

What Corporations Do
James Allison
December 25, 2011

Author's note: "The Prosecution of Judge Waite" was performed twice at the Democracy Convention in Madison, Wisconsin, in August, 2011. After the second performance, as I sat in a downtown church waiting for a plenary session to begin, an unidentified woman leaned over and said "You know, you really should do something with the Dodge v. Ford decision." "Yes," I replied. "A very good suggestion. Thanks." This play is for her.

Characters (in order of appearance):
Four students: Ford, Friedman, Madison, and Smith
Professor

The setting is a Monday morning classroom on a university campus. Neither class nor professor is identified, but each has something to do with corporate law and economics. Eight students are enrolled but only four show up for class, all males. (The professor role can be male or female.)

At stage right are four plain chairs, arranged side by side in a line angled 45 degrees toward the audience. Facing them at stage left is another chair with a table or desk for the professor. Each student carries a pencil and a copy of this manuscript fastened to a clipboard. The professor carries a copy inside a briefcase.

The action begins when the four students enter stage left, more or less at the same time, in no particular order, and take their seats without ado. Ten seconds later the professor enters stage left, opens the briefcase, puts the manuscript on the desk or table, and sits down. The professor proceeds to take attendance by checking names on a class roster.

Professor: Celeri. [No answer.]

Professor: Ford.

Ford: Yup.

Professor: Friedman.

Friedman: Yo!

Professor: Jensen. [No answer.]

Professor: Madison.

Madison: At your service.

Professor: Richter. [No answer.]

Professor: Smith.

Smith: Aye!

Professor: Waldorf. [No answer.] Well. Maybe we should wait a few minutes for the others to show up.

Ford: Not much chance of that. They're probably still recovering from the weekend.

Professor: The weekend? What weekend?

Friedman: Last weekend, the big game weekend.

Smith: We get to keep the ax. Or a bucket? Maybe a jug.

Friedman: No, it's an ax.

Madison [sings]:

Oh, it's whiskey, whiskey, whiskey,
That makes you feel so frisky,
On the Farm,
On the Farm,
Oh, it's whiskey, whiskey, whiskey,
That makes you feel so frisky,
On the Leland Stanford Junior Farm.

Friedman [sings]:

Oh, it's cold roast duck,
That makes you . . .

Professor [interrupts]: All **right!** I **get** it.

Ford: I'd fire them all if it were up to me. Hung over sots. Not on **my** assembly line. Not in **my** day.

Professor: Yes, Mr. Ford, we know all about that. But that day is long past, and the present belongs to your grandson, "Henry Deuce," who sent you here to study the **modern** corporation.

Ford: It's all bunk. But here I am, and I hope he's happy now.

Professor: Where did we leave off?

Smith: You were about to talk about legal restraints on corporate charity, when somebody interrupted with a simple question: What do corporations do?

Professor: Maybe not so simple.

Smith: I know one thing they do.

Professor: What's that, Adam?

Smith: As I said in 1776, "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or some contrivance to raise prices."

[**Madison** raises his hand.]

Professor: James Madison.

Madison: In my day we usually called them monopolies. We founders knew we had to keep a close watch on them, whatever they did. I said it would be well to reserve to the State, a right to terminate the monopoly by paying some reasonable sum. This would guard against the public discontents resulting from the exorbitant gains of individuals, and from the inconvenient restrictions combined with them.

Professor: Inconvenient restrictions?

Madison: Had you been a colonial tea merchant in the heyday of the British East India Company, you would know the meaning of an inconvenient restriction.

Professor: I see.

[**Friedman** raises his hand.]

Professor: Milton Friedman.

Friedman: Yes. That's part of the truth, but you're nibbling around the edges.

Professor: Let me guess. "The social responsibility of business is to increase its profits." The title of your article in the New York Times Magazine, September 13, 1970.

Madison: That could never have passed muster with the founding fathers.

Friedman: Probably not. But they would have found more favor with the whole quote, from my book: ". . . in a free society . . . there is one and only one social responsibility of business--to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say,

engages in open and free competition without deception or fraud.”

Madison: That sounds very grand indeed. But how much injury may accrue during the pursuit of redress? A lot of mischief can be done while the authorities track down that deception or fraud--if they ever do.

Professor: All good observations. But listen: This is what professors of corporate law usually say when students ask them what corporations do. They say: “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.”

Madison: Outrageous! That would never have got past me, Jefferson, or even Hamilton.

Professor: Who knows where it comes from? Mr. Ford?

Ford [with reluctance]: Well, in a way it comes from me and the two Dodge brothers, John and Horace.

Professor: I thought you made cars.

Ford: If you sell enough Model Ts, you can make **law** too.

Professor: Tell us more.

Friedman, Madison, and Smith: “More,” “Proceed,” and “Aye!”

Ford: My first two ventures flopped. I knew all about how to design a car, but not how to make one. By the time I started my third venture, I knew enough to outsource the manufacturing to the real experts. Mine were two crackerjack machinists named John and Horace Dodge.

Professor: And what did they get in return?

Ford: By 1908, each of them had 50 shares--together, about 10% of the ownership. A big chunk. But I had 585, about 59% ownership.

Professor: So, what you said went.

Ford: Yes. Or so I thought. And I could never abide being told what to do by a bunch of money men, Wall Street banker types with no practical skills. The Dodges at least were car men.

Professor: If I recall my Ford history correctly, your first masterpiece came the following year: 1909, the Model T. A big success.

Ford: You said it.

Professor: And your second masterpiece came in 1913. There was some irony there. Although you say your strength was design, your second masterpiece came in manufacturing: The assembly line.

Ford: Exactly as you say.

Professor: And the results were astonishing. A few numbers help to tell that story. In 1905 you produced 2,000 cars; in 1923, two million. When it first came in, in 1913, the assembly line raised production 700%.

Ford: All true.

Professor: You got huge economies of scale: They enabled you to improve the car enormously while cutting its retail price in half. By 1923 half the cars on the road were Fords.

Ford: And we all got filthy rich. Take the two Dodge brothers. On their **\$10,000 investment**, in a period of 13 years Ford returned over **\$35 million**--nearly **100% annual return!**

Professor: Another irony there. They made enough money to start their own car manufacturing business. They started the Dodge marque that continued in the Chrysler company.

Friedman: They became your competitors. Always a good thing.

Ford: That's what you think.

Smith: What a twist! Contriving to reduce your price! And I thought they always contrived to **raise** prices.

Ford: More than one way to skin a cat!

Madison: But a truly dangerous accretion of wealth. We've not heard the end of **this** tale.

Ford: You said a mouthful there.

Professor: And all the while, you massaged your public image as the folksy friend of the common working man. You made a big deal about raising your workers' wages, and cutting prices so all your workers could afford to buy a Ford.

Ford: That wouldn't have fooled you. But it did make a big splash: Doubling their wages; the Five-Dollar Day.

Professor: Tell us the real reason.

Ford: Well, I did want them to buy more Fords. But the real reason was competition for labor. You see, that new assembly line did make us more efficient than anyone. But it had unintended consequences. It made workers miserable. The job became repetitive and boring. I'll never forget that worker whose job was to install Nut 86. He said that if he kept putting on Nut 86, he would soon become Nut 86 in the Pontiac bug house.

Professor: Like Charlie Chaplin in his film "Modern Times."

Ford: So I hear. Anyhow, employee turnover and absenteeism just went right through the roof. I **had** to double their wages just to keep them on the job, making Fords. And it worked. It was just about the best cost-cutting move we ever made.

Professor: And the wage raise was not automatic. That is not widely known.

Ford: No. You had to work at least 6 months. And your life style had to meet the approval of a Ford social worker. You couldn't be a drinker, had to save your money, keep a tidy household, and so forth.

Madison: And so forth. Just as the founders feared.

Smith: More connivance than I ever imagined!

Professor: But it worked so well. Mr. Ford's photo appeared in Soviet factories, right next to Lenin. A Socialist worker's hero!

Friedman: But tell us more about those Dodge brothers, those salubrious competitors of yours.

Ford: They didn't look so salubrious to me, if you mean wholesome and beneficial.

Friedman: I do indeed.

Ford: Well, let numbers do the talking. Between 1915 and 1916 Ford revenues went from \$121 million to \$207 million. Profit went from \$27 million to \$60 million. But dividends **dropped** from \$16 million to \$3 million. And the percentage of profits distributed **dropped**--get ready--from 66% to 5%. From a record high to a record low.

Professor: And how did the Dodges respond?

Ford: They sued me. They thought the shareholders should have a bigger share of those enormous 1916 profits. But that wasn't all.

Professor: No?

Ford: No. You see, the reason I gave was that I wanted the extra cash to expand production. I wanted to build the River Rouge plant. It would be the biggest factory ever built anywhere, for anything. I even wanted to build my own smelters for steel production. We had silos full of ready cash, yes, but I wanted to use it to build a bigger plant: more jobs, lower prices, higher wages.

Professor: And why did that bother the Dodge brothers?

Ford: They thought it would put the other car companies--including theirs--out of business, give Ford a monopoly.

Madison: Please expatiate.

Ford: Sure. If nobody else could afford that kind of scale, nobody else could achieve our economies of scale--which Ford just might use to price them right out of business.

Madison: I see.

Ford: So the Dodge brothers asked the court for more money--which I knew they would use to build up their own car business. And on top of that, they asked the court to enjoin us from building the River Rouge plant--so as not to drive everyone else out of business.

Professor: And what did the court do?

Ford: The court ordered us to pay our stockholders another \$19.3 million. And the court enjoined us not to build the River Rouge plant.

Professor: You lost.

Ford: Yes, but we appealed to the Michigan Supreme Court.

Professor: And the case became known as Dodge v. Ford Motor Co., 204 Mich. 459, 170 N.W. 668 (1919). More commonly, Dodge v. Ford (1919). One of the most famous cases in corporate law, even today.

Ford: But not for the actual decision. I wonder how many corporate law professors could tell you the actual decision.

Professor: Me too.

Ford: It was really pretty simple. Each side got something. The Michigan Supreme

Court agreed that we had to pay the \$19.3 million. Much more important to me, the court also refused to keep us from building the River Rouge plant.

Professor: That plant had a lot of steel magnates worried.

Ford: You can say that again. They did not like our having our own smelters. Not one bit. And the federal government! By then I was kind of in bad with them, for my opposition to our entry into World War 1. Heavens, they sent poor old Eugene Debs to prison! He had told our boys to resist the military draft. Lucky I was an important industrialist. Poor Debs was only a Socialist politician, with 20 million votes for president.

Professor: The Russian Revolution had the government pretty nervous too. It was two competing economic systems, American capitalism vs. the Soviet experiment in socialism.

Ford: That too. Some folks had taken my socialistic posturing a little too seriously. I did it mainly to sell more cars. And we did build River Rouge, and it worked just fine. But the whole thing got so big, it wasn't so much fun any more.

Professor: All right. But if Dodge v. Ford is not famous for the decision, why is it famous?

Ford: For what the judge said about the decision. What do they call it? Dicta. Not law, but remarks in passing about the law. Idle chit chat, commentary. Say, read it again!

Professor: Chief Justice Strander's opinion included this statement: "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."

Friedman: Well, it sure sounds like law.

Professor: Maybe so, but it was not the basis of the court's decision. The court actually ruled on very narrow grounds.

Madison: And what were those very narrow grounds?

Professor: That Henry Ford, as the controlling shareholder, had breached his trust, his fiduciary duty of good faith to his minority investors.

Friedman: That's it?

Professor: That's it. You see, any court that knows its stuff will begin a case like this with the business judgment rule.

Smith: The business judgment rule?

Professor: Yes. No court will substitute its own judgment for the careful, unconflicted decision of a board of directors. What was the business decision at issue? It was Ford's refusal to pay a special dividend after its most profitable year. The business judgment rule says that this decision is none of the court's business, as long as the decision can be tied to some rational business purpose.

Ford: So, why did the court put its oar in here? Remind me.

Professor: Because it thought you were going to run the business as a semi-charitable institution. After all, you had said you were going to reduce your selling price from \$440 to \$360. And your folksy pose had you running off at the mouth about Ford making too much money and other such nonsense. To the court, this looked like a quite unnecessary reduction in net profits--not a rational business purpose.

Ford: Ridiculous. We could always compensate the lower price with higher volume.

Professor: Of course. And this kind of second guessing, even if it were sensible, is completely foreign to modern corporate law. But that was the reasoning of the Michigan Supreme Court. You'd have been better off in Delaware, where they really know their corporate law. So many corporations are chartered there, corporate law is practically the state industry.

Smith: Michigan makes cars, Delaware makes corporate law. Specialization strikes again!

Madison: It seems, then, that Dodge v. Ford deals not with directors' duties to maximize shareholder wealth. Instead, it deals with the duty of controlling shareholders not to oppress minority shareholders.

Professor: Exactly. In the last 30 years there has been only one case in Delaware law that cited Dodge v. Ford. And it did so on that very point, the fiduciary duty of controlling shareholders to look out for minority shareholders. Nothing about maximizing shareholder wealth.

Madison: Mere dicta, not law.

Professor: And mealy-mouthed dicta at that. Look carefully at the wording. The Michigan court described profit seeking as the "primary" goal, not the exclusive goal. And at a later point in its opinion the court even acknowledged that corporate directors retained--get this-- ". . . implied powers to carry on with humanitarian motives such charitable works as are incidental to the main business of the corporation."

Smith: So much for shareholder wealth maximization. It's old, it's Michigan--not Delaware, the gold standard of corporate law--and it's not even law, just dicta. So, can we just let it rest in peace?

Professor: Not quite. What if we could show that it's a brilliant anticipation of a modern legal principle?

Smith: And by what magical trickery might that be done?

Professor: Well, where does legal principle come from? It does not come from the unsupported bloviating of journalists, economists, pundits or law professors. No disrespect to you, Mr. Smith, or you, Mr. Friedman.

Madison: I was beginning to wonder. Where **does** it come from these days?

Professor: Corporate law comes from three main sources. First, internal requirements set out in actual corporate charters and bylaws. Second, corporate codes set out by the states. Third, corporate case law.

Ford, Smith, and Friedman: Hmmmmm.

Madison: Wait, gentlemen. This sounds most promising.

Professor: First. If the corporate founders want to, they are perfectly free to put Dodge v. Ford right into the charter, a bald statement that this here corporation is carried on primarily for the benefit of the stockholders. But is that common practice? Most emphatically not. The typical charter defines the corporate purpose as anything "lawful." Period.

Friedman: Well, what about that second one, state codes? Do any of them limit corporate purpose to the maximization of shareholder wealth?

Professor: No. In fact, the great majority of state codes expressly authorize corporations, in making business decisions, to consider the interests not only of shareholders, but also the interests of employees, creditors, and the community.

Friedman: Good god!

Madison: Wait, sir. We come now to the third source, case law.

Professor: Yes. Does case law positively require that corporate directors maximize shareholder wealth? Well, here and there you can find a modern case with dicta that seem to echo Dodge v. Ford. Here's one: ". . . directors [are obliged] to attempt, within the law, to maximize the long-run interests of the corporation's stockholders. . . ."

Madison: Long-run interests? Are those the same thing as shareholder wealth? If we foul our water and land in the pursuit of shareholder wealth, do we serve anyone's long-run interests?

Professor: Precisely.

Smith: Aye, there's the rub.

Ford: You've got a point there.

Professor: And plenty of modern cases contain contrary dicta, in favor of duties beyond the duties owed to shareholders.

Friedman: For example?

Professor: There's a famous Delaware decision in an oil company case. The court remarked that corporate directors could consider the impact of their decisions on constituencies other than shareholders--creditors, customers, employees, the general community.

Smith: And have we now, at long last, driven a fatal stake through the heart of that great horrid beast, Dodge v. Ford?

Professor: Alas, not quite. Many legal instructors teach Dodge v. Ford, not to show that the law compels corporations to behave like selfish, irresponsible psychopaths obsessed with shareholder profit--an outright falsehood, as you now know--but as a lesson on how corporations **ought** to behave.

Madison: What **wonderful** things you have done with the mother tongue. Selfish, irresponsible psychopaths obsessed with shareholder profit. Marvelous!

Professor: Scholars call this the **normative** vision of corporate purpose. The **right and proper** purpose of the well tuned corporation.

Madison: But why on earth would anyone think that corporations should maximize shareholder wealth?

Friedman: I can answer that one. Economic theory. Specifically, the theory that shareholders are entitled to all of the corporation's residual profits.

Smith: And what exactly are residual profits?

Friedman: All of the profits left over after the firm has met its fixed contractual obligations--its obligations to employees, customers, and creditors. Those obligations are fixed. But the rest is variable. And if you maximize that variable rest, you maximize the total social value of the firm. Q.E.D.

Smith: And what's wrong with that theory?

Professor: What's wrong is that we now know that shareholders are not the sole residual claimants. For one thing, there's the idea of **externalities**. Those are costs imposed on third parties--customers, employees, the environment--costs forced upon innocent bystanders by somebody else's single-minded pursuit of shareholder profit. For another thing, we now know all too well that a **business risk** that's good for the shareholder can do great harm to the creditor. The shareholder can run off with millions, with the creditor holding the bag.

Madison: Does it not seem evident that the moment the firm acquires more than one shareholder, it also acquires a multiplicity of shareholder interests? Does it make any sense to speak of shareholder interest as a simple unity?

Professor: No, it does not. Different shareholders have different time horizons, different tax concerns, different tolerance for risk. And their other investments will respond idiosyncratically to the decisions of any one firm they hold in common. Some of those other investments may profit, some may not. And different shareholders will surely differ in their willingness to sacrifice profit for a clean environment. To sacrifice profit for good worker wages, for other social interests. Clearly, the normative view of Dodge v. Ford simply ignores individual differences in shareholder values.

Ford: So why does it hang on? I had to change my Model T. Don't professors ever have to change their case books?

Professor: We've changed our case books many times, but Dodge v. Ford alone hangs on, revision after revision. Nobody really knows why. We really should stop teaching it. It isn't law at all. At the very best, it's the very worst law I can imagine.

Smith: You say that nobody knows why it hangs on. Could its persistence simply reflect a human law of least effort?

Professor: One serious scholar has suggested that very explanation. Laziness.

Friedman: Laziness?

Professor: Well, a corporation can be a supremely intricate thing. Many directors, dozens of executives, thousands of employees and shareholders, millions of customers, dispersed all over the world, several decades old. Economic power? The biggest corporations have more economic power than lots of nation states.

Friedman: A real can of worms.

Professor: Exactly. You almost hope that nobody will ask that dynamite question:

“What do corporations do?” But somebody always does. So you have to be ready with something quick, something easy, something that won’t take up the rest of the semester. Something that satisfies. You know what that something is?

Ford: “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.”
Dodge v. Ford, 1919.

Professor: None other. But you know what? I’m taking the oath right now. I’m swearing off Dodge v. Ford. No more pat, comfortable myths. No more pretty stories about storks delivering babies. From now on I’m doing it the hard way, come what may.

[**Madison, Smith, Ford and Friedman** stand and applaud the professor.]

Ford: Let’s give the professor a prize!

Madison: Something more tangible than applause!

Ford: Something to look at!

Madison: Something to grasp!

Smith: Something hefty!

Friedman: I know just the thing! Here, gather around.

[They huddle and confer. **Madison** writes something on a piece of paper, which they all sign.]

Madison [Stands to address the professor and reads the paper, as follows]: “An IOU for our learned professor, the bearer of this note. This note is good for one ax, to be purchased at Berkeley Hardware in commemoration of a great victory for our beloved university. (signed) Adam Smith, James Madison, Henry Ford, Milton Friedman.”

Ford [aside, to Adam Smith]: Say, I have a question about this Madison fellow. Didn’t he have something to do with our Constitution?

Smith: He did indeed. He wrote most of it. **And** he signed it.

Ford: That’s what I thought.

Friedman [to Madison]: Madison, that is a significant scrap of paper. You won’t believe how much pleasure it gives me to put my name to such an important document.

Madison: Oh, my dear Friedman. You have no idea.

References

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