

***Dodge v. Ford Motor Co.*, 170 N.W. 668 (Mich. 1919)**

[The Ford Motor Company (“FMC”) was founded in 1903 by a number of investors, including Henry Ford and brothers John F. Dodge and Horace E. Dodge (“the Dodge brothers”). Henry Ford, who held a 58% interest in FMC, was also FMC’s President and a director on its board. The Dodge brothers held a 10% interest, were not on the board of directors nor employed by FMC.

FMC’s business strategy was focused on mass-market cars that were lower priced but appealed to a larger group of potential customers. To afford to sell cars at a low price, FMC focused on mass production of cars and vertical integration (owning the businesses that produced the raw materials needed to produce cars). These allowed it to continuously reduce the cost of its cars, and the lower costs allowed selling the car at a lower price, making its cars affordable to customers who were previously priced-out. For example, according to Wikipedia, the standard Model T 4-seat open tourer of 1909 cost \$850 (equivalent to \$20,513 today). The price dropped to \$550 in 1913 (equivalent to \$12,067 today); to \$440 in 1915 (equivalent to \$9,431 today); and to \$290 (equivalent to \$3,258 today) in the 1920s.

Beginning in 1911, regular annual dividends were \$1.2M. In addition, between 1913 and 1915 the company paid special dividends of \$10-11M each year. Then, in 1916, Henry Ford announced that FMC would no longer pay special dividends and that profits would be retained to pay for the new River Rouge plant, which will allow FMC to expand its production capacity; to double employees’ salaries; and to cut the price of cars.

The Dodge brothers sued: (1) for a decree requiring FMC to distribute to stockholders at least 75% of the accumulated cash surplus, and to distribute in the future all of its earnings “except such as may be reasonably required for emergency purposes”; and (2) to enjoin the construction of the River Rouge plant.]

* * *

[The court rejects plaintiffs’ arguments that FMC violated a state law ceiling on a corporation’s capital; that FMC exceeded the activities it was authorized to conduct (*ultra vires*); or that FMC violated antitrust laws.]

As we regard the testimony as failing to prove any violation of anti-trust laws or that the alleged policy of the company, if successfully carried out, will involve a monopoly other than such as accrues to a concern which makes what the public demands and sells it at a price which the public regards as cheap or reasonable, the case for plaintiffs must rest upon the claim, and the proof in support of it, that the proposed expansion of the business of the corporation, involving the further use of profits as capital, ought to be enjoined because inimical to the best interests of the company and its shareholders, and upon the further claim that in any event the withholding of the special dividend asked for by plaintiffs is arbitrary action of the directors requiring judicial interference.

The rule which will govern courts in deciding these questions is not in dispute. [...] This court, in *Hunter v. Roberts, Throp & Co.*, recognized the rule in the following language:

It is a well-recognized principle of law that the directors of a corporation, and they alone, have the power to declare a dividend of the earnings of the corporation, and to determine its amount. Courts of equity will not interfere in the management of the directors unless it is clearly made to appear that they are guilty of fraud or misappropriation of the corporate funds, or refuse to declare a dividend when the corporation has a surplus of net profits which it can, without detriment to its business, divide among its stockholders, and when a refusal to do so would amount to such an abuse of discretion as would constitute a fraud, or breach of that good faith which they are bound to exercise towards the stockholders.

In Cook on Corporations (7th Ed.) §545, it is expressed as follows:

The board of directors declare the dividends, and it is for the directors, and not the stockholders, to determine whether or not a dividend shall be declared.

When, therefore, the directors have exercised this discretion and refused to declare a dividend, there will be no interference by the courts with their decision, unless they are guilty of a willful abuse of their discretionary powers, or of bad faith or of a neglect of duty. It requires a very strong case to induce a court of equity to order the directors to declare a dividend, inasmuch as equity has no jurisdiction, unless fraud or a breach of trust is involved. There have been many attempts to sustain such a suit, yet, although the courts do not disclaim jurisdiction, they have quite uniformly refused to interfere. The discretion of the directors will not be interfered with by the courts, unless there has been bad faith, willful neglect, or abuse of discretion.

Accordingly, the directors may, in the fair exercise of their discretion, invest profits to extend and develop the business, and a reasonable use of the profits to provide additional facilities for the business cannot be objected to or enjoined by the stockholders.

[...] One other statement may be given from *Park v. Grant Locomotive Works*:

In cases where the power of the directors of a corporation is without limitation, and free from restraint, they are at liberty to exercise a very liberal discretion as to what disposition shall be made of the gains of the business of the corporation. Their power over them is absolute so long as they act in the exercise of their honest judgment. They may reserve of them whatever their judgment approves as necessary or judicious for repairs or improvements, and to meet contingencies, both present and prospective. And their determination in respect of these matters, if made in good faith and for honest ends, though the result may show that it was injudicious, is final, and not subject to judicial revision.

[...] When plaintiffs made their complaint and demand for further dividends, the Ford Motor Company had concluded its most prosperous year of business. The demand for its cars at the price of the preceding year continued. It could make and could market in the year beginning August 1, 1916, more than 500,000 cars. [...] It had declared no special dividend during the business year except the October 1915, dividend. It had been the practice, under similar circumstances, to declare larger dividends. Considering only these facts, a refusal to declare and pay further dividends appears to be not an exercise of discretion on the part of the directors, but an arbitrary refusal to do what the circumstances required to be done. These facts and others call upon the directors to justify their action, or failure or refusal to act.

In justification, the defendants have offered testimony tending to prove, and which does prove, the following facts: It had been the policy of the corporation for a considerable time to annually reduce the selling price of cars, while keeping up, or improving, their quality. As early as in June 1915, a general plan for the expansion of the productive capacity of the concern by a practical duplication of its plant had been talked over by the executive officers and directors and agreed upon; not all of the details having been settled, and no formal action of directors having been taken. The erection of a smelter was considered, and engineering and other data in connection therewith secured. In consequence, it was determined not to reduce the selling price of cars for the year beginning August 1, 1915, but to maintain the price and to accumulate a large surplus to pay for the proposed expansion of plant and equipment, and perhaps to build a plant for smelting ore. It is hoped, by Mr. Ford, that eventually 1,000,000 cars will be annually produced. The contemplated changes will permit the increased output.

The plan [...] calls for a reduction in the selling price of the cars. [...] The plan does not call for and is not intended to produce immediately a more profitable business, but a less profitable one; not only less profitable than formerly, but less profitable than it is admitted it might be made. The apparent immediate effect will be to diminish the value of shares and the returns to shareholders.

It is the contention of plaintiffs that the apparent effect of the plan is [...] to continue the corporation henceforth as a semi-eleemosynary institution and not as a business institution. In support of this contention, they point to the attitude and to the expressions of Mr. Henry Ford.

Mr. Henry Ford is the dominant force in the business of the Ford Motor Company. No plan of operations could be adopted unless he consented, and no board of directors can be elected whom he does not favor. [...] ‘My ambition,’ said Mr. Ford, ‘is to employ still more men, to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes. To do this we are putting the greatest share of our profits back in the business.’ [...]

He had made up his mind in the summer of 1916 that no dividends other than the regular dividends should be paid, ‘for the present.’

‘Q. For how long? Had you fixed in your mind any time in the future, when you were going to pay-- A. No.

‘Q. That was indefinite in the future? A. That was indefinite; yes, sir.’

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

[...] There should be no confusion (of which there is evidence) of the duties which Mr. Ford conceives that he and the stockholders owe to the general public and the duties which in law he and his codirectors owe to protesting, minority stockholders. A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among stockholders in order to devote them to other purposes.

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

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

We are not, however, persuaded that we should interfere with the proposed expansion of the business of the Ford Motor Company. [...] The ultimate results of the larger business cannot be certainly estimated. The judges are not business experts. It is recognized that plans must often be made for a long future, for expected competition, for a continuing as well as an immediately profitable venture. The experience of the Ford Motor Company is evidence of capable management of its affairs.

It may be noticed, incidentally, that it took from the public the money required for the execution of its plan, and that the very considerable salaries paid to Mr. Ford and to certain executive officers and employees were not diminished. We are not satisfied that the alleged motives of the directors, in so far as they are reflected in the conduct of the business, menace the interests of shareholders. It is enough to say, perhaps, that the court of equity is at all times open to complaining shareholders having a just grievance.

[...] Defendants say, and it is true, that a considerable cash balance must be at all times carried by such a concern. But, as has been stated, there was a large daily, weekly, monthly, receipt of cash. The output was practically continuous and was continuously, and within a few days, turned into cash. Moreover, the contemplated expenditures were not to be immediately made. The large sum appropriated for the smelter plant was payable over a considerable period of time. So that, without going further, it would appear that, accepting and approving the plan of the directors, it was their duty to distribute on or near the 1st of August, 1916, a very large sum of money to stockholders.

[The court upholds the lower court's decree that a dividend must be paid, but reverses the lower court's injunction against building the smelting plant.]