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# Corporations

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# WASHINGTON LEGISLATION—1953

In this series of articles, the faculty of the University of Washington School of Law analyzes the enactments of the Thirty-third Session of the Washington State Legislature. Coverage is limited to those statutes having the greatest significance to the practicing lawyer.

## CIVIL RIGHTS

*Racial Discrimination.* The 1909 statute[1] forbidding denial of service, etc., at "places of public resort" because of "race, creed, or color," has been amended[2] by providing very broad definitions of all its terms, definitions which, however, are no broader than could reasonably be given the general terms of the original statute.[3] The legislature failed to provide a civil remedy to redress the private injury, which remedy would probably be a more potent deterrent than the threat of criminal prosecution for a misdemeanor, the sanction provided. The courts had created a tort remedy to implement the old statue.[4] It is to be hoped that the new statute will not be construed as an implied legislative repudiation of this judicial invention.

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[1] RCW 9.91.010 [RRS § 2686].
[2] L. 1953, c. 87.
[3] In fact, the older statute had, because it was a criminal statute, been rather narrowly construed, even in civil litigation. *See* Goff v. Savage, 122 Wash. 194, 210 Pac. 374 (1922).
[4] Anderson v. Pantages Theatre Co., 114 Wash. 24, 194 Pac. 813 (1921).

## CORPORATIONS

*Corporate Charitable Contributions.* The Washington state legislature in its 1953 session adopted an act specifically authorizing corpora-

tions to make contributions for charitable and other public purposes.[1] By this action Washington joins an ever increasing number of states which have enacted similar legislation.[2]

Although the Supreme Court of Washington has not had occasion to rule upon the propriety of charitable or similar contributions by corporations in the absence of such statutory authorization, it is most probable that it would in large measure have recognized the propriety of such corporate action without the aid of the statute. It is common knowledge that present day corporations do contribute substantially to the support of charitable and public enterprises and of recent years the legality of such contributions has not been seriously challenged.[3] Nevertheless, legal advisers to corporations are, in the absence of statutory authorization, confronted by some doubts as to legality of such contributions, particularly where no *direct* benefit to the corporation is demonstrable.

The historic and current rules on the subject have been thoroughly reviewed in three articles published in the American Bar Association Journal in 1952.[4] In view of the comprehensive treatment of the subject in those articles, a detailed survey of the problem here would be largely repetitive. In general, however, the problem involves the *ultra vires* doctrine. In the early history of the modern business corporation, there was much litigation concerning corporate action which was asserted to be invalid because it was beyond the purposes and powers of the corporation. The courts were disposed to take a narrow view of the proper scope of corporate activity [5] Action not directly related to the business operations of the corporation was frequently enjoined or declared unenforceable by or against the corporation. By the same line of reasoning, corporate expenditures which were not directly designed

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[1] L. 1953, c. 213.

[2] Bleicken, *Corporate Contributions to Charities· The Modern Rule,* 38 A.B.A. JOURNAL 999 (1952) cites statutes of twenty-four states and Hawaii which in varying terms authorize charitable contributions by corporations.

[3] Sec. 23 (q) of the Internal Revenue Code permits a corporation to deduct charitable contributions up to five per cent of the corporation's net income in computing its income tax.

[4] Bleicken, *Corporate Contributions to Charities· The Modern Rule,* 38 A.B.A. JOURNAL 999 (1952), Bell, *Corporation Support of Education—The Legal Basis,* 38 A.B.A. JOURNAL 119 (1952), de Capriles and Garrett, *Legality of Corporate Support to Education. A Survey of Current Development,* 38 A.B.A. JOURNAL 209 (1952). See also Cousens, *How Far Corporations May Contribute to Charity,* 35 Va. L. REV. 401 (1949).

[5] An excellent example of the extremely strict views of an earlier period is Davis v. Old Colony Railroad Co., 131 Mass. 248, 41 Am. Rep. 221 (1881) where it was held that the railroad could not contribute to the support of a World Peace Jubilee and International Music Festival to be held in Boston, even though it appeared that patronage of the railroad might be increased by the holding of these events.

to produce corporate income were declared improper. Even as late as a generation ago, the study of corporate law was concerned in substantial part with the *ultra vires* doctrine. At the present time, however, the *ultra vires* doctrine has declined in practical importance until it has become a mere shadow of its former self.

The reasons for the decline of the doctrine are several. The disposition of present day corporate draftsmen is to broaden the statement of corporate purposes so as to permit a much wider variety of activities than was indicated by the charters issued by state legislatures or obtained under earlier general incorporation statutes. It is, however, doubtful if this practice has done much to meet the charitable or public contribution problem, since charter provisions specifically dealing with that subject are seldom encountered. The real inroads on the *ultra vires* doctrine so far as this specific problem is concerned have come from a general change in judicial and popular views of the proper range of corporate activity. More and more the courts have extended the concept of implied corporate powers and, more to the point, recognized that the welfare of the general community is a matter of interest and importance to the corporation which operates within it. In effect the modern judicial attitude is a paraphrase of the recently widely quoted statement of Mr. Charles E. Wilson, the Secretary of Defense, to the effect that what is good for General Motors is good for the country. The judicial praraphrases would be that what is good for the community is beneficial to the corporation.

There have of course always been and will continue to be contributions by coporations which, although broadly classified as charitable, are in fact quite directly related to the business activities of the corporation. For example, contributions by General Electric Company toward research or even general study in schools of electrical engineering bear such a patent relationship to the corporate business as to satisfy all but the most technical advocates of a rigid *ultra vires* rule. When, however, no such direct relationship exists as, for example, when the same corporation contributes to the support of a college generally, or to its department of philosophy, or to a children's hospital or to the community fund, a larger view of corporate functions and permissible activities is necessary. Although custom has long since vindicated financial contributions in some of these areas, community fund contributions, for example, doubts have remained as the possibility of

demonstrating apparent corporate benefits becomes more remote. The statute is designed to remove those doubts.

Parenthetically it should be observed that such concern as may have been felt by corporate directors and their advisers is not entirely limited to the *ultra vires* problem. Even assuming that the court might hold a particular contribution to be *intra vires*, there is always the possibility of adverse criticism by corporate shareholders as to the wisdom of he contribution both as to amount and the recipient.

For the most part, statutory enactments authorizing contributions have been quite brief. The Washington statute, on the contrary is quite detailed.[6] The act (1) declares that charitable contributions made in accordance therewith are a valid and proper use of corporate funds and are approved as a matter of public policy unless forbidden by express charter provision, (2) states that such contributions shall be deemed to inure to the benefit of the corporation and its shareholders; (3) authorizes contributions "from surplus or reserve funds" of such amounts as the directors may deem proper; (4) names as eligible recipients the United States or any territory or possession thereof, any state or political subdivision thereof or any corporation, community chest fund or foundation organized for religious, charitable, scientific, literary or educational purposes; (5) limits contributions to any governmental recipient to those made for "public purposes", (6) specifies that private recipients must be non-profit organizations not substantially engaged in "carrying on propaganda or otherwise attempting to influence legislation", (7) validates prior gifts as fully as those made after the effective date of the statute.

The limitation of the power to "surplus and reserve funds" is of some importance. The use of these terms is perhaps unfortunate from a technical standpoint. Legislatures have historically been prone to use similar vague expressions in prescribing the conditions under which corporations may lawfully pay dividends. The basic purpose of such statutes is to permit corporate distributions to shareholders only to the extent that the value of the assets exceeds debts owing to third persons plus the liability attributable to issued stock. Statutes attempting to establish such a formula employ such terms as "surplus," "surplus profits," "net earnings," "net profits," or approach the matter negatively by forbidding payment where the effect would be to "impair capital." Al-

[6] Note 1 *supra*. The Washington statute, in substantial part, appears to have been patterned on Sec. 23 (q) of the Internal Revenue Code, note 3 *supra*, although there are substantial differences between the two statutes.

though the same fundamental idea runs through all of these words or phrases, litigation inevitably arises in which some peculiar significance is asserted to rest in the particular language used. The Washington statute on dividends is quite detailed and specifies the conditions under which dividends may be paid with considerable certainty.[7] If, as appears probable, the charitable contributions statute has the same motivation, it would have been preferable to define the conditions for making such contributions by reference to the dividend statute. In all probability, however, the courts will reach the same result under the statute as drawn. It is to be hoped that the use of the words "reserve" in addition to "surplus" will not be interpreted to justify payments to the extent of "reserves" created for other specific purposes.

Although the statute, read literally, purports to validate all charitable contributions to designated classes of recipients up to the amount of "surplus and reserve funds," it probably goes no farther than to overcome the possibility of *ultra vires* attacks. Certainly directors still should be required to strike some reasonable balance between dividends and charitable contributions. It would be totally alien to the modern concept of corporate contributions to charity to permit the directors to pay all or the lion's share of corporate surplus to charity. To do so would convert a commercial enterprise into an eleemosynary one. The familiar limitation of resonableness must be read into the statute. The real purpose of the act is to relieve the directors of the necessity of showing some direct connection between the contribution and the business in which the corporation is engaged.

It may also be doubted whether the act will permit directors to favor charities in which they have strong personal interests to the exclusion of others. It takes no great imagination to envision shareholder complaint concerning contributions restricted to some particular charity in which the directors or their wives have an intense personal interest not shared by the shareholders generally. Some diversification of contributions would no doubt be indicated where such objection appears probable.

In the final analysis, the act is designed to aid solicitors for those charities which have, in the past, encountered some resistance because their projects, though worthy, have no direct connection with a particular corporate enterprise. They can no longer be turned down with the answer that the corporation would like to contribute but that it would

[7] RCW 23.24.020, 23.24.030, 23.24.040 [RRS § 3803-24].

be contrary to law for it to give to a particular charity, because its activities bear no resemblance to the corporate business. Boards of directors are now assured that the type of charity is of no moment, so long as the recipient meets the general statutory standards. The children's hospital, the liberal arts college and the humane society are qualified to receive charitable contributions from corporations whose business enterprises may be restricted to the manufacture of rubber tires or cosmetics or nuts and bolts. Whether such corporations are to contribute to such charities is, within reasonable limitations as to amount, a matter of director discretion unfettered by the ultra vires doctrine.

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## CREDITORS' RIGHTS

*Labor Liens—Restaurant, Hotel, Tavern, Etc. Employees.* Chapter 205 gives to persons performing labor in the operation of "any restaurant, hotel, tavern, or other place of business engaged in the selling of prepared foods or drinks, or any hotel service employee" a lien on the earnings of and the property used in the operation of, the "said business." It will require litigation to determine precisely what business institutions fall within the statutory coverage. The reference to restaurants and taverns is clear enough. The reference to "hotel—or any hotel service employee" is unclear. Does it mean that all hotel employees are beneficiaries of the statute, or only those engaged in "service" employment or employment concerned with the selling of food or drink?

The statutory language "or other place of business engaged in the selling of prepared foods or drinks" is a particularly fruitful source of controversy The statute does not read "engaged solely in the selling", it refers to hotels, whose food and drink dispensing business is but a part of the overall activity. What of other institutions a part of whose operations is the sale of food or drinks? The usual so-called "drug" store is an example. So is the department store or other mercantile establishment which operates a soda fountain, lunch counter or dining room. So is the establishment which operates a cafeteria for its employees. What of the business institution on whose premises a food or drink vending machine is situated?

That counsel who represents employees of employers like these will claim the benefits of the statute for their clients would seem fairly certain. Employees of establishments like grocery stores, markets and baked goods shops may be tempted too, since these sell food and possi-