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# **POLITICAL DONATIONS BY COMPANIES**

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**A Consultative Document  
March 1999**

**URN 99/757**

# **POLITICAL DONATIONS BY COMPANIES**

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The Prime Minister announced in November 1997 that he was extending the terms of reference of the Committee on Standards in Public Life to enable the Committee to study the funding of political parties in the United Kingdom. The Committee presented its report to the Prime Minister in October 1998.

One of the issues considered by the Committee in its report was whether shareholders should have to give consent to company political donations at given intervals. The Committee were responding to increasing concern by both the public and shareholders that many corporate political donations appear to reflect the directors' personal political affiliations rather the interests of the company.

The Committee made two main recommendations in relation to political donations by companies. First, it recommended that a company wishing to make a donation to a political party should have to have the prior authority of its shareholders. Secondly, it recommended that "donation" should be defined so that it covers not only monetary donations but other forms of financial benefit, including any sponsorship, or loans or transactions at a favourable rate. The Government accepts both of these recommendations, but wishes to seek views both on their implementation and on related issues, such as the disclosure by companies of political donations.

The Committee has set out seven principles of public life: selflessness, integrity, objectivity, accountability, openness, honesty, and leadership. These principles do, of course, have a wider application than public life, and I believe that the principles of openness and accountability are of particular importance to companies and their directors. The Committee's recommendations on corporate political donations, together with the related proposals set out in this consultation paper, should ensure that the public and shareholders may have much greater confidence that, when a company makes a donation to a political party, it is doing so because the donation is demonstrably in the company's interest. This will be of benefit to everyone with an interest in this area: company directors, shareholders, politicians, party fundraisers, and, not least, all those who care about the democratic process in this country.

1.1 The Companies Act 1985 (“the Act”) recognises that, notwithstanding directors’ general powers to manage the business of their company as they see fit, there are circumstances under which directors should be required to seek shareholder approval before they undertake a particular course of action. In particular, Part X of the Act requires directors to seek prior shareholder approval in circumstances where a director’s personal interests might conflict with his duty to the company. More generally, a board of directors is accountable to the shareholders as a whole for its stewardship of the company.

1.2 In recent years there has been growing concern about directors’ accountability to shareholders in relation to political donations by companies. This concern is due in part to the scope for conflict between a director’s personal wishes or interests and his duty to the company. Moreover, the Companies Act, by requiring all donations in excess of £200 to be declared in the directors’ report and the recipients identified, already recognises that even small political donations may cause justifiable concern to shareholders and cannot be treated as routine business expenditure. The very low threshold for disclosure suggests that the key issue is not whether the sums are material to the company’s finances but whether the donation is in the company’s interest.

1.3 In October 1998 the Committee on Standards in Public Life, chaired by Lord Neill of Bladen, presented to the Prime Minister its report<sup>1</sup> on the the funding of political parties in the United Kingdom (“the Neill Report”). The Report recommended that any company wishing to make a donation to a political party in the United Kingdom should have to have the prior authority of its shareholders (recommendation 34).

1.4 The Government accepts this recommendation, and intends to amend the Companies Act 1985 and the Companies (Northern Ireland) Order 1986 to give it effect. There are three areas on which it seeks views:

- how should a “political donation” be defined with respect to donations by companies ?
- how should companies legislation be amended to give effect to the Neill Committee’s recommendation that a company should have to have the prior authority of its shareholders ?
- what changes should be made to the existing disclosure provisions relating to political donations in Schedule 7 to the Companies Act 1985 ?

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<sup>1</sup> Cm 4057-I “The Funding of Political Parties in the United Kingdom”, October 1998.

## **Deadline for comments**

1.5 Comments on any issue raised by this consultative document would be welcomed.  
**Replies should be submitted by 23 April 1999 to:**

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1.6 Further copies of this document may be ordered (quoting the document's identifying reference URN 99/757) from:

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## **Open Government**

1.7 Under the Code of Practice on Access to Government Information, comments may be made publicly available unless consultees specifically request otherwise. Consultees should indicate, therefore, if they wish their response to remain confidential.

## **Further consultation and implementing legislation**

1.8 The Government intends to publish a draft Bill to implement the main findings of the Neill Report by the Parliamentary Summer Recess. The results of this consultation will inform the drafting of the relevant sections of that Bill.

2.1 The Government believes that it is important that directors should be fully accountable to shareholders in respect of donations by companies to political parties. It is not convinced that current practice and procedures are achieving this goal.

2.2 The Committee on Standards in Public Life has recommended to the Government that a company wishing to make a donation should have to have the prior authority of its shareholders. The Committee did not believe that the current arrangements for company donations, under which directors have discretion whether to contribute to a political party and whether to seek shareholders' consent, would be satisfactory in an era of greater openness about the sources and uses of party funds.

2.3 There is clear evidence that shareholders do not view political donations as routine business expenditure. According to a report<sup>2</sup> by Pensions Investment Research Consultants Limited (PIRC), investors holding approximately 13% of the shares on the UK equity market have either stated their opposition to political donations or have said that they expect companies seeking approval for such donations to provide a clear statement as to how the donations would be in shareholders' interests. Moreover, companies which have put down resolutions seeking shareholder approval have seen significant levels of opposition. In its evidence to the Committee, PIRC cited the example of an annual general meeting in 1995 where 48% of proxy votes were cast against a resolution by the company to make a political donation.

2.4 It may also be considered that, in a case where one of the directors was a member of the political party to which a donation was to be given, there could be a conflict between the director's personal interests and his duty to the company which would make such a requirement analagous to the requirements for shareholder approval under Part X of the Companies Act 1985 (e.g. the requirement under section 319 for prior shareholder approval for a director's contract of employment for more than five years).

2.5 The current disclosure requirements under the Act are in some respects already tightly drawn; directors are, for example, required to disclose donations to a person who is carrying on activities which could be reasonably be regarded as likely to affect support for a political party. The requirements have, however, been criticised for applying only to monetary donations; companies have, therefore, been able to provide other forms of financial benefit to political parties without the knowledge of shareholders.

2.6 The Government believes, therefore, that the Neill Committee has made a strong case for its recommendations on political donations by companies. It accepts the Committee's views that companies should need shareholder authority to make any type of donation or provide any form of financial benefit to a political party or organisation, and that all such donations and benefits should be disclosed annually in

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<sup>2</sup> "Trends in Political Donations and Shareholder Authorisation", January 1998.

the directors' report.

Recommendations in the Neill Report

3.1 The Neill Committee’s recommendation relating to political donations by companies describes a “political donation” by a company as any donation (whether in cash or in kind, and including sponsorship, or loans or transactions at a favourable rate) to a political party or organisation.

3.2 The main discussion in the Neill Report about the definition of a political donation is in relation to disclosure by the political parties themselves (sections 4.44 and 4.45). In this context, the Committee recommended that the definition should cover all means by which financial aid could be given to a political party or to candidates or Members of Parliament including:

- the provision of paid employees’ time and free use of equipment and facilities;
- any goods or services supplied at below their true cost, the gift element being the difference between true cost and the charge actually made;
- loans made on other than “arm’s length” open-market terms, examples being interest-free loans, loans with uncommercial rates of return, and loans which revert to gifts (at the time they revert);
- sponsorship.

3.3 The Neill Committee accepted that sponsorship may be seen by the sponsor as marketing expenditure, but felt that this did not change the fundamental position that sponsorship provides financial support for a political party. The Committee pointed out that the effect of sponsorship is to replace (and so to release) funds which the party would otherwise have to or would like to spend.

3.4 The Neill Committee recognised that a company “donation” might be made primarily for political purposes even when it is not made to a registered political party. The Report noted that:

“The parties themselves could set up a wide range of front organisations. Alternatively, even without any collusion between the parties and outsiders, individuals or organisations could engage in large-scale propaganda that was clearly intended either to promote the election of one party or to discourage the election of another” (section 10.72).

3.5 The Report recommended that any individual or organisation which incurs election expenses should be subject to limits on campaign expenditure (section 10.76), and that “election expenses” should be taken to include expenses that are clearly intended to promote or have the foreseeable effect of promoting some parties or to disparage other parties irrespective of whether such parties are mentioned by name in

the individual's or organisation's advertising or other promotional material (section 10.80).

### Provisions in the Companies Act 1985

3.6 Under paragraph 5(2) of Schedule 7 to the Companies Act, a company is treated for the purposes of disclosure in the directors' report as giving money for political purposes if, directly or indirectly-

- (a) it gives a donation or subscription to a political party of the United Kingdom or any part of it; or
- (b) it gives a donation or subscription to a person who, to the company's knowledge, is carrying on, or proposing to carry on, any activities which can, at the time at which the donation or subscription was given, reasonably be regarded as likely to affect public support for such a political party as is mentioned above.

### Government's position

3.7 The Government agrees with the view of the Neill Committee that, in the context of companies, the definition of a "political donation" should include:

- all forms of donation to a political party (whether in cash or in kind);
- loans to, or transactions with, a political party at a favourable rate;
- sponsorship of a political party or an event sponsored by a political party, although, as the Neill Report noted<sup>3</sup>, this form of donation is arguably rather different from a company perspective.

3.8 It believes also that the definition should cover "donations" (as defined above) to other organisations or individuals engaged in activities which could reasonably be regarded as likely to affect public support for a political party.

3.9 The Government wishes to seek the views of consultees on the two following points:

- whether the definition of "donation" in respect of political donations by companies should cover any advertising or other promotional material by a company which could reasonably be regarded as likely to affect public support for a political party;

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<sup>3</sup> Neill Report, section 4.45: "Money provided by way of sponsorship may be seen by the sponsor as marketing expenditure."

- whether the definition of a “political donation” should, in relation to companies, include donations to foreign political parties or organisations.

3.10 Comments on this approach are invited.

Current provisions in company law

4.1 Shareholders' current powers in relation to political donations are in practice very limited. Given the management powers conferred on directors by the articles of association of almost all companies, shareholders seeking to prevent a company's directors from making political donations would have to follow one of three routes:

(a) *challenge the donations in court on the grounds that the making of political donations fell outside the objects clause in the company's memorandum*

The objects clause sets out the objects for which a company is formed. A company cannot enter into activities and contracts which are outside its object clause as it would then be acting *ultra vires* (although the validity of such activities and contracts as regards third parties cannot be challenged). A shareholder may, however, seek to obtain an injunction restraining a director from engaging in future action of such kind. The company may also institute proceedings against a director for breach of duty and for recovery of the amounts disbursed by the director in breach of the company's constitution. It is, however, very unlikely that a legal challenge on these grounds would be successful. Most objects clauses are expressed very broadly, and whatever is incidental to the objects set out in the memorandum would be regarded as *intra vires* unless expressly forbidden. It is implicit in the disclosure requirements in Schedule 7 of the Companies Act 1985 that political donations are not necessarily beyond the capacity of a company.

(b) *challenge the donations in court on the grounds that the directors have acted in breach of their fiduciary duties*

The exercise by the directors of their management powers within the objects of the company can be challenged if the action taken is in breach of the fiduciary duties of the directors. Thus, if a political contribution was not made *bona fide* in the interests of the company for the purposes of its business, the director would be in breach of duty. However, the courts have always been highly reluctant to review the merits of business decisions of the board. They regard it as the directors' function to run the company and not the courts'. A decision to which some genuine business purpose can be attached is very unlikely to fall to a challenge on these grounds. Moreover, fiduciary duties are enforceable by the company and not by individual shareholders save in exceptional circumstances and under conditions which it is very difficult for the individual shareholder to meet.

*(c) require the directors to obtain prior shareholder approval by amending the company's Articles or by giving directions under the Articles*

This would require the passing of a special resolution at a general meeting. Members holding 5 % of the total voting rights, or not less than 100 members holding shares on which there has been paid an average sum per member of not less than £100, may on giving six weeks' notice to the company require it to send to all members notice of a resolution that they intend to move at the next annual general meeting. The difficulties of collective action by shareholders in the face of a hostile management are well known and the requirement would be an unusual intervention by shareholders in the management of the company.

4.2 Shareholders could also put down an ordinary resolution on political donations. Although this would not be binding on the directors, even if passed by a huge majority on a poll vote, it would carry moral weight.

4.3 **Annex C** provides a fuller account of the company law provisions relating to directors' accountability to shareholders.

#### Recommendation in the Neill Report

4.4 The Neill Report proposed that a company wishing to make a donation to a political party should have to have the prior authority of the shareholders. It suggested that this authority could be in the form of a broad enabling power, valid for no longer than four years, and typically conferred by a resolution passed at an annual general meeting giving the board of directors discretion about the making of such donations up to a prescribed limit (recommendation 34).

#### Possible reform of company law: prior shareholder approval

4.5 The most widely canvassed option is that favoured by the Neill Committee, namely a requirement on companies to obtain shareholder approval before making political donations.

4.6 Under this option, directors would be obliged to obtain prior approval from shareholders for political donations by the company. A provision to this effect in the Companies Act would override any contrary provisions in a company's memorandum and articles. The amendment to the Companies Act could be drafted in a number of different ways.

- It could, for example, permit the board to seek a general and unlimited authority from shareholders, so that the directors were left with total discretion over the amount, timing and recipient of future donations;
- It could permit the board to seek a broad enabling power, but require the company to seek renewed shareholder authority after a time period laid

down in the Companies Act. (The Neill Report suggested that a broad enabling power should be valid for no longer than four years).

- There could be a requirement for the board to seek shareholders' approval for each individual donation before it was made.
- The board could be required to seek shareholders' approval annually for expenditure up to a prescribed limit, in order to support an identified political party.

4.7 The position of subsidiaries would require special consideration. It would clearly be unacceptable if a requirement for prior shareholder approval could be circumvented by donations being made through a subsidiary company, particularly in cases where the parent company was the subsidiary company's only beneficial shareholder. The Department therefore proposes that, in the case of a company which is a subsidiary (as defined by section 736 of the Companies Act 1985) of a company incorporated in Great Britain or Northern Ireland, it should be a requirement that the shareholders of both that subsidiary company itself and any parent company should give their prior approval to a donation being made.

4.8 The position of a company which is a subsidiary of a foreign company (that is, a company not incorporated in Great Britain or Northern Ireland) will be considered by the Government in relation to the proposed ban on the foreign funding of UK political parties.

4.9 It is also necessary to consider whether effective remedies would be available. Generally it is for the company itself, acting through the board, to bring an action against a director if he appears to have acted in breach of his fiduciary duties. It would, for example, be possible for the company to bring an action for misappropriation of money against one or more of the executive directors if they had made a corporate donation without the approval of the board. Directors who had made political donations in these circumstances would, however, be able to prevent legal proceedings being brought against them by the company if they controlled, or obtained the support of, the majority of votes on the board. Court action by the company to force directors to reimburse the company from their personal funds would, therefore, be feasible only in circumstances where directors who made political donations without proper authorisation did not have majority support on the board.

4.10 Alternatively, shareholders collectively or individually could bring an action against the company. Under existing company law, the scope for such action is in practice very limited, although reforms are in prospect..

4.11 The Law Commission published a report<sup>4</sup> in 1997, in consultation with the Scottish Law Commission, which considered the remedies available to a minority shareholder of a company who is dissatisfied with the way in which the company is run. The report recommended that the common law rule on derivative action (that is,

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<sup>4</sup> Law Com No 246 "Shareholder Remedies", October 1997.

an action where a member of a company brings proceedings on behalf of the company, in relation to wrong done to the company) should be modernised by being replaced with a new derivative procedure. The Department provisionally supports the majority of the Law Commission's recommendations, and is currently assessing responses to its own consultation based on the Law Commission's proposals. It believes that the proposals may provide a more effective means of redress for individual shareholders in circumstances where a company made a political donation without shareholder authorisation.

4.12 Other options which might be considered include:

- (a) making directors liable to a criminal offence if they agree to a political donation being made by a company without shareholder approval. The directors of a holding company would be liable where they permitted a subsidiary to make a donation without the approval of the shareholders of the holding company;
- (b) creating special procedures under which directors who agreed to a political donation being made by a company without shareholder approval could be required personally to repay to the company the amounts donated (or under which the directors of a holding company who failed to obtain the necessary authority from their shareholders to a donation by a subsidiary would be required personally to repay to the subsidiary the amounts donated);
- (c) giving shareholders special rights of action in relation to political donations.

The Department would welcome the views of consultees on these options.

4.13 There could also be a requirement on political parties to ensure that all corporate donations had been approved by shareholders.

#### Possible reform of company law: other options

4.14 Two other main options for reform have been put forward since 1985. These are:

- (a) a requirement on companies to ballot shareholders about the making of political donations if they made such donations in the preceding financial year;
- (b) a requirement on companies which wish to make political donations to establish a separate political fund.

4.15 Option (a) would be similar to the amendment moved by Lord Williams of Elvel at Committee stage in the Lords during the passage of the Companies Act 1989, which would have required that, where a directors' report disclosed that political donations had been made, that part of the report should not be signed, but should be put to the general meeting for approval by ordinary resolution. This would give shareholders a

right to vote on political donations, but would not give them the power to undo such donations once they had been made. Since shareholders can already make their views known to directors, by, for example, formally putting the question of donations on the agenda of a general meeting, this option would add little of substance to shareholders' existing rights. In any event, the Act requires the report as a whole to be signed and not a part of it. It is difficult to see what the consequences of shareholder disapproval would be. The donation would already have been made, and refusal to accept a report of what had occurred would appear futile.

4.16 Option (b) would oblige companies that wished to make donations for political purposes to establish a political fund entirely separate from other company funds. It is likely that, under this option, a percentage of dividends payable to shareholders would be put into a political fund; shareholders who objected to payment of part of their dividend to a political party would have the right not to contribute, and to receive the full value of their dividend payment.

4.17 There are two main arguments which may be put forward against option (b):

- It departs fundamentally from the accepted principles of company law. The orthodox view is that political donations are made by the directors to promote the interests of the company. They are thus an expense in earning the return to shareholders, not part of that return itself; the donations are made from company funds, not shareholder funds. Under this option, however, political contributions would be viewed as the expenditure of funds which rightly belong to the the shareholder. The Department believes that this view would be incorrect. Shareholders have an interest in the company, not in the company's assets. These can only become the shareholders' assets if lawfully distributed. If a company's assets were put in such a fund, the company would no longer be the beneficial owner of the assets, and provision would need to be made for the operation and safeguarding of the fund. There would also be taxation implications for the shareholders.
- There would be considerable costs and bureaucracy involved in allowing individual shareholders to choose the destination of the fund. Even a collective decision-making procedure would incur costs which would, presumably, have to be financed by or from the political fund itself. It is likely, therefore, that the whole business of setting up and running such a fund would be deeply unattractive to most companies.

#### Government's position

4.18 The Government accepts the Neill Committee's recommendation that a company wishing to make a donation to a political party should have to have the prior authority of its shareholders.

4.19 The Government believes that, as a result of its acceptance of the Neill Committee's recommendation, there is no need for it to give further consideration to a

possible requirement on companies to ballot shareholders about the making of political donations if they made such donations in the preceding financial year.

4.20 The Government does not believe that a strong case has been made for a requirement on companies which wish to make political donations to establish a separate political fund. It does not therefore intend to take this option further.

4.21 Comments on this approach are invited.

## Chapter 5

## Disclosure by companies of political donations

### Current provisions in company law

5.1 The disclosure requirements in the Companies Act 1985 are already, in many respects, tightly drawn. The directors of a company are required by section 234 of the Companies Act 1985 to prepare a report for each financial year which, in accordance with Schedule 7 to the Act, includes:

- (a) if money given in the financial year for political purposes or charitable purposes exceeds £200 in amount, a statement of the amount of money given for political purposes;
- (b) the name of each person to whom money has been given for political purposes exceeding £200 in amount, and the amount of money given;
- (c) if money exceeding £200 in amount has been given by way of donation or subscription to a political party, the identity of the party and the amount of money given.

5.2 The requirements in Schedule 7 relating to the disclosure of political gifts do not apply to wholly-owned subsidiaries of companies incorporated in Great Britain. Paragraph 4 of Schedule 7 requires the parent companies of such subsidiaries to disclose the money given by the parent company and the subsidiaries between them.

5.3 The requirement on directors to prepare a directors' report applies to all directors. Companies which qualify as "small" under section 247 of the Companies Act 1985 are, however, not required to send a copy of the directors' report to the registrar of companies; as a result, reports prepared by the directors of small companies are available only to shareholders.

5.4 Under the current requirements:

- companies are required to disclose only monetary donations, and not other forms of financial benefit, such as sponsorship or loans at a favourable rate;
- companies are not not required to disclose political donations made, directly or indirectly, to foreign political parties.

5.5 The threshold for disclosure was increased from £50 to £200 by statutory instrument in 1980. It has stood at £200 since 1980.

### The Neill Report

5.6 The Neill Report (sections 6.24 - 6.26) outlines the current disclosure requirements, but does not make any recommendations relating directly to disclosure by companies.

5.7 The main recommendations in the Neill Report relating to the disclosure of political donations by political parties are that:

- donations to the funds of political parties from one source which total £5,000 or more in one year must be publicly disclosed;
- donations to party constituency organisations or to regional organisations of political parties from one source which total £1,000 or more in one year must be publicly disclosed;
- audited annual accounts of income and expenditure of political parties should be delivered to the proposed Election Commission within three months of each year's end;
- the published information concerning donations should clearly identify the donor, specify the amount of the donation or its cash value, state the date when made (or, in the case of a series of donations exceeding the statutory limit, the date of the last one) and whether made to the central funds of the party or to a constituency association etc.

5.8 The Committee's recommendation on political donations strongly implies that the Companies Act disclosure requirements should be amended to apply to the provision of all forms of financial benefit and not only to monetary donations; this is not, however, directly stated.

#### The Government's position

5.9 The Government believes that the current Companies Act disclosure requirements need to be re-examined in light of the Neill Committee's overall recommendations on political donations by companies. In particular, the Government believes that companies should be required to disclose all forms of financial benefit to political parties, including donations in kind, sponsorship, or loans at a favourable rate.

5.10 There are other points relating to disclosure on which the Government wishes to seek the views of consultees. These concern:

- the threshold for disclosure;
- a possible requirement that a director be required to disclose in the directors' report any connection with a political party or organisation which might give rise either to a conflict of interest or to the perception of a conflict of interest;
- the disclosure of donations to foreign political parties.

5.11 Comments on this approach are invited.

## **Chapter 6**

## **Summary**

6.1 The Government accepts the Neill Committee's recommendation that legislative provision should be made to require any company intending to make a donation (whether in cash or in kind, and including any sponsorship, or loans or transactions at a favourable rate) to a political party or organisation to have the prior authority of its shareholders.

6.2 The Government would, however, welcome comments on the implementation of the Committee's recommendation, and on related issues. In particular, it would welcome views on:

- the definition of a "political donation" with respect to donations by companies;
- the way in which companies legislation should be amended to give effect to the Neill Committee's recommendation that a company should have to have the prior authority of its shareholders;
- what changes, if any, should be made to the existing disclosure provisions relating to political donations in Schedule 7 to the Companies Act 1985.

These views will influence the drafting of the relevant sections of the draft Bill to implement the main findings of the Neill Report, which the Government intends to publish by the Parliamentary Summer Recess.

6.3 If you have comments on any of the issues raised in this consultation paper, please provide them to the address given in paragraph 1.5 by 23 April 1999.

**Report by the Committee on Standards in Public Life on the Funding of Political Parties in the United Kingdom - extracts relating to political donations by companies**

1 The Prime Minister announced in November 1997 that he had asked the Committee to review issues in relation to the funding of political parties, and to make recommendations as to any changes in present arrangements.

2 The Committee published its recommendations to the Government in October 1998. The sections of the Committee's report relating to political donations by companies are set out in full below.

**“Political donations by companies**

**6.24** The Companies Act 1967 (the 1967 Act)" imposes a duty on companies to declare (via the directors' report) any political donations above a certain threshold. Initially the threshold was set at £50, but it was increased to £200 by statutory instrument in 1980 . The declaration requirement applies only to monetary donations. It does not apply to donations in kind (for example, the provision of property or equipment) nor to favourable rates on business transactions or loans. It is the only explicit regulation regarding corporate donations to political parties.

**6.25** Monetary political donations greater than £200 must be declared in full and published in the company's directors' report. Small companies are not required to file such reports. Directors' reports of companies which do have to file them are open to scrutiny by shareholders, and the public, but there is no central record of the companies that give political donations. That information is held in the reports of over one million registered UK companies. (The extent of political donations set out in these reports has, however, been compiled in part by various organisations, most notably by Pensions and Investment Research Consultants (PIRC), the Labour Research Department and some Internet sites.) Our recommendation that any donation at or above £5,000 should be disclosed to the Election Commission, which would subsequently publish all details, will make obsolete this time-consuming compilation for the most significant of company donations. Aggregate donations of less than £5,000 in a year will not be recorded by the Election Commission, and we believe it should be at the discretion of the monitoring bodies involved whether they wish to undertake the task of recording such donations.

**6.26** Company law places the responsibility for all financial decisions ultimately on the Board of Directors, and their authority in acting for the good of the company is usually enough to justify a political

donation. Further, the Board of Directors generally has discretion to delegate any decision-making power. The establishment of a company, however, involves drawing up a Memorandum and Articles of Association which state the objects of the company. These must be clearly set out and made public. The Board of Directors is bound by their contents.

**6.27** If the Board of Directors, or indeed any individual director, acts outside the terms of the Memorandum and Articles of Association, the issue can be taken to court by the company, a shareholder or even a member of the public. The 1983 case of *Simmonds v. Heffer and Others* concerned an £80,000 donation from the League Against Cruel Sports to the Labour Party prior to the 1979 General Election. The donation was in fact £50,000 directly for the Labour Party and £30,000 for specific activity related to animal welfare. The former was declared by the courts to be beyond the powers conferred by the Memorandum and Articles of Association of the League Against Cruel Sports, a non-profit-making limited company. The absence of any other cases may be because Memoranda and Articles of Association are usually sufficiently broad to enable political donations to be made legally.

**6.28** Discussion about the legality of corporate political donations has encouraged some companies to change their Memorandum and Articles of Association to include explicit objects authorising the making of political donations. A recent PIRC report identified 42 companies which made political donations in 1996-97, of which 24 per cent had explicit authority within their Memorandum and Articles of Association to make a political donation. The Memorandum and Articles of Association can be amended through a special resolution at the annual general meeting (AGM), for example to require the Board of Directors to ballot shareholders before making political donations. This kind of action is rare, as is any direct challenge to the authority of the Board of Directors.

**6.29** In many companies the ordinary shareholders have little voting strength in comparison with the large institutional shareholders such as pension funds. So it may be difficult for them to bring about a change in the Articles or in the Board's policy. If a shareholder objects to a political donation his only recourse may be to sell his or her shareholding.

**6.30** Although Boards of Directors are generally not required to seek shareholder approval before making a political donation, some companies now regard it as good practice to do so. Nevertheless, there are no established procedures or rules. Resolutions may be subject to a show of hands or card vote at the AGM or to a postal ballot. The form of resolutions ranges from authorisation for a specific donation to the granting of powers to the Board of Directors to make political donations for the next 3-5 years. The declared votes against political donations have ranged from 6 per cent to 48 per cent, which is significant

considering that resolutions at AGMs are carried by an average 98 per cent approval for actions of the Board of Directors.

### **Extent of institutional donations**

**6.31** In the mid-1980s trade unions provided around 80 per cent of the Labour Party's £5.8 million a year income. By 1996 that proportion had fallen to 35 per cent of the Party's £21 million income although in absolute terms it had risen from £4.64 million to £7.35 million. It is not so much that trade unions are giving less but that companies are now contributing more to the Labour Party than they used to do. According to the Labour Research Department (LRD) in 1995-96 the Caparo Group gave Labour £47,000, GLC Ltd gave £30,000, and Mirror Group £21,000, while the Political Animal Lobby gave £125,000. Some companies (Pearson, Sun Life, Tate & Lyle) made donations both to Labour and the Conservatives. The LRD told us that in the mid 1980s they would expect to find some 50 per cent of Conservative Party income coming from corporate sources, whereas now the party admits the figure is down to 20 per cent.

### **The consent of shareholders**

**6.32** The Committee wants to ensure first that information about significant donations to political parties by trade unions or companies is publicly available. That objective will be achieved by our general recommendations about disclosure in Chapter 4. Secondly, we want to be satisfied that arrangements exist to confer the authority of trade-union members and company shareholders on expenditure by institutions for political purposes.

**6.33** As we have said above, our view is that the reforms introduced by the 1984 Act are sufficient to secure the assent of trade-union members for donations to political parties. In particular, we support the long-standing arrangements which enable dissenting members to contract out of making contributions. We have considered whether the 10-year interval between ballots about a political fund is too long, but we conclude that the system has settled down well and works satisfactorily.

**6.34** We are less supportive of the present arrangements for company donations. It does not seem satisfactory, in the new era of transparency which we advocate, that companies should have no obligation to obtain shareholders' consent for donations to political parties. In our view, it is time that the obligations on companies were put on a footing comparable with that to which the trade unions have become accustomed. We propose that a company wishing to make a donation to a political party should have to have the prior authority of the shareholders. It would not be necessary to seek such authority annually or before making each donation. A general prior authority would be

sufficient, subject to renewal at reasonable intervals, which we suggest should be every four years. We choose that period because it corresponds to the average length of a Parliament. The principle should extend to donations to political organisations other than political parties and to other forms of financial benefits made available to political parties: free services, interest free loans, sponsorship and so forth. The authority granted should specify an upper limit for donations.

**6.35** We recognise that this will leave a dissenting shareholder with no real remedy other than the sale of his or her shares, but at least such a shareholder will have had an opportunity to vote specifically on the matter, and the company will be more accountable for any political action which it takes in the name of the shareholders.

*Recommendation 34 Legislative provision should be made to require any company intending to make a donation (whether in cash or in kind, and including any sponsorship, or loans or transactions at a favourable rate) to a political party or organisation to have the prior authority of its shareholders. This authority could be in the form of a broad enabling power, valid for no longer than four years, and typically conferred by a resolution passed at an annual general meeting giving the board of directors discretion about the making of such donations up to a prescribed limit.*

**6.36** We are conscious that this recommendation will, if implemented, seem to put a greater onus on companies wishing to make donations than on trade unions setting up political funds. A distinction has to be drawn, however, between the bureaucracy involved in holding a ballot of trade-union members, and the adding of a single question to the agenda of an AGM. In any event, trade unions normally have annual conferences which give any member or group of members an opportunity to table motions about any aspect of the use of political funds.

**6.37** It was put to us that dissenting shareholders ought to have some sort of rebate, or augmented dividend. We invited some witnesses with long business experience to give us their view of that proposition. They confirmed our impression that there would be considerable complications in administering any kind of rebate scheme. We have not considered this idea further.”

**Companies Act 1985: current disclosure requirements relating to political donations**

Schedule 7 to the Companies Act 1985 sets out the matters to be dealt with in the directors' report. Paragraphs 3-5 of Schedule 7, which relate to the disclosure of political and charitable gifts, are given in full below.

*Political and charitable gifts*

3 (1) The following applies if the company (not being the wholly-owned subsidiary of a company incorporated in Great Britain) has in the financial year given money for political purposes or charitable purposes or both.

(2) If the money given exceeded £200 in amount, there shall be contained in the directors' report for the year -

(a) in the case of each of the purposes for which money has been given, a statement of the amount of money given for that purpose, and

(b) in the case of political purposes for which money has been given, the following particulars (so far as applicable) -

(i) the name of each person to whom money has been given for those purposes exceeding £200 in amount and the amount of money given,

(ii) if money exceeding £200 in amount has been given by way of donation or subscription to a political party, the identity of the party and the amount of money given.

4 (1) Paragraph 3 does not apply to a company which, at the end of the financial year, has subsidiaries which have, in that year, given money as mentioned above, but is not itself the wholly-owned subsidiary of a company incorporated in Great Britain.

(2) But in such a case there shall (if the amount of money so given in that year by the company and the subsidiaries between them exceeds £200) be contained in the directors' report for the year -

(a) in the case of each of the purposes for which money has been given by the company and the subsidiaries between them, a statement of the amount of money given for that purpose, and

(b) in the case of political purposes for which money has been given, the like particulars (so far as applicable) as are required by paragraph 3.

5 (1) The following applies for the interpretation of paragraphs 3 and 4.

(2) A company is to be treated as giving money for political purposes if, directly or indirectly -

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

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

(3) Money given for charitable purposes to a person who, when it was given, was ordinarily resident outside the United Kingdom is to be left out of account.

(4) "Charitable purposes" means purposes which are exclusively charitable; and, as respects Scotland, "charitable" is to be construed as if it were contained in the Income Tax Acts.

## Company law: directors' accountability to shareholders

### The nature of a limited liability company incorporated under the Companies Act

- 1 From the date of incorporation, a company becomes a body corporate or corporation. It is an artificial legal person with rights and duties distinct from its members or shareholders.
- 2 Every company must have a memorandum of association, which is filed with the Registrar of Companies on a company's incorporation. The memorandum outlines a company's constitution and defines the scope of a company's powers. Section 2(1) of the Companies Act 1985 ("the Act") requires that the memorandum must state the **objects of the company**. A company cannot enter into activities and contracts which are outside its objects clause as it would then be acting *ultra vires*, or beyond its powers, although, if it does do so, the validity of such activities and contracts as regards third parties is preserved by section 35 and 35A of the Act..
- 3 Many commercial companies have an objects clause which will allow the company to carry on any trade or business whatsoever and to do all things that are incidental or conducive to the carrying on of any such trade or business. A company's objects should be reasonably interpreted, and whatever is incidental to the objects set out in the memorandum should be regarded as *intra vires*, that is, within the company's powers, unless expressly forbidden.
- 4 Many large companies, including those with an official listing on the London Stock Exchange will have an objects clause which explicitly permits the company to make donations for charitable or other reasons. A typical clause would allow the company to support, or subscribe to, any charitable funds or institutions, or any benevolent schemes or projects of public or general interest, where the directors consider that the company's support may be considered likely, directly or indirectly, to further the objects of the company or the interests of its members.
- 5 Section 7 of the Act states that a company limited by shares may register with the memorandum articles of association signed by the subscribers to the memorandum and prescribing regulations for the company. In practice, all companies have articles of association. (Companies limited by guarantee and unlimited companies must register articles of association). The articles govern the rights of members among themselves and set out the way in which a company must conduct its affairs.
- 6 The Secretary of State may prescribe by regulations model articles of association. In the case of a company limited by shares, the model articles known as Table A will constitute the company's articles if articles are not registered, or to the extent that such articles adopt or do not disapply Table A.

## Role of directors

7 As a company is an artificial legal entity, it cannot exercise any of its powers in person, and must of necessity act through the medium of its agents - its directors.

8 The articles of association of almost all companies delegate the power of managing the company to the directors. Article 70 of the Model Articles set for a company limited by shares under The Companies (Tables A to F) Regulations 1985 states that:

“Subject to the provisions of the [Companies] Act, the memorandum and the articles and to any directions given by special resolution, the business of the company shall be managed by the directors who may exercise all the powers of the company. No alteration of the memorandum or articles and no such direction shall invalidate any prior act of the directors which would have been valid if that alteration had not been made or that direction had not been given”.

9 Section 282 of the Companies Act 1985 stipulates that every public company registered on or after 1st November 1929 must have at least two directors; public companies registered before that date and private companies must have at least one director.

10 The making of political donations will be decided on by the directors, under Article 70 and specific articles equivalent to it, as expenditure which they consider appropriate or necessary to make having regard to the interests of the company. If the making of political donations is within the company's powers, it is highly unlikely that the courts would seek to review the merits of the directors' decision and declare the donation invalid. The courts are extremely reluctant to review any business decision of the board on its merits, although they might take a more interventionist approach in relation to non-commercial companies, e.g. incorporated charities when asked to decide whether a decision was within such a company's constitution. It is, however, the directors' function, not the courts', to run the company.

## Position and rights of shareholders

11 A person becomes a member of a company when he agrees to become a member and his name is entered in the register of members. In the case of a company limited by shares, its shareholders are its members.

12 The main rights of a member relevant to this consultation paper are that:

- he is entitled to a copy of the memorandum and articles of the company and, unless provided otherwise by the articles, to receive a notice of general meetings;
- he has a right to vote at company meetings;
- he is entitled to receive a copy of the company's annual accounts, together with a copy of the directors' report for that financial year and the auditors' report on the accounts, at least twenty-one days before a general meeting;

- he may, on his own or with other members, requisition a general meeting and circulate resolutions;
- he is entitled to a dividend, when a dividend has been duly declared.

13 The Companies Act 1985 requires shareholder approval in respect of the following types of proposals by the board of directors:

*(a) Proposals for fundamental change to the company*

Such proposals require the passing of a special resolution. Under section 378(2) of the Act, a resolution is a special resolution when it has been passed by a majority of not less than three-fourths of such members as (being entitled to do so) vote in person or, where proxies are allowed, by proxy, at a general meeting of which not less than 21 days' notice, specifying the intention to propose the resolution as a special resolution, has been duly given. The following are some of the changes requiring a special resolution:

- alteration of the objects clause in the memorandum;
- alteration of the articles;
- reduction of share capital;
- approval of an *ultra vires* transaction i.e. relieving a director of liability for causing the company to engage in activity beyond its capacity.

*(b) Proposals relating to the proper governance of the company*

These proposals may be passed by ordinary resolution:

- under section 303 of the Act, a company may remove a director from office, notwithstanding anything in the articles or in the agreement between him and the company;
- for public companies only] the appointment of auditors;
- the remuneration of auditors appointed by the company in general meeting.

The Act does not require shareholders to approve the appointment of directors but it does require that, in the case of a public company, each proposed director must be voted on individually unless there is unanimous consent to a block resolution.

*(c) Proposals where a director's personal interests might conflict with his duty to the company*

Part X of the Companies Act 1985, which deals with the enforcement of fair dealing by directors, requires prior approval by ordinary resolution in each of the following circumstances:

- payment to a director by way of compensation for loss of office (that is, payment beyond his contractual entitlement);
- a contract of employment for a director for more than 5 years;

- substantial property transactions between a director and the company.

14 Articles of association commonly require companies to seek approval by ordinary resolution before distributing the dividend. Since 1996, the Stock Exchange Listing Rules have required listed companies to obtain shareholder approval for directors' long-term incentive schemes prior to their adoption, because they potentially commit shareholders' funds for more than one year ahead, or dilute the equity.