LONG-TERM CONTINUING RELATIONS: THE AMERICAN EXPERIENCE REGULATING DEALERSHIPS AND FRANCHISES

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I. Introduction

Problems of distribution must be analyzed in the context of long-term continuing relations. Far too often legal writers, lawyers and judges talk about franchises and dealerships as if they involved discrete transactions. Most American scholars are aware of relational ideas about contracts, but, with a few notable exceptions, they reject these ideas by partial incorporation. These neoclassical contract theorists deal with long-term continuing relations in several unsatisfactory ways: they create exceptions and use wild cards such as waiver and the reliance doctrine or they damn judicial and legislative attempts to cope with modern economic transactions. Nonetheless, the tension between neoclassical and relational ideas will not go away. Messy reality keeps intruding on elegant theories.

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This essay will survey some of the American literature and doctrine concerning distributional problems. We will also describe an ongoing struggle from the early 1930s to the present day between large business organizations and those who hold their franchises and dealerships. First, we will review the literature concerning relational ideas in contract theory, empirical work about modern contract relationships, and judicial doctrine. Second, we will consider American efforts to change the balance of power in dealership relations. Here we will look at the elaborate federal and state regulation of dealer-manufacturer interaction. Then we will present an account of the struggle between franchisors and franchisees before courts, legislatures and administrative agencies on both the federal and state level. Finally, we will offer some conclusions. Here we will bring together the theoretical literature and the franchise story.

II. A Review of the Theoretical and Empirical Literature

Little of the significant theoretical literature has focused on franchises and dealerships. Nonetheless, we will find no difficulty in applying ideas about private government and long-term continuing relations to distribution arrangements. We begin with private government and then turn to relational theories about contract.

1. A Private Government Perspective and Relational Contract

Over the past thirty years, legal scholars have written much about relational theories and perspectives. American ideology, culture and law focuses on individuals. Often we talk and write as if we believed people act alone or interact with others apart from the context of social relations. When, however, we add long-term relationships, social fields and private governments, our theories and laws become more complex but more accurate. In this section, we will consider aspects of an empirical picture of human action and then turn to the implications for law and legal systems.

We begin with a simple but often overlooked empirical observation: human transactions range from the discrete to the highly relational, and interaction toward one end of the range will differ from that at the other end. For example, suppose a motorist on a long trip drives into a service station located near a major highway and far from a city. The attendant points out that the motorist's tires are dangerously defective, and the motorist recognizes that he can continue safely only by buying new tires. The station attendant understands that the motorist is far from home and unlikely to return to the station. The motorist knows

that he will not patronize the station again. The sale of new tires is a discrete transaction[1].

Suppose, however, another motorist discovers that she needs new tires and she drives to a service station near her home that she regularly patronizes. The dealer values his regular customers, and the motorist recognizes that she may want to claim favors in the future, such as the dealer's help in starting a stalled automobile on a cold morning. The sale of tires is but one of many actual and potential transactions which form a larger relationship.

We can suspect that these two transactions will differ. Of course, the owner and attendants at the freeway service station might believe that they should treat travelers in distress with great compassion. Their consciences and guilt might sanction exploiting the situation. They might assume that a few well-treated travelers would find ways to reward them. Nonetheless, our motorist is vulnerable because he has very limited power to exit without buying tires from this service station. Moreover, the station attendant does not expect that the traveler will ever return, and so the traveler's potential future business provides little incentive affecting this sale of tires. In a more typical case, we expect competition to regulate the transaction. If there were other service stations and tire stores near the one our traveler visited, and if the traveler knew of them and could get to them, market incentives should affect the tire purchase transaction.

The other motorist shopping for tires at her local station faces a different situation. The tire transaction is but part of a stream of transactions extending from the past to the present and possibly into the future. A major sanction is the threat of exit. The motorist always could take her business elsewhere. However, she is unlikely to do this without provocation. She would have to search for another service station as good as her present one. Moreover, she would then have to establish a similar relationship at her new station. If she were to violate the norms of the present relationship, the service station might cease treating her as a special regular customer entitled to advice and favors. Even if market forces would push the service station to continue special treatment despite her violation of the norms of the relationship, she might not feel entitled to ask for treatment above and beyond the call of duty.

Ian Macneil has produced an impressive body of work about relational theory[2]. He notes that bargains almost always take place in a rich context that colors the

1 Even this example may include relational elements. The driver could hold a credit card, and the credit card company may exert influence on the practices of businesses that accept the card. The service station could be a franchised dealership of a major oil company, and the franchisor could exert some influence on the practices of its dealers. Pure discrete transactions in modern society are hard to imagine.

2 See, e.g., I. R. Macneil, The New Social Contract (New Haven: 1980); Macneil, Relational Contract: What We Do and Do Not Know, 1985 Wisconsin Law Review 483; Macneil, Values in Contract: Internal and External, 78 Northwestern University Law Review 340 (1983); Macneil, Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neo-Classical, and Relational Contract

parties' expectations. He points out that relationships are based on trust and the assumption of mutual advantage over the long-term. Culture and experience in relationships develop expectations which may crystallize into norms.

Relationships involve overarching obligations of good faith, solidarity, role integrity, and mutuality. Solidarity demands that the parties preserve the unique and continuing relationship within which transactions take place. They must maintain some measure of role integrity: highly complex roles govern a transaction, and we assume that others will stay in role. A partner cannot suddenly become a self-interested hard bargainer. There also must be mutuality: the parties must divide the exchange surplus properly so that each gains appropriate but not necessarily equal returns[3].

Recognizing that much human interaction takes place in a rich and complex relational context affects theories about law and functioning legal systems. For example, writing about legal regulation often assumes that only two entities are involved: the state confronts an individual with a command. The individual then complies because of his conscience, his fear of sanctions or both. However, the state is composed of people working in organizations who are subject to political influence if not control. Furthermore, the targets of regulation usually are not isolated individuals but rather people involved in multiple and overlapping groups. Moore drew our attention to what she called "semi-autonomous social fields"[4]. Any group of people who regularly interact tend to adopt rules, interpret them in light of specific situations, and sanction their violation. If the group has some permanence, and if the actors within it value participation, we have a semi-autonomous social field.

Social fields can blunt enforcement of laws and transform their practical meaning. Moore notes "new laws are thrust upon going social arrangements in which there are complexes of binding obligations already in existence. Legislation is often passed with the intention of altering the going social arrangements in specified ways. The social arrangements are often effectively stronger than the new laws"[5].

Law, 72 Northwestern University Law Review 854 (1978); Macneil, The Many Futures of Contracts, 47 Southern California Law Review 691 (1974).

3 Kaufmann and Stern, Relational Exchange Norms, Perceptions of Unfairness, and Retained Hostility in Commercial Litigation, 32 Journal of Conflict Resolution 534 (1988), empirically tested part of Macneil's theory. They studied parties to contract litigation in The United States District Court for the Northern District of Illinois. They found support for Macneil's norms of solidarity and role integrity. They say "[t]entatively, findings indicate the character of an exchange relationship prior to a major dispute erupting between exchange partners, can be linked to the feelings they retain after their dispute has been terminated. Adherence to the norms of the relationship may dampen retained hostility; betrayal of those norms may heighten it. The existence of a relational (as opposed to a discrete) exchange may, in the absence of a sense of willful betrayal, lead to more tolerance of conflict behavior attributed to circumstances beyond the parties' control". Id. at 549.

4 S. F. Moore, Law as Process: An Anthropological Approach (London: 1978).

5 Moore, ibid. at 78.

Macaulay began with Moore's idea and developed what he called a "private government perspective"[6]. We can observe many more or less continuing relationships in society which fashion rules, allocate resources, and sanction deviance[7]. We can arrange these relationships in terms of structure and formality of processes. There are customary rules and sanctions that govern actions in places: there is a private law (which we often call custom or social norms) regulating behavior in an elevator or in an airport. Family relationships, friendships, and business relationships also rest on predictable norms and private sanctions. Residential relationships often rest on a more structured private government. Private organizations increasingly take over what most of us think of as public functions. Apartment dwellers', condominium owners', and neighborhood residents' associations may publish formal rules and provide for mediation or arbitration of disputes. Some neighborhood associations, many shopping centers, and many large business corporations run their own private police forces and dispute resolution arrangements[8]. Private governments may organize activity which public government declares illegal. Industry cartels are illegal in the United States, but, nonetheless, they exist. They regulate, or suppress, patterns of competition. Apparently, the illegal drug industry is organized, patterned, and operates as a very strong private government. There are few breaches of contract in this industry.

Macaulay advocates a private government perspective. On one hand, thought about law must deal with functioning legal systems, and these systems exist in a world of legal pluralism. Public government is both aided and hindered by social fields and private legal structures. On the other hand, Macaulay stresses that distinctions between public and private break down when we examine functioning legal systems. Public governmental officials may have to strike bargains with private governments in order to provide some measure of effective regulation. Regulators and the targets of regulation may share a culture and speak the same language. Those who work for governmental regulatory agencies may plan for a future where they will work for those they now regulate. Moreover, the process of law making involves complex interactions between judges and legislators and representatives of private interests.

Relational theories and stories of legal pluralism may paint a picture of neat self-regulating social systems and harmony. Often these social fields and private governments do operate to satisfy most of those affected by them. Those who are disaffected leave and find satisfying roles in other groups. However, relation-

6 Macaulay, Private Government, in: L. Lipson & S. Wheeler (eds.), Law and Social Science, 445-518 (New York: 1986).

7 See, e.g., Asbury, Social Control in a Local Community: The Role of the Apartment Superintendent, 25 Journal of Research in Crime and Delinquency 411 (1988); Leblebici/ Salancik, Stability in Interorganizational Exchanges: Rulemaking Processes of the Chicago Board of Trade, 27 Administrative Science Quarterly 227 (1982).

8 Private police often adopt the symbols — uniforms, badges, and equipment — of public police, and private arbitration systems increasingly look more and more as do public courts.

ships break down, and some of those involved suffer serious injury. Exit, or being forced out, may impose high costs. Often those aggrieved seek help from the courts, asserting contract or related theories to justify redress.

Macneil argues that classic and neoclassic contract law largely assume a world of discrete transactions. As a result, our legal tradition responds poorly to disruptions of long-term continuing relationships. For example, traditional contract law focuses on a magic moment of formation. Until a contract is formed, a party is free to back out without regard to the other's expectations and reliance. There is no duty of good faith in negotiations. Negotiating a contract involves bringing the future to the present. Risks then are allocated and the entire transaction is planned once and for all. As a result, disputes during the life of a transaction are to be resolved by returning to the planning at the outset, largely ignoring all that has taken place thereafter. Moreover, the terms "contract" and "agreement" can slip subtly from referring to the reasonable expectations of the parties to only the formal text of the document that they signed. Neoclassical contract law accepts this general picture but imposes exceptions designed to bring contract law closer to modern business practices. Unfortunately, it is not clear when the general body of law applies and when the exceptions come into play.

Macneil stresses that relational transactions usually do not involve a magic moment at which all the planning is final. "[R]elations are characterized by extensive post-commencement planning, the fundamental source of which is the ongoing operation of the relations themselves"[9]. The parties often write extremely general and vague contract provisions and continue their planning and adjustments throughout the life of the transaction. Even when the parties to a relational contract sign a precise lawyer-drafted document, they may assume that it is just a formality or that its provisions are subject to many tacit understandings and will be modified as circumstances change. As Gordon says, in relational contracts:

> "parties treat their contracts more like marriages than like one-night stands. Obligations grow out of the commitment that they have made to one another, and the conventions that the trading community establishes for such commitments; they are not frozen at the initial moment of commitment, but change as circumstances change; the object of contracting is not primarily to allocate risks, but to signify a commitment to cooperate. In bad times parties are expected to lend one another mutual support, rather than standing on their rights; each will treat the others insistence on literal performance as willful obstructionism; if unexpected contingencies occur resulting in severe losses, the parties are to search for equitable ways of dividing the losses; and the sanction for egregiously bad behavior, is always, of course, refusal to deal again"[10].

9 Macneil, The Many Futures of Contracts, 47 Southern California Law Review 691, 774 (1974).

10 Gordon, Macaulay, Macneil, and the Discovery of Solidarity and Power in Contract Law, 1985 Wisconsin Law Review 565, 569.

What does all this mean for the law of contracts? Neoclassical contract law may serve discrete transactions reasonably well[11], but writing about relational transactions falls short of creating a body of law better suited for their governance. For example, Whitford tells us,

> "Macneil believes the legal system needs to take radically different approaches to relational contracts than it traditionally has. In dealing with disputes, he favors greater reliance on procedures oriented toward mediation and less emphasis on adversary processes looking toward adjudication. In regulating contracts, he counsels greater reliance on proactive administrative agencies that can take account of the many third-party interests at stake and less reliance on courts able to apply regulatory rules only when a disadvantaged party initiates a court procedure"[12].

Macneil points to the norms implicit in transactions and says that courts could use them to develop a modern contract law[13]. In some relationships there are elements of coercion and dependence; in others, trust, cooperation, reciprocity and role integrity are essential. But Macneil counsels that the legal system should proceed cautiously. While lawmakers could recognize relational norms, they also must consider the consequences of imposing legal duties on parties. This is not a neutral act. People may resent being coerced to do what they recognize they ought to do. The more powerful may seek to offset or evade the legal norm in order to preserve more control over the relationship. This behavior itself may undermine trust and reciprocity![14]

My colleague William Whitford has offered several propositions about relational contracts which could be, but have not been, tested empirically[15]. They bring together Macneil's perspectives with Whitford's insights about how these perspectives might affect legal action. Three of these propositions suggest difficulties in fashioning contract law based on relational theories. Whitford says:

11 Campbell criticizes Macneil for not going far enough in rejecting neoclassical views: "What emerges from this radically relational view is, or should be, the theoretical rejection of the basic *explanatory* adequacy of the neoclassical economic model articulated in the classical law. When contracting is viewed as being constituted of the relations which facilitate it, the assumption of the independent, utility maximising individual must be replaced by that of a cooperative relation. However, Macneil does not press his argument this far". Campbell, The Social Theory of Relational Contract: Macneil as the Modern Proudhon, 18 International Journal of the Sociology of Law 75, 81 (1990). He continues, "Macneil actually manages to find a central place for discrete exchange in the social theory of relational contract . . . By virtue of his liberal leanings, Macneil substantially undercuts his attack on neoclassicalism and limits its impact". Ibid. at 83.

12 Whitford, Ian Macneil's Contribution to Contracts Scholarship, 1985 Wisconsin Law Review 545, 551.

13 See Feinman, The Significance of Contract Theory, 58 University of Cincinnati Law Review 1283, 1299-1304 (1990).

14 For a discussion of an exchange relationship model of contract cognate with Macneil's relational theories, see Lightsy, A Critique of the Promissory Model of Contract, 26 William & Mary Law Review 45 (1984).

15 Whitford, Unpublished Memorandum.

— As contracts become more relational, the parties will comply less frequently with formalities (including the parol evidence rule). Hence, a strict enforcement strategy with respect to formalities is more likely to raise issues about protection of reasonable reliance with respect to relational than discrete contracts.

— As contracts become more relational, it becomes more difficult for courts to apply sensibly doctrine that requires courts to make qualitative judgments about a course of conduct. Courts lack the capacity to understand complex relations between all the affected parties.

— As contracts become more relational, there is an increasing tendency of the parties to value nonmaterial aspects of the relation (continuation of the relation, maintenance of harmony and respect, etc.). Courts have no effective way to protect these expectations, and hence they tend to over commodify the relation — that is, they try to compensate in money for that which is really not commensurable this way.

Scott also urges caution. He uses the techniques of decision analysis and game theory to clarify the relationship between the risk distribution and adjustment functions of long-term contracts. He suggests that legal rules could function to ameliorate tensions in efforts to reallocate risks[16]. He accepts much of the picture of relational norms and sanctions that we have drawn up to here, explaining cooperative behavior in terms of decision analysis. He points out that legal enforcement of contracts becomes important "whenever the shadow of the future proved insufficient to prevent evasive behavior"![17]

Scott argues that categorical binary contract rules may complement the more flexible extralegal mechanisms that regulate adjustment of ongoing relationships. Legally imposed adjustments may create perverse incentives that undermine the stability of the cooperate equilibrium of contracting parties[18]. When the stakes are large, the chance that a court may rework the distribution of risk in a contract may be enough to offset possible future rewards for cooperative behavior. Even the threat of going to court to seek relief may affect how the parties readjust matters. Scott concedes that we do not know how judicial activity will affect decisions about cooperation and readjustment. He concludes:

> [T]he relational context is a complex environment of many regulatory systems, including individualized and patterned responses, legal and social norms, and ex ante and ex post bargains. The challenge for contract law is to construct a legal apparatus that complements these forces. As a first step, we must abandon the assumptions of legal centrism and acknowledge our incomplete understanding of contractual relationships and of the linkages between legal rules and social norms[19].

16 Scott, Conflict and Cooperation in Long-Term Contracts, 75 California Law Review 2005 (1987). John Kidwell makes a point similar to Scott's; Kidwell asks whether neoclassical contract law may best support relational exchanges. See Kidwell, A Caveat, 1985 Wisconsin Law Review 615.

17 Scott, ibid. at 2044.

18 Ibid. at 2051.

Even when long-term relationships are functioning, they may reflect marked inequality of power[20]. While the less powerful could exit, often they would prefer to continue the relationship with a change in its power configuration. Their interest groups can bring test cases, seeking rules which will affect functioning relationships, and they can lobby for statutes granting their members rights. American state and federal statute books are filled with provisions reflecting this process. As we shall see, many of these statutes deal with franchise and distribution relationships.

However, the powerful seldom are silent when the weaker appeal to the legal system for modifications of the balance of power. Sometimes the powerful can block passage of a reform statute. When the powerful cannot defeat such proposals, they will work to modify the terms of the legislation so that the new rights burden them as little as possible. At times, the powerful can so influence the definition of rights and remedies that a statute is largely symbolic. If a reform statute has real teeth, the powerful challenge its constitutionality or seek to have courts construe it as narrowly as possible.

The beneficiaries of reform, in most instances, do not assert their new rights directly. Usually we find them bargaining in the shadow of the law and using their rights as bargaining entitlements. For example, Moore[21] points out that actors within social fields often attempt to use law as a resource with which to control their environment. Legal regulation designed to bring about what a legislator thought desirable may be traded for something the beneficiaries want more. Moore's example involves workers, most of them women, in the better dress industry in New York City. The law and union collective bargaining agreements purport to regulate their hours and working conditions. However, demand in this industry is seasonal. Sometimes there is much work which must be done by a deadline; sometimes there is relatively little to do. When work must be done on time, employees do the job and work overtime and skip breaks. This means their employer has violated laws and union contract provisions about the hours and conditions of work. However, now the employer owes the employees something. For example, an employee's friend will register the worker present at work — punching in on a time clock — when there is little to do. Actually she has taken the day off. The employer knows this but accepts it as part of the system.

19 Ibid. at 2053-4.

20 Joerges criticizes Macneil for neglecting this aspect of relational transactions. See Joerges, Relational Contract Theory in a Comparative Perspective: Tensions Between Contract and Antitrust Principles in the Assessment of Contract Relations Between Automobile Manufacturers and Their Dealers in Germany, 1985 Wisconsin Law Review 581.

21 Moore, op. cit. (supra note 5).

Gottlieb responds to legal pluralism and this common use of claims in bargaining by advocating a relational perspective based on patterns established in international affairs[22]. He views what he calls "the formal system", "the mediating systems", and "the regime of relational orders" as sources of juridical obligations. A mediating system consists of the techniques used to reconcile the informal system with the requirements of the formal system of rules and institutions. A regime is composed of the rules, procedures, precedents, and practices of particular relationships. It is a combination of the formal, informal and mediating systems.

Gottlieb observes that relationalism does not outline an ideal form of legal relations but rather a necessary one. Relational approaches force us to confront difficult problems, particularly insofar as we recognize legal pluralism: Conflicts may occur between the juridical systems of different relational orders and the State. The rights and interests of third parties may be adversely affected by a course of dealing between parties to an ongoing relationship. Moreover, the conduct of the parties may cease to bear any relevance to the underlying juridical order. The resolution of these conflicts poses serious problems which are difficult to solve without high costs. Nonetheless, Gottlieb concludes, any legal theory that emphasizes courts and legally enforceable remedies, and which focuses mainly on individuals, the State, regulation, and discrete transactions in markets, is based on a woefully inadequate model of modern societies.

2. *Empirical Work on Long-Term Continuing Relations: The Wisconsin Research Program*

Macaulay[23] wrote about business practices related to the problems dealt with by contract law in 1963. He found that business contracting typically does not involve complete planning for performance and nonperformance. As Rogowski notes, Macaulay's explanations were largely cultural[24]. Relational norms and sanctions define obligations with needed flexibility as well as offering adequate incentives to perform or negotiate acceptable settlements. Many business people see the costs of planning for trouble as unnecessary. They dislike formal contracts and litigation. Business people also desire flexibility to deal with the future. Lawyers often draft a contract tailored for a transaction or written as standardized planning. Business people, however, often ignore these documents and

22 Gottlieb, Relationism: Legal Theory for a Relational Society, 50 University of Chicago Law Review 567 (1983).

23 Macaulay, Non-Contractual Relations and Business: A Preliminary Study, 28 American Sociological Review 55-69 (1963).

24 Rogowski, West German Business Litigation: Some Preliminary Observations and Research Proposals, paper delivered at the 1989 Annual Meeting of the Law and Society Association, June, 1989.

as a transaction progresses it creates expectations. Any particular transaction may be but part of a larger relationship. As a result, there is often a tension between the real and the paper deal.

Moreover, usually the legal system involves high costs, considering what it offers. Contract law's remedies as delivered through the functioning American legal system offer little to all but a small subset of litigants. Contract law in action is a defective product, promising far more than it can deliver.

In 1985, Macaulay reviewed his earlier article from the perspective of twenty years of experience[25]. He observed that both journalism and appellate reports show that in the 1970s and 1980s there have been many more major contracts cases than his 1963 article suggested that we should expect. He thought that the culture of cooperation he found twenty years early had been strained by major economic changes. Relational sanctions still played a significant role, but economic change had exposed their limits. Nonetheless, these demands on applied contract law have shown its strengths and weaknesses, much as described in the 1963 article. For example, Pennzoil sued Texaco for interfering with the performance of a contract under which Pennzoil was to buy control of Getty Oil[26]. The parties disputed whether Getty and Pennzoil had gone far enough to create a contract before Texaco offered a higher bid for Getty. After full-scale legal warfare, Pennzoil won a multimillion dollar verdict, defended it on appeal, and collected a judgment. Newspapers, television, and the business press endlessly discussed the case. Most of the comment in the business press and the law reviews was highly critical. Scholars concluded that Pennzoil had won a questionable remedy in light of its actual damages at an extraordinarily high cost to the two companies and to third parties affected by the litigation.[27]

The highly publicized Westinghouse cases were more typical of modern contract litigation. Westinghouse promised to supply uranium oxide at a fixed price so it could sell nuclear power plants to electric utilities. Producers of uranium formed a cartel, and, as a result, the world market price soared. Westinghouse unexpectedly faced extremely burdensome obligations: performing the contracts could have destroyed Westinghouse. It announced that it would not honor its many uranium oxide contracts, asserting that it was excused by the doctrine of commercial impracticability. Westinghouse's customers sued. Ultimately, the entire litigation proved to be an expensive exercise in coercive mediation, orchestrated by a federal trial judge, leading to a multiparty settlement. The judge used the threat of an adverse judgment as an incentive for settlement. Contract litigation

25 Macaulay, An Empirical View of Contract, 1985 Wisconsin Law Review 465-482.

26 See *Texaco, Inc.* v. *Pennzoil, Co.*, 729 S.W.2d 768 (Texas Ct.Ap. 1987).

27 See Epstein, The Pirates of Pennzoil: A Comic Opera Made Possible by a Grant from the Texaco Corporation, 32 The [University of Chicago] Law School Record 3 (Fall 1986); Weintraub, The Ten Billion Dollar Jury's Standards for Determining Intention to Contract: *Pennzoil v. Texaco*, 9 Review of Litigation 371 (1990).

here served as an alternative to bankruptcy. However, contract doctrine played a marginal role in this drama. The litigation provided a theater where the drama could be played out.

In 1989, Professors Galanter, Macaulay, Palay and Rogers of the University of Wisconsin Law School began the Wisconsin Business Disputes Group Project[28]. The project was prompted by several observations: there has been a sharp increase in all business disputing over the past two decades[29]. Firms in cooperative relations have contracts (or contract-related) disputes with each other. The number of such cases filed in the federal courts has increased; uses of alternative dispute resolution also has risen rapidly. Firms in competitive relations increasingly sue for patent, copyright and trademark violations as well as various unfair business practices.

Corporate legal practice also has changed substantially over the same period. Large corporations spend more money on legal services, and many have brought legal functions inside their businesses. The size of law firms serving corporate clients also has increased rapidly. Law firms have become national and international organizations with many branch offices. Litigation has become a greater part of large elite corporate law firm practice.

There are several possible explanations for these changes. Macaulay's 1963 article could have been wrong or misleading as to the use of the contract legal system by business. It was essentially an attitude study and established no hard empirical baseline. It does not tell us, for example, even roughly what proportion of disputes were litigated. There are more transactions today than in 1963, and it is possible that the ratios of disputes to transactions and disputes to litigation are exactly the same today as then. Alternatively, there may have been a major change in the rate of disputes and litigation caused by drastic changes in national and world economic conditions. We do not have data that allows us to choose between these explanations. We do have some suggestive correlations.

What the Business Disputes Group sees as the sharp post-1970 increase in business use of law coincides with a period of fundamental change in the environment and strategy of American business firms. Prominent environmental changes include[30]: the rapid internationalization of American product and capital markets; declining rates of growth, profitability, and productivity; a qualitative increase in the importance of the financial sector in the economy and the greater availability of debt in corporate financing; changes in the style and extent of

28 This is a large long-term research project which has been underway for a little over two years; all statements here reflect planning and initial work rather than firm conclusions. See Galanter, Macaulay, Palay and Rogers, The Transformation of American Business Disputing: A Sketch of the Wisconsin Project, Institute for Legal Studies Dispute Processing Research Program Working Paper DPRP 10-6 (March 1991).

29 This supports Macaulay's 1985 observations which were based on appellate opinions.

30 This section relies heavily on material written by my colleague on the Business Disputes Project, Professor Joel Rogers.

government regulation (from the introduction of "new" generic regulations of firm behavior such as OSHA and employment discrimination to movements to deregulate such sectors as transportation, communication, banking and professional services); and increased instability in the labor market.

Partly in response to these changes, and partly facilitated by them, there are new firm strategies. They include: increasingly specialized products tailored to niche markets; the tighter integration of design, engineering, marketing, and production facilities within and across firms; general efforts to internalize scarcity and externalize risk in an increasingly competitive and uncertain environment, including downsizing and outsourcing of production tasks to affiliates and subcontractors, heavier reliance on contingent workers, and increased use of joint ventures and other mechanisms to spread risk among competitors; firm-led industrial restructuring ("merger mania"); and increased use of financial instruments and opportunities as a supplement to or substitute production.

These factors may affect business disputing and resort to litigation in many ways. Business people are more accountable to third parties. They are not as free to look to the long-run and work out solutions that benefit all concerned. For example, mergers have created larger bureaucracies and less freedom to ignore standard procedures within organizations. The rise of regulation requires business people to refer more things to lawyers to avoid major problems.

Important forms of wealth more and more involve intellectual property. It is hard to protect exclusive rights without careful and formal procedures. The economic incentives are to come as close to violating intellectual property rights as possible without crossing the line (e.g., the original IBM-PC was matched by clone machines which could process software written for the PC). Parties frequently debate whether the line has been crossed. Moreover, when a firm buys the product of intellectual property, such as computer software, often the buyer may not receive the benefits it expected. Parties often debate whether the buyer's expectations were justified. Sellers complain that buyers have unreasonable expectations about what computers can do. Buyers think sellers promise more than they know how to deliver. This may lead to disputes involving amounts that make negotiated solutions difficult to achieve.

Many factors have contributed to some erosion of structures of continuing relations and their sanctions. Competition increases firms' attention to short run "bottom-line" concerns. Many executives cannot wait for long-run rewards for cooperative behavior. Product specialization increases the number of disputes because of the lack of readily available substitutes and because the parties do not deal repeatedly. Multiparty transactions make it harder to gain agreement from everyone for readjustments and settlements. Spatial and cultural dispersion of the parties may undercut long-term relationships. Parties may assume they agree and discover that their words taken in context have very different meanings. As transactions get bigger, stakes get higher. The amounts in question may tempt parties to invest in litigation. Rapid economic changes increases instability, and thus increases the temptations and opportunities for defection from present commitments.

Legal system variables also may affect litigation rates. Legal costs have increased sufficiently to catch the attention of business people. Many have responded by creating or expanding the role of house counsel. Lawyers, because of their roles and training, tend to call for formality in planning. They also represent the regulatory state within the corporation, and they press business people to attend to regulation that they otherwise might have ignored or evaded. Business lawyers also may try to prove their worth by offering cutting-edge legal theories in response to disputes. Often the theories are creative but because their strength only can be tested by litigation, these theories may not prompt settlements.

Drastic economic changes have caused large losses, and these losses have prompted litigation. Most simply, unlike in the late 1950s and early 1960s, litigation began to be seen in the 1970s as a paying proposition. Some firms broke contracts and ignored conventional understandings when large sums were at stake. Some aggrieved firms responded by going to court. These refusals to honor commitments were well publicized, and this may have further undercut traditional assumptions and trust. Other firms tried to hold buyers to strict performance of contracts despite established customs calling for performance to be excused or stretched out over a long time. Formal written contracts often contain only absolute promises without excuses for changed economic conditions. Other contracts contain traditional but vague *force majeure* clauses. Customary responses to drastic economic changes did not fit within older legal ideas of impossibility or frustration. These customs also may have involved excusing performance when reasonable amounts were at issue; it was not clear that they required excuse when there were huge gains or losses to be had from performance or excuse.

Finally, we must distinguish filing law suits from litigating cases to a final conclusion. Often filing a complaint or pretrial motions is but a way to facilitate or coerce settlement. These steps may focus the issues and clarify facts and bargaining power. Judges attempt to prompt settlement in various ways before they try a case. Pressures from the threat of reversals on appeal and orders for new trial may prompt settlement even after trial has begun or a verdict rendered. Often the parties do not want to invest what would be necessary to start over again.

At present, the existence and scope of the business disputes problem is still to be studied. Although the Wisconsin Business Disputes Project is still in its early stages, it is clear that disputes concerning franchises and dealerships are an important part of American federal and state courts dockets. These disputes also may be an important part of the business of federal and state administrative

agencies, but the nature of administrative records means that this will be much harder to establish.

III. American Law and Relational Disputes in the Area of Distribution of Goods and Services

Manufacturers can buy the services of dealers and distributors to get their product to consumers. When everything works well, the interests of a manufacturer and a dealer coincide. The dealer sells many products to the public, and both manufacturer and dealer profit. However, friction in the relationship is common. For example, unforeseen events can cause losses which burden manufacturer, dealer or both. Manufacturers and dealers may disagree about how these losses should be allocated. Manufacturers may want more sales effort and investment than dealers offer. Manufacturers may want many dealers competing while dealers may want protected sales territories. Disputes between manufacturers and their distributors or dealers often enter the American legal system. Often, too, these disputes raise the tension between views of business as resting on discrete contracts versus views of long-term continuing relations. Just as often, these disputes raise the tension between reasonable expectations and justifiable reliance on one side and power and authority on the other.

In this section of the report on American developments, we will look first at strains in the way judges apply the Uniform Commercial Code[31] to problems of distribution. Then we will turn to a sketch of franchise regulation found at both federal and state levels.

1. Distribution, the Uniform Commercial Code, and Relational and Neoclassical Approaches to Contract

Macneil recognizes that the existing body of contract law contains doctrines which could serve relational purposes. Indeed, he calls the eclectic collection of contract rules which rest on both discrete transaction and relational assumptions, "neoclassical contract". Sometimes our courts recognize that businesses often work together almost as partners over the long term. Sometimes, however, they write as if they assumed the typical business transaction was a swap between

31 Article II of the Uniform Commercial Code was passed by all but one of the American state legislatures between the 1950s and 1970s. Its provisions apply to "transactions in goods". Courts have debated whether a distributorship is a transaction in goods because the relationship involves services and trademarks as well. American state appellate courts seek uniformity in construing the U.C.C., but appellate courts in each state are free to give their own reading to the Code's provisions.

strangers who do not expect to meet again. Judicial reaction to "price protection" in asphalt distribution offers an example of neoclassical contract law.

The oil producing nations' cartel (OPEC) raised oil prices in the early 1970s. The Nixon Administration responded by imposing regulation and price controls on petroleum products. However, asphalt was left unregulated, and the major oil companies suddenly raised their prices sharply. Asphalt distributors had bid on paving jobs, using the original prices as the basis for their price calculations. When they were awarded the paving jobs after the oil companies' price increases, the distributors faced obligations to perform at substantial losses.

Documents and practice conflicted. The written distribution contracts were explicit. Buried in the pages of clauses were provisions allowing the oil companies to raise prices at any time before a distributor placed an order. However, before OPEC's actions, oil companies would "price protect" distributors — that is, a distributor awarded a contract could order asphalt at the price in effect at the time it made its bid rather than at the higher price in effect when it received the award. The oil companies ignored the pricing clause in the standardized written contract. Were the major oil companies bound by this customary practice or could they assert their contract clauses which did not recognize it?

Nanakuli v. Shell Oil[32] represents one court's answer. We can tell a simplified story about the case: Shell wanted to compete with Standard of California in supplying asphalt to the Hawaiian market. It developed Nanakuli Paving Co. as its Hawaiian distributor. Nanakuli used Shell's trademarks and colors, and the line between the two corporations was blurred in practice. Shell's Hawaiian representative influenced Nanakuli's business decisions, and he was aware of Nanakuli's outstanding bids.

The Shell-Nanakuli printed form distribution contract gave Shell the right to increase prices until Nanakuli placed an order for a specific quantity. However, Shell's Hawaiian representative knew of the price protection practice in the local road paving trade. All suppliers followed the practice. On the only two prior occasions when Shell had raised prices between Nanakuli's bid and an award, Shell had price protected Nanakuli's orders.

Nanakuli bid on a state road paving job, Shell greatly increased the price for asphalt, and then the State of Hawaii awarded Nanakuli the contract. Shell refused to price protect and demanded the new higher price. Shell's asphalt sales had been transferred to a new division, and the old senior managers had retired. The new managers knew nothing of the practices in the field, but they did not ask those who did know.

Nanakuli sued Shell for its failure to price protect. The trial court found for Shell, saying that the parol evidence rule barred evidence which would contradict the Shell-Nanakuli written contract. The appellate court reversed this decision, finding that price protection did not contradict the price term of the written contract. It said that when printed stock forms were used, "if the trade regards an express term and a trade usage as consistent because the usage is not a complete contradiction but only an occasional but definite exception to a written term, the courts should interpret the contract according to the usage". A usage may be used to qualify the agreement, which means to cut down the express terms although not to negate them entirely. Moreover, Shell did not set its new price in good faith. Unlike its competitors, Shell did not give notice before it raised prices, and its new higher prices went into effect immediately.

The case exemplifies the common gap between the real expectations of the parties and the written document drafted by corporate lawyers and imposed on the transaction by the dominant party. Here, the court focused on the actual expectations created by practice during the life of the long-term relationship. By its application of a good faith standard, the court denied Shell the power to control the relationship entirely for its benefit. In short, the court policed the private government which Shell's lawyers had created. It honored the expectations created by the long-term business relationship.[33]

But there was a counterrevolution: Other courts rejected *Nanakuli*, using a narrow interpretation of the U.C.C.'s statute of frauds writing requirements. *W.H. Barber Co. v. McNamara-Vivant Contracting Co., Inc.*[34] involved a suit by a contractor against a supplier of asphalt which had failed to price protect on work not completed in 1973 and carried over into 1974. The jury found that the supplier's representatives orally had agreed to keep the old price in effect. The trial judge then held that the statute of frauds barred the contractor's claim. There was no writing adequate to show the *quantities* of asphalt to be supplied. The court read the U.C.C. as demanding this term be reduced to writing.

If a proper reading of the statute demanded that courts apply the writing requirement (and this is debatable[35]), courts could have turned to widely recognized exceptions. Many courts have protected reliance on oral statements in situations where they found enforcing the statute of frauds unjust. However, in *Lige Dickson Co. v. Union Oil of California*[36], the Supreme Court of Washington re-

32 664 F.2d 772 (9th Cir. 1981).

33 See Hadfield, Problematic Relations: Franchising and the Law of Incomplete Contracts, 42 Stanford Law Review 927 (1990), advocating such an approach.

34 293 N.W.2d 351 (Minn. 1979).

35 Section 2-201 of the Uniform Commercial Code states: "the contract is not enforceable under this paragraph *beyond the quantity* of goods shown in such writing [Emphasis added]". A court could read this as saying that if, and only if, a quantity is stated in writing, then a party cannot claim more than this amount. Most courts have read the provision as requiring a quantity to be stated in writing in order for a contract to be legally enforceable. In other words, if no quantity is stated, the contract is to be read as calling for 0 goods. Any amount, then, is an amount "beyond" 0. For a strong criticism of the common judicial reading of Section 2-201, see Bruckel, The Weed and the Web: Section 2-201's Corruption of the U.C.C.'s Substantive Provisions — The Quantity Problem, 1981 University of Illinois Law Review 911. But see Gibson, Promissory Estoppel, Article 2 of the U.C.C., and the Restatement (Third) of Contracts, 73 Iowa Law Review 659 (1988).

36 96 Wash.2d 291, 635 P.2d 103 (1981).

jected this approach and came to the same conclusion as the *W.H. Barber* case on similar facts. At the trial, a Union Oil official conceded "there was an unwritten custom in the Tacoma area, well known and acted upon by suppliers and users, that any increase in the price of liquid asphalt would not be applicable to . . . [outstanding bids]". Nonetheless, the court said that while it appreciated the contractor's dilemma, "we cannot help but foresee increased litigation and confusion as being the necessary result of the eroding of the U.C.C. if promissory estoppel is held to override [the statute's writing requirements]".

These courts, then, are ready to ignore relational considerations in order to facilitate bureaucratic functioning through standardization. In essence, these opinions grant power to corporate lawyers to control relationships through contract drafting. While actual practice may create or reinforce norms honoring a relationship, it is hard for the home office to control agents in the field or even know what they have done. Large organizations cut costs when they standardize transactions; courts support this when they treat the charters for these private governments as if they were the frozen expectations of the parties. The courts appeal to ideology for comfort, talking about distributors' obligations to protect themselves by reading standard form contracts and assuming that expectations to the contrary will not control. Such an approach may run counter to business practice, but it does serve to justify empowering corporate lawyers. Perhaps the *W.H. Barber* and the *Lige Dickson* courts reached the best result. But they did decide to protect authority at the price of defeating reasonable expectations, with little explanation of why they made this choice.

2. *Protecting Distributors and Dealers Through Legislation*

For over fifty years, franchisors and franchisees have struggled to pass or defeat proposed legislation which would limit the control of franchisors over franchisees. Various dealers' associations took the lead over the years. Automobile dealers were the first and the most successful. Retail gasoline dealers came next, and while they enjoyed some success, their victories were not as impressive as those of the automobile dealers. More recently, farm implement and heavy equipment dealers, beer and wine distributors, and office equipment dealers have sought legislation and have had some success. About a third of the states have general franchise protection laws, offering some protection to all dealers and distributors. We will consider motor vehicle dealer, retail gasoline dealer and general franchise statutes in turn.[37]

37 The farm implement and heavy equipment dealers' and beer and wine distributors' statutes are very similar to the ones we will discuss.

a) *Automobile Dealers*

Automobile dealers were the pioneers. Reacting to manufacturers' practices during the depression of the 1930s[38], Wisconsin passed a statute in 1935 and amended it in 1937. The Wisconsin act requires all automobile manufacturers, dealers, and the representatives of both to be licensed to do business in the state. The statute is administered by an independent state agency with an advisory board of dealers available for consultation. The act labels as wrongful many kinds of conduct, including the following actions by manufacturers and their representatives: (1) inducing or coercing a dealer to accept delivery of cars or other things the dealer did not order, or attempting to do this[39]; (2) inducing or coercing a dealer to enter any agreement with the manufacturer or "to do any other act unfair to said dealer" by threatening to cancel the dealer's franchise, or attempting to do this[40]; or (3) "[u]nfairly, without due regard to the equities of said dealer and without just provocation . . . canceling the franchise of a dealer".[41]

38 Economics and law writing paints a vision of manufacturer-dealer relations as one of happy harmony based on pure merit. For example, Klein and Saft, in an otherwise interesting article, state:

> "Postcontract . . . a franchisor can use the threat of termination to "hold up" a franchisee that has made a specific investment in the marketing arrangement . . . The arrangement creates a potential contracting problem, one that . . . is a necessary part of the efficient scheme of franchisor policing. The franchisor is not likely to terminate franchisees merely to confiscate their sunk investments opportunistically because franchisors must be concerned about their reputations when attempting to sell additional franchise locations".

Klein & Saft, The Law and Economics of Franchise Tying Contracts, 28 Journal of Law & Economics 345, 356 (1985). They continue in a footnote: "Termination of only some franchisees is unlikely to be wealth maximizing because the remaining franchisees will be convinced that they also will be unfairly terminated. Therefore the remaining franchisees will cheat on quality". Id. at n. 38. For a similar argument, see Wiggins, Franchising —A Case of Long-Term Contracts, 144 Journal of Institutional and Theoretical Economics 149, 151 (1988).

Undoubtedly, this is one of many incentives which franchisors must consider. Nonetheless, franchisors have acted opportunistically toward their franchisees when other incentives proved more powerful. See A. Nevins & F. Hill, Ford — Expansion and Challenge: 1915-1933 at 580-583 (New York: 1957); S. Macaulay, Law and the Balance of Power: The Automobile Manufacturers and Their Dealers, 16-21 (New York: 1966). Moreover, it is one thing to deduce what is in the franchisor's long-term interest. It is another to consider what is in the interests of the various people who make up a corporation. Middle and lower level officials who supervise and evaluate franchisees often are evaluated on short-run bottom-line standards. They do not have the luxury of worrying about the impact of their actions on the franchisor's long-run reputation. They assume that they can detect and punish any dealer who might react to coercion by cheating on quality. This may not be wealth maximizing for the franchisor, but it may be wealth maximizing for the franchisor's employees. Indeed, as Henry Ford II conceded at a congressional hearing and Nevins and Hill discuss, during the 1930s Ford dealers had to bribe Ford roadmen with lavish personal gifts to retain their franchises.

Macaulay argues that one of the functions of all of the dealer protection legislation is to bring the actions of franchisor "roadmen" to the attention of those at the top of major corporations.

In short, the law and economics approach is not necessary wrong, but it is sadly incomplete and ignores history. Compare Hadfield, Problematic Relations: Franchising and the Law of Incomplete Contracts, 42 Stanford Law Review 927, 978 n. 232 (1990).

39 Wisconsin Statutes 218.01(3)(15).

40 Id. at 218.01(3)(16).

41 Id. at 218.01(3)(17).

The primary sanction under this statute is the denial, suspension or revocation of a manufacturer's, dealer's, or individual representative's license. The statute also provides for criminal penalties[42] and allows injured dealers to bring civil actions for damages.[43]

After World War II, automobile manufacturers put great pressure on dealers to sell cars by threatening to cancel franchises. In 1953, Oklahoma passed its manufacturer-dealer statute. This statute follows the Wisconsin pattern closely, but with several significant changes. Importantly, the Oklahoma act is administered by a Motor Vehicle Commission composed of seven members appointed by the Governor. "[E]ach shall be of good moral character and each shall have been actually engaged in the manufacture, distribution or sale of motor vehicles in the State of Oklahoma for not less than ten (1) consecutive years . . ." Few, if any, automobiles are manufactured in Oklahoma. In effect, rather than an independent state agency as in Wisconsin, a group controlled or influenced by established automobile dealers sits in judgment on other dealers and on manufacturers and their representatives[44]. Many states have followed the Oklahoma pattern and allowed dealers to exercise state powers, thus blurring the line between the public and private governments.[45]

By 1956, seventeen states had some form of dealer-manufacturer legislation, and many of them followed the Wisconsin and Oklahoma patterns. Attempts to pass such statutes had been defeated in at least ten states. The National Automobile Dealers Association then turned to the United States Congress. Their original bill would have allowed dealers to recover double damages and attorneys' fees where manufacturers had failed to act in "good faith" in doing business with a dealer or in canceling or failing to renew a dealer's franchise. The bill defined "good faith" as:

> "the duty of the automobile manufacturer . . . to act in a fair, equitable, and nonarbitrary manner so as to guarantee the dealer freedom from coercion . . . or intimidation, and in order to preserve and protect all the equities of the automobile dealer which are inherent in the nature of the relationship between the automobile dealer and automobile manufacturer".

William P. Rogers, then a Deputy Attorney General, announced the Eisenhower Administration's position. While it did not object to protection against coercion, it opposed anything which would deny consumers the benefits of competition. Rogers took aim at the "equities of the dealer" language. He argued that a dealer

42 Id. at 218.01(8).
43 Id. at 218.01(9).
44 The Oklahoma statute was amended to add two lay members to the Commission in addition to the seven members from the industry. See Oklahoma Statutes Annotated 563A.
45 Brown, State Motor Vehicle Franchise Legislation: A Survey and Due Process Challenge to Board Composition, 33 Vanderbilt Law Review 385, 432-433 (1980), argues "many motor vehicle commissions [composed of dealer members] violate due process irrespective of the fact that other commissions regulating other professions are often composed of members of that profession". So far, the courts have not agreed.

with a large investment might have an equity in a certain margin of profit, and the manufacturer might have to produce and operate to protect that margin rather than to get as many cars as possible sold to customers at the lowest price. Thus, the language could build "a sanctuary from the rigors of competition".

The sponsors needed votes to get the bill passed, and they worried about a presidential veto. They amended the bill to meet objections. They dropped the right to double damages and offered a new definition of "good faith" which read:

> "The term "good faith" shall mean the duty of each party to any franchise . . . to act in a fair and equitable manner toward each other so as to guarantee the one party freedom from coercion, intimidation, or threat of coercion or intimidation from the other party: Provided, That recommendation, endorsement, exposition, persuasion, urging or argument shall not be deemed to constitute a lack of good faith".

The federal statute stated that it did not preempt state legislation regulating automobile manufacturer-dealer relations. The Department of Justice and the Federal Trade Commission did not object to the bill in this form. Congress passed the "Dealers Day in Court Act of 1956", and President Eisenhower signed it on August 8.

While one could stress the obligation to "act in a fair and equitable manner", the courts have read the statute narrowly and limited its protections to coercion. There are few dealer victories under this statute. However, the manufacturers changed franchise terms and business practices as they tried to block passage of the legislation. These changes may have had more impact than the statute itself.

The automobile dealers organizations returned to the state legislatures. Many states passed statutes offering motor vehicle dealers some protection during the early 1970s, and by the mid-1980s almost every state had some type of restriction on terminating or failing to renew dealer franchises[46]. The standards vary. Four states follow the Wisconsin phrase: "unfairly, without due regard to the equities, of the dealer". Many use some variant of "due cause", but they differ as to whether they continue and define the term. About half of the states create a cause of action to be enforced through the courts; about half use an administrative-licensing provision. During the 1980s, states began to pass restrictions on manufacturers placing another dealership in a dealer's marketing area without good cause[47].

46 Comparative studies of state legislation in the United States are very difficult to carry out. The researcher faces fifty sets of statutes and fifty different indexing schemes. Computer data bases such as LEXIS and WESTLAW make the task much easier. Nonetheless, it is still hard to be sure that one has found every relevant statute. One can miss a provision that uses a synonym for the terms in the search request. Thus, in the discussion that follows, I have avoided offering exact counts of the number of states with particular provisions.
47 Anderson, *American Motors Sales Corp. v. Peters*: Green Light to Territorial Security for Automobile Dealers, 63 North Carolina Law Review 1081 (1985), argues that provisions in the North Carolina dealer statute protecting dealers' sales territories unfairly burden consumers.

It is difficult to assess the impact of motor vehicle dealer protective legislation. In the twenty-eight years from 1959 to 1988, there was an average of about five reported cases a year under the federal Dealers' Day in Court Act. Each of the three major American manufacturers faced about the same number of cases. The cases disclose few notable dealer victories. Close analysis of the text of the federal statute suggests that few dealers will be able to establish the required lack of good faith. Of course, when dealers might win major victories, manufacturers are likely to settle the case or not appeal a defeat before a jury. Thus, the cases which prompted reported decisions may not be good ones for dealers.

It is even harder to assess the impact of the state motor vehicle dealer statutes. Records of proceedings before state administrative agencies are not published regularly. There are few reported appellate cases. When Macaulay interviewed dealer trade association representatives in the early 1960s, they did not see these statutes as very effective[48]. Nonetheless, motor vehicle dealer trade associations worked to get these statutes passed in the 1970s and 1980s. There was a major legislative battle in Florida in 1988. That state had a "sunset law", which automatically repealed many regulatory statutes including the dealer protection act. Manufacturers and officials of Reagan Administration Department of Justice sought to persuade the Florida legislation not to reenact the dealer protection law[49]. They failed, and a revised version of the statute was enacted[50]

48 See S. Macaulay, Law and the Balance of Power: The Automobile Manufacturers and Their Dealers 39 (New York: 1966).

49 See, NEXIS, Press Release Newswire, April 13, 1988, Motor Vehicle Manufacturers of America Release. "The Federal Trade Commission (FTC) and a report by the staff of the Florida Senate's Economic, Community and Consumer Affairs Committee advocate termination of those provisions of the Florida Motor Vehicle Dealer Franchise and Licensing Law that limit a manufacturer's ability to establish new franchises . . . 'Residents of states with similar laws are paying an average $800 more for a new car, according to an FTC study . . . The FTC, in a letter to Florida State Sen. Gwen Margolis, said, 'We believe that repeal would likely result in lower automobile prices for consumers'".

The FTC study is Rogers, The Effect of State Entry Regulation on Retail Automobile Markets, Bureau of Economics Staff Report to the FTC (1986). The study was based on data General Motors supplied to the FTC about the prices charged by Chevrolet dealers for each of nine Chevrolet body-types for the year 1978. Rogers said:

> "Our results indicate that increasing population growth leads to greater RMA [Relevant Market Area law] effects. In areas where population had increased since the passage of an RMA law, our estimates of the effect of the RMA laws had on the average price of a new Chevrolet range from 3.68 percent for the Sportvan to 16.82 percent for the Corvette. We estimate that the RMA laws caused the average price across all nine models to increase by 7.63 percent".

Rogers at 7. He also says: "the RMA laws appear to have little or no effect in areas where population growth is zero or negative". Id. at 83.

We must notice that Rogers is analyzing an average. Some of his results reflect the great impact RMA laws had on Corvette prices. It may be that interbrand competition has little effect on Corvette buyers. Perhaps these buyers see no other car as a substitute. However, I have difficulty basing a judgment about RMA laws on their impact on Corvette buyers. For example, these buyers might want their cars to cost more because then fewer others would own them. Practical considerations must be far from the mind of anyone considering purchasing a Corvette.

50 Florida Statutes Annotated Chapter 88-395, 320.27-320.6991 (West's Florida Session Law Service, Aug. 1988.) Section 320.642 deals with "dealer licenses in areas previously served". The amended

At the very least, these statutes offer dealers some protection against the most arbitrary actions by manufacturers. Unfortunately, it is not in the manufacturers' interest to tell us if there is a significant deterrent effect. The statutes could be taken as a warrant for some degree of relational contract law. However, most courts have construed them too narrowly to serve this purpose.

During the 1950s and 1960s, the Wisconsin statute prompted an informal system. When a manufacturer wanted to cancel a dealer, it would present its case to the Executive Director of the Wisconsin new car dealers trade association. This man had supervised the drafting of the Wisconsin statute, and he could provide dealers with lawyers expert in its provisions. If the Executive Director thought the factory did not have a case, he would tell its representative this. The representative knew that the trade association and its lawyers could stage a costly fight before the Motor Vehicle Department officials who administered the statute. As a result, usually the representative gave the dealer another chance, often setting precise sales targets to be reached by specified dates. If, however, the Executive Director thought that the factory had good cause to cancel, he would make sure that the factory would give the dealership a good price for its inventory and treat the dealer fairly as the business was closed. Then the Executive Director would persuade the dealer to accept this solution rather than fight[51]. Moreover, the Motor Vehicle Department tried to avoid formal hearings about franchise terminations. Its officials held prehearing conferences which served as mediation and bargaining sessions[52]. These forms of alternative dispute resolution are rare today. To a large extent, the automobile manufacturers have established internal units such as Ford's Dealer Policy Board which offer dealers second chances, compromise settlements and the like. Moreover, the automobile manufacturers' legal staffs now are experts on state regulation. Manufacturers now act only when they think they have a strong case.

Smith[53] studied the impact of state dealer protection statutes. He compared data from 1954, when most states did not have dealer protection statutes to data from 1972, when many states had such regulation. He found "state regulation has enhanced the ability of dealers to restrict new entry and has protected them from involuntary termination. Over all states, the average impact of regulation from 1954 to 1972 appears to be a 15.3 percent reduction in the number of new-car dealerships". Using data from the Census of Retail Trade on the new-car dealer total revenue per new registration[54], Smith calculates that the impact of regula-

version runs three and one half printed pages, creating an elaborate procedure to review a proposed new dealership after an objection by a dealer or dealers with standing to protest.

51 S. Macaulay, Law and the Balance of Power: The Automobile Manufacturers and Their Dealers 152-153 (New York: 1966).

52 Id. at 153-155.

53 Smith, Franchise Regulation: An Economic Analysis of State Restrictions on Automobile Distribution, 25 Journal of Law & Economics 125 (1982).

54 Rogers questions Smith's data:

tion on vehicle prices is an increase of 13.7% in states with low growth rates. The increase in states with high growth rates is 9.9%, but this result is not statistically significant. He argues "the net effect is fewer dealerships and increased market power resulting in higher prices. The impact appears mitigated somewhat by increased scale economies arising from restricted entry"[55]. Smith's data suggest that the impact of regulation on dealer revenue per vehicle may be to compel consumers to buy unwanted optional equipment. "This could occur if the scarcity of competing dealerships of the same line-make makes it hard for the consumer to locate the exact set of product attributes he desires"[56]. Finally, Smith concludes "[t]he estimated resource loss attributable to regulation-fostered increases in price packing, based on an average price increase of $390, was $3.9 billion for 1979"[57]

Perhaps Smith is right. However, he makes several assumptions which we might question. These concerns about Smith's assumptions may not affect his analysis of the data, but they should prompt us to read his argument carefully. For example, he assumes there is no gap between the law on the books and the law in action. Some of the dealer protection statutes may be enforced in such a way that the dealer always wins. In other states dealers may not be able to prompt the enforcement agency to act except, perhaps, in very clear cases. We can assume that those statutes which are not enforced rigorously will have little impact on prices unless manufacturers lack information about the actual situation.

Smith also tells us that manufacturers use a sales quota system to prevent dealers from gaining an above competitive return available to them when they have territorial security[58]. If dealers failed to sell their quota, then they would risk cancellation of their franchise. He then assumes that under state regulation this means of dealer discipline is lost or so severely restricted as to have little impact[59]. However, even in states with regulatory statutes, manufacturers can and do still use quota systems. Under regulation, the quota must be set in relation to the sales of dealers in comparable situations. In most states, failure to meet such a sales objective, after notice and an opportunity to cure, would be cause for cancellation[60].

> "Because Smith's quantity data are for total sales of all makes of cars in the given states, he has an aggregation problem. The price differences between various types of automobiles make it difficult to determine whether or not the apparent regulation effects result from the differences across states and over time in the composition of vehicles sold. For dealer costs and other variables, he also uses aggregate state data which might present a similar problem".

Rogers, op. cit (supra note 49), at 28.

55 Smith, op. cit. (supra note 53), at 150.

56 Id. at 151.

57 Id. at 154.

58 Id. at 128-129.

59 Id. at 136

60 But see 73 Pennsylvania Statutes 202-3(d)(2), note 63, infra. This statute prohibits use of a sales quota system. It is very unusual and has been preempted by federal regulation.

Smith assumes that absent regulation there would be more dealers in a state. If manufacturers were free to do so, he assumes that they would open more dealerships in order to increase competitive pressure on each dealer. However, since the 1960s, manufacturers have wanted to close small dealerships in rural areas and small towns. They find it more efficient to deal with fewer but larger dealers who order both cars and parts in large quantities.

We might agree that, given total freedom, manufacturers would want to cancel more dealers than they can under regulation. Manufacturers will not want to cancel their best dealers, and they can and do cancel their poor performers. Presumably borderline dealers gain the most under regulation. Some of them remain in business only because their manufacturer does not think it worth the cost to try to establish that there is good cause to cancel them. However, bankruptcy and other responses to a poor return on investment probably end franchises in many of these cases. The legislation does not require banks to continue to lend money to dealers who are not performing well[61]

Finally, Smith discounts the effect of interbrand competition. He compares 1954 with 1972, but 1972 is before Japanese car markers were such an important factor in the American car market. Even a Ford dealer with a nicely protected sales territory and a requirement of reasonable cause and a chance to cure before cancellation, faces great competition from the Toyota, Nissan, and Honda dealers. Chevrolet, Pontiac, Oldsmobile and Buick dealers long have sold the essentially the same car with only a few differences in trim and the name stamped on the front and back. A state statute might prohibit General Motors from opening another Chevrolet dealership a few blocks away from its existing Chevrolet dealer, but General Motors could establish a Pontiac dealer nearby. For many customers Fords, Chevrolets and Plymouths were more or less interchangeable cars. Even a customer with a not-totally-rational brand loyalty to, say, Chevrolet always could get a price quotation from a Ford dealer to use in negotiating with the Chevrolet dealer. Unless we assume that absolute brand loyalty exists, it is not clear why establishing a second Chevrolet dealer in a city would create enough additional competition to have a substantial effect on car prices.

Having said all this, Smith's general conclusion is plausible. Dealers fight for these statutes because they think such legislation will have impact. At least in the short run, dealer protection statutes should ease some of the pressure from manufacturers to sell the maximum number of cars possible. This may mean that some consumers pay more for new cars[62]

61 While regulation may affect opening new dealerships and canceling old ones, it is not clear what the balance will be. It is possible that, absent regulation, manufacturers would have exactly the same number of dealers that they have under regulation. However, absent regulation, they might have more larger dealers in big cities and fewer smaller dealers in small towns. This might increase some consumers' costs and lower the prices paid by others.

62 Even if manufacturers were free to push dealers to sell the maximum number of cars, consumers might not obtain all of the benefits which Smith suggests. There is always the problem of information.

b) *Retail gasoline Dealers*

Retail gasoline dealers tried to follow the precedent set by motor vehicle dealers. After the OPEC cartel raised petroleum prices, the major refiners sought to close many service stations and change the way others did business. Gasoline dealers won major victories in many states. From 1972 to 1978, about twenty states passed statutes regulating terminations and non-renewals of franchises as well as unfair practices of petroleum refiners and distributors. Most of these statutes required "good cause" for termination or non-renewal. Some statutes did not define the term. Others offered elaborate definitions of good cause and stated that certain actions were not good cause[63]. Many statutes required that in most instances a dealer be given a notice of deficient performance and an opportunity to cure its performance.

After lengthy lobbying and negotiation among representatives of oil companies, dealers and others, the United States Congress passed the Petroleum Marketing Practices Act (PMPA) in 1978[64]. This statute provided that franchisors could not terminate or fail to renew franchises except for reasons provided in the act. For example, a franchise could be canceled during its term because of "[a] failure by

Sales persons can walk the borders of fraud to make customers think they are paying less for a car than they actual are. Dealers can minimize new car preparation and warranty repairs. Dealers can sell cars at what appear to be very low prices, but recapture some or all of the profit lost in the sales price by selling financing with high finance charges. It is possible that regulation penalizes the very-well-informed consumer who is a skilled bargainer but benefits the average consumer who is less well informed and less skilled at bargaining. Compare Ayres, Fair Driving: Gender and Race Discrimination in Retail Car Negotiations, 104 Harvard Law Review 817 (1991).

63 For example, 73 Pennsylvania Statutes 202-3(b) provides:
"(b) It shall be a violation of this act for any lessor supplier to directly or indirectly terminate, cancel or fail to renew an agreement with the lessee dealer unless the termination, cancellation or failure to renew is for one of the following reasons:
(1) The lessee dealer has abandoned or has given notice of its intention to abandon the leased premises, in which event the requirement of 90 days' notice need not be given.
(2) The lessee dealer has filed for or has been declared bankrupt or has petitioned for a reorganization, creditor arrangement or insolvency under the applicable statutes . . .
(6) Failure to pay financial obligations to the lessor supplier when due including, but not limited to, rents or payment for gasoline, petroleum products or accessories supplied to the lessee dealer by the lessor supplier.
(7) Adulteration, commingling, or mislabeling or misbranding of products supplied by the lessor supplier . . .
(c) Nothing in subsection (b) shall prohibit termination, cancellation or failure to renew: . . .
(3) where there is such cause for termination as a court of competent jurisdiction might find to be reasonable and just under all of the circumstances.
(d) In determining whether or not an agreement shall be terminated, canceled or not renewed the failure or refusal of the lessee dealer to do any of the following shall not be grounds for such action: . . .
(2) Failure by the lessee dealer to meet sales quotas suggested by the lessor supplier . . ."

64 15 U.S.C. 2801-2806.

the franchisee to comply with any provision of the franchise, which provision is both reasonable and of material significance to the franchise relationship . . ."[65]

A franchisor could *refuse to renew* a franchise because of "[t]he failure of the franchisor and the franchisee to agree to changes or additions to the provisions of the franchise, if — (i) such changes or additions are the result of determinations made by the franchisor in good faith and in the normal course of the business; and (ii) such failure is not the result of the franchisor's insistence upon such changes or additions for the purpose of preventing the renewal of the franchise relationship"[66]. There are several other reasons justifying non-renewal as well. For example, a franchisor can refuse to renew if "in good faith and in the normal course of business" it determined that "renewal of the franchise relationship is likely to be uneconomical to the franchisor despite any reasonable changes or reasonable additions to the provisions of the franchise which may be acceptable to the franchisee"[67]. Oil companies also can terminate or fail to renew when they make a determination "in good faith and in the normal course of business to withdraw from the marketing of motor fuel through retail outlets in the relevant geographic market in which the marketing premises are located . . ."[68]

Finally, the PMPA preempted state regulation dealing with franchise termination and non-renewal and the notices required to take these steps[69]. This wiped out the gasoline dealers' victories in over twenty states. It is the most important difference between the federal statute governing automobile dealers and the one governing gasoline dealers.

Again, it is difficult to determine the impact of these statutes on relationships between large international oil companies and their local dealers. From 1978 to 1988, there were 178 cases reported under the PMPA or an average of about 18 a year[70].

65 Sec. 2802(a).

66 Sec. 2802(3)(A).

67 Sec. 2802(D)(i)(IV).

68 Sec. 2802(E).

69 Sec. 2806(a) provides: "To the extent that provisions of this subchapter applies to the termination (or the furnishing of notification with respect thereto) of any franchise, or to the non-renewal (or the furnishing of notification with respect thereto) of any franchise relationship, no State or any political subdivision thereof may adopt, enforce, or continue in effect any provision of any law or regulation (including any remedy or penalty applicable to any violation thereof) of any such franchise or to the non-renewal (or the furnishing of notification with respect thereto) of any such franchise relationship unless such provision of such law or regulation is the same as the applicable provision of this subchapter".

70 Reported cases give only a rough indication of the impact of a law. See Siegelman & Donohue, Studying the Iceberg from Its Tip: A Comparison of Published and Unpublished Employment Discrimination Cases, 24 Law & Society Review 1133 (1990). However, reported cases show that the Petroleum Marketing Practices Act clearly is not a dead letter; there are many published opinions dealing with the statute. There were 78 cases reported from 1978 to 1983. The dealer lost in 68% of them, and the dealer had a positive outcome in 23%. In one case a dealer won a judgment for money. In 13 a dealer was awarded a temporary injunction against termination of the franchise, and summary judgment for the oil company was denied in 4. In 7 of the reported cases the ultimate result was unclear.

However, Kleeger argues that the federal courts' application of the PMPA "have frustrated congressional intent and have permitted the major oil companies to terminate their franchise relationships arbitrarily"[71]. For example, Kleeger comments:

> "In *Palmieri v. Mobil Oil Corp.*[72], Mobil proposed to renew the franchise agreement with a 377 percent increase in monthly rent. The rent increase was calculated by using a formula based on Mobil's desired gasoline sales rather than actual gasoline sales by the franchisee. In affirming the lower court's holding that Mobil legally ended the franchise relationship, the Second Circuit stated that the PMPA requires only that a franchisor who institutes rent hikes calculated by formula act without intent to discriminate against selected franchisees. The court held specifically that the Act does not require the franchisor to act in an objectively reasonable manner. This holding is remarkable . . . because it apparently condones all uniform rent hikes regardless of their harsh effects"[73].

United States District Courts in Michigan, for example, have emphasized that they are prepared to play only a very limited role in the relationship between oil companies and their dealers. One said that the statutory requirement of reasonableness and materiality of franchise provisions did not permit the court to substitute its judgment for decisions of the franchisor derived from ordinary business experience and knowledge[74]. Another decision stressed that Congress intended the recognize the legitimate needs of the oil companies to terminate franchises or not renew when market conditions and consumer preferences changed[75]. Another court approved non-renewal when the dealer would not agree to convert his station from a full-service gasoline station with repair facilities to a high-volume "pumper" type station. The economic impact on the dealer was irrelevant, as was the fact that the franchisor had encouraged the dealer to operate a repair business in the past. The franchisor acted for a legitimate business reason in the context of changing economic circumstances. The court said

71 Kleeger, Judicial Interpretation of the Petroleum Marketing Practices Act: Conflict and Diversity, 32 Emory Law Journal 273 (1983). Compare Greco, Franchise Legislation in the Petroleum Industry: The Petroleum Marketing Practices Act, 25 Mid-Atlantic Journal of Business 59 (1988). Greco examined 92 PMPA cases brought between 1978 and 1984. He found that the statute did not unduly benefit either franchisors or franchisees.

72 529 F. Supp. 506 (D. Conn.), *aff'd per curiam*, 682 F.2d 295 (2d Cir. 1982).

73 Kleeger, supra at 313-314. In *Meyer v. Amerada Hess Corp.*, 541 F. Supp. 321 (D.N.J. 1982). the court said that an oil company's proposed new franchise agreement did not violate the statute where the rent formula was developed in the ordinary course of business, was not shown to be applied discriminatorily, and called for the dealer to pay a rent significantly below the reasonable rate of return on the value of the land, improvements and equipment made available to him. Although the new rent might make the operation of the station unprofitable, this was not enough to show that there was an improper purpose.

74 *Gruber* v. *Mobil Oil Corp.*, 570 F. Supp. 1088 (D. Mich. 1983).

75 *Ames* v. *Texaco, Inc.*, 568 F. Supp. 1317 (D. Mich. 1983).

that Congress did not intend to destroy a franchisor's flexibility to meet changed economic circumstances or impair its ability to remain competitive[76].

Chafee might view this as a clash between what he called "the strangle hold policy" and a combination of "the dismal swamp" and the "living tree"[77]. The courts have refused to look into the reasonableness of the business judgments made by the oil companies or consider the impact of their decisions on individual dealers. All the many years of effort to produce the state and federal statutes have not brought drastic changes. Whether or not we agree with Kleeger's view that the federal courts "have frustrated congressional intent", it is clear that the gasoline dealers received far less under the federal act than under most of the state statutes which the PMPA preempted[78].

After their disappointment with the federal statute, the gasoline dealer trade associations returned to the state legislatures. Once again their political power produced success in many states. They could not lobby for statutes which dealt directly with termination or non-renewal because the federal PMPA took away the states' power to regulate these matters. Instead the dealers lobbied for statutes designed to solve specific problems they faced. For example, in 1984 Mas-

76 *Baldauf* v. *Amoco Oil Co.*, 553 F. Supp. 408 (D. Mich. 1981). In *Bellmore* v. *Mobil Oil Corp.*, 524 F. Supp. 850 (D. Conn. 1981), the court stressed that the statute directed courts to inquire into a franchisor's intent rather than the effects of its actions.

77 Chafee, The Internal Affairs of Associations not for Profit, 43 Harvard Law Review 993 (1930). Chafee said that sometimes a relationship is so important to one or both parties that changing or leaving it would have unusually serious consequences. The relationship then has a "strangle-hold" on one or both parties. However, legal agencies may hesitate to get into a "dismal swamp" where they will not be able to sort out conflicting claims in a complex relationship. Moreover, legal agencies may hesitate to intervene when their attempts will cause great resentment and resistance. They will avoid these "hot potatoes". Refusing to intervene may help the "living tree" of relationships grow.

78 Bloom, Heinzelmann & Alt, An Evaluation of Franchisee-Protection Legislation in the Petroleum Industry, 5 Journal of Policy & Marketing 105 (1986), evaluated the impact of state legislation in the 1970s before it was preempted by the federal statute. Using interrupted time series analysis, they found that the state statutes were somewhat effective at slowing the decline of the number of dealer-operated stations during the 1970s, but they did not significantly affect competition and efficiency in gasoline retailing. They note that having more competitors does not necessarily lead to greater competition and efficiency. Moreover, these laws could not divert the strong trends that were developing in the petroleum industry during the 1970s.

Nevin, Hunt & Ruekert, The Impact of Fair Practice Laws on a Franchise Channel of Distribution, 28 MSU [Michigan State University] Business Topics 27 (1980), conducted in 1978 a mail survey of retail gasoline dealers in two states with state franchise protection statutes and two states without such legislation. Dealers were asked: "Has your franchisor ever threatened to revoke your franchise (terminate your franchise agreement)"? There were no significant differences in the responses between either of the two states that had fair practice legislation and the control states that had no such law. The authors concluded that the statutes had not reduced the use of termination threats. However, they speculated that "oil companies [may] have discontinued using certain unfair practices as a result of recent widespread attention by the press, the Federal Trade Commission, and the courts". Id. at 36. It is also possible that the laws in some states affect practices in other states. Oil companies are national or regional organizations. It may not be worth the effort to have different procedures in New Jersey which had a statute at the time of the Nevin, Hunt and Ruekert study and New York which did not. Indeed, as Nevin and his colleagues speculate, as a result of the New Jersey and other laws, the oil companies might change their practices in New York to help their lobbyists there argue that no law was needed.