II. THE STANDARDIZED CONTRACTS OF UNITED STATES AUTOMOBILE MANUFACTURERS

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INTRODUCTION

21. The automobile industry in the United States is large, very complex and has great economic power. The major manufacturers are run as bureaucratic structures designed to operate efficiently at all levels. Those people and organizations that deal with the manufacturers have patterned their conduct to accommodate this model of economic efficiency. However, new models of automobiles must be designed several years before they are offered to the public and the demand for new automobiles fluctuates significantly. Bureaucratic operation in the service of economic efficiency, time-span and fluctuating demand are all critical factors which are reflected in many different kinds of exchange transactions found in this industry. In this paper we will consider some of the exchange relationships between the manufacturers, and their suppliers, their dealers and their customers in order to generalize about contract as it is found in this kind of large scale industry. This discussion will be limited to practices within the United States and the consequences of those practices under its legal system. We lack data for a full comparative analysis. Nonetheless what is said here is likely to have relevance in other nations. The automobile manufacturers are important transnational corporations and their practices are models for other large corporations. While the precise legal techniques used will differ, it is likely that the goal of risk avoidance and minimization will be pursued in all nations in which such organizations operate.[76]

A. CONTRACTS TO BUILD AND SELL CARS

i. *The Manufacturers and Their Suppliers*[77]

a. Description of the Relationship

22. Although the manufacturers can and do make in their own plants some of almost all of the parts which go into an assembled automobile, they also buy many of these parts from suppliers. There are a number of reasons why they purchase from outside suppliers. First, the manufacturer gets a product without investing additional capital in buildings, machines and a trained work force. Second, the manufacturer gets a yardstick which can be used to measure the efficiency of its own division making the same item. If a division making grease seals can produce them at 2 cents each, but an outside supplier can make them for $1\frac{1}{2}$ cents each, the manufacturer knows he must reexamine the efficiency of his internal operation. Third, the manufacturer increases the chance that he may benefit from technological innovation. The supplier's designers and engineers may be able to suggest a different design or an improved manufacturing process. On the other side, most businesses, but not all, that can produce parts for automobiles want to sell their output to the automobile manufacturers because of the possibilities for extremely high volume production which, in an efficiently managed firm, can be highly profitable.

There are three additional factors influencing the course a manufacturer-supplier relationship takes: First, the mass production techniques of

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76 For a comparative analysis of contract law and contract provisions used in relationships between automobile manufacturers and dealers in the UNITED STATES, DENMARK, SWEDEN, GREAT BRITAIN, GERMANY, SWITZERLAND and AUSTRIA see *Foighel and Gammeltoft-Hansen*, The Law of Automobile Dealer Contracts (Copenhagen 1970).

77 The discussion about the manufacturer-supplier relationship is based on information supplied by and interviews with representatives of automobile manufacturers and suppliers. The information was supplied on condition that it not be used in such a way as to identify its source.

American automobile manufacturing require that the assembly line not be stopped. When, for example, a particular Ford sedan arrives at a certain point on the assembly line four hubcaps must be there ready to be installed. It would be extremely costly to the manufacturer if the line had to be stopped because the supplier's machines that stamp out hubcaps broke down, because a suppliers' inventory was not great enough to meet the demand or because the parts were lost in shipment. However, demand for automobiles and even for particular types of automobiles fluctuates. To a great extent, this second factor offsets the first. The easiest way to avoid stopping assembly lines would be to produce large quantities of parts far in advance of need. Yet this approach increases costs because of the possibility of waste and the loss of the use of funds thus devoted to inventories. If, for example, the demand for station wagons declines during the year, exhaust pipes that fit only station wagons that will never be produced are mere scrap metal. Third, component parts can be defective, the defect can cause injury to property or person, and in United States law the injured party in such cases has increasingly been gaining rights against manufacturers. Not surprisingly, one finds that manufacturers wish to hold suppliers responsible for such claims, and the suppliers must defend themselves against the costly results of seemingly minor defects in the parts they make.

b. The Blanket Order System

aa. The System Described

23. The *manufacturers* have accommodated all of these economic and legal factors in an imaginative piece of transaction architecture which is usually called a "blanket order."[78] Coupled with the suppliers' great desire to do business with the automobile manufacturers, the blanket order system almost always insures that parts will arrive at the assembly plants at the right time, that the suppliers will take the risk of scrapped parts caused by fluctuations in demand, and that the suppliers will be responsible for claims caused by defects. Moreover, the system gives the manufacturers great leverage to ward off price increases caused by the suppliers' increased costs.

This is how it works: Some time before the beginning of the model year, the manufacturer will issue a blanket order to a supplier of, for example, tail pipes designed specifically for one of the manufacturer's station wagons. The blanket order states a number of "agreements." One of the most important is the price per unit. This price is computed on the basis of an estimated number of units to be ordered, and it will not be increased if fewer are actually ordered. Thus, the manufacturer has made the supplier run the risk that he will not even recover his cost of producing the items actually shipped to the manufacturer in the event that the manufacturer uses substantially fewer than the estimated number. And the blanket order does not oblige the manufacturer to take and pay for *any* of the parts described in it. That obligation comes only when the manufacturer sends the supplier documents called "releases." The idea seems to be that the blanket order creates a force which is held back until released little by little.

Each month, sometimes more often, the manufacturer sends the supplier a release, ordering him to manufacture and ship a specified number of the parts each week. On the release form, the manufacturer also will estimate the number of parts he will require for the next two or three months, but this estimate, to quote one manufacturer's form, "is for planning purposes only and does not constitute a commitment." Typically, manufacturers do not send releases calling for more parts than they will need in a month since their monthly estimates of sales are fairly accurate. However, sometimes they do order too few or too many parts. If there is an increase in public demand for a particular model, the blanket order allows the manufacturer to send another release form to the supplier calling for increased deliveries. Such sudden increases may be a great strain on the supplier if he does not have unused capacity for production. Moreover, a supplier must always guard against a break-down of his machinery, which temporarily destroys his ability to meet the manufacturer's demands. As a result, the supplier usually makes more than the number of parts ordered by the manufacturer so that the supplier will have an inventory to cover anticipated future demands. He builds this inventory at his own risk since the blanket order clearly provides

[78] Many divisions of the General Motors Corporation use what are called requirements contracts rather than blanket orders. However, because of the way the General Motors' requirements contracts are written and administered, the two systems are essentially the same in operation. The General Motors' standard agreement form for production requirements calls for it to "purchase . . . approximately the percentage shown on the attached exhibit (of) the Buyer's requirements . . ." Legally, the key word would be "approximately" since it might be interpreted to undercut any commitment to buy.

that "Seller shall not fabricate any articles covered by this order, or procure materials required therefor, or ship any articles to Purchaser, except to the extent authorized by... written releases... Purchaser will make no payments for finished work, work in process or raw material fabricated or produced by Seller in excess of Purchaser's written releases."

If a manufacturer has "released" too many parts in light of a sudden decrease in demand, the blanket order gives it the right to cancel the amount ordered in whole or in part. It then is obligated to pay the contract price for each part finished and "the cost to Seller (excluding profit or losses) of work in process and raw material, based on any audit Purchaser may conduct and generally accepted accounting principles..."[79]

bb. Blanket Orders and American Contract Law

(1) Legal Enforceability

24. American contract law would likely support the manufacturer's plan for the transaction so that, when the law is combined with the market situation, the manufacturer's interests would be favored. Under that law there must be an exchange of promises or of performances to create a legally enforceable contract. In a blanket order the manufacturer makes no promise until it sends a "release," and so until then there has been no exchange and contract rights have not been created.[80] In effect, at the manufacturer's request, the supplier makes an offer – a promise to supply certain goods if they are ordered – which the manufacturer accepts every time it sends a release. The continuing offer and the many acceptances create a series of contracts. It is possible that two developing doctrines in the Common Law of the United States might be applied in the future to offer remedies despite the absence of a contract. Reliance by the manufacturer on the supplier's promise to fill all orders might receive legal protection, in the unlikely event it were needed, by the growing "firm offer" doctrine.[81] Reliance by the supplier on any assurances (most likely implied ones) of the manufacturer that it would order a reasonable quantity might be protected by the development of rules requiring fairness in negotiations.[82]

25. One can only speculate about the legal

[79] General Motors' requirements contract reserves no such right. Interviews, however, indicate that General Motors occasionally does cancel these contracts and pays what it deems reasonable cancellation charges. These charges would be no more than those stated in the text.

[80] *American Law Institute*, Restatement of the Law of Contracts § 19, 75 (St. Paul, Minn. 1932).

[81] In *Drennan v. Star Paving Co.*, 51 Cal.2d 409, 333 P.2d 757 (1958), the Supreme Court of California found that reliance by a general contractor on a subcontractor's oral bid made the bid irrevocable. There was no express promise not to revoke the offer, but the Court found such a promise by implication and applied Restatement of Contracts § 90 which provides: "A promise which the promisor should reasonably expect to induce action or forbearance of a definite and substantial character on the part of the promisee and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise." The UCC § 2-205, provides that one can make an irrevocable offer without consideration in a signed writing which "by its terms gives assurance that it will be held open..." It is not clear whether the UCC overrules the *Drennan* decision insofar as it might be applied to transactions in goods. That decision did give protection to an oral bid which by its terms made no mention of irrevocability. The statute may be held to overrule the earlier case or it may be taken as merely providing another way to make a legally binding firm offer: One can do it by reliance under the circumstances involved in *Drennan* or one can execute the writing called for in UCC § 2-205. It is not clear, moreover, whether a supplier's response to a blanket order would be interpreted as an offer which by its terms gives the requisite assurance. A final clause in UCC § 2-205, might offer another difficulty. It provides "but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror." The manufacturer supplies the blanket order form and the supplier only signs the entire document once at the end. Of course, if a manufacturer wanted a legal right to a supplier's continued performance, it would be easy enough to plan the transaction to achieve this under the Common Law. Most simply, it could give the supplier consideration in exchange for an option to buy parts.

[82] In *Hoffman v. Red Owl*, 26 Wis.2d 683, 133 N.W. 2d 267 (1965), *Red Owl's* agent repeatedly assured *Hoffman* that he would become the operator of a franchised *Red Owl* grocery store if certain conditions were met. As *Hoffman* met one set of conditions, *Red Owl* repeatedly made new demands which *Hoffman* also met. Finally, *Red Owl* refused to award *Hoffman* the contract. The Court found that *Hoffman*'s reliance on the agent's assurances should be protected under Restatement of Contracts § 90. However, it awarded very limited damages. The decision may mark the beginning of the development of a new doctrine of fairness in negotiations or it may be only a relatively isolated instance. The precise contours of such a doctrine will be difficult to mark out. For similar earlier decisions, see *Goodman v. Dicker*, 169 F.2d 684 (D.C. Cir. 1948); *Kearns v. Andree*, 107 Conn. 181, 139 A. 695 (1928). However, in *Monte Carlo Motors, Inc. v. Volkswagenwerk*, 1 Cal.Rptr. 920 (1960), the Court refused to adopt such a doctrine. It stressed that the plaintiff knew it had yet to conclude a contract and so

situation in light of general principles of contract law and the Uniform Commercial Code, since litigation testing these conclusions is unlikely.[83] The large automobile manufacturers try to avoid placing total reliance on any one supplier, and other suppliers usually can increase production so that a manufacturer's assembly line is not stopped for lack of an item. Thus manufacturers tend to avoid injury rather than litigate for compensation. On the other hand, no automobile parts supplier is likely to bring a case against a manufacturer; the loss on any one order is very unlikely to be large enough to justify jeopardizing future business. Of course, the trustee of a bankrupt supplier would be free of this constraint. However, in light of the uncertainty of the supplier's legal position, many trustees would think it unwise to risk the cost of legal action against a manufacturer.

26. What are the consequences of the legal situation? If we assume that the developing reliance and fairness doctrines would not apply, the parties get legal rights only after the manufacturer has issued a release and only as to the goods ordered in that release. This means that there can be a great deal of reliance by the supplier which is unprotected by contract rights. On the other hand, legally the supplier would be free to refuse to continue the relationship by revoking his outstanding offer to supply the parts as ordered by the release forms. As we have said previously, few suppliers who were not going out of business could afford to exercise such a right; very few situations short of bankruptcy would justify losing the good will of General Motors, Ford, Chrysler or American Motors. Most importantly for the manufacturer, it does get legal rights once a release is issued. As a result, it manages to avoid any question that the supplier will bear liability for injuries caused by defective parts which it ships. Once the parts are ordered by a release there is a contract which the manufacturer has written, and the disclaimers and limitations of remedy so typically found in documents drafted by sellers are thus avoided.[84] As between Chrysler and its suppliers, the responsibility for compliance with federal safety and air pollution regulations is also clearly placed on the supplier.[85]

(2) Remedies

27. The standard blanket order documents

it was taking its chances when it relied. It seems likely that today most automobile parts suppliers are well aware of the risks they are taking under a blanket order system if this is to be the decisive factor. See, generally, *Henderson*, Promissory Estoppel and Traditional Contract Doctrine: 78 Yale L.J. 343 (1969).

[83] Only one case involving a manufacturer-supplier dispute has been found. This case arose shortly after General Motors started using the blanket order system, and the supplier claimed he was misled. The court was very critical of the General Motors' blanket order system. See *Streich v. General Motors Corp.*, 5 Ill.App. 2d 485, 126 N.E.2d 389 (1955). Perhaps General Motors now uses the form of a requirements contract in response to this criticism.

Apparently, resort to litigation and arbitration by those in manufacturing industry is far more common in the SOVIET UNION than in the UNITED STATES. *Dietrich Loeber* states that "it is likely that State and Departmental Arbitrazh together decide about one million cases yearly." *Loeber*, Plan and Contract Performance in Soviet Law: *LaFave* (ed.), Law in the Soviet Society (Urbana 1965) 128, 133. My study of reported cases from 1945 to 1960 involving the 500 largest manufacturing corporations in the UNITED STATES indicates that a comparable estimate for the UNITED STATES would be only a small fraction of this amount. One can only speculate about the reasons for the difference. Perhaps a planned economy by its nature requires those who manage its units to be more formal and to obtain authoritative resolutions of rights and duties. Perhaps this is influenced by the greater or lesser number of alternative sources of supply open to the managers.

[84] For example, the Chrysler clause reads: "Seller warrants that the supplies or services covered by this order will comply with the specifications, drawings, descriptions or samples furnished or specified by Purchaser (Chrysler) and that the same will be merchantable, of good material and workmanship and free from defects. Seller warrants that any supplies furnished under this order that are designed by Seller will be fit and sufficient for the purposes intended. Seller specifically agrees to defend, indemnify and hold harmless Purchaser from and against any and all claims, losses, damages and settlement expenses resulting from or arising out of a breach of Seller's warranties and of which Purchaser notifies Seller at any time." Most sellers would give a purchaser no more warranty than replacement or repair of defective goods if the purchaser gives notice within a limited time. It is interesting to contrast what large corporations demand as warranties in the form contracts they use in the role of buyers of goods with what they offer in the forms they use in the role of sellers. See the discussion of the warranties offered by Chrysler and the other manufacturers *supra* s. 40–43 of this article.

[85] "Parts furnished under this order, being SAFETY /FED items, call for special attention to quality control procedures during their manufacture and/or assembly."

"Supplier's attention is drawn to the application of Chrysler's SAFETY/FED Performance Standard (Form 200-35-A) to these parts and the possible effect upon them of Federal Health and Safety Standards."

drastically limit the remedies to which a supplier would otherwise be entitled under American contract law once a legally binding contract is created by the issuance of a release. Typically, the manufacturer reserves a right to cancel the goods ordered by its release, either in whole or in part. Under American contract law such a cancellation would be a breach if not authorized by the agreement, and, absent a contract provision to the contrary, the seller would be entitled to recover what he had spent in performance before the buyer's notice of cancellation plus the profit he would have made had he been allowed to complete his performance.[86] Most blanket order cancellation clauses, however, exclude a right to profit except as to those parts which have been completed before cancellation. Thus even when a contract is formed by a release, the supplier's rights in most situations will be minimal. The manufacturer gains a practical commitment from the supplier to meet the demands of its assembly line. It retains maximum flexibility by making no commitment to buy any parts until a release is given and making only a very limited payment if it wishes to cancel after one is sent.

c. The Absence of a Reform Movement

28. There are no statutes attempting to regulate this relationship, and no movement seeking such legislation has been discovered. Insofar as statutes in the United States are the result of pluralistic struggle and compromise, one essential element of pluralism seems lacking. It would be hard to form a group of suppliers to seek legislation. Supplying the manufacturers is very profitable for a firm that can accept all of the risks allocated to it by the blanket order system. Such successful firms would hesitate to jeopardize their standing with the manufacturers by supporting an organization taking a stand antagonistic to the manufacturers' interests. Without the most successful firms, such a group would lack political power. Firms that do not wish to assume the risks of the blanket order system can easily seek other customers since their facilities are not limited to producing original-equipment automobile parts. "Exit" is a relatively cheap remedy for dissatisfaction in this case.[87] The facilities devoted to producing original-equipment parts can be converted readily to producing parts for repairing automobiles – the so-called "after market" – or to supplying related industries such as truck or industrial engine manufacturers which, generally, do not have the bargaining power to use the blanket order system. "Voice" – using private or legal power to change the allocation of risks – would entail high costs and the chances of success would not be great in light of the many resources of the manufacturers.

Moreover, insofar as statutes flow from the efforts of those with access to the communications media attempting to enhance their status and power by acting as champions of the deserving underprivileged, this seems an unpromising area. The auto parts suppliers typically are not small businessmen but only smaller organizations than the giant auto manufacturers. The image of the suppliers is that of junior partners who are well-paid for taking large but acceptable risks: it would be hard for an ambitious United States Senator to champion them as the exploited victims of the corporate system.

Finally, insofar as one explains United States legislation as an instrument of the powerful to further their interests, no statutory action is needed in this area. The Common Law of contracts serves to legitimate and support the manufacturers' procedures by minimizing or denying rights to the suppliers.

29. In summary, the manufacturers have tailored a relationship whereby they get most of the advantages of producing parts in a division of their own firms while preserving most of the advantages of dealing with an outside organization. The suppliers are offered a chance to make high profits in exchange for assuming great risks. Most suppliers are eager for the chance to play the blanket order game.[88] The public may get better automobiles at a lower price as a result of the system,

[86] UCC § 2-704 (2); 2-708 (2).

[87] See the analysis in *Hirschman*, Exit, Voice and Loyalty (Cambridge, Mass. 1970).

[88] The blanket order system may not be very different from the pattern of expectations which would exist if the manufacturers made contracts for fixed quantities of parts with their suppliers. Study of the contract documents typically used in other industries and interviews with businessman and their lawyers disclose that in many situations purchasers assume they may "cancel" their orders when a change in demand causes them to no longer need the items ordered; suppliers usually accept this as one of the risks of business, particularly if the item in question is not being made specially for the buyer but is what the seller offers in the normal course of his business. At times the contract documents contain cancellation clauses, but even where they do not, the right to cancel is widely but not always assumed to exist. After cancellation, the key question is what the buyer must pay to the seller to use this privilege. The obligation is not always clear. Many purchasers think that the supplier is not entitled to his full anticipated profit on the transaction. Many would limit cancellation charges

but one cannot be sure. There are important parallels to the contract system used by the United States government to procure military equipment such as tanks and aircraft. Since experience may change the need for a weapon or call for a modification in its design, the government retains great power to change or terminate its orders to private industry while paying less than the damages specified in general contract law (see *infra* ch. 4). It is thought that the risks in dealing with the United States government are reflected in higher prices paid to the weapons industry on government contracts. The automobile manufacturers may also pay for the flexibility in the blanket order system. However, unlike the United States government, the manufacturers make some of their own needs of each type of part. They can turn to their own divisions if prices are too high, and they can negotiate about prices with suppliers in the light of detailed knowledge about what it costs to make the item. Moreover, unlike the government's, the manufacturers' decisions and negotiations are not directly subject to a political process.

ii. *The Manufacturers and Their Dealers*

a. Description of the Relationship

30. The automobile manufacturers sell most of their cars through networks of "franchised" dealers. The dealers are independent businessmen. The franchise system offers, or at one time offered, a number of advantages to manufacturers as compared to operation of their own stores at the retail level. Instead of having its capital tied up in show-rooms and garages, the manufacturer can pass this burden on to a dealer. Moreover, a dealer who has invested his own money in the business has incentives which would not work as forcefully on an employee managing a factory-owned sales branch. The dealer will want to maximize his own return by his sales success. Selling cars is also a trading business since most potential customers have an older machine to trade in on a new one. A dealer will have more incentive to keep a trade-in allowance at a reasonable level than would an employee. As to the public interest, independent dealerships offer advantages of decentralization in decisionmaking. The dealer should be able to treat the customer as an individual rather than merely apply rules developed by a home office for governing branch office operations. These are the reasons usually offered to explain the franchise system. Today, however, the manufacturers may not need the contribution of capital from their dealers, and they may have adequate incentives and controls as bureaucratic techniques have developed. Nonetheless, the manufacturers would face significant political opposition if they attempted to end the franchise system suddenly and openly. American society has been concerned about the size and power of the automobile industry for a number of years, and such a display of power and the resulting injury to small businessmen would likely prompt some governmental response.

The franchise contracts impose certain controls which are designed, primarily, to serve the *manufacturers'* goals. A dealer might want to sell fewer units at a high profit on each one; the manufacturer wants to sell more units and wants dealers to take a smaller profit on each to maximize volume. It is easier to coordinate a network of dealers across the United States if there is a certain amount of standardization. A manufacturer wants its trade name used so as to exploit its advertising, but some actions of a dealer can injure that trade name. For example, customers may identify poor service with the manufacturer when the local dealer's performance is poor. All in all, the manufacturer wants to gain the advantages of having a network of independent businessmen handling problems at the retail level while still enjoying the advantages of the control it would have if it ran its own retailing entirely.

to payment at the contract rate for items completed before cancellation and payment for the raw materials which cannot be salvaged in partially completed items. Thus, the conventional measure of contract damages in the UNITED STATES contract law awards an aggrieved party more than many businessmen think appropriate. Of course, the possibility of a breach of contract action with its damage measure defined as the net profit on the entire transaction had it been performed plus expenditures in part performance, may serve indirectly as one factor in inducing industrial buyers to cancel only when suppliers would accept as legitimate the reasons for not wanting the goods. It may be that it is legitimate to cancel an order for steel when there is no demand for the product which the buyer planned to manufacture with the steel; it would not be legitimate to cancel because another supplier of steel offered a lower price. Another way of viewing the matter is that businessmen recognize far broader impossibility and commercial frustration excuses for nonperformance than does the law. In summary, the pattern of risk allocation found in the blanket order system may deviate far more from the contract lawyer's model of business than from the actual expectations of those managing the relationships between large business corporations. See *Macaulay*, Non-Contractual Relations in Business. A Preliminary Study: 28 Am. Soc. Rev. 55 (1963).

The dealer sees the franchise as a way to run a very profitable business, trading on the good name of the manufacturer. And most dealers are among the most successful retailers in their communities. But dealers tend to want independence from factory control; they want freedom to run "their" business as they see fit. From a standpoint of bargaining power, the relationship is one of dependence of the dealers on the manufacturer. A dealer's building, organization and skills cannot readily be shifted into another type of business, and there are few alternative franchises available. Rarely, will a manufacturer ever need the services of a specific dealer.

b. The Original Dealer Franchise: A Contract at Will

31. Sometime in the mid-1950's, the manufacturers changed the relationships they had with their dealers because of the impact of the legal system. Before this time, the relationship with the dealers was very similar to the one they have with the parts suppliers. The franchise document typically was relatively short; it required, in effect, that the dealer keep the company satisfied with his sales, service, facilities, and personality; carefully said that the manufacturer was not promising to fill any of the dealer's orders for cars or parts and that the dealer was not an agent for the company; and allowed either party to terminate the relationship at will. The dealer had no contract rights that could be enforced in court, third parties would have had trouble holding the company responsible for the dealer's actions, and the company could press for greater sales by being hard to satisfy and using its right to terminate at will as a sanction. Upon cancellation a dealer lost any going-business value and found himself with a sales and service building which could not easily be put to any other use. And manufacturers did threaten to cancel franchises and in fact did so. Moreover, dealers were coerced to purchase hard-to-sell types of cars and accessories from the manufacturers. During the depression of the 1930's, manufacturers pushed dealers relentlessly for more sales, sales which were extremely difficult to make. During the early 1950's, General Motors and Ford competed for dominance in the market, and both used great pressure on their dealers to outsell the competition.

c. Reform Through the Legal System

aa. The Law of Contracts

32. Increasingly during this period, cancelled automobile dealers turned to the legal system to try to offset the manufacturers' power under the franchise system. Some sued for breach of contract, attempting to convince courts to construe the franchises as imposing a duty of good faith on the manufacturers.[89] Most of these suits were unsuccessful as the courts stressed that the dealers had assumed the risks of the franchise system voluntarily when they entered into such one-sided relationships. The standard of free contract served to justify the use of the manufacturers' economic power.

bb. The State Legislation

33. In 1937, an automobile dealers' trade association successfully lobbied for legislation in Wisconsin which was to become the model for legislation in 20 other states.[90] The most successful of these statutes required manufacturers and their representatives who contacted dealers to obtain state licenses. Licenses could be revoked if a manufacturer or his representative: (1) induced or coerced a dealer to accept delivery of cars or other things that he did not order, or attempted to do this; (2) induced or coerced a dealer to enter any agreement with the manufacturer or "to do any other act unfair to said dealer"[91] by threatening to cancel the dealer's franchise, or attempting to do this; (3) "(u)nfairly, without due regard to the equities of said dealer and without just provocation . . ." cancelled the franchise of a dealer. As a result of these statutes, in many states informal mediation procedures have evolved. Dealers with complaints meet representatives of the manufacturers in informal hearings before the agencies which administer these statutes and bargain out their differences. Typically, it is unnecessary to hold formal hearings for license revocation or to go to court for enforcement of private rights granted by the statutes, steps which are expensive for both parties and used only as a last resort for recouping losses or for vengeance when all else fails. The statutes create and maintain bargaining power for the dealers to offset, to some degree, the manufacturers' natural advantages.

While many of these state statutes were highly

[89] See, *e.g., Bushwick-Decatur Motors, Inc. v. Ford Motor Co.*, 116 F.2d 675 (2 Cir. 1940).

[90] Wis.Stat. § 218.01 (1971). A table of state legislation introduced, passed and defeated appears in *Macaulay* 35-37.

[91] Wis.Stat. § 218.01 (1971).

effective, some were not. In a few cases, state supreme courts declared them unconstitutional.[92] In other states, the statutes assigned enforcement responsibilities to agencies which had neither the desire nor the resources to enforce them. Finally, the automobile manufacturers successfully lobbied to prevent passage of such statutes in many states. All of this prompted an appeal to the federal government.

cc. The Federal Legislation

(1) The Impact of Hearings

34. The National Association of Automobile Dealers sought help before the Federal Congress in 1954. Full dress hearings were held before two Senate Committees and received wide press and television coverage. As a result of, and in defense against these hearings, the manufacturers rewrote their franchise agreements. Most significantly, they set up standards of performance. In order to justify cancellation, a dealer would have to fail to meet one of these standards; no longer did the manufacturers reserve the power to cancel at will. For example, now a Ford dealer's sales performance is measured by first comparing the dealer's sales to (1) the total registration of all cars in his locality, (2) the sales objectives established by Ford for his locality, and (3) the sales of Chevrolet, Plymouth and American Motors in his locality. Secondly, the dealer's sales are compared to (1) those of three other Ford dealers of comparable size in the nearest comparable areas, and (2) the average of all Ford dealers in his zone, district, region, and nationally. In making these comparisons Ford will also consider (1) the history of the dealer's sales performance, (2) the availability of cars to the dealer, and (3) "special local conditions that might affect the dealer's sales performance." While this is a more limited right to cancel than the old requirement that a dealer sell "to the satisfaction" of Ford, the factory still retains broad discretion to increase the sales objectives for an area as it conducts new surveys, to select the areas for comparison purposes, and to judge both whether cars were available and whether there were local conditions which adversely affected sales. In addition to rewriting the franchise documents, the manufacturers created internal review systems to which dealers could appeal if they were unhappy with the administration of the relationship. General Motors has an umpire, who acts as a judge within their private legal system.[93]

(2) The "Dealers Day in Court" Act

35. In addition to these manufacturer-initiated changes, the hearings before Congress in the mid-1950's produced legislation. The federal "Dealers Day in Court" Act[94] giving dealers the right to sue manufacturers who failed to act in "good faith" was passed. "Good faith" was defined as: "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."[95]

The *proviso* was drafted by the Ford Motor Company and accepted by a House of Representatives Committee. Many dealers have sought relief under the Act, but only a handful have won judgments which have not been reversed by the appellate courts.[96] The *proviso* and the Committee Report on the statute have been used to construe the statute so that it does not apply to any conduct likely to occur within the manufacturer-dealer relationship. Although it is possible that judicial construction may open a new avenue leading to change, so far the statute cannot be shown to have been an important influence on transactions between manufacturers and their dealers.

dd. New Problems: New Attempts at Reform

36. In the mid-1960's, a new problem became significant. Manufacturers, particularly the Chrysler Corporation, turned to creating very large dealerships located in the fastest growing areas in large cities. The factories either put up buildings and ran the dealerships themselves or financed a man to begin such a dealership. The older established dealers were angered – and often financially hurt – by the new competition. They turned to suits under the Dealers Day in Court Act, to lobbying

[92] See, *e.g.*, *Rebsamen Motor Co. v. Phillips*, 226 Ark. 146, 289 S.W.2d 170 (1956).

[93] See *Whittaker*, The General Motors Dealer Relations Umpire Plan: 29 Bus. Law. 623 (1973).

[94] 15 U.S.C. § 1221-1225 (1964).

[95] *Ibidem* § 1221 (e).

[96] The dealers' lack of success is reflected in a table in *Macaulay* 94.

for more state statutes to license manufacturers and to a new round of hearings before the United States Senate.[97] This battle continues.

iii. *The Manufacturers and Their Customers*

a. Description of the Relationship

37. The manufacturers' goals concerning their customers are simple: they want to sell all of the new cars they possibly can. The products are heavily advertised, and people are urged to buy new cars while their old ones still have useful life as machines. Models generally are changed in appearance each year to create a demand for something new. The manufacturer strives to build an image for its products of quality, safety and reliability. Since a manufacturer's ideal customer will buy a new car to replace his old one every year or every other year, manufacturers are concerned about the continuing good-will and continuing loyalty of car buyers. The context in which the manufacturers have pursued their goals has changed over time. Since the Second World War, the United States has become more and more a nation of people who live great distances from their places of employment and shopping areas. At the same time there has been a decrease in the amount and quality of public transportation. Great amounts of government funds have gone into a network of roads to support this pattern of living. The private passenger car has become a "necessity." Judged by the way they used automobiles in the post Second World War period, most Americans formerly believed that their cars were safe and reliable. However, more recently complaints about unreliability and poor repairs have become more frequent and more loud.

b. The Changing Legal Context: The Statutes and Cases

aa. Introduction

38. When an automobile is sold, what obligations concerning safety and reliability are assumed by or imposed on the manufacturer? To what extent are American automobile manufacturers selling safety and reliability in their advertising, and to what extent do they pass through the terms of sales contracts the risk of danger and unreliability on to the people who buy their cars? To what extent have the courts and legislatures influenced the allocation of these risks? At the outset, one must observe that under the law of the various states it is still possible for an individual to sell his used car to another "as is," so that the buyer assumes the risk of any defects (UCC § 2-316 (3) (a)). An uncharitable observer might describe the practices of the American automobile manufacturers as an attempt to create strong expectations of safety and quality but to limit legal liability at the same time to an "as is" sale. There has been a change in the law in many states over the past 20 years; the trend has been to limit the manufacturers' power to avoid liability for unsafe automobiles although its responsibility for unreliability not likely to cause accidents is less clear. Moreover, when one takes into account the practices of the manufacturers, the situation is even more complex.

Suppose an owner of a new automobile is injured in an accident involving his car; suppose his car is damaged in an accident; or suppose his car will not function reliably. The owner believes that his physical or economic injury was caused by a defect in the automobile. What legal remedies might he seek? He could attempt to recover for the manufacturer's negligence in designing or building the car; he could attempt to hold the manufacturer responsible for promising that the car would be safe and reliable; and, since the mid-1960's in many states, he could seek to recover for his physical injuries under a developing liability without fault theory.

bb. The Tort of Negligence

39. At least theoretically, the owner's negligence suit would face two great problems. First, it is very difficult to prove that a manufacturer failed to act reasonably in making any particular automobile since it is almost impossible to recreate the events surrounding the building of any one of the hundreds of automobiles produced daily on an assembly line. Second, it is often impossible to show that damage to the car or to a person was caused by a defective part rather than by some intervening factor completely out of the control of the manufacturer. For example, suppose a car leaves the road and crashes. After the event, we can find broken parts. Did they break causing the accident or did the driver's inattention cause the accident that caused the parts to break? While one cannot be sure of the explanation, before the 1960's, negligence suits were not a major problem for the manufacturers.

[97] See, *e.g.*, *U.S. Senate, Subcommittee on Antitrust and Monopoly of Committee on the Judiciary*, Hearings on Franchise Legislation (90th Cong., 1st Sess.) (Washington, D.C. 1967).

cc. Warranty, Disclaimers and Absolute Liability

(1) Before 1960: Liability Limited by Contract

40. The law of the United States has long offered another theory of liability which avoids the problem of proving fault. Typically, a purchaser of goods can sue for breach of contract – a breach of warranty – on the theory of an express or implied obligation that goods supplied under a contract will be suited for their normal functions and will have at least the quality typical of such items. While the origins of this liability rest on implied contract, it is now codified into statute in almost all states (UCC § 2-313 – 2-315). However, historically, this obligation ran only to a party to the sales contract, one in "privity" with the buyer. The manufacturers once attempted to avoid liability by using this doctrine. They sold their products to their dealers who, in turn, sold them to consumers. Thus the consumers were not in privity with the manufacturer-dealer contract, and the manufacturer was not in privity with the dealer-consumer contract. The privity doctrine has been slowly dying, but any consumer seeking to sue a manufacturer had to be prepared to argue that his case came within one of its many exceptions. Moreover, sellers and buyers could disclaim the warranty obligation by contract (Uniform Sales Act § 71). Before 1960, all American manufacturers used a uniform warranty clause prepared by the Automobile Manufacturers Association. Most of the clause talked about a guarantee which was being given to the customer by the manufacturer. In essence, the manufacturer promised to repair the car until a specified period of time had elapsed or until the car had been driven a stated distance. The customer did receive a remedy not imposed by the law – repair of defects. However, in 23 words buried in a 154 word sentence, the uniform clause stated that "this warranty . . . (is) expressly in lieu of all other warranties expressed or implied and of all other obligations or liabilities on its part . . ." Thus, while the customer got a limited right to repairs, he paid a high price in exchange. He lost a right to damages for personal injury or injury to the car caused by its defects and a right to return an unreliable car and recover what he paid for it – all remedies which he would have had if the contract had said nothing. In the words which emphasized what the customer was given, a great deal was being taken away.

(2) After 1960: New Warranty Disclaimers and Liability Imposed by Government

41. During the early 1960's, two developments prompted the manufacturers to cease using the Automobile Manufacturers Association clause and to write their own warranties in a slightly different way. First, during the late 1950's and early 1960's, almost all American states adopted the Uniform Commercial Code. The Code raises questions about the ability of a manufacturer of an advertised consumer product to disclaim all warranties or to limit the remedies available for breach of warranty. Under one plausible reading of the Code, a manufacturer cannot create reasonable expectations of quality and reliability by advertising or representations at the point of sale while warding off legal responsibility by disclaimers or limitations of remedy that are written and presented so as to minimize the chance that the consumer will understand the risks that are being imposed upon him.[98] For example, under this view, Ford could not advertise the high

[98] Put as briefly as possible, the argument would be that statements about quality and reliability are "affirmations of fact" "which relate to the goods and become part of the basis of the bargain" and, therefore, create an express warranty (UCC § 2-313 (1) (a)). Even if a buyer could not point to specific statements, unless effectively disclaimed, there is also an implied warranty of merchantability (UCC § 2-314 (1)), which would require that a new automobile be of such quality and reliability as to "pass without objection in the trade under the contract description . . ." (UCC § 2-314 (2) (a)). Exclusion or modification of warranties is covered in UCC § 2-316. Express warranties and disclaimers are to be construed when possible as consistent but where such a construction is "unreasonable," "negation or limitation is inoperative." To "exclude or modify the implied warranty of merchantability or any part of it, the language must mention merchantability and in case of a writing must be conspicuous." "A term or clause is conspicuous when it is so written that a reasonable person against whom it is to operate ought to have noticed it . . . Language in the body of a form is 'conspicuous' if it is in larger or other contrasting type or color . . ." (UCC § 1-201 (10)). The Official Comment to UCC § 2-316 explains that the section "seeks to protect a buyer from unexpected and unbargained language of disclaimer by . . . permitting the exclusion of implied warranties only by conspicuous language or other circumstances which protect the buyer from surprise (no. 1)." One could argue that language of disclaimer should be deemed to be "conspicuous" only if as a matter of fact it does protect a buyer from surprise. Thus, a clause reading, "There is no implied warranty of merchantability" would not necessarily serve as an effective disclaimer even though it were printed in

quality of its vehicles and, then, by language hidden in the fine print of a form contract which was understandable only to some lawyers, so disclaim and limit its liability that it was selling its cars "as is" and "with all faults." However, a contrary reading is also possible. Under this interpretation of the Code, the question is a matter of form. If certain key words are used and the provisions are not too outrageously hidden, warranties may be disclaimed and remedies sharply limited.[99] The meaning of the UCC will remain open until the highest courts in at least several states address the question. The manufacturers' lawyers took the second interpretation of the UCC, and they were prompted to do what they could to protect the manufacturers by redrafting the form contracts which their dealers used in sales of automobiles.

42. The second development that prompted changes in automobile warranties has received a great deal of attention in legal journals. Appellate courts in several states expressed disapproval of the manufacturers' uniform warranty clause. The highest court of Massachusetts commented that this "is not the kind of agreement which commends itself to the sense of justice of the court."[100]

Then, in *Henningsen v. Bloomfield Motors* (and *Chrysler Corporation*),[101] the Supreme Court of NEW JERSEY found the manufacturers' warranty practices to be against the public policy of that state. The court objected to the fact that all American manufacturers used a single clause, that the clause was hidden from all but the most cautious who had the ability to translate legal language, and that the clause disclaimed a liability which the court implied ought to be assumed by

slightly larger type or a contrasting color. This might be the case where a reasonable person could have failed to notice the clause as, for example, where the clause was part of a lengthy and complex document customarily used in a manner to discourage reading before signing. Moreover, even if a consumer-buyer ought to have noticed such a clause, it seems likely that a high percentage of consumers would have no idea of the meaning of the statement: "There is no implied warranty of merchantability", particularly when presented as part of a clause purporting to grant consumers valuable rights in the context of the purchase of a product widely advertized to be of high quality and reliability. See *Whitford*, The Functions of Disclosure Regulation in Consumer Transactions: 1973 Wis.L.Rev. 400, 420, 425, 449. Such a taking away of rights in the guise of granting something when done by a national advertiser could well be deemed by a court to be "unconscionable" under UCC § 2-302. The Official Comment to that section states that its principle is "the prevention of oppression and unfair surprise (no. 1)."

Attempts to grant a warranty but to limit the remedy for breach are governed by UCC § 2-719. Generally, one can warrant his goods but limit the remedy to replacement or repair of any that are defective. However, the statute does provide: "Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not" (UCC § 2-719 (3)). Automobile warranties are worded as if only a limited warranty is being given. However, a court might well find that actually a full warranty is being given but that an attempt is being made to limit the remedy to replacement or repair at the option of the manufacturer. Despite the words used by the automobile companies, there is no such thing as a warranty of replacement or repair. Rather there is a warranty of *quality* (either an express one or an implied one of merchantability or fitness for a particular purpose) and *remedies* of replacement or repair. The manufacturers' purported disclaimers are, in substance, remedy limitations subject to UCC § 2-719 (3). If the manufacturer's clause were read as involving a limitation, it would be *prima facie* unconscionable where a defect in the car had caused injury to the person. See *Matthews v. Ford Motor Co.*, 479 F.2d 399 (4 Cir. 1973).

[99] This argument would first emphasize that the manufacturers are careful to create no express warranties. UCC § 2-313 (2) says that "a statement purporting to be merely the seller's opinion or commendation of the goods does not create a warranty." Advertising which commends the goods should not be deemed part of the basis of the bargain; the bargain is reflected solely by the written contract of sale. Second, implied warranties of merchantability are effectively disclaimed by conspicuous language which mentions merchantability (UCC § 2-316 (2)). Section 1-201 (10) says: "Language in the body of a form is 'conspicuous' if it is in larger or other contrasting type or color . . ." Automobile manufacturers almost always print a statement that "there is no implied warranty of merchantability" in larger type face, and thus they effectively disclaim the warranty. A court should not find such a disclaimer unconscionable under § 2-302 because the Code itself specifically authorizes such a limitation of risk in the words quoted from § 1-201 (10). Moreover, the language of the disclaimer is just that – a disclaimer. There is no reason to construe it as a limitation of remedy subject to § 2-719. In sum, the Code authorizes a certain form of achieving a purpose, and the legislatures which passed the Code have found that the use of the form of language mentioning merchantability in larger or contrasting type adequately balances the interests of manufacturers and consumers.

[100] *Hall v. Everett Motors, Inc.*, 340 Mass. 430, 165 N.E.2d 107 (1960).

[101] 32 N.J. 358, 161 A.2d 69 (1960).

the producers. In sum, the opinion implicitly charged the automobile manufacturers with dealing dishonestly with the public in order to be free to put dangerous vehicles on the road.

43. In order to deal with the set-back of the *Henningsen* case, to meet the challenge of an increase in the coverage offered by the Ford Motor Company warranty, and to gain some competitive advantage in marketing its cars, Chrysler Corporation then announced a greatly expanded warranty on all of its cars. The warranty offered customers a guarantee of some parts up to five years, but still, in terms, disclaimed any liability beyond repair or replacement of defective parts. The other manufacturers followed this lead. The new warranties of the four manufacturers differed in wording and in detail, but there are some common elements. All gave a warranty from the manufacturer to the consumer; they no longer attempted to use privity as a defense. All continued to disclaim liability for personal injuries and consequential damages such as lost profits caused by not being able to use the car. For example, Chrysler's warranty stated that this "warranty is the only warranty applicable to passenger cars manufactured by Chrysler Corporation and is expressly in lieu of any warranties otherwise implied by law (including, but not limited to, implied warranties of merchantability or fitness for a particular purpose). The remedies under this warranty shall be the only remedies available to any owner thereof or other person . . ." This statement still could be overlooked by consumers who were not alerted to look for it, and one can question whether most consumers would have understood its legal effect even if they did read the warranty carefully enough to find it.[102] The legal effect of all this effort at redrafting was limited in about one-third of the states during the mid- and late-1960's, when the highest courts in those jurisdictions adopted a rule of liability without fault covering defective consumer products which caused physical harm.[103] In these states the disclaimers apply only to purely economic harm such as damage to the vehicle.

c. Manufacturers' Practices: The Law in Action

44. A study of the litigation involving those injured by automobiles who sought to recover from the manufacturers and of the settlement practices of the manufacturers concluded that in the typical case the manufacturer did not assert its rights under the disclaimer as a defense.[104] The only question really in issue was whether or not a defect in the automobile caused the injury. If there was evidence that it had, the manufacturer was willing to settle despite its legal right to assert the assumption of risk defense or to assert that there was no proof of negligence in making the car. Litigation centered around the causation issue, too. Even in the landmark *Henningsen* case, Chrysler had not raised the disclaimer as a defense; the appellate court raised it on its own motion. At the trial, Chrysler relied on a hospital record on which it was stated that *Mrs. Henningsen* had said that she had lost control of the car because her hand slipped on the steering wheel.[105] Apparently, the manufacturers are moved by public relations considerations to deny that their cars are defective, and they are constrained by these same considerations not to be put in a public posture of saying that even though our car was defective and hurt a buyer, we will hide behind an obscure and technically worded clause to evade liability. The clause has been used when there was a claim of consequential damages. It always could be asserted where public relations considerations were outweighed by some other factor, and it might have an impact on settlement negotiations.

45. A study of the administration of the expanded warranties shows that consumers have had difficulty in many instances in getting the repairs which are promised to them.[106] The warranties were advertised widely in the mid-1960's and may have created expectations in the minds of new-car buyers far beyond the literal words used by the manufacturers. Dealers have reason to make repairs without charge in order to gain customer good-will which might aid the dealer when a customer next was in the market for a new car. While such good-will could also aid the manufacturer, it could be very costly. Moreover, some dealers who did not have enough service business to keep their mechanics busy might solve this problem by making unnecessary repairs if they could freely bill the manufacturer for them. The manufacturers control this process by a complex system governing payment of dealers for claimed warranty repairs. Most questions are covered in a detailed book of regulations given

[102] For evidence that consumers would not understand the disclaimer, see *Whitford*, Strict Products Liability 143-150.

[103] See *Titus*, Restatement (Second) of Torts Section 402A and the Uniform Commercial Code: 22 Stan.L.Rev. 713, 714 (1970).

[104] See *Whitford*, Strict Products Liability 160-163.

[105] See Appendix to Appellants' Brief in *Henningsen v. Bloomfield Motors, Inc.* (*supra* n. 101) 401a.

[106] See *Whitford*, Law 1094-1096.

to the dealer – if the claim is not authorized by regulation, the manufacturer will not reimburse the dealer for the work, and, as a result, dealers usually are careful not to make repairs unless they are clearly authorized. In the case of some expensive repairs, the dealer must notify the manufacturer before the work is begun and a manufacturer's representative must inspect the car and authorize the work. Moreover, many dealers claim that the manufacturer reimburses them for warranty work at a rate lower than that usually charged customers. This, too, provides an incentive to refuse to do warranty work, to do it quickly and not too carefully, or to delay doing it as long as non-warranty work is available to occupy a dealer's staff of mechanics.

46. How far can the legal system aid a consumer in getting repairs? At the outset, one must note that the expectations of many consumers are based on advertising which creates the impression that far more responsibility is being assumed by the manufacturer than the literal words of the warranty do assume. Often, the warranty coverage is not clearly presented to the customer when he is negotiating for the purchase of the car (although some manufacturers and some dealers do make great efforts to make the obligation clear). Secondly, the document which, as a practical matter, controls the extent of warranty coverage is the book of regulations sent by the manufacturer to the dealer, a book which the customer almost never sees. It is likely that the automobile-buyer does have a legally enforceable contract right to the guarantee made by the warranty for replacement or repair of defective parts. Moreover, it is likely that the coverage of that warranty obligation would be construed by a court in light of a customer's reasonable expectations based on the language of the warranty as read in the light of the manufacturer's advertising rather than its regulations sent to dealers. Nonetheless, the new-car buyer faces real difficulty in asserting these rights. Most warranty repairs, although involving significant amounts to the purchaser, still involve too little to make litigation worthwhile in view of the costs of suing a manufacturer. The one clearly effective remedy would be a right to rescind, return the car and obtain a refund of the purchase price. However, the express terms of the warranty bar this remedy and this limitation has yet to be overturned as unconscionable, if, indeed, it is.

d. Safety and Reliability as a Public Issue

47. All of this concerns individual complaints about particular vehicles. On another level, automobile safety became a general public issue in the United States and thus the government became interested in regulation of automobile safety and reliability. Hearings were held before the United States Senate to look into charges that automobiles were generally unsafe.[107] These hearings received wide publicity. The manufacturers made a number of modifications in their designs to better their positions as they appeared before Congress. But these efforts did not succeed. Legislation was passed creating an administrative agency and setting a procedure for framing safety standards for all automobiles sold in the United States.[108] Although controversy continues about whether or not these standards are adequate and about the nature of the enforcement tactics pursued by the agency, there is no doubt that the manufacturers are far more concerned about safety and reliability than in the past. From an era where injured buyers had few if any rights against the automobile manufacturers, we have come to a time when not only are private rights being expanded, but the very design of the automobile has become a matter in which the government has come to assume a responsibility to protect the buyer.[109]

B. CONCLUSIONS

i. *The Balance of Power and Risk*

a. The Manufacturers' Power

48. One can see some common elements in all of these relationships between manufacturers and others. Generally, the automobile manufacturer has great power and the market does not prevent him from writing a contract to serve his own interests, whether the other party is a supplier, dealer

[107] See, *e.g.*, Hearings on § 3005 before the Committee of Commerce on Safety Standards of Motors Vehicles (89th Cong., 2d Sess.) (Washington, D.C. 1966).

[108] See 15 U.S.C. § 1381-1410 (Supp. IV 1969).

[109] The Federal Trade Commission in February 1970 proposed a statute to the Congress which "would create a meaningful mandatory, statutory warranty instead of the meaningless involuntary, unilateral warranty now issued by the manufacturers . . ." The quotation is from an F.T.C. Report summarized in the Anti-Trust and Trade Regulation Reporter 24 Feb. 1970, p. A-18, A-19. The *Nixon* Administration gave support to the Bill. See New York Times of 12 March 1970, p. 1 col. 2, p. 18 col. 6-8. The Bill was not enacted.

or new car buyer. For example, the manufacturer offers both suppliers and dealers the chance to earn unusually great returns on their investments which for most suppliers and dealers makes the power of the manufacturers easy to accept. Buyers of automobiles have relatively few manufacturers to choose from, and there is little competitive advantage in assuming a liability for injuries caused by defects in cars since a manufacturer could not advertise that he had assumed such a responsibility without, at the same time, drawing to the attention of potential buyers the fact that cars are sometimes defective and hurt people. Also buyers often are concerned with the appearance of a car and its price far more than with its safety and reliability – qualities which they just take for granted. Even in the rare instances where the other party – a supplier, for example, writes the contract, the automobile manufacturer's economic power serves to deter any attempt to use rights formally reserved. For example, Ford and Reynolds Aluminum Corporation had a contract drafted by Reynolds whereby it received a legal right to supply up to 30 per cent of the dollar volume of Ford's annual purchases of aluminum products.[110] A Reynolds executive responded to a question from a Congressional Committee by saying:

"I don't think I agree with you that the contract requires Ford to buy 30 per cent from us . . . Maybe that is the final legal commitment but we are not in position to require Ford to do much of anything at the time we try to sell it."[110]

A Ford executive stressed that Ford viewed the contract, despite its express terms, as merely giving Reynolds "an opportunity to quote" prices.[110]

b. Dependent Relationships

49. What kinds of relationships do manufacturers create when they exercise their power? They create contracts of adhesion with all the characteristics of standardization to serve the ends of coordinating large scale enterprise. These contracts can be viewed profitably as a type of private legislation – the Ford dealer franchise document even looks like a statute; it has a preamble, an elaborate organization with cross references and definitions, and a detailed index. Much first class legal and business talent has been applied to planning and drafting these "contracts." These men have produced elaborate systems for dealing with complicated situations in uniform ways. Transaction plans have been mass produced so that lower status personnel have relatively few important decisions to make. Moreover, economic power and standardization have been used to ward off risks by transferring them to others. If demand for automobiles falls, suppliers must assume some of the loss. If the factory wants to replace a dealer, he takes the risk of a loss of going business value. If there is an accident, the consumer takes the risk of injury. Of course, as a matter of administering these relationships the manufacturers can grant favors to suppliers, dealers or buyers,[111] but these are favors and not legal rights except in the instances where legal regulation has interfered.

50. These standardized contracts are carefully worded to avoid contractual liability in most instances. No major commitments are made under blanket orders which could justify a suit for breach of contract. Originally, a dealer franchise was terminable at will. Now it can only be terminated for failure to comply with a complex standard which, however, gives the manufacturer the power to make a series of judgments as to the adequacy of a dealer's sales. While the courts might find that these judgments must be made in good faith, it is unlikely that this would be a serious limitation on the manufacturer's power to behave so as to maximize its economic interests. To a great extent, in these areas freedom of contract is the freedom to have no contract – as far as having a legally enforceable agreement is concerned.[112] The new car warranty granted to buyers, on the other hand, is designed as a legally

[110] *Peck*, Competition in the Aluminum Industry 1945–1958 (Cambridge, Mass. 1961) 141–142.

[111] See *Fuller and Braucher*, Basic Contract Law (St. Paul, Minn. 1964) 308.

[112] In one important situation the manufacturers were and are careful to safeguard their formal legal rights against dealers. Many dealers need credit to finance the inventory of new vehicles they must have on hand in order to do business. Usually, the manufacturer sells vehicles to its dealers for cash and not on credit. In order to pay the manufacturer, dealers must borrow money. In a financing arrangement called "floor planning," dealers can use their inventory of new vehicles as security for loans to pay manufacturers. Frequently, the lender will be an organization with no connection with the automobile industry. However, most UNITED STATES automobile manufacturers have a relationship with a lending institution which offers floor planning to its dealers – the General Motors Acceptance Corporation, for example, is a subsidiary of General Motors. GMAC is very concerned about the legal structure which supports the security arrangements involved in financing the inventory of its dealers. Commercial law makes a difference where security interests are involved. For a study of the law and business practices relating to floor

enforceable contract, but the main reason it is designed to be legally enforceable is to disclaim a liability which would be imposed if no contract were made concerning it. It, too, is an attempt to avoid legal control over private power.

ii. *Evaluation: Benefits at What Price?*

a. The Balance of Gains and Costs

51. Undoubtedly, this kind of rationalized planning has advantages. It is not an insignificant part of a system which has produced great wealth for executives of automobile manufacturers, stockholders in these companies, automobile dealers, parts suppliers, and even, to some extent, for workers employed by this industry and its satellites. The high demand for automobiles produces opportunities for profit and jobs in many related industries and has a major impact on the total American economy. The system may have produced less expensive automobiles than could be made by any other, since one can assume that if the manufacturers had had to assume all of the risks they avoid by these contracts, they would have passed on these costs to buyers in the form of higher prices for new cars.

52. However, these benefits have not come without important economic and social costs. Perhaps the most significant cost is the contribution that this rationalization has made to a system of private transportation based on replacing private machines before the end of their useful lives. One can point to the waste of scarce resources and the misallocation of public funds that this society has used for super-highways and car storage at the price of the decline of the mass transportation system and the neglect of the needs of those who cannot and do not wish to drive their own automobiles.

There are also costs even if one assumes that the United States' system of transportation based largely on the private automobile is, on balance, a good thing. The planning structures which have been described here maximize economic rationality at the cost of other values, most of which we can categorize as personal concerns. Parts suppliers and automobile dealers must operate under great emotional pressure, constantly facing economic tests that are hard to pass. The blanket order and the dealer franchise are designed to minimize the pull of considerations such as sympathy and forgiveness of mistakes. These mechanisms call for people to devote major portions of their lives to a kind of competitive "sport" – can Jones Corporation make a grease seal more cheaply than Ford's own division can? Can the Ford dealer in a particular city overtake the Chevrolet dealer and sell more cars? Moreover, in order for rationalized economic plans to work, parts suppliers, dealers and automobile buyers must surrender important amounts of control of their own destinies and enter relationships of dependency on large and relatively impersonal organizations.[113] For example, an executive for a major supplier to the automobile industry has described to me the frustration of trying to talk about changes in the blanket order system or in its administration with a representative of the manufacturer. The representatives with whom the executive could talk have no authority to make changes in procedures. The executive tried to get an appointment with officials who had this power, but these men refused to see him. Automobile dealers make similar complaints. They must use advertising designed by the manufacturer, install the manufacturer's bookkeeping and accounting system, and rely on the manufacturer to offer and make available to the dealers the kinds of cars that they can sell without having any voice themselves in these matters. This dependency and control stands in sharp contrast with the usual invocation of the advantages of being an "independent businessman" in the American "free enterprise" system. The new car buyer similarly cannot negotiate with those who have power to bind the manufacturer; the buyer must deal with a dealer who lacks this authority. The buyer usually gets an automobile of a certain degree of reliability and safety. However, a buyer's ability to purchase cars produced by competitors is only one of many influences on that degree of reliability and safety since most cars offered to the public are about equally safe and reliable. Also, there are few channels of information about the matter so that most buyers will lack knowledge. Manufacturers do warrant their cars against certain defects for a given period of time, but automobile buyers have complained that often they have real difficulty in getting a dealer even to make the warranted repairs. In order to control dealers who might too liberally make repairs for good-will purposes at the manufacturer's expense, the manufacturers have set up

planning, see *Skilton*, Cars for Sale – Some Comments on the Wholesale Financing of Automobiles: 1957 Wis.L.Rev. 352.

[113] One can see interesting parallels to the argument developed in *Cockcraft, Gunder, Frank and Johnson*, Dependence and Underdevelopment. Latin America's Political Economy (New York 1972).

great economic disincentives that discourage dealers from performing warranty repairs except in clear cases. If a dealer refuses a claimed warranty repair, there is little a buyer can do. If the buyer writes to the manufacturer, he will be referred back to the dealer. Such a letter and reference will serve to insure that the dealer is applying the manufacturer's standards for repairs which should be made under the warranty. However, the buyer is subject to the manufacturer's interpretation of its warranty, an interpretation not necessarily consonant with the buyer's expectations based on the manufacturer's advertising. Private lawsuits are too expensive to offer a remedy in any but a few cases. Few buyers have the resources or courage to follow the successful tactics adopted by one man who was very dissatisfied with his new Chevrolet and the dealer's and manufacturer's attempts to fix it. This buyer continually telephoned the home of the man who was then the head of the Chevrolet Division of General Motors and asked for action. Finally, in exchange for an agreement not to harass the Chevrolet executive, General Motors gave its dissatisfied customer a new car.

53. One could point to a mitigating factor, perhaps. One could argue that in each instance an individual made a choice to enter the relationship with the automobile manufacturer. To some extent this is true. The parts supplier is, perhaps, the most free. Exit is a real option for him. There are alternative uses for the supplier's enterprise, most suppliers know the implications of the system, and blanket orders are written anew each year in most cases. If a supplier is willing to sacrifice the chance for a high return offered by the automobile industry, he can turn to other kinds of business. Dealers, too, are probably aware of the implications of the franchise system, but they are locked in with few alternatives. There are few, if any, other uses for their skills, capital investment and going business value. Buyers of new cars neither know the system nor have realistic alternatives. Essentially the same disclaimer is used by all four American manufacturers of automobiles;[114] practically, one cannot bargain for a different contract to buy a new car if one wanted to do so since a consumer must negotiate with a dealer who lacks authority to increase the obligations assumed by the manufacturer; and the disclaimer is, as a practical matter, effectively hidden from the consumer – at the time of the sale, it is not easy to find the disclaimer clause and if one does notice it, its wording would carry meaning only to a lawyer.

Of course, if a manufacturer were to acquire a reputation for producing unreliable or unsafe cars, consumers could deal with its competitors. Whatever the problems with the legal response to disclaimers and poor service, the possibility of this kind of exit could minimize the number of unsafe or unreliable cars produced. Undoubtedly, this is an important sanction influencing manufacturers to build safer and more reliable automobiles or to use public relations techniques to avoid a bad reputation.[115] It has been suggested, however, that dissatisfied customers may tend to cancel each other out thereby lessening the impact of this sanction – unhappy buyers of Fords purchase new Chevrolets only to be replaced as Ford customers by unhappy buyers of Chevrolets. Insofar as cost pressures mean that all automobiles selling for a comparable price will be of about equal quality, exit will produce no signal to the managements of manufacturers that there is real dissatisfaction.[116]

b. Legal Ideology and Reality

54. The law of any country tends to support its prevailing economic structures. The United States is no exception. However, bureaucratic rationality is a principle which often clashes with older individualistic values also found in Western culture and in its law. Recently, the accommodations between these competing values made in the late nineteenth and early twentieth centuries have been giving way. English and American contract law have long been based on an ideology of free choice or manifested free choice. Yet economic rationality has been furthered by standardization that disregards individual differences. Large organizations have controlled risks and set patterns with form contracts that minimize the element of even manifested choice. On one hand, these documents originally were drafted to give the party dealing with the organization few or no rights. Until recently, courts were willing

[114] Foreign cars sold in the UNITED STATES offer, generally, no better warranties and use about the same disclaimers as do the AMERICAN manufacturers. At best, they offer about the same limited remedies for a longer period of time.

[115] See *Hirschmann* (*supra* n. 87) 26-29.

[116] See the testimony quoted in *Comstock v. General Motors Corp.*, 358 Mich. 163, 99 N.W.2d 627 (1959), that a defect in the power brakes on 1953 Buicks was to be corrected whenever the cars came to dealers for any kind of service but that the defect was not to be communicated to owners of the cars. "It was a hush thing. They didn't want the public to know the brakes were bad and they were alarmed."

to accept this, and they reconciled such economic planning with their individualistic doctrines by speaking of assuming the risk of what might be written in a standard form contract if one did not read and understand it.[117] Where it was obvious that the individual in no way had led the large organization's representatives to understand that he was assuming a particular risk assigned to him by the organization's forms, courts responded by talking of the duty to read and what the individual ought to have known. On the other hand, where the documents purported to create legally enforceable obligations, the courts were willing to enforce them although the individual had very little opportunity to discover particular provisions or to understand them. For example, disclaimers are often buried in small type on the backs of forms. Before 1960, most buyers of new cars could discover the disclaimer of liability for injuries caused by defects in the car only after they took delivery of the automobile and long after they signed the contract to buy it. Courts did not give serious consideration to the question of whether the disclaimer ever had made its way into the contract between the parties. In a real sense, courts were willing to distort the legitimating ideals of contract law – that is, choice or manifest choice – in the service of economic development through facilitating large scale private corporate economic power. To be sure, liability for what one "should have" known can be made to appear consistent with manifested choice, but the appearance is a matter of form rather than substance in light of the announced purposes of the manifest choice doctrine. Perhaps, such a cover for facilitating rational bureaucratic operations of private corporations was once socially useful; perhaps, in certain industries, such a policy could be defended openly today.

55. But recently there has been a trend toward recognition of the fictitious quality of the individual choice assumed in the application of contract doctrine and toward substitution of rules imposed by government for those imposed by one party and adhered to by the other. The *Henningsen* decision that overturned the manufacturers' uniform disclaimer is but one manifestation of this. Moreover, government has begun to move in other, perhaps more effective, ways. Publicity techniques of a congressional committee may be the most effective control of a powerful industry such as automobiles. The operations of the automobile industry are now of great concern to a number of United States Senators, and this concern is publicized in the news media. Charges of unsafe cars, unfair treatment of dealers and customers and atmospheric pollution by the internal combustion engine get attention in the newspapers and on television. Restrictive legislation is introduced. Some is passed. Even that which does not pass is a threat to the industry. Perhaps at one time automobile manufacturing was an infant industry in the United States to be fostered by all means available, including the legal. Today, many would have it face an accounting measured by values other than economic efficiency – most goods for least cost – and bureaucratic rationality. In fact, the success of this view in the past 10 to 20 years has prompted some to worry about the costs of imposing these new standards. Concern for suppliers, dealers and purchasers of new cars could increase the price of new automobiles and decrease job opportunities in making, selling and repairing the vehicles insofar as increased cost causes decreased demand. To the extent that this is the case, the middle class part supplier, the automobile dealer and the consumer of more costly cars will be benefited at the expense of workers who will lose jobs and the less well off who no longer will be able to afford a car in a society where a car is often both a symbol of success and an economic necessity.

(Completed in April 1973)*

[117] See *Macaulay* (*supra* n. 20).

* List of Principal Works: See *supra** note on p. 18.