The "Corporate Purpose"
Mock Class – Admitted Student Weekend

A. Note on the Corporate Form
B. Agency Costs
C. Note on Dodge v. Ford Motor Co.
D. Dodge v. Ford

A. Note on the Corporate Form

Characteristics of a Corporation

The corporation is the standard form for almost all large U.S. firms. The chief attributes of the corporate form are generally listed as:

1) legal personality;
2) limited liability (shareholders not liable for corporation's debts);
3) transferability of shares; and
4) centralized management.

From a doctrinal perspective, the key attributes of corporate form all depend, directly or indirectly, on the legal identity of corporations as distinct "persons" apart from their shareholders and directors. State corporation statutes establish this identity and provide the basic rules governing relationships among corporate shareholders, directors, and managers.

The historical alternative to the corporate form was the general partnership, which had none of these four attributes except (to a certain extent) legal personality. The general partnership's creditors could go after the partners for the partnership's unpaid debts. Partnership interests were not freely transferable. And management of the general partnership was by majority vote of the partners. How does each of the three corporate-specific attributes make the corporate form more desirable to business parties than the general partnership?

In addition to the common features of the corporations, however, there are also cross-cutting differences among corporations that are at least as important as the distinction between corporations and partnerships. Small or "closely-held" corporations (so named because their shares seldom trade) that incorporate for tax or liability purposes often attempt to avoid other standard features of corporate law that seem inappropriate to their status as "incorporated partnerships." By contrast, corporate law is generally better suited to large – or at least largish – firms with numerous shareholders ("public" or "publicly-traded" firms).

The Incorporation Process

Forming a corporation is simple. In Delaware, it involves filing a certificate of incorporation with the Secretary of State and paying a fee. It can be done by anyone and for any lawful purpose. You can even do it online.

Sources of Corporate Law

The primary emphasis of corporate law is on the relationship between (and among) the corporation, its shareholders, and its directors. (If you are not familiar with the terms shareholders and directors, you should think of shareholders as the "owners" of the corporation -- i.e. those who are ultimately entitled to the profits the corporation makes -- and of directors as the "managers" of the corporation -- i.e. those who decide how to run the corporation.) There are several sources that define these relationships. Some of these sources are laws (statutes or case law); other are regulations promulgated by federal (or, less commonly, state) agencies; others are contractual.

1. *State Corporation Law*

A. Corporation Statutes

The most important laws on corporations are the state corporation statutes. Each corporation is (primarily) governed by the state corporation statute of the state in which the corporation is incorporated. Each corporation generally has the choice to incorporate in any one of the 50 states. Thus, when one decides to form a corporation, one basically has the choice between 50 laws to be governed by. Though these corporation statutes differ from state to state, a century of borrowing and reform efforts by the corporate bar have contributed to a general uniformity of structure. The task of analyzing state law is made even simpler by the fact that one state, Delaware, has emerged as the state of incorporation of choice for the majority of large U.S. corporations. In light of the special position of Delaware, we will focus chiefly on the Delaware General Corporation Law ("DGCL"). All (or almost all) of the DGCL provisions we will cover can be found in the document “Select DGCL Provisions 2014” on the course website.

Consider why it may be that Delaware, one of the smallest states, has become the domicile of choice for public corporations. That companies can essentially incorporate in any state they want (regardless of where they conduct most of their operations) is a necessary condition for the prominence of Delaware, but does not explain why so many companies *chose* Delaware. What does explain Delaware's prominence, and whether this prominence is desirable, has spawned a lively academic debate. And what Delaware needs to do to retain this prominence is important for the understanding of state corporation law.

Before we continue with our overview of the sources of corporate law, it is important to briefly discuss the basic allocation of power laid down by the corporate statutes. (Legal terms of art are in italics. You should start getting familiar with these terms and their meaning) Basically, there are three classes of people that share power: stockholders, directors and officers.

Shareholders (a.k.a. stockholders). The main source of power for shareholders is that they elect *directors*. Generally, all directors are elected every year at an *annual meeting* of shareholders. If shareholders are dissatisfied with the directors, they can

(i) elect different directors at the next annual meeting; or

(ii) in some circumstance *remove* directors either at a *special meeting* or by *written consent* (i.e. by signing a form stating that they want to remove them).

Directors. Directors have the legal power to manage the corporation. This means that directors decide how to run the business operations, how much salary they receive, and how much is distributed to shareholders in *dividends*. (If a corporation decides to distribute money to its shareholders, it pays dividends.) In managing the business, directors are generally not bound by directions given to them by the shareholders. All directors together form the *board of directors* or, in short, the *board*.

Officers. Officers help the directors to manage day-to-day business operations. Officers have fancy titles (such as President and Chief-Executive Officers). Despite these fancy titles, they are, as a legal matter, bound by directions given to them by the board of directors.

Directors that are also officers (or otherwise employees) of the company are commonly referred to as *inside directors*. Directors that are not otherwise affiliated with the company are *outside directors*. Outside directors generally do not spend much of their time in managing the company, are often hand-picked by the inside directors, and receive, relative to inside directors, a small amount of compensation. Directors (in particular inside directors) and/or officers are sometimes also referred to as management. (Note that, while these terms appear in case law, popular and academic writing, they are not used in the DGCL.) Even though, as a matter of law, all directors have equal powers, the real power is often exercised by the CEO. *Shareholder Management Powers*. Though directors have the general power to manage the corporations, certain extraordinary decisions require as well the approval of shareholders.

These decisions include:

(i) the dissolution of the corporation;
(ii) a sale by the corporation of all of its assets;
(iii) a *merger* of the corporation with another corporation (a merger of two corporation essentially means that they become one corporation that holds all the assets and owes all the liabilities previously held or owed by either one of the two corporations);
(iv) an amendment to the *certificate of incorporation* (more on the certificate is to follow soon).

B. State Case Law

Not all of the state corporation law is contained in the corporation statutes. Equally important is the state case law. In particular, case law (and not statutory law) defines the two important duties owed by directors and officers to the corporation and its shareholders: the duty of care (i.e. the duty not to be negligent in managing the corporation) and the duty of loyalty (i.e. the duty to manage the company for the benefit of the shareholders, and not for their own personal benefit).

In Delaware (though not in other states) corporate cases are heard by a specialized trial court: the Court of Chancery. The Chancery Court has five judges (one Chancellor and four

Vice-Chancellors) and has jurisdiction over all disputes arising under Delaware's corporate law (and some others). There are no juries in the Chancery Court. All decisions are thus rendered by judges that have a fair degree of subject-matter expertise. Appeals from the Chancery Court are heard by the Delaware Supreme Court, which has five members and normally sits in panels of three judges. A limited cast of characters is thus responsible for the generation of most of the important state case law.

2. *Federal Law and Regulations*

The main source of federal law of corporations is the *Securities Exchange Act of 1934* (also referred to as the 1934 Act, the Exchange Act, or the Securities Exchange Act). The Exchange Act (together with the Securities Act of 1933, which is not important for our purposes) forms the core of a complex regulatory scheme. As part of that scheme, Congress established the *Securities and Exchange Commission* (*SEC*) and empowered it to enforce the provision of the Exchange Act and to promulgate detailed rules and regulations in a number of areas. For our purposes, the most important of these regulations are those on acquisitions of corporations, and on insider trading. An additional source of federal law applicable to corporations is the U.S. Bankruptcy Code, some of whose provisions we will examine.

3. *Corporate Contracts*

Apart from legal rules, the relationship between shareholders, directors, officers, and the corporation is governed by two documents which are similar to contracts: the *certificate of incorporation* (a.k.a. *charter*) and the *by-laws*.

The various sources of rights discussed above form a hierarchy. On top of the hierarchy are federal laws (and regulations). If state law is inconsistent with federal law, federal law governs. Next are the state corporation statutes and (below) state case law. Then comes the charter. Charter provisions are only valid if they are not inconsistent with federal or state law. Finally, there are the by-laws. By-law provisions are trumped both by federal and state law and by the charter. (Note, however, that corporation statutes will often contain "default" rules, i.e. rules that, by their terms, can be modified by charter or by-law provisions. Such rules will contain phrases such as "unless otherwise provided in the corporation's certificate of incorporation ..."

A. The Certificate of Incorporation

Every corporation must have a charter. Indeed, a corporation is formed by filing the charter with the Secretary of State. A charter contains two kinds of provisions: mandatory and optional ones. The provisions that *must* be contained in the charter are listed in DGCL §102(a). The provisions that *may* be contained in it are listed in DGCL §102(b).

B. By-Laws

Almost all corporations also have by-laws. DGCL §109 specifies how by-laws are adopted or changed and what provisions may be contained in them. Many by-law provisions are technical (and boring).

While some governance provisions must be contained in the charter, others can be either in the charter or the by-laws. The bylaws can generally be amended by either shareholders or directors. In contrast, a charter amendment requires approval by both the board and shareholders. If one has the choice, why would a company chose to put provisions into its by-laws rather than into its charter, and vice versa?

Objective of the Corporation (and Corporate Law)

What is the objective of the corporation? Some might say the objective is to maximize value for its shareholders. But if the objective is to maximize value for the shareholders, which shareholders? Short-term shareholders? Long-term shareholders? What about future shareholders of the corporation (those buying the stock tomorrow, or next week)? Do they count? What if maximization of shareholder value, however defined, comes at the expense of creditors, employees, or the environment?

Others might say that it is pointless to speak of the corporation as having an objective. Corporate law generally permits directors run the corporation as they see fit unless they engage in naked self-dealing, deceive shareholders, patently abuse corporate machinery to entrench themselves, or exhibit gross negligence. Subject to only very loose corporate law restrictions, how will directors run the firm? Directors will run the firm in ways that suit their own financial and psychic interests (including their interest in retaining their board seats), constrained by other (non-corporate) sources of law (employment law, environmental law, etc.) as well by personal ethics, reputational concerns, and the like.

B. Agency Costs

An agency costs are the economic costs that arise when a "principal" (an organization, person or group of persons) hires an "agent" to act on its behalf. Because the two parties have different interests and the agent has more information, the principal cannot directly ensure that its agent is always acting in its (the principal's) best interests.

Common examples of agency costs include the costs borne by shareholders (the principal), when corporate management (the agent) spends money on wasteful pet projects, instead of maximizing shareholder value. Though agency costs are present in any economic agency relationship, the term is most used in business contexts.

There are three types of agency costs:

(1) Monitoring costs: the cost incurred by the principal seeking to prevent the agent from acting contrary to the principal's interests

(2) Bonding costs: the cost incurred by the agent to prevent itself from acting contrary to the principal's interests, which it incurs in the hope of being "hired" by the principal

(3) Residual costs: the costs that arise in the agency relationship because of different interests between the principal and the agent that cannot cost-effectively be eliminated by monitoring and bonding.

If agency costs would be too high, the agency relationship may not generate enough benefits to make it worthwhile to create.

In the public corporation, there are three potential types of agency costs:

(1) Managerial Agency Costs

The classic case of corporate agency cost is the professional manager—specifically the CEO—with only a small stake in ownership, having interests differing from those of firm's owners. Instead of making the company more profitable for shareholders, the CEO may be tempted to:

- engage in empire building (i.e. increasing the size of *the corporation* when doing does not serve rather than the value profits, "which usually increases the executives' prestige, perks, compensation", etc., but at the expense of the efficiency and thus value of the firm);

- not fire subordinates whose mediocrity or even incompetence may be outweighed by their value as friends and colleagues;

- not work hard or smart; or

- obtain a maximum of compensation with a minimum of "strings"—in the form of pressure to perform—attached.

(2) Controlling Shareholder Agency Costs

If the firm has a controlling shareholder, managerial agency costs will be lower (but not zero) because the controlling shareholder will have the incentive and ability to monitor the executive team. But the controlling shareholder might use its control over the firm to divert value from minority investors by:

- Selling itself cheap stock, selling the minority shareholders inflated-price stock, having the firm buy back its own stock at a high price, or having the firm buy back its own shares from minority shareholders at a low price;

- Engage in other self-dealing transactions with the firm, that siphon value out of the firm to the controlling shareholder

(3) Agency Costs of Debt

Creditors would prefer that the firm take few risks because they do not benefit from higher profits, but bear a disproportionate amount of any downside loss. Stockholders on the other hand have an interest in taking on more risk. If a risky project succeeds shareholders will get all of the profits themselves (once creditors are paid), whereas if the project fails the creditors bear most for the costs. Creditors are also concerned that shareholders may siphon assets out of the firm at their expense.

Because creditors understand these risks, they often have costly and large ex-ante contracts in place prohibiting firms from engaging in various types of activities. The drafting and monitoring of these contracts give rise to bonding and monitoring costs. To the extent creditors are still exposed to risk, they will simply raise the interest rate demanded, increasing the cost of capital for the company.

C. Note on Dodge v. Ford Motor Co (attached separately).

One of the most famous corporate-law cases in corporate law is Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919). It is one of the earliest (and few) cases in which the court is asked to consider the purpose of the corporation.

Ford Motor Co. had been incorporated in 1903. Henry Ford owned 58% of Ford Motor's stock and controlled the board. The Dodge brothers owned 10% and five other shareholders owned the balance. From 1908 on, Ford Motor had paid a regular annual dividend of $1.2 million, and between December 1911 and October 1915, it paid special one-time dividends totaling $41 million. In 1916, Henry Ford declared it to be the settled policy of the company not to pay in the future any special dividends, but to put back into the business for the future all of the earnings of the company, other than the regular dividend of $1.2 million. "My ambition, declared Mr. Ford, "is to employ still more men; to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes. To do this, we are putting the greatest shared of our profits back into the business." At the time of the announcement, Ford Motor had a surplus of $112 million, including $52.5 million in cash.

The Dodge brothers then brought a suit whose objects included compelling a dividend equal to 75% of the accumulated cash surplus. The trial court ordered Ford Motor to declare a dividend of 419.3 million – equal to half of its cash surplus as of July 31, 1916 minus special dividends paid between the time the complaint was filed and July 31, 1917.[1] The Michigan Supreme Court (in the case you are about to read) affirmed this portion of the trial court's decree.

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[1] Henry Ford had earlier given an interview to the Detroit News, in which he said:

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. …

Questions on Dodge v. Ford

(1) What type of agency problem does Henry Ford's behavior represent?
(2) How does reducing this agency problem benefit entrepreneurs selling shares to raise capital for their firms?
(3) Does the ruling eliminate this agency problem? How might a future Henry Ford get around it?
(4) There is a possible alternative account of what transpired in the case of Dodge v Ford. On this alternative account, Henry Ford intended to serve the interests of Ford Motor Company and its shareholders by suspending special dividends and selling cars at a low price. How? By depriving the Dodge Brothers, 10% owners of Ford, of capital to build a competing car business (Dodge Brothers Company). There is in fact some evidence that Henry Ford, in suspending special dividends, was driven at least in part by competitive considerations (starving the Dodge Brothers) rather than solely by a desire to benefit humanity and go down in history as a visionary philanthropist. (The tax rates on special dividends at the time were also exceptionally high, giving Ford another reason to suspend them.) But the court was either unaware, or chose to be unaware, of the possible competitive or tax reasons for Henry's actions.
(5) Let's suppose that Ford's only motivation in suspending special dividends was to starve the Dodge Brothers of capital, and he had frankly acknowledged that the dividends were suspended for that purpose. And suppose that starving the Dodge Brothers of capital would, over time, increase the value flowing from Ford to all of Ford's shareholders (including both Ford and the Dodge Brothers) by crippling a potential competitor of Ford. Should a court permit Henry to starve the Dodge Brothers? We'll discuss in class.

Dodge v. Ford Motor Co.

Supreme Court of Michigan

April 9, 1918, Submitted ; February 7, 1919, Decided; Rehearing Denied May 1, 1919

Docket No. 47

Reporter

204 Mich. 459 *; 170 N.W. 668 **; 1919 Mich. LEXIS 720 ***; 3 A.L.R. 413

DODGE v. FORD MOTOR CO.

Counsel: *Stevenson, Carpenter, Butzel & Backus* (*Elliott G. Stevenson, William L. Carpenter,* and *Thomas G. Long,* of counsel), for plaintiffs.
Lucking, Helfman, Lucking & Hanlon (**[***55]** *Alfred Lucking* and *Alexis C. Angell,* of counsel), for defendants.

Opinion

[*491] **[**679]** OSTRANDER, J. *(after stating the facts).*

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As we regard the testimony as failing to prove any violation of anti-trust laws or that the alleged policy **[***67]** of the company, if successfully carried out, will involve a monopoly other than such as accrues to a concern which makes what the public demands and sells it at a price which the public regards as cheap or reasonable, the case for plaintiffs must rest upon the claim, and the proof in support of it, that the proposed expansion of the business of the corporation, involving the further use of profits as capital, ought to be enjoined because inimical to the best interests of the company and its shareholders, and upon the further claim that in any event the withholding of the special dividend asked for by plaintiffs is arbitrary action of the directors requiring judicial interference.

The rule which will govern courts in deciding these questions is not in dispute. It is, of course, differently phrased by judges and by authors, and, as the phrasing in a particular instance may seem to lean for or **[**682]** against the exercise of the right of judicial interference with the actions of corporate directors, the context, or the facts before the court, must be considered. This court, in *Hunter v. Roberts, Throp & Co., **[*500]** 83 Mich. 63, 71*, recognized the rule in the following **[***68]** language:

"It is a well-recognized principle of law that the directors of a corporation, and they alone, have the power to declare a dividend of the earnings of the corporation, and to determine its amount. 5 Am. & Eng. Enc. Law [1st Ed.], p. 725. Courts of equity will not interfere in the management of the directors unless it is clearly made to appear that they are guilty of fraud or misappropriation of the corporate funds, or refuse to declare a dividend when the corporation has a surplus of net profits which it can, without detriment to its business, divide among its stockholders, and when a refusal to do so would amount to such an abuse of discretion as would constitute a fraud, or breach of that good faith which they are bound to exercise towards the stockholders."

In 2 Cook on Corporations (7th Ed.), § 545, it is expressed as follows:

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

"When, therefore, the directors have exercised this discretion and refused to declare a dividend, there will be no interference by the courts with their decision, unless they **[***69]** are guilty of a wilful abuse of their discretionary powers, or of bad faith or of a neglect of duty. It requires a very strong case to induce a court of equity to order the directors to declare a dividend, inasmuch as equity has no jurisdiction, unless fraud or a breach of trust is involved. There have been many attempts to sustain such a suit, yet, although the court do not disclaim jurisdiction, they have quite uniformly refused to interfere. The discretion of the directors will not be interfered with by the courts, unless there has been bad faith, wilful neglect, or abuse of discretion.

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

[*501] In 1 Morawetz on Corporations (2d Ed.), § 447, it is stated:

"Profits earned by a corporation may be divided among its shareholders; but it is not a violation of the charter if they are allowed to accumulate and remain invested in the company's business. The managing agents of a corporation are impliedly invested **[***70]** with a discretionary power with regard to the time and manner of distributing its profits. They may apply profits in payment of floating or funded debts, or in development of the company's business; and so long as they do not abuse their discretionary powers, or violate the company's charter, the courts cannot interfere.

"But it is clear that the agents of a corporation, and even the majority, cannot arbitrarily withhold profits earned by the company, or apply them to any use which is not authorized by the company's charter. The nominal capital of a company does not necessarily limit the scope of its operations; a corporation may borrow money for the purpose of enlarging its business, and in many instances it may use profits for the same purpose. But the amount of the capital contributed by the shareholders is an important element in determining the limit beyond which the company's business cannot be extended by the investment of profits. If a corporation is formed with a capital of $100,000 in order to carry on a certain business, no one would hesitate to say that it would be a departure from the intention of the founders to withhold profits, in order to develop the company's **[***71]** business, until the sum of $500,000 had been amassed, unless the company was formed mainly for the purpose of accumulating the profits from year to year. The question in each case depends upon the use to which the capital is put, and the meaning of the company's charter. If a majority of the shareholders or the directors of a corporation wrongfully refuse to declare a dividend and distribute profits earned by the company, any shareholder feeling aggrieved may obtain relief in a court of equity.

"It may often be reasonable to withhold part of the earnings of a corporation in order to increase its surplus **[*502]** fund, when it would not be reasonable to withhold all the earnings for that purpose. The shareholders forming an ordinary business corporation expect to obtain the profits of their investment in the form of regular dividends. To withhold the entire profits merely to enlarge the capacity of the company's business would defeat their just expectations. After the business of a corporation has been brought to a prosperous condition, and necessary provision has been made for future prosperity, a reasonable share of the profits should be applied in the payment of regular **[***72]** dividends, though a part may be reserved to increase the surplus and enlarge the business itself."

One other statement may be given from *Park v. Grant Locomotive Works, 40 N.J. Eq. 114 (3 Atl. 162, 45 N.J. Eq. 244, 19 Atl. 621)*:

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

It is not necessary to multiply statements of the rule.

To develop the points now discussed, and to a considerable extent they may be developed together as a single point, it is necessary **[**683]** to refer with some particularity to the **[***73]** facts.

When plaintiffs made their complaint and demand for further dividends the Ford Motor Company had concluded its most prosperous year of business. The demand for its cars at the price of the preceding year **[*503]** continued. It could make and could market in the year beginning August 1, 1916, more than 500,000 cars. Sales of parts and repairs would necessarily increase. The cost of materials was likely to advance, and perhaps the price of labor, but it reasonably might have expected a profit for the year of upwards of $60,000,000. It had assets of more than $132,000,000, a surplus of almost $112,000,000, and its cash on hand and municipal bonds were nearly $54,000,000. Its total liabilities, including capital stock, was a little over $20,000,000. It had declared no special dividend during the business year except the October, 1915, dividend. It had been the practice, under similar circumstances, to declare larger dividends. Considering only these facts, a refusal to declare and pay further dividends appears to be not an exercise of discretion on the part of the directors, but an arbitrary refusal to do what the circumstances required to be done. These facts and **[***74]** others call upon the directors to justify their action, or failure or refusal to act. In justification, the defendants have offered testimony tending to prove, and which does prove, the following facts. It had been the policy of the corporation for a considerable time to annually reduce the selling price of cars, while keeping up, or improving, their quality. As early as in June, 1915, a general plan for the expansion of the productive capacity of the concern by a practical duplication of its plant had been talked over by the executive officers and directors and agreed upon, not all of the details having been settled and no formal action of directors having been taken. The erection of a smelter was considered, and engineering and other data in connection therewith secured. In consequence, it was determined not to reduce the selling price of cars for the year beginning August 1, 1915, but to maintain the price and to accumulate a large surplus to pay for the proposed expansion of plant **[*504]** and equipment, and perhaps to build a plant for smelting ore. It is hoped, by Mr. Ford, that eventually 1,000,000 cars will be annually produced. The contemplated changes will permit **[***75]** the increased output.

The plan, as affecting the profits of the business for the year beginning August 1, 1916, and thereafter, calls for a reduction in the selling price of the cars. It is true that this price might be at any time increased, but the plan called for the reduction in price of $80 a car. The capacity of the plant, without the additions thereto voted to be made (without a part of them at least), would produce more than 600,000 cars annually. This number, and more, could have been sold for $440 instead of $360, a difference in the return for capital, labor and materials employed of at least $48,000,000. 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. The apparent immediate effect will be to diminish the value of shares and the returns to shareholders.

It is the contention of plaintiffs that the apparent effect of the plan is intended to be the continued and continuing effect of it and that it is deliberately proposed, not of record and not by official corporate declaration, but nevertheless **[***76]** proposed, to continue the corporation henceforth as a semi-eleemosynary institution and not as a business institution. In support of this contention they point to the attitude and to the expressions of Mr. Henry Ford.

Mr. Henry Ford is the dominant force in the business of the Ford Motor Company. No plan of operations could be adopted unless he consented, and no board of directors can be elected whom he does not favor. One of the directors of the company has no stock. One share was assigned to him to qualify him **[*505]** for the position, but it is not claimed that he owns it. A business, one of the largest in the world, and one of the most profitable, has been built up. It employs many men, at good pay.

"My ambition," said Mr. Ford, "is to employ still more men, to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes. To do this we are putting the greatest share of our profits back in the business."

"With regard to dividends, the company paid sixty per cent. on its capitalization of two million dollars, or $1,200,000, leaving $58,000,000 to reinvest for the growth of the company. This is Mr. **[***77]** Ford's policy at present, and it is understood that the other stockholders cheerfully accede to this plan."

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

"Q. For how long? Had you fixed in your mind any time in the future, when you were going to pay --

"A. No.

"Q. That was indefinite in the future?

"A. That was indefinite, yes, sir."

The record, and especially the testimony of Mr. Ford, convinces that he has to some extent the attitude towards shareholders of one who has dispensed and distributed to them large gains and that they should be content to take what he chooses to give. His testimony creates the impression, also, that he thinks the Ford Motor Company has **[**684]** made too much money, has had too large profits, and that although large profits might be still earned, a sharing of them with the public, by reducing the price of the output of the company, ought to be undertaken. We have no doubt that certain sentiments, philanthropic and altruistic, creditable to Mr. Ford, had large influence in determining the policy to be pursued by the Ford **[*506]** Motor **[***78]** Company -- the policy which has been herein referred to.

It is said by his counsel that --

"Although a manufacturing corporation cannot engage in humanitarian works as its principal business, the fact that it is organized for profit does not prevent the existence of implied powers to carry on with humanitarian motives such charitable works as are incidental to the main business of the corporation."

And again:

"As the expenditures complained of are being made in an expansion of the business which the company is organized to carry on, and for purposes within the powers of the corporation as hereinbefore shown, the question is as to whether such expenditures are rendered illegal because influenced to some extent by humanitarian motives and purposes on the part of the members of the board of directors."

In discussing this proposition, counsel have referred to decisions such as *Hawes v. Oakland, 104 U.S. 450*; *Taunton* v. *Royal Ins. Co.,* 2 Hem. & Miller, 135; *Henderson* v. *Bank of Australasia,* L.R. 40 Ch. Div. 170; *Steinway v. Steinway & Sons, 40 N.Y. Supp. 718*; *People, ex rel. Metropolitan Life Ins. Co., v. Hotchkiss, 136 App. Div. 150 (120* ***[***79]*** *N.Y. Supp. 649*). These cases, after all, like all others in which the subject is treated, turn finally upon the point, the question, whether it appears that the directors were not acting for the best interests of the corporation. We do not draw in question, nor do counsel for the plaintiffs do so, the validity of the general propositions stated by counsel nor the soundness of the opinions delivered in the cases cited. The case presented here is not like any of them. The difference between an incidental humanitarian expenditure of corporate funds for the benefit of the employees, like the building of a hospital for their use and the employment of **[*507]** agencies for the betterment of their condition, and a general purpose and plan to benefit mankind at the expense of others, is obvious. There should be no confusion (of which there is evidence) of the duties which Mr. Ford conceives that he and the stockholders owe to the general public and the duties which in law he and his codirectors owe to protesting, minority stockholders. A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for **[***80]** that end. The discretion of directors is to be exercised in the choice of means to attain that end and does not extend to a change in the end itself, to the reduction of profits or to the nondistribution of profits among stockholders in order to devote them to other purposes.

There is committed to the discretion of directors, a discretion to be exercised in good faith, the infinite details of business, including the wages which shall be paid to employees, the number of hours they shall work, the conditions under which labor shall be carried on, and the prices for which products shall be offered to the public. It is said by appellants that the motives of the board members are not material and will not be inquired into by the court so long as their acts are within their lawful powers. As we have pointed out, and the proposition does not require argument to sustain it, it is not within the lawful powers of a board of directors to shape and conduct the affairs of a corporation for the merely incidental benefit of shareholders and for the primary purpose of benefiting others, and no one will contend that if the avowed purpose of the defendant directors was to sacrifice the interests **[***81]** of shareholders it would not be the duty of the courts to interfere.

We are not, however, persuaded that we should interfere with the proposed expansion of the business **[*508]** of the Ford Motor Company. In view of the fact that the selling price of products may be increased at any time, the ultimate results of the larger business cannot be certainly estimated. The judges are not business experts. It is recognized that plans must often be made for a long future, for expected competition, for a continuing as well as an immediately profitable venture. The experience of the Ford Motor Company is evidence of capable management of its affairs. It may be noticed, incidentally, that it took from the public the money required for the execution of its plan and that the very considerable salaries paid to Mr. Ford and to certain executive officers and employees were not diminished. We are not satisfied that the alleged motives of the directors, in so far as they are reflected in the conduct of the business, menace the interests of shareholders. It is enough to say, perhaps, that the court of equity is at all times open to complaining shareholders having a just grievance.

Assuming **[***82]** the general plan and policy of expansion and the details of it to have been sufficiently, formally, approved at the October and November, 1917, meetings of directors, and assuming further that the plan and policy and the details agreed upon were for the best ultimate interest of the company and therefore of its shareholders, what does it amount to in justification of a refusal to declare and pay a special dividend, or dividends? The Ford Motor Company was able to estimate with nicety its income and profit. It could sell more cars than it could make. Having ascertained what it would cost to produce a car **[**685]** and to sell it, the profit upon each car depended upon the selling price. That being fixed, the yearly income and profit was determinable, and, within slight variations, was certain.

There was appropriated -- voted -- for the smelter $11,325,000. As to the remainder voted there is no **[*509]** available way for determining how much had been paid before the action of directors was taken and how much was paid thereafter, but assuming that the plans required an expenditure sooner or later of $9,895,000 for duplication of the plant, and for land and other expenditures **[***83]** $3,000,000, the total is $24,220,000. The company was continuing business, at a profit -- a cash business. If the total cost of proposed expenditures had been immediately withdrawn in cash from the cash surplus (money and bonds) on hand August 1, 1916, there would have remained nearly $30,000,000.

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

In reaching this conclusion, we do not ignore, but recognize, the validity of the proposition that plaintiffs have from the beginning profited by, if they have not lately, officially, participated in, the **[***84]** general policy of expansion pursued by this corporation. We do not lose sight of the fact that it had been, upon an occasion, agreeable to the plaintiffs to increase the capital stock to $100,000,000 by a stock dividend of $98,000,000. These things go only to answer other contentions now made by plaintiffs and do not and cannot operate to estop them to demand proper dividends upon the stock they own. It is obvious that an annual **[*510]** dividend of sixty per cent. upon $2,000,000, or $1,-$200,000, is the equivalent of a very small dividend upon $100,000,000, or more.

The decree of the court below fixing and determining the specific amount to be distributed to stockholders is affirmed. In other respects, except as to the allowance of costs, the said decree is reversed. Plaintiffs will recover interest at five per cent. per annum upon their proportional share of said dividend from the date of the decree of the lower court. Appellants will tax the costs of their appeal, and two-thirds of the amount thereof will be paid by plaintiffs. No other costs are allowed.

STEERE, FELLOWS, BROOKE, and STONE, JJ., concurred with OSTRANDER, J.

Concur by: MOORE

Concur

MOORE, J. *(concurring).* **[***85]** I agree with what is said by Justice OSTRANDER upon the subject of capitalization. I agree with what he says as to the smelting enterprise on the River Rouge. I do not agree with all that is said by him in his discussion of the question of dividends. I do agree with him in his conclusion that the accumulation of so large a surplus establishes the fact that there has been an arbitrary refusal to distribute funds that ought to have been distributed to the stockholders as dividends. I therefore agree with the conclusion reached by him upon that phase of the case.

BIRD, C.J., and KUHN, J., concurred with MOORE