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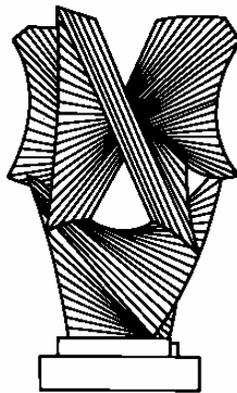
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Everything Old Is New Again:  
Lessons from *Dodge v. Ford Motor Company*

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**Everything Old Is New Again:  
Lessons from *Dodge v. Ford Motor Company***

*M. Todd Henderson\**

On November 2, 1916, the day after his son Edsel's wedding,<sup>1</sup> Henry Ford received a copy of the complaint that instigated one of the most famous lawsuits in the history of American corporate law. The case, *Dodge v. Ford Motor Company*,<sup>2</sup> was about minority shareholders' ability to challenge the authority of the board of directors to make business decisions that were alleged to be serving interests other than maximizing the value of plaintiffs' shares. The plaintiffs, John and Horace Dodge, were not strangers to Henry Ford: they were his longest and most important business partners, they were fellow board members for over a decade (1903 to 1913), and they had celebrated together at Edsel's wedding the night before. The Dodges, who had recently founded their own firm to compete with Ford, objected to a decision by the board to withhold special dividends and spend the millions of dollars to build the world's largest auto manufacturing facility. Their claim was that the decision was based on Henry Ford's idiosyncratic preferences about doing social good for workers and customers as opposed to making the most money for shareholders.

The Michigan courts struggled. Ford was emphatic in both his pretrial comments and his testimony that the decision to build the factory was about doing "as much good as we can, everywhere, for everybody concerned . . . [a]nd incidentally to make money."<sup>3</sup> Faced with Ford's candor about using someone else's money to achieve his personal goals, the court ordered the payment of a large dividend (about \$19 million), and enjoined construction of the factory.

The intervention by the court was a radical and outrageous result. Courts generally do not interfere with business decisions—deciding to build a factory is a quintessential one—even in the face of allegations that they are not profit-maximizing decisions. As long as the board considered the issue seriously and there is some plausible claim that the decision is in the best interests of the firm, courts defer to the business judgment of management. This test was met here: regardless of Henry Ford's rhetoric, expanding manufacturing capacity may

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\* University of Chicago Law School. I am grateful to Douglas Baird and Mark Ramseyer for their help and to the Sarah Scaife Foundation and the John M. Olin Foundation for research funding. Ali Beyer provided extremely able research support.

<sup>1</sup> There is a division of opinion about the timing of the suit that reflects the various opinions on the merits of the case. According to one historical account, the suit's "timing seemed a calculated insult . . . They had conversed congenially with the entire Ford family and said nothing about filing the suit." See STEVEN WATTS, *THE PEOPLE'S TYCOON* 255 (2005). Another book takes a more benign view:

The Dodges had already filed their suit when the invitations to Edsel's wedding arrived. They knew that the timing would upset Ford and they originally planned not to attend, but Edsel's fiancée, Eleanor Clay had been John Dodge's neighbor for six years, and she convinced the brothers to attend.

See Gelderman, Carol "Henry Ford: The Wayward Capitalist" 72 (1989).

<sup>2</sup> 204 Mich. 459 (1919).

<sup>3</sup> See ALLEN NEVINS & FRANK E. HILL, *FORD: EXPANSION AND CHALLENGE, 1915-33*, at 99-100 (1957) (quoting interview).

reduce costs and help increase profits. But Ford's comments made deference difficult for the court.

The Michigan Supreme Court corrected the mistake. Focusing less on Ford's silly comments and more on the policy implications of the ruling, the Court lifted the injunction. Declaring that "judges are not business experts", the court announced the widely accepted rule that courts generally will not substitute their judgment for those of boards.<sup>4</sup> It did not, however, give a complete victory to Ford. Splitting the baby, it held that the suspension of dividends allegedly needed to fund construction was an arbitrary and unlawful action by the board. Since there were other ways in which the company could fund the construction—for example, Ford himself was to receive about 60 percent of the dividend, which he could then reinvest<sup>5</sup>—this decision could send a signal that firms are about shareholder wealth creation, without inhibiting the firm from taking actions that might, after all, be good for shareholders in the long run. It did cost Ford personally, however, since tax rates on the forced dividend were quite high (about 70 percent), and therefore impressed on him and other business leaders the importance of shareholder wealth maximization. Viewed in this way, this seemingly Solomonic decision was arguably the right result.

But there is much more to this case than meets the eye. Many of the practices common today in venture capital transactions and corporate reorganizations appear vividly in the back-story of this case and show students of law that seemingly new ideas are not always so. The case's history also foreshadows the nature of ubiquitous conflicts between majority and minority investors that would animate corporate law litigation for decades to come. In addition, it demonstrates how modern techniques for allocating control rights separately from economic rights would have helped the parties here avoid costly and acrimonious litigation. Perhaps most interestingly, however, the backstory of the case shows that it is not clear at all that the parties *wanted* to avoid litigation. Both the Dodges and Henry Ford used the legal process as a tool in what was at base a business dispute. To paraphrase von Clausewitz, litigation is business by other means. The history of this case provides a prototypical example.

This essay examines the background of the litigation in an attempt to shed new light on the wisdom of what the *Dodge* court did, and to offer a new way of thinking about where the case fits in our modern understanding of corporate law.

## **I. The Beginning: Lessons Ford Learned from Failure**

Like most entrepreneurs, Henry Ford was originally and repeatedly a failure. His first two companies, the Detroit Automobile Company and the Henry Ford Company, made no cars and no profits.<sup>6</sup> They lasted less than three years

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<sup>4</sup> *Dodge*, 204 Mich. at 508-09.

<sup>5</sup> As discussed below, this would have been tremendously inefficient since tax rates on dividends increased to nearly 70 percent, which means less than a third of the dividend would have been available to reinvest. Ford had other options, however, including issuing new equity or borrowing from a bank.

<sup>6</sup> As discussed below, the Henry Ford Company was a failure for Ford but it survived him, took a new name, and became an incredible success. *See infra* \_\_\_\_.

combined and lost over \$200,000 in equity capital for investors.<sup>7</sup> After these failures, Ford's prospects did not look good. He had no obvious comparative advantage over hundreds of rivals racing to make the first commercially successful automobile. Ford was not the inventor of the automobile nor did he hold any valuable intellectual property rights in the new technology—in fact, he openly flouted purported patents held on the automobile by others. His failures also alienated wealthy individuals in Detroit who were funding new automobile companies.

Ford's failures, however, taught him lessons about corporate governance and law that ultimately enabled him to build one of the most successful companies of all time. Ford learned that majority shareholders (like the proto-venture capitalists who backed him) are tough taskmasters that demand results and profits. Like many entrepreneurs, Ford was stubborn, arrogant, confident in his own abilities, and fiercely independent. Although he needed other people's money to turn his ideas into reality, Ford, like most inventors, didn't want their opinions or their oversight—just the money. This is not the way things work. Entrepreneurs who use other people's money must account to those other people, often in disagreeable ways.

Investors demand control rights in return for their investments, lest the entrepreneur take the money and divert it into self-serving ends, such as shirking, stealing, or merely following a self-utility maximizing, but not profit-maximizing, path. The backers of Ford and his first attempts to build a "horseless carriage" acted just as investors in start-ups do today: they took board seats; they installed managers of their choosing to supervise work; they contracted for the ability to bring in outsiders to monitor at certain times or under certain conditions; and they preserved their rights to control how the firm would grow or die. Control rights do not always work, however, and the history of Ford's businesses shows this clearly. Notwithstanding explicit and implicit control rights, Ford did not do what his backers wanted, and without his final designs delivered, the investors cut their losses and put the companies out of business.

Examining the history of the failure of Ford's first two companies sheds light on his actions that led to litigation by the Dodges: in each case, Ford the inventor bristled and was ultimately forced out of what he viewed as "his" firms under the pressure of majority investors to deliver production cars and profits quickly. In short, Ford learned from his failures the perils of being a minority shareholder. Later, after *Dodge*, he would learn not to be a majority shareholder either. But we are getting ahead of ourselves. Let's start at the beginning.

#### *A. The Detroit Automobile Company*

Ford's first company, the Detroit Automobile Company, was a total failure. Ford blamed this on the investors who financed the company—they demanded cars be made and sold, while Ford was busy perfecting his design. Ford bristled under shareholder supervision, and he actively subverted efforts of the managers

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<sup>7</sup> WATTS, *supra* note 1, at 53-57.

to generate immediate profits. This caused delays, frustration on both sides, and eventually shutdown.

Many entrepreneurs raise their first capital from “friends and family”. Borrowing from family has its own perils, but for entrepreneurs, the ability to remain in control despite using other people’s money is more likely when the other people are family. Ford had a troubled relationship with his father, however, so instead, he turned to the Detroit business community and individuals he worked with at the Edison Illuminating Company, where he was a mechanic.<sup>8</sup>

George Peck, president of Edison, let Ford use a workshop to develop his first prototype, in return for a small equity stake. The Mayor of Detroit, William Maybury, provided loans, facilitated other loans with friendly banks, and greased the legal works, such as providing a license for Ford’s first test vehicle when some citizens complained about the noise. Three other wealthy individuals Ford knew from prior work and social experiences invested \$500 to help Ford build his second prototype in 1899.<sup>9</sup> It was a success.

With a workable car built and a fawning treatment by the local press,<sup>10</sup> Ford began to attract the attention of the local business community beyond his personal contracts. Ford’s key fundraiser was William Murphy, a wealthy Detroit businessman who acted as a proto-venture capitalist. The first step for Murphy, as for any start-up investor then or now, was to determine the technology to bet on. It was far from obvious at this time that Ford and his horseless carriage was the one. Ford was an unknown mechanic working at a power company, and although he had built a successful prototype, he did not have any valuable intellectual property, his design was not unique or especially novel, and he was not alone in pursuing the technology—there were over 500 nascent car companies in Detroit at the time.<sup>11</sup>

Murphy’s due diligence on Ford and his vehicle was an 80-mile test drive. It went well, and after he said to Ford: “We will now organize a company.”<sup>12</sup> Murphy planned to take a large stake in the new firm in return for his money, his business expertise, and access to his rich friends. Several famous Detroiters, including business owners, a United States Senator, life insurance executives, and wealthy heirs, invested a total of \$15,000 and received 1500 shares in the Detroit Automobile Company, which was incorporated on August 5, 1899.<sup>13</sup> Ford, as is typical in start-up firms today, invested no money but took a minority share of the equity in the firm in return for his designs and ideas.

Things started promisingly, as they always do. The firm made investments in a workspace and a small workforce of 13. There was energy and hope on the floor of the firm’s manufacturing space on Cass Avenue in Detroit. But hope was

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<sup>8</sup> DAVID L. LEWIS, *THE PUBLIC IMAGE OF HENRY FORD: AN AMERICAN FOLK HERO AND HIS COMPANY* 17 (1976).

<sup>9</sup> WATTS, *supra* note 1, at 51.

<sup>10</sup> “Ford’s Automobile Has New Features and Is a Novel Machine”, *DETROIT JOURNAL*, Jul. 29, 1899.

<sup>11</sup> Charles E. Duryea, “*Motor’s* Historical Table”, *MOTOR*, March 1909.

<sup>12</sup> J. BELL MORAN, *THE MORAN FAMILY: 200 YEARS IN DETROIT* 126 (1949).

<sup>13</sup> WATTS, *supra* note 1, at 51.

not enough for the investors who had put money on Ford and his prototype. To protect their investment, holders of a large percentage of the shares dominated the board and installed their agents in senior management positions. These managers were supposed to closely supervise Ford to protect the shareholders' investments. The governance protections, which resemble those in modern venture capital transactions, did not work.

There were numerous problems. Ford went through several designs (including a truck), and he was constantly tinkering with the design. This made it difficult to begin production. At this point, Ford was simply much better at designing cars than producing them, and his interests were in creating one design that would last rather than producing cars from an inferior design. The battle lines here were short term versus long-term interests, and entrepreneur (a belief in the thing partially for its own sake) versus investor (a belief in the thing only for the cash it produces).

Ford's initial car design was also not a good one, and no amount of management skill or corporate governance can save a company from a bad product. It is for this reason that successful venture capitalists today bet on the horse (the product) and not the jockey (the management) when funding startups.<sup>14</sup> Murphy and the other investors bet on a bad horse—according to one of Ford's engineers, Ford's first car that investors wanted to force into production rarely worked and when it did it had few virtues.<sup>15</sup>

Another problem was that Ford was not then interested in the manufacturing process, nor was he highly skilled in the machining of all necessary parts. Ford had shown he could make one car, but his short time running the shop at the Detroit Automobile Company showed that he did not know how to massproduce them to tight specifications. Ford would eventually solve this problem through outsourcing—yet another seemingly modern phenomenon—and then through a revolutionary manufacturing process, but that was years away. There is a deep irony here: the thing Ford was the worst at—assembly—would become his most enduring legacy.

Ford also bristled under the supervision of investors and their manager agents. Aggressive governance had a high cost. Ford was still tinkering with his design, and he resisted pressure by the shareholders to finalize the design so that production could begin. Here we see the first signs of the schism between entrepreneur and investor that was to plague Ford until after the *Dodge* case. Ford was still a designer and not yet a businessman, and he did not understand the pressure for profits and that majority shareholders demand control.

Ford's resistance to shareholder control took several forms, not the least of which was trickery. For example, when Ford heard that the investors were sending the company president, an investor-appointed stooge in his view, to visit the workshop to gauge progress and pressure Ford to move toward production, he ordered work done that would have the appearance of progress but that was

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<sup>14</sup> See Steven N. Kaplan et al., "Should Investors Bet on the Jockey or the Horse? Evidence from the Evolution of Firms from Early Business Plans to Public Companies" (August 2007). CRSP Working Paper No. 603 Available at SSRN: <http://ssrn.com/abstract=657721>.

<sup>15</sup> WATTS, *supra* note 1, at 55.

just obfuscation. The ruse worked, and the axels Ford ordered built during the visit were discarded as junk.<sup>16</sup>

Sometime later when the investors started to panic, several arrived at the factory for inspections. As recounted by one of Ford's engineers, Ford ordered workers to pretend as if work was being done toward making a final version of the car:

We had parts for about a half-dozen automobiles. We had a long bench, and all the parts we had finished were on it. [The investors] would come along and see all these parts on the bench . . . and it looked wonderful.<sup>17</sup>

The success of these tricks would not last long. After several months without progress, investors with small stakes, little information, and no control began to look for ways of exiting. The lead investors were the only willing buyers, and as a result consolidated their ownership interests.

Consolidation in times of financial distress is another modern phenomenon that the history of this case shows existed long ago. It was sensible here since the lead investors were wealthy and could afford the rising risk profile of the firm. Consolidation also reduced the collective action problem among investors in terms of monitoring. Fewer holders means lower decision costs on questions like whether to make additional investments, whether and how to monitor, and what should be done to dispose of assets in the event of a failure. This is a common feature of modern corporate reorganizations,<sup>18</sup> but it is also evident in the failure of the Detroit Automobile Company.

When the fate of the firm was clear, investors Murphy and Mayor Maybury moved quickly and with force impossible with dispersed ownership. They called Ford to a meeting in November 1900 to discuss the lack of progress, demanding immediate action towards completion of a production version of the car. Ford refused to attend and kowtow before what he viewed as speculators and people only interested in money. Shortly thereafter in January 1901, the board dissolved the firm.

### *B. The Henry Ford Company*

Some of the investors who steered the Detroit Automobile Company toward dissolution bought its assets in order to try again. They turned again to Ford, who they still believed had the best extant design. The investors, led by Murphy, funded Ford's work for about a year, at which point he had a new design. Murphy was willing to take a longer-term view, while the other remaining shareholders of the defunct Detroit Automobile Company would not. Murphy's

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<sup>16</sup> *Id.* at 56.

<sup>17</sup> *Id.*

<sup>18</sup> See Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. PA. L. REV. 1209 (2006) (showing how creditors today routinely cash out minority investors or creditors on the eve of bankruptcy in order to reduce barriers to efficient decisionmaking during this period).

patience appeared to pay off. Ford developed a new prototype, and Murphy and Ford incorporated the “Henry Ford Company” in November 1901 to prosecute the design. Ford took a 17 percent equity interest in the firm in return for his contribution of his human capital and the new design.<sup>19</sup> Although the ideas behind the firm were 100 percent Ford’s, his interest was, again, subordinated to those who were putting up the money to finance the firm.

At this point, Ford was still an inventor and a car man; he had yet to realize that his contribution to world history and his path to unprecedented self-made wealth would be the production process for and marketing of cars, rather than in their design. In fact, Ford believed so strongly that his future success was tied to car design, he focused much of his energy at this time in developing racing versions of his cars to compete in the growing local auto racing circuits. Murphy and the other investors knew of Ford’s interest in racing, but believed it was a dalliance. Ford, who again did not like being a minority shareholder, especially one whose name was on the corporate charter and the sign out front, shirked more and more, putting almost all of his energies into designing a racing car instead of a consumer one. Frustration again mounted under the strain of a classic principal-agent problem.

As the Henry Ford Company spiraled toward failure, the lead investors turned to an outside expert to help turn the struggling firm around. They brought in mechanical expert, Henry Leland, to spy on Ford. This is another modern practice—bringing in an outside expert, known as a Chief Restructuring Officer—that the history of the *Dodge* case shows is nothing new. Leland, who had earned a great reputation making engines for rival automaker Ransom Olds, was supposed to inspect Ford’s facility and report back to the board and majority shareholders on ways in which the firm could improve the design of the car or structure of the firm. Ford did not react well to what he viewed as meddling by the board. The strongly independent Ford considered the monitoring and restructuring efforts of Leland a personal and professional insult.<sup>20</sup>

Throughout his entire career, Ford viewed the board of directors as elitists and speculators who knew nothing about machines, cars, or manufacturing. He despised not only their meddling, but also their motives and who they were. Part of this was his populist preference for Main Street (people who made things) over Wall Street (people who made money with money). Ford’s newspaper mouthpiece—the *Dearborn Independent*—published a series of articles on this subject, with give-away titles such as “Speculation vs. Production: Which Creates Wealth?”<sup>21</sup> From his earliest days until his end, Ford idolized those who worked with their hands to create. He even built a sort of theme park, known as Greenfield Village, which was dedicated to showcasing the virtues of simple life, the outdoors, and working with one’s hands.

Ford’s rabid anti-Semitism also may have contributed to his distrust of investors and moneymen on the board. In an interview around the time of the *Dodge* case, he said: “The Jew is a mere huckster, a trader, who doesn’t want to

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<sup>19</sup> WATTS, *supra* note 1, at 57.

<sup>20</sup> *Id.* at 58.

<sup>21</sup> NEIL BALDWIN, HENRY FORD AND THE JEWS: THE MASS PRODUCTION OF HATE 85-86 (2001).

produce, but to make something out of what somebody else produces.”<sup>22</sup> His newspaper also published a series of articles—known as the “The International Jew”—that made this point and other negative ones about Jews over and over.<sup>23</sup> These articles, available then and now in a pamphlet form, revealed not only his anti-Semitism, but also his dislike of shareholders or investors as a class. This aversion to shareholders, who Ford would later call “parasites” and “idol drones”,<sup>24</sup> foreshadowed his conflict with the Dodges.

Whatever the reasons, Ford could not tolerate shareholders hiring another mechanic to spy on him. He quit (or was fired by) the eponymous firm only three months after it was incorporated. The board agreed to pay Ford a small sum for his shares (about \$1000), to give him the drawings for a racing car he designed, and to discontinue using the name “Henry Ford Company”.<sup>25</sup> Lead-investor Murphy quickly reorganized the firm, replacing Ford with Leland and renaming the firm the “Cadillac Automobile Company”.

Although for Ford this was another failure, Cadillac became a fantastic success. Ford designed a great car but it took someone else—in this case, Leland—to make the product a success. History again supports the horse theory of venture capital investing. A good product can survive mismanagement precisely because investors have control rights that give them the power to change management, even when the manager is the entrepreneur without whom the company would not even exist.<sup>26</sup>

The story of the failure of the Henry Ford Company is not so much about the evils of overbearing investors, as it was Ford’s inability to work constructively with them. The investors realized that Ford was not capable of leading a team of machinists or commercializing his design. In this situation, the power and value of control rights become evident. Investors did not act irrationally in ousting Ford, but rather used their rights to maximize the profitability of the firm. It is a textbook case of outside investors exercising control rights deftly.

Ford found success in his next venture in part because outsourcing of manufacturing was forced on him. Ford was able to focus on his strengths (mostly design) while having others, specifically the Dodges, do the things that Ford did not do well. Ford, however, had a different take on the failure and its causes.

### *C. The Ford Motor Company*

Ford’s assessment of the cause of the failure of his first two firms was clear from his public statements. In his autobiography, he criticized the directors and shareholders of his first two firms as wanting only to get as much money as possible from each car.<sup>27</sup> Viewing money as a benefit tangential to other forms of

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<sup>22</sup> WATTS, *supra* note 1, at 382

<sup>23</sup> JEFFREY S. GUROCK, *ANTI-SEMITISM IN AMERICA* 470 (1998).

<sup>24</sup> WATTS, *supra* note 1, at 256.

<sup>25</sup> LEWIS, *supra* note 6 at 102.

<sup>26</sup> For a similar argument, see Douglas G. Baird & M. Todd Henderson, *Other People's Money*, 60 *STAN. L. REV.* \_\_\_\_ (2008).

<sup>27</sup> HENRY FORD, *MY LIFE AND WORK* 36 (1922).

success, Ford decided to create his own firm without moneymen and speculators telling him what to do. Ford promised at the time of the second failure: “From here in, my shop is always going to be my shop . . . I’m not going to have a lot of rich people tell me what to do.” He was “determined never again to put [himself] under orders.”<sup>28</sup>

As nice as this sounded, it was impossible. Ford was not wealthy, and he needed someone else’s money to fund his operations. No one stepped forward. Stung by his business failures and the inability to raise money for his next business, Ford turned from trying to commercialize the auto to racing it. Ford and his friends built a racecar, raced it, and Ford became famous. His racer, the “999”, won the then-famous Challenge Cup in record time, and then later, on a frozen Lake St. Clair and with Ford at the wheel, set the world speed record at over 100 miles per hour.<sup>29</sup> He used these exploits to make “Ford” a household name synonymous with automobiles.

Trading on this fame, he convinced another wealthy Detroit, Alexander Malcomson, to bankroll a third effort at manufacturing automobiles for the public. Given the failure of the last two corporate efforts, Ford and Malcomson decided to work together as partners, with Malcomson agreeing to fund the creation of a new prototype and Ford agreeing to invest his intellectual property and energy into the new enterprise. In the summer of 1902 they started work, agreeing that if they could build a successful prototype they would seek out additional investors and form a new corporation.

Ford had a design, but he needed to build the car in large quantities to make it a success. His failure to effectively manage the machining and construction of vehicles for his first two firms taught him the importance of outsourcing the manufacturing to others. He was a designer, not a builder. The Dodges, well-regarded machinists and who had, like Leland, success building engines for Ransom Olds, were hired to build the entire mechanical vehicle (engine plus transmission). Other firms were employed to provide finished chasses and tires. Their work quickly yielded a workable prototype, known as the “Model A”. Based on this success, Malcomson, Ford’s new venture capitalist, recruited 10 additional investors, and incorporated the “Ford Motor Company” on June 16, 1903.<sup>30</sup> It would become one of the greatest achievements of all time.

Two of these investors were the Dodges. Their investment was not a cash infusion for equity, but a complicated investment of two \$5000 promissory notes in return for a contract to build 650 vehicles. In addition, the Dodges demanded a \$10,000 upfront payment, covering their initial investment, as an advance on the machines they were to build. According to one account, Ford was forced into

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<sup>28</sup> *Id.*

<sup>29</sup> The historical accounts about the actual speed differ. According to a Ford biography, the speed was over 100 m.p.h. See *WATTS*, supra note 1, at 81. Other sources confirm that Ford set the record, but report a speed of around 90 m.p.h. See [http://www.speedace.info/land\\_speed\\_record\\_history.htm](http://www.speedace.info/land_speed_record_history.htm).

<sup>30</sup> RICHARD S. TEDLOW, *GIANTS OF ENTERPRISE: SEVEN BUSINESS INNOVATORS AND THE EMPIRES THEY BUILT* 178 (2003).

giving an equity stake to the Dodges because he was habitually late in making payments to them and was short of cash.<sup>31</sup>

Unlike the two earlier ventures, success came quickly and in bunches for the Ford Motor Company. Although like most start-ups its funds dwindled to nearly zero (in this case, about \$200), after its first sale of a Model A to a Chicago dentist on July 15, 1903 (just one month after incorporation), sales and profits came in droves. In its first two years, the Ford Motor Company had revenues well in excess of \$3 million, and paid out about \$200,000 in dividends to shareholders.<sup>32</sup> At this point, the Dodges' \$10,000 investment gave them a spectacular return over and above the profits they made on their exclusive contract to build all of Ford's cars. Had the Dodges received nothing else from their investment, they would have earned a return of about 100 percent per year.

Success, however, did not change Ford's views about investors. He referred to board members and other employees of the Ford Motor Company who did not work on the design or manufacture of the cars as "not contributing and . . . parasite[s]."<sup>33</sup> The board quickly divided along these lines, with the engineers on one side and the money on the other.

Not satisfied with a divided board and the existence of other large shareholders who were not "real" workers, Ford and his inner circle of manufacturing associates cooked up a clever scheme to force out Malcolmson and the other "parasite" investors. Ford created a new corporation, the "Ford Manufacturing Company", on November 22, 1905.<sup>34</sup> This company, which was organized without the participation of Malcolmson and the other passive investors, would get the exclusive rights to manufacture the engines and other parts for the new Ford "Model N".

The Dodges stood to lose their exclusive manufacturing contract, but curiously John Dodge joined the board of the Ford Manufacturing Company. This is not something he would have done if the plan were to take business from his firm. In fact, it would have created an obvious conflict of interest that would have disabled him from serving on the board. The scheme to squeeze out the other shareholders was plain. One shareholder in the new firm said: "I have Mr. Ford's promise that when things get straightened out with Mr. Malcolmson, the Ford Manufacturing Company is to be taken into the Ford Motor Company, just as if it never existed."<sup>35</sup>

Malcolmson responded by forming his own company to manufacture automobiles—the Aerocar Company. Since setting up a rival firm was a clear breach of his loyalty to the Ford Motor Company, the board forced him out. Ford took nearly complete control of the firm with his name on it, buying out Malcolmson's shares for \$175,000 and those of his friends on the board who were

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<sup>31</sup> CHARLES K. HYDE, *THE DODGE BROTHERS: THE MEN, THE MOTOR CARS, AND THE LEGACY* 33 (2005).

<sup>32</sup> LAWRENCE H. SELTZER, *A FINANCIAL HISTORY OF THE AMERICAN AUTOMOBILE INDUSTRY* 111 (1928).

<sup>33</sup> WATTS, *supra* note 1, at 98.

<sup>34</sup> See HARRY BARNARD, *INDEPENDENT MAN: THE LIFE OF SENATOR JAMES COUZENS* 62 (2002).

<sup>35</sup> *Id.*

offended by Ford scheme.<sup>36</sup> After the freezeout and shakeup, Ford held 54 percent of the shares of the Ford Motor Company, with his head of operations, James Couzens, holding another 10 percent. Through some deception and corporate machinations, they were now firmly in control. Within a few years control was further consolidated; nearly half of the original 13 stockholders sold their stock to Ford. In 1908, the shareholder list looked as follows:

*Table 1: Shareholders of the Ford Motor Company, circa 1908<sup>37</sup>*

| Shareholder     | Number of shares | Percent ownership |
|-----------------|------------------|-------------------|
| Henry Ford      | 585              | 59                |
| James Couzens   | 110              | 11                |
| The Gray Estate | 105              | 11                |
| Horace Dodge    | 50               | 5                 |
| John Dodge      | 50               | 5                 |
| J.W. Anderson   | 50               | 5                 |
| H.H. Rackham    | 50               | 5                 |
|                 | 1000             |                   |

The remaining few shareholders held small minority stakes, and would no longer be able to pressure Ford to run the Ford Motor Company in a way he did not like.<sup>38</sup> Or so Ford thought.

### III. The Run-up to *Dodge*: Litigation as a Business Tactic

Ford’s first masterpiece, the “Model T”, arrived in 1909; his second, the “assembly line” arrived in 1913. The latter helped increase production by over 700 percent in two years.<sup>39</sup> Production rose from less than 2000 cars per year in 1905 to over 2 million by 1923.<sup>40</sup> At this time, more than half of the vehicles on the roads were Fords. This was in part because the economies of scale from the new production methodology allowed Ford to reduce the price of the Model T by almost half in the span of a few years, all while adding more features and better materials to its construction.

This revolution in production capacity and efficiency brought the Ford Motor Company and all of its shareholders unprecedented wealth. For example,

<sup>36</sup> See REGINALD M. CLEVELAND & SAMUEL T. WILLIAMSON, *THE ROAD IS YOURS: THE STORY OF THE AUTOMOBILE AND THE MEN BEHIND IT* 198 (1951).

<sup>37</sup> SELTZER, *supra* note 32 at 94.

<sup>38</sup> Ford famously said that his goal was a business with “no stockholders, no directors, no absentee owners, no parasites.” FORD R. BRYAN, *BEYOND THE MODEL T: THE OTHER VENTURES OF HENRY FORD* 17 (1997).

<sup>39</sup> The assembly line was only one of the ways in which Ford was able to cut costs and make production more efficient. He also innovated with design, manufacturing techniques, and materials. For example, Ford deployed single-purpose machine tools to automate much production. Ford also learned that vanadium steel had a much higher tensile strength and could be machined more easily than conventional steel, so he used it to make “better, lighter, and cheaper car[s].” See CHARLES E. SORENSON, *MY FORTY YEARS WITH FORD* 141 (1962).

<sup>40</sup> SELTZER, *supra* note 32 at 104.

the Dodges' \$10,000 investment returned more than \$35 million over 13 years, an almost 100 percent constant annual return. This is extraordinary beyond any imagination, and for Ford was enough. Ford believed that investors did not deserve the incredible returns the firm was generating year after year, especially when they, unlike he, did nothing to contribute to the success other than their initial investment.

The company's success was fed by populist accounts of Henry Ford as a new kind of robber baron. While Carnegie, Mellon, and Rockefeller were portrayed as aloof, highfalutin, and otherworldly in their wealth and privilege, Ford cast himself as everyman. He spoke in a folksy tone, praised the virtues of the common man, and famously said that he would not give "five cents for all the art in the world."<sup>41</sup> An article in a California newspaper captured the public sentiment at the time:

Personally there is not much outward difference between Henry Ford, maker and dispenser of millions, and many of his workmen. Money has not made the slightest difference in his habits, his manner of life, or his friendships.<sup>42</sup>

The various biographies of Ford give us little reason to doubt Ford's sincerity in the image he projected, but the public relations spin is evident nevertheless. According to one biographer, Ford's behavior was highly calculated: "Quite self-consciously, Henry Ford set about making himself a sensation."<sup>43</sup>

Perhaps the most famous example of this is when Ford doubled employee wages (creating the so-called "Five-Dollar Day") in 1914 under the guise of having the interests of workers above all else. Ford characterized it as a "sort of dividend" to workers to share the wealth that the workers helped create.<sup>44</sup>

This is, of course, fanciful. The Five-Dollar Day was a response to business pressures and was brilliant competitive strategy. The problem it addressed stemmed from the unintended consequences of the assembly line. While it greatly increased productivity, it made workers miserable, since the work was boring and repetitive. As one laborer described the problem: "If I keep putting on Nut No. 86 for about 86 more days, I will be Nut No. 86 in the Pontiac bughouse."<sup>45</sup> Consequently, employee turnover increased dramatically, reaching nearly 400 percent per year in the year before the wage increase.<sup>46</sup> Absenteeism also was high, reaching over 10 percent per day, with the result that Ford had to

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<sup>41</sup> WATTS, *supra* note 1, at 160.

<sup>42</sup> "Millionaire Ford's Tastes Are Worker's", *San Francisco Bulletin*, Jan. 17, 1914. This trait or tactic is practiced today too. Sam Walton, the founder of Wal-Mart and once the richest man in the world, famously drove a run-down truck and shared hotel rooms when traveling for business.

<sup>43</sup> WATTS, *supra* note 1, at 169.

<sup>44</sup> "Henry Ford Explains Why He Gives Away \$10,000,000", *NEW YORK TIMES*, Jan. 11, 1914.

<sup>45</sup> STEPHEN MEYER, *THE FIVE DOLLAR DAY: LABOR MANAGEMENT AND SOCIAL CONTROL IN THE FORD MOTOR COMPANY, 1908-1921*, 40 (1981).

<sup>46</sup> In 1913, Ford had to hire over 50,000 workers to maintain a workforce of just over 13,000. See SUMNER SLICHTER, *TURNOVER OF FACTORY LABOR* (1921).

employ over 1500 replacement workers each day just to maintain production levels. The doubling of wages was merely a profit-maximizing move to constrain total labor costs and increase efficiency.<sup>47</sup> It worked, as turnover fell to about 50 percent almost immediately after the introduction of the plan, and to 15 percent within one year.<sup>48</sup> Ford later claimed that it was “one of the finest cost cutting moves we ever made.”<sup>49</sup>

The wage was also tied to at least two prerequisites, both of which show that the plan, which wasn't even Ford's idea, was not done as an act of charity or friendly feelings towards the workingman. First, the new wage required a vesting period. Workers did not get five dollars per day, but rather that was an average amount, and only for those who worked at least six months.<sup>50</sup> This supports the claim that it was really about reducing turnover.

Second, Ford set up a vast “Sociological Department” to ensure the precondition that workers “not debauch the additional money [they] receive[.]”<sup>51</sup> Workers who drank, did not save, or otherwise did not comport with Ford's views of the good life, would not qualify for the wage. The Department published pamphlets offering advice on a range of topics, and, somewhat shockingly, sent “investigators”, to workers homes to “observe[] firsthand the tidiness and hygiene of the home.”<sup>52</sup> Ford believed in strongly in paternalism for his workers, and used the Sociological Department to “shape the character, domestic life, and financial habits of Ford workers.”<sup>53</sup>

The idea that firms would take an active role in the personal life of workers is another modern (or perhaps, post-modern) notion that history of this case shows existed long ago. At the beginning of the Twenty-First Century, firms, who typically pay the bulk of employee healthcare costs, began to become increasingly active in policing behaviors outside of the workplace. For example, in 2004, Weyco Inc. told employees who smoked that they had 15 months to quit, and when four employees refused to submit to a breath test, the firm fired them.<sup>54</sup> The trend toward greater paternalism is evident and likely to continue to grow.

Strategically, Ford's plan increased wage costs for potential competitors, who were all much smaller and less wealthy. This also gave Ford unrivaled access to all labor, especially semi-skilled and experienced workers. The day after the plan was announced, 10,000 men came to the gates of Ford's Highland Park factory looking for work, and the police had to threaten the crowd with fire hoses to get them to disperse after more than half were turned away without hopes of

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<sup>47</sup> Daniel M.G. Raff & Lawrence H. Summers, *Did Henry Ford Pay Efficiency Wages?*, 5 J. LABOR ECON. S57, S69 (1987) (arguing that the increase was largely about increasing productivity and efficiency of employees).

<sup>48</sup> See SLICHTER, *supra* note 46 at 244.

<sup>49</sup> FORD, MY LIFE AND WORK, *supra* note 27 at 147.

<sup>50</sup> *Id.*

<sup>51</sup> MEYER, *supra* note 45 at 125.

<sup>52</sup> WATTS, *supra* note 1 at 201-205.

<sup>53</sup> *Id.* at 205.

<sup>54</sup> Marisa Schultz et al., “Workers fume as firms ban smoking at home”, DETROIT NEWS, Jan. 27, 2005, available at <http://www.detnews.com/2005/business/0501/27/A01-71823.htm>.

working for Ford.<sup>55</sup> Firms like the new General Motors Corporation increased wages a bit to compete, but none had the wealth of Ford and so it was years before they were competitive for certain types of auto labor again.<sup>56</sup>

The increase also helped preempt unionization of Ford's factories by seemingly radical elements. The Industrial Workers of the World (better known as the "Wobblies") were threatening to unionize the firm's workers, and a dramatic and unprecedented pay raise was a way of blunting the union's arguments.<sup>57</sup> In an interview, Ford argued that labor unions "have never succeeded in organizing our factory" and have not given him "a particle of trouble", because "[w]e pay better than anybody else . . ."<sup>58</sup>

Whatever the exact mix of reasons for Ford's decision, the myth developed and persevered that Ford was doing this out of benevolence for workers. So much so that he became the first capitalist to be embraced by the political left in America and his picture even famously hung next to Lenin's in Soviet factories.<sup>59</sup> The virtuous circle that Ford developed, however, depended entirely on a mythology that Ford fostered. Workers that believed in Ford's politics bought his cars, which made his firm ridiculously profitable, which afforded him the luxury of having his politics. It doesn't make sense to ask what Ford really believed, since what he believed was tied inexorably to the context of his situation. About the only thing we can say for sure is that Ford knew that his rhetoric fed his success, and therefore even purely self-serving or profit-maximizing decisions were couched in charitable terms.

This tactic—putting competitive strategy in the guise of benevolence—is something Ford would do successfully over and over, with tremendous benefits for the Ford brand. (As we will see, these tactics also lead to litigation with his friends the Dodges.) Ford was an unrivaled master of public relations, and his actions and statements were carefully crafted into a message about the virtues of the automobiles he was selling. Buying a Ford meant not only buying a particular car, but also buying an idea and an image.

One of the crucial components of Ford's public relations strategy was his use of litigation. Ford built a brand (for himself and his firm) through a series of famous lawsuits, not only in terms of what was litigated but how and what was said during the litigation. Ford's first success using this tactic involved an alleged patent held on the automobile by a New York lawyer named George Selden. The lawsuit made him a "folk hero" and "a beloved figure" in the public mind.<sup>60</sup>

Selden and the Electric Vehicle Company, which licensed the patent from him, filed suit against the Ford Motor Company in 1903, alleging that it infringed a patent granted in 1895 for an internal combustion engine used to power a four-

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<sup>55</sup> "Henry Ford Explains Why He Gives Away \$10,000,000", NEW YORK TIMES, Jan. 11, 1914.

<sup>56</sup> SORENSEN, *supra* note 39 at 141.

<sup>57</sup> See J. BRADFORD DELONG, *SLOUCHING TOWARDS UTOPIA?: THE ECONOMIC HISTORY OF THE TWENTIETH CENTURY (XIII. The Roaring Twenties)* (1997).

<sup>58</sup> "Henry Ford Explains Why He Gives Away \$10,000,000", NEW YORK TIMES, Jan. 11, 1914.

<sup>59</sup> A parade of left-leaning journalists, including Upton Sinclair, Ida Tarbell, and John Reed, praised Ford. WATTS, *supra* note 1, at 195-198.

<sup>60</sup> WATTS, *supra* note 1, at 160.

wheeled car.<sup>61</sup> Prior to the suit against Ford, a group of car companies, called the Association of Licensed Automobile Manufacturers, negotiated a royalty of about one percent on all vehicles sold by its members. ALAM agreed to pay royalties in order to establish a cartel that would try to restrict entry by issuing “official licenses” to produce and sell cars.

In 1903, Ford approached ALAM about joining the cartel, but they refused to license him as an authorized manufacturer. Then ALAM took out advertisements threatening new entrants like Ford with patent infringement in the event they tried to go around the cartel. This sowed the seeds of Ford’s life-long antipathy toward consolidated business power, known then as “trusts”.

Ford responded by running his own advertisements, trumpeting the cost advantage of his new car compared with those of the ALAM manufacturers: “[The Ford car] costs only \$900. The Trust car that compares with it costs \$1500.”<sup>62</sup> Ford also sold cars without a license from Selden or EVC. This invited a lawsuit on the validity of the patent, which was the only means of enforcing of the cartel. The suit lasted about eight years and created a media sensation. The trial court returned a verdict for the patent holders. Ford appealed, however, and on January 10, 1911 the Second Circuit Court of Appeals ruled that the automobile in all of its potential forms and types was not capable of being patented.<sup>63</sup> According to Ford, “Perhaps nothing so well advertised the Ford car . . . as did this suit.”<sup>64</sup> The link between litigation and publicity was a lesson Ford would not forget.

Another lawsuit that brought Ford fame was his libel suit against the *Chicago Tribune*. In an editorial on June 25, 1916, the paper described Ford as “an ignorant idealist [and] an anarchistic enemy of the nation,” because of his anti-war efforts. Ford sought \$1 million in damages on the grounds that the editorial “sought to bring [Ford] into public hatred, contempt, ridicule, and financial injury.”<sup>65</sup> Ford’s testimony was the stuff of legend—he flubbed easy question after easy question on basics of current events and history, finally admitting “I am ignorant about most things.”<sup>66</sup> The freak-show atmosphere and the laying bare of Ford’s simple ways shocked elite opinion makers. He was uniformly branded a simpleton. A New York paper editorialized that he was “a joke” and a leading magazine declared that “[h]e has achieved wealth but not greatness.”<sup>67</sup>

Ford did not care about elite opinion, since they made up only a small fraction of the potential customers for Ford vehicles. To average Americans, his suit, although it won him only \$0.06 in damages, was an enormous victory. Ford stood up to the powerful interests who were backing the war in Europe and control of America’s industries. As one paper wrote: “A few less smart-aleck

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<sup>61</sup> Selden based his invention on the large internal combustion engine that George Brayton presented at the Philadelphia Centennial Exposition of 1876.

<sup>62</sup> WATTS, *supra* note 1, at 163-4.

<sup>63</sup> *See* Columbia Motor Car Co. v. C.A. Duerr & Co., 184 F. 893 (1911).

<sup>64</sup> FORD, MY LIFE AND WORK, *supra* note 27 at 103.

<sup>65</sup> WATTS, *supra* note 1, at 266.

<sup>66</sup> PETER COLLIER & DAVID HOROWITZ, THE FORDS: AN AMERICAN EPIC 89 (1987).

<sup>67</sup> LEWIS, *supra* note 8 at 106.

attorneys and a few more Henry Fords, and the world would have less troubles . . .”<sup>68</sup> The demand for Ford cars soared.

This is the conventional wisdom gleaned from Ford’s biographies—Ford’s man-of-the-people manner endeared him to potential customers and helped sell cars. This is somewhat strange, since one would not generally expect someone making an enormous investment to be moved by whether Ford was a humble robber baron or an effete one. But branding is powerful precisely because it creates abnormal attachments between people and objects. One need only examine the rivalry between drivers of Chevrolet and Ford trucks to understand that one’s transportation is often about much more than getting from here to there.<sup>69</sup>

As part of his branding and publicity strategy, Ford also learned not to be afraid of the uncertainty of litigation. In his hands lawsuits, win or lose, were good public relations, and therefore good business. Ford could safely reason that legal expenses and even a large monetary defeat would likely be offset by the increase in demand for his cars, so long as Ford continued to choose legal fights where he could portray his battle and himself as on the side of workers and average citizens.

This may have been on Ford’s mind on September 28, 1916, when he received a letter from the Dodges threatening to sue him and the Ford Motor Company. The letter read in part:

We have for some time, as you know, been endeavoring to make an appointment to see you, for the purpose . . . of discussing the affairs of the Ford Motor Company from the standpoint of our interest as stockholders and with a view to securing action by the board of directors looking to a very substantial distribution from its cash surplus as dividends. . . . The conditions shown by your recent financial statement—showing approximately \$60,000,000 of net profits for the past year and cash surplus in bank exceeding \$50,000,000—it seems to us would suggest . . . the propriety of the board taking prompt action to distribute a large part of the accumulated cash surplus as dividends to the stockholders to whom it belongs. While we would be sorry to have any controversy over the matter, we feel that your attitude toward the stockholders of the company is entirely unwarranted.

Here again we see what we might think of as the thoroughly modern practice of activism by minority shareholders. Letters like this one (sent over 90 years ago) are common today from activist investors like Carl Icahn and Nelson Peltz, often

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<sup>68</sup> WATTS, *supra* note 1, at 270-71.

<sup>69</sup> An Internet search reveals dozens of web sites devoted to the virtues of one brand and the vices of the other. Passions clearly run very deep. On my own family’s farm, Hendersons drove Fords, they always did. I didn’t get a chance to ask my great-grandfather why, but I have no doubt given the family politics that Ford’s public relations spin was a factor. For my old-time farmer relatives, there was something about being a Ford man.

from minority positions of about 10 percent. Like the Dodges before them, these letters often demand that the firm distribute cash on hand to shareholders.

Ford rebuffed the Dodges' demand without response or acknowledgement.<sup>70</sup> This is unusual and seems designed to invite conflict. The Dodges were not only 10 percent shareholders—who firms ignore at their peril—but they were also crucial to the success of the firm. The reaction from firms today is typically like that of Ford, and for the same reason: a dislike of meddling by shareholders and a concern that the request is in the best interests of the particular shareholders but not shareholders as a whole. Ford had another reason for his chilly reaction: the request was merely a gambit by the Dodges to create a rival firm.

The Dodges wanted to make their own fame by selling “Dodge” vehicles instead of making cars for Ford, so they started their own eponymous automobile company in 1913. Since this was a clear conflict of interest with their role as directors of the Ford Motor Company, they resigned their positions on the board the same year. As permissible under corporate law then and now, the Dodges held onto their shares, hoping that their investment would help fund their rival business.

It did, but the nascent Dodge firm needed more than money to compete with Ford. This was especially true in light of Ford's plans to add capacity and reduce costs by building a giant new factory. This plan threatened to make rival firms, especially small ones without scale, incapable of competing on any terms. The Dodges needed to stop or delay the plans in order to give their firm a chance to succeed. What they wanted, and what the complaint they filed only about a month later asked for, was an injunction to prevent Ford from increasing his manufacturing base.

The reason the dividend did not really matter to the Dodges is that they could (and did) easily raise funds from other sources to build out their capacity. As shown from their performance during the time before and during the duration of the litigation, their firm was not desperate for funding. Over the period from 1915 to 1919 (before the final verdict), production increased from about 18,000 to over 120,000 cars, sales increased from about \$11 million to over \$120 million, and profits increased from under \$300,000 to over \$24 million. These results suggest a firm that was far from needing a cash infusion to survive.<sup>71</sup>

There is also some historical support for a claim that the injunctive relief sought was motivated by larger political and economic concerns. In the two years before the suit, Ford began to alienate powerful interests with his political rhetoric. His “political crusade”, which would include an unsuccessful run for the United States Senate, included a denunciation of Wall Street financiers, a

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<sup>70</sup> According to Ford, the letter was not the first demand the Dodges made. Ford claimed that the Dodges demanded he buy their shares for \$35 million to fund the expansion of their business, and, if he refused, they would use their position as minority shareholders to harass him. WATTS, *supra* note 1, at 256. “They put a price of \$35 million on their stock, and they told me unless I bought they would harass me in anything I tried to do.” *Id.* Ford refused to pay anything, however, and the *Dodge* litigation followed quickly thereafter.

<sup>71</sup> HYDE, *supra* note 31 at 113.

campaign against World War I, and a tirade against corporate privilege.<sup>72</sup> John Reed, made famous for modern Americans by Warren Beatty's portrayal in the movie *Reds*, corroborated this claim. In an article entitled "Why They Hate Henry Ford", Reed claimed that Ford's Five-Dollar Day ploy made capitalists hate him as a traitor to his class: "That is why the Steel Trust would like to cut off his steel—and Wall Street curb his power."<sup>73</sup> A contemporary news account offered another, less political reason why powerful steel firms would support the Dodges' suit. The article quoted a "man high in the inner circles of Detroit's manufacturing and financial world":

Back of the demand of the Dodges . . . is the grim determination of the steel kings that Henry Ford shall not erect a huge blast furnace . . . . The successful putting into operation of that plan would be a staggering blow at the commercial and industrial domination of the steel [trust].<sup>74</sup>

Ford also may have generated ill will among steel firms and other trusts when he criticized them for their role in pushing America to war—what President Eisenhower would warn about when he described the "military industrial complex" some four decades later. Whether the Dodges were a stalking horse for the steel barons or merely pursuing their own self-centered strategy, litigation knocking Ford down was a plausible means of achieving the desired business end.

#### IV. The Case

So the stage was set. The players were all rich but with hopes of getting richer. They were all savvy. Ford, for one, was predisposed to think of shareholders, even his long-time friends and business associates, as greedy and opportunistic. Ford also knew they were trying to build a firm to compete with him, and given their experience at and wealth earned from the Ford Motor Company, they no doubt had to the tools to do so. In light of this, Ford obviously wanted to deny them funds. Litigation would also give Ford a soapbox from which he could again portray himself as looking out for workers and average consumers instead of the self-interested shareholders. Ford knew that even if he lost the suit, he would likely still prevail, both because of the alternative means of achieving the same ends and because of the publicity the case would bring him and the Ford Motor Company.

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<sup>72</sup> Ford spoke out repeatedly against the war, saying that all war did was "tear [a worker] away from his home and family to send him forth to a death against his will . . . ." HENRY BOURNE JOY, MILLIONS FOR TRIBUTE, NOT ONE CENT FOR DEFENSE": A REPLY TO HENRY FORD 15 (1915).

<sup>73</sup> WATTS, *supra* note 1 at 194.

<sup>74</sup> See "Sees Dodge Fight on Ford Smelter Backed by Trust", *Detroit Journal*, January 10, 1917.

A. *The Trial Court*

The complaint filed by the Dodges asked the trial court to do two things: first, to require the Ford Motor Company to establish a dividend policy that required the firm to “distribute all of the earnings of the company except such as may be reasonably required for emergency purposes in the conduct of the business”, including the immediate issue of dividends amounting to 75 percent of retained earnings (cash on hand was over \$50 million)<sup>75</sup>; and second, to enter an injunction forbidding the proposed construction of a new manufacturing facility on the River Rouge near Detroit. The two were related. Ford claimed that he needed to eliminate the dividend to fund the construction of the factory. As we will see, this was certainly not the case.

As shown on Table 2, the revenue and profitability growth of the Ford Motor Company was increasing tremendously, with plenty of cash on hand. Dividend policy varied widely over time. The level for the decade leading up the litigation, however, showed a fairly constant level averaging about 45 percent of profits.<sup>76</sup> In the year before the Dodges filed suit (1916), the dividend rate fell to about 5 percent despite the firm’s profits nearly doubling from the prior year. It was this deviation from the traditional payout levels and Ford’s plan to deploy these funds (as well as the excess profits from prior years) to build a new factory to build cars that the Dodges sued to stop.

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<sup>75</sup> *Dodge*, 204 Mich. at 474.

<sup>76</sup> If this same ratio had been used during 1916-1918, the total payouts would have been about \$53 million instead of the nearly \$18 million paid out. The final court ruling in *Dodge* did not require quite this amount. As can be seen in the dividend payout for 1919, the year when Ford paid the forced dividend out, the firm would have expected to pay a dividend of about \$11 million (45% of \$24.9 million), but paid out about \$13 million more, far less than the \$35 million shortfall in dividends over the period in question.

Table 2: Performance and Payouts of the Ford Motor Company (1904-1919)<sup>77</sup>

| Year                     | Revenues<br>(\$ MM) | Profit<br>(\$ MM) | Dividends<br>paid (\$ MM) | Percent of<br>profits<br>distributed |
|--------------------------|---------------------|-------------------|---------------------------|--------------------------------------|
| 1904                     | 1.3                 | 0.3               | 0.09                      | 30                                   |
| 1905                     | 1.9                 | 0.3               | 0.1                       | 33                                   |
| 1906                     | 1.5                 | 0.1               | 0.1                       | 100                                  |
| 1907                     | 5.8                 | 1.1               | 0.1                       | 9                                    |
| 1908                     | 4.7                 | 1.2               | 0.6                       | 50                                   |
| 1909                     | 9.0                 | 3.1               | 1.8                       | 58                                   |
| 1910                     | 16.7                | 4.5               | 2.0                       | 44                                   |
| 1911                     | 24.7                | 6.3               | 3.0                       | 48                                   |
| 1912                     | 42.5                | 13.1              | 5.2                       | 40                                   |
| 1913                     | 89.1                | 25.0              | 11.2                      | 45                                   |
| 1914                     | 119.5               | 30.3              | 12.2                      | 40                                   |
| 1915                     | 121.2               | 24.6              | 16.2                      | 66                                   |
| <b>1916 (suit filed)</b> | <b>206.9</b>        | <b>60.0</b>       | <b>3.2</b>                | <b>5</b>                             |
| 1917                     | 274.6               | 26.7              | 9.2                       | 34                                   |
| 1918                     | 308.7               | 30.3              | 5.2                       | 17                                   |
| 1919                     | 305.6               | 24.9*             | 24.2**                    | 97                                   |

\* Estimate based on 5 months of data.

\*\* Includes about \$19.3 million paid as required by court ruling in *Dodge*.

In terms of legal arguments, the Dodges grounded their claims in a curious mix of irrationality of the board decision and the implications it would have on competition in the auto manufacturing business. The first argument was that the board's decision to build a new factory made no business sense, and therefore was motivated by something other than maximizing profits:

(27) In the face of the increased labor and material cost and the uncertain conditions that will prevail in the business world at the termination of [World War I], the policy of said Henry Ford, in continuing the expansion of the business of [the Ford Motor Company], is reckless in the extreme and seriously jeopardizes the interest of . . . stockholders in said corporation.<sup>78</sup>

In other words, the complaint alleged that the board's strategic forecasting was erroneous. The Dodges believed that the demand for cars would be less than what the board believed, and that converting shareholder cash to fixed assets was evidence of something other than profit-maximizing behavior. As seen below, their claim was supported by statements by Ford in the press and at trial to the effect that he viewed the firm first as a means of doing social good (in this case,

<sup>77</sup> SELTZER, *supra* note 32 at 111.

<sup>78</sup> *Dodge*, 204 Mich. at 473.

providing work and cheap cars for the masses) and only second as a means of making money.

The Dodges' argument was preposterous, and every court presented with it today would dismiss under the business judgment rule. Decisions about supply and demand are pure business decisions, and absent a showing of a breach of the duty of loyalty or care are completely protected, even if they turn out to be disastrous. Whatever information the board had about supply and demand would surely be superior to the plaintiffs, who were outsiders at this point, and the costs of involving courts in these decisions (both decision costs and error costs) would have a huge chilling effect on business decisionmaking.

The Dodges' other claim was that the construction of a factory on the scale contemplated by Ford would have the effect of creating a monopoly in the low-priced car market. Although not styled as an antitrust claim, this is clearly the rhetorical force behind their complaint:

(28) . . . That if the said Henry Ford is permitted to continue the policy that he has inaugurated and announced he is determined to carry out, of increasing production, reducing the price of cars, and increasing the capital investments in the conduct of such business by withholding the dividends from stockholders to which they are entitled, the necessary result will be the destruction of competition on the sale of [low-priced cars] manufactured by [the Ford Motor Company] and the creation of a complete monopoly in the manufacture and sale of such cars . . .<sup>79</sup>

In other words, Ford was cutting off dividends to kill one competitor (the Dodges) and building a huge new factory to threaten the competitive position of them and others. In 1916, the Ford Motor Company produced about one out of every three cars sold in America, and manufactured over four times more than the second biggest company.<sup>80</sup> According to the complaint, ensuring competition in the nascent but thriving automobile market required limiting Ford's power in every way possible.<sup>81</sup>

The trial began on May 21, 1917. The central issue was Henry Ford's motivation for his chosen direction for the firm. Had Ford just claimed that there were perfectly good business reasons for the dividend cancellation and the factory construction—increasing production to meet demand, creating economies

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<sup>79</sup> *Id.*

<sup>80</sup> ALLAN NEVINS & FRANK E. HILL, *FORD: EXPANSION AND CHALLENGE, 1915-1933* 8-9, 92 (1957).

<sup>81</sup> This alone is not a legitimate antitrust claim. Doing well is not a violation of the Sherman Act. There is, however, an antitrust claim that might fit. If one firm builds an inefficiently large plant (and incurs large sunk costs) in order to deter new entrants, it may be covered by the doctrine of preemption and strategic commitment. Although plausible, it seems a rough fit on these facts. It is not clear that there were large capital investments that were sunk in building the River Rouge plant. The factory could be used for any type of manufacturing activity, and was in fact originally used for making boats.

of scale, ensuring raw material supply during the war,<sup>82</sup> etc.—he undoubtedly would have won. Ford’s judgment was strategically sound, but that is not even required. It was at least plausible that the strategy would maximize shareholder profits,<sup>83</sup> and that is all that is legally required. (Even the Dodges knew that the decision to vertically integrate was sensible. While the case was pending, they pursued plans to build their own version of River Rouge.)<sup>84</sup>

Ford, however, desperately did not want to be viewed as a robber baron. To blunt this perception, he made ridiculous comments to the media and at the trial that forced the court into overreaching. In an interview with the *Detroit News* before the trial, Ford gave his views on the purpose of his firm and its new strategy:

I do not believe that we should make such an awful profit on our cars. A reasonable profit is right, but not too much. So it has been my policy to force the price of the car down as fast as production would permit, and give the benefits to users and laborers . . .<sup>85</sup>

This sounds silly to modern corporate ears. Any CEO who believed this (as opposed to just saying it for effect) would quickly be looking for work. Shareholders do not invest in companies to give economic profits or surplus to workers or consumers, unless, of course, it is part of a plan to maximize long-term profits. Amazingly, Ford went even further during the trial. Under cross-examination by the Dodges’ lawyer Elliott G. Stevenson, he gave what must be among the worst testimony given by any corporate defendant in any trial at any time:

Counsel: Do you still think those profits were awful profits?  
 Ford: Well, I guess I do, yes.  
 Counsel: And for that reason you were not satisfied to continue to make such awful profits?  
 Ford: We don’t seem to be able to keep the profits down.

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<sup>82</sup> As the demands of the war effort increased, raw material supplies of steel, rubber, iron, plastic, wood, oil, and other materials became uncertain. The plan to vertically integrate the firm’s supply chain was one of the major purposes of the River Rouge factory. The factory would include facilities to create all of the products needed to build a Model T, including steel mills, oil refineries, and even sheep farms for the wool needed for seat covers. [cite] Ford’s plan was to have “raw materials coming in on one end of the Rouge plant and the finished cars going out the other end.” SORENSEN, *supra* note 39 at 159.

<sup>83</sup> In retrospect, it is not obvious that the River Rouge plant would be a good thing for shareholders or hurtful for competitors like the Dodges. It turned out that there were not great economies of scale with respect to assembling cars during this period and the assembly of Model Ts was in fact done in a number of different places across the country. There seemed to be gains from making parts in a single place, but doing this did not require all the parts to be made under a single roof, nor does it require that you do your own smelting. This is, of course, legally irrelevant, as all that is required is a plausible (and not self-interested) reason for the decision to ensure protection of the business judgment rule. Any other rule would overly chill corporate risk taking and regularly substitute the decisions of courts for those of boards.

<sup>84</sup> HYDE, *supra* note 31 at 114.

<sup>85</sup> FORD, MY LIFE AND WORK, *supra* note 27 at 162.

- Counsel: Are you trying to keep them down? What is the Ford Motor Company organized for except profits, will you tell me, Mr. Ford?
- Ford: Organized to do as much good as we can, everywhere, for everybody concerned. And incidentally to make money.
- Counsel: Incidentally to make money?
- Ford: Yes, sir.<sup>86</sup>

This doesn't make any sense, especially coming from a businessman as savvy as Ford.<sup>87</sup> In fact, Ford's rhetoric was just public relations, and his reasoning was not as silly as it seems.

Whether Ford's motives were benevolent or instrumental,<sup>88</sup> the effect, which is all shareholders would care about, was plain. In the language missing in the ellipsis above, Ford makes clear that his do-good philosophy of corporate management was a great way of doing well. The complete quote is:

So it has been my policy to force the price of the car down as fast as production would permit, and give the benefits to users and laborers *with surprisingly enormous benefits to ourselves*.<sup>89</sup>

This is a perfectly sensible profit-maximizing strategy.<sup>90</sup> Ford set out his business strategy plainly: "[People should] go into business with the idea that they are going to serve the public and their employees as well as themselves, [and] they would be assured of success at the very start."<sup>91</sup> This is not a view of the firm as eleemosynary institution or existing to maximize social good, but rather a belief that the best way to ensure profit maximization is through a broad view of the firm's mission. Corporate law then and now permits tremendous leeway for firms to decide how to organize firms and what strategies to follow because outsiders (shareholders and courts) are unlikely to have better information or better incentives to get the right answer. There is also the potential for certain shareholders to misuse judicial scrutiny for self-serving and opportunistic ends that actually may destroy firm value.

But Ford's testimony was too much for the trial court to bear. After all, if a firm as large and important to the American economy were permitted to pursue

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<sup>86</sup> ALEXANDER R. CRABB, *BIRTH OF A GIANT: THE MEN AND INCIDENTS THAT GAVE AMERICA THE MOTORCAR* 359 (1969).

<sup>87</sup> Ford espoused a theory of firm as "steward" of monies generated in part by investors but largely by workers. "The money I have gathered together is not mine to do with altogether as I please. I do not own it. It is mine to control simply as the steward of it. The men who have worked with me have helped to create it." WATTS, *supra* note 1 at 184.

<sup>88</sup> The most widely accepted view is that of the Ford family minister, Samuel S. Marquis: "Ford's folk-hero image was partly genuine and partly contrived, accurate in its essence yet self-consciously magnified." WATTS, *supra* note 1 at 176.

<sup>89</sup> FORD, *MY LIFE AND WORK*, *supra* note 27 at 162 (emphasis added).

<sup>90</sup> Ford did virtually the same thing when he declared the Five-Dollar Day: he transferred enormous wealth from shareholders to workers for sound business reasons, but couched it in charitable terms.

<sup>91</sup> Henry Ford, "How I made a Success of My Business", *SYSTEM: THE MAGAZINE OF BUSINESS*, 448-49 (1916).

an overtly socialist strategy, the political impact and the effect on other firms could be enormous. The geopolitical context of the trial made this point clear. Amid the war raging across Europe, socialism as a political ethos was being seriously considered by many nations, and the Russian Revolution was already in motion. It is not fantastic considering the prevailing social forces to think that trial court viewed the *Dodge* case as a test case of the foundations on which American capitalism would be built.

Ford expounded his contrarian corpopolitical philosophy in a famous and widely read interview with the *New York Times*.<sup>92</sup> Ford disavowed a policy of “sharing other people’s money without [the recipients] doing any work”, but declared that the Five-Dollar Day plan was about giving profits to workers: “[I]t is not higher wages we are going to pay our employes [sic], but profits.”<sup>93</sup> Discussing the role of businesses in improving social welfare, Ford rejected the trickle-down approach and praised a direct role for businesses in improving the lives of workers. Ford made his preference for worker interests over owner interests clear:

I believe it is better for the nation, and far better for humanity, that between 20,000 and 30,000 people should be contented and well fed than that a few millionaires should be made.<sup>94</sup>

Ford’s progressive rhetoric was thus not limited to the courtroom; he spoke widely and loudly about how he was going to lead a transformation of the way in which American business conceptualized their relationship with workers. The court may have believed that if a business genius such as Henry Ford declared that profits were bad and that workers rights prevailed over investor rights, the money flowing to new businesses might be dramatically curtailed, with dire consequences for those very workers he intended to protect.

Judgment was rendered on December 5, 1917 (about a year after the complaint was filed). The lower court entered an injunction that prohibited the Ford Motor Company from building the factory. In addition, it ordered the payment of a special dividend of about \$19 million, of which the Dodges would get only \$1.9 million. Despite a rather small sum for them, especially in light of their intended use of the funds, the Dodges did not appeal. They had their injunction.

For Ford, both outcomes were big losses. Although he and his operations head, James Couzens, would receive over 70 percent of the dividend (about \$13 million), which they could immediately reinvest in the firm, tax rates at this time meant that the government would tax over two thirds of their dividends in taxes. In order to avoid this inefficiency, Ford could have turned to other sources of funding, such as raising money from new shares or borrowing from a bank. Ford

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<sup>92</sup> “Henry Ford Explains Why He Gives Away \$10,000,000”, *NEW YORK TIMES*, Jan. 11, 1914.

<sup>93</sup> *Id.*

<sup>94</sup> *Id.*

was trying to reduce or even eliminate the role of investors in his firm, however, so these were not desirable from a corporate governance perspective.

The injunction was an even bigger loss. Ford viewed the River Rouge factory as essential to the future success of the Ford Motor Company, and without an order from the Michigan Supreme Court removing the injunction it would not be built. This legal imprimatur on shareholder meddling could not have sat well with Ford or portended a bright future for how he planned to run his firm. Ford appealed.

### *B. The Supreme Court*

The decision from the Michigan Supreme Court did not come for 18 months. When it did, Chief Justice Strander's opinion seemed to deliver victory to both sides. The Dodges would get their special dividend, which the Court said was arbitrary for the board to deny them, but Ford would get to build his factory. An injunction to prevent construction was just too risky given the importance of the Ford Motor Company to the American economy and given the possibility that the Court could get the answer wrong. But the Court was obviously troubled by Ford's testimony, and took the opportunity to chastise him and his firm for following a seemingly non-profit maximizing path. It did so by forcing the dividend and, in powerful and memorable dictum, telling Ford and all other firms that the purpose of corporations is profits. The message from the split decision was clear—do what you want, but make sure that there is a plausible link with making money.

The Court began, where it should have, with the business judgment rule: courts will not substitute their judgment on purely business matters for that of a well considered and not conflicted decision of the board. Applying this to Ford's decision to refuse to pay a special dividend after the firm's most profitable year, the result of which was to increase retained earnings to well over \$60 million, the Court held that the refusal was arbitrary.<sup>95</sup> A board might decide to withhold distributions to shareholders (at the time, the only way in which shareholders of a closely held firm like the Ford Motor Company could easily profit from their investment), but only if it was based on a clear plan to increase shareholder profits. This is a key point. So long as the board's decision could plausibly be tied to a rational business purpose, it would be shielded from judicial review.

The Court reasoned, somewhat speciously, that it was not, and that Ford was running (or was going to run) the Ford Motor Company as "a semi-eleemosynary institution and not as a business institution".<sup>96</sup> This incredible decision was based on two related things. First, the Court looked to the business plan laid out by Ford's defense. The Court simply multiplied the initial capacity

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<sup>95</sup> "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." *Dodge*, 204 Mich. at 500.

<sup>96</sup> *Id.* at 504.

increase from the proposed factory by the planned selling price (a reduction from \$440 to \$360), and determined that the net profits in the future would be less than in the current year. With this cartoon picture of the business plan, the Court wrote:

In short, the plan does not call for and is not intended to produce immediately a more profitable business, but a less profitable one; not only less profitable than formerly, but less profitable than it is admitted it might be made.<sup>97</sup>

This sort of second-guessing is completely foreign to modern corporate law.<sup>98</sup> It isn't even sensible. As the Court itself acknowledged later in the opinion, capacity could always be increased, thus offsetting the price reduction with increased volume, and this was in fact the plan as made clear from Ford's other contemporaneous statements.

Second, the Court looked to the "attitude and to the expressions of Mr. Henry Ford."<sup>99</sup> It quoted Ford's testimony:

My ambition . . . 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.<sup>100</sup>

The Court went on to note that Ford dominated the firm and had the view that "shareholders . . . should be content to take what he chooses to give," and that his "sentiments, philanthropic and altruistic . . . had large influence in determining the policy to be pursued."<sup>101</sup>

The Court observed that it is okay for a firm to donate to charitable causes, as later cases and statutes would make crystal clear,<sup>102</sup> but emphasized that this must be secondary to the main purpose—making profits for stockholders. The Court's most famous passage (notably in dictum) sets forth the *standard of conduct* for firm officers and directors:

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

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<sup>97</sup> *Id.*

<sup>98</sup> The dividend ruling no longer good law.

<sup>99</sup> *Dodge*, 204 Mich. at 504.

<sup>100</sup> *Id.* at 505.

<sup>101</sup> *Id.*

<sup>102</sup> See Lynn A. Stout, "Why We Should Stop Teaching *Dodge v. Ford*", UCLA School of Law, Law-Econ Research Paper No. 07-11 Available at SSRN: <http://ssrn.com/abstract=1013744>.

nondistribution of profits among stockholders in order to devote them to other purposes.<sup>103</sup>

The concern here is about a majority shareholder diverting firm resources to self-serving ends. So, while courts generally will not enforce a strict shareholder wealth maximization on all firm decisionmaking—the maximization norm from *Dodge* is not a *standard of review*—they will intervene in cases in which directors or majority shareholders engage in conduct that is clearly not in the interests of shareholders.

The Court was able to make this rhetorical point on the dividend issue because, as noted above, it was a red herring. The firm’s dividend policy was irrelevant to its ability to follow the strategic plan laid out by Ford. Nearly three-quarters of the dividend would be paid to Ford and his allies, who could then simply reinvest these monies in the firm. This would have been inefficient from a tax perspective, however, since Ford and the others would have been taxed on the unnecessary dividend transaction. Marginal tax rates on income (including dividends) rose from 7 percent in 1913 to over 70 percent by 1920, so the use of retained earnings to fund the factory construction was in part driven by tax avoidance considerations. It is not unreasonable for the court to consider these issues since it potentially impacted the firm’s cost of capital unnecessarily. But there was a way around this problem.

If Ford wanted to avoid these transaction costs and inefficiencies, the firm could have simply raised the money for the construction through a debt or equity offering. Surely a syndicate of banks would loan to the highly successful firm, and investors would clamor for a stake in the firm. But Ford’s experience with shareholders and his anti-Wall Street sentiments biased him against looking to anyone outside the firm for financing. In a famous *New York Times* article, Ford was emphatic on this point: “We don’t borrow money. When we first started business we decided we would be our own bankers.”<sup>104</sup>

This was not just rhetoric or a litigation position. Over the three-year period leading up to the lawsuit, the Ford Motor Company’s average retained earnings (specifically, its ratio of cash to sales) was nearly double the average of the largest 15 firms in the United States. Ford held almost 30 percent of yearly sales in cash, compared with 18 percent for the United States Steel Corporation and 15 percent for the General Motors Corporation.<sup>105</sup> Unlike the tax issue, which the Court might reasonably consider as an inefficiency worthy of its consideration of the policy issues in the case, Ford’s idiosyncratic views about shareholders were obviously irrelevant.

The forced dividend was also not likely to raise the firm’s costs or imperil its competitive position, something the Court should certainly consider. Unlike other potential legal requirements, such as a minimum wage or safety regulations, the obligation to make payouts to shareholders does not necessarily raise a firm’s marginal costs. In this light, it is curious that the Dodges did not sue

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<sup>103</sup> *Dodge*, 204 Mich. at 507.

<sup>104</sup> “Henry Ford Explains Why He Gives Away \$10,000,000”, *NEW YORK TIMES*, Jan. 11, 1914.

<sup>105</sup> SELTZER, *supra* note 32 at 131.

Ford when he raised the wages of workers under the Five-Dollar Day plan. This strategy, which was motivated by practical business concerns but couched in strongly socialist rhetoric, resulted in the effective transfer of \$10 million in shareholder wealth to workers. The inaction here also underscores the point that they had ulterior motives for challenging the River Rouge plan.

Today, the Court's holding on the dividend issue is not good law: courts will not compel dividends, probably even in the face of silly and over-the-top testimony. Instead, the typical case is whether firm in financial trouble may issue a dividend, not whether it must. This case law plus state statutes that limit dividend size—such as Delaware's "nimble dividend test"—serve as a crude creditor protection device.

The Dodges' initial strategy in sending a letter to Ford is commonly used today. Instead of relying on litigation as the leverage, however, minority shareholders use the pressure of public securities markets, in the form of threats to sell, negative publicity, and information to traders about management competency. For example, in 2005 famed corporate raider Carl Icahn took a 10 percent stake in video retailer Blockbuster in an attempt to change the firm's strategic direction. Instead of spending millions to build a new online business, Icahn pressed the board to issue a large dividend to shareholders. This should sound familiar, as it is fundamentally the same goal the Dodges were pursuing. Icahn did not sue, however, but instead led a proxy fight for a seat on the Blockbuster board. He and two other dissidents succeeded. Icahn chose his method of attack largely because any legal claim would undoubtedly have failed. The decision to withhold dividends and invest in new businesses is, under current law, unassailable.

Icahn also had at his disposal the tools of the market for corporate control that have been developed in the past decades. A public firm, like Blockbuster, is subject to this sort of market pressure in ways that private firms, like Ford's firm in the early 20<sup>th</sup> Century were not. In those cases, the only efficient solution to these disputes was clear contracting over economic and control rights. The shareholder agreements in the Ford Motor Company did not have these. In this light, the Dodges' only choice was to sue.

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The injunction issue was, in contrast to the dividend ruling, not a place where the Court could afford to make a policy statement, since the costs of its decision were much higher here. Starting with two unassailable truths—that "judges are not business experts" and "[t]he experience of the Ford Motor Company is evidence of capable management of its affairs"<sup>106</sup>—the Court deferred to the board's decision to expand capacity through building a new factory. Deference was justified for two reasons: first, the uncertainty of the inquiry into what would be best for the firm;<sup>107</sup> and second, the concern that shareholders, like the Dodges, might be focused on short-term rather than long-term

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<sup>106</sup> *Dodge*, 204 Mich. at 508.

<sup>107</sup> "[T]he ultimate results of the larger business cannot be certainly estimated." *Id.*

interests.<sup>108</sup> Here we see the traditional justification for a board-centered approach to governance. Shareholders have heterogeneous preferences and imperfect information, and courts will respect their delegation of decisionmaking to the board in all cases absent self-dealing by board members or, in very rare cases, a grossly negligent decisionmaking process.

Though the legal verdict went against him in part, Ford once again emerged utterly victorious. He was praised as establishing a new, enlightened business philosophy characterized by one editorial as “the only one upon which great and enduring success can be established.”<sup>109</sup> Although his testimony about looking out for workers—“giving labor its just reward” as the *New York Evening Mail* opined<sup>110</sup>—forced the courts to hand him a partial legal defeat and a good scolding, he won the “hearts of ordinary American citizens.”<sup>111</sup> This enhanced the Ford legend and therefore expanded the market for “Ford” cars.

Despite these various victories, Ford learned that being a majority shareholder was potentially as perilous as being a minority shareholder. But for the intervention of the Michigan Supreme Court, his plan for his company would have been foiled. Ford decided it was time to get rid of shareholders all together.

## V. The Aftermath: Ford Finally Wins Control

Ford had experience squeezing out shareholders, including majority shareholders like Murphy and Malcolmson, so getting rid of minority shareholders like the Dodges was easy. In fact, he pulled almost the same scheme. While traveling in California after the opinion was handed down, he gave an interview with the *Los Angeles Examiner* in which he announced plans to start a new company to make even better and cheaper cars. The Dodges issued a threatening statement—“Henry Ford is under contract to the Ford Motor Co. and he will not be allowed to . . . start a competitive business”—but it did not allay shareholder panic.<sup>112</sup> Anticipating this panic, Ford sent agents to shareholders to inquire about them selling their shares. According to some accounts, “they sold out for a lower price than they would have gotten under normal conditions.”<sup>113</sup> The Dodges got \$25 million for their 2000 shares (\$12,500 each), which was about \$10 million less than they demanded from Ford in 1917 to avoid litigation.<sup>114</sup> Overall, the Dodges earned over \$32 million from their relationship with the Ford Motor Company.<sup>115</sup>

To accomplish the acquisition and consolidation of shares, Ford incorporated two new firms, Henry Ford & Son, Inc. (a New York firm) and

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<sup>108</sup> “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.” *Id.*

<sup>109</sup> WATTS, *supra* note 1 at 258.

<sup>110</sup> *Id.*

<sup>111</sup> *Id.*

<sup>112</sup> *Argument Centers About the Fordlet*, AUTOMOBILE TOPICS 655, Mar. 15, 1919.

<sup>113</sup> See BOOTON HERNDON, FORD: AN UNCONVENTIONAL BIOGRAPHY OF THE MEN AND THEIR TIMES 117 (1969).

<sup>114</sup> HYDE, *supra* note 31 at 83-84.

<sup>115</sup> The total includes: \$25 million from the sale of the stock; \$5 million in dividends; and about \$2 million in profit on sales to the firm. *See id.* at 84.

Eastern Holding Company (a Delaware firm). These firms, with funds from Ford's contribution of his personal stock, purchased the remaining shares from the minorities. As of July 31, 1919, the stockholders of Ford were as follows:

*Table 3: Shareholders of the Ford Motor Company, circa 1919*<sup>116</sup>

| <b>Shareholder</b>     | <b>Number of shares</b> | <b>Percent ownership</b> |
|------------------------|-------------------------|--------------------------|
| Henry Ford & Son, Inc. | 11,697                  | 58                       |
| Eastern Holding Co.    | 6100                    | 31                       |
| James Couzens          | 2180                    | 11                       |
| Mrs. A.P. Hauss        | 20                      | <1                       |
| Henry Ford             | 1                       | <1                       |
| Edsel Ford             | 1                       | <1                       |
| F.L. Klingensmith      | 1                       | <1                       |
|                        | 20,000                  |                          |

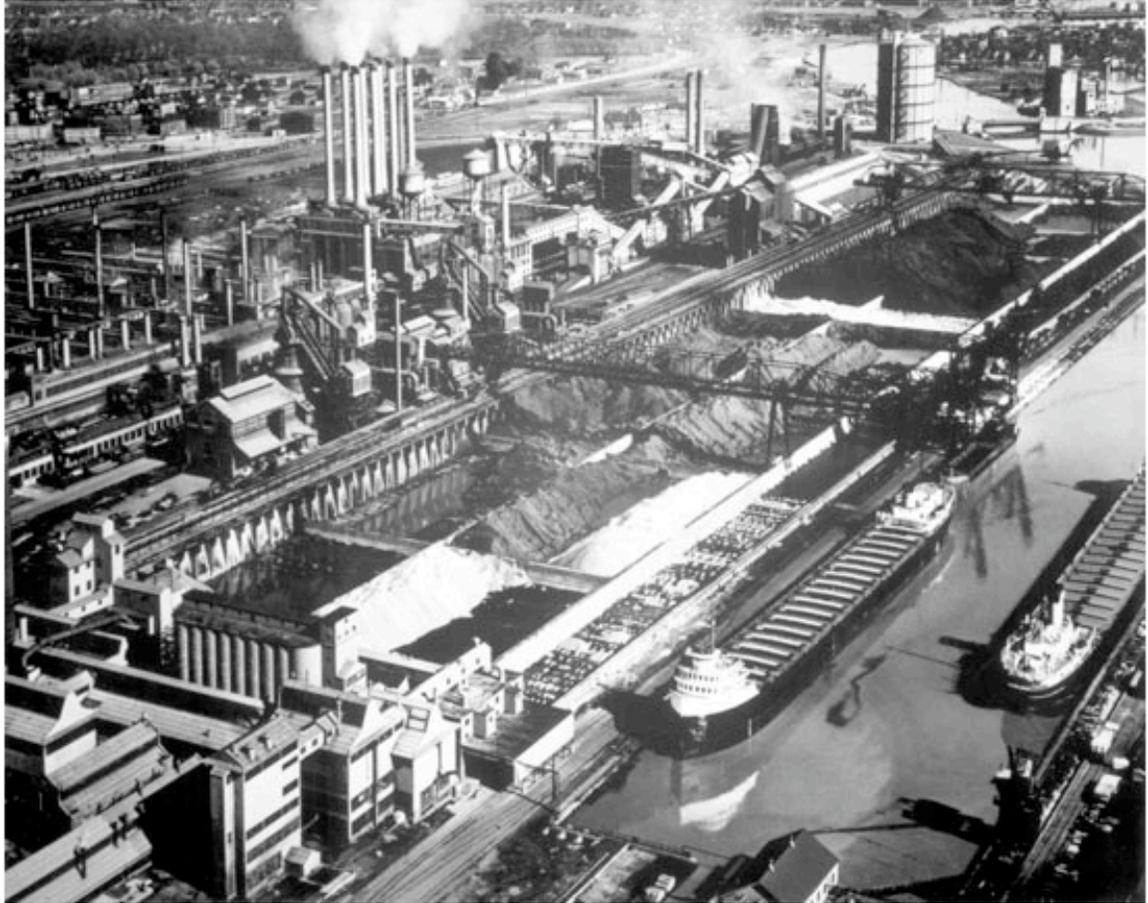
Eastern Holding Company then amended its charter to change its name to the Ford Motor Company, and then, with a loan from a banking syndicate led by Chase National Bank, bought the remaining shares of the Michigan company of the same name. Ford proceeded to buy out his long-time friends and collaborators, acquiring the shares of Couzens and his sister in September 1919. He had had enough with shareholders, even minorities and friends.

As required by the Court's decision, the Ford Motor Company paid the \$19 million dividend. And, as permitted by it, went on to build the River Rouge factory, which the firm still operates today. (See Figure 1.) A two square-mile facility that would eventually employ over 100,000 workers and produce about 4000 cars per day, the River Rouge factory would be the largest manufacturing facility built until then or since. It would be so large, in fact, that Ford would describe it as "so big it's not fun any more."<sup>117</sup>

<sup>116</sup> SELTZER, *supra* note 32 at 111.

<sup>117</sup> "Mr. Ford Doesn't Car", FORTUNE, Dec. 1933, p. 134

**Figure 1: Aerial view of the River Rouge Facility, Jan. 19, 1947**



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The squeeze out and consolidation of power also transformed the Ford Motor Company. The innovative company that rose from Ford's failures to unprecedented success became "more like the court of an oriental monarch in its combination of sycophancy and ruthlessness" after Ford took total control.<sup>118</sup> Ford "was not an organization man" and wanted to "call all the signals and carry the ball".<sup>119</sup> The new governance model that Ford felt was essential to the early success of his firm did not serve it well when competitors, like General Motors, responded with their own counter strategy. Model T sales started to fall by the 1920s as GM head Alfred P. Sloan built an auto conglomerate that offered customers a range of vehicles for every price range. Ford also faced a serious rival in the new Chrysler firm, which took serious market share as Ford stubbornly resisted innovating beyond the Model T. The spirit and total control needed to start the company was not conducive to its continued flourishing. Recognizing this eventually, Ford stepped aside and turned the reigns over to his son, Edsel.

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<sup>118</sup> Robert Little, *Henry Ford*, NEW REPUBLIC, 304, Nov. 14, 1923.

<sup>119</sup> WATTS, *supra* note 1 at 515-16.

The Ford Motor Company remained private and family owned from 1920 to 1956, when Henry Ford's grandson, Henry II, took it public. Even then, the Ford family retained effective voting control (about 40 percent of the vote) by holding preferred shares with super-voting rights. Hank the Deuce, as he was known, used sophisticated corporate finance contracts to separate economic ownership from voting control, solving in part the dilemma his grandfather faced. This ownership structure still exists, and as of the end of 2007 Henry Ford's great grandson, William Clay Ford, Jr., remained chairman of the board.

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Things did not turn out as well for the Dodges. Although Henry Ford made them fabulously wealthy and their new firm was having tremendous success, they would not enjoy it for long. While attending the New York auto show in January 1920, the brothers contracted influenza. John died within weeks. He was 55. Horace buried his brother, retreated to Florida, but was dead within the year. He was 52.<sup>120</sup> The rivalry between Ford and the Dodges was so passionate that rumors quickly circulated, and even persist, that the brothers were poisoned at the auto show, and that Ford was the perpetrator. Modern biographers of both Ford and the Dodges dismiss these accusations outright,<sup>121</sup> but the existence of them shows the nature of the battle between these powerful families.

The brothers' widows put the firm on the market in 1925. The investment banking firm Dillon, Read & Company bought the firm for \$146 million in cash, the largest cash transaction in history at that time. This offer topped that of General Motors, which offered \$124 million in cash and securities.<sup>122</sup> Dillon, Read quickly replaced Dodge management with their own men in the hopes of bringing more rigorous analytically thinking and management to the company. (Here we see the precursor to the modern private equity movement in which investors replace managers of private or public firms in the hopes of reducing agency costs and extracting value from mismanaged assets.) The investor-appointed managers were not good car men. Dodge faltered dramatically over the next few years, with sales falling from over 260,000 in 1926 to less than 150,000 in 1927. Sensing an opportunity, Walter Chrysler and his eponymous auto firm bought Dodge in a stock-for-stock deal in 1928. The Dodge brand is still part of the Chrysler today.

## VI. Conclusion

Although the Court's dictum about the shareholder wealth maximization norm is the most widely cited part of the *Dodge* opinion, it is not the most interesting or illuminating aspect of the case. As this essay has shown, *Dodge* is about much more than it appears on first reading.

First, the case demonstrates how corporate litigation often is one battle in a broader business battle between the parties. *Dodge* allows students of the law to explore how ancillary or hidden issues often drive litigation, and to consider the

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<sup>120</sup> HYDE, *supra* note 31 at 117-22.

<sup>121</sup> *See id.* at 123.

<sup>122</sup> *See id.* at 178.

difficult position of courts in these instances. The case presented to the courts was motivated by multiple factors on both sides: for the Dodges it was a ploy in their ongoing attempt to start a rival auto company to Ford, but was also an attempt to prevent a majority shareholder from diverting firm profits for seemingly personal ends; for Ford it was about denying potential rivals cash and avoiding taxes, but it was also about following what was at least plausibly a smart and profit-maximizing business strategy.

Courts often face such mixed motives in business litigation. Neither party comes with clean hands or pure motives, and the relief sought is often not about making the plaintiff whole or the defendant secure in its rights, but about something else. Courts are in a difficult position, since looking behind the complaint and the defense, they will see a complicated battle in which the litigation is a small part. Ignoring these issues risks having the law serving instrumental ends of opportunistic parties and establishing legal rules that allow other parties to exploit the law in ways unanticipated by the parties at the time of contracting. Paying full attention to them, on the other hand, also has risks, since a highly contextual decision may not translate easily to other cases, and therefore may create inefficiencies in contracting or dispute resolution.

Given this tension, the Michigan Supreme Court did about as well as could be expected in *Dodge*. Whether it saw the whole picture painted above or not, the Court crafted a holding that made a bold policy statement, while recognizing the limits of courts and law in resolving what are fundamentally business disputes. The decision of the board to invest in a new factory was not an act of charity, and the Court recognized this. But Ford's rhetoric could not be left unanswered. Drawing on the expressive function of law, the Court took an opportunity to announce a standard for firms to use in decisionmaking—that firm's exist to make profits—but simultaneously limiting the role of courts in policing this standard to extreme cases of self-dealing or grossly negligent decisionmaking.

Second, *Dodge* shows how explicit contracting over control rights is essential to the success of any business organization. Getting corporate governance right is not only something that can help firms make better decisions, but can also be used defensively to prevent certain shareholders from holding up the firm and extracting economic rents. The tools and techniques used by Ford were crude by our modern understanding, but the problems are very familiar to corporate lawyers, executives, and investors today.

Ford's vision was actually thoroughly modern, and yet another example of how this case foreshadowed by almost a hundred years our modern corporate world. He claimed to "not want stockholders in the ordinary sense of the term" as they limited his ability to do what he thought was in the best interest of the Ford Motor Company.<sup>123</sup> A similar concern about shareholder meddling was seen in the 2004 initial public offering of stock in Google, Inc. The entrepreneurs who invented the Internet search engine, Larry Page and Sergey Brin, wanted what Ford wanted when he first approached William Murphy in 1899—other people's money but full control. Their solution to the problem of control rights typically following risk was a contractual one. Page and Brin issued two classes of stock:

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<sup>123</sup> WATTS, *supra* note 1, at 257.

Class A shares, which would be sold to the public and would contain very limited voting rights, and Class B shares, which they would hold and would have super voting rights. Shareholder advocacy groups, like proxy voting advisor Institutional Shareholder Services, criticized this governance model: “[It] guaranteed that insiders will have 'carte blanche' authority in running the company over the near term.”<sup>124</sup> Shareholders thought differently, as Google’s share price soared from the moment of its IPO, and three years later was about eight times its initial price.

Ford would have preferred this model, but it was unavailable to him for a variety of reasons. For one, so-called dual class shares were a fairly sophisticated financing technique, and would have likely been foreign to him when he started his initial firms. In addition, the market for venture capital and public financing of start-ups, which the Google founders exploited, was not existent. There was no standard technique for investing in new firms, no venture capital industry with experienced players and valuable reputations, and there was no robust market for pricing public shares in firms with innovative governance models. In short, Ford was faced with a problem that has been largely solved by the free contracting and robust markets that we have today.

In this light, we can view the decision of the Michigan Supreme Court as an attempt to force consideration of precisely these questions about control rights. By narrowly defining the role of law, the Court forced parties to negotiate over control rights. “Don’t come to us to write your bargains after the fact,” the Court seemed to say, but bargain for control and cashflow rights at the time of investment. This is especially appropriate because the parties in these cases are sophisticated, knowledgeable, and represented by counsel. Forcing these parties to define their rights and responsibilities clearly by contract is a move in the direction of efficiency that the *Dodge* court seemed to get about right. And it set the theoretical framework in which Hank the Deuce, the Google founders, and others solved these problems.

The period in which Ford and the Dodges battled over control of the Ford Motor Company looked a lot like our modern world, but not so much like the world that would exist between then and now. We see the roots of venture capital contracts, shareholder activism, modern bankruptcy concepts like consolidation and restructuring specialists, and litigation as a business tactic. When Ford solved the problems that animated the *Dodge* case, he led the move toward a model of managerial capitalism and insulation of firms from shareholder pressure that would persevere for decades until the takeover battles of the 1980s. *Dodge* tells us much about our modern world that was lost for decades.

The *Dodge* case is often misread or mistaught as setting a legal rule of shareholder wealth maximization. This was not and is not the law. But the case is a part of the canon because it is about much more than this. This essay shows how the opinion can help us understand the difficult task for courts in these cases and how many of prominent aspects of corporate law and practice have long and underappreciated histories.

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<sup>124</sup> See Dawn Kawamoto, “Google gets low marks for governance”, CNET NEWS.COM, Aug. 24, 2004.

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