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LEGISLATURES, COURTS AND THE SEC: REFLECTIONS ON SILENCE AND POWER IN CORPORATE AND SECURITIES LAW

FAITH STEVELMAN KAHN*

A major focus of this essay¹ is the corporate law governing corporate charitable giving.² The essay begins by comparing the states' modern corporate philanthropy laws to the laws which existed in the first half of the twentieth century. As this historical comparison reveals, the modern laws have conferred extraordinary power and discretionary authority on individual corporate officers and boards of directors. In particular, the modern laws have afforded corporate managers³ discretion to alienate corporate assets for philanthropic purposes independent of commercial objectives. This discretionary authority is unique within corporate law, and it fits uncomfortably alongside the profit-driven, shareholder-centered principles characteristic of this body of law.⁴

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1. This essay represents a reconsideration of certain matters discussed in my article, *Pandora's Box: Managerial Discretion and the Problem of Corporate Philanthropy*, 44 UCLA L. REV. 579 (1997) [hereinafter Kahn, *Corporate Philanthropy*], as well as my first treatment of certain related issues.

2. The observations in this essay are confined to philanthropically motivated contributions by corporations, that is, those which are not principally motivated by the objective of maximizing corporate profit. This category includes all corporate donations which are properly deducted under § 170 of the Internal Revenue Code, since only those contributions made without the expectation of receiving a commensurate benefit qualify for deductibility thereunder. In 1996, United States corporations deducted nearly \$8.5 billion of charitable gifts under § 170. See AAFRC TRUST FOR PHILANTHROPY, GIVING USA 1997: THE ANNUAL REPORT ON PHILANTHROPY FOR THE YEAR 1996, at 94 (1997) [hereinafter GIVING USA 1997]. (All references to the Code, unless otherwise specified, are to the Internal Revenue Code of 1986, as amended, I.R.C. § 1-9722 (the "Code" or the "Tax Code")). For additional recent data on corporate charitable contributions, see David R. Morgan, *Trends in Corporate Charitable Contributions*, 41 N.Y.L. SCH. L. REV. 771 (1997).

3. The term is used herein to describe senior corporate officers and directors collectively.

4. See FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (1991). The view that corporation law is fundamentally economic and "private" in nature is widely accepted in mainstream corporate legal scholarship. For commentary on this point, and description of the efforts of "progressive" corporate legal scholars to broaden the discourse, see Carl Landauer, Book Review, 84 CAL. L. REV. 1693 (1996); Paul N. Cox, *The Public, the Private and the Corporation*, 80 MARQ. L. REV. 391 (1997); see also *infra* note 87.

But the modern philanthropy laws are also remarkable for the fact that their significance is barely discernable from their language. The modern laws, in sharp contrast to their historical antecedents, represent facially unremarkable affirmations of corporate charitable power.⁵ Their significance arises primarily from what they fail to say, and from the limits and requirements which they fail to impose. Thus, in promulgating these laws, the state legislatures have established a system under which corporate managers may give away seemingly unlimited amounts of corporate capital for charitable purposes, and they have done so without having to be entirely explicit or candid about the dramatic changes which they effectuated. In leaving most of the hard questions in the area unaddressed, these laws reflect a kind of failure of responsibility on the part of the legislatures.

The second section of the essay focuses on the judicial dilemma posed by the silence in the philanthropy laws. Because state legislatures have elected not to define the appropriate objectives, limitations, and decisional processes which should pertain to corporations' charitable contributions, they have left the courts in the predicament of either "doing too much" or "doing too little" in adopting standards to resolve disputes over particular contributions. In the face of this difficulty (consistent with accepted norms of judicial power), the courts have elected the latter, safer course—with certain important variations. While in the most recent charitable contributions case, the Delaware Chancery and Supreme Courts applied the traditional norms of corporate law adjudication—the business judgment rule and the principle of fiduciary care—this approach is highly problematic. Corporate charitable contributions cannot appropriately be judged according to these traditional, commercially-oriented standards. The same courts have also endorsed a loose standard of "reasonableness" in reviewing corporate contributions, a standard given content by the application of federal income tax principles. As discussed below, this latter approach succeeds in taking account of the extra-commercial character of corporate charitable contributions, but it also reflects the conceptual limits of traditional corporate law.

The third section of the essay addresses problems of silence and disclosure in the federal securities regulations. The point of departure is the fact that there is no disclosure requirement pertaining to corporate charitable contributions under state corporate law, the federal securities regulations or any other system of law or regulation. The absence of such a reporting requirement has compromised shareholders' property interests, as well as other, nonpecuniary shareholder interests.⁶ Moreover, the absence of a contributions disclosure requirement raises the larger question

5. See *infra* Part I.

6. See Kahn, *Corporate Philanthropy*, *supra* note 1.

of what other information is missing from the universe of SEC-mandated disclosure. In addition to charitable contributions, this unreported information includes most data regarding corporate political contributions and corporate conduct affecting employees, the environment, and product safety. These gaps exist despite the fact that in Section 14(a) of the Securities Act of 1934⁷ (and in other provisions of the Securities Acts),⁸ Congress has given the SEC a mandate to promulgate rules "in the public interest or for the protection of investors." Thus, Congress has left the SEC with substantial discretion to determine the scope of required corporate disclosure, but while the SEC has exercised its authority to require public corporations to disclose extensive financial and commercial information, it has declined to require disclosure of information it considers primarily of social significance rather than direct economic significance to investors.

In addition, like the normative, political dimensions of the modern corporate philanthropy laws, the normative, political dimensions of the SEC's disclosure policies are not express in the securities regulations themselves, and hence are not readily apparent. Indeed, in the rare instance where the SEC has addressed the question of the proper boundaries of required corporate disclosure, it has defended its reluctance to expand the current disclosure mandates (and therefore shareholder power in matters of corporate social policy) in terms of maintaining the neutrality and objectivity of the Commission and of the investment process generally. The final section of the essay criticizes the notion of neutrality put forward by the SEC and argues that the Commission should expand shareholders' ability to obtain information about corporate conduct affecting matters of social policy.⁹

7. See 15 U.S.C. § 78n(a) (1994); see generally Securities Exchange Act of 1934, ch. 404, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a-78ll (1994)) [hereinafter the '34 Act]. The Securities Act of 1933, ch. 38, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a-77aa (1994)) [hereinafter the '33 Act], and the '34 Act are referred to collectively in the text as the "Securities Acts" or the "Securities Laws."

8. See '33 Act, §§ 7, 10(c), 15 U.S.C. §§ 77g, 77(c) (1994); '34 Act, §§ 10(b), 12(b)(1), 14(a), 15 U.S.C. §§ 78j(b), 78l(b)(1), 78n(a) (1994).

9. Outside of the area of shareholder proposals, there has been relatively little commentary on the normative dimensions of the SEC's rules. An exception is Jill E. Fisch, *From Legitimacy to Logic: Reconstructing Proxy Regulation*, 46 VAND. L. REV. 1129 (1993); see also Russell B. Stevenson, Jr., *The SEC and the New Disclosure*, 62 CORNELL L. REV. 50 (1976).

I. LEGISLATIVE SILENCE AND THE ENLARGEMENT OF MANAGERIAL POWER: THE MODERN PHILANTHROPY STATUTES

Each of the states has enacted a statutory provision authorizing corporations to make charitable contributions. Most of the laws presently in force are modeled on the corporate philanthropy provision first proposed by a committee of the American Bar Association ("ABA") in 1948,¹⁰ and codified as Section 4(m) of the ABA's Model Business Corporation Act of 1950.¹¹ The Model Act's philanthropy provision was a streamlined affirmation of corporate charitable authority. It provided, in pertinent part, that "[e]ach corporation shall have power . . . [t]o make donations for the public welfare or for charitable, scientific or educational purposes."¹² In fact, it was the uncompromising simplicity of the Model Act's corporate philanthropy provision that made it, and still makes it—in the various formulations adopted by the states—so revolutionary.

The radically simplified nature of the Model Act's philanthropy provision—and, thus, the modern laws which represent its progeny—becomes obvious when viewed in historical perspective. Prior to the publication of the Model Act, several states had enacted statutory provisions governing corporate charitable giving.¹³ These first generation corporate philanthropy laws¹⁴ were largely a response to the uncertainty

10. Ray Garrett, who in 1948 was Chairman of the ABA's Committee on Business Corporations (shortly thereafter renamed the Committee on Corporate Laws), was instrumental in leading a movement for widespread liberalization of the states' corporate philanthropy laws. He expressed his strong views on the merits of expanded corporate charitable authority and increased corporate giving in his 1948 address to the Annual Meeting of the Section of Corporation, Banking and Mercantile (subsequently "Business") Law. See Ray Garrett, *Corporate Donations to Charity*, 4 BUS. LAW. 30 (1948) (presenting the full text of the address). The members of this ABA subcommittee were largely responsible for the first draft of the Model Business Corporation Act (which included the unrestrictive philanthropy provision). The Model Act was completed in 1946, but first widely publicized in 1950.

11. See MODEL BUS. CORP. ACT § 4(m) (1971).

12. *Id.*

13. In his 1948 address to the ABA, Ray Garrett indicated that as of that date 15 states and the Territory of Hawaii had enacted some form of statutory authorization for corporate charitable contributions. See Garrett, *supra* note 10, at 31.

14. In 1952, two years after the publication of the ABA's model philanthropy provision, F. Emerson Andrews published the first comprehensive treatment of corporate charitable giving. As part of his work, Andrews compiled a statutory appendix which set forth the states' philanthropy provisions, as well as laws which had previously been amended or repealed. See F. EMERSON ANDREWS, CORPORATION GIVING app. C (1952). Andrews' Appendix C provides the basis of my statutory analysis of the early philanthropy laws. For full citation to these earlier laws, the reader is directed to

regarding corporate charitable authority; their most obvious function was to codify this authority. The legal uncertainty regarding corporate power to make charitable gifts in the absence of statutory authorization stemmed from the notion of "defined," that is, circumscribed corporate powers, referred to as the "*ultra vires*" doctrine.¹⁵ The *ultra vires* doctrine strictly limited corporate powers to those expressly sanctioned by law and, consistent therewith, provided for in the corporation's charter. Thus, the earliest, most fundamental problem of legal authority in the area of corporate charitable giving was whether the institution itself, apart from its agents, had the power to make charitable gifts. Silence in the early corporate statutes led, uniquely, to a denial of corporate (and thus managerial) authority to make charitable contributions.

While the early philanthropy laws were entirely permissive in certain states,¹⁶ in most the laws went beyond resolving the general issue of the corporate entity's authority *vis a vis* the state, and imposed a multiplicity of substantive and procedural restrictions on corporate charitable giving. In order to balance this expanded managerial authority with the protection of shareholders' property interests, these prescriptive laws attempted to delimit the precise nature of the charitable authority afforded corporate boards. In particular, states frequently required board of director approval of contributions,¹⁷ and two states expressly provided for shareholder

Andrews' work. The early philanthropy laws are identified herein by state and by the date of their enactment.

15. Until the early 1950s, the cases and commentaries on corporate charitable giving focused almost exclusively on the *ultra vires* issue, which still figured prominently in the landmark case of *A.P. Smith Manufacturing Co. v. Barlow*, decided by the New Jersey Supreme Court in 1953. *See A.P. Smith Mfg. Co. v. Barlow*, 98 A.2d 581 (N.J. 1953). For further discussion of the *ultra vires* issue in the context of corporate philanthropy, see Kahn, *Corporate Philanthropy*, *supra* note 1, at 594-95 nn.58-61.

16. The following states enacted unqualified philanthropy laws prior to the mid to late 1940s: Illinois (1919, but confined to war-time donations); Michigan (1935); New Mexico (1941); and Texas (1917). *See ANDREWS, supra* note 14, at 295, 299, 303, 314.

17. As of 1952 (two years after the initial publication of the Model Act and the year of *Corporation Giving's* publication), of the 26 states which had enacted charitable contributions provisions, 15 states expressly required that a company's board of directors approve the gifts. These states included: Colorado, (1947); Indiana, (1949); Kansas, (1951); Maryland, (1945); Massachusetts, (1933); Minnesota, (1949); New Jersey, (1930); New York, (1931); North Carolina, (1945); Ohio, (1920); Oklahoma, (1949); Pennsylvania, (1945); Tennessee, (1925); Virginia, (1945); and West Virginia, (1949). *See id.* at 293-315. Delaware adopted the language of the Model Act, thus repealing the requirement of board approval, in 1951. *See id.* at 294-95.

approval.¹⁸ In addition, certain states imposed quantitative limits on the size of the gifts within the board's discretion;¹⁹ geographic limits pertaining to acceptable charitable beneficiaries;²⁰ limits tying corporate contributions to corporate "purposes" or "interests";²¹ and, in two instances, express disclosure requirements.²² In these more prescriptive

18. Hawaii's law (1947) required the approval of the holders of a majority of the stock of the corporation to approve contributions. *See id.* at 316. Pennsylvania's law (1945) provided for board control over contributions, unless otherwise specifically provided "by resolution duly adopted by its shareholders." *Id.* at 311.

19. New Jersey's law, enacted in 1930 (and still in effect in 1952), provided as follows:

When, however, . . . the expenditures for those purposes in any calendar year shall in the aggregate amount to one per centum (1%) of the capital and surplus as of the end of the preceding year, then before any further expenditure is made during the year for those purposes by the corporation, ten days' notice shall be given to the stockholders in the manner the directors or trustees direct, of the intention to make the further expenditure, specifying the amount thereof, and if written objections be made by the stockholders holding twenty-five per centum (25%) or more of the stock of the corporation the further expenditure shall not be made until it has been authorized at a stockholders' meeting.

Id. at 301. This law was repealed in 1968. Ohio's law, enacted in 1920 (and also still in effect in 1952), included an analogous provision. *See id.* at 309. In 1918 New York enacted a war-time contributions provision which included this type of quantitative limit. *See id.* at 305-06. North Carolina's law, enacted in 1945, imposed an absolute upper limit of five percent of net income on contributions (which were also subject to board approval). *See id.* at 308-09.

20. Such geographic limits imposed a loose version of the common law benefit-to-the-business requirement. Massachusetts' law (1933) provided for donations to charities formed for the purpose of improving "social and economic conditions . . . in any community in which such corporation is doing business." *Id.* at 298. New York's law (1931) provided for contributions to charities operating "in any community or communities in which such corporation is operating." *Id.* at 306.

21. New Jersey (1930), Ohio (1920), and Delaware (enacted 1941, repealed 1951). *See id.* at 295, 301, 309. New York's laws had persistently included such a benefit-to-the-business requirement. In 1952, New York's laws provided for contributions as "may be beneficial to the business activities of the corporation or the well being of its employees." *Id.* at 304.

22. In 1950 New York amended its philanthropy law to add the following requirement:

A domestic corporation which submits an annual report to its stockholders and which, pursuant to the authority of this section, appropriates, spends or contributes a sum or sums aggregating in excess of five hundred dollars to or on behalf of any one donee, during the period covered by such report, shall include in such report the identity of each such donee together with the total amount appropriated, spent or contributed to it or on its behalf during such period. If such corporation does not submit such an annual report

formulations, the problem of legal authority was transmuted from the issue of institutional constraints to one addressing the authority of the corporate agent (the board of directors) *vis a vis* the principal (the shareholders).

Beginning in 1948, outspoken members of the American Bar Association's Committee on Business Corporations,²³ in conjunction with various community chests and other nonprofit leaders,²⁴ campaigned vigorously in favor of the widespread adoption of unrestricted philanthropy provisions by the state legislatures. The Committee "sent to all secretaries of state and state bar association presidents a memorandum embodying its opinion that corporate giving had the general approval of management and stockholders and that it should be expressly authorized by statute."²⁵ Whether or not stockholders (as opposed to corporate

to its stockholders it shall send to each one a statement of the total amount of all such appropriations, expenditures and contributions made during each fiscal year and any stockholder, upon written request, shall be entitled to an itemized list of such donees and amounts. The corporation need not comply with such a request regarding any year more than five years prior to that in which such request is made.

Id. at 307. The disclosure requirement was repealed the following year.

Beginning in 1920, Ohio's law provided that all corporations making charitable contributions "report annually to the Secretary of State the sums so appropriated or expended and the name or names of the community funds or philanthropic, charitable or benevolent instrumentalities in whose behalf such sums were appropriated or expended."

Id. at 310. Ohio's disclosure requirement was repealed in 1927. *See id.*

23. In addition to Ray Garrett—Chairman of the ABA Committee which produced the 1950 Model Business Corporation Act, author of the Model Act's preface and of the 1948 "call to arms" exhorting liberalization of the states' philanthropy laws (*see* Garrett, *supra* note 10)—another outspoken member of the ABA Committee on Corporate Laws was Prof. E. Merrick Dodd, of Harvard Law School. Along with Garrett, Dodd was also involved in drafting the first Model Business Corporation Act. *See* Preface to 1950 Revision of Model Business Corporation Act Prepared by the Committee on Corporate Laws, Section on Corporation, Banking and Business Law of the American Bar Association, in Joint Legislative Committee to Study Revision of Corporation Laws, Interim Report to 1957 Session of New York State Legislature, app. H [hereinafter 1957 Interim Report] (listing Dodd as one of the authors). Dodd's favorable view of corporate social spending was made famous in a series of essays he exchanged with Prof. Adolf A. Berle. *See* E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932); *see also* E. Merrick Dodd, Jr., *Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable?*, 2 U. CHI. L. REV. 194 (1934-1935).

24. The involvement of community nonprofit leaders in this effort is described, though cursorily, in ANDREWS, *supra* note 14, at 234-35; *see also* Burt S. Prunty, Jr., *Love and the Business Corporation*, 46 VA. L. REV. 467, 470-71 (1960).

25. Miguel A. de Capriles & Ray Garrett Jr., *Legality of Corporate Support to Education: A Survey of Current Developments*, 38 A.B.A. J. 209, 211 (1952).

managers, nonprofit leaders, and lawyers' organizations²⁶) actually endorsed expanded corporate giving, this activism on the part of the bar,²⁷ including the unrestrictive philanthropy provision incorporated in the Model Business Corporation Act, proved highly influential with the legislatures.

From the late 1940s and early 1950s onward, the states codified the death of the common law benefit requirement,²⁸ and, at the same time, effectuated the comprehensive deregulation of the law of corporate charitable giving. Section 122(9) of Delaware's General Corporation Law, which was enacted (in substance) in 1951, precisely mirrors the sparse terms of the Model Act. It currently provides, simply, that "Every corporation . . . shall have power to . . . [m]ake donations for the public welfare or for charitable, scientific or educational purposes"²⁹ Section 202(a)(12) of New York's Business Corporation Law, enacted in 1961, provides under the heading "General Powers," that "[e]ach corporation . . . shall have power . . . [t]o make donations, *irrespective of corporate benefit*, for the public welfare or for community fund, hospital, charitable, educational, scientific, civic or similar purposes"³⁰ The philanthropy provisions in the other forty-eight states vary in

26. While the ABA Committee's memorandum to the secretaries of state expressed "its opinion" that increased giving enjoyed stockholder approval, there is no evidence of data supporting its conclusion.

27. For example, in February 1957, in its reponse to a questionnaire distributed by the Joint Legislative Committee to Study Revision of Corporation Laws, the New York City Bar Association's Committee on Corporate Law expressed its displeasure with New York's prescriptive philanthropy provision. See 1957 Interim Report, *supra* note 23, at app. G (containing the questionnaire and the City Bar's response). In its Second Interim Report, the Joint Legislative Committee noted that "[i]n the opinion of some organizations, the present New York law is too restrictive" Joint Legislative Committee to Study Revision of Corporation Laws, Second Interim Report to 1958 Session of New York State Legislature, app. A at 48 (emphasis added) [hereinafter 1958 Interim Report].

28. The lingering influence of the common law benefit-to-the business requirement, and its chilling effect on increased national giving in support of higher education, is described by de Capriles and Garrett in an essay in the ABA's Journal, published in 1952. These lawyers exhorted their colleagues to consider the "professional importance" of reviewing the "legal obstructions to this highly desirable development" of increased corporate support of higher education. See de Capriles & Garrett, *supra* note 25, at 210. They argued that "the solution, of course, should come through statutes." *Id.* at 211.

29. DEL. CODE ANN. tit. 8, § 122(9) (1993).

30. N.Y. BUS. CORP. LAW § 202(a)(12) (McKinney 1994) (emphasis added).

only minor detail from those of New York and Delaware quoted above.³¹ Nearly without exception, terms mandating the proper size, objectives, and decisional processes appropriate to corporate charitable contributions have

31. Twenty-three states and the District of Columbia have provisions which are nearly identical to Delaware's. These states include: Alabama, Alaska, Arizona, Arkansas (except requires board approval of charitable contributions), Connecticut, Hawaii, Idaho, Kansas, Louisiana, Maryland (except requires board approval of charitable contributions), Michigan, Missouri, Nebraska, Nevada, New Mexico, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Dakota, Texas and West Virginia. See ALA. CODE § 10-2B-3.02(13) (1994); ALASKA STAT. § 10.06.010(13) (Michie 1996); ARIZ. REV. STAT. ANN. § 10-004(A)(13) (repealed 1996); ARK. CODE ANN. § 4-25-103 (Michie 1991); CONN. GEN. STAT. ANN. § 33-291(d) (West 1987); HAW. REV. STAT. § 415-4(13) (1993); IDAHO CODE § 30-1-4(m) (1996); 805 ILL. COMP. STAT. ANN. 5/3.10(m) (West 1993); KAN. STAT. ANN. § 17-6102(9) (1995); LA. REV. STAT. ANN. § 12:41(12) (West 1994); MD. CODE ANN., CORPS & ASS'NS § 2-103(13)(ii) (1993); MICH. STAT. ANN. § 21.149 (West 1996); MO. ANN. STAT. § 351.385(12), (15) (West 1991); NEB. REV. STAT. § 21-2004(13) (1991); NEV. REV. STAT. § 78.070(6) (1995); N.M. STAT. ANN. § 53-11-4(M) (Michie 1993); OHIO REV. CODE ANN. § 1701.13(D) (Anderson 1992 & Supp. 1996); OKLA. STAT. ANN. tit.18, § 1016(9) (West 1987); 15 PA. CONS. STAT. ANN. § 1502 (9) (West 1994); R.I. GEN. LAWS § 7-1.1-4(13) (1992); S.D. CODIFIED LAWS § 47-2-58(13) (Michie 1991); TEX. BUS. CORP. ACT art. 2.02(A)(14) (1997); W.VA. CODE § 31-1-8(m) (1996). In addition to New York, six other states' philanthropy laws include language which expressly repeals the benefit requirement. These states are California, Maine, Massachusetts, Minnesota, New Jersey (except requires board approval of contributions) and North Dakota. See CAL. CORP. CODE § 207(e) (West 1995); ME. REV. STAT. ANN. tit. 13-A, § 202.1(G) (West 1981); MASS. GEN. LAWS ANN. ch. 156B, § 9(k) (West 1992); MINN. STAT. ANN. § 302.A.161(11) (West 1985); N.J. STAT. ANN. § 14A:3-4(1) (West 1985); N.D. CENT. CODE § 10-19.1-26(11) (1995). In 19 other states, there are two donations provisions, one governing donations benefitting the business (*e.g.*, political contributions), while the other provides for donations for charitable, scientific, or educational purposes, etc. The states following this pattern include Colorado, Florida, Georgia, Indiana, Iowa, Kentucky, Mississippi, Montana, New Hampshire, North Carolina, Oregon, South Carolina, Tennessee, Vermont, Utah, Virginia, Washington, Wisconsin and Wyoming. See COLO. REV. STAT. § 7-103-102(m), (n) (Supp. 1996); FLA. STAT. ANN. § 607.0302(12), (14) (West 1993); GA. CODE ANN. § 14-2-302(13), (16) (1994); IND. CODE ANN. § 23-1-22-2(13), (15) (Michie 1995); IOWA CODE ANN. § 490.302(13), (15) (West 1991); KY. REV. STAT. ANN. § 271B.3-020(m), (o) (Michie 1989); MISS. CODE ANN. § 79-4-3.02(13), (15) (1996); MONT. CODE ANN. § 35-1-115(13), (15) (1995); N.H. REV. STAT. ANN. § 293-A:3.02(13), (15) (Supp. 1996); N.C. GEN. STAT. § 155-3-02(13), (15) (1996); OR. REV. STAT. § 60.077(2)(n), (p) (1995); S.C. CODE ANN. § 33-3-102(13), (15) (Law. Co-op. 1990); TENN. CODE ANN. § 48-13-102(13), (14) (1995); UTAH CODE ANN. § 16-10a-302(13), (15) (1995); VT. STAT. ANN. tit. 11A, § 3.02 (13), (15) (1997); VA. CODE ANN. § 13.1-627(12), (13) (Michie 1993); WASH. REV. CODE ANN. § 23B.03.020(2)(o), (q) (West 1994); WIS. STAT. ANN. § 180.0302(13), (15) (West 1992); WYO. STAT. ANN. § 17-16-302(a)(xiii), (xv) (Michie 1997).

been omitted in favor of unqualified grants of corporate charitable authority.

The significance of the open-ended modern philanthropy laws is fundamentally related to the issue of managerial authority—since donating someone else's money to charity is fundamentally different from making a charitable donation of one's own funds. The grant of donative power to corporate managers is remarkable precisely because the modern corporate philanthropy laws allow corporate contributions to be made *without regard to the firm's commercial objectives*. By virtue of these laws, corporate managers are freed from the necessity of adhering to commercial objectives in the allocation of the firm's charitable funds, and are thus empowered to pursue whatever philanthropic objectives meet their fancy. In affording corporate managers this unique form of discretion, the modern philanthropy laws depart from the fundamental, unifying principle within corporate law: wealth-creation in the interest of corporate shareholders. The modern philanthropy laws, therefore, pose a fundamental problem with respect to corporate "agency costs."³²

In establishing room for a redistributive dimension within corporate law, the modern corporate philanthropy laws are *sui generis*, and their presence within the states' modern corporate laws is puzzling. Nowhere else in the states' corporate laws are corporate managers afforded authority to depart from commercial, profit-motivated objectives in the allocation of corporate resources.³³ The disjunction between the unrestrictive corporate philanthropy laws and the larger framework of state corporate law suggests that the state legislatures validated corporate charitable authority without reconciling it with the broader principles and objectives of corporate law. Indeed, it is easy to imagine the state legislators as being relatively naive or passive—and thus less than ideally "responsible"—in enacting the modern philanthropy laws proposed by the ABA. Perhaps the generally "enabling" nature of state corporate law, in conjunction with the persuasive authority of the ABA, served to obscure, even from those who

32. It is important to note that while the benefits accruing to corporate managers as a result of these gifts do not reduce the value of the philanthropy to the recipients, the donations themselves—which might not be made in the absence of such correlative, managerial benefits—do impose costs on the corporation and hence the stockholders. See Kahn, *Corporate Philanthropy*, *supra* note 1, at Part III. For the seminal analysis of agency costs in the economics literature, see Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976). This work has been extraordinarily influential in focusing corporate legal scholars on the agency cost problem affecting public corporations.

33. For a comparison of the corporate philanthropy laws and the "constituency" statutes widely enacted by the states (but not by Delaware) in the 1980's, see Kahn, *Corporate Philanthropy*, *supra* note 1, nn.213-15 and accompanying text.

enacted them, the full significance of “enabling” corporate philanthropy laws.³⁴

In fact, there is evidence of precisely this kind of “laissez-faire” in the legislative record surrounding New York’s adoption of an unqualified philanthropy provision in 1961. In its 1958 Interim Report, the Joint Legislative Committee appointed to study the revision of the State’s corporate laws noted that:

In the opinion of some organizations, the present New York Law is too restrictive—the corporation statute should enunciate a simple corporate power, leaving the limitations to be imposed by the tax laws,³⁵ the penal laws,³⁶ and court decisions relating to the reasonableness of action by corporate directors and officers.³⁷ Such a policy is embodied in the Model Act provision on the subject.³⁸

Thus, in deciding to incorporate in its comprehensive revision of New York’s corporate laws an unrestrictive philanthropy provision similar to the Model Act’s, the State legislature appears to have followed the “recommendation” of the Joint Committee: It officially decided not to decide, as a matter of corporate law, what limits and requirements should govern corporate contributions.

In light of the difficulty or impossibility of retrieving pertinent legislative history from the states, the motives and objectives surrounding the adoption of the modern philanthropy laws remain unclear. Perhaps the legislators believed that the public interest would best be served by increased corporate charitable giving. But it is equally plausible that they were more calculating and focused on their own interests; that is, the expectation that increased corporate social spending might forestall

34. As I have argued elsewhere, the flexibility otherwise present in the state corporation codes is intended to serve the interests of corporate profit-maximization; whereas the flexibility in the philanthropy laws frees corporate managers from the necessity of observing this otherwise universal norm. See Kahn, *Corporate Philanthropy*, *supra* note 1, at 602-05.

35. It is the Federal Income Tax Code, rather than the states’ laws governing taxation, which have been critically important in the development of law and practice in this area. See *infra* Part II; see also Nancy J. Knauer, *The Paradox of Corporate Giving: Tax Expenditures, the Nature of the Corporation and the Social Construction of Charity*, 44 DEPAUL L. REV. 1 (1994).

36. It is difficult to understand which, if any, penal laws would be relevant.

37. For the problem of applying the existing case law concerning “the reasonableness of action by corporate directors and officers,” see *infra* Part II.

38. 1958 Interim Report, *supra* note 27, app. A, at 48.

increased taxation and, therefore, increased anti-government sentiment. As for the intentions of the ABA in encouraging the deregulation of corporate giving, its reform campaign has served the philanthropic predilections of corporate managers, as well as those nonprofit leaders and organizations and segments of the public that have benefited from increased corporate social spending.³⁹ Nevertheless, it is apparent that for both the ABA and the state legislatures, concerns over shareholders' interests were secondary, at best, since there is no evidence that actual stockholder preferences were taken into consideration, either by the ABA or the state legislatures, and, furthermore, neither the ABA's model law, nor the laws enacted by the states have provided shareholders a right to affect corporate decision-making in regard to contributions.

Indeed, the manner in which these laws have operated to confer decisional authority over charitable contributions on corporate officers and boards of directors merits further scrutiny. Again, the states' current philanthropy provisions are entirely silent on this question of decisional authority. The grant of decisional authority to corporate management has arisen by implication (and has been respected by the courts) as a result of this silence in the modern laws. Since they *do not* expressly provide, as Ray Garrett had suggested in 1948, that corporations have charitable authority to make such gifts "as the board of directors may deem proper,"⁴⁰ this corporate governance question—that is, who shall have decisional authority over corporate contributions—is resolvable only by reference to other provisions in the states' corporation codes and the principles embodied in the corporate law cases and commentaries.⁴¹

In regard to other provisions in the states' corporation codes, nearly every state has enacted a provision substantially analogous to Delaware's

39. For data concerning the allocation of corporate donations among various kinds of charitable organizations (*e.g.*, educational groups, health and community services and arts organizations), see *GIVING USA 1997*, *supra* note 2, at 98. Education has traditionally been the highest recipient of corporate funds. Nevertheless, the range of organizations qualifying as "educational" is notoriously broad, and the policy implications of "educational" giving differ depending on whether the recipient is, for example, the CEO's alma mater, a public school in an economically disadvantaged community, or a public policy institute qualified as a nonprofit, educational organization. (For a discussion of technically philanthropic corporate donations to politicized public policy organizations, see Kahn, *Corporate Philanthropy*, *supra* note 1, at Part V.).

40. Garrett, *supra* note 10, at 33.

41. Although the philanthropy laws are silent on the matter of decisional authority, the legislators enacting the laws, and certainly the lawyers serving on the Joint Legislative Committee to Study Revision of Corporation Laws, should have been aware of the fact that silence on the matter of charitable decision-making authority would result in this power accruing to corporate directors and officers, consistent with the status quo within corporation law. See generally *supra* note 23.

section 141, which provides that “The business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors”⁴² The relevant question is, therefore, whether these general affirmations of directors’ power over corporate business and affairs should govern *philanthropic* decision-making. Where the charitable contributions have a nexus to enhancing the firm’s profits,⁴³ the principles otherwise validating centralized corporate decision-making logically seem to apply. (However, such profit-motivated donations would not properly be eligible for the charitable deduction under § 170 of the Internal Revenue Code.)⁴⁴ Alternatively, in regard to philanthropically motivated corporate contributions (ordinarily deductible as *charitable* contributions under § 170), the argument for board of director control—and against shareholder voice—is a weak one.

Interestingly, there are no cases in which the issue of managerial control over corporate charitable contributions has expressly been litigated. While litigants have challenged the propriety of the amount or purpose of particular gifts, they have never directly challenged the justification for managerial control over corporate charitable contributions. The issue may be too theoretic, and insufficiently lucrative, to be the subject of ordinary, commercial litigation. Alternatively, the status quo, that is the prevailing framework of centralized board of director control, may be so widely accepted by attorneys, litigants, judges and commentators that it appears beyond challenge, even in this area. But if the latter assumption has prevailed, it has rested on a misapprehension. Centralized corporate decision-making has been justified on the basis of efficiency concerns (that is, the maximization of corporate, shareholder and, consequently, “social wealth”)⁴⁵ and managerial expertise in commercial affairs. But philanthropically motivated charitable contributions cannot, by definition, be rationalized on the basis of corporate profit maximization, and there is no reason to believe that managerial expertise in commercial affairs carries

42. DEL. CODE ANN. tit. 8, § 141(a) (1991). See also, e.g., CAL. CORP. CODE § 300(a) (West 1997); 110 ILL. COMP. STAT. ANN. 30/5 (West 1993); N.J. STAT. ANN. § 17:12B-62 (West 1992); N.Y. BUS. CORP. LAW § 701 (McKinney 1986); 15 PA. CONS. STAT. ANN. § 1721 (West 1995).

43. For a discussion of the curious notion of “profit maximizing” charitable contributions, see Kahn, *Corporate Philanthropy*, *supra* note 1, at Part VI.

44. I.R.C. § 170(c) (1994).

45. For a discussion of the concept of efficiency, see *Symposium on Efficiency as a Legal Concern*, 8 HOFSTRA L. REV. 485 (1980); see also Jeffrey N. Gordon, *Institutions as Relational Investors: A New Look at Cumulative Voting*, 94 COLUM. L. REV. 124, 125 n.2 (1994) (“Indeed the ultimate defense of the shareholder wealth criterion must be cast in social wealth terms.”).

with it greater expertise in regard to the allocation of social and cultural resources.

Thus, the fact that the board of directors has been accepted as the appropriate locus of decision-making authority in regard to corporate charitable contributions is based neither on express legislation (that is, majoritarian consensus), nor on principles of efficiency or managerial expertise. Furthermore, although corporate commentators frequently justify corporate law rules on the basis that they reflect the bargain which would otherwise voluntarily be struck by informed participants in a world without transaction costs,⁴⁶ the status quo in regard to corporate charitable giving fails to fit this model. The absence of systematic disclosure of corporate charitable contributions undercuts notions of consent, and hence metaphors of contract, as they apply to the relationship of corporation and shareholder in this context. Furthermore, it is simply not credible that shareholders would willingly confer unqualified charitable authority over corporate resources on corporate management. (Ask yourself the conditions under which you would give someone else unqualified charitable authority over your assets.) Thus, neither the principles of majoritarian consensus, wealth-producing efficiency, commercial expertise or freedom of contract support the current allocation of philanthropic decision-making authority in favor of corporate management.

Rather, corporate managers have inherited corporate charitable authority because the corporate philanthropy statutes (that is, the legislatures) did not expressly allocate decisional authority to corporate shareholders, because shareholders have never forced either the legislatures or the courts to reexamine this aspect of the corporate status quo, and because corporate charitable giving has unreflectively been lumped together with the rest of corporate "business and affairs." Thus, the legislatures have used the philanthropy provisions' silence on the matter of philanthropic decisional authority to stimulate increased corporate giving and to enlarge the power of corporate officers and directors in this area;

46. I am referring to the school of thought in which corporate law is conceived of as an outgrowth of contract law, that is, as a system of private ordering. See William H. Simon, *Contract Versus Politics in Corporation Doctrine*, in *THE POLITICS OF LAW*, 387-409 (David Kairys ed., 1990). This view is reflected most recently in the "nexus of contracts" school of corporate legal theory. See, e.g., Jeffrey N. Gordon, *The Mandatory Structure of Corporation Law*, 89 COLUM. L. REV. 1549 (1989); Symposium on Contractual Freedom in Corporate Law, 89 COLUM. L. REV. 1395 (1989). For important critiques of the nexus of contracts model of the corporation, see William W. Bratton Jr., *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407 (1989); Victor Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403 (1985); Cox, *supra* note 4; Alan Wolfe, *The Modern Corporation: Private Agent or Public Actor?*, 50 WASH. & LEE L. REV. 1673 (1993).

and they have avoided controversy in so doing by not appearing obviously or directly responsible for allocating corporate power in this fashion.

In sum, while the modern laws appear unremarkable on their face, upon reflection it is apparent that the authority which they create is highly controversial. While corporate commentators speak of the "economic" nature of corporate law, the modern philanthropy laws are fundamentally political in nature, as they provide authority for reallocating capital from corporations and shareholders to nonprofit organizations, and place this authority beyond the hands of corporate shareholders. These laws are not the product of market evolution, nor can they be defended on the basis of "efficiency," as traditionally understood. Rather than simulating bargained-for terms, the philanthropy laws reflect the preferences of particular powerful persons and professional organizations at a definite point in time. Ultimately it is unclear whether inertia, relative ignorance among shareholders and the public, or some unarticulated consensus about corporate charitable giving keeps the modern philanthropy laws in force and keeps power over giving in the hands of corporate management.

II. THE ABSENCE OF STATUTORY STANDARDS FOR CORPORATE CONTRIBUTIONS: JUDICIAL AUTHORITY AND THE LIMITS OF CORPORATE LAW

The absence of objective standards in the modern corporate philanthropy laws has also presented the courts with a dilemma. In light of the state legislatures' decision to sanction truly philanthropic corporate contributions and to avoid imposing objective limits or requirements on such contributions, by what standards should the courts adjudicate the propriety of particular contributions? In those instances where a statute is relevant, the legal system prescribes that courts confine themselves to applying the existing statutory standards or to otherwise fulfilling the will of the legislature. But while the modern philanthropy laws expressly validate corporate charitable authority, they supply no particular, objective terms for courts to apply in resolving shareholder challenges to corporate contributions. The legislatures have therefore left the courts in the predicament of weighing the dangers of doing "too little" (since a system of unlimited charitable contributions by business corporations would be untenable, despite the absence of statutory limits) against the dangers of doing "too much" (by crafting significant limiting criteria where the legislatures have repealed them) and thereby exceeding the proper scope of judicial authority.

Although the absence of explicit, statutory standards in the corporate charitable contributions area raises difficult questions, in the larger context of corporate law it is rarely the case that corporate managers' acts and

decisions are governed by express, statutory standards.⁴⁷ Instead, the most important corporate law standards governing directors' and officers' acts and decisions are the fiduciary obligations of care and loyalty which have been elaborated through the common law.⁴⁸ These fiduciary standards—the duty of care and the duty of loyalty—exhort managers to be conscientious and unconflicted by personal, self-interested motivations in their administration of corporate affairs.

Moreover, these substantive standards of fiduciary obligation have been recast in the litigation context as the “business judgment rule.”⁴⁹ The business judgment rule “is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.”⁵⁰ The rule, which incorporates a management-friendly bias into the law, has been justified on several grounds, including the need to encourage competent individuals to serve on corporate boards; the desire to stimulate wealth-producing risk-taking on the part of corporate management; and the belief that the professional class of corporate managers should not ordinarily be second-guessed either by judges or by shareholders (who both, presumptively, have less competence to administer the corporation's affairs).

Thus, in the established pattern of corporate law adjudication, plaintiffs are allowed to overcome the business judgment rule and challenge corporate managers' acts and decisions “on the merits” only if

47. The essentially permissive flavor of state corporation law is captured in the widespread description of the corporation codes as enabling statutes. For discussion of corporate law's mix of mandatory and “optional” rules, see Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542 (1990); John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618 (1989); Gordon, *supra* note 46.

48. See, e.g., *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928) (stating that copartners owe one another a fiduciary duty of “finest loyalty”); *Bayer v. Beran*, 49 N.Y.S.2d 2, 6 (Sup. Ct. 1944) (asserting that the “business judgment rule,” while discouraging interference with corporate directors' independence, must yield to individual fiduciary loyalty); see also *Pepper v. Litton*, 308 U.S. 295, 306-07 (1939) (holding that the common law rules governing good faith and fiduciary responsibility apply in the context of bankruptcy claims).

49. For commentary on the business judgment rule, and its application, see DENNIS J. BLOCK ET AL., *THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS* (3d ed. 1991); Franklin A. Gevurtz, *The Business Judgment Rule: Meaningless Verbiage or Misguided Notion?*, 67 S. CAL. L. REV. 287 (1994); Bayless Manning, *Symposium: Current Issues in Corporate Governance: The Business Judgment Rule in Overview*, 45 OHIO ST. L.J. 615 (1984).

50. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

they can present facts indicating either gross negligence⁵¹ or a conflict of interest⁵² on the part of the corporate officials. Where a plaintiff succeeds in making a showing of one of the former "defects," the business judgment rule will no longer apply and the court will require the defendants to demonstrate the "inherent fairness" to the corporation and its shareholders of their acts and decisions.⁵³ Thus, the standards of fiduciary care and loyalty and the business judgment rule form the bedrock principles of adjudication in the area of corporation law.

One might assume that the aforementioned fiduciary standards and the business judgment rule would govern shareholder challenges to corporate contributions—in light of the absence of express statutory standards for corporate contributions and the pervasive application of these standards in the corporate case law. In fact, this assumption is evident in the 1958 Interim Report of the Joint Legislative Committee (set forth in full above).⁵⁴ The Report suggested that the courts could respond to the absence of standards in the unqualified corporate philanthropy laws by applying (the usual) court decisions relating to the reasonableness of action by corporate directors and officers.⁵⁵ But this is far more problematic than the Joint Committee's Report suggested. There is a fundamental disjunction between the assumptions underlying the business judgment rule and directors' fiduciary obligations, on the one hand, and corporate charitable giving, on the other. The existing standards of fiduciary care and loyalty and the business judgment rule cannot appropriately be applied, at least as they have traditionally been defined in the corporate case law, to the review of management's decisions regarding charitable contributions. The courts have thus had to grapple both with the absence of express statutory standards and the essential ill-fit of the traditional common law standards to the corporate charitable contributions area.

Perhaps as a result of the relative absence of public information regarding individual corporations' charitable contributions, or because of the lax standards applied in the review of contributions (as described more fully below), there are only two cases where shareholders have challenged corporate contributions under the modern, unrestrictive corporate

51. See *Smith v. Van Gorkom*, 488 A.2d 858, 873 (Del. 1985).

52. See *Fliegler v. Lawrence*, 361 A.2d 218 (Del. 1976).

53. See *Weinburger v. UOP, Inc.* 457 A.2d 701, 703, 710 (Del. 1983); *Fliegler*, 361 A.2d at 221; *Globe Woolen v. Utica Gas & Elec. Co.*, 121 N.E. 378 (N.Y. 1918); (reflecting examples of the application of the "inherent fairness" test).

54. See *supra* note 38 and accompanying text.

55. See *id.*

philanthropy laws.⁵⁶ *Theodora Holding Corp. v. Henderson*,⁵⁷ decided by the Delaware Chancery Court in 1969, established that a valid corporate charitable gift “must merely be within reasonable limits both as to amount and purpose.”⁵⁸ In contrast, it is the facts in *Kahn v. Sullivan*⁵⁹—decided by the Delaware Supreme Court in 1991—which leave an almost indelible impression. *Kahn v. Sullivan* is the only case in which the size of the gift in question—\$85 million—attained the proportions possible for a major contributing public corporation;⁶⁰ and it is, in fact, the only litigation involving a shareholder challenge to a corporate contribution by a public corporation.⁶¹

The far more modest contribution in *Theodora* involved a transfer of company stock valued at \$550,000 to a foundation established by the company’s controlling shareholder-director. Notably, the chancery court made no attempt to resolve the dispute over the gift by applying traditional fiduciary norms of care and loyalty. Furthermore, while the court adopted a posture of extreme deference to the philanthropic decisions of the controlling shareholder-director, it did not attempt to justify this deference in terms of the business judgment rule. Rather than adhering to these accepted patterns of corporate law adjudication, the court first described contemporary social and economic developments favoring increased corporate philanthropy, and then invoked a decision of the New Jersey Supreme Court it interpreted as holding “that a corporate charitable or educational gift to be valid must merely be within reasonable limits both as to amount and purpose.”⁶² Thus, in *Theodora*, “reasonableness in amount and purpose” was held to be the dispositive standard for judging the propriety of a corporation’s charitable contributions, and the court

56. The language of the philanthropy laws may itself have played a part in discouraging shareholder suits, since the laws appear to sanction any and all charitable contributions.

57. 257 A.2d 398 (Del. Ch. 1969).

58. *Id.* at 404.

59. 594 A.2d 48 (Del. 1991).

60. There are two opinions in the case. The Delaware Supreme Court reviewed and approved the chancery court’s approval of a proposed settlement of one of the shareholder suits challenging Occidental’s proposed charitable contribution. *See id.*; *see also* Sullivan v. Hammer, [1990 Decisions] Fed. Sec. L. Rep. (CCH) § 95,415, at 97,061 (Del. Ch. 1990).

61. The absence of shareholder challenges to gifts by public corporations is more remarkable for the fact that publicly held firms are responsible for the vast majority of the total corporate charitable contributions made annually. *See* AUDRIS TILLMAN, CORPORATE CONTRIBUTIONS IN 1995, THE CONFERENCE BOARD, 1996.

62. *Theodora Holding Corp.*, 257 A.2d at 404; *see also* A.P. Smith Mfg. Co. v. Barlow, 98 A.2d 581 (N.J. 1953).

upheld the challenged gift as reasonable in both respects.⁶³ *Theodora* is noteworthy as the first deliberate attempt to give substantive content to the notion of "reasonable" charitable corporate contributions, and the contours of "reasonableness" are examined fully below.⁶⁴

Theodora is also significant for the fact that the court did not apply the business judgment rule in its review of the contribution. As described above, the business judgment rule "is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."⁶⁵ As the court appears to have recognized, because philanthropically motivated corporate contributions do not involve business judgments, the business judgment rule presumption is fundamentally unsuited to their review—just as principles of efficiency, expertise and wealth creation are generally inapposite in this context. The fact that the court also declined to apply a duty of loyalty analysis in reviewing the plaintiff's claim—notwithstanding that circumstances surrounding the company's contribution raised the issue of self-interest on the part of the controlling shareholder-director⁶⁶—is also significant. The standard of self-interest applied by the courts in reviewing corporate management's conduct has not traditionally encompassed the kind of nonpecuniary personal and professional benefits and indirect pecuniary benefits accruing to managers as a result of their control over corporate contributions.⁶⁷

63. See *Theodora Holding Corp.*, 257 A.2d at 405.

64. The concept of "reasonable donations" floated through the early statutes and case law, but had never been given any distinct meaning. The following states had "pre-modern" philanthropy laws which authorized "reasonable" contributions: Maryland (1945); Massachusetts (1933); New Jersey (1930); and New York (1923). See ANDREWS, *supra* note 14, at 297-98, 301-02, 306.

65. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) (emphasis added).

66. Mr. Henderson, who, as the court recognized, effectively controlled the affairs of the corporation, established the foundation which received and dispursed the gift, determined the ultimate beneficiary of the gift, and also maintained a private residence (at an apparently below market rate) at the site of the camp which was the beneficiary of the gift. See *Theodora Holding Corp.*, 257 A.2d at 402.

67. Self-interest on the part of corporate directors and officers has been analyzed in depth in the corporate case law in a number of paradigmatic contexts, most particularly unsolicited takeover attempts, executive compensation, self-dealing transactions, and corporate opportunity cases. Aside from the takeover cases, which consider the general motive of entrenchment in office, the issue has always been the potential divergence between the pecuniary interests of the insider and that of the corporation and the shareholders. For a fuller analysis of the problem of managerial self-interest in regard to corporate contributions, see Kahn, *Corporate Philanthropy*, *supra* note 1, at Part III.

The contribution at issue in the *Kahn v. Sullivan* litigation was an \$85 million gift by Occidental Petroleum Corporation to construct and fund the Armand Hammer Museum and Cultural Center.⁶⁸ The museum project had been initiated by Dr. Hammer himself, the founder and Chairman of the Board of Occidental. In order to neutralize Dr. Hammer's obvious self-interest in having Occidental fund the museum, the company established a Special Committee of outside directors to determine whether the company would go forward with the proposal.⁶⁹ Both the chancery court and the supreme court (both courts were reviewing a proposed settlement to one of the shareholder suits over the gift) determined that the business judgment rule would likely be applied if the case were tried on the merits. Both courts decided that this fact severely limited the plaintiffs' chances of ultimately prevailing in their claims.

The *Kahn* decisions contrast sharply with the opinion in *Theodora*. Where *Theodora* departed from the business judgment rule analysis, both courts in *Kahn* emphasized the importance of the business judgment rule issue in reviewing the propriety of the charitable gift. The chancery court concluded that the business judgment rule represented "an almost impenetrable barrier to the plaintiffs." Yet in deciding that the business judgment rule would be applied, and would insulate the Committee's decision, both the chancery court and the supreme court apparently failed to register the extraordinary nature of the decision confronting the Committee—the approval of an \$85 million *charitable* contribution in the name of the company's Chairman.

The chancery court's insensitivity to the extraordinary, extra-commercial corporate conduct in question is apparent in several respects. First, most obviously, the court never addressed whether the business judgment rule *should* apply to the review of a corporate charitable

68. The facts surrounding the museum proposal, Dr. Hammer's role in initiating the proposal, and the actions of the Special Committee of the board of directors are described at length in the supreme court's opinion. See *Kahn v. Sullivan*, 594 A.2d 48, 52-56 (Del. 1991).

69. The term "outside director" is used within corporate legal analysis to distinguish directors who are also officers (or otherwise formally employed by the corporation), from directors who have no other such affiliation with the firm. The notion is that outside directors will add greater objectivity to the deliberation of the board. Academic commentators and institutional investors have extensively addressed the proper composition of the corporate board of directors. See PRINCIPLES OF CORPORATE GOVERNANCE § 3A.01 (Am. Law Inst. 1994); Barry D. Baysinger & Henry N. Butler, *Revolution Versus Evolution in Corporate Law: The ALI's Project and the Independent Director*, 52 GEO. WASH. L. REV. 557 (1984); Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863 (1991); see also, Adam Bryant, *The Search for the Perfect Corporate Board*, N.Y. TIMES, Aug. 3, 1997, § 3 (Business), at 1.

contribution, notwithstanding that it regarded the business judgment rule issue as nearly dispositive. And while the chancery court described certain factors which, if present, would mandate that the presumption be overturned, the factors—such as the defendants' expectation of deriving a "personal *financial* benefit,"⁷⁰ or a decision "so irrational that it could not have been the reasonable exercise of the *business judgment* of the board"⁷¹—are inapposite in the charitable contributions context. Indeed, on this rationale, the business judgment rule would always apply to management's charitable contributions decisions, and would thus act "as an almost impenetrable barrier" to any and all shareholder suits over corporate contributions.⁷²

The language used by the chancery court to describe Occidental's gift is also revealing. The court most frequently referred to the contribution as the "proposal for funding the museum,"⁷³ or the "transaction"⁷⁴—terms which ordinarily apply to commercial dealings and which are largely nondescriptive of Occidental's proposed charitable contribution. Finally, the court described two other judgments by boards of directors where the business judgment rule was applied—a rejection of a tender offer and a decision to repurchase a "dissident" director's stock—to further support its conclusion that the business judgment rule would be applied to the Committee's approval of the gift.⁷⁵ But rather than supporting its reasoning, the court's analogy actually undercut its conclusion that the business judgment rule would apply to the Committee's approval of the gift, since both comparisons involve commercial transactions fundamentally dissimilar to the charitable contribution in question.⁷⁶

The supreme court's analysis of the business judgment rule issue reflects similar shortcomings. The court focused on the "independence" of the Committee's members, which it analyzed in terms of the absence of their receipt of a direct, pecuniary gain from approving the gift, the absence of specific facts demonstrating they were dominated by Dr.

70. *Sullivan v. Hammer*, [1990 Decisions] Fed. Sec. L. Rep. (CCH) § 95,415, at 97,061, 97,064 (Del. Ch. 1990) (emphasis added).

71. *Id.* (emphasis added).

72. *Id.* Perhaps this universal application of the business judgment rule is the intended result. In this manner the courts could secure the social benefits arising from corporate giving and remove it from shareholder scrutiny—much as the legislatures have done—without drawing attention to their decisions.

73. *See id.* at 97,062.

74. *See id.* at 97,064.

75. *See id.* at 97,065; *see also* *Paramount Communications, Inc. v. Time Inc.*, 571 A.2d 1140 (Del. 1990); *Grobow v. Perot*, 539 A.2d 180 (Del. 1988).

76. *See Sullivan*, [1990 Decisions] Fed. Sec. L. Rep. (CCH) at 97,065.

Hammer, and their consultation with independent legal counsel.⁷⁷ In sum, the supreme court focused entirely on the issue of Committee process in its business judgment rule analysis, while ignoring the relevance of the charitable nature of the Committee's decision.

In addition to the business judgment rule question, both courts considered the plaintiffs' claim of breach of due care. Yet this aspect of the decisions appears even more perfunctory. The chancery court merely stated that "[t]he record also shows that the directors and the Special Committee gave due consideration to the transaction."⁷⁸ And the supreme court merely restated the chancery court's conclusion and described it as "the product of an orderly and logical deductive process . . . supported by the record."⁷⁹ Again, a myopic focus on the procedural aspects of the Committee's conduct supplanted a thorough analysis by these courts of what, precisely, due care would mean in the Committee's approval of the charitable contribution.

These weaknesses in the *Kahn* decisions reflect the fact that the business judgment rule and the duty of care are essentially extraneous to the issue of the propriety of a corporation's charitable contributions. Indeed after concluding this aspect of their analysis, both courts entirely changed their focus. They proceeded to analyze Occidental's gift in relation to Delaware's unrestrictive philanthropy law and the objective, tax-based standards of reasonableness which had been endorsed in *Theodora*. Based on their interpretation of the business judgment rule and the lax standard of reasonableness, both courts finally concluded that the plaintiffs had almost no chance of succeeding on the merits, and they approved the proposed settlement.

In conclusion, although the courts in *Kahn* applied the business judgment rule analysis and invoked the duty of care, these standards have little meaning in regard to charitable contributions, and to the extent that they are invoked, they serve unjustifiably to extend the prevailing managerial bias within corporation law to the charitable contributions area. Philanthropically motivated business contributions do not involve a business judgment which should be protected by the business judgment rule. In addition, although the obligation of due care seems essentially concerned with deliberation or "process," by necessity it involves some underlying notion of what the relevant actors should be diligent about—which, in corporate law, has always meant the maximization of corporate wealth. However, because wealth maximization need not be a consideration in a company's contributions, and because the judicial standards for "reasonable" contributions are so lax (as discussed more

77. See *Kahn v. Sullivan*, 594 A.2d 48, 60 (Del. 1991).

78. *Sullivan*, [1990 Decisions] Fed. Sec. L. Rep. (CCH) at 97,065.

79. *Kahn*, 594 A.2d at 61.

amply below), there is little in the administration of a company's charitable contributions about which corporate managers must be diligent.

In addition, as mentioned above, the duty of loyalty cannot be readily adapted to this context, since managerial self-interest in corporate law has traditionally been defined in terms of direct pecuniary gain, and has not encompassed the nonmonetary or less quantifiable benefits accruing to managers as a result of their control over corporate charitable contributions.⁸⁰ Finally, even the standard of inherent fairness, which is applied when a court determines that managerial self-interest is present, is inapposite as traditionally interpreted. "Fairness" in corporate law (like "self-interest") has been defined exclusively in terms of narrow, monetized concepts applicable to commercial transactions.⁸¹ Since corporate *charitable* contributions are not bilateral, mutually self-enhancing exchanges, a norm of fairness based on a notion of bargaining or market-based exchange cannot address the deeper philosophical, political and social issues posed by such contributions.⁸²

Of course, courts could address the issue of fairness more directly, outside of the established confines of corporate law adjudication, and require corporations (that is, directors and officers in charge of charitable contributions decisions) to justify their charitable contributions according to broader norms of "fairness." This would have far-reaching practical and legal implications, however. Most obviously, it would severely chill the practice of corporate *charitable* giving, since—and this is the heart of the problem—there is no established consensus of when philanthropic contributions by business corporations are "fair" to the corporation and its shareholders.⁸³

Finally, to conclude the analysis of the case law, the lack of fit between the traditional standards of corporate law adjudication and corporate charitable contributions explains the Delaware courts' fabrication of the "reasonableness" standard. Indeed, it is this question of "reasonable" versus "wasteful" charitable contributions which is ultimately

80. See *supra* note 67 and accompanying text.

81. For discussion of the limited nature of the fairness analysis in corporation law see, for example, Lawrence E. Mitchell, *Fairness and Trust in Corporate Law*, 43 DUKE L.J. 425 (1993).

82. For an interesting critique of the current hegemony of markets, see ROBERT KUTTNER, *EVERYTHING FOR SALE* (1997).

83. An effort to formulate a relevant, authentic theory of fairness to support corporate charitable contributions might involve an inquiry into moral philosophy, organizational theory or sociology (and perhaps even evolutionary theory), as well as theories of democratic organization. That is, such a theory of fairness would have to be constructed from principles and ideas largely foreign to corporate law and even mainstream corporate theory.

the relevant and more trenchant one. In giving content to the standard of reasonableness, the courts (first in *Theodora*, and then in both opinions in *Kahn v. Sullivan*) implicitly analogized the corporation to a natural person.⁸⁴ That is, in defining “reasonableness in amount” the courts looked to the firms’ capacity to alienate assets without impairing their overall financial condition—something approximating the “reasonableness in amount” of a natural person’s charitable gifts. They also weighed the financial benefits (including tax benefits) potentially accruing to the corporate donors from their gifts in calculating their actual cost to the corporation and its shareholders—and hence their reasonableness in amount.⁸⁵ But the analogy to natural persons’ philanthropy ignores the operation of the corporate agency problem arising from managers’ control over corporate contributions—a fact which bears fundamentally on the reasonableness of any amount of *corporate* charitable contributions. Just as problematically, this line of reasoning fails to generate a definite, predictable standard for determining the maximum allowable annual amount of a company’s charitable contributions.

The “reasonableness in purpose” standard has the potential to be equally perplexing. However, as described earlier, by enacting the modern corporate philanthropy laws, the state legislatures have resolved the larger issue—that philanthropy is a reasonable corporate objective. Accordingly, the “reasonableness in purpose” inquiry, as elaborated in both *Theodora* and *Kahn v. Sullivan*, has been limited to the question of the appropriate recipients of corporate charitable contributions, consistent with the beneficiaries enumerated in the statutes (e.g., public welfare, community fund, hospital, charitable, educational, scientific, civic or similar purposes).

Ultimately, in order to resolve the ambiguities surrounding the determination of “reasonable” contributions, the Delaware courts, in both the *Theodora* and the *Kahn* decisions, relied on standards imported from the Federal Income Tax Code. The Code’s maximum annual allowance for the deductibility of corporate contributions under § 170—currently ten percent of corporate pre-tax income⁸⁶—has been accepted as the

84. See *Kahn v. Sullivan*, 594 A.2d 48 (Del. 1991); *Sullivan v. Hammer*, [1990 Decisions] Fed. Sec. L. Rep. (CCH) § 95,415 (Del. Ch. 1990); *Theodora Holding Corp. v. Henderson*, 257 A.2d 398 (Del. Ch. 1969). For discussion of the tendency to reify and personify the charitable corporation, and the theoretic problems arising therefrom, see Linda Sugin, *Theories of the Corporation and the Tax Treatment of Corporate Philanthropy*, 41 N.Y.L. SCH. L. REV. 835 (1997).

85. See *id.*

86. As a result of the Economic Recovery Tax Act of 1981, Congress amended the ceiling for annual deductible charitable contributions by corporations from five percent of corporate taxable income—which had been the rule at the time when *Theodora* was

appropriate standard for “reasonableness in amount;” and the set of groups qualifying for status as charitable organizations under § 501(c)(3) of the Code has been adopted as the standard for determining “reasonableness in purpose.” These tax-based standards have lent definiteness to the interpretation of “reasonableness,” and have allowed the courts to escape further personification of the corporation.

Nevertheless, this clarity has been purchased at the expense of a kind of conceptual void. The policy objectives underlying the Tax Code’s corporate philanthropy provisions—Congress’ desire to encourage non-tax based corporate expenditures on social and cultural affairs—are grossly distinct from the traditionally shareholder-centered concerns of corporate law.⁸⁷ Thus, the Delaware courts’ adoption of federal, tax-based standards as the basis for defining the reasonableness of corporate charitable contributions, while effective in “getting the job done,” illustrates that the traditional framework of state corporate law has provided insufficient grounds to rationalize a system of philanthropically motivated corporate contributions. The silence in the corporate philanthropy laws, and the courts’ importation of extra-corporate law standards to resolve the interpretive problems resulting from these silences, reflects the existing conceptual boundaries of corporate law.

decided—to ten percent (without regard to any net operating loss or capital loss carry back). See I.R.C. § 170(b)(2) (1994).

87. Certain corporate legal scholars have reintensified the project of connecting corporate law to disciplines other than neoclassical economics. See, e.g., MARGARET M. BLAIR, *OWNERSHIP AND CONTROL: RETHINKING CORPORATE GOVERNANCE FOR THE TWENTY-FIRST CENTURY* (1995); *PROGRESSIVE CORPORATE LAW* (Lawrence E. Mitchell ed., 1995); Richard M. Buxbaum, *Corporate Legitimacy, Economic Theory, and Legal Doctrine*, 45 OHIO ST. L.J. 515 (1984); Gerald E. Frug, *The Ideology of Bureaucracy in American Law*, 97 HARV. L. REV. 1276 (1984); David Millon, *Communitarians, Contractarians and the Crisis in Corporate Law*, 50 WASH. & LEE L. REV. 1373 (1993); Eric W. Orts, *The Complexity and Legitimacy of Corporate Law*, 50 WASH. & LEE L. REV. 1565 (1993); Mark Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10 (1991); Roberta Romano, *Metapolitics and Corporate Law Reform*, 36 STAN. L. REV. 923 (1984); Simon, *supra* note 46. For a compelling argument that a central project of contemporary legal scholarship is the construction of a new, contextualized theory of our formative social institutions, including business corporations, see Edward L. Rubin, *The New Legal Process: The Synthesis of Discourse, and the Microanalysis of Institutions*, 109 HARV. L. REV. 1393 (1996). And outside of corporate legal scholarship, see, for example, SCOTT R. BOWMAN, *THE MODERN CORPORATION AND AMERICAN POLITICAL THOUGHT: LAW, POWER, AND IDEOLOGY* (1996), and, more generally, FRANCIS FUKUYAMA, *TRUST* (1995); George Soros, *The Capitalist Threat*, ATLANTIC MONTHLY, Feb. 1997, at 45.

III. SHAREHOLDERS' LIMITED POWER TO OBTAIN SOCIALLY SIGNIFICANT CORPORATE INFORMATION UNDER STATE AND FEDERAL LAW

As described earlier, the early philanthropy laws which afforded shareholders veto rights over contributions exceeding a prescribed level presumed that shareholders would be notified of at least certain proposed charitable contributions;⁸⁸ and two states, at different times, expressly provided for disclosure of charitable contributions.⁸⁹ In contrast, the states' modern philanthropy laws fail to provide shareholders any right to contributions information. In addition, the ordinary channels by which shareholders obtain corporate information—through inspection of corporate books and records or, in the context of publicly held companies, through SEC-mandated filings and reports⁹⁰—do not provide for disclosure of corporate charitable contributions. This section of the essay examines the limited nature of shareholders' informational rights, both in relation to corporate charitable contributions and in regard to other socially significant areas of corporate conduct, and considers the political implications of these limits.

Under state law, shareholders have a right to inspect corporate books and records.⁹¹ However, in many states, as at common law,⁹² these rights are qualified by a concept of "proper purpose."⁹³ Most relevantly, it has been generally accepted that a shareholder's inspection request may be refused where it is motivated by a "social concern" unrelated to enhancing

88. See *supra* note 19 and accompanying text.

89. See *supra* note 22 and accompanying text.

90. In addition to state law inspection and periodic corporate reporting required by the SEC, shareholders have obtained additional disclosure of matters affecting social policy under SEC Rule 14a-8, the "shareholder proposal rule." See *Roosevelt v. E.I. Du Pont de Nemours & Co.*, 958 F.2d 416 (D.C. Cir. 1992). However, the SEC has recently expanded its interpretation of "ordinary" corporate business, and thus diminished the ability of shareholders to demand supplemental social disclosure through the shareholder proposal process. See *Cracker Barrel Old Country Store, Inc.*, SEC No-Action Letter, [1992-1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) § 76,418, at 77,284 (Oct. 13, 1992). For further discussion of shareholder proposals under the federal proxy rules, see *infra* notes 115-17 and accompanying text.

91. See ROBERT CHARLES CLARK, *CORPORATE LAW* 96-105 (1986).

92. See *id.* at 97.

93. See *id.* at 100 ("Whatever the variations in statutory procedure, proper purpose has become the substantive touchstone in most jurisdictions."). For statutory versions of the proper purpose requirement see, for example, CAL. CORP. CODE § 1601(a) (West 1996); DEL. CODE ANN. tit. 8, § 220(b) (1996); FLA. STAT. ANN. § 607.1602 (West 1996); 805 ILL. COMP. STAT. ANN. 5/7.75 (West 1997); N.Y. BUS. CORP. LAW § 624(c) (Consol. 1996).

the firm's financial performance.⁹⁴ Under this rationale, ironically, although corporations have legal authority to make charitable contributions irrespective of business objectives, shareholders would not have a right to inspect corporate records documenting such contributions absent a business, that is, profit-motivated purpose. A desire to obtain contributions information in order either to advocate increased giving in the interest of society or to investigate the identities of particular beneficiaries—as these concerns are unrelated to profit-maximization—would not constitute a basis for inspection. Clearly there is a “double standard” applied to corporate versus shareholder conduct in this area. The corporate entity, which is to say its managers, have a legally protected freedom to spend corporate funds on social concerns unrelated to profit maximization, whereas shareholders lack even a right to obtain information about such spending. The double standard reflects a startling incongruity within corporate law: the disjunction between the activist, charitable corporation and the law's otherwise uncompromising commitment to conceiving of both the firm and corporate shareholders as, properly, purely economic, profit maximizing units.⁹⁵

The notion that corporate shareholders' interests are properly limited to matters affecting financial performance is also reflected in the SEC's disclosure requirements promulgated pursuant to the Federal Securities Laws. The SEC has the authority to broaden the existing limits of required corporate disclosure. In section 14(a) of the '34 Act, and elsewhere in the Securities Laws, Congress has given the SEC authority to promulgate disclosure provisions (and other rules) “in the public interest or for the protection of investors”⁹⁶—a mandate plainly broad enough to encompass disclosure of matters beyond corporate financial performance.⁹⁷

94. See *National Consumers Union v. National Tea Co.*, 302 N.E.2d 118 (Ill. App. Ct. 1973); *State ex. rel. Pillsbury v. Honeywell, Inc.*, 191 N.W.2d 406 (Minn. 1971).

95. For an example of the Commission's insistence that corporate shareholders' interests are properly limited to economically material matters, see DIVISION OF CORP. FIN., SEC. AND EXCH. COMM'N, STAFF REPORT ON CORPORATE ACCOUNTABILITY (1980) [hereinafter STAFF REPORT ON CORPORATE ACCOUNTABILITY].

96. '34 Act § 14(a), 15 U.S.C. § 78(n)(a).

97. In describing the scope of its authority, the SEC has observed as follows: The [Securities] Acts and the relevant legislative history also suggest that a prime expectation of the Congress was that the Commission's disclosure authority would be used to require the dissemination of information which is or may be economically significant.

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It is also evident, however, that insofar as the Commission's rulemaking authority under Section 14(a) of the Securities Exchange Act is concerned, the primacy of economic matters, particularly with respect to shareholder proposals, is somewhat less.

The SEC itself has expressed the view that its "discretion to determine what disclosure is appropriate to fulfill its responsibilities under the federal securities laws is extremely broad."⁹⁸ But the Commission has been extremely reluctant to give independent significance to the "public interest" part of this mandate, or to interpret investors' interests in voting and investment decisions as exceeding narrow economic parameters.⁹⁹

Securities Act Release No. 5627, [1975-76 Decisions] Fed. Sec. L. Rep. (CCH) § 80,310, at 85,706, 85,710-11 (Oct. 14, 1975) [hereinafter Release No. 5627].

98. *Id.* at 85,713.

99. The argument for increased corporate disclosure of socially significant information made herein received extensive consideration by the SEC and various interested parties between 1969 and 1980. The contexts included the SEC's response to a rulemaking petition filed by the Natural Resources Defense Council and certain ethical investor groups on June 1, 1971, public proceedings on disclosure and corporate accountability conducted by the SEC, and litigation in the federal courts. In each instance, the Commission and its staff consistently opposed almost every attempt to require enhanced disclosure of socially significant information, arguing that (1) shareholders are fundamentally interested only in matters materially affecting corporate financial performance and (2) broadened disclosure would be unduly costly, disruptive and otherwise unfeasible. *See* THE WHEAT REPORT, DISCLOSURE TO INVESTORS, STAFF REPORT (1969) [hereinafter THE WHEAT REPORT]; Exchange Act Release No. 9252 ['70-'71 Decisions] Fed. Sec. L. Rep. (CCH) § 78,150, at 80,487 (July 19, 1971) (clarifying obligation to disclose environmental and civil rights matters when economically material); Securities Act Release No. 5235, ['71-'72 Decisions] Fed. Sec. L. Rep. (CCH) § 78,524, at 81,134 (Feb. 16, 1972) (announcing proposed supplemental disclosure) [hereinafter Release No. 5235]; Securities Act Release No. 5386, [1973 Decisions] Fed. Sec. L. Rep. (CCH) § 79,342, at 83,029 (Apr. 20, 1973) (announcing decision not to enlarge disclosure of environmental and employment matters) [hereinafter Release No. 5386]; Securities Act Release No. 5569 ['74-'75 Decisions] Fed. Sec. L. Rep. § 80,110 at 85,109 (February 11, 1975) (announcing public proceedings on expanding social disclosure); Release No. 5627, *supra* note 97 (announcing SEC's conclusion to adopt minimal additional environmental disclosure requirements and no additional disclosure requirement in the area of employment data); Exchange Act Release No. 13482, ['77-'78 Decisions] Fed. Sec. L. Rep. (CCH) § 81,130, at 87,889 (Apr. 28, 1977) (announcing public proceedings on corporate governance, shareholder participation and disclosure matters) [hereinafter Release No. 13482]; Exchange Act Release No. 13901, ['77-'78 Decisions] Fed. Sec. L. Rep. (CCH) § 81,296, at 88,461 (Aug. 29, 1977) (enumerating questions to be considered regarding the expansion of social disclosure) [hereinafter Release No. 13901]; STAFF REPORT ON CORPORATE ACCOUNTABILITY, *supra* note 95 (discussing history and philosophy of SEC's continued opposition to expanded social disclosure); *see also* Natural Resources Defense Council, Inc. v. SEC, 389 F. Supp. 689 (D.D.C. 1974) (finding SEC in nonconformity with Administrative Procedure Act in failing to give adequate notice of rulemaking proceeding on enhanced disclosure, and in failing to supply rationale for decision to maintain disclosure status quo); Natural Resources Defense Council, Inc. v. SEC, 432 F. Supp. 1190 (D.D.C. 1977) (finding SEC's decision to reject expansion of environmental disclosures arbitrary and capricious,

To appreciate the limits of required disclosure, it is necessary to understand the organization and operation of the SEC's disclosure regulations. Disclosure under the securities regulations follows two general principles. First, there are specific disclosure requirements set forth in the Securities Laws,¹⁰⁰ and, more amply, in the rules and forms promulgated by the Commission.¹⁰¹ In addition to these specific disclosure mandates, the antifraud provisions, and thus the concept of "materiality," affect what disclosure is required.¹⁰² Thus, the disclosure system is not an organic whole, but rather a network of interrelated authorities and principles. For this reason, the limits of required disclosure, and thus the normative implications of those limits, are not readily apparent. As a result, there is widespread misunderstanding regarding the actual breadth of required corporate disclosure under the securities regulations.¹⁰³

A variety of principles significantly limit required corporate disclosure. First, the specific disclosure mandates enumerated in the SEC's forms and the S-K regulations are limited to a fairly narrow range of commercial and financial topics.¹⁰⁴ In addition, the anti-fraud provisions merely require disclosure of any supplementary information necessary to complete the informational portrait rendered in response to

and decision to reject disclosure of employment data lacking a rational basis, *rev'd*, 606 F.2d 1031 (D.C. Cir. 1979); H.R. 7010, 96th Cong. (1980); S. 2567, 96th Cong. (1980).

100. *See, e.g.*, '33 Act § 5, 15 U.S.C. § 77e (1994) (registration and prospectus requirements in connection with public offerings of securities); '34 Act § 13(a), 15 U.S.C. § 78m(a) (1994) (annual and periodic reporting requirements); '34 Act § 13(e), 15 U.S.C. § 78n(e) (1994) (requirements for issuer tender offers); '34 Act § 14(a), 15 U.S.C. § 78n(a) (1994) (requirements for proxy solicitations).

101. *See, e.g.*, Form 10-K, 17 C.F.R. § 249.310 (1997); Form 10-Q, 17 C.F.R. § 249.308a (1997); Form 8-K, 17 C.F.R. § 249.308 (1997); Schedule 13D, 17 C.F.R. § 240.13d-101 (1997); Schedule 14D-1, 17 C.F.R. § 240.14d-100 (1997); Schedule 14A, 17 C.F.R. § 240.14a-101 (1997) [hereinafter collectively Forms]; *see also* Regulation S-K, 17 C.F.R. § 229.103 (1994); Regulation S-X, 17 C.F.R. 210 (1996).

102. For example, SEC Rule 14a-9 prohibits any solicitation of a proxy based on a material misstatement or omission of fact. *See* SEC Rule 14a-9, 17 C.F.R. § 240.14a-9 (1997); *see also* '33 Act § 17(a), 15 U.S.C. § 77q(a) (1994) (prohibiting fraud in offer or sale of securities); '34 Act § 10(b), 15 U.S.C. § 78j(b) (1994) (prohibiting manipulative or deceptive practices in purchase or sale of securities).

103. For example, in numerous conversations I have observed that even attorneys knowledgeable and sophisticated in the area of corporate and securities law were surprised to learn of the absence of required disclosure of charitable contributions.

104. This reflects the Commission's view that Congress intended that the SEC would craft regulations protective of shareholders' *economic* interests. For the SEC's statements in this regard see Release No. 5627, *supra* note 97, at 85,710.

the financially-driven, line-item disclosure requirements.¹⁰⁵ As a result, the anti-fraud provisions neither “require disclosure of all material information” (as commentators frequently describe in shorthand), nor enlarge upon the kinds of information corporations must disclose.¹⁰⁶ Moreover, companies are under no continuous or general duty to disclose even all the “material” information in their possession;¹⁰⁷ and, furthermore, the concept of “material information” is a fairly narrow term of art. “All material information” does not encompass the full range of corporate information which actual investors might consider important.¹⁰⁸ In fact, although both the SEC and the courts have described the concept

105. See 17 C.F.R. §§ 210.3-06, 230.408, 240.14a-3(b)(3) (1997).

106. For example, although the *Staff Report on Corporate Accountability* states that “The Commission’s proxy rules include the requirement that all ‘material’ facts be disclosed in proxy and information statements,” in fact the disclosure mandate arising from the antifraud provision of the proxy rules is not nearly so comprehensive. STAFF REPORT ON CORPORATE ACCOUNTABILITY, *supra* note 95, at 260. Rather, Rule 14a-9(a) provides:

No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading (emphasis added).

Rule 14a-9(a), 17 C.F.R. § 240.14a-9 (1997).

107. *Basic Inc. v. Levinson*, 485 U.S. 224, 239 n.17 (1988); *Chiarella v. United States*, 445 U.S. 222, 235 (1980); *Levine v. NL Indus.*, 926 F.2d 199, 202 (2d Cir. 1991).

108. Although the SEC and the courts describe the body of material information in terms of the information desired by reasonable investors, the system is not designed to monitor and reflect the actual interests of real investors. Rather, the SEC’s disclosure system operates on the basis of a reified “reasonable investor.” This issue—whether the disclosure system should be “responsive” to actual shareholders’ disclosure preferences—was addressed by the SEC in its proceedings during the mid-1970’s. For example in Release No. 5627, the SEC stated “We have serious reservations as to whether Commission rulemaking can be premised upon an attempt to quantify investor interest” Release No. 5627, *supra* note 97, at 85,719. The SEC defended the propriety of operating independent of “the actual interests of investors,” on the rationale that a statistical survey “would at best produce results that might rapidly become outdated in light of the shifting and fluctuating nature of public opinion and the focus of popular attention from time to time.” *Id.* at 85,712. The SEC concluded that reference to the actual interests of investors “would not have been workable and would have been totally unstable.” *Id.* The Commission has thus manufactured a scheme of disclosure which reflects *its own view* of what investors should be interested in.

of materiality in terms of the information desired by "reasonable" investors, the SEC has applied the concept of materiality in narrow, purely economic terms.¹⁰⁹

Rule 405 of the '33 Act (which has been influential in interpreting '34 Act disclosure requirements as well) defines material information as that information "to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered."¹¹⁰ And in *TSC v. Northway*, the United States Supreme Court held that a "fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."¹¹¹ Although these regulations and the cases interpreting them suggest that the interest of reasonable investors in the disclosure of information will be met by the SEC's requirements, these authorities have in fact limited the scope of required disclosure according to an *unstated* criterion of *economic* materiality. In addition, they have failed to explain why shareholders' interest in corporate conduct of social but not immediate economic significance is not "reasonable."¹¹²

In light of the foregoing, the absence of a disclosure requirement in the charitable contributions area is unmysterious. First, from the perspective of economic materiality, there is no indication that the SEC is aware of the increased size of the charitable donations which are made by many major public corporations. Indeed, the SEC's probable ignorance on this matter is unsurprising, in light of the fact that company-specific contributions data is not routinely made publicly available, and relatively little academic study or popular commentary has been devoted to this

109. See, e.g., STAFF REPORT ON CORPORATE ACCOUNTABILITY, *supra* note 95, at 262-76.

110. 17 C.F.R. § 230.405 (1996); see also SEC Rule 12b-2, 17 C.F.R. § 240.12b-2 (1997).

111. *TSC Indus. Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

112. The point was made by Judge Richey in *Natural Resources Defense Council, Inc. v. SEC*:

There are many so-called "ethical investors" in this country who want to invest their assets in firms which are concerned about and acting on environmental problems of the nation. This attitude may be based purely upon a concern for the environment; but it may also proceed from the recognition that awareness of and sensitivity to environmental problems is the mark of intelligent management. *Whatever their motive, this Court is not prepared to say that they are not rational investors and that the information they seek is not material information within the meaning of the securities laws* (emphasis added).

389 F. Supp. 689, 700 (D.D.C. 1974). Nevertheless, in subsequent stages of the litigation the plaintiffs were unsuccessful in forcing the SEC to respond to their interests in broadened disclosure. See *Natural Resources Defense Council, Inc. v. SEC*, 432 F. Supp. 1190 (D.D.C. 1977), *rev'd*, 606 F. 2d 1031 (D.C. Cir. 1979).

subject. Yet even if the Commission was aware of the expanded dimensions of contemporary corporate giving, the standard of economic materiality applied by the SEC is in the range of five percent or even ten percent of annual corporate profits.¹¹³ Thus, many public corporations could make annual donations of tens of millions of dollars without meeting the SEC's threshold of economic materiality.¹¹⁴

In addition, there are non-economic rationales for requiring disclosure of corporate charitable contributions. Shareholders may wish to alter the amount or chosen beneficiaries of the company's philanthropy, or they may seek to ascertain whether the expenditures are in conformity with their personal beliefs. But although the SEC has acknowledged its obligation to promote "the fair opportunity for corporate suffrage," it has chosen largely to ignore nonmonetary shareholder interests in promulgating its regulations. One exception to this monetized view of shareholders' interests has been in the area of shareholder proposals. The SEC has created the opportunity for investors to submit proposals on matters of social significance independent of the usual criterion of economic materiality.¹¹⁵ But the Commission has always been uncertain about its

113. For example, although Item 103 of the S-K regulations requires disclosure of "material pending legal proceedings," the instructions to the rule clarify that no disclosure is required with respect to any proceeding "that involves primarily a claim for damages if the amount involved, exclusive of interest and costs, does not exceed 10 percent of the current assets of the registrant and its subsidiaries on a consolidated basis." Regulation S-K, 17 C.F.R. § 229.103 (1996). Even the disclosure of litigation arising under federal, state or local environmental provisions is, with narrow exception, governed by a "10 percent of the current assets of the registrant and its subsidiaries" standard. *Id.*

114. For example, in 1995, General Motors earned \$4.9 billion and Exxon Corp. earned \$7.5 billion. See Robert J. Sherwood, *The Forbes 500s Profits*, FORBES, Apr. 21, 1997, at 188. On this basis, annual charitable contributions of less than \$490 million and \$750 million, respectively, would not only conform to the existing state law standards, but might not even meet the threshold economic standard for required disclosure.

115. SEC Rule 14a-8 of the '34 Act, 17 C.F.R. § 240.14a-8, the so-called shareholder proposal rule, provides shareholders a mechanism to have their proposals submitted to a vote of shareholders through inclusion in the company's proxy. See 17 C.F.R. § 240.14a-8 (1997). Nevertheless, the Rule includes 13 grounds for a company's exclusion of the shareholder's proposal from the corporate proxy statement. See *id.* Substantial controversy has surrounded the exclusions for matters not sufficiently economically material to the company and matters relating to the conduct of the company's ordinary business; that is, exceptions (c)(5) and (c)(7) under the Rule. Nevertheless, from the late 1970's until the early 1990's, the SEC and the Staff of the Division of Corporate Finance had refused to sanction exclusion under these provisions where a shareholder's proposal related to a significant matter of social policy, independent of the usual criterion of economic materiality.

position on “social proposals,”¹¹⁶ and since 1992 it has sought to narrow shareholders’ ability to force the inclusion of social proposals in corporate proxies.¹¹⁷

The narrower scope given to socially significant shareholder proposals and the absence of a charitable contributions disclosure requirement is especially problematic in light of recent developments. As Nancy Knauer has described,¹¹⁸ Presidents Reagan, Bush and Clinton, as well as recent Congresses, have taken an active interest in encouraging corporate charitable contributions. These efforts have included sponsoring the creation of nonprofit corporations they hoped would be funded primarily by corporate contributions. Most recently, the need for increased corporate giving was an important theme of the “Presidents’ Summit on America’s Future,” held in Philadelphia at the end of April, 1997.¹¹⁹ The featured speakers included Nancy Reagan, George Bush, Bill Clinton, Al Gore, and General Colin Powell. Thus, while the Congress and prominent politicians have sought to create new incentives for corporations to use

116. Because it is so critical to shareholders’ ability to voice their concerns, the shareholder proposal rule has been the subject of substantial controversy and persistent amendment by the Commission. The literature on shareholder proposals is large. For a concise history and (negative) critique of its operation, see Richard Y. Roberts, *Shareholder Proposal Reform—A Search for Objectivity in Rule 14a-8*, 22 SEC. REG. L.J. 235-46 (1994).

117. For example, in 1993 the Commission approved the determination of the Staff of the Division of Corporate Finance that shareholder proposals relating to general employment could be excluded by companies, under exception (c)(7) of Rule 14a-8, as “ordinary business”—notwithstanding the relevance of social policy issues. See *Cracker Barrel Old Country Store, Inc.* SEC No-Action Letter, [1992-1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) § 76,418, at 77,284 (Oct. 13, 1992). In response, the shareholder which had submitted the proposal, the New York City Employees’ Retirement System (NYCERS), sued the SEC for failure to comply with the Administrative Procedure Act in altering its interpretation of the Rule. Although NYCERS succeeded at the district court level, the Second Circuit Court of Appeals ruled in favor of the SEC. The upshot of the controversy is that the SEC has expanded its authority to deny shareholders access to the proxy under an enlarged view of what is “ordinary [corporate] business.” Shareholders who disagree with the SEC’s determination that a given proposal is excludable as “ordinary business,” and a company’s consequent decision to exclude it, are faced with the costly prospect of suing individual companies to force inclusion of the proposal. For the argument that expanding the ordinary business exclusion, and thus the ability of shareholders to submit socially significant proposals, represents a move towards objectivity see Roberts, *supra* note 116.

118. See Nancy J. Knauer, *Reinventing Government: The Promise of Institutional Choice and Government Created Charitable Organizations*, 41 N.Y.L. SCH. L. REV. 945 (1997).

119. See T.J. Rodgers, *Holding Up the Shareholder*, N.Y. TIMES, Apr. 29, 1997, at A23.

charitable contributions to subsidize federally-sponsored social policy initiatives, the SEC has limited shareholders' power to have a voice in, or even knowledge of, corporate social expenditures.¹²⁰

Furthermore, recent campaign finance controversies (including the official reprimand of the current Speaker of the House, Newt Gingrich)¹²¹ have illuminated how corporations have used charitable contributions to influence federal election campaigns.¹²² Such expenditures are highly controversial, in light of the Tax Code's prohibition of electoral politicking by nonprofit organizations,¹²³ as well as the Federal Election Campaign Act's prohibition on corporate campaign contributions.¹²⁴ Nevertheless, in light of the relevance of corporate free speech guarantees, and for more political reasons,¹²⁵ it is unlikely that legal reform will significantly limit the political influence of public policy institutes,¹²⁶ and hence the ability

120. The SEC's conservative stance in regard to shareholder proposals might potentially be forced to change as a result of the findings of a study mandated by the National Securities Markets Improvement Act of 1996. Congress asked the SEC to study "whether shareholder access to proxy statements . . . has been impaired by recent statutory, judicial, or regulatory changes" and to evaluate "the ability of shareholders to have proposals relating to corporate practices and social issues included as part of proxy statements." National Securities Market Improvement Act of 1996, Pub. L. No. 104-290, § 510(b)(1), 110 Stat. 3416 (1996).

121. In January of 1997, in response to the findings resulting from an Ethics Committee investigation, the House of Representatives voted to reprimand the Speaker and to fine him \$300,000. Mr. Gingrich was found to have been insufficiently attentive to the legal limits pertaining to activities of his political action committee and a network of politicized charitable organizations which benefited him in his campaign for office. For further discussion of Mr. Gingrich's relationship to certain politicized charitable organizations, see Kahn, *Corporate Philanthropy*, *supra* note 1, at 644-51.

122. *See id.* at Part V.

123. *See* I.R.C. § 501(c)(3) (1994) (prohibiting on charitable organizations' participation in elections and in "substantial" lobbying).

124. *See* Federal Election Campaign Act, 2 U.S.C. § 441b(a) (1994).

125. Politicians themselves—because they are under constant fund-raising pressure—have a stake in quashing reforms which would limit their access to corporate funds. In the fall of 1997, both the Senate and the House held hearings on campaign finance reform which were marked by highly partisan battles.

126. Public policy institutes or "think tanks" are active in influencing politics and policy formation in ways which extend beyond electoral politics. For example, the *New York Times* recently reported on the "research arm" of the National Governors Association, which received millions of dollars in tax deductible contributions from major corporations including AT&T, Exxon, General Motors, Dow Chemical, Pfizer, Blue Cross/Blue Shield, Philip Morris and Goldman, Sachs & Company. The National Governors Association defended the practice in terms of assuring the availability of "the best advice on important issues," but critics view the donations as affording big business

of corporations to use charitable contributions to subsidize their political activities. In this regard, the absence of a corporate charitable contributions disclosure requirement serves powerful political interests.

Of course, the limits of required corporate disclosure are more troubling for the fact that they are implicit rather than express. As described above, the securities regulations do not give notice of the fact that they require disclosure of only a narrow range of corporate conduct—conduct deemed economically material by the SEC.¹²⁷ Because the SEC's disclosure requirements do not articulate the normative principles which define them (that is, the narrow and essentially economic interpretation of materiality and the limited scope of the line-item disclosure requirements), we—as investors, commentators, or legislators—are less likely to “miss” what we do not see. As was true in regard to the states' modern corporate philanthropy laws, we are unlikely to perceive the significance of what has been left unstated. By keeping this vital, defining aspect of their architecture unstated, the securities regulations have contributed to the widespread misperception that they require disclosure of all the corporate information in which investors might reasonably be interested. This misperception has given investors and the public a false sense of confidence in the transparency of corporate conduct.

While the SEC has portrayed itself as attempting to “stick to business” in establishing the limits of required disclosure, its policies have had undeniable political implications: they have supported the concentration of not only economic but also social power in the hands of corporate management. Once the limits of SEC-required corporate disclosure become apparent, one must question why the standards of accountability which apply to the exercise of governmental power (and which underlie the Freedom of Information Act, for example) are inapplicable to corporate conduct. Even if we accept the propriety of centralized, board control in many areas of corporate affairs (as we accept the notion of “representative” democracy), prospective investors surely have a right to base their investment and voting decisions on a broadened universe of information, including “socially significant information,” if they so choose. In light of the widespread unavailability of corporate social information, it is insufficient to argue that shareholders are free to invest “elsewhere.” In addition, a justification for limited corporate disclosure

“a lobbying advantage unavailable to their adversaries on major policy issues.” John H. Cushman Jr., *Corporate Gifts Help Gain Access to U.S. Governors*, N.Y. TIMES, May 17, 1997, at A1.

127. This “exclusionary” work is done, again, by the absence of line-item disclosure requirements in regard to charitable and political contributions, and most environmental, employment, and product safety information; and also by virtue of the limited definition of “materiality” which has been employed by the SEC and the federal courts.

which points to the "private" nature of corporate affairs is increasingly suspect in a political climate in which the government is dedicated to shifting traditionally public functions to the "private" sector.¹²⁸ This trend towards privatization should force a reconsideration of the limits of "rights" in a corporate-dominated world, and the limited power of shareholders to obtain socially relevant corporate information.

Interestingly, although the SEC's regulations fail to articulate a justification for their exclusion of most socially significant information, the Commission addressed itself to this question in certain litigation and proceedings held in the 1970s.¹²⁹ Although the SEC failed to expand the disclosure status quo significantly as a result of these proceedings, the proceedings did succeed in forcing the agency's views into the open. In a series of releases and reports issued by the Commission and its staff from the mid to late 1970s,¹³⁰ the SEC presented arguments supporting its decision to decline to expand corporate disclosure. Most of the SEC's arguments against expanded disclosure were practical, rather than conceptual or philosophical in nature; and twenty years later, in light of changed circumstances, these practical arguments should be reevaluated.

The SEC had argued that the transaction costs of social disclosure were prohibitive, in relation to the amount of investor interest. Yet the continued vitality of "social choice" investing (notwithstanding the existing informational hurdles which hinder the practice)¹³¹ suggests that there is

128. The issue of privatization within the United States has arisen in regard to the funding of the arts, management of welfare reform and other social services, waste and water management, as well as the administration of schools and prisons, for example. See, e.g., Abner J. Mikva, *Privatization Temptation*, CONN. L. TRIB., Oct. 21, 1996, at 23; Gary Peller, *The New Private Law: Public Imperialism & Private Resistance*, 73 DENV. U. L. REV. 1001 (1996); Paul Starr, *The Meaning of Privatization*, 6 YALE L. & POL'Y REV. 6 (1988); Robert H. Wessel, *Privatization in the United States*, BUS. ECON., Oct. 1995, at 45.

129. See *supra* note 99.

130. See Release Nos. 5235, 5386, 13482, 13901, *supra* note 99; Release No. 5627, *supra* note 97; THE WHEAT REPORT, *supra* note 99; STAFF REPORT ON CORPORATE ACCOUNTABILITY, *supra* note 95.

131. The need for mandatory corporate reporting of environmental, employment and contributions data through SEC-mandated filings is accentuated by the fact that such information is often difficult or impossible to obtain from public agencies on a timely basis. In addition, corporations do not consistently voluntarily comply with informational requests from shareholders or the public. According to Paul Hilton, a social research analyst at Smith Barney, although substantial progress has been made in regard to pollution data (on the basis of the Community Right to Know Act and the Toxic Release Inventory), EEO-1 forms, which are filed with the Equal Employment Opportunity Commission, may be obtained from individual companies only upon their consent or, otherwise, in many but not all cases, through correspondence with the Contract and

substantial investor interest in corporate social policies, both among individual and institutional investors.¹³² In addition, because of increased investor interest in corporate social policies, as well as the presence of increased regulation (and penalties) affecting corporate hiring, employment and environmental policies, corporate conduct which is socially irresponsible is frequently also financially reckless.¹³³

The SEC has also argued that the costs of producing and disseminating this socially significant information are prohibitive, and that an "avalanche" of social information would undermine the system. However, recent changes in information technology, including low cost web sites and software systems which include word-search capabilities, alter the potential costs associated with furnishing investors with social information, and diminish the dangers of informational "overload." In particular, it is easy to imagine a system in which interested shareholders would be furnished with a computer disk or, alternatively, would log on to a company's web site containing socially relevant corporate information, in which they could "word-search" for the particular matters about which they were concerned.¹³⁴ Furthermore, in many areas of social concern, including

Compliance Office of the Department of Labor. Most social choice investing is conducted on the basis of reports compiled by a few professional organizations such as Kinder, Lydenberg, Domini & Co., Inc., which are specifically dedicated to amassing the available data. Although helpful in systematizing this data, these organizations have no superior access to the kind of corporate information under discussion. Telephone Interview with Paul Hilton, Social Research Analyst, Smith Barney (May 15, 1997). For further discussion of "socially responsible" investing, see George Djurasovic, *The Regulation of Socially Responsible Mutual Funds*, 22 IOWA J. CORP. L. 257 (1997); see also Maria O'Brien Hylton, "Socially Responsible" Investing: *Doing Good Versus Doing Well in an Inefficient Market*, 42 AM. U. L. REV. 1 (1992).

132. Furthermore, the SEC's disclosure policies themselves affect or even shape investor interest, since people cannot become concerned about corporate social issues unless they have significant information about them.

133. The costs associated with employment discrimination suits have reached the tens of millions of dollars, for example. In the first half of 1997, a settlement of \$176 million was approved in a race discrimination case against Texaco, while Publix Super Markets settled a claim of sex discrimination for \$81.5 million.

134. On-line information services will inevitably alter the debate over corporate social disclosure. For example, the annual Toxics Release Inventory, credited with "encouraging companies to voluntarily control their pollution," is currently published on-line, as well as in hard copy. See John H. Cushman, Jr., *E.P.A. Is Pressing Plan To Publicize Pollution Data*, N.Y. TIMES, Aug. 12, 1997, at A1. Furthermore, the E.P.A. is currently working on a new initiative named the Sector Facility Indexing Project which would consolidate such information as plant emissions, spills, inspections, and penalties relating to factories in five industries and present it in an accessible form on the agency's World Wide Web site. While the industries are trying to block the project on the grounds that it will "confuse and alarm the public," the New York Times described it as "the most

corporate charitable contributions, corporations are presently required to compile and to organize a substantial amount of data, either to comply with existing regulations or to respond to potential governmental inquiries (such as income tax audits of charitable deductions). For this reason, corporate disclosure could be broadened substantially without adding significant information gathering costs for firms.

The political ramifications of limited corporate social disclosure must also be considered. Limited corporate social disclosure has enhanced the ability of corporate managers to affect the workforce, the community and the environment without having to be accountable to investors or the public for their acts and decisions. Reasonable persons may disagree about the optimum level of direct shareholder participation in corporate affairs, but the question of participation is distinct from the prior question of knowledge and information. Limited social disclosure has abridged shareholders' power to exercise their existing voting and investment rights consistent with social conscience concerns. Furthermore, by limiting disclosure according to a norm of economic materiality, the SEC has validated and institutionalized a system in which investors are encouraged to ignore the social implications of most corporate conduct.

The political and normative content of the SEC's regulations should be recognized and addressed more fully. The SEC's position in limiting shareholders' access to socially significant corporate information (and, thus, corporate power) has been inherently conservative and elitist, and neither the Commission nor (at various instances) the individual commissioners, have been entirely forthright in this regard. In particular, in electing to preserve the disclosure status quo after the proceedings and litigation of the 1970s, as well as in its recent efforts to limit shareholder proposals on matters of social concern,¹³⁵ the agency has defended its positions in terms of preserving the "neutrality" or "objectivity" of the agency and of the investment process generally.¹³⁶

innovative step so far in a steady campaign by the Clinton Administration to expand 'right to know' initiatives." *Id.* If the project is realized, "anyone with a computer and a modem could browse through data that, while held in public files, are usually inaccessible to most citizens." *Id.* Such initiatives will pressure companies to coordinate their own environmental disclosure with that required by the E.P.A.

135. *See supra* notes 99, 117.

136. The Commission has historically defended its reliance on a standard of *economic* materiality on the basis that it provides an objective standard for required disclosure. *See* Release No. 5627, *supra* note 97, at E-10-13; STAFF REPORT ON CORPORATE ACCOUNTABILITY, *supra* note 95 at 269. In addition, the idea that commerce is somehow neutral, and to be protected against the influence of meddling, activist investors, is implicit in the notion of "ordinary business" as it operates in the SEC's shareholder proposal rule. *See supra* note 117. Furthermore, in response to the problem of deciding which employment proposals constitute ordinary business, and would

This notion of neutrality is unsound and misleading. Because the SEC has assumed primary responsibility for administering the shareholder voting process and regulating the flow of information to investors in public companies, there is no neutral position available to the SEC. Whatever rules the Commission adopts will substantially affect the allocation of power between corporate managers and corporate investors. Thus, the accepted exclusion of social disclosure, as well as the recent drive to limit shareholder proposals on social matters, has not made the SEC neutral or objective, has not made investing neutral or objective and has not made corporate conduct socially or politically neutral or objective. Rather than a move towards neutrality or objectivity, limiting the ability of shareholders to know about and to express their views about socially significant corporate conduct has merely institutionalized a form of silence at the expense of corporate shareholders and the broader community.

This bureaucratic intensification in the corporate form, and the lack of transparency surrounding it, has encouraged the devaluation of individual responsibility (limited information discourages shareholder interest and influence) and, in turn, even corporate responsibility (limited information limits corporate accountability). If shareholders were to become more informed, and if they elected to use their influence to affect corporate social policy, they might or might not pay a price in terms of investment return,¹³⁷ but the current regime of enforced ignorance carries its own price. Limited corporate social disclosure has fostered a false distinction between shareholders as investors and shareholders as citizens. It is time for the SEC's disclosure system to be broadened to allow for moral and social values, as well as economic ones.

therefore be excludable by corporations, the Staff (with full Commission endorsement) has determined to consider all such proposals as ordinary business—as if this blanket decision to allow exclusion represents a return to objectivity. *See id.* (“In recent years, however, the line between includable and excludable employment-related proposals based on social policy considerations has become increasingly difficult to draw As a result, the Division has determined that the fact that a shareholder proposal concerning a company’s employment policies and practices for the general workforce is tied to a social issue will no longer be viewed as removing the proposal from the realm of ordinary business operations of the registrant.”) In sum, there has been a confusion between the search for standards based on objective criteria, and the inherently non-neutral, politically significant role of the SEC in policing corporate disclosure. *See Roberts, supra* note 115; *but cf.* Steven M.H. Wallman, *Equality is More Than Ordinary Business*, N.Y. TIMES, Mar. 30, 1997, at § 3 (Money & Business), at 12; John J. Coffee, Jr., *Blocking Bias Via Reform*, WALL ST. J., Feb. 2, 1993, at A14.

137. The *New York Times* recently reported that corporate America implemented required environmental reforms throughout the late 1970s and 1980s at costs which were substantially less than they had feared and protested. *See* Claudia H. Deutsch, *Cooling Down the Heated Talk*, N.Y. TIMES, May 27, 1997, at D1.

IV. CONCLUSION

The modern philanthropy laws establish legal grounds for an “activist” corporation. Rather than dissolving into a “nexus of contracts,” the philanthropic firm is a social institution which may actively engage the culture and community which surrounds it. While the influence of the law and economics movement has highlighted the private, contractual aspect of corporate law and notions of allocative efficiency, the philanthropy laws, in contrast, deal with distributive issues. For this reason, and because they authorize corporate managers to administer social as well as economic resources, the philanthropy laws are fundamentally political in nature. Indeed, as discussed above, they cannot be adjudged according to the ordinary commercial or fiduciary standards applied by courts in the corporate context.

The active involvement of the bar and community nonprofit organizations provides a historical explanation for the genesis of these laws, and reminds us that law is a cultural and political artifact, rather than the product of inhuman, evolutionary forces. But the concise nature of the philanthropy laws begs the hard questions about corporate giving, leaving these laws “ungrounded.” Indeed, it is likely that the philanthropy laws have escaped controversy because they are sufficiently terse as to seem inconsequential, because they have been camouflaged by the rest of the enabling corporate laws, and because they fail to provide for company-specific required disclosure, which would focus attention on them.

While corporate law has accommodated the notion of the socially active corporation, neither corporate law nor the securities regulations have afforded investors a reliable means of obtaining information about corporate charitable and political contributions, or most employment practices and environmental matters. By interpreting concepts such as “reasonable investors,” and “materiality,” according to exclusively economic norms, the SEC has sought to limit controversy regarding these aspects of corporate conduct. Limited social disclosure has also signalled to investors that they are free to disregard the social effects of corporate business. Although the Commission may continue to oppose expanded corporate social disclosure, these subjects—corporate community involvement, corporate political participation, environmental contamination, and fairness and humane practices in employment matters—show every sign of remaining prominent on the political and journalistic landscape and significant to the operation of corporate business. For these reasons it is unlikely that the SEC will continue to succeed in warding off controversy by arguing that corporate social disclosures are either impracticable or unimportant.