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WHY WE SHOULD KEEP TEACHING *DODGE V. FORD MOTOR CO.*

BY

STEPHEN M. BAINBRIDGE

*WILLIAM D. WARREN DISTINGUISHED PROFESSOR OF LAW*

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## WHY WE SHOULD KEEP TEACHING *DODGE V. FORD MOTOR CO.*

Stephen M. Bainbridge\*

### INTRODUCTION

What is the purpose of the public business corporation? Is it to maximize shareholder value? Or is it to simultaneously enhance the welfare of shareholders, stakeholders, and the larger society? These are perennial questions, of course, but they also have been much in the news in recent years.<sup>1</sup> Whether tagged as stakeholder capitalism, stakeholder theory, corporate social responsibility, or ESG (i.e., environmental, social, and governance), much attention is being paid.<sup>2</sup>

In the 2020 U.S. Presidential campaign, for example, numerous Democratic politicians carved out strong positions in favor of stakeholder capitalism. Senator Elizabeth Warren (D-MA) was especially active in that regard, contending that a root cause of many of America's economic problems was the emphasis by businesses on maximizing shareholder wealth.<sup>3</sup> Her proposed Accountable Capitalism Act would have required boards of public corporations with over \$1 billion in revenues to consider the interests of stakeholders when making corporate decisions.<sup>4</sup> Eventual Democratic 2020 nominee and now President Joe Biden called for an end to the era of "shareholder

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\* William D. Warren Distinguished Professor of Law, UCLA School of Law. Portions of this article were adapted with Permission of the publisher from my forthcoming Cambridge University Press book *THE PROFIT MOTIVE: DEFENDING SHAREHOLDER VALUE MAXIMIZATION* (2022).

<sup>1</sup> See Martin J. Regimbal, *Promoting Employer-Sponsored Volunteering Without Running Afoul of FLSA*, 26 No. 3 MISS. EMP. L. LETTER 4 (noting that "corporate social responsibility has received increased attention in academia and from the media" in recent years).

<sup>2</sup> See, e.g., Thomas Lee Hazen, *Social Issues in the Spotlight: The Increasing Need to Improve Publicly-Held Companies' CSR and ESG Disclosures*, 23 U. PA. J. BUS. L. 740 (2021) ("There is ever-increasing investor interest in corporate social responsibility (CSR) generally, and environmental social governance (ESG) in particular."); Ira M. Millstein, Leo E. Strine, Jr., Eric Talley, *Looking Back with A Legend: Ira Millstein Reflects on the Impact of Milton Friedman's Views on Corporate Governance*, 76 BUS. LAW. 945, 946 (2021) (noting a "new focus on ESG and stakeholder capitalism").

<sup>3</sup> See David Benoit, *Move Over, Shareholders: Top CEOs Say Companies Have Obligations to Society*, WALL ST. J. (Aug. 19, 2019, 6:55 PM) ("Democratic presidential candidate Elizabeth Warren has argued that the primacy of shareholder returns has worsened economic inequality, enriching wealthy investors at the expense of workers."), <https://www.wsj.com/articles/business-roundtable-steps-back-from-milton-friedman-theory-11566205200> [https://perma.cc/NC3D-AUFG].

<sup>4</sup> See Emily Barreca, Note, *Accountable Compensation: The Progressive Case for Stakeholder-Focused, Board-Empowering Executive Compensation Laws*, 37 YALE J. ON REG. 338, 374 (2020) (discussing Senator Warren's proposal).

capitalism.”<sup>5</sup> Strikingly, one also finds skepticism about shareholder wealth maximization on the right end of the political spectrum. Senator Marco Rubio (R-FL), for example, argues that shareholder wealth maximization “provides a framework to reduce or ignore the longer-term, economy-and-society wide negative externalities that result [from business activity], by placing them outside the realm of business decisions.”<sup>6</sup>

There also have been many important pertinent anniversaries in the last few years. The foundational *Dodge v. Ford Motor Co.*<sup>7</sup> opinion turned 100 in 2019. Milton Friedman’s famous New York Times essay on corporate social responsibility turned 50 in 2020.<sup>8</sup> The not-quite-so famous—but perhaps more important—debate between Adolf Berle and Merrick Dodd in the pages of the Harvard Law Review turned 70 in 2022.<sup>9</sup>

The time has thus seemed propitious to many legal scholars to revisit the law of corporate purpose.<sup>10</sup> Many of these scholars have been influenced by my former colleague the late Lynn Stout’s work on the topic. Ten years ago, Stout published her book, *The Shareholder Value Myth*,<sup>11</sup> which built on her earlier article, *Why We Should*

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<sup>5</sup> Fields Pierce, Note, *Dynamic Corporate Purpose: Decentralizing the Choice over Director Orientation*, 75 VAND. L. REV. 325, 335 (2022).

<sup>6</sup> Marco Rubio, *American Investment in the 21st Century* 22, [https://www.rubio.senate.gov/public/\\_cache/files/9f25139a-6039-465a-9cf1-feb5567aebb7/4526E9620A9A7DB74267ABEA5881022F.5.15.2019.-final-project-report-american-investment.pdf](https://www.rubio.senate.gov/public/_cache/files/9f25139a-6039-465a-9cf1-feb5567aebb7/4526E9620A9A7DB74267ABEA5881022F.5.15.2019.-final-project-report-american-investment.pdf) (last visited June 7, 2021).

<sup>7</sup> 170 N.W. 668, 670 (Mich. 1919).

<sup>8</sup> Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970, § 6 (Magazine), at 32.

<sup>9</sup> E. Merrick Dodd, Jr., For Whom Are Corporate Managers Trustees?, 45 Harv. L. Rev. 1145 (1932); A. A. Berle, Jr., For Whom Corporate Managers Are Trustees: A Note, 45 Harv. L. Rev. 1365 (1932).

<sup>10</sup> March 31, 2002, searches of the Westlaw Law Reviews and Journals database identified 373 articles published in the last three years containing the phrase “corporate purpose,” 853 containing the phrase “corporate social responsibility,” 529 containing the term ESG, 131 containing the term “stakeholder capitalism,” and 142 containing the phrase “stakeholder theory.” The searches identified 29, 21, 61, 2, and 12 articles in the last three years with those phrases in their title, respectively. My own contributions to the recent literature include Stephen M. Bainbridge, *Christianity and Corporate Purpose*, in CHRISTIANITY AND MARKET REGULATION: AN INTRODUCTION 101 (Cambridge University Press; Daniel A. Crane & Samuel Gregg eds. 2021); Stephen M. Bainbridge, *Making Sense of the Business Roundtable’s Reversal on Corporate Purpose*, 46 J. CORP. L. 285 (2021) [hereinafter cited as Bainbridge, *Making Sense*]; Stephen M. Bainbridge, *Corporate Purpose in a Populist Era*, 98 NEB. L. REV. 543 (2020).

<sup>11</sup> LYNN STOUT, THE SHAREHOLDER VALUE MYTH (2012).

*Stop Teaching Dodge v. Ford*.<sup>12</sup> As the latter title suggests, Stout's principal foil was the *Dodge* case.<sup>13</sup>

Stout's focus on *Dodge* was well chosen, since the case and "its statement of shareholder primacy have taken on lives of their own in law school casebooks, in the academic literature, and in the minds and hearts of American businesspeople."<sup>14</sup> Stout's critique of *Dodge* has been described as "novel and provocative"<sup>15</sup> and "a compelling critique of the shareholder-centric view"<sup>16</sup> of corporate purpose. The influence her work has had was confirmed by a March 31, 2022, search of the Westlaw Law Reviews and Journals database, which identified 98 articles published in the last three years that cited her book and 43 during the same period that cited her article.

Given the renewed attention to the corporate purpose question and the continuing influence of Stout's work on that debate, it seems appropriate to revisit her arguments to determine whether she was correct that law professors should stop teaching *Dodge*. Part I of this article sets the context for the discussion that follows by reviewing the facts and holding of the *Dodge* decision. Part II identifies Stout's numerous doctrinal arguments against *Dodge*.<sup>17</sup> I conclude that law professors ought to keep teaching *Dodge*. It was good law when handed down in 1919 and remains good law today.

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<sup>12</sup> Lynn A. Stout, *Why We Should Stop Teaching Dodge v. Ford*, 3 VA. L. & BUS. REV. 163 (2008).

<sup>13</sup> 170 N.W. 668, 670 (Mich. 1919).

<sup>14</sup> Miriam A. Cherry & Judd F. Sneirson, *Beyond Profit: Rethinking Corporate Social Responsibility and Greenwashing After the BP Oil Disaster*, 85 TUL. L. REV. 983, 1016 (2011).

<sup>15</sup> Jonathan R. Macey, *Corporate Law As Myth*, 93 S. CAL. L. REV. 923, 937 (2020).

<sup>16</sup> Saule T. Omarova, *Bank Governance and Systemic Stability: The "Golden Share" Approach*, 68 ALA. L. REV. 1029, 1070 (2017).

<sup>17</sup> Stout's critique of *Dodge* was not limited to challenging its doctrinal merits. To the contrary, her critique of the shareholder value maximization principle set out in *Dodge* ranged widely across a number of arguments. Indeed, she was criticized for "attempting to argue that the shareholder primacy norm does not guide American corporate law theory by conflating prospective policy arguments for replacing shareholder primacy with stakeholder theory with claims that stakeholder theory is, in fact, already the guiding principle." Marc A. Greendorfer, *Discrimination as a Business Policy: The Misuse and Abuse of Corporate Social Responsibility Programs*, 8 AM. U. BUS. L. REV. 307, 322 n.60 (2020). In this article, however, I focus on the doctrinal aspects of the debate, leaving the normative debate for my forthcoming book. See STEPHEN M. BAINBRIDGE, *THE PROFIT MOTIVE: DEFENDING SHAREHOLDER VALUE MAXIMIZATION* (2022).

## I. THE DECISION

## A. The Facts

The Ford Motor Company (FMC) was incorporated in 1903.<sup>18</sup> It was hugely successful almost from the outset. By the time the 1916 fiscal year ended, FMC was earning almost \$60 million on annual sales of \$207 million.<sup>19</sup> In just 13 years, it had accumulated surplus of \$112 million, even while paying out \$41 million in special dividends on top of regular quarterly dividends “equal to 5 per cent. monthly on the capital stock of \$2,000,000.”<sup>20</sup>

FMC’s financial success came despite—or, as some have argued, because—pursuing policies that today might well be regarded as socially responsible.<sup>21</sup> In 1914, FMC raised its shop floor employees’ minimum pay to \$5 per day, which was twice the going rate for industrial workers.<sup>22</sup> FMC claimed that the new pay rate was intended give employees a stake in the business.<sup>23</sup> Indeed, it characterized half of the new pay packet not as wages but as a share of company profits.<sup>24</sup> In addition to the increased daily pay, FMC cut the working day from nine to eight hours.<sup>25</sup> These new policies infuriated some elements of the business community, while drawing praise from some surprised social reformers.<sup>26</sup>

As far as customers were concerned, FMC benefited that critical constituency by consistently lowering prices. Starting with an original selling price of \$900 per car, regularly repeated cuts lowered the price to \$360 per car by 1916.<sup>27</sup> Not surprisingly,

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<sup>18</sup> *Dodge v. Ford Motor Co.*, 170 N.W. 668, 669 (Mich. 1919). For an excellent detailed history of the disputes between Ford and the Dodge brothers and legal analysis of the case, see M. Todd Henderson, *The Story of Dodge v. Ford Motor Company: Everything Old Is New Again*, in *CORPORATE LAW STORIES* 37 (J. Mark Ramseyer ed., 2009).

<sup>19</sup> Henderson, *supra* note 18, at 58-59 (extracted from table 2).

<sup>20</sup> *Dodge*, 170 N.W. at 670.

<sup>21</sup> See Matthew W. Seeger & Steven J. Hipfel, *Legal Versus Ethical Arguments: Contexts for Corporate Social Responsibility*, in *THE DEBATE OVER CORPORATE SOCIAL RESPONSIBILITY* 156 (George Cheney, Juliet Roper, Steven K. May eds., 2007) (suggesting that Ford’s conduct was “characteristic” of “early efforts at corporate social responsibility”).

<sup>22</sup> RICHARD SNOW, *I INVENTED THE MODERN AGE: THE RISE OF HENRY FORD* 215 (2013).

<sup>23</sup> Henderson, *supra* note 18, at 50.

<sup>24</sup> *Id.*

<sup>25</sup> See Theresa M. Beiner, *Theorizing Billable Hours*, 75 MONT. L. REV. 67, 97 (2014) (“Ford set the minimum wage for his workers at \$5.00/day for eight hours of work/day.”).

<sup>26</sup> See MICHAEL PERELMAN, *THE END OF ECONOMICS* 106 (1996) (discussing the business community’s hostile reaction to Ford’s decisions).

<sup>27</sup> See *Dodge v. Ford Motor Co.*, 170 N.W. 668, 670 (Mich. 1919) (outlining price cutting policy).

customers flocked to FMC. It was working at full capacity and selling cars as fast as it could make them.<sup>28</sup>

The driving force behind all of these dramatic developments was Henry Ford, who was FMC's largest shareholder (owning 59% of the stock), a director, and president of the company.<sup>29</sup> The other shareholders included the Dodge brothers—John and Horace—who each owned five percent of FMC's stock.<sup>30</sup> In addition to being investors, the Dodge brothers were also suppliers, as FMC outsourced making of its cars' engines to the Dodge's machinery company.<sup>31</sup> In 1913, the Dodge brothers also became competitors, as they founded their eponymous automobile manufacturing company, using the massive dividends they received on their FMC shares to help get Dodge Motor off the ground.<sup>32</sup>

In October 2015, FMC stopped paying the special dividends.<sup>33</sup> Instead, FMC plowed the bulk of its earnings back into the business. As a result, by the end of the 2016 fiscal year, FMC had accumulated over \$52 million in cash (out of total assets of \$132 million).<sup>34</sup> Ford announced that the accumulating cash would be used to further reduce the price of the company's cars and to construct a new plant at River Rouge, Michigan, which would be the world's largest auto factory.<sup>35</sup>

In response, the Dodge brothers sued. They sought an injunction forbidding FMC from undertaking the River Rouge expansion and compelling FMC to issue a special dividend out of its accumulated earnings.<sup>36</sup> The trial court granted both requests, ordering FMC to pay half of its cash assets out as a dividend.<sup>37</sup> Ford and the other defendants appealed.

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<sup>28</sup> SNOW, *supra* note 22, at 214.

<sup>29</sup> See generally Henderson, *supra* note 18, at 46-49 (describing Ford's role in FMC).

<sup>30</sup> *Id.* at 49.

<sup>31</sup> See CHARLES K. HYDE, THE DODGE BROTHERS 30 (2005) (discussing the Dodge brothers' provision of engines to FMC).

<sup>32</sup> See Henderson, *supra* note 18, at 56 (discussing the Dodge brothers' building up a competitor to FMC).

<sup>33</sup> See *Dodge v. Ford Motor Co.*, 170 N.W. 668, 670 (Mich. 1919) ("No special dividend having been paid after October, 1915 . . .").

<sup>34</sup> See *id.* at 670 (reproducing FMC's balance sheet as of July 31, 1916).

<sup>35</sup> See *id.* at 673-74 (summarizing Ford's plans).

<sup>36</sup> See *id.* at 673 (describing the relief sought by the Dodge brothers).

<sup>37</sup> See generally Henderson, *supra* note 18, at 58-64 (summarizing trial court proceedings and decision).

## B. The Historical Context

Although there were a few recognizably modern business corporations in Colonial America, they remained rare until the late 1700s.<sup>38</sup> Into the early 1800s, moreover, most business corporations in the U.S. were actually quasi-public works such as canals and turnpikes.<sup>39</sup> Almost all early corporations thus served public interests beyond making a profit for their shareholders.<sup>40</sup>

The public regarding nature of these early corporations was reinforced by the moral climate and social structures within which they operated. The owners of these businesses often were leaders of the local communities their business served.<sup>41</sup> Many believed that noblesse oblige was therefore the order of the day.<sup>42</sup>

Early American society was not prepared to trust to the good will of corporate shareholders and directors, however. At that time, forming a corporation required obtaining a charter from the state legislature.<sup>43</sup> This requirement likely “reflected the ‘cloud of disfavor under which corporations labored’ in the early years of this Nation,”<sup>44</sup>

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<sup>38</sup> As of 1800, only “317 business corporations had been chartered in the U.S.” Frederick Tung, *Before Competition: Origins of the Internal Affairs Doctrine*, 32 J. CORP. L. 33, 51 n.72 (2006)

<sup>39</sup> See David B. Guenther, *Of Bodies Politic and Pecuniary: A Brief History of Corporate Purpose*, 9 MICH. BUS. & ENTREPRENEURIAL L. REV. 1, 23 (2019) (“The most common purposes thus appear to have involved public or quasi-public infrastructure.”); Elizabeth Pollman, *The History and Revival of the Corporate Purpose Clause*, 99 TEX. L. REV. 1423, 1434 (2021) (“The vast majority of business corporations chartered before 1800 concerned activity that we now traditionally associate with government infrastructure, such as transportation companies (canals, turnpikes, bridges, aqueducts) and others that provided local public services.”). Professor Carney observes that “as of 1800 there were fewer than eighty chartered corporations not engaged in public utility activities.” William J. Carney, *Limited Liability Companies: Origins and Antecedents*, 66 U. COLO. L. REV. 855, 873 (1995).

<sup>40</sup> See A. A. Sommer, Jr., *Whom Should the Corporation Serve? The Berle-Dodd Debate Revisited Sixty Years Later*, 16 DEL. J. CORP. L. 33, 36 (1991) (explaining that, “while clearly the organizers of early corporations did so with the expectation of profits, the corporations were to serve a public purpose”).

<sup>41</sup> See MORRELL HEALD, *THE SOCIAL RESPONSIBILITIES OF BUSINESS* 3 (rev. ed. 1988) (noting that early corporations were led by individuals who “often found themselves the chief proprietors” in their communities).

<sup>42</sup> See *id.* at 3-4 (discussing motivations of early corporate leaders).

<sup>43</sup> See Margaret M. Blair, *Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century*, 51 UCLA L. REV. 387, 425 (2003) (noting that “each corporation had to be created by a separate act of the relevant state legislature”).

<sup>44</sup> *Citizens United v. Fed. Election Commn.*, 558 U.S. 310, 427 (2010) (Stevens, J., concurring in part).

which was driven by fear of “the evils attendant upon the free and unrestricted use of the corporate mechanism.”<sup>45</sup>

Supreme Court Justice Louis Brandeis claimed that, as a consequence of this fear, state legislatures granted charters only when “necessary in order to procure for the community some specific benefit otherwise unattainable.”<sup>46</sup> If Brandeis intended to suggest that a stated commitment to social welfare was legally required in order to obtain a legislative charter, there is no evidence of such a requirement.<sup>47</sup> If all Brandeis meant was there was an expectation that corporations have a public regarding purpose, however, there is some evidence of such an expectation at least up until the 1830s. In the famed *Dartmouth College* case, for example, Chief Justice John Marshall observed that states created corporations to accomplish such “objects ... as the government wishes to promote.”<sup>48</sup> The “advantages to the public” that followed from granting a charter constituted the sole consideration to which the state was entitled.<sup>49</sup>

In any case, after New York in 1811 adopted the first modern enabling corporation statute—pursuant to which one may form a corporation simply by filing the appropriate paperwork with the requisite state agency—special legislative chartering quickly fell by the wayside.<sup>50</sup> The considerably greater ease of incorporating a business provided by the new enabling statutes facilitated a vast increase in the number of corporations in the U.S. during the 19th Century.<sup>51</sup> More important, the nature of corporations drastically changed. Instead of being quasi-public enterprises, the vast majority of corporations were now recognizably modern business corporations devoted primarily to the private pursuit of profit.<sup>52</sup> Corporations were mainly engaged in manufacturing or finance rather than the

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<sup>45</sup> *Louis K. Liggett Co. v. Lee*, 288 U.S. 517, 548 (1933).

<sup>46</sup> *Id.* at 549.

<sup>47</sup> See Lyman Johnson, *Law and Legal Theory in the History of Corporate Responsibility: Corporate Personhood*, 35 SEATTLE U.L. REV. 1135, 1145 (2012).

<sup>48</sup> *Trustees of Dartmouth Coll. v. Woodward*, 17 U.S. 518, 637 (1819).

<sup>49</sup> *Id.* at 638.

<sup>50</sup> See Guenther, *supra* note 39, at 47-48 (discussing the 1811 New York statute).

<sup>51</sup> See Blair, *supra* note 43, at 425-27 (explaining how the adoption of general incorporation statutes facilitated a rapid increase in the number of corporations).

<sup>52</sup> See, e.g., Reuven S. Avi-Yonah, *Corporate Taxation and Corporate Social Responsibility*, 11 N.Y.U.J.L. & BUS. 1, 20 (2014) (arguing that “developments since the mid-nineteenth century (such as general incorporation and the decline of ultra vires) have led to the view that the corporation fulfills its purpose sufficiently by engaging in its normal for-profit activities”); Allan C. Hutchinson & Ian Langlois, *Salomon Redux: The Moralities of Business*, 35 SEATTLE U.L. REV. 1109, 1120 (2012) (noting mid-19<sup>th</sup> Century developments legitimating “private pursuit of profit”); Detlev F. Vagts, *Reforming the “Modern” Corporation: Perspectives from the German*, 80 HARV. L. REV. 23, 36 (1966) (“While early authority put emphasis on the public service aspect of corporations, by the late nineteenth century profit prevailed.”). But see Guenther, *supra*



turnpikes, canals, and other quasi-public services characteristic of late 18<sup>th</sup> and early 19<sup>th</sup> Century corporations.<sup>53</sup> Many rivaled today's large business corporations in size and influence:

Before the 1880s, even the largest factories employed no more than a few hundred workers, and even these larger enterprises were still predominately family-owned. By contrast, the business corporation of the latter half of the nineteenth century grew in size and complexity. Each of the large railroads employed more than 100,000 workers by 1890 and the common stock of many of the largest corporations was publicly traded. The single-plant, one-function enterprise was replaced by a multifaceted and vertically integrated operation spread over several locations, often in different states. ... Corporations were becoming "large-scale, hierarchical business enterprises."<sup>54</sup>

These developments fundamentally changed the relationship between society and incorporated businesses. Indeed, by the middle part of the 19th Century, the law recognized that the rationale of existence for business corporations was private profit rather than public benefit.<sup>55</sup> The issue posed by *Dodge* was how to operationalize that recognition. Did the fiduciary duties of corporate directors and officers make the pursuit of private profit mandatory or merely permissive?

### C. Was There a Business Case for Ford's Plans and Policies?

What is rather curious about *Dodge* is the way in which Ford eschewed what likely would have been a winning argument. Consider, for example, Ford's policy of steady reductions in the Model T's price. FMC's profit per car fell, but increased sales volume more than made up the difference.<sup>56</sup> As Ford himself observed, every time he cut the

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note 39, at 48 (contending that "early manufacturing corporations—like the internal improvement, early bank and early railroad corporations—were considered to have a public purpose").

<sup>53</sup> See, e.g., KERMIT L. HALL, *THE MAGIC MIRROR: LAW IN AMERICAN HISTORY* 96-97 (1989) (explaining that in the period 1789 to 1861 corporations were increasingly formed to engage in banking, insurance, and manufacturing).

<sup>54</sup> Steven A. Bank, *Entity Theory as Myth in the Origins of the Corporate Income Tax*, 43 WM. & MARY L. REV. 447, 493-94 (2001).

<sup>55</sup> See Guenther, *supra* note 39, at 63 (explaining that by the 1850s "banking, insurance, and manufacturing corporations have lost all meaningful trace of the public purpose with which they were formerly seen to be endowed; their purpose is now only 'private advantage,' and any public benefit is 'incidental'").

<sup>56</sup> See Geoffrey Miller, *Narrative and Truth in Judicial Opinions: Corporate Charitable Giving Cases*, 2009 MICH. ST. L. REV. 831, 833 ("Over the years, Ford progressively reduced the price of its Model T from \$900 at the outset to \$440 in 1916, each year selling more automobiles than the year before.").

price by a dollar, he gained “a thousand new buyers.”<sup>57</sup> FMC’s share of the new car market in fact rose from 9.7% in 1909 to 42.4% in 1917, before eventually peaking at 55.7% in 1921.<sup>58</sup> As a result, FMC achieved nearly monopoly status in the inexpensive car market sector.<sup>59</sup> Granted, customers might have wanted more variety, such as the ability to buy a car in a color other than black, the provision of which eventually allowed General Motors to catch FMC,<sup>60</sup> but Ford had turned the automobile from an expensive hobby for the rich into everyday transportation for the masses.

As for employees, there was likewise a business case to made for FMC’s treatment of its workers. Ford was one of the early adopters of so-called scientific management.<sup>61</sup> As popularized by management theorist Frederick W. Taylor, scientific management had three core principles: (1) extract craft knowledge from employee artisans and transform it into work rules taught to employees; (2) strict planning of worker schedules by management; and (3) eliminate the need for independent thought on the part of workers.<sup>62</sup> Industrial engineers and management experts used those principles to break down a factory’s production process into a large number of small steps, each of which would then be allocated to a single, closely supervised worker.<sup>63</sup> Thus, was born the idea behind the mass production assembly line.<sup>64</sup> Ford’s genius was turning that academic theory into industrial practice.<sup>65</sup>

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<sup>57</sup> SNOW, *supra* note 22, at 214.

<sup>58</sup> Lawrence J. White, *The Rise and Fall of Dominant Firms in the U.S. Automobile Industry: A Twice Told Tale*, in MARKET DOMINANCE: HOW FIRMS GAIN, HOLD, OR LOSE IT AND THE IMPACT ON ECONOMIC PERFORMANCE 109, 113 (David I. Rosenbaum ed., 1988) (table 7.2).

<sup>59</sup> Daniel M. G. Raff & Lawrence H. Summers, *Did Henry Ford Pay Efficiency Wages?*, 5 J. Lab. Econ. S57 (1987).

<sup>60</sup> See Henderson, *supra* note 18, at 71 (discussing how General Motors overtook FMC by offering customers greater variety).

<sup>61</sup> See Stephen M. Bainbridge, *Participatory Management Within a Theory of the Firm*, 21 J. CORP. L. 657, 674 (1996) (“Taylorism and the comparable forms of scientific management pioneered by Henry Ford and others designed firms as highly centralized, hierarchical bureaucracies.”).

<sup>62</sup> JOHN L. COTTON, EMPLOYEE INVOLVEMENT 4-5 (1993).

<sup>63</sup> Bainbridge, *supra* note 61, at 674.

<sup>64</sup> See Stephen M. Bainbridge, *Privately Ordered Participatory Management: An Organizational Failures Analysis*, 23 DEL. J. CORP. L. 979, 989 (1998) (“Taylorism was designed for the classic assembly line in which the product moved past a succession of workers, each of whom carried out one task.”).

<sup>65</sup> See Ruth O'Brien, *A Subversive Act: The Americans with Disabilities Act, Foucault, and an Alternative Ethic of Care at the Global Workplace*, 13 TEX. J. WOMEN & L. 55, 69 (2003) (explaining that “the primary distinction between Taylorism and Fordism stemmed from the latter applying scientific-management techniques to a more sophisticated assembly line”).

As anyone who has ever worked on an assembly line knows, the work is repetitive, often boring, and sometimes dangerous.<sup>66</sup> The upshot was that FMC faced massive problems with absenteeism and turnover.<sup>67</sup> In 1914, for example, absenteeism was such a problem that FMC had to maintain a workforce of 20,000 to ensure that the necessary 10,000 workers would show up on any given day.<sup>68</sup> Both the higher pay and its structure were intended to discourage absenteeism and turnover.<sup>69</sup> In addition to providing pay so high that workers who lost their job would not be able to replace their lost income, the profit-sharing aspect of the pay structure gave workers a feeling of ownership in the enterprise that further incentivized them.<sup>70</sup> Not surprisingly, the policies proved highly successful in reducing absenteeism, increasing employee retention, and attracting new workers.<sup>71</sup> Upon introduction, for example, the wage plan slashed employee turnover from an annual rate of over 400% to 50% and, after just one year, to a mere 15%.<sup>72</sup>

Although some of Ford's fellow industrialists virulently objected to his new policies, fearing that it would lead the public to regard those who did not match his new policies as greedy robber barons and lead to worker unrest,<sup>73</sup> his paternalistic attitude towards his workers and customers was not wholly atypical of the era's corporate giants.<sup>74</sup> Indeed, the phenomenon of industrial paternalism was an important antecedent to the development of modern corporate social responsibility concepts.<sup>75</sup> In 1912, for example,

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<sup>66</sup> Henderson, *supra* note 18, at 50-51 (describing assembly line labor)..

<sup>67</sup> *See id.* (discussing FMC's problems with absenteeism and turnover).

<sup>68</sup> Adam B. King & Gary Alan Fine, *Ford on the Line: Business Leader Reputation and the Multiple-Audience Problem*, in 1 HENRY FORD: CRITICAL EVALUATIONS IN BUSINESS AND MANAGEMENT 84, 94 (John Cunningham Wood & Michael C. Wood eds., 2003).

<sup>69</sup> Daniel J.H. Greenwood, *Looting: The Puzzle of Private Equity*, 3 BROOK. J. CORP. FIN. & COM. L. 89, 97 (2008) ("Henry Ford decided to pay more than a market clearing wage in order to reduce absenteeism and turnover and, therefore, keep the assembly line moving more consistently . . .").

<sup>70</sup> *See generally* Samuel M. Levin, *Ford Profit Sharing, 1914-1920*, in 1 HENRY FORD: CRITICAL EVALUATIONS IN BUSINESS AND MANAGEMENT 160 (John Cunningham Wood & Michael C. Wood eds., 2003) (discussing the design and purpose of FMC's profit-sharing plan).

<sup>71</sup> *See* Yoshiro Miwa & J Mark Ramseyer, *Corporate Governance in Transitional Economies: Lessons from the Prewar Japanese Cotton Textile Industry*, 29 J. LEG. STUD. 171, 190 (2000) ("Henry Ford cut absenteeism by doubling wages and hiring social workers . . .").

<sup>72</sup> Henderson, *supra* note 18, at 51.

<sup>73</sup> *See id.* at 57 (discussing business hostility to Ford's pro-worker policies).

<sup>74</sup> On the paternalistic aspects of Ford's treatment of FMC's workers, see DOUGLAS M. EICHAR, *THE RISE AND FALL OF CORPORATE SOCIAL RESPONSIBILITY* 86 (2015).

<sup>75</sup> *See generally* JEREMY MOON, *CORPORATE SOCIAL RESPONSIBILITY: A VERY SHORT INTRODUCTION* 9 (2014) (discussing industrial paternalism as an antecedent to corporate social responsibility).

U.S. Steel provided a range of health insurance and pension benefits to its employees.<sup>76</sup> Other corporations went even further by providing such amenities as housing, recreational facilities, hospitals, and educational programs.<sup>77</sup> But while some leading industrialists thus “were keen on demonstrating their concern for their workers, and their commitment to improving their conditions,” they were not necessarily acting from altruistic motives but instead were often seeking to stave off unionization and government regulation—a pattern we will see recurring frequently even up to today.<sup>78</sup>

Ford’s policies with respect both to his customers and his employees, as well as his plans for the River Rouge plant expansion, were no different. As Harvard corporate law professor Mark Roe explains, the “\$5/day wage, the company’s pricing strategy for its automobiles, and the River Rouge construction should be reinterpreted as an uneasy labor-owner coalition that was splitting a monopoly profit and aiming to keep that monopoly, both for Ford Motor’s owners and its employees.”<sup>79</sup> Smaller competitors could not match FMC’s new pay scale, which limited their ability to compete with Ford.<sup>80</sup> The proposed plant expansion would give FMC significant economies of scale, which its smaller competitors could not achieve, further enhancing Ford’s competitive position.<sup>81</sup> Cutting the dividend would put less money in the Dodge brothers’ pockets, thereby undermining one potentially important competitor. As Roe points out, however, “Ford could not have built and kept that monopoly unless he had sufficient labor peace, with the \$5/day wage being his main way to achieve it.”<sup>82</sup> Lastly, in addition to maximizing FMC’s market dominance, the plan helped stave off efforts to unionize FMC’s workforce.<sup>83</sup> The Industrial Workers of the World (the Wobblies) was trying to unionize the automotive industry, including both manufacturers like FMC and suppliers.<sup>84</sup> Ford was notoriously anti-union and FMC developed a reputation for going to extreme lengths to fend off unions.<sup>85</sup> The labor peace bought by Ford’s policies thus was intended

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<sup>76</sup> Dalia Tusk Mitchell, *From Dodge to eBay: The Elusive Corporate Purpose*, 13 VA. L. & BUS. REV. 155, 166 (2019).

<sup>77</sup> See EICHAR, *supra* note 74, at 47 (discussing corporate provision of such facilities).

<sup>78</sup> Mitchell, *supra* note 76, at 166.

<sup>79</sup> Mark J. Roe, *Dodge v. Ford: What Happened and Why?*, 74 VAND. L. REV. 1755, 1758 (2021).

<sup>80</sup> See Henderson, *supra* note 18, at 52 (discussing competitive impact of Ford’s labor policies).

<sup>81</sup> *Id.* at 56.

<sup>82</sup> Roe, *supra* note 79, at 1766.

<sup>83</sup> Henderson, *supra* note 18, at 52.

<sup>84</sup> See Roe, *supra* note 79, at 1764 (discussing the Wobblies’ unionizing efforts).

<sup>85</sup> *Id.*

not only to reduce absenteeism and turnover, but also to discourage workers from unionizing.<sup>86</sup>

### 1. If Ford Had Made the Business Case, What Would the Court Have Said?

If Ford had chosen to lay out the business case for his plans and policies, the court likely would have approved. Indeed, there was well-established case law at the time permitting employer concern with employee welfare. To be sure, as the 1909 New York decision in *Metropolitan Life Insurance Co. v. Hotchkiss*<sup>87</sup> explained, the law did not permit unfettered business altruism. Corporate expenditures for the benefit of employees would be upheld, however, unless they were “shown to be wasteful of the company's money and unproductive of beneficial results.”<sup>88</sup> As such, expenditures for the benefit of employees were “not to be defended upon the ground of gratuity or charity, but [because they] were a part of the inducement for the employé to enter the employment and serve faithfully for the wage agreed upon.”<sup>89</sup> If Ford had framed his defense on these lines, “he undoubtedly would have won.”<sup>90</sup> As we have seen, the pay raise and other benefits were all intended to attract and retain high quality employees.

### 2. Ford Declines to Make the Business Case

In testifying at trial in *Dodge*, Ford did not make the business case for his plans and policies. Instead, he defiantly expressed “the attitude towards [FMC’s] 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.”<sup>91</sup> His stated ambition was not to increase profits, which he supposedly thought were already excessive and therefore should be shared “with the public,” but rather “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.”<sup>92</sup> In sum, his stated goal was to do “as much good as we can, everywhere, for everybody concerned . . . [a]nd incidentally to make money.”<sup>93</sup> Whether his testimony was sincere or was part of a disingenuous effort to persuade his workers

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<sup>86</sup> See *id.* (“Ford paid the \$5/day wages to buy the company's workers away from the Wobblies”).

<sup>87</sup> *People ex rel. Metro. Life Ins. Co. v. Hotchkiss*, 120 N.Y.S. 649 (N.Y. App. Div. 3d Dept. 1909).

<sup>88</sup> *Id.* at 651.

<sup>89</sup> *Id.*

<sup>90</sup> Henderson, *supra* note 18, at 60.

<sup>91</sup> *Dodge v. Ford Motor Co.*, 170 N.W. 668, 683 (Mich. 1919).

<sup>92</sup> *Id.* at 683-84.

<sup>93</sup> Henderson, *supra* note 18, at 38.

and customers that FMC was a socially responsible business rather than a union-busting quasi-monopoly remains the subject of debate.<sup>94</sup>

#### D. The Opinion

Much of the Michigan Supreme Court's opinion is devoted to a rather long and somewhat tedious recitation of the facts of the dispute, most of which were relevant mainly to the dispute about payment of dividends. As to the dividend issue, one of the Dodge brothers' arguments relied on a provision in the Michigan corporation statute limiting the total authorized capital stock of the corporation to \$50 million.<sup>95</sup> According to the Dodge brothers, although the authorized capital stock in FMC's articles of incorporation was \$2 million, Ford's the policy of retaining and accumulating earnings had increased FMC's "capital" to over \$60 million.<sup>96</sup>

As the supreme court recognized, the term "capital stock" as used in the statutory provision on which the Dodge brothers relied meant the total value of the money, property, or other assets the shareholders had agreed to contribute to the company in return for their shares.<sup>97</sup> Unlike most other states, Michigan law at the time limited the

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<sup>94</sup> Harvard law professor Mark Roe observes that:

Several prominent theories explain the underlying transaction and Ford's testimony that he was serving the public by expanding his operations. One theory is that the company cut cash dividends to starve the Dodge brothers of the money they needed to compete with Ford Motor or just to set up Ford profitably squeezing out the Dodge brothers--by buying them out at a low price. A second explanation is the reverse, that the Dodge brothers wanted the dividend to deny Ford Motor the cash to build out the River Rouge factory. A third explanation is business branding: Ford's public-oriented stance won the "hearts of ordinary American citizens." In this view, the litigation posture was an instance of Henry Ford's intuitive and effective marketing. A fourth explanation is tax: the new income tax taxed dividends unfavorably compared to how it taxed other income.

Roe, *supra* note 79, at 1761–62 (footnotes omitted). A further explanation is that Ford's concern for workers and consumers was genuine. See Franklin A. Gevurtz, *Getting Real About Corporate Social Responsibility: A Reply to Professor Greenfield*, 35 U. CAL. DAVIS L. REV. 645, 665 (2002) ("At this point in his life (before he got into fights with his employees), Henry Ford evidently had developed a certain grand view of his mission in life as the person to bring industrial prosperity to America.").

<sup>95</sup> See *Dodge v. Ford Motor Co.*, 170 N.W. 668, 678 (Mich. 1919) (quoting defense counsel's summary of the plaintiffs' argument "that a manufacturing corporation in Michigan may not have more than twenty-five millions (now fifty million) of capital assets").

<sup>96</sup> See Henderson, *supra* note 18, at 64 (stating that FMC's accumulated earnings had increased to over \$60 million).

<sup>97</sup> See *Dodge*, 170 N.W. at 679 (explaining that the term capital stock "means the fund, property, or other means contributed or agreed to be contributed by shareholders").

amount shareholders could contribute to the company as start-up capital.<sup>98</sup> As the court interpreted the statute, however, the cap did not apply to “the value of assets—capital—which may be” accumulated as a result of profitable earnings.<sup>99</sup> FMC’s accumulation of net assets exceeding \$60 million thus did not violate the statutory limitation.<sup>100</sup>

This may seem like a minor point legal capital arcana, which deals with an esoteric legal limitation that was rare at the time and was repealed a century ago.<sup>101</sup> It is relevant for our purposes, however, because the court’s conclusion that the statute did not apply to post-incorporation retained earnings rested on an assumption that while “the Legislature looked with disfavor upon an initial aggregation of capital exceeding a certain amount,” the Legislature did not look “with disfavor upon a profitable corporate existence.”<sup>102</sup> This assumption rested on the court’s belief that the purpose of a corporation is making profits, which may be retained and used to grow the business.<sup>103</sup> The discussion thus foreshadowed the critical holding to follow.

The supreme court then disposed of a number of makeweight arguments advanced by the Dodge brothers. It concluded, for example, that vertical integration of the business was not *ultra vires*.<sup>104</sup> FMC may have been organized to manufacture automobiles, but

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<sup>98</sup> See *id.* at 669 (describing the statute that capped the amount of capital stock a company could issue).

<sup>99</sup> *Id.* at 681.

<sup>100</sup> *Id.* at 680-81.

<sup>101</sup> See *Louis K. Liggett Co. v. Lee*, 288 U.S. 517, 564 (1933) (“In 1921 the corporation laws of Michigan were revised, eliminating, among other things, the maximum limitation on capital stock.”).

<sup>102</sup> *Dodge*, 170 N.W. at 680.

<sup>103</sup> See *id.* at 681 (“Undistributed profits belong to the corporation, and, so far as any limitation can be found in this act, may be lawfully employed as capital.”).

<sup>104</sup> *Id.* Nineteenth Century corporation statutes generally mandated that a corporation’s articles of incorporation set forth with considerable specificity the purposes for which it was created and the powers it would utilize in pursuit thereof. See E. Norman Veasey & Christine Di Guglielmo, *History Informs American Corporate Law: The Necessity of Maintaining A Delicate Balance in the Federal "Ecosystem,"* 1 Va. L. & Bus. Rev. 201, 203 (2006) (discussing early corporation codes). A contract or other transaction entered into for an unauthorized purpose or whose accomplishment would require the corporation to use a power not authorized in the charter was *ultra vires* and would be declared void. See, e.g., *Central Transp. Co. v. Pullman's Palace Car Co.*, 139 U.S. 24, 59 (1891) (“A contract of a corporation, which is *ultra vires*, in the proper sense, that is to say, outside the object of its creation as defined in the law of its organization, and therefore beyond the powers conferred upon it by the legislature, is not voidable only, but wholly void, and of no legal effect.”); *McDermott v. Bear Film Co.*, 33 Cal. Rptr. 486, 489 (Cal. App. 1963) (defining *ultra vires* as “an action which is beyond the purpose or power of the corporation”). Today, “[m]ost states have sharply emasculated this doctrine . . . so that *ultra vires*

that did not limit FMC to assembling parts made by others or even to making its own parts. Instead, manufacturing might include not just processing raw materials into parts but also owning and operating the sources of the raw materials.<sup>105</sup> The ruling could not have surprised anyone, since the Dodge brothers had not seriously pressed the point on appeal,<sup>106</sup> but it was significant because it preserved the possibility that Ford's expansion plans would survive judicial review.

Finally, after 14 pages of preliminary throat clearing, the supreme court came to the meat of the case. The court began with the question whether the trial court had erred in ordering FMC to reinstate the former dividend policy.<sup>107</sup> As the court acknowledged, the decision whether to pay a dividend was vested in the board of directors.<sup>108</sup> If the directors chose to retain earnings and reinvest them in growing the business, the shareholders generally had no legal recourse. A court will only intervene to compel payment of a dividend if the complaining shareholders can prove that the directors' refusal to pay one amounted to an abuse of discretion.<sup>109</sup>

Noting that Ford was "the dominant force" in FMC's business, the supreme court pointed to multiple statements by Ford conveying an impression that he had an "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."<sup>110</sup> The supreme court further surmised from Ford's statements "that he thinks the Ford Motor Company has made too much money, has had too large profits, and that, although large profits might be still earned, a sharing of them with the public, by reducing the price of the output of the company, ought to be undertaken."<sup>111</sup>

Although there is some reason to think Ford's embrace of social responsibility was disingenuous,<sup>112</sup> the Michigan Supreme Court took him at his word:

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is now largely a dead letter." STEPHEN M. BAINBRIDGE, *CORPORATION LAW AND ECONOMICS* 58 (2002).

<sup>105</sup> See *Dodge*, 170 N.W. at 681.

<sup>106</sup> See *id.* ("Strictly, upon the pleadings, the question of ultra vires is not for decision, and this is not seriously denied.").

<sup>107</sup> See *id.* (stating the issues on which the plaintiff's case rested).

<sup>108</sup> See *id.* at 681-82 (quoting various authorities stating that proposition).

<sup>109</sup> *Id.* at 682.

<sup>110</sup> *Id.* at 683.

<sup>111</sup> *Id.* at 684.

<sup>112</sup> See, e.g., King & Fine, *supra* note 68, at 95 (arguing that Ford's communications to FMC's various constituencies contained subtle signals to shareholders that "profits were still be maximized"); see also *supra* note 94 (discussing various theories about Ford's motives).



A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among stockholders in order to devote them to other purposes.<sup>113</sup>

Consequently, the court explained, “it is not within the lawful powers of a board of directors to shape and conduct the affairs of a corporation for the merely incidental benefit of shareholders and for the primary purpose of benefiting others, and no one will contend that, if the avowed purpose of the defendant directors was to sacrifice the interests of shareholders, it would not be the duty of the courts to interfere.”<sup>114</sup> As we will see in Part II, while this was not the birth of the shareholder value maximization norm, it was a clarion call that echoed down through the decades that followed.

*Dodge* should not be read as requiring corporate directors to behave like Scrooges focused exclusively on short-term profits. The supreme court acknowledged that directors should be free to plan for the long term, recognizing “that plans must often be made for a long future, for expected competition, for a continuing as well as an immediately profitable venture.”<sup>115</sup> Likewise, the supreme court further acknowledged that directors had discretion to set “the infinite details of business, including the wages which shall be paid to employés, the number of hours they shall work, the conditions under which labor shall be carried on, and the price for which products shall be offered to the public.”<sup>116</sup> Accordingly, the supreme court drew what it called an “obvious” distinction between “an incidental humanitarian expenditure of corporate funds for the benefit of the employés, like the building of a hospital for their use and the employment of agencies for the betterment of their condition,” which would be permissible, “and a general purpose and plan to benefit mankind at the expense of others . . .”<sup>117</sup> Ford lost because he claimed to have embraced the latter.

Turning to the *Dodge* brothers’ requested relief, the supreme court agreed with the trial court that the dividends should be resumed. As we just saw, it was a well-established principle that the decision whether to pay a dividend or not was one for the board of directors to make, as to which the board was “at liberty to exercise a very liberal discretion.”<sup>118</sup> As long as the board made its decision in good faith, their decision was

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<sup>113</sup> *Dodge v. Ford Motor Co.*, 170 N.W. 668, 684 (Mich. 1919).

<sup>114</sup> *Id.*

<sup>115</sup> *Id.*

<sup>116</sup> *Id.*

<sup>117</sup> *Id.*

<sup>118</sup> *Id.* at 682 (quoting *Park v. Grant Locomotive Works*, 3 A. 162, 165 (N.J. Ch. 1885), *aff’d*, 19 A. 621 (N.J. 1888)).

“final, and not subject to judicial revision,” even if the decision proved to be “injudicious.”<sup>119</sup> Courts therefore would not compel an unwilling board to pay a dividend unless the board’s failure to do so was an abuse of discretion amounting to “an arbitrary refusal to do what the circumstances required to be done.”<sup>120</sup> On the facts before it, given FMC’s substantial profits and rapidly growing reserves, coupled with Ford’s alleged effort to turn FMC into what the Dodge brothers called a “semi-eleemosynary institution,” there was just such an abuse of discretion and, accordingly, the supreme court affirmed the trial court’s order that FMC resume paying special dividends.<sup>121</sup>

On the other hand, however, the supreme court reversed the trial court’s injunction against FMC’s expansion plans.<sup>122</sup> The supreme court explained its reticence by observing that “judges are not business experts.”<sup>123</sup> In contrast, as the court further observed, FMC’s successes were evidence of “capable management of its affairs.”<sup>124</sup> The court’s ruling thus operationalized its observation that, so long as the directors are exercising their discretion so as to maximize shareholder value, courts will defer to the board rather than evaluating the merits of the board’s decision. Directors have wide discretion to make business plans, develop long-term strategies, set prices, and determine employee working conditions, pay, and benefits, as long as they claim to be doing so in the name of shareholder value rather than stakeholder capitalism.

Although the supreme court did not use the phrase, its analysis strongly suggests that it was invoking the business judgment rule.<sup>125</sup> The business judgment rule was at least a century old when *Dodge* was decided.<sup>126</sup> Under it, as an 1847 Alabama decision explained, directors could not be held liable for errors of judgment, “unless the error be of the grossest kind.”<sup>127</sup> Accordingly, courts would defer to the judgment of the directors unless a complaining shareholder could show something beyond mere negligence, such

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<sup>119</sup> *Id.* (same).

<sup>120</sup> *Id.* at 683.

<sup>121</sup> *See id.* at 685 (“The decree of the court below fixing and determining the specific amount to be distributed to stockholders is affirmed.”).

<sup>122</sup> *See id.* at 684 (“We are not . . . persuaded that we should interfere with the proposed expansion of the business of the Ford Motor Company.”).

<sup>123</sup> *Id.* at 684.

<sup>124</sup> *Id.*

<sup>125</sup> *See, e.g.,* Alaska Plastics, Inc. v. Coppock, 621 P.2d 270, 278 (Alaska 1980) (“Judges are not business experts, *Dodge v. Ford Motor Co.*, . . . a fact which has become expressed in the so-called ‘business judgment rule.’”).

<sup>126</sup> Marcia M. McMurray, *An Historical Perspective on the Duty of Care, the Duty of Loyalty, and the Business Judgment Rule*, 40 VAND. L. REV. 605, 613 (1987) (citing cases).

<sup>127</sup> *Godbold v. Bank at Mobile*, 11 Ala. 191, 200 (1847).

as fraud or self-dealing on the directors' part.<sup>128</sup> Subsequent courts fleshed out the rule, explaining that "directors' decisions will be respected by courts unless" the plaintiff can show that "the directors are interested or lack independence relative to the decision, do not act in good faith, act in a manner that cannot be attributed to a rational business purpose or reach their decision by a grossly negligent process that includes the failure to consider all material facts reasonably available."<sup>129</sup> In the specific context of disputes over corporate purpose, Chancellor William Chandler of the Delaware Chancery Court explained that:

When director decisions are reviewed under the business judgment rule, this Court will not question rational judgments about how promoting non-stockholder interests—be it through making a charitable contribution, paying employees higher salaries and benefits, or more general norms like promoting a particular corporate culture—ultimately promote stockholder value. In adopting a business judgment rule-based approach to reviewing board decisions, Dodge thus set a critical precedent that continues to define the extent to which directors who depart from shareholder value maximization face personal liability to shareholders or the entity.<sup>130</sup>

## II. DEFENDING *DODGE*

Stout and her fellow critics of *Dodge* contend that the decision was wrong when decided and is not the law today.<sup>131</sup> By my count Stout and her allies advanced eight separate arguments to support the claim that *Dodge* is bad law. As we shall see in this Part, none of them proves persuasive on close examination.

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<sup>128</sup> See, e.g., *Goebel v. Herancourt Brewing Co.*, 7 Ohio N.P. 230 (Ohio Super. 1893) ("The court will not interpose in matters which relate solely to the natural management of the concern, in the absence of fraud . . ."); see generally Ramesh K.S. Rao et. al., *Fiduciary Duty A La Lonnais: An Economic Perspective on Corporate Governance in A Financially-Distressed Firm*, 22 J. CORP. L. 53, 58 (1996) ("At least since the late nineteenth century, when the size and influence of American corporations began to increase astronomically, corporate directors were virtually immunized from liability by the business judgment rule unless their judgment was tainted by "fraud, illegality, or conflict of interest.").

<sup>129</sup> *Brehm v. Eisner*, 746 A.2d 244, 264 (Del. 2000). The Delaware Supreme Court has noted but not adopted "a distinction between the business judgment rule, which insulates directors and management from personal liability for their business decisions, and the business judgment doctrine, which protects the decision itself from attack." *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 180 n.10 (Del. 1986).

<sup>130</sup> *eBay Dom. Holdings, Inc. v. Newmark*, 16 A.3d 1, 33 (Del. Ch. 2010).

<sup>131</sup> See David B. Guenther, *The Strange Case of the Missing Doctrine and the "Odd Exercise" of Ebay: Why Exactly Must Corporations Maximize Profits to Shareholders?*, 12 Va. L. & Bus. Rev. 427, 449 (2018) (noting that various "commentators have argued that the court's statement was merely dictum, that Michigan law is not important, and that *Dodge v. Ford* is not good law").

### A. Is *Dodge* Mere Dicta?

Stout contended that *Dodge*'s famous statement of shareholder value maximization was merely "an offhand remark" that can be dismissed as dicta.<sup>132</sup> Granted, Stout's position is not an outlier; to the contrary, many other critics have made the same argument.<sup>133</sup> But, as Yale law professor Jonathan Macey has explained, a close examination of the decision demonstrates "the shareholder maximization ideal actually drives the holding and is not mere dicta."<sup>134</sup> In addition to the structure and text of the opinion itself, efforts to dismiss *Dodge* as mere dicta flounder on the fact that the decision was a logical extension of legal trends of the time and was accepted almost immediately by both judges and scholars as a correct statement of the law of corporate purpose.

As we've seen, Henry Ford likely would have won the case if he had been willing to embrace profit maximization as the motivation for his decisions. The court expressly confirmed "that the issues in the case, including (but presumably not limited to) employee wages, working hours and conditions, and product pricing are at the discretion of the directors."<sup>135</sup> Accordingly, "what mattered in this case was not what Mr. Ford did, but what he said he was doing."<sup>136</sup> Ford therefore lost precisely because he repeatedly testified that he would not exercise that discretion "in the choice of means to" carry on the corporation's business affairs "primarily for the benefit of the stockholders."<sup>137</sup> The necessary holding of the case thus was that "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."<sup>138</sup>

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<sup>132</sup> Stout, *supra* note 12, at 165. Portions of this section were adapted by permission of the publisher from my article Stephen M. Bainbridge, *Making Sense of the Business Roundtable's Reversal on Corporate Purpose*, 46 J. Corp. L. 285 (2021).

<sup>133</sup> See, e.g., Cherry & Sneirson, *supra* note 14, at 1021 (arguing that "the Dodge case speaks in dicta of shareholder profit as the central purpose of the corporation"); Eric H. Franklin, *A Rational Approach to Business Entity Choice*, 64 U. KAN. L. REV. 573, 613 (2016) (asserting that "the [relevant] language in *Dodge* was merely dicta and had no bearing on the court's holding"); Jeffrey M. Lipshaw, *The False Dichotomy of Corporate Governance Platitudes*, 46 J. Corp. L. 345, 366 (2021) (noting "the dictum about corporate obligations in *Dodge*"); Judd F. Sneirson, *The Sustainable Corporation and Shareholder Profits*, 46 WAKE FOREST L. REV. 541, 550 (2011).

<sup>134</sup> Jonathan R. Macey, *A Close Read of an Excellent Commentary on Dodge v. Ford*, 3 VA. L. & BUS. REV. 177, 180 (2008).

<sup>135</sup> *Id.* at 183.

<sup>136</sup> *Id.*

<sup>137</sup> *Dodge v. Ford Motor Co.*, 170 N.W. 668, 684 (Mich. 1919).

<sup>138</sup> *Id.* See, e.g., Leo E. Strine Jr., *Our Continuing Struggle with the Idea That For-Profit Corporations Seek Profit*, 47 WAKE FOREST L. REV. 135, 146-48 (2012) (explaining that "the

Put another way, in order to compel FMC to pay the special dividend demanded by the Dodge Brothers, the Michigan Supreme Court had to hold that Ford and FMC's board abused their discretion by refusing to pay a dividend. In turn, to hold that the board had abused its discretion, the board had to conclude that the board was conducting FMC's business "for the merely incidental benefit of shareholders and for the primary purpose of benefitting others . . ."<sup>139</sup> The conclusion that Ford had abandoned shareholder value maximization was thus essential to the result, which makes the court's statement of corporate purpose holding rather than dicta.

### 1. Dodge's Judicial Antecedents

Implicit in Stout's argument that *Dodge* may be dismissed as mere dicta is the idea that *Dodge* was a unique departure in the law.<sup>140</sup> Although the relevant pre-*Dodge* case law is sparse, it is fair to say the Michigan Supreme Court did not invent the shareholder value maximization rule out of whole cloth.<sup>141</sup> Instead, it rested on well established legal precedents. As even proto-corporate social responsibility advocate Merrick Dodd admitted in 1932, *Dodge* represented the orthodox understanding at that time of the law governing directors' duties.<sup>142</sup>

To be sure, many early cases approached the problem from a different doctrinal direction. Recall that the *Dodge* opinion disposed of plaintiffs' *ultra vires* claim with ease. In the 19<sup>th</sup> and early 20<sup>th</sup> Century, by contrast, the *ultra vires* doctrine was the main vehicle by which plaintiffs challenged corporate actions allegedly departing from shareholder value maximization pre-*Dodge* cases. In an 1896 New York decision, *Steinway v. Steinway & Sons*, for example, the plaintiff complained "that the acts of the trustees of Steinway & Sons in providing... for the physical, intellectual, and spiritual wants of their employés" were *ultra vires*.<sup>143</sup> In the latter part of the 19<sup>th</sup> Century, famed piano Steinway & Sons moved its principal factory from New York City to Astoria,

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Michigan Supreme Court *held* that Ford could not justify his actions that way . . . [because] he could not subordinate the stockholders' best interest" and describing the statement of that rule as a "*holding*"; emphasis supplied).

<sup>139</sup> *Dodge v. Ford Motor Co.*, 170 N.W. 668, 684 (Mich. 1919).

<sup>140</sup> See Stout, *supra* note 12, at (arguing that *Dodge* "was a judicial 'sport'"). See also George A. Mocsary, *Freedom of Corporate Purpose*, 2016 B.Y.U. L. REV. 1319, 1343 (2016) (noting that among the objections to *Dodge* is the claim that the opinion "improperly invented the shareholder wealth maximization norm")

<sup>141</sup> See Guenther, *supra* note 131, at 454 (arguing that although "*Dodge v. Ford* may have announced the profit maximization doctrine, it does not appear to have invented it from whole cloth").

<sup>142</sup> See Dodd, *supra* note 9, at 1158 (describing *Dodge* as the reflecting "orthodox legal attitude . . . which is generally regarded as representing the law on the subject.").

<sup>143</sup> *Steinway v. Steinway & Sons*, 40 N.Y.S. 718, 720 (N.Y. Sup. Ct. 1896).

N.Y.<sup>144</sup> At that site, Steinway & Sons undertook construction of a company town providing not just housing for its employees, but also a church, school, library, and public bath.<sup>145</sup> Steinway & Sons' articles of incorporation stated that the corporation had been formed "for the purpose . . . of manufacturing and selling pianofortes and other musical instruments."<sup>146</sup> Plaintiff contended the funds expended on building the company town were improperly spent because the project had engaged the corporation in what amounted to "an extensive land business, which was outside of its chartered powers."<sup>147</sup> The court rejected that argument, holding that, "under the circumstances of the case," those acts "were not *ultra vires*."<sup>148</sup>

Although the framing of the case channeled the opinion into *ultra vires* issues of corporate powers and purposes, rather than fiduciary duties, the court's analysis of those issues anticipated *Dodge's* view that incidental expenditures for the benefit of the company's employees were permissible so long as the corporation's purpose remains shareholder value maximization.<sup>149</sup>

The corporation is and has been doing all that the court could require it to do in transmuting [expenditures for the benefit of employees] into money. The expenditures to which I have referred were advantageous to the property, such as at some time at least would have to be made, and tended to render the property salable.<sup>150</sup>

In the subsequent *People ex rel. Metro. Life Ins. Co. v. Hotchkiss* decision,<sup>151</sup> the New York Appellate Division reviewed a challenge to an insurance corporation's decision to

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<sup>144</sup> *Id.* at 719.

<sup>145</sup> *Id.* Company towns of the sort were a common phenomenon in the 19<sup>th</sup> Century, reflecting the industrial paternalism of the time. See HEALD, *supra* note 41, at 9-10 (discussing company town phenomenon).

<sup>146</sup> *Steinway*, 40 N.Y.S. at 718.

<sup>147</sup> *Id.* at 720.

<sup>148</sup> *Id.*

<sup>149</sup> Compare *Dodge v. Ford Motor Co.*, 170 N.W. 668, 684 (Mich. 1919) ("The difference between an incidental humanitarian expenditure of corporate funds for the benefit of the employés, like the building of a hospital for their use and the employment of agencies for the betterment of their condition, and a general purpose and plan to benefit mankind at the expense of others, is obvious. ") with *Steinway v. Steinway & Sons*, 40 N.Y.S. 718 (Sup. Ct. 1896) ("I am not prepared to hold that the very moderate expenditures or contributions of the company toward church, school, library and baths were outside of its incidental powers.").

<sup>150</sup> *Steinway*, 40 N.Y.S. at 721. See also *Virgil v. Virgil Practice Clavier Co.*, 33 Misc. 200, 201, 68 N.Y.S. 335, 336 (1900) (finding that establishment of a school by a corporation who stated purpose was the manufacture musical instruments was not *ultra vires*).

<sup>151</sup> 120 N.Y.S. 649 (App. Div. 1909).

finance hospital grounds that would benefit its employees. The court acknowledged that “formerly might have been questioned as not fairly within the powers or duties of the corporation,” but posited that “the enlightened spirit of the age... has thrown upon the employer other duties, which involve... [the] well-being of the employé.”<sup>152</sup> Because provision of such benefits had become essential to acquire “competent and effective service,” in creating the hospital the company was “merely transacting the business of the corporation” and the act, accordingly, was not *ultra vires*.

In 1922, a federal district court cited *Steinway* as supporting the court’s view that corporate charitable donations to the University of Buffalo and Canisius College were not *ultra vires* but rather were within the corporation’s power because the contributions tended to benefit the corporation.<sup>153</sup> The court opined that the donations “would in all probability inure to the future advantage of the company to be able to secure employees trained and skilled in corporate business and industrial affairs,” since both colleges had active business education programs.<sup>154</sup> In addition, the court recognized that public donations of this sort amounted to advertising that would generate considerable goodwill for the corporation.<sup>155</sup> The latter was of particular concern in this instance because several of the corporation’s competitors had made similar donations.<sup>156</sup> Failing to match those contributions, the court explained, might result in the company losing prestige in the community.<sup>157</sup>

Conversely, however, an Illinois court of the same time period expressly held that corporate charitable contributions were *ultra vires*. The court found that the financial contribution by the First National Bank of Charleston to a local manufacturer for the alleged retention of further services within their city was not within the bank’s incidental powers. To the contrary, the court held that the law presumed that such “donations are

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<sup>152</sup> *Id.* at 651.

<sup>153</sup> *Armstrong Cork Co. v. H.A. Mendrum Co.*, 285 F. 58, 59 (W.D.N.Y. 1922).

<sup>154</sup> *Id.* at 58–59.

<sup>155</sup> *Id.*

<sup>156</sup> *Id.* at 59.

<sup>157</sup> *Id.* As interesting wrinkle to the case is the court’s observation that the board of directors and senior officers made their decision only “after full discussion as to the possible benefits to be derived by the corporation from their action.” *Id.* at 58. The court further noted that, in doing so, they “exercised their best judgment.” *Id.* at 59. Such findings were not necessary to the court’s decision, which turned solely on the *ultra vires* issue, but today would be highly relevant. Today, the case doubtless would be decided under the business judgment rule and, accordingly, whether the directors made an informed decision would be a critical issue. *See Granada Investments, Inc. v. DWG Corp.*, 823 F. Supp. 448, 456 (N.D. Ohio 1993) (stating that an essential precondition of the business judgment rule is “evidence of an informed decision with a reasonable effort to become familiar with the relevant and available facts”).

injurious to a bank and unwarrantable.”<sup>158</sup> The court conceded that the retention of the manufacturer might generally benefit the city and therefore benefit the bank indirectly; however, the court reiterated that the funds could still only be used for the “strict furtherance of the business objects and financial prosperity” of the bank and that the bank’s own “pecuniary interest will be advanced and directly forwarded cannot be assumed” in such cases of charitable contributions.<sup>159</sup>

In the early 20<sup>th</sup> Century, the legal regime governing corporate purpose eventually segued from *ultra vires* to fiduciary duties of directors and officers.<sup>160</sup> In *Raynolds v. Diamond Mills Paper Co.*,<sup>161</sup> a case bearing many factual similarities to *Dodge*, a New Jersey court declined to compel the board of directors of a closely-held paper manufacturing corporation to cause the corporation to pay a dividend.<sup>162</sup> The minority shareholder alleged the directors had adopted a policy of not paying dividends so that the corporation could retain earnings to finance a program of expansion, which left the shareholder without any way to realize the increased value of the company.<sup>163</sup> Although the court sympathized with the difficulty the minority shareholder faced with being unable to sell his shares to a publicly traded market given the nature of a closely held corporation, the court none-the-less stated it was a matter of common knowledge that to “enable the business to be prosecuted advantageously and with profit” it must expand.<sup>164</sup> Despite this knowledge, the court nevertheless limited the directors’ ability to expand indefinitely without consideration to the stockholders by reminding the directors it could only retain profits and expand so long as it did the not lead to the “practical starvation of the stockholders.”<sup>165</sup>

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<sup>158</sup> *McCrory v. Chambers*, 48 Ill. App. 445, 453 (Ill. App. Ct. 1892).

<sup>159</sup> *Id.* See also *Brinson Ry. Co. v. Exch. Bank of Springfield*, 85 S.E. 634, 635 (Ga. App. 1915) (holding it was beyond the powers of a railway company to donate company funds to assist in the erection of a public school or promoting of the town in which the school is located even though the railway’s “transportation business might thereby be increased” as a result). For useful discussions of the subsequent development of the law pertaining to corporate philanthropy, see Faith Stevelman Kahn, *Pandora’s Box: Managerial Discretion and the Problem of Corporate Philanthropy*, 44 UCLA L. REV. 579, 594 (1997); Miller, *supra* note 56, at 837-41.

<sup>160</sup> See Mitchell, *supra* note 76, at 175 (observing that “the doctrine of fiduciary obligations (rather than *ultra vires*) [became] the site where corporate purpose was to be found”).

<sup>161</sup> 60 A. 941 (N.J. Ch. 1905).

<sup>162</sup> See *id.* at 946 (“I do not think that a point was reached when this bill was filed at which it became the duty of this court to intervene and compel this corporation to declare a dividend for the benefit of its stockholders . . .”).

<sup>163</sup> See *id.* at 944 (noting that “the charge is that the directors are unreasonably refraining from declaring a dividend”).

<sup>164</sup> *Id.* at 945.

<sup>165</sup> *Id.*



In effect, the *Raynolds* court applied—albeit without naming it—the business judgment rule to the case.<sup>166</sup> In the course of doing so, however, the court emphasized that directors need “to bear in mind that the only sure benefit to stockholders to be derived from the successful prosecution of the corporate business must come from the distribution of dividends in cash . . . .”<sup>167</sup> The implication seems to be that the directors ultimately must pursue shareholder value, which was further suggested by the court’s observation that “[t]he success of a great business or manufacturing corporation is measured by what the stockholders get, and not by mere accumulation of assets.”<sup>168</sup>

As early as 1850, such precedents led legal treatise writers to conclude that “[b]oth the property and the sole object of every such corporation are essentially private, and from them the individuals composing the company corporate are to derive profit.”<sup>169</sup> *Dodge* was the logical culmination of these developments. “The purpose of the corporation was increasingly understood to be private and pecuniary, until in 1919, . . . the Michigan Supreme Court famously declared, as if it had always been true, that ‘[a] business corporation is organized and carried on primarily for the profit of the stockholders.’”<sup>170</sup>

## 2. Contemporary Scholarly Comment on *Dodge*

In addition to these judicial antecedents, the efforts to dismiss *Dodge*’s endorsement of shareholder value maximization as mere dicta by Professor Stout and her allies are further undermined by the immediate acceptance of *Dodge* by lawyers and legal scholars as a well-established legal principle. A 1919 American Law Reports annotation, for example, described *Dodge* as bringing “into clear relief the principle, which earlier decisions had previously recognized, that the fundamental purpose of a business corporation is to earn as large a profit as trade conditions and the business sagacity of its management will permit . . . .”<sup>171</sup> A 1920 Chicago legal newspaper likewise described *Dodge* as confirming that “the fundamental purpose of a business corporation is to earn as large a profit as possible,” although incidental expenditures for the benefit of employees are permissible so long as doing so redounds to the corporation’s long-term benefit.<sup>172</sup> An essay in the 1922-23 volume of the Yale Law Journal by Donald Richberg,

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<sup>166</sup> See *id.* at 945 (“I cannot, as a single equity judge sitting here, say that these gentlemen . . . were not doing an act that was absolutely necessary to the preservation of the successful business of the corporation.”).

<sup>167</sup> *Id.*

<sup>168</sup> *Id.* at 948.

<sup>169</sup> David B. Guenther, *Of Bodies Politic and Pecuniary: A Brief History of Corporate Purpose*, 9 MICH. BUS. & ENTREPRENEURIAL L. REV. 1, 64–65 (2019).

<sup>170</sup> *Id.* at 68

<sup>171</sup> Annot., *Right of Business Corporation to Use Its Funds or Property for Humanitarian Purposes*, 3 A. L. R. 443 (1919).

<sup>172</sup> *Using Corporate Funds for Humanitarian Purposes*, 52 CHI. LEGAL NEWS 300 (1920).

who was a prominent union lawyer and progressive politician of the period, cited *Dodge* for the proposition that “the primary objective of industry is the enrichment of the owner of the property or tools utilized in the industry; and that the objectives of the public and of the workers are secondary” and that that principle had “been little affected by ideas of social responsibility or of the interdependence of man upon man in modern life.”<sup>173</sup> Taken together, the commentary confirms contemporaneous experts regarded *Dodge* as neither a doctrinal sport, a statement of new law, or mere dicta. Instead, it was seen as restating an established principle of law as to the purpose of a corporation.<sup>174</sup>

#### B. Is *Dodge* Too Old to Matter?

Professor Stout asked “[w]hy rely on a case that is nearly one hundred years old if there is more modern authority available?”<sup>175</sup> Note how her question actually conflates two distinct issues. One is an implied claim that there is modern authority that contradicts *Dodge*. As we shall see, however, modern authority supports *Dodge*. The other implied claim is that old cases have minimal precedential weight.

As to the latter component of her argument, Stout is demonstrably wrong. A federal judge emphatically explained that “State supreme court decisions do not lose precedential value as they age.”<sup>176</sup> To the contrary, the court noted, the proposition “that cases lose their precedential value as they age” is “completely erroneous.”<sup>177</sup> The Supreme Court of New Hampshire likewise declined a defendant’s “invitation to discount [an 1864 decision’s] precedential value on account of its age.”<sup>178</sup>

In fact, Stout’s argument got it backwards. U.S. Supreme Court Justice Antonin Scalia observed, albeit in dissent, that “the respect accorded prior decisions increases, rather than decreases, with their antiquity, as the society adjusts itself to their existence,

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<sup>173</sup> Donald R. Richberg, *Developing Ethics and Resistant Law*, 32 YALE L.J. 109, 117-118 (1922-1923).

<sup>174</sup> Other contemporaneous commentary quoting the relevant passages from *Dodge* with either approval or, at least, without surprise, includes H.L. Wilgus, *Corporations, Shareholders’ Right to Have a Dividend Declared and Paid Out of Surplus*, 17 MICH. L. REV. 502, 503 (1919); Editorial, *Minority Stockholders—Compelling Directors to Declare Dividends—Right of a Corporation Organized for Business Purposes to Devote Any of its Assets to Eleemosynary Purposes*, 5 VA. L. REG. 558, 565 (1919).

<sup>175</sup> Stout, *supra* note 12, at 166.

<sup>176</sup> *In re Ryan*, 80 B.R. 264, 267 (D. Mass. 1987), *aff’d*, 851 F.2d 502 (1st Cir. 1988).

<sup>177</sup> *Id.*

<sup>178</sup> *Del Norte, Inc. v. Provencher*, 703 A.2d 890, 893 (N.H. 1997). The California Court of Appeal has held that it was unaware of any authority “that makes the mere age of an opinion relevant in determining its precedential value.” *Mech. Contractors Assn. v. Greater Bay Area Assn.*, 78 CAL. RPTR. 2d 225, 233 (Cal. App. 1st Dist. 1998).

and the surrounding law becomes premised upon their validity.”<sup>179</sup> He explained that “[t]he freshness of error not only deprives it of the respect to which long-established practice is entitled, but also counsels that the opportunity of correction be seized at once, before state and federal laws and practices have been adjusted to embody it.”<sup>180</sup>

### C. Does Modern Case Law Reject *Dodge*?

As discussed in the preceding section, Stout claimed that “shareholder wealth maximization is not a modern legal principle” in part because it is not supported by modern corporate case law.<sup>181</sup> That is, *Dodge*’s statement that “a business corporation is organized and carried on primarily for the profit of stockholders”<sup>182</sup> was formerly binding precedent, it is no longer binding precedent.<sup>183</sup>

While it is admittedly true that there have been relatively modern few cases on point, they have confirmed that *Dodge* remains a well-accepted holding. The Westlaw database of judicial opinions identifies only two cases as negatively referencing *Dodge*: *Churella v. Pioneer State Mut. Ins. Co.*<sup>184</sup> and *Hill v. State Farm Mutual Automobile Ins. Co.*<sup>185</sup> Neither really poses any threat to *Dodge*. Indeed, to the contrary, both actually confirm *Dodge*’s holding. Both involved not business corporations but rather mutual insurance companies. As the Michigan appellate court explained in *Churella*, the distinction between business corporations and mutual insurance companies is critical because while “the purpose of a business corporation is to provide profit to its shareholders . . . this is not the purpose of a mutual insurance company. The purpose of a mutual insurance company is to provide affordable insurance coverage to its members.”<sup>186</sup> In other words, the court accepted the validity of *Dodge* as applied to business corporations, while rejecting it for the unique context of a mutual insurance company.

The Westlaw database further identifies 11 judicial decisions citing the relevant portion of the *Dodge* decision, all of which are consistent with *Dodge*. A 1935 Michigan Supreme Court decision cited *Dodge* with approval,<sup>187</sup> for example, as did a 2006

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<sup>179</sup> *South Carolina v. Gathers*, 490 U.S. 805, 824 (1989) (Scalia, J., dissenting).

<sup>180</sup> *Id.* See also Daniel M. Tracer, *Stare Decisis in Antitrust: Continuity, Economics, and the Common Law Statute*, 12 DEPAUL BUS. & COM. L.J. 1, 38 (2013) (“In fact, older cases that have been continually affirmed are thought to have greater precedential value.”).

<sup>181</sup> Stout, *supra* note 12, at 168.

<sup>182</sup> *Dodge v. Ford Motor Co.*, 170 N.W. 668, 684 (Mich. 1919) .

<sup>183</sup> See Stout, *supra* note 12, at 169-72.

<sup>184</sup> 671 N.W.2d 125 (Mich. App. 2003).

<sup>185</sup> 83 Cal.Rptr.3d 651 (Cal. App. 2 Dist. 2008).

<sup>186</sup> *Churella*, 671 N.W.2d at 132.

<sup>187</sup> *Wagner Electric Corp. v. Hydraulic Brake Co.*, 257 N.W. 884, 887 (Mich. 1934).

Michigan Court of Appeals decision.<sup>188</sup> Accordingly, 2020 Michigan federal court concluded that it was still “well established under Michigan law that the primary purpose of a business corporation is to benefit and profit the stockholders.”<sup>189</sup>

Outside of Michigan, a 1933 West Virginia Supreme Court cited *Dodge* with approval.<sup>190</sup> A 1964 Missouri Court of Appeals decision stated that the court had “no quarrel with” the proposition that *Dodge* (among other decisions) governed the decisions of a board of directors.<sup>191</sup> A 1973 federal district court decision described *Dodge* as finding “that the [FMC] directors were running the corporation for the benefit of persons other than the stockholders,” while explaining that the case at bar presented no such facts.<sup>192</sup> A dissenting opinion in a 1983 U.S. Supreme Court decision stated that “Henry Ford’s philanthropic motives did not permit him to set Ford Motor Company dividend policies to benefit public at expense of shareholders.”<sup>193</sup> A concurring opinion in a 1986 federal Ninth Circuit decision cited *Dodge* for the proposition that a corporation’s “management have the duty to maximize the value of the corporation’s assets for the benefit of the corporation’s residual claimants.”<sup>194</sup> In sum, contrary to Stout’s claim, “*Dodge* remains good law and the shareholder wealth maximization theory has been widely upheld and accepted by courts.”<sup>195</sup>

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<sup>188</sup> Wojcik v. McNish, 2006 WL 2061499, at \*5 (Mich. App. July 25, 2006).

<sup>189</sup> Smith v. Smith, 2020 WL 2308683, at \*8 (E.D. Mich. May 8, 2020).

<sup>190</sup> Gilbert v. Norfolk & W. Ry. Co., 171 S.E. 814, 815 (W. Va. 1933) (citing *Dodge* for “the general rule that a private business corporation is carried on primarily for the profit of its stockholders”).

<sup>191</sup> Long v. Norwood Hills Corp., 380 S.W.2d 451, 476 (Mo. Ct. App. 1964).

<sup>192</sup> Levin v. Mississippi River Corp., 59 F.R.D. 353, 365 (S.D.N.Y. 1973), *aff’d sub nom.* Wesson v. Mississippi River Corp., 486 F.2d 1398 (2d Cir. 1973).

<sup>193</sup> Dirks v. SEC, 463 U.S. 646, 674 (1983) (Blackmun, J., dissenting).

<sup>194</sup> In re Rigden, 795 F.2d 727, 737 (9th Cir. 1986) (Hall, J., concurring in part and dissenting in part).

<sup>195</sup> Roxanne Thorelli, *Providing Clarity for Standard of Conduct for Directors Within Benefit Corporations: Requiring Priority of a Specific Public Benefit*, 101 MINN. L. REV. 1749, 1761–62 (2017). See also William W. Bratton, *Confronting the Ethical Case Against the Ethical Case for Constituency Rights*, 50 WASH. & LEE L. REV. 1449, 1456 (1993) (“Both *Dodge v. Ford Motor Co.*, the leading precedent for shareholder primacy, and *A.P. Smith Manufacturing Co. v. Barlow*, a leading precedent for a management privilege to make charitable contributions, are good law.”); David Braun, *Turbulent Times in Corporate Board Rooms: The Emerging Changes in Corporate Governance*, 1993 DET. C.L. REV. 1663, 1685 (1993) (“The current state of the law regarding corporate governance remains represented by the seventy-four year old doctrine in *Dodge v. Ford Motor Co.*”); William H. Clark, Jr. & Elizabeth K. Babson, *How Benefit Corporations Are Redefining the Purpose of Business Corporations*, 38 WM. MITCHELL L. REV. 817, 825–26 (2012) (*Dodge* remains good law”); Guenther, *supra* note 131, at 432 (“*Dodge v. Ford* remains good law . . .”).

#### D. What Does Delaware Say?

As have many scholars, Stout claimed that Delaware law does not embrace shareholder value maximization as it is articulated by *Dodge*.<sup>196</sup> In fact, however, Delaware courts arguably have embraced an even stronger version of shareholder value maximization than did *Dodge*. Recall that the latter held that business corporations are “organized and carried on *primarily* for the profit of the stockholders.”<sup>197</sup> According to some commentators, the qualifier “primarily” “suggests that other things may be considered in the operation of the corporation.”<sup>198</sup> Whether or not that claim is correct,<sup>199</sup> the relevant Delaware cases contain no such limitation.<sup>200</sup>

In *Katz v. Oak Industries Inc.*,<sup>201</sup> for example, the late Delaware Chancellor William Allen stated that directors have obligation “to attempt, within the law, to maximize the long-run interests of the corporation's stockholders.”<sup>202</sup> In the early 1980s, Oak Industries fell into serious financial difficulties.<sup>203</sup> It suffered several consecutive years of losses.<sup>204</sup> Oak's balance sheet tipped deeply into the red, such that the shareholder equity account showed a \$62 million deficit.<sup>205</sup> In the balance sheet meaning of the term, Oak was thus

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<sup>196</sup> Former Delaware Chief Justice Leo Strine helpfully collected a list of such claims in a long string cite in Leo E. Strine, Jr., *The Dangers of Denial: The Need for A Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761, 763 n.7 (2015).

<sup>197</sup> *Dodge v. Ford Motor Co.*, 170 N.W. 668, 684 (Mich. 1919) (emphasis supplied).

<sup>198</sup> Eric C. Chaffee, *A Theory of the Business Trust*, 88 U. CIN. L. REV. 797, 833 (2019); Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 773 (2005).

<sup>199</sup> The qualifier seems a very weak reed on which to rest a claim that *Dodge* validates stakeholder capitalism. The Michigan Supreme Court made clear that the discretion vested in the board of directors did not authorize “the reduction of profits” or “the nondistribution of profits among stockholders in order to devote them to other purposes.” *Dodge v. Ford Motor Co.*, 170 N.W. 668, 684 (Mich. 1919).

<sup>200</sup> For a particularly detailed examination of Delaware law, see DAVID YOSIFON, *CORPORATE FRICTION: HOW CORPORATE LAW IMPEDES AMERICAN PROGRESS AND WHAT TO DO ABOUT IT* 60-95 (2018). Professor Yosifon concludes that “Delaware's law requires shareholder primacy . . .” *Id.* at 93.

<sup>201</sup> 508 A.2d 873 (Del. Ch. 1986).

<sup>202</sup> *Id.* at 879.

<sup>203</sup> *See id.* at 875 (“Even a casual review of Oak's financial results over the last several years shows it unmistakably to be a company in deep trouble.”).

<sup>204</sup> *Id.*

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

insolvent.<sup>206</sup> Its stock price plummeted from over \$30 to less than \$2.<sup>207</sup> Its debt securities were trading at substantial discounts.<sup>208</sup>

Oak's board of directors undertook a massive restructuring involving the sale of certain assets and an exchange offer that swapped some of Oak's outstanding debenture for a package of notes, stock, and warrants.<sup>209</sup> The initial restructuring helped but did not solve Oak's long-term problems. Accordingly, the board entered into negotiations with Allied-Signal, which eventually resulted in two agreements.<sup>210</sup> The key one for our purposes was the Stock Purchase Agreement, pursuant to which Allied-Signal agreed to inject new equity capital into Oak by buying 10 million Oak common shares for \$15 million.<sup>211</sup> The agreement conditioned Allied-Signal's obligation to effect the purchase on the holders of at least 85% of Oak's outstanding debt securities accepting an exchange offer in which the debt would take a haircut.<sup>212</sup> Bondholders who accepted the offer would receive a payment certificate for between \$655 to \$918 in cash for each \$1,000 face value bond they surrendered, with the amount depending on which class of bonds the holders surrendered.<sup>213</sup>

The indentures for all of six classes of Oak's debt contained restrictive covenants that precluded the company from effecting the exchange offer.<sup>214</sup> Accordingly, bondholders who wanted to accept the offer were required to vote in favor of amending the indentures to remove those covenants.<sup>215</sup> If the requisite number of bonds voted for the amendments, holders of any remaining unexchanged bonds would be left holding illiquid securities that had been stripped of key contractual protections.<sup>216</sup> The plaintiff bondholder sued,

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<sup>206</sup> See Alan W. Tompkins, *Directors' Duties to Corporate Creditors: Delaware and the Insolvency Exception*, 47 SMU L. REV. 165, 179 (1993) ("Oak Industries was not in good financial condition and could reasonably have been called a corporation 'operating in the vicinity of insolvency.'"). To decide whether a corporation is insolvent in the balance sheet sense, "courts must determine whether a debtor's liabilities were greater than his or her assets on the date in question." In re Penney, 632 B.R. 181, 192 (Bankr. E.D. Ark. 2021).

<sup>207</sup> Katz v. Oak Industries Inc., 508 A.2d 873, 875 n.2 (Del. Ch. 1986).

<sup>208</sup> *Id.*

<sup>209</sup> See *id.* at 875-76 (describing the board's initial efforts to rescue Oak).

<sup>210</sup> *Id.* at 876.

<sup>211</sup> *Id.*

<sup>212</sup> See *id.* (describing the agreement).

<sup>213</sup> See *id.* at 876-77 (describing terms of the exchange offer).

<sup>214</sup> See *id.* at 877 (describing the relevant covenants).

<sup>215</sup> See *id.* (describing the condition "that tendering security holders must consent to amendments in the indentures").

<sup>216</sup> See *id.* at 878 (describing the consequences to shareholders who did not accept the exchange offer).

claiming that the exchange offer was intended by the board “to benefit Oak's common stockholders at the expense of the Holders of its debt securities . . .”<sup>217</sup>

Chancellor Allen had little difficulty rejecting plaintiff's arguments. As noted, he stated that the directors have a fiduciary duty to try to maximize long-term shareholder value.<sup>218</sup> Critically, he went even further, explaining that directors “may sometimes do so ‘at the expense’ of” other corporate constituencies.<sup>219</sup> Accordingly, Allen stated the *Oak Industries* plaintiff's argument “does not itself appear to allege a cognizable legal wrong.”<sup>220</sup>

Other than the unremarkable requirement that directors act “within the law,”<sup>221</sup> *Oak Industries* stands as an unqualified statement of shareholder value maximization by one of the most prominent corporate law jurists of the 20<sup>th</sup> Century.<sup>222</sup> As such, it poses a serious problem for those commentators who claim Delaware law does not embrace shareholder value maximization. Professor Stout tried to avoid that problem by focusing on the supposed “qualifying phrases ‘attempt’ and ‘long-run,’” claiming they allow courts to make tradeoffs favoring stakeholders at the expense of shareholders,<sup>223</sup> but that argument is specious. Surely no one thinks directors must succeed in maximizing shareholder value in order to avoid liability. Instead, they merely must attempt to do so. Trying to succeed is what the law requires, not actual success. Otherwise, every director of every company that suffers a loss would have breached their fiduciary duty. Turning to

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<sup>217</sup> *Id.* at 878.

<sup>218</sup> See *supra* text accompanying note 202.

<sup>219</sup> *Katz v. Oak Industries Inc.*, 508 A.2d 873, 879 (Del. Ch. 1986).

<sup>220</sup> *Id.*

<sup>221</sup> See *supra* text accompanying note 202. As for the requirement that directors act within the law, I have argued elsewhere that whether anyone seriously argues that directors should violate the law in pursuit of shareholder value maximization, I have argued that directors who cause the corporation to break the law should face liability under the relevant criminal or civil laws, should not be liable to shareholders in breach of fiduciary duty litigation for violating *malum prohibitum* laws. See, e.g., Stephen M. Bainbridge et. al., *The Convergence of Good Faith and Oversight*, 55 UCLA L. REV. 559, 592 (2008).

<sup>222</sup> As to Chancellor Allen's status in the field, see Lee C. Buchheit & G. Mitu Gulati, *Exit Consents in Sovereign Bond Exchanges*, 48 UCLA L. REV. 59, 74 n.58 (2000) (“Chancellor William Allen... was one of the most respected judges in the area of corporate law....”); John C. Coffee, Jr., *Court Has a New Idea on Directors' Duty*, NAT'L L.J., Mar. 2, 1992, at 18 (“Chancellor Allen is probably the country's most influential and respected judge on corporate law matters....”).

<sup>223</sup> Stout, *supra* note 12, at 170.

the supposedly qualifying phrase “the long run,” no serious jurist or scholar thinks directors are legally required to maximize short-term profits.<sup>224</sup>

In any case, Stout’s dismissal of *Oak Industries* ignores other statements of Delaware law lacking such qualifiers. In *TW Services, Inc. v. SWT Acquisition Corp.*, for example, Chancellor Allen held that directors “owe a duty to shareholders as a class to manage the corporation within the law, with due care and in a way intended to maximize the long run interests of shareholders.”<sup>225</sup> Similarly, in *Malone v. Brincat*, the Delaware Supreme Court explained held that directors have a “legal responsibility to manage the business of a corporation for the benefit of its shareholder owners.”<sup>226</sup> More recently, albeit after Stout’s book was published, in *In re Trados, Inc. S’holder Litigation*, Vice Chancellor Travis Laster held that “the standard of conduct for directors requires that they strive in good faith and on an informed basis to maximize the value of the corporation for the benefit of its residual claimants, the ultimate beneficiaries of the firm’s value, not for the benefit of its contractual claimants.”<sup>227</sup>

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<sup>224</sup> Daniel J. H. Greenwood, *Discussing Corporate Misbehavior the Conflicting Norms of Market, Agency, Profit and Loyalty*, 70 BROOK. L. REV. 1213, 1235 (2005) (stating that “courts generally do not require anything resembling a strong version of short-term profit-maximization”); Darian M. Ibrahim, *A Return to Descartes: Property, Profit, and the Corporate Ownership of Animals*, 70 L. & CONTEMP. PROBS. 89, 105 (Winter 2007) (stating that “even if the law mandates that corporate managers pursue the sole end of profit maximization, it does not require that profits be maximized in the short term”); Jeremy Kidd, *The Economics of Workplace Drug Testing*, 50 U. Cal. Davis L. Rev. 707, 710 n.6 (2016) (stating that “maximizing the present value of profits does not require a particular preference for long-term profits”).

Stout’s argument was inapt, moreover, because it conflated the issue of whether *Oak Industries* embraces shareholder value maximization with the role of the business judgment rule in litigating shareholder value maximization cases. See *infra* Part II.G (discussing the business judgment rule).

<sup>225</sup> *TW Services, Inc. v. SWT Acq. Corp.*, 1989 WL 20290, at \*7 (Del. Ch. Mar. 2, 1989) (Allen, J.) (stating that directors “owe a duty to shareholders as a class to manage the corporation within the law, with due care and in a way intended to maximize the long run interests of shareholders”).

<sup>226</sup> *Malone v. Brincat*, 722 A.2d 5, 9 (Del. 1998).

<sup>227</sup> *In re Trados, Inc. S’holder Litig.*, 73 A.3d 17, 40–41 (Del. Ch. 2013). There has been a longstanding normative debate about whether shareholder value maximization should be a mandatory rule or a default rule out of which parties may contract. See, e.g., Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971, 985 (1992) (opining that “state law arguably does not permit corporate organic documents to redefine the directors’ fiduciary duties”); Joan MacLeod Heminway, *Shareholder Wealth Maximization as A Function of Statutes, Decisional Law, and Organic Documents*, 74 WASH. & LEE L. REV. 939, 957 (2017) (arguing that “a charter provision that is inconsistent with the shareholder wealth maximization norm should be valid”); Stefan J. Padfield, *The Role of Corporate Personality Theory in Opting Out of Shareholder Wealth Maximization*, 19 TRANSACTIONS: TENN. J. BUS. L.



A critical refinement of Delaware law on this issue came in the mid-1980s in response to the emergence of hostile corporate takeovers and target company defenses against them.<sup>228</sup> In *Unocal Corp. v. Mesa Petroleum Co.*,<sup>229</sup> Delaware Supreme Court held that a target company board of directors deciding how to respond to an unsolicited takeover proposal could consider the impact of that proposal on numerous concerns, including “the impact on ‘constituencies’ other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally) . . .”<sup>230</sup> Oddly, the court cited no statute or judicial precedent in support of that claim, which is a remarkable omission given the potentially portentous nature of that statement.<sup>231</sup> In any event, the Delaware Supreme Court reversed course almost immediately.

In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,<sup>232</sup> the Delaware Supreme Court reviewed a number of takeover defenses adopted by Revlon in response to an unsolicited tender offer by Pantry Pride. For our purposes, the critical stage of the takeover fight came at the end when Revlon’s board authorized management to negotiate

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415, 439 (2017) (suggesting that “Chancellor Chandler’s comments in the *eBay* decision suggest that” efforts to opt out of shareholder value maximization may be unavailing). Citing Vice Chancellor Laster’s *Trados* decision, Robert Miller argues that, as a descriptive matter, Delaware law is mandatory:

[T]he language typically used in describing the board’s consideration of other constituencies under the shareholder-wealth maximization model—the board may consider the interests of other constituencies, subject to the fundamental limitation about increasing value for shareholders—is unjustifiably permissive. It is not that the board may consider such constituencies; if the relevant condition is satisfied, that is, if conferring a benefit on the other constituency results in a net benefit for the shareholders, then the board not only may act to benefit the other constituency but must act to do so under Delaware’s applicable standard of conduct (at least if there is not some other use for the available funds that would produce an even greater benefit for the shareholders). . . . The duty does not become optional when the best available means of maximizing value for the shareholders involves payments to non-shareholder constituencies. In other words, the commonly used language is permissive (the board may consider other constituencies, if the relevant condition applies) but the actual standard of conduct is mandatory (the board shall consider other constituencies, if the relevant condition applies).

Robert T. Miller, *How Would Directors Make Business Decisions Under a Stakeholder Model?* 10 n.27 (Feb. 18, 2022), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=4032539](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4032539).

<sup>228</sup> For an overview of takeover defenses and the law governing them, see STEPHEN M. BAINBRIDGE, *MERGERS AND ACQUISITIONS* 353-445 (4<sup>th</sup> ed. 2021).

<sup>229</sup> 493 A.2d 946 (Del. 1985).

<sup>230</sup> *Id.* at 955.

<sup>231</sup> See YOSIFON, *supra* note 200, at 66 (calling that omission remarkable).

<sup>232</sup> 506 A.2d 173 (Del. 1986).

with other prospective bidders. That process culminated with an agreement between Revlon and private equity fund Forstmann Little & Co. (“Forstmann”), pursuant to which Forstmann would acquire Revlon through a leveraged buyout.<sup>233</sup> The deal included three provisions intended to ensure that Forstmann would prevail over Pantry Pride. First, Forstmann was given an option to buy two Revlon business divisions at a below market price in the event that some other party—including Pantry Pride—acquired 40% or more of Revlon’s stock.<sup>234</sup> Such options are known as asset lockups, because they are intended to end or prevent competitive bidding for the target—i.e., to lockup the deal.<sup>235</sup> Accordingly, the subject of the option is usually either the assets most desired by a competing bidder or those essential to the target’s operation. Second, Revlon agreed to a no shop clause, pursuant to which it agreed not to negotiate with any other potential buyers (including Pantry Pride).<sup>236</sup> Finally, the deal required Revlon to pay Forstmann a cancellation fee of \$25 million in the event the Forstmann acquisition failed to take place.<sup>237</sup> All of these are examples of what today are called “deal protection devices”; i.e., contractual terms intended to ensure that the favored bidder prevails in the event that one or more competitors offers an alternative acquisition proposal.<sup>238</sup>

The Delaware Supreme Court held that deal protection devices are not illegal *per se*, but that the specific devices adopted by *Revlon* were invalid given the facts at bar:

The *Revlon* board’s authorization permitting management to negotiate a merger or buyout with a third party was a recognition that the company was for sale. The duty of the board had thus changed from the preservation of Revlon as a corporate entity to the maximization of the company’s value at a sale for the stockholders’ benefit. . . . The directors’ role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company.<sup>239</sup>

The situations in which directors are obliged to act as auctioneers rather than corporate defenders are collectively known as *Revlon*-land.<sup>240</sup>

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<sup>233</sup> See *id.* at 178 (describing deal between Revlon and Forstmann).

<sup>234</sup> See *id.* (describing the option).

<sup>235</sup> Albert H. Choi, *Deal Protection Devices*, 88 U. CHI. L. REV. 757, 818-19 (2021) (explaining asset lockup options).

<sup>236</sup> See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 175 (Del. 1986) (describing the no-shop provision).

<sup>237</sup> *Id.*

<sup>238</sup> See Choi, *supra* note 235, at 794-819 (discussing deal protection devices).

<sup>239</sup> *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986).

<sup>240</sup> See generally Stephen M. Bainbridge, *The Geography of Revlon-Land*, 81 FORDHAM L. REV. 3277, 3314 (2013) (describing *Revlon*-land’s borders).

In the course of the opinion, the Delaware Supreme Court imposed two important limitations on its earlier *Unocal* holding. First, once the board enters *Revlon*-land, any “concern for non-stockholder interests is inappropriate.”<sup>241</sup> In other words, getting the best possible deal for the shareholders—regardless of the potential impact on other corporate constituencies—must be the board’s sole focus.<sup>242</sup> Second, even when the board is not in *Revlon*-land, it can consider the interests of non-shareholder constituencies only if “there are rationally related benefits accruing to the stockholders.”<sup>243</sup> In other words, shareholder value must remain the board’s focus, although the board is allowed to consider whether concern for stakeholders would redound to the benefit of the shareholders.<sup>244</sup>

As with *Oak Industries*, *Revlon* poses a serious problem for those who claim Delaware does not embrace shareholder value maximization. Not surprisingly, Professor Stout therefore attempted to explain it away. In her article advising law professors to stop teaching *Dodge*, she dismissed it as “a dead letter” that “for practical purposes” “is

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<sup>241</sup> *Revlon*, 506 A.2d at 182.

<sup>242</sup> In re Micromet, Inc. Shareholders Litig., 2012 WL 681785, at \*5 (Del. Ch. Feb. 29, 2012) (stating that when the board enters *Revlon*-land, the board’s sole duty “becomes to maximize the value of the sale of the company for the benefit of its shareholders”).

<sup>243</sup> *Revlon*, 506 A.2d at 182.

<sup>244</sup> Although we are concerned herein with the development of the law in the United States, it is interesting to note that the rule analogous to that announced in *Revlon* was articulated in a 19<sup>th</sup> Century United Kingdom case. In *Hutton v. West Cork Ry. Co.*, (1883) 23 Ch D 654, a railway corporation was preparing for dissolution and decided to pay—without legal obligation to do so—renumeration to its exiting directors. The court rejected this attempt at renumeration because the directors’ decision did not pass its test of being “done within the ordinary scope of the company’s business, and whether it is reasonably incidental to the carrying on of the company’s business for the company’s benefit.” *Id.* at 673. The court further explained, regardless of whether the renumeration attempt was laudable, that the “law doesn’t say there are to be no cakes and ale, but that there are to be no cakes and ale except such as are required for the benefit of the company.” *Id.* As Robert Miller observes:

*Hutton* even anticipates the more famous [Delaware Supreme Court] holding in *Revlon* that, once the board has decided to sell the company for cash, . . . consideration of the interests of other corporate constituencies becomes impermissible, and the board must focus exclusively on maximizing value for shareholders. That is, in *Hutton*, because the company was winding up its affairs and was no longer a going concern, “the company was gone as a company carrying on business for the purpose of making profit,” and so amounts not legally required to be paid to employees “could not be looked upon as an inducement to them to exert themselves in future, or as an act done reasonably for the purpose of getting the greatest profit from the business of the company,” with the result that corporation could not make such payments.

Miller, *supra* note 227, at 2 n.5.

largely irrelevant to modern corporate law and practice.”<sup>245</sup> Put bluntly, this is simply false. In fact, *Revlon* governs “the majority of friendly deals affecting a Delaware public company.”<sup>246</sup> As such, *Revlon* is “the basis of the Delaware law governing negotiated transactions,”<sup>247</sup> which hardly sounds like a dead letter.

Second, in her book, *The Shareholder Value Myth*, Stout elaborated on her critique of *Revlon*, arguing that it is the “exception that proves the rule.”<sup>248</sup> She explained that, in her view, *Revlon* carves out a very narrow and largely trivial requirement pursuant to which directors must “embrace shareholder wealth as their only goal” “only when a public corporation is about to stop being a public corporation.”<sup>249</sup> In fact, however, *Revlon* applies to a much broader range of situations in which there is a change of control of the company or certain other fundamental transformations.<sup>250</sup>

More important, as David Yosifon explains, Stout’s analysis “committed the fallacy of ‘denying the antecedent’”:

For the logical statement, “if A, then B” it is a fallacy to conclude “not A, therefore not B.” In *Revlon*, the Delaware Supreme Court held that if [A] the firm is for sale, then [B] directors must maximize profits. Stout concludes from this that if the firm is not for sale, directors do not have to maximize profits. But this does not follow as a matter of logic, and it is not *Revlon*’s teaching.<sup>251</sup>

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<sup>245</sup> Stout, *supra* note 12, at 172. Again, Leo Strine helpfully collected a list of commentators making similar claims in a long string cite in Strine, *supra* note 196, at 766 n.20.

<sup>246</sup> Matteo Gatti, *Upsetting Deals and Reform Loop: Can Companies and M&A Law in Europe Adapt to the Market for Corporate Control?*, 25 COLUM. J. EUR. L. 1, 74 n.381 (2019).

<sup>247</sup> Robert T. Miller, *Smith v. Van Gorkom and the Kobayashi Maru: The Place of the Trans Union Case in the Development of Delaware Corporate Law*, 9 WM. & MARY BUS. L. REV. 65, 73 (2017).

<sup>248</sup> STOUT, *supra* note 11, at 30. Professor Lipshaw likewise dismissed *Revlon* as an “exception that proves the ordinary rule.” Lipshaw, *supra* note 133, at 368.

<sup>249</sup> STOUT, *supra* note 11, at 31. Professor Elhauge makes the same error, arguing that directors’ “profit-maximization duty applies only to . . . sales of corporate control” and “does not apply otherwise.” See Elhauge, *supra* note 198, at 766.

<sup>250</sup> See Amy Y. Yeung & Charles B. Vincent, *Delaware’s “No-Go” Treatment of No-Talk Provisions: Deal-Protection Devices After Omnicare*, 33 DEL. J. CORP. L. 311, 325 (2008) (“Enhanced scrutiny under *Revlon* applies generally in situations where “a fundamental change of corporate control occurs or is contemplated,” particularly where the target corporation: (1) undertakes a transaction causing a change in corporate control; (2) initiates an active bidding process seeking to sell the corporation; or (3) makes the break-up of the corporate entity inevitable.”).

<sup>251</sup> David G. Yosifon, *The Law of Corporate Purpose*, 10 BERKELEY BUS. L.J. 181, 199 (2013).

Yosifon therefore rhetorically asked: “If Delaware really blankets workers, consumers, and communities with the warmth of directorial attention in the days, weeks, and years before a sale of the firm is in the works, . . . then why would it yank it off and leave these groups cold at the very moment where they are most vulnerable to the (market) elements?”<sup>252</sup> In fact, contrary to Stout and her allies, Delaware only allows directors to pay attention to “workers, consumers, and communities . . . in the days, weeks, and years before a sale of the firm is in the works” if there is a nexus between the stakeholder interests and profit.<sup>253</sup>

This brings us to the third problem with Stout’s analysis of *Revlon*. A few pages preceding her book’s discussion of *Revlon*, Stout wrote:

[S]ome cases explicitly state that directors can look beyond shareholder wealth in deciding what is best for the corporation. For example, in the 1985 opinion *Unocal Corp. v. Mesa Petroleum Co.*, the Delaware Supreme Court stated that in weighing the merits of a business transaction, directors can consider “the impact on ‘constituencies’ other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally).”<sup>254</sup>

Apparently, Stout wanted readers to believe that *Unocal* thereby stated the general rule to which *Revlon* is a limited exception, but that is simply not true. First, in neither her book nor her essay, does Stout acknowledge the Delaware Supreme Court’s statement in *Revlon* that that was the case in which the Court was “address[ing] *for the first time* the extent to which a corporation may consider the impact of a takeover threat on constituencies other than shareholders,”<sup>255</sup> which suggests that the earlier discussion in *Unocal* was not binding. Second, Stout nowhere acknowledges the limitation *Revlon* puts on consideration of non-shareholder interests in cases falling outside *Revlon*-land. In particular, “she never quotes the Delaware Supreme Court’s crucial statement in *Revlon* that there must be ‘rationally related benefits accruing to the stockholders’ before the considerations noted in *Unocal* would be permissible.”<sup>256</sup>

Stout is not the only commentator to have misread *Revlon*.<sup>257</sup> Professor Einer Elhauge perpetuated Stout’s error in the portion of his article discussing the content of Delaware

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<sup>252</sup> *Id.* at 204.

<sup>253</sup> *Id.* Professor Yosifon’s view are particularly worthy of consideration because he expressly acknowledges having a “normative agenda” of replacing shareholder value maximization with stakeholder capitalism but also strongly argues “that shareholder primacy *is* the law . . .” YOSIFON, *supra* note 200, at 61.

<sup>254</sup> STOUT, *supra* note 11, at 28-29.

<sup>255</sup> *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 176 (Del. 1986) (emphasis supplied).

<sup>256</sup> Yosifon, *supra* note 251, at 199.

<sup>257</sup> See YOSIFON, *supra* note 200, at 74 (“This is a common error.”).

law. At that point in the article, he cited *Unocal* as a statement of Delaware law without acknowledging the limitations *Revlon* imposes on *Unocal*.<sup>258</sup> Almost 100 pages later, he noted the limiting language from *Revlon* but dismissed it essentially out of hand.<sup>259</sup>

Finally, we come to a case that Professor Stout simply ignored; i.e., Delaware Chancellor William Chandler's opinion in *eBay Domestic Holdings, Inc. v. Newmark*.<sup>260</sup> In *eBay*, Chandler faced a case whose key facts were oddly reminiscent of *Dodge*. eBay was a minority shareholder of the corporation that owned internet online classified ad web site craigslist.com.<sup>261</sup> Craig Newmark ("Craig") and James Buckmaster ("Jim") were the company's controlling shareholders and dominated the board of directors,<sup>262</sup> just as Henry Ford was the dominant shareholder of FMC.<sup>263</sup> Craig and Jim explicitly rejected shareholder value maximization, proclaiming that craigslist.com was—and in the future would remain—concerned with aiding local, national, and global communities rather than profit for the shareholders.<sup>264</sup>

Chancellor Chandler expressed his personal admiration of Craig and Jim's altruism, but made clear that the law does not allow them to put other interests ahead of those of the shareholders:

The corporate form in which craigslist operates . . . is not an appropriate vehicle for purely philanthropic ends, at least not when there are other stockholders interested in realizing a return on their investment. Jim and Craig opted to form craigslist, Inc. as a for-profit Delaware corporation and voluntarily accepted millions of dollars from eBay as part of a transaction whereby eBay became a stockholder. Having chosen a for-profit corporate form, the craigslist directors are bound by the fiduciary

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<sup>258</sup> See Elhauge, *supra* note 198, at 764.

<sup>259</sup> See *id.* at 849-50 (arguing that "this language apparently just reflects the incomplete waning of the prior incompletely theorized agreement, for . . . Delaware case law in fact does not make shareholder interests controlling and thus allows consideration of nonshareholder interests other than just when that happens to maximize shareholder value"). As former Delaware Chief Justice Leo Strone thus observed, "Professor Elhauge gives little weight to this key statement, and Professor Stout does not quote it in her influential book on this subject." Strine, *supra* note 196, at 766 n.20.

<sup>260</sup> 16 A.3d 1 (Del. Ch. 2010).

<sup>261</sup> See *id.* at 6 (noting that "eBay owned 28.4% of craigslist").

<sup>262</sup> *Id.*

<sup>263</sup> See *Dodge v. Ford Motor Co.*, 170 N.W. 668, 671 (Mich. 1919) (stating that "the board of directors has been dominated and controlled absolutely by Henry Ford, the president of the company, who owns and for several years has owned 58 per cent. of the entire capital stock of the company").

<sup>264</sup> See *eBay Dom. Holdings, Inc. v. Newmark*, 16 A.3d 1, 34 (Del. Ch. 2010) (discussing Craig and Jim's beliefs).

duties and standards that accompany that form. Those standards include acting to promote the value of the corporation for the benefit of its stockholders. The “Inc.” after the company name has to mean at least that.<sup>265</sup>

Although Stout’s essay critiquing *Dodge* predated *eBay*, the subsequent book that grew out of that essay was published two years after *eBay* was decided but the book failed to address it. As Professor Yosifon aptly observed, that “omission is particularly troubling given that Stout’s book is aimed not just at scholars and corporate insiders, but also ‘informed laypersons,’ who would have no reason to note or decide for themselves about the significance of omitting a case so obviously relevant to the discussion.”<sup>266</sup>

Turning to those commentators who have addressed *eBay*, some forthrightly acknowledge that *eBay* is a clear statement of Delaware law embracing shareholder value maximization.<sup>267</sup> On the other hand, some commentators contend that the opinion leaves directors with wriggle room to pursue purposes other than shareholder wealth maximization, at least so long as there is some benefit to the shareholders.<sup>268</sup> Still others dismiss Chandler’s statement as mere dicta.<sup>269</sup>

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<sup>265</sup> *Id.*

<sup>266</sup> Yosifon, *supra* note 251, at 200.

<sup>267</sup> See, e.g., Elisabeth de Fontenay, *Individual Autonomy in Corporate Law*, 8 HARV. BUS. L. REV. 183, 211 (2018) (noting that “Delaware courts have recently suggested that managers of for-profit corporations are bound to maximize shareholder wealth”); Janine S. Hiller & Scott J. Shackelford, *The Firm and Common Pool Resource Theory: Understanding the Rise of Benefit Corporations*, 55 AM. BUS. L.J. 5, 16 (2018) (stating that *eBay* “is in a line of cases that can give a director pause before taking nonshareholder interests into consideration in corporate decision making, and it highlights the application of shareholder wealth maximization not just to publicly held corporations but also under certain circumstances to closely held corporations”); Kristin A. Neubauer, *Benefit Corporations: Providing A New Shield for Corporations with Ideals Beyond Profits*, 11 J. BUS. & TECH. L. 109, 123–24 (2016) (“As Chandler’s analysis clearly articulates, while a company’s decision to embark on charitable endeavors is admirable under traditional corporate law, if that charitable endeavor threatens the traditional fiduciary obligations of directors, then the charitable endeavor will not be sustained as a viable defense in Delaware courts”). Delaware Vice Chancellor Travis Laster, in an extended and favorable treatment of *eBay*, observed that under Delaware law “directors owe duties to the corporation for the ultimate benefit of the residual claimants.” J. Travis Laster, *Revlon is a Standard of Review: Why It’s True and What It Means*, 19 FORDHAM J. CORP. & FIN. L. 5, 28 (2013).

<sup>268</sup> See, e.g., Lyman Johnson, *Pluralism in Corporate Form: Corporate Law and Benefit Corps.*, 25 REGENT U. L. REV. 269, 274–75 (2013) (stating “the 2010 *eBay* decision is touted by some ... as mandating shareholder primacy. Yet, the opinion ... did nothing to alter craigslist’s business focus strategy”); Robert A. Katz & Antony Page, *Sustainable Business*, 62 EMORY L.J. 851, 868 (2013) (“The *eBay* case may even permit a company’s directors to pursue a philanthropic purpose, as long as it is not the company’s exclusive purpose”); Jena Martin, *Business and Human Rights: What’s the Board Got to Do with It?*, 2013 U. ILL. L. REV. 959, 970

Former Delaware Supreme Court Chief Justice Leo Strine came down firmly in the former camp in a 2015 law review article:

As with Chancellor Allen's reading of *Dodge v. Ford*, scholars have taken issue with Chancellor Chandler's holding, indicating that he did not need to rule for the reasons he said he did, or did not in fact premise his ruling on the reasons he stated. I understand that there are forms of legal thought tied to deconstructionist linguistics and philosophy, such as critical legal studies, and that are premised on the idea that authors themselves can never understand what they intend to say or are in fact saying. For those of us who are more traditional, we tend to credit accomplished jurists such as Chancellor Chandler, Chancellor Allen, and Justice Moore with understanding most of what they write, especially when it is in a high-profile context and when they underscore their understanding of the importance of the subject matter they are addressing.<sup>270</sup>

In a law review article written three years earlier, Strine had quoted Chancellor Chandler's holding that Delaware law does not allow directors to openly eschew shareholder value maximization, which he described it as a “rather expected statement.”<sup>271</sup>

In his 2015 article, Strine more broadly addressed claims by numerous progressive corporate law scholars “that directors may subordinate what they believe is best for stockholder welfare to other interests, such as those of the company's workers or society generally.”<sup>272</sup> In assessing that claim, the Chief Justice minced no words; to the contrary, he hurled multiple verbal grenades into the debate:

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n.53 (2013) (claiming “that a determined corporation could still maintain a strategy that values stakeholders (perhaps even above shareholders) in Delaware, so long as the corporation were to frame it within a shareholder-benefit framework”).

<sup>269</sup> See, e.g., Paul Weitzel & Zachariah J. Rodgers, *Broad Shareholder Value and the Inevitable Role of Conscience*, 12 N.Y.U. J.L. & BUS. 35, 79 (2015) (stating Chancellor Chandler's comments in *eBay* are “just strongly worded dicta”); David A. Wishnick, *Corporate Purposes in A Free Enterprise System: A Comment on eBay v. Newmark*, 121 YALE L.J. 2405, 2417 (2012) (“Future interpreters should read [*eBay*’s] ‘mandatory’ language as dicta because the opinion offers two grounds for rescission of the poison pill that do not require inquiry into the definition of ‘proper corporate purposes’”).

<sup>270</sup> Strine, *supra* note 196, at 775-76. Chief Justice Strine's pronouncements in scholarly settings are, at the very least, strong evidence of what the law is and, arguably, themselves should be treated as law. See Bainbridge, *Making Sense*, *supra* note 10, at 299-300 (discussing the principle of *opinio juris* and Strine's standing in the field).

<sup>271</sup> Strine, *supra* note 138, at 149.

<sup>272</sup> Strine, *supra* note 196, at 763.



- “These well-meaning commentators, of course, ignore certain structural features of corporation law . . . .”<sup>273</sup>
- “Indeed, these commentators essentially argue that Delaware judges do not understand the very law they are applying, and the Delaware General Assembly does not understand the law it has created.”<sup>274</sup>
- “It is not only hollow but also injurious to social welfare to declare that directors can and should do the right thing by promoting interests other than stockholder interests.”<sup>275</sup>

Perhaps most damningly, however Strine essentially accused the commentators—whom he called out by name in lengthy string cites<sup>276</sup>—of misrepresenting the law, arguing that they “*pretend* that directors do not have to make stockholder welfare the sole end of corporate governance, within the limits of their legal discretion, under the law of the most important American jurisdiction—Delaware.”<sup>277</sup> It is about as damning a dismissal of academic arguments as one encounters.

#### E. Is *Dodge* Limited to Controllers of Close Corporations?

In a thoughtful analysis, Gordon Smith advanced the provocative argument that *Dodge* maintains is properly understood as a case about the duties controlling shareholders of close corporations owe to minority shareholders.<sup>278</sup> Lynn Stout likewise claimed that *Dodge* sets out not the law of corporate purpose but rather the law governing efforts by a controlling shareholder to oppress minority shareholders.<sup>279</sup> Einer Elhauge similarly argued that the case is really one about the conflict of interest between controlling and minority shareholders.<sup>280</sup>

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<sup>273</sup> *Id.* at 765.

<sup>274</sup> *Id.* at 766-67.

<sup>275</sup> *Id.* at 767.

<sup>276</sup> *Id.* at 763-64 nn. 7 & 9.

<sup>277</sup> *Id.* at 763 (emphasis supplied). Professor Yosifon more gently described these arguments as reflecting “some sloppiness.” YOSIFON, *supra* note 200, at 75.

<sup>278</sup> D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 320 (1998) (“In short, *Dodge v. Ford Motor Co.* is best viewed as a minority oppression case.”). *See also* Miller, *supra* note 56, at 835 (contending that that *Dodge* is about not shareholder value maximization but rather protection of minority shareholders); Mitchell, *supra* note 76, at 169-75 (2019) (same).

<sup>279</sup> Stout, *supra* note 12, at 4.

<sup>280</sup> Elhauge, *supra* note 198, at 774 (“That is, the otherwise aberrational court decision to interfere with the exercise of managerial discretion about dividend levels seems best explained on the view that the case really involved a conflict of interest raising duty of loyalty concerns.”).

It is certainly true that Henry Ford was FMC's dominant shareholder.<sup>281</sup> It is also true that some contemporaneous scholarship treated *Dodge* as being about minority shareholders right to dividends.<sup>282</sup> Yet, as Professor Amir Licht observes, this reading of *Dodge* ultimately proves unpersuasive, because if *Dodge* were "merely a case of majority-minority relationships in the corporation it would not have gained the pride of place it has among the seminal authorities on U.S. corporate law."<sup>283</sup> The bulk of contemporary scholarship treated *Dodge* as stating a rule applicable to corporations generally rather than as one announcing a rule confined to close corporations.<sup>284</sup>

Turning to the modern cases discussed above, the leading *eBay* decision admittedly was also a case involving a dispute between the controlling and minority shareholders of a close corporation.<sup>285</sup> But nothing in Chancellor Chandler's opinion suggests that he was limiting his decision to close corporations. To the contrary, Chandler expressly stated that "[f]iduciary duties apply regardless of whether a corporation is 'registered and publicly traded, dark and delisted, or closely held.'"<sup>286</sup> In any case, *Revlon* and *Oak Industries* both involved public corporations neither of which had a controlling shareholder.<sup>287</sup> Accordingly, even if it were true that *Dodge* originally was intended as a statement about the duties of controllers, the evolutionary processes of the common law have led to *Dodge* being interpreted as establishing a basic rule for all boards of directors.

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<sup>281</sup> See *supra* note 263 and accompanying text.

<sup>282</sup> See, e.g., Current Decisions, *Corporations—Distribution of Dividends—Arbitrary Withholding on the Part of Directors*, 28 YALE L. J. 710, 711 (1918-1919) (describing the dividend portion of *Dodge* as addressing "protection of minority holders against the arbitrary acts of a numerically small majority").

<sup>283</sup> Amir N. Licht, *The Maximands of Corporate Governance: A Theory of Values and Cognitive Style*, 29 DEL. J. CORP. L. 649, 689 (2004).

<sup>284</sup> See, e.g., *Right of Business Corporation to Use Its Funds or Property for Humanitarian Purposes*, 3 A. L. R. 443 (1919) (describing *Dodge* as addressing "the fundamental purpose of a business corporation"); 52 Chi. Legal News 298, 300 (1920) (same); 50 Wash. L. Rep 17, 25 (1922) (same).

<sup>285</sup> See *eBay Dom. Holdings, Inc. v. Newmark*, 16 A.3d 1, 6 (Del. Ch. 2010) (noting that at the relevant time there were "only three craigslist stockholders").

<sup>286</sup> *Id.* at 31 (quoting *Kurz v. Holbrook*, 989 A.2d 140, 183 (Del.Ch.2010), *rev'd on other grounds*, 992 A.2d 377 (Del.2010)).

<sup>287</sup> See Stephen M. Bainbridge, *Much Ado About Little? Directors' Fiduciary Duties in the Vicinity of Insolvency*, 1 J. BUS. & TECH. L. 335, 364 (2007) (noting that *Oak Industries'* common stock had a stock market price); Vahid Dejiwakh, *The Directorist Model of Corporate Governance: Why a Dual Board Structure for Public Corporations is Good for Shareholders, Entrepreneurs, Employees, Capitalism, and Society*, 8 WM. & MARY POL'Y REV. 57, 71 (2016) (identifying *Revlon* as a public corporation).

## F. Opting In/Opting Out

Professor Stout observed that corporate articles of incorporation almost never explicitly opt into shareholder value maximization.<sup>288</sup> She correctly explained that state corporation codes generally oblige the articles of incorporation to include a statement of corporate powers and the purposes for which those powers will be exercised.<sup>289</sup> Yet, she noted, although it would be easy enough to include shareholder value maximization as one of those stated purposes, it is almost unheard of for articles to include such a statement.<sup>290</sup>

Although descriptively correct, Stout's argument fails to undermine *Dodge's* status as good law. Under the Model Business Corporation Act, a purpose provision is purely optional.<sup>291</sup> The Delaware General Corporation Law still requires a statement of the purposes for which the business was formed, but provides that a statement that the corporation was formed to conduct any lawful business will suffice.<sup>292</sup> Most corporations use that broad formulation rather than offering a more specific statement.<sup>293</sup>

Contrary to Stout's argument, the fact that most articles of incorporation are silent on the issue thus actually suggests that shareholder value maximization is the law. If shareholder value maximization is the default rule of corporate law, it would be surprising to see firms expressly embracing shareholder value maximization. After all, the whole point of a default rule is to reduce transaction costs by eliminating the need for contracts or other standard form documents to address the issue. The silence of corporate articles is thus evidence that shareholder value maximization is the law.

The silence of corporate articles is also evidence that most corporations prefer shareholder capitalism to stakeholder capitalism. As Leo Strine observed, "one does not find many, if any, public companies that say that they exist to pursue any lawful business for the purpose of protecting the environment, curing disease, or alleviating hunger."<sup>294</sup> The absence of efforts to opt out of the default rule suggests that most firms are content with the default rule.<sup>295</sup>

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<sup>288</sup> Stout, *supra* note 12, at 169.

<sup>289</sup> *Id.*

<sup>290</sup> *Id.*

<sup>291</sup> MOD. BUS. CORP. ACT § 2.02(b)(2)(i).

<sup>292</sup> DEL. CODE ANN., tit. 8, § 102(3).

<sup>293</sup> Yosifon, *supra* note 251, at 185 (stating that most articles of incorporation state that the business' purpose to pursue "any lawful" activity).

<sup>294</sup> Strine, *supra* note 196, at 783.

<sup>295</sup> Having said that, however, it must be acknowledged that default rules often prove sticky and thus difficult to opt out of. See Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CAL. L. REV. 1051,

### G. Doesn't the Business Judgment Rule Make All of This Moot?

Suppose Netflix signed a contract with a top Hollywood star to appear in a planned film. At the last minute, the star backed out, causing the project to collapse and costing Netflix an enormous amount of money. The star is in clear breach of contract. If Netflix sued, the case would be the proverbial slam dunk. Yet, Netflix's board opted not to authorize a lawsuit. This might very well be a smart business decision. After all, preserving good will with the star and the broader talent community easily could pay off in the future. Yet, if a Netflix shareholder sued to challenge that decision, the judge would not inquire into the board's motives.<sup>296</sup> Instead, the court would simply invoke the business judgment rule and dismiss the case long before trial.<sup>297</sup>

Or suppose that the board of directors of a cigarette manufacturer voluntarily adopted a complete ban on advertising its products. The board does so despite being fully aware that the company will sell fewer cigarettes as a result. Again, the business judgment rule doubtless would insulate the board's decision from judicial review, just as it insulated Henry Ford's decision to pay the \$5 per day wage and to build the Rouge River plant.<sup>298</sup>

Many scholars have argued that the business judgment rule thus makes *Dodge* irrelevant. Professor Stout, for example, contended that when board decisions are "challenged on the grounds that the directors failed to look after shareholder interests, courts shield directors from liability under the business judgment rule so long as any plausible connection can be made between the directors' decision and some possible future benefit, however intangible and unlikely, to shareholders."<sup>299</sup> Professor Jeffrey Lipshaw asserted that the business judgment rule, not shareholder value maximization, "is the prevailing rule of decision when the dispute arises from management's ordinary and routine mediation of various constituency interests."<sup>300</sup> Law professor David Millon likewise observed that, due to the business judgment rule, "courts will not second-guess decisions—including decisions that appear to benefit nonshareholders at the expense of

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1112 (2000) (observing that "contracting parties are likely to see default terms as part of the status quo and, consequently, prefer them to alternative terms, all other things equal").

<sup>296</sup> In a case involving a challenge to a board's alleged decision to put concern for the local community ahead of corporate profit, the court speculated about the board's possible motives, but concluded that deciding whether the board in fact acted from proper motives was beyond its "jurisdiction and ability." *Shlensky v. Wrigley*, 237 N.E.2d 776, 780 (Ill. App. 1st Dist. 1968).

<sup>297</sup> See *Smith v. Van Gorkom*, 488 A.2d 858, 873 (Del. 1985) (explaining that where the business judgment rule applies "considerations of motive are irrelevant"); see generally AMERICAN LAW INSTITUTE, PRINCIPLES OF CORP. GOVERNANCE § 2.01 illus. 1 (1994) (indicating that a board decision to perform on an unenforceable contract would be consistent with the board's duty to pursue shareholder value).

<sup>298</sup> See *id.* § 2.01 illus. 3 (offering a version of that hypothetical).

<sup>299</sup> Stout, *supra* note 12, at 170–71.

<sup>300</sup> Lipshaw, *supra* note 133, at 365.

shareholders—as long as management can assert some plausible connection with the corporation's long-run best interests.”<sup>301</sup> Harvard Law Professor Einer Elhauge similarly contended that, the business judgment rule makes plain that the duty of care cannot be enforced in a way that would bar managers from exercising discretion to sacrifice corporate profits in the public interest.”<sup>302</sup> Constant repetition of the argument by multiple academics, however, doesn’t make it true.<sup>303</sup>

In the first place, of course, the business judgment rule does not always insulate board decisions from judicial review in all cases. The business judgment rule did not preclude judicial review in *eBay*, *Oak Industries*, or *Revlon*. As we have seen, while *eBay* was a somewhat unique case, there are many recapitalization transactions governed by *Oak Industries* and even more mergers governed by *Revlon*, with annual values in the billions of dollars.

In the second place, the business judgment rule is neither a rule of decision, a standard of liability, nor a standard of review.<sup>304</sup> Instead, the business judgment rule is properly understood as an abstention doctrine.<sup>305</sup> A decision to abstain is not a decision

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<sup>301</sup> David Millon, *Two Models of Corporate Social Responsibility*, 46 WAKE FOREST L. REV. 523, 527 (2011).

<sup>302</sup> Elhauge, *supra* note 198, at 770.

<sup>303</sup> See Strine, *supra* note 196, at 782-83 (stating that “the problem” with the claim that “the business judgment rule is cloaking a system of law that is focused on giving directors the ability to act for any reason they deem appropriate” “is that it does not happen to be true”).

<sup>304</sup> See William T. Allen et al., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1297 (2000) (describing the business judgment rule as “an expression of a policy of non-review of a board of directors' decision when a judge has already performed the crucial task of determining that certain conditions exist”); Bernard S. Sharfman, *Being Informed Does Matter: Fine Tuning Gross Negligence Twenty Plus Years After Van Gorkom*, 62 BUS. LAW. 135, 145 (2006) (arguing that “the BJR is better described as a ‘standard of non-review’”).

<sup>305</sup> Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83 (2004). No less an authority than former Delaware Chief Justice Norman Veasey has confirmed that that articulation of the rule is “consistent” with Delaware law. See E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance From 1992–2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1421–28 (2005) ([“Professor Bainbridge’s] approach is consistent with the Delaware doctrine that the [business judgment] rule is a presumption that courts will not interfere with, or second-guess, decision making by directors.”). See also *Boland v. Boland*, 5 A.3d 106, 122 (Md. Spec. App. 2010) (holding that “the business judgment rule serves as one of abstention”), *rev’d on other grounds*, 31 A.3d 529 (Md. 2011); *Houle v. Low*, 556 N.E.2d 51, 59 (Mass. 1990) (“Massachusetts has always recognized the need for courts to abstain from interfering in business judgments.”); *Gut v. MacDonough*, 2007 WL 2410131, at \*12 (Mass. Super. Aug. 14, 2007) (“The business judgment rule allows courts to presume that the board of directors acted in the

on the merits of a case.<sup>306</sup> To the contrary, when a court abstains, it is expressly refusing to decide the case on the merits.<sup>307</sup> In other words, in abstention cases, there is an underlying rule of law that the court for prudential or other reasons has decided not to apply to the facts of the case before it.

When I teach the business judgment rule in class, I use a homely analogy to make the point. I show a PowerPoint slide with a picture of a Tootsie Pop. The reader will recall that the Pop is lollipop with a hard candy shell filled with a chocolate-flavored chewy candy. As long as the hard candy shell remains intact, it protects the center chewy candy from being eaten. Yet, even though the shell insulates the center, no one would deny that there really is a center.

Just so, even though an abstention doctrine (the hard candy shell) prevents the court (the eater) from invoking the underlying substantive doctrine (the chewy center), no one would dispute that there is still a substantive doctrine at the core of the case.<sup>308</sup> This is precisely what the business judgment does. In the typical business judgment rule case, the underlying doctrine is the duty of care.<sup>309</sup> The fact that the business judgment rule applies to such cases does not mean that there is no underlying duty of care.<sup>310</sup> Likewise, the fact that the business judgment rule typically precludes a court from deciding whether directors breached the shareholder wealth maximization norm does not mean that the norm is not the underlying doctrine. The *Dodge/eBay* rule thus remains the chewy center even when the hard candy shell of the business judgment rule protects it from judicial

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best interests of the corporation and, therefore, to largely abstain from evaluating the validity of the board's decisions.”).

<sup>306</sup> See, e.g., *Quackenbush v. Allstate Ins. Co.*, 517 U.S. 706, 713 (1996) (explaining that abstention-based stay orders raise “an important issue separate from the merits” of the case).

<sup>307</sup> See, e.g., *In re Jt. E. and S. Dist. Asbestos Litig.*, 78 F.3d 764, 775 (2d Cir. 1996) (discussing *Burford* abstention, under “which a federal district court may properly decline to decide difficult questions of state law”).

<sup>308</sup> *FSI Green Park S. Prop., LLC v. City of Pelham, Alabama*, 2019 WL 12094030, at \*2 (N.D. Ala. Jan. 28, 2019) (“When a federal court decides to invoke the Colorado River Abstention Doctrine, the court contemplates that it will have no further role in resolving the substantive issues in the controversy . . .”).

<sup>309</sup> This is so because the business judgment rule does not preclude judicial review of violations of the duty of loyalty. See, e.g., *Bayer v. Beran*, 49 N.Y.S.2d 2, 6 (N.Y. Sup. Ct. 1944) (“The ‘business judgment rule’ . . . yields to the rule of undivided loyalty.”).

<sup>310</sup> See *In re Fleming Packaging Corp.*, 351 B.R. 626, 634 (Bankr. C.D. Ill. 2006) (stating that “the rule serves to preclude judicial review of the substantive merits of the decision”); *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 33 (Del. Ch. 2010) (“When director decisions are reviewed under the business judgment rule, this Court will not question rational judgments about how promoting non-stock-holder interests—be it through making a charitable contribution, paying employees higher salaries and benefits, or more general norms like promoting a particular corporate culture—ultimately promote stockholder value.”).

review.<sup>311</sup> Hence, “just because shareholder primacy cannot be easily enforced through lawsuits does not alter the fact that it is the prevailing law of corporate governance in Delaware” and, one might add, elsewhere.<sup>312</sup>

#### H. But What About Constituency Statutes?

Thirty states have adopted constituency statutes (a.k.a. non-shareholder constituency statutes or stakeholder statutes). Although the details vary somewhat, Massachusetts’ statute is typical:

(a) A director shall discharge his duties as a director, including his duties as a member of a committee: . . . (3) in a manner the director reasonably believes to be in the best interests of the corporation. In determining what the director reasonably believes to be in the best interests of the corporation, a director may consider the interests of the corporation's employees, suppliers, creditors and customers, the economy of the state, the region and the nation, community and societal considerations, and the long-term and short-term interests of the corporation and its shareholders, including the possibility that these interests may be best served by the continued independence of the corporation.<sup>313</sup>

Although these statutes seem to contradict *Dodge*, it is easy to make too much of them.

First, understanding the statutes requires that they be contextualized. The statutes were almost uniformly adopted as part of a package of state anti-takeover laws passed in response to the wave of hostile takeovers in the 1980s and early 1990s,<sup>314</sup> not in response to some burgeoning demand for corporate social responsibility or ESG. Their intended beneficiaries were not corporate stakeholders but rather corporate managers faced with a hostile takeover bid likely to result in significant job losses at the management level.<sup>315</sup>

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<sup>311</sup> I have argued at length elsewhere that the fact that the business judgment rule sometimes will preclude judicial review of decisions in which directors departed from shareholder value maximization is not the intended purpose of the rule but rather an unintended consequence of the board centric nature of corporate law. Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U.L. REV. 547, 600-05 (2003)

<sup>312</sup> Yosifon, *supra* note 251, at 223.

<sup>313</sup> MASS. GEN. LAWS ch. 156D, § 8.30(a).

<sup>314</sup> See Nathan E. Standley, *Lessons Learned from the Capitulation of the Constituency Statute*, 4 ELON L. REV. 209, 212 (2012) (explaining that “corporate constituency statutes were rushed through state legislatures as part of antitakeover legislation packages”).

<sup>315</sup> See Michael E. DeBow & Dwight R. Lee, *Shareholders, Nonshareholders and Corporate Law: Communitarianism and Resource Allocation*, 18 DEL. J. CORP. L. 393, 400 (1993) (arguing that the “statutes’ primary beneficiaries appear to have been incumbent managers”); Ryan J. York, *Visages of Janus: The Heavy Burden of Other Constituency Anti-Takeover Statutes on*

The principal legislative goal was to prevent courts of the adopting states from following *Revlon* and thereby allow directors justify takeover defenses by invoking purported concerns about the effect of a takeover on non-shareholder constituencies.<sup>316</sup>

Second, notice that the Massachusetts statute is permissive not mandatory. This is universally the case; none of the statutes mandate that directors consider any interests other than shareholders.<sup>317</sup> At one point, Connecticut was a lonely outlier, mandating that directors consider such interests, but it has since amended its statute to make such consideration optional on the part of the board.<sup>318</sup> Because the statutes are permissive, they create no duties on the part of directors that are enforceable by stakeholders. Several courts have interpreted the Ohio constituency statute, for example, as making “consideration of creditors’ interests permissive” and, accordingly, as imposing no fiduciary duty on directors to consider creditor interests when making decisions.<sup>319</sup> As such, the statutes fall considerably short of the stakeholder theorists’ ideal.<sup>320</sup>

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*Shareholders and the Efficient Market for Corporate Control*, 38 WILLAMETTE L. REV. 187, 207 (2002) (“Instead of protecting nonshareholder constituencies, these statutes act as a subterfuge for management, allowing them to extract gains rightfully belonging to the corporation’s shareholders.”).

<sup>316</sup> See Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971, 1015 (1992) (explaining that “the nonshareholder constituency statutes reject the *Revlon* gloss” on director fiduciary duties in takeover settings); see, e.g., *Shoen v. AMERCO*, 885 F. Supp. 1332, 1341 n.22 (D. Nev. 1994) (“The text of [the Nevada constituency statute] makes clear that the statute is an anti-takeover provision, designed to give directors greater discretion to resist hostile tender offers by allowing them to consider factors other than the shareholders’ immediate financial gain.”); *Dixon v. Ladish Co., Inc.*, 785 F. Supp. 2d 746, 752 (E.D. Wis. 2011) (arguing that the Wisconsin constituency statute precludes *Revlon* from being part of Wisconsin law), *aff’d sub nom. Dixon v. ATI Ladish LLC*, 667 F.3d 891 (7th Cir. 2012); *Crandon Capital Partners v. Shelk*, 181 P.3d 773, 783 n.10 (Or. App. 2008) (“Other states have rejected the heightened scrutiny standard of *Unocal* by [adopting a constituency] statute.”).

<sup>317</sup> See Lee-Ford Tritt & Ryan Scott Teschner, *Re-Imagining the Business Trust as a Sustainable Business Form*, 97 WASH. U. L. REV. 1, 55 n.107 (2019) (noting “the permissive language in all state constituency statutes”); see, e.g., *Hill v. State Farm Mut. Automobile Ins. Co.*, 83 Cal. Rptr. 3d 651, 686 (Cal. App. 2d Dist. 2008) (explaining that the Illinois statute “permits, but does not require, a director to consider the interests of the listed constituencies”).

<sup>318</sup> Tritt & Teschner, *supra* note 317, at 55 n.107.

<sup>319</sup> In re I.E. Liquidation, Inc., 06-62179, 2009 WL 2707223, at \*4 (Bankr. N.D. Ohio Aug. 25, 2009). See also In re Amcast Indus. Corp., 365 B.R. 91 (Bankr. S.D. Ohio 2007); *Custom Associates, L.P. v. VSM Logistics, LLC*, 154 N.E.3d 178, 182 (Ohio App. 11th Dist. 2020).

<sup>320</sup> Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579, 631 (1992) (“Curiously, the centerpiece of constituent recognition, the constituency statute, stops short of fulfilling its ultimate goal.”).



Third, while constituency statutes allow directors to consider interests of non-shareholder constituencies, the statutes do not expressly authorize directors to harm shareholder interests in order to benefit stakeholders.<sup>321</sup> A North Carolina court discussing the context in which the constituency statutes arose explained that:

Illinois, for example, adopted a statute that specifically authorized directors to consider the interests of corporate constituents other than shareholders when responding to a hostile takeover. In doing so, Illinois statutorily adjusted the balance of power between shareholders and other corporate constituents by giving additional power to directors that *Revlon* had arguably taken away. It did so not to advance the power of directors, but to permit directors to assert the interests of other corporate constituents in the heat of the takeover battle. It did not eliminate shareholder rights; it arguably put a little more tension in the elasticity on the side of the directors so that they could consider “corporate value” as including values important to society.<sup>322</sup>

Accordingly, the constituency statutes could plausibly be interpreted as preserving a requirement that director actions taken after considering stakeholder interests must still be rationally related to shareholder interests.<sup>323</sup> Put another way, the most pro-stakeholder capitalism spin one can put on the statutes is that they “are mere tie-breakers, allowing managers to take the interests of non-shareholder constituencies into account when doing so does not harm shareholders in any demonstrable way.”<sup>324</sup>

Fourth, cases in which the statutes have been invoked are extremely rare. Cases in which the statutes have been dispositive of the result are essentially non-existent. As of 2020, courts in only 15 states had even cited one of these statutes.<sup>325</sup> The total number of decisions in which the statutes have been cited barely exceeds thirty, which is surprising given that some of these statutes have been on the books since as long ago as 1984 and all but two were in force by 2000.<sup>326</sup> Most of the claims were brought by creditors rather than the other classes of stakeholders—such as employees and communities—with which

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<sup>321</sup> See Committee on Corporate Laws, *Other Constituencies Statutes: Potential for Confusion*, 45 BUS. LAW. 2253, 2265 (1990) (“Statutes designed like Illinois’ do not expressly give directors the power and right to prefer the interests of other constituencies to the detriment of shareholders.”).

<sup>322</sup> *First Union Corp. v. SunTrust Banks, Inc.*, 2001 WL 1885686, at \*5 (N.C. Super. Aug. 10, 2001).

<sup>323</sup> See Committee on Corporate Laws, *supra* note 321, at 2266.

<sup>324</sup> Macey, *supra* note 134, at 179.

<sup>325</sup> See Jitendra Aswani et. al, *The Cost (and Unbenefit) of Conscious Capitalism* 36 (table 1) (September 16, 2021).

<sup>326</sup> See Jitendra Aswani et. al, *The Cost (and Unbenefit) of Conscious Capitalism* 36 (table 1) (September 16, 2021).

corporate social responsibility advocates are mainly concerned.<sup>327</sup> Courts have generally seemed reluctant in these cases “to deviate from the longstanding principle of shareholder primacy.”<sup>328</sup> All of which tends to confirm that the statutes have had little impact on the development of the law. Accordingly, it seems fair to conclude that “constituency statutes currently function only to the extent that they do not conflict with shareholder primacy.”<sup>329</sup>

In any case, a number of important states declined to adopt a constituency statute. *Dodge*’s home state—Michigan—has not adopted a constituency statute but rather, as we have seen, continues to endorse *Dodge*. The drafters of the Model Business Corporation Act declined to include a constituency provision in their statute.<sup>330</sup> Most importantly, Delaware has no such statute. As David Yosifon notes, the Delaware legislature’s failure to adopt a constituency statute plausibly can be “read to express legislative acquiescence in shareholder primacy,” since the legislature and Delaware bar are alert to important developments and has been willing to reverse judicial decisions of which it disapproves.<sup>331</sup>

It is thus difficult to disagree with Professor Julian Velasco’s conclusion that the constituency statutes have proven “ultimately insignificant as a practical matter”:<sup>332</sup>

Cases involving constituency statutes have been few and far between, and they rarely, if ever, hinge upon such provisions. More importantly, there is no evidence that constituency statutes have had any effect on director behavior. In light of the foregoing, it would be specious to argue that constituency statutes have effected a fundamental change in corporate law.<sup>333</sup>

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<sup>327</sup> Data on file with author.

<sup>328</sup> Standley, *supra* note 314, at 223.

<sup>329</sup> Anthony Bisconti, *The Double Bottom Line: Can Constituency Statutes Protect Socially Responsible Corporations Stuck in Revlon Land?*, 42 LOY. L.A. L. REV. 765, 784 (2009).

<sup>330</sup> See Committee on Corporate Laws, *supra* note 321, at 2253. Despite the absence of a constituency provision in the Model Business Corporation Act, “a supermajority of” “states that have adopted the” Model Act have “enacted a constituency statute.” Leo E. Strine, Jr., *The Soviet Constitution Problem in Comparative Corporate Law: Testing the Proposition That European Corporate Law Is More Stockholder Focused Than U.S. Corporate Law*, 89 S. CAL. L. REV. 1239, 1307 (2016).

<sup>331</sup> YOSIFON, *supra* note 200, at 71.

<sup>332</sup> See Julian Velasco, *Shareholder Ownership and Primacy*, 2010 U. ILL. L. REV. 897, 945.

<sup>333</sup> Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U. CAL. DAVIS L. REV. 407, 464 (2006).

## CONCLUSION

Lynn Stout wanted us to believe that *Dodge* tells a “charming and easily understood fable of shareholder wealth maximization.”<sup>334</sup> In fact, however, it is her interpretation of the law that is a fable.<sup>335</sup> Law professors thus should have no qualms about continuing to teach *Dodge*. It remains what it has been for the last century; namely, a clear statement of the mainstream of American corporate law.

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<sup>334</sup> Stout, *supra* note 12, at 176.

<sup>335</sup> As Professor Marc Greendorfer correctly notes, “the position that board actions that ignore shareholder wealth maximization in favor of the promotion of third-party stakeholder interests are a proper corporate goal is a fringe, aspirational position, rather than a reflection of what the law and weight of scholarship articulate.” Greendorfer, *supra* note 17, at 342.