporation” interesting and useful. It portrays the modern corporation as often dysfunctional, even sociopathic. Featuring several prominent commentators, including Milton Friedman, it describes the shareholder primacy and CSR arguments. “The Corporation” is available for free download through YouTube and other online sources. Additional resources are at [http://www.thecorporation.com](http://www.thecorporation.com/).
3. Implications of Board Discretion

A central tenet of modern U.S. corporate law is that the board of directors supervises and manages the business and affairs of the corporation. Does the board have the discretion to decide whether the corporation should exclusively maximize shareholder value, or instead should pursue a different agenda? Many modern corporate statutes, though interestingly not Delaware’s, specifically recognize the discretion of the board to make decisions that prefer non-shareholder constituencies.

Ohio Revised Code § 1701.59
Authority of Directors

(A) All of the authority of a corporation shall be exercised by or under the direction of its directors.

(E) For purposes of this section, a director, in determining what the director reasonably believes to be in the best interests of the corporation, shall consider the interests of the corporation's shareholders and, in the director's discretion, may consider any of the following:

(1) The interests of the corporation’s employees, suppliers, creditors, and customers;

(2) The economy of the state and nation;

(3) Community and societal considerations;

(4) The long-term as well as short-term interests of the corporation and its shareholders, including the possibility that these interests may be best served by the continued independence of the corporation.

The discretion and responsibilities of the board are particularly tested in corporations that operate globally. Multinational corporations must account for the different legal, regulatory, and business risks they face abroad. Simply complying with domestic laws and regulations often might not be enough. In many countries, particularly in continental Europe, stakeholders wield greater power, and the CSR movement is widely accepted. Corporations must decide whether to treat workers better than local workplace rules require, or whether to implement environmentally friendlier policies than otherwise would apply. These decisions depend not only on the legal rules of the countries in which the corporation operates, but also on the perceptions and preferences of the corporation's shareholders and stakeholders throughout the world. (We consider in the next section the role of lawyers in advising corporate boards of the multinational corporations when CSR may demand more than compliance with local laws.)
Boards also have discretion to make charitable contributions on behalf of the corporation. Naturally, there is a concern that corporate directors might prefer their own pet charities and causes. They might make contributions for which they receive personal benefits, such as a seat on the board of trustees of a prestigious community organization. Given these concerns, should shareholders have a greater voice in how the corporation spends money on items related to CSR? (We cover at the end of the next section the issue of corporate charitable contributions.)

As you read the materials that follow, consider some of the fundamental questions about corporate law and policy. What is the corporation? Is it essentially the private property of the shareholders, or is it an entity that should serve public ends? Is it contractual in nature or is it a creature of the state which created it and to which it is responsible? To whom are the corporation and its directors and officers accountable? What interests must or may the board consider? Under what circumstances may the directors favor interests other than those of shareholders?

B. CSR in Two Legal Contexts

We now present two cases that raise many of the challenging questions presented by CSR. First, we look at the dispute between the Dodge brothers and Henry Ford, a classic case in corporate law, even though it generally is not regarded as having much if any precedential authority. Dodge v. Ford illustrates the polar views of the role of the corporation, and also shows how some people (including judges) might try to use shareholder primacy and the ideals of CSR to further their own purposes. Second, we look at how corporate law treats corporate charitable giving and posits some suggestions for reform.

1. The “Classic” Case

Although the principal issue in Dodge v. Ford was whether the corporation could be compelled to pay a dividend, the case is best remembered for its discussion of the role of a corporation in society, a discussion that was elicited by Henry Ford’s insistence on describing his motives for business decisions in terms of social rather than economic values.

This action was brought by the Dodge brothers, two minority shareholders, against the Ford Motor Company, Henry Ford, and other members of the board of directors, to compel the payment of a dividend, to enjoin construction of the company’s River Rouge plant, and for other relief. The lower court granted all relief requested by plaintiffs.
Ford Motor Company was organized in 1903 with an initial capitalization of $150,000. Henry Ford took 225 of the 1,500 shares authorized, the Dodge brothers took 50 shares each, and several others subscribed to a few shares each. At the time the suit was brought, the company's capital was $2,000,000, the plaintiffs owned 10% of the outstanding stock, and Ford owned 58% and completely dominated the company.

The company paid regular quarterly dividends amounting to $1,200,000 per year and, in addition, had paid during the years 1911 through 1915 a total of $41 million in “special dividends.” In 1916, Ford had “declared it to be the settled policy of the company not to pay in the future any special dividends, but to put back into the business for the future all of the earnings of the company other than the regular dividend.”

The defendants appealed from a lower court order directing the corporation to pay a dividend of $19 million, enjoining it from building a smelter at the River Rouge plant and restraining it from “increasing of the fixed capital assets,” or “holding of liquid assets in excess of such as may be reasonably required in the proper conduct and carrying on of the business and operations” of the corporation.

Dodge v. Ford Motor Co.

204 Mich. 459, 170 N.W. 668 (1919)

Ostrander, C.J.

To develop the points now discussed, and to a considerable extent they may be developed together as a single point, it is necessary to refer with some particularity to the facts.

When plaintiffs made their complaint and demand for further dividends, the Ford Motor Company had concluded its most prosperous year of business. The demand for its cars at the price of the preceding year continued. It could make and could market in the year beginning August 1, 1916, more than 500,000 cars. Sales of parts and repairs would necessarily increase. The cost of materials was likely to advance, and perhaps the price of labor; but it reasonably might have expected a profit for the year of upwards of $60,000,000. In justification of their dividend policy and business plan, the defendants have offered testimony tending to prove, and which does prove, the following facts: It had been the policy of the corporation for a considerable time to annually reduce the selling price of cars, while keeping up, or improving, their quality. As early as in June, 1915, a general
plan for the expansion of the productive capacity of the concern by a practical
duplication of its plant had been talked over by the executive officers and direc-
tors and agreed upon; not all of the details having been settled, and no formal
action of directors having been taken. The erection of a smelter was considered,
and engineering and other data in connection therewith secured. In consequence,
it was determined not to reduce the selling price of cars for the year beginning
August 1, 1915, but to maintain the price and to accumulate a large surplus to pay
for the proposed expansion of plant and equipment, and perhaps to build a plant
for smelting ore. It is hoped, by Mr. Ford, that eventually 1,000,000 cars will be
annually produced. The contemplated changes will permit the increased output.

The plan, as affecting the profits of the business for the year beginning August
1, 1916, and thereafter, calls for a reduction in the selling price of the cars. It is
true that this price might be at any time increased, but the plan called for the
reduction in price of $80 a car. The capacity of the plant, without the additions
thereto voted to be made (without a part of them at least), would produce more
than 600,000 cars annually. This number, and more, could have been sold for
$440 instead of $360, a difference in the return for capital, labor, and materials
employed of at least $48,000,000. In short, the plan does not call for and is not
intended to produce immediately a more profitable business, but a less profitable
one; not only less profitable than formerly, but less profitable than it is admitted
it might be made. The apparent immediate effect will be to diminish the value of
shares and the returns to shareholders.

It is the contention of plaintiffs that the apparent effect of the plan is intended
to be the continued and continuing effect of it, and that it is deliberately proposed,
not of record and not by official corporate declaration, but nevertheless proposed,
to continue the corporation henceforth as a semi-eleemosynary institution and
not as a business institution. In support of this contention, they point to the
attitude and to the expressions of Mr. Henry Ford.

Mr. Henry Ford is the dominant force in the business of the Ford Motor
Company. No plan of operations could be adopted unless he consented, and no
board of directors can be elected whom he does not favor. One of the directors
of the company has no stock. One share was assigned to him to qualify him for
the position, but it is not claimed that he owns it. A business, one of the largest
in the world, and one of the most profitable, has been built up. It employs many
men, at good pay.

“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? A. That was indefinite; yes, sir.”

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 herein referred to.

It is said by his counsel that—

Although a manufacturing corporation cannot engage in humanitarian works as its principal business, the fact that it is organized for profit does not prevent the existence of implied powers to carry on with humanitarian motives such charitable works as are incidental to the main business of the corporation.

And again:

As the expenditures complained of are being made in an expansion of the business which the company is organized to carry on, and for
purposes within the powers of the corporation as hereinbefore shown, the question is as to whether such expenditures are rendered illegal because influenced to some extent by humanitarian motives and purposes on the part of the members of the board of directors.

The cases referred to by counsel, after all, like all others in which the subject is treated, turn finally upon the point, the question, whether it appears that the directors were not acting for the best interests of the corporation. We do not draw in question, nor do counsel for the plaintiffs do so, the validity of the general proposition stated by counsel nor the soundness of the opinions delivered in the cases cited. The case presented here is not like any of them. The difference between an incidental humanitarian expenditure of corporate funds for the benefit of the employees, 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 employees, 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.

We are not, however, persuaded that we should interfere with the proposed expansion of the business of the Ford Motor Company. In view of the fact that the selling price of products may be increased at any time, the ultimate results of the
Chapter 4 Corporate Social Responsibility

larger business cannot be certainly estimated. The judges are not business experts. It is recognized that plans must often be made for a long future, for expected competition, for a continuing as well as an immediately profitable venture. The experience of the Ford Motor Company is evidence of capable management of its affairs. It may be noticed, incidentally, that it took from the public the money required for the execution of its plan, and that the very considerable salaries paid to Mr. Ford and to certain executive officers and employees were not diminished. We are not satisfied that the alleged motives of the directors, in so far as they are reflected in the conduct of the business, menace the interests of shareholders. It is enough to say, perhaps, that the court of equity is at all times open to complaining shareholders having a just grievance.

The decree of the court below fixing and determining the specific amount to be distributed to stockholders is affirmed. In other respect, the said decree is reversed.

Points for Discussion

1. Shareholder wealth maximization.

Dodge v. Ford is often cited in support of the shareholder primacy view: “A business corporation is organized and carried on primarily for the profit of the stockholders.” Does it support that view? Notice the court used the word “primarily,” not “exclusively,” suggesting that “an incidental humanitarian expenditure for the benefit of the employees” would be permissible. Thus, the decision seems to leave room for activities that are not profit maximizing if they are “incidental” to the “primary” purpose of the corporation. And, of course, the court refused to question the business judgment of management and enjoin the proposed expansion of the company even though that expansion would reduce short-term profits.

2. Precedential value.

In assessing the precedential force of Dodge v. Ford, keep in mind the underlying business struggle. Ford's business then principally involved assembling cars using parts supplied by others. The Dodge brothers owned 10% of Ford's stock and were among Ford's largest suppliers. In addition, the Dodges had begun assembling cars in competition with Ford. Ford's plan to vertically integrate the company (from ore mining to smelting to manufacturing to car assembly), as well as the withholding of dividends and the reduction of the selling price of its cars, placed the Dodge brothers in a competitive disadvantage. In ruling (in part) for the Dodges, the Michigan court may have been more concerned about the future
of the auto industry in the state, and the economic and political implications of a one-company industry, than shareholder rights.

The Dodge brothers were mostly concerned about Ford's plans to develop the River Rouge factories. Access to capital was not a problem for them, and before the case Ford had offered them $30 million for their interest in the company. Why didn't they accept?

3. Court's view on CSR?

Does *Dodge v. Ford* express a consistent view on CSR? On one hand, the court defers to Ford's judgment about how to price its cars and whether to expand its plant. On the other hand, the court rejects Ford's judgment that it needed to maintain a large cash cushion during its expansion. Might these arguably inconsistent holdings have been motivated by the court's social vision about how best to promote competition in the burgeoning automobile industry?

4. Long-term vs. short-term?

Was Henry Ford really sacrificing corporate profits for the welfare of non-shareholder constituents? Ford had asserted on numerous occasions that he wanted only a small profit from his venture:

I hold this view because it enables a large number of people to buy and enjoy the use of a car and because it gives a larger number of men employment at good wages. Those are the two aims I have in life. But I would not be counted a success if I could not accomplish that and at the same time make a fair amount of profit for myself and the men associated with me in the business.

And let me say right here, that I do not believe that we should make such an awful profit on our cars. A reasonable profit is right, but not too much. So it has been my policy to force the price of the car down as fast as production would permit, and give the benefits to users and laborers, with resulting surprisingly enormous benefits to ourselves.

Does Ford's refusal to "make such an awful profit" also constitute good economics and contain the seeds of substantial future profits (and dividends) for the shareholders?
Chapter 4 Corporate Social Responsibility

2. Corporate Charitable Contributions

In the early twentieth century, many courts held that corporate charitable contributions were “ultra vires,” or beyond the powers granted by the articles of incorporation with respect to the operation of the corporation’s business. In response to these decisions, every state amended its corporate law to authorize charitable contributions. These statutes, like the statute in the example that follows, did not limit authority to only donations that increased corporate profits.

Theodora Holding Corp. v. Henderson

257 A.2d 398 (Del.Ch.1969)

[For many years, Girard Henderson dominated the affairs of Alexander Dawson, Inc., through his controlling interest in that corporation. In 1955, he transferred as part of a separation agreement 11,000 shares of common stock to his wife, Theodora Henderson. Ms. Henderson owned in her own name 3,000 of first preferred, 12,000 of second preferred, and 22,000 of third preferred stock of Alexander Dawson, Inc. In 1967, Mrs. Henderson formed the Theodora Holding Corporation (plaintiff) and transferred in those 11,000 shares of Alexander Dawson, Inc. common stock (At the time of the transfer the market value of this stock was $15,675,000 and had a net asset value of $28,996,000). During that year of the disputed charitable donation, the combined dividends paid by Alexander Dawson, Inc. on the preferred and common stock held Mrs. Henderson and her corporation totaled $286,240.

From 1960 to 1966, Girard Henderson had caused Alexander Dawson, Inc. to make annual corporate contributions ranging from $60,000 to more than $70,000 to the Alexander Dawson Foundation (“the Foundation”), which Henderson had formed in 1957. All contributions were unanimously approved by the shareholders. In 1966, Alexander Dawson, Inc. donated to the Foundation a large tract of land valued at $467,750 for the purpose of establishing a camp for under-privileged boys. In April 1967, Mr. Henderson proposed that the board approve a $528,000 gift of company stock to the Foundation to finance the camp. One director, Theodora Ives, objected and suggested that the gift be made instead to a charitable corporation supported by her mother (Girard Henderson’s ex-wife) and herself. Girard Henderson responded by causing a reduction in the Alexander Dawson, Inc. board of directors from eight members to three. The board thereafter approved the gift of stock to the Foundation.

Theodora Holding Corp. then brought suit against certain individuals, including Girard Henderson, challenging the gift and seeking an accounting and the appointment of a liquidating receiver for Alexander Dawson, Inc.]
Corporations A Contemporary Approach

Marvel, Vice Chancellor.

Title 8 Del.C. § 122 provides as follows:

Every corporation created under this chapter shall have power to—

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

There is no doubt but that the Alexander Dawson Foundation is recognized as a legitimate charitable trust by the Department of Internal Revenue. It is also clear that it is authorized to operate exclusively in the fields of “religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals”. Furthermore, contemporary courts recognize that unless corporations carry an increasing share of the burden of supporting charitable and educational causes that the business advantages now reposed in corporations by law may well prove to be unacceptable to the representatives of an aroused public. The recognized obligation of corporations towards philanthropic, educational and artistic causes is reflected in the statutory law of all of the states, other than the states of Arizona and Idaho.

In A.P. Smith Mfg. Co. v. Barlow, 13 N.J. 145, 98 A.2d 581 (1953), a case in which the corporate donor had been organized long before the adoption of a statute authorizing corporate gifts to charitable or educational institutions, the Supreme Court of New Jersey upheld a gift of $1500 by the plaintiff corporation to Princeton University, being of the opinion that the trend towards the transfer of wealth from private industrial entrepreneurs to corporate institutions, the increase of taxes on individual income, coupled with steadily increasing philanthropic needs, necessitate corporate giving for educational needs even were there no statute permitting such gifts, and this was held to be the case apart from the question of the reserved power of the state to amend corporate charters. The court also noted that the gift tended to bolster the free enterprise system and the general social climate in which plaintiff was nurtured. And while the court pointed out that there was no showing that the gift in question was made indiscriminately or to a pet charity in furtherance of personal rather than corporate ends, the actual holding of the opinion appears to be that a corporate charitable or educational gift to be valid must merely be within reasonable limits both as to amount and purpose.

I conclude that the test to be applied in passing on the validity of a gift such as the one here in issue is that of reasonableness, a test in which the provisions of the Internal Revenue Code pertaining to charitable gifts by corporations furnish
Chapter 4 Corporate Social Responsibility

Make the Connection
The study of corporate law frequently requires knowledge of the tax code and regulations. For example, corporate directors and officers typically are more likely to approve, and shareholders are less likely to contest, charitable contributions if they are tax deductible, so that the amount of corporate income subject to tax is reduced by the amount of the charitable contribution. Internal Revenue Code § 170(a) generally allows tax deductions for charitable contributions. Today, § 170(b)(2)(A) provides that, with certain limited exceptions: “The total deductions under subsection (a) for any taxable year ... shall not exceed 10 percent of the taxpayer's taxable income.” When Henderson was decided, the limitation on charitable deductions was only 5 percent.

a helpful guide. The gift here under attack was made from gross income and had a value as of the time of giving of $528,000 in a year in which Alexander Dawson, Inc.'s total income was $19,144,229.06, or well within the federal tax deduction limitation of 5% of such income.

The contribution under attack can be said to have “cost” all of the stockholders of Alexander Dawson, Inc. including plaintiff, less than $80,000, or some fifteen cents per dollar of contribution, taking into consideration the federal tax provisions applicable to holding companies as well as the provisions for compulsory distribution of dividends received by such a corporation. In addition, the gift, by reducing Alexander Dawson, Inc.'s reserve for unrealized capital gains taxes by some $130,000, increased the balance sheet net worth of stockholders of the corporate defendant by such amount. It is accordingly obvious, in my opinion, that the relatively small loss of immediate income otherwise payable to plaintiff and the corporate defendant’s other stockholders had it not been for the gift in question, is far out-weighed by the overall benefits flowing from the placing of such gift in channels where it serves to benefit those in need of philanthropic or educational support, thus providing justification for large private holdings, thereby benefiting plaintiff in the long run. Finally, the fact that the interests of the Alexander Dawson Foundation appear to be increasingly directed towards the rehabilitation and education of deprived but deserving young people is peculiarly appropriate in an age when a large segment of youth is alienated even from parents who are not entirely satisfied with our present social and economic system.

On notice, an order in conformity with the holdings of this opinion may be presented.
Points for discussion

1. Relevance of statute.

Notice that the court, while initially reciting the Delaware statute that authorizes corporate charitable giving, does not base its decision on the statute. Instead, the court adopts a rule of “reasonableness” for reviewing corporate giving, even though the statute has no such limitation. Where does the “reasonableness” standard come from?

2. Corporate gifts as profit maximizers.

Corporations frequently cite their own economic interests in justifying corporate gifts. The New Jersey Supreme Court, in *A.P. Smith Manufacturing Co. v. Barlow*, cited above, upheld the corporate gift to Princeton University, citing the company’s argument that the gift arguably advanced its long-run business interests. Would you advise a corporation to make only those gifts that managers believe further the corporation’s long-run business interests? Must the managers quantify how much the charitable contributions will enhance the corporation’s reputation for social responsibility? Should corporations be permitted to make contributions that do not generate demonstrable benefits for the corporation? Put another way, must the corporation limit its activities solely to maximizing profits?

**Take Note!**

How much do corporations give to charities? In its “Giving U.S.A.” annual report for 2002, the American Association of Fundraising Counsel found that total corporate charitable giving (including by corporate foundations) amounted to $12.2 billion. This represented only 5.1% of all charitable giving in the country, and only 1.3% of corporate pretax profits.

By comparison, charitable giving by non-corporate foundations totaled $26.9 billion, or 11.2% of all charitable giving. And giving by individuals, mostly to churches, amounted to $183.7 billion, representing 76.2% of all charitable contributions and 1.8% of personal income.

3. Corporate gifts as social function.

As Professor Berle observed, *Barlow* recognized that “modern directors are not limited to running business enterprise for maximum profit, but are in fact and recognized in law as administrators of a community system.” Is *Henderson* also consistent with this view? Does the corporation owe something to society in exchange for the privileges society makes available, including limited liability for shareholders? State law provides advantages to corporations so they can attract capital. Can corporate philanthropy be seen a kind of repayment for these advantages? If so, should it be required?
4. Corporate gifts as self dealing.

Does the calculus change when corporate charity is tinged with conflicts of interest. For example, suppose a major oil company agrees to donate $50 million to help build an art museum that will house the art collection of the company’s founder and CEO. Is the fairness of the gift subject to review? That is, given the apparent conflict of interest, should a court scrutinize whether the corporation will actually realize $50 million worth of advertising and reputational benefits? Or will it be enough that the gift was considered by a group of independent directors (not financially beholden to the CEO) who concluded the donation was reasonable in light of the company’s revenues and earnings? For Delaware’s answer, see Kahn v. Sullivan, 594 A.2d 48 (Del. 1991) (upholding conclusion by chancery court that charitable donations approved by independent directors are subject to review under business judgment rule).

5. Shareholders decide?

Shareholders generally cannot challenge corporate gifts, given the discretion afforded corporate directors under the business judgment rule, and shareholders have no formal voice in how and in what amounts corporations engage in charitable giving. Some commentators have argued that, after directors decide how much money a corporation will give to charities, shareholders should then be able to select the beneficiaries. Does this seem like a useful solution to the problem of “agents” giving away the money of their “principal”?

6. Disclosure of corporate gifts?

Managers also have broad discretion over charitable contributions because corporations generally are not required to disclose such contributions to shareholders. Securities regulators are reluctant to require such disclosure. As former SEC Chairman, Richard Breeden, has said, “If I were still in government, I would not want to touch the issue of ‘regulating’ corporate philanthropy with a 500 foot pole.” If disclosure rules are unlikely, should corporate law play a more prominent role in making corporate charitable contributions more transparent?

C. Role of Corporate Lawyers in CSR

Now that we have seen how malleable corporate law is toward CSR, we consider the roles of corporate directors in deciding matters of CSR and corporate lawyers in advising corporations on such matters. We start with a modern hypothetical, introduced in an address by Delaware Vice-Chancellor Leo Strine. The hypothetical identifies the challenges facing directors of public corporations...
who must respond to takeovers that potentially benefit the short-term interests of current shareholders at the longer-term expense of other corporate constituents (including shareholders with long-term perspectives). Then we consider the hypothetical case of Exogen, which puts you (as corporate counsel) in the position of advising the board of a multinational corporation and illustrates the challenges posed to corporations with global businesses.

1. Choices in Corporate Takeover

Assume that James Trains is a publicly-traded Delaware corporation that manufactures children’s toys. It started as a family-owned business and went public some 25 years ago. James has plants in four different communities in the midwestern United States. Over the years, James has been generally profitable for its stockholders. At times, however, it has experienced some significant financial challenges. In order to help it through, each of the states in which James operates plants has provided the company with incentive financing packages and tax breaks that have enabled the company to survive tough times. The states have done so because they want to keep the plants open in their communities and because James’ management is known for caring for its workers.

Importantly, by the beginning of the twenty-first century, the toy manufacturing business was consolidating. James was under increasing pressure to generate profits and to maintain the fair wage structure and strong environmental record that had earned it respect in the communities where it had operations. The company also faced some difficulty in manufacturing and marketing its toys efficiently, since it was smaller than many other industry players that could capitalize on economies of scale and other opportunities unavailable to James. Equally important, the company needed to invest in its plants and reduce its cost of capital, which was greater than that of larger concerns in the industry.

Looking to the future, the James board reluctantly concluded that it could not remain independent and hope for its operations to continue to thrive on a long-term basis. Rather, it decided that the company needed to combine with some
other larger entity to secure its future. The board was hopeful that a favorable sale or merger could be realized, because the company’s replica trains, trucks, and cars were well-regarded American staples of high quality. Its brand names alone were valuable.

The James board hired a high-quality investment bank to shop the company and came up with three financially attractive, all-cash bids. The first – an all-cash offer reflecting a 35% premium over the highest price for James stock in the last three years – was from All American Toys, a publicly traded corporation four times the size of James. Descendants of its founders, the Washington family, controlled 75% of its voting stock through a family trust. Like James, All American Toys manufactured high-quality toys in American plants. Its workforce was well-paid and the company had a good reputation for keeping its folks employed even during tough times. Like James, All American Toys was respected in the communities in which it operated and had a good record of environmental compliance.

All American Toys indicated that its intention was to keep all of James’ plants operational and to make the necessary capital investments to maintain their viability. Moreover, its pay structure was such that the James employees could make a transition to its payroll without personal pain. Some of James’ higher-level administrative executives would lose their jobs, but its plant-level employees would be retained.

James received two other all-cash, fully financed bids – both for a 40% premium to market. Toys Of The World was one of the world’s leading toy manufacturers. Although it had distribution facilities in the United States, most of its manufacturing operations were conducted abroad, in nations with weak environmental and labor protection laws. Sadly, Toys Of The World sometimes employed children of the developing world to manufacture toys for export to Western Europe and the United States. The principal value that Toys Of The World saw in James was in its name-brand toys, and it refused to make any promises that it would continue manufacturing in the United States.

The final bid was from Piggy Banks, Inc., which represented a group of financial investors. Piggy Banks proposed a leveraged buy-out (“LBO”) that would result in James taking on a very heavy debt burden. Piggy Banks wanted to keep James’ top management, but was committed to stringent cost reductions (read: job cuts) to ensure that it could repay the debt it had incurred to fund its highly leveraged tender offer.

The James board is comprised of ten persons. Only two are full-time managers. Two are members of the James family, which still owned 18% of the company’s stock. The other six were independent directors, each of whom lived in a community in which James operated.
The investment bankers told the James board they had extracted the best bids they could get, at least until the board selected its favorite, in which case an additional round of (perhaps egoistic) bidding might ensue. The board deliberated long and hard on which bid to select. The directors knew that the bidders were offering cash, not stock, and that the Piggy Bank and Toys Of The World offers were the highest and that both could pay. But it bothered them that a sale to either of the two would end the legacy of James on a sour note.

Moreover, the board had looked at the James shareholder profile carefully. Aside from the James family holdings and the stock owned by employees, institutions that had bought the stock in the past three years primarily held the rest of the company's stock. For them, the All American bid was a premium to any price that James' stock had traded at during that period.

In addition, All American shared the same values that made James such a respected company. Indeed, All American was even going to keep the James name for use in connection with certain of its most established toys, something All American had successfully done in the past. Most importantly, All American had a solid business plan for building high-quality toys at a profit at domestic manufacturing plants with well-paid workers. Its catalogs and retailing efforts dovetailed nicely with sales of its products through more traditional retailers. Thus, a sale to All American seemed to be the fairest to the employees and communities whose efforts had contributed to the company's prosperity. It also seemed to be a good long-term economic move.

By contrast, the board feared that Piggy Bank's business model was a mess. The debt that Piggy Bank had taken on to finance its offer seemed untenably high. The board feared that Piggy Bank either would run the company into bankruptcy or would be forced to bust it up. Nothing about Piggy Bank seemed to bode well for the company's workforce. And of course, Toys Of The World's goal seemed to be clear: buy the value of the company's name brands, keep making them for a time in the current plants without any plan for refurbishment of those facilities, and eventually make them offshore at low cost in nations with bad reputations for labor protection. The directors found this distasteful.

The board counseled with its legal advisors, who told them they were in a straitjacket: they had to accept the highest bid. The two James family representatives on the board got hacked off. "Damn it, we have the biggest stake in this company and we're willing to take less to do the right thing. By God, the rest of you ought to be able to stand up and do the right thing, too." The James board noted that privately held businesses are sold to less-than-the-highest bidders all the time, precisely because their owners feel that the lower bidders will treat employees better and maintain their companies' legacies. Thought the board: "Who hasn't
heard of the owner of a local restaurant, drugstore, or car dealership selling out to his long-time manager rather than to a higher bid from an interloper? Or picking a particular chain to sell to because it treated its workers better than others? Why shouldn’t our stockholders have the opportunity to make the same choice?”

Points for discussion

1. Board response?

How should the directors respond to these three bids? Would you expect directors to assess the bids differently depending on their backgrounds? How should the board weigh the interests of shareholders versus employees? And what about this notion that some shareholders have a short-term perspective, while others have a long-term perspective? If the share price reflects the market’s assessment of the corporation’s future potential, shouldn’t the short-term share price also reflect the value associated with long-term corporate decisions? Finally, are “values” relevant to the decision?

2. Legal advice.

Consider the advice by the lawyers that the company must be sold to the bidder offering the highest price to the shareholders. Is that correct, given the discretion of the board to manage the affairs of the corporation?

When we get to Chapter 27, Antitakeover Devices, we will see that Revlon v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1985) places on boards who have decided to “auction” their company the duty to choose the highest bid, without regard to the effect on other constituencies. Boards still have a good deal of discretion to determine which is the highest bid, particularly when stock is offered or there are other financial contingencies. In the James Trains hypothetical, can the board really be sure that Piggy Bank will be able to close on the deal, given that its business model is a “mess” and its debt burden would be “untenably high”?

3. Relevant law.

There is no shortage of legal sources available that purport to help directors answer these kinds of difficult questions. Consider (below) the ALI Principles of Corporate Governance. Do they provide any guidance in assessing this example or others that raise CSR issues?
(a) Subject to the provisions of Subsection (b), a corporation should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain.

(b) Even if corporate profit and shareholder gain are not thereby enhanced, the corporation, in the conduct of its business:

1. Is obliged, to the same extent as a natural person, to act within the boundaries set by law;

2. May take into account ethical considerations that are reasonably regarded as appropriate to the responsible conduct of business; and

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

COMMENT

e. Corporate objective and corporate conduct. These Principles take as a basic proposition that a business corporation should have as its objective the conduct of such activities with a view to enhancing corporate profit and shareholder gain. This objective, which will hereafter be referred to as “the economic objective,” is embodied in Subsection (a). The basic proposition is qualified in the manner stated in Subsection (b), which speaks to the conduct of the corporation. The provisions of Subsection (b) reflect a recognition that the corporation is a social as well as an economic institution, and accordingly that its pursuit of the economic objective must be constrained by social imperatives and may be qualified by social needs.

f. The economic objective. In very general terms, Subsection (a) may be thought of as a broad injunction to enhance economic returns, while Subsection (b) makes clear that certain kinds of conduct must or may be pursued whether or not they enhance such returns (that is, even if the conduct either yields no economic return or entails a net economic loss). In most cases, however, the kinds of conduct described in Subsection (b) could be pursued even under the principle embodied in Subsection (a). Such conduct will usually be consistent with economic self-interest, because the principle embodied in Subsection (a)—that the objective of the corporation is to conduct business activities with a view to enhancing corporate profit and shareholder gain—does not mean that the objective of the corporation must be to realize corporate profit and shareholder gain in the short run.
Chapter 4  Corporate Social Responsibility

2. Legal Arbitrage in Multinational Corporation

Assume that you are an outside director of (fictitious) Exogen, a company that manufactures components for automobile engines. One of the solvents used in the manufacturing process, Durasol, has been implicated as a potential carcinogen in recent scientific studies. The data from this research is consistent with internal information and reports by Exogen scientists about the dangers of Durasol. The Occupational Health and Safety Administration (OSHA) has begun to consider the possibility of banning the use of Durasol because of its effect on workers who breathe in its fumes. OSHA officials have approached the company about the possibility of voluntarily discontinuing the use of the solvent.

Exogen officials privately have concluded that they eventually will have to discontinue the use of Durasol. The Occupational Health and Safety Administration (OSHA) has begun to consider the possibility of banning the use of Durasol because of its effect on workers who breathe in its fumes. OSHA officials have approached the company about the possibility of voluntarily discontinuing the use of the solvent.

Indeed, the contrary is true: long-run profitability and shareholder gain are at the core of the economic objective. Activity that entails a short-run cost to achieve an appropriately greater long-run profit is therefore not a departure from the economic objective. An orientation toward lawful, ethical, and public-spirited activity will normally fall within this description. The modern corporation by its nature creates interdependencies with a variety of groups with whom the corporation has a legitimate concern, such as employees, customers, suppliers, and members of the communities in which the corporation operates. The long-term profitability of the corporation generally depends on meeting the fair expectations of such groups. Short-term profits may properly be subordinated to recognition that responsible maintenance of these interdependencies is likely to contribute to long-term profitability and shareholder gain. The corporation's business may be conducted accordingly.
leniently than does the United States, and Exogen would be able to use Durasol in its operations there. If the company could delay OSHA efforts to ban the solvent for three years, Exogen would be able to sustain its profits by continuing to use Durasol in its United States plants during that period. At the end of that time, its major manufacturing activities would take place in Indonesia, where it would not have to worry about the OSHA ban.

Company officials have considered a legal campaign that could accomplish this goal. First, rather than voluntarily cease using Durasol, Exogen could insist that OSHA institute formal procedures to prohibit use of the solvent. This would require hearings, the opportunity for Exogen to present data that question whether the harms of Durasol have been adequately established, the chance to respond to adverse testimony, and other elaborate procedural measures.

Next, Exogen has learned that the daughter of the OSHA official who would play a major role in the OSHA proceedings works for an insurance subsidiary of Panoply Corporation. Panoply is a multinational holding company that has just purchased a small corporation that manufactures a solvent that some companies might use if Durasol were banned. Exogen plans to hold on to this information until OSHA formally prohibits use of Durasol, then challenge the OSHA action on the ground that the lead agency official has a conflict of interest because of his daughter’s employment with Panoply.

Finally, even if it loses, Exogen could appeal to the U.S. Court of Appeals and, if necessary, seek review by the Supreme Court. All these steps would likely delay OSHA prohibition of Durasol for about three years.

Points for discussion

1. Ethics vs. legality.

   How would you advise that the board to proceed? Is anything illegal about what the company is proposing to do – under U.S. law or Indonesian law? If the company voluntarily discontinues use of Durasol, is there any way it can compel its competitors to do the same? What might be the advantages for the company to discontinue its use of Durasol? Should the board be concerned only about legalities or also about ethics?

2. Who is the client?

   As corporate attorney, your client is the corporation. What is your role as corporate attorney? May you raise ethical considerations beyond what is required by law? Or is your role to merely advise the company on legal matters and present
to the company its legal options? Does your role vary according to whether the company embraces CSR principles?