"The More Things Change . . .": Business Litigation and Governance in the American Automobile Industry

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Business litigation is a relatively neglected area of corporate governance, particularly given its enormous rise in the United States over the past generation. As a preliminary effort to engage this issue, we examine dispute avoidance and resolution in the automotive sector since the early 1970s—focusing on relationships between auto manufacturers and their suppliers and dealers. We generally presume intercorporate litigation to be a "last resort" in business practice, chosen only on the breakdown of less costly means of dispute avoidance or resolution; we take such breakdown typically to be caused by shifts in the terms of competition among firms (e.g., increased competition, instability, uncertainty); and we expect that, over time, the costs of litigation will motivate efforts to construct new structures of nonlitigious dispute resolution. In the case of the U.S. auto industry, we find disruptive shifts in the terms of competition and increased recourse to litigation. Throughout, however, this litigation effect is mitigated by the dominance of major manufacturers over their suppliers and dealers. Over time, it is further dampened by industry development of mechanisms for arbitration or other nonlitigious dispute resolution.

Automobile manufacturing requires people with many skills. We immediately think of engineers, stylists, assembly line workers, sales people,

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advertising agency staff, and even mechanics putting cars back together. Less obviously, auto manufacturing has long required the services of a small army of lawyers. They have created structures for selling cars on credit and repossessing them when customers could not pay. They have warded off antitrust challenges and participated in securities issues. They have played a part in collective bargaining with organized labor. They have attempted to cope with products liability litigation and employment discrimination claims. Disputes arising from relations with suppliers, dealers, and other auto producers, while not unknown, have not been the major part of their work. In the mid-1960s these relationships provoked only a small amount of litigation. Much, however, has changed in the industry during the past 25 years.

Over the past generation, and particularly since the early 1970s, there has been an enormous increase in business litigation and other use of law in the United States. When it is noted at all, increased litigation by businesses is usually attributed to a general (and generally unexplained) rise in the "litigiousness" of American society. Expenditures on legal services have increased among all three major categories of law "consumers"—business, individuals, and government—in the past two decades. But the growth of business consumption has greatly outpaced growth in consumption by individuals and government, with the result that business has recently emerged as the primary consumer in the rapidly expanding legal services market.

Litigation is a high-profile phenomenon in our society, but as a mechanism of dispute resolution—particularly of disputes between business firms—it has received far less attention than it merits. Indeed, it is difficult to think of another major area of business practice, especially one of such potentially critical importance to economic performance and social ordering, about which so little is known. Given recent trends, this neglect is particularly curious. Why do firms turn to litigation to resolve disputes? What explains the dramatic increase in the rate at which companies in the United States have done so over the past two decades? Addressing these questions is an important task for those seeking to understand the processes and patterns of business governance. This article represents a preliminary effort to engage these issues.

We examine dispute avoidance and resolution in the automotive sector—the governance of this industry—over approximately the past 25 years. This industry, an important part of the world economy, has undergone substantial change during the past several decades. Furthermore, we know a good deal about governance in the industry in the 1960s, which allows us a baseline against which to see transformations.

In the first section we briefly outline a set of economic factors that should affect trends in corporate litigation. In the second we discuss changes in the environment, structure, and governance of the automobile industry over the past three decades. In the third section we examine litigation trends in the auto industry. Finally, in the fourth part of the story, we consider the implications of our findings.

I. CORPORATE LITIGATION: SOME EXPECTATIONS

Litigation trends are, plainly, determined by a wide variety of factors. Our principal interest here is in economic influences on the corporate decision to litigate. We suspect that, all else being equal, the incidence of intercorporate litigation is a positive function of the degree of competition, uncertainty, and instability firms face.[1] Increases in competition, uncertainty, and instability both increase the number of potential disputes between firms and erode the structures of continuing relations that permit less contentious or more noncontractual[2] dispute handling.

Competition, for instance, increases firms' attention to short-run bottom-line concerns. Firms can less easily afford to forgo opportunities for immediate gain, and their room for maneuver, and ability to sustain the costs of constructing and applying alternative sanctions, are reduced. Competition also raises the relative stakes in individual transactions by reducing margins of permissible error. Each deal becomes more "all or nothing" and less susceptible to compromise. Instability and uncertainty have similar effects. They reduce the likelihood of long-term, stable relationships among familiar parties, and thereby foster opportunism and mistrust. The basis for reliance on informal dispute resolution is eroded.

Of course, all else is rarely, if ever, equal. Other factors may intervene to moderate, or cancel out, the effects of competition, uncertainty, and instability on business litigation. Furthermore, it seems reasonable to assume that increases in litigation will themselves call forth a strategic business response to seek alternative means of dispute resolution. Thus, environmental changes may cause a temporary upward jump in litigation, followed by a deceleration in the rate of increase and perhaps even a return to lower rates.

Our approach differs from that of several leading theories of firm behavior. Like neoclassical economic theory, we view business firms as rational agents responding to incentives and constraints. But unlike neoclassical theory, we do not assume perfect competition or complete information. Instead, we take the degree of competition firms encounter to be variable, and we assume that companies often act based on incomplete information and with imperfect decision-making capacities. Transaction cost

1. For a more thorough explication of the theoretical expectations on which we draw, see M. Galanter & J. Rogers, "The Transformation of American Business Disputing? Some Preliminary Observations," Working Paper DPRP 10-3, Institute for Legal Studies, University of Wisconsin Law School (1991).

2. See Stewart Macaulay, "Non-contractual Relations in Business: A Preliminary Study," 28 *Am. Soc. Rev.* 55 (1963).

economic theory posits that firms adjust the arrangements governing their relationships with suppliers, customers, and employees in an attempt to reduce costs associated with search, bargaining, monitoring, and dispute resolution.[3] We take this to be generally true, as should be evident throughout our discussion. Yet the transaction cost approach, like neoclassical theory, presumes that more efficient governance arrangements tend to supplant less efficient ones. We do not view litigation as an optimally efficient mechanism of dispute resolution, but we do suspect that is is likely to become more prominent under conditions of heightened competition, uncertainty, and/or instability.[4] Finally, relative to the new institutional perspective in the sociology of organizations, we place greater emphasis on specifically economic factors and less on legitimacy and imitation as determinants of the prominence of the particular governance mechanism in which we are interested—litigation.[5]

Our intention here, however, is to offer not a theory of business litigation but a set of orienting assumptions that can guide empirical research. Subject to various qualifications, we suspect that, to the extent corporate litigation in the United States has increased over the past 25 years, heightened competition, uncertainty, and instability faced by American business have played a key causal role.

II. A STUDY OF THE AUTOMOBILE INDUSTRY

This study does not seek to assess or explain overall trends in intercorporate litigation. To get a firm understanding of developments in business litigation, it is necessary to look at particular sectors and firms. Only at this

3. See Oliver E. Williamson, "Transaction Cost Economics and Organization Theory," in Neil J. Smelser & Richard Swedberg, eds., *The Handbook of Economic Sociology* (Princeton, N.J.: Princeton University Press, 1994); Williamson, *The Economic Institutions of Capitalism* (New York: Free Press, 1985) ("Williamson, *Economic Institutions*"); *id.*, "The Economics of Organization: The Transaction Cost Approach," 87 *Am. J. Soc.* 548 (1981).

4. The transaction cost perspective may be correct about selection tendencies over the long run, with less-than-optimal governance mechanisms eventually supplanted by more efficient ones. Our own observed result of increased litigation provoking efforts to curb it is consistent with this result. But as John Maynard Keynes once aptly noted, "in the long run we are all dead." As an economic matter, slow selection can approach no selection; the road to new, efficient governance structures may be long, with large amounts of loss along the way. More interesting, it may also be winding, with passage through suboptimal governance mechanisms effectively required before progress can be made in forging a new optimal one. And it is almost certainly path-dependent, with the governance mechanisms available at t influenced by those chosen at $t - 1$. Once indirectness and path dependency are admitted, moreover, there is no particular reason to believe that the curves in the road don't amount to a whole new road, leading in a different direction with substantially different optimizing dynamics—a sort of hysteresis in governance mechanism development.

5. See W. W. Powell & P. J. DiMaggio, eds., *The New Institutionalism in Organizational Analysis* (Chicago: University of Chicago Press, 1991).

level is it possible to investigate directly the impact (or lack of impact) of economic changes on the individual decision to litigate.

The automobile industry is an attractive starting point for such analysis. By almost any measure—product value, employment, linkage to other industries—auto manufacturing is one of the most important sectors in the U.S. economy and has been so for the bulk of this century. At the same time, the domestic auto industry has been profoundly affected by a number of the changes mentioned above, particularly heightened competition and declining performance (in market share and profits), stemming largely from internationalization. Governance relations in the automobile sector have clearly been disturbed by these changes. In particular, relationships between the auto manufacturers and their suppliers and dealers have undergone shifts during the past two decades.

In our attempt to piece together an understanding of industry developments and their impact on governance relations and litigation, we have made use of a wide variety of data sources. Unfortunately, no single source is capable of providing us with an accurate picture of litigation rates. To get estimates for the auto industry, we have utilized the LEXIS and WESTLAW legal databases, which include reported federal and state court cases. Of course, there are severe problems associated with drawing conclusions from a count of published cases.[6] Hence we use these numbers only as a provisional indicator of trends in litigation rates. We also look at federal court filings for large firms in the auto industry, utilizing a database of firms listed among the Fortune 500 during the past 20 years.[7] In addition, we have interviewed officials of each of the three U.S.-based auto manufacturers, 15 supplier firms, several dealers, and representatives of state and national dealer associations. Finally, we conducted a written survey of 150 automotive supplier firms. (The response rate for the survey, 39%, is comparable with those obtained in other research of this nature.[8]) For the most part, our data and the following discussion focus on U.S.-based automotive firms.

We stress at the outset that our findings here should be taken as suggestive. This study is limited in two respects. First, we have no single reliable dataset for our dependent variable—the rate of intercorporate litigation in the automobile industry over time—that we could use to perform a set of sophisticated statistical tests of our thesis. Second, we examine only one

6. See Peter Siegelman & John J. Donohue, "Studying the Iceberg from Its Tip: A Comparison of Published and Unpublished Employment Discrimination Cases," 24 *Law & Soc'y Rev.* 1133 (1990).

7. The WISRAND Database on Corporate Litigation, Institute for Legal Studies, University of Wisconsin Law School.

8. See, e.g., R. Florida & M. Kenney, "Transplanted Organizations: The Transfer of Japanese Industrial Organization to the U.S.," 56 *Am. Soc. Rev.* 381 (1991); J. Lincoln & A. Kalleberg, "Work Organization and Workforce Commitment: A Study of Plants and Employees in the U.S. and Japan," 50 *Am. Soc. Rev.* 738 (1985). There is no indication of response bias in our survey.

industry. This report is part of a larger, ongoing research project on intercorporate litigation and the use of law in sectoral business governance. Other industries are now being studied, and we hope to generate improved data on intercorporate litigation rates. Our effort here aims to make a preliminary contribution to this broader effort.

A. Auto Industry Developments

1. *The Way We Were: The 1960s*

The years 1960 to 1972 were relatively happy ones for the major American auto manufacturers. The market for automobiles was stable and growing. Auto production in the United States increased from 8 million units in 1960 to more than 11 million in 1972, with only slight downturns during the period (see fig. 1 below). Profit rates during these years averaged 13%. This compared favorably to the profit rate for U.S. manufacturing as a whole, which averaged 10% over this period.[9] By the 1960s the big three U.S. assemblers held the American automobile market largely to themselves. Most of the smaller independent manufacturers, such as Kaiser, Willys, and Studebaker, had been forced to merge or fold in the 1950s, although Studebaker-Packard continued to produce until 1966. American Motors Corporation, formed by the merger of Nash and Hudson in 1954, captured no more than 3% of U.S. auto sales in the 1960s. The big three's share of the American market remained large and stable during these years, with 45–50% for GM, 22–26% for Ford, and 12–16% for Chrysler.[10]

There were some potentially ominous trends. The share of world motor vehicle production accounted for by U.S. automakers fell from 48% to 33% during these 12 years.[11] This decline, however, stemmed primarily from expansion of the market for cars in Western European and Soviet bloc countries, many of which were dominated by domestic (often government-supported) producers. The U.S. balance of trade in automobiles and auto parts fell from a surplus of $2.2 billion in 1964 to a deficit of $4.3 billion in 1972.[12] But this was to a substantial extent the result of the American manufacturers shifting some of their production and assembly operations overseas, in part to reduce labor costs but also to accommodate domestic content restrictions imposed by foreign governments. More troublesome was the fact that the share of imports in the U.S. market, which had peaked at 10% in 1959 before falling to 5% in 1963, increased gradually until by 1971 it reached 15%.[13] By and large, however, the 1960s was an extremely stable and profitable decade for the American auto industry.

9. R. Crandall, "Import Quotas and the Automobile Industry: The Costs of Protectionism," *Brookings Rev.*, no. 8, 10 (Summer 1984). The figures refer to after-tax rate of return on equity.

10. L. White, *The Automobile Industry since 1945*, appendix (Cambridge: Harvard University Press, 1971) ("White, *Automobile Industry*").

11. Motor Vehicle Manufacturers Association, *Facts and Figures* 30 (Detroit: MVMA, 1988).

12. J. Womack, "The US Automobile Industry in an Era of International Competition: Performance and Prospects," in MIT Commission on Industrial Productivity, 1 *Working Papers of the MIT Commission on Industrial Productivity* 3 (Cambridge, Mass.: MIT Press, 1990) ("Womack, 'US Automobile Industry'").

2. *Environmental Shifts*

Beginning in the late 1960s and accelerating in the period since 1973, American auto manufacturers have faced three dramatic changes in their economic environment.

First, the product market experienced a sudden, dramatic shift toward smaller cars and a general increase in variability and volatility. This owed to several factors: (1) a general satiation of demand for standard cars (as consumers purchase their second or third of any consumer durable, they typically search for a cheaper and less standardized model); (2) the oil price shocks of 1973 and 1979, with resulting increases in gas prices; and (3) macroeconomic instability. Table 1 indicates the extent of the shift toward subcompact cars, which grew from 9% of domestic new car sales in 1967 to 23% in 1972, then to 32% in 1975. The share accounted for by standard-size cars dropped from 48% in 1967 to 36% in 1972, to 18% in 1975. The American manufacturers were ill prepared to deal with this shift. Figure 1 shows the dramatic (temporary) declines in motor vehicle production following the two oil shocks of the 1970s. Production fell from 12.6 million units in 1973 to 9 million in 1975, and from 12.9 million in 1978 to 7

TABLE 1
Structure of New Car Sales in the United States

	Subcompact	Compact	Intermediate	Standard	Luxury
1967	9.3%	15.7%	23.6%	47.9%	3.1%
1972	22.7	15.4	21.7	36.1	3.4
1975	32.4	20.3	24.2	17.9	4.0
1977	27.1	21.2	26.9	19.4	4.6
1979	34.0	20.0	24.2	15.3	5.5

SOURCE: National Academy of Engineering and National Research Council, *The Competitive Status of the U.S. Auto Industry* table 2.2 (Washington: National Academy Press, 1982).

13. A. Altshuler *et al.*, *The Future of the Automobile: The Report of MIT's International Automobile Program* 25 (Cambridge, Mass.: MIT Press, 1984).

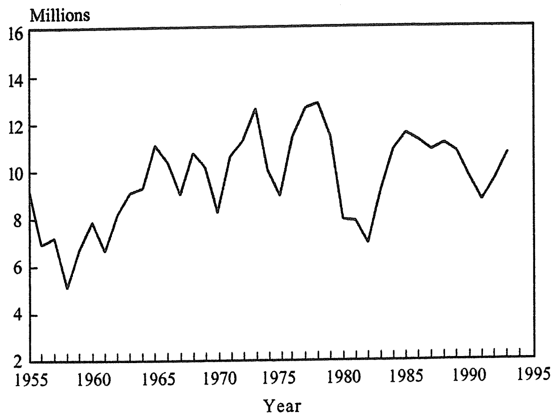

Fig. 1. Motor vehicle production in the United States, 1955–1993.
Source: American Automobile Manufacturers Association; Ward's Automotive Reports.

million in 1982. These downturns, particularly the latter, were among the most severe in the industry's history.

The second change was an increase in foreign competition. This owed largely to the oil shock in 1973 and the consequent growth in demand for small cars, which Japanese and European producers were immediately capable of filling. As figure 2 indicates, the import share of the American auto market doubled between 1967 and 1975, rising from 9% to 18%. By 1987 it had reached 31%. Most of this increase was accounted for by Japanese producers, whose share of U.S. sales grew from 1% in 1967 to 9% in 1975 to 23% by 1981. In the late 1980s the import share of the U.S. market began to decline, dropping to 21% by 1993. This was due chiefly to a reduction in imports of Japanese cars, which stemmed partly from increased production by Japanese automakers in the United States (to escape voluntary import restraints negotiated in the early 1980s) and partly from the increasing strength of the yen.

Third and finally, costs increased substantially. Government regulatory activity became a significant financial burden on the automakers by the mid-1970s. New safety regulations were imposed in 1966, federal emissions controls in 1968, and fuel-economy regulations in 1978. The costs of these regulations were substantial, and they hit with greatest force in the years following the first oil shock. Prior to 1972, emissions control costs were negligible, and safety equipment costs were less than $200 per car. By the early 1980s they reached nearly $2,000 per car.[14] A second component of the cost increase stemmed from the shift in demand and the increase in

14. Crandall, *Brookings Review*, no. 8, at 9–10 (cited in note 9).

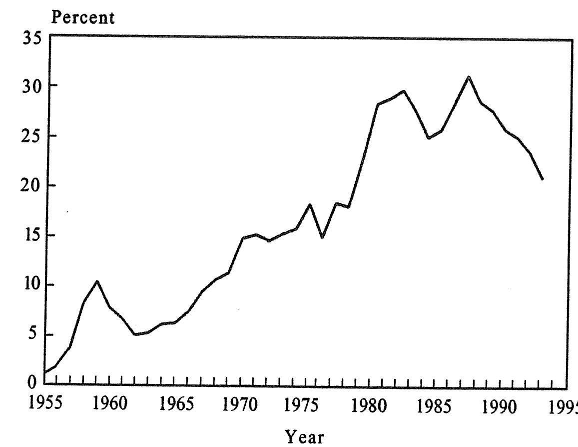

Fig. 2. Automobile imports as a percentage of U.S. sales, 1955–1993.
Source: American Automobile Manufacturers Association; Ward's Automotive Reports.

competition. Production of small cars required altogether new production technologies and processes, such as four-cylinder engines and front-wheel drive, which necessitated significant capital replacement. Moreover, the growth in competitive pressure shifted the locus of design change from styling and sheet metal to fundamental redesign of the entire car, a much more expensive undertaking.

3. *Strategic Responses*

The automakers' response to these new pressures has had various components and has changed substantially over time. Their initial reaction consisted largely of ignoring the new environment. The manufacturers simply continued their existing practice of yearly styling changes. They were not convinced there was any pressing need to make a substantial shift toward smaller cars, or to move toward genuine product variation.[15] They believed the increased demand for small cars was purely a product of the 1973 oil shock, and that this problem would soon disappear. Thomas Murphy, chair of General Motors from 1974 to 1980, would later remark:

15. D. Friedman, "Beyond the Age of Ford: The Strategic Basis of the Japanese Success in Automobiles," *in* J. Zysman & L. Tyson, eds., *American Industry in International Competition* 364–67 (Ithaca, N.Y.: Cornell University Press, 1983); M. Salter, A. Webber, & D. Dyer, "U.S. Competitiveness in Global Industries: Lessons from the Auto Industry," *in* B. Scott & G. Lodge, eds., *U.S. Competitiveness in the World Economy* 201 (Boston: Harvard Business School Press, 1985).

> The Arabs were sitting on that pot of oil over there and they were trying to punish the United States for favoring Israel. I think the people in this country felt, well, okay, they're having their fun. But it was not a real serious concern. It was a concern about the fact that they were dictating to us and were raising the price of oil. But I think people felt it was a phase and we'll get it behind us.[16]

Most of the automakers' attention was focused on complying with the new regulatory standards.

By the late 1970s, however, the automakers had reversed course. Convinced that the rise in oil prices necessitated a once and for all design shift toward smaller cars that would be even more standardized than their predecessors, General Motors and Ford each attempted to design a small "world car" that could be sold with little design and styling variation in a wide variety of markets.[17]

After 1979 the car manufacturers adopted a variety of new strategies. Beginning in 1980 they began to appeal for quotas (technically, voluntary import restraints) to stem the flood of Japanese imports. At the same time, in order to gain access to new technology and alternative modes of management and work organization, the American assemblers began entering into a variety of joint ownership and production ventures with Japanese and European automakers.[18] They have also attempted to emulate the Japanese strategy of genuine product variation coupled with rapid product alterations, though to a very limited extent.[19] Each of the assemblers has also tried in various ways to diversify into production of more specialized "luxury" cars, on which profit margins are higher.[20]

The most comprehensive strategic reorientations of the past two decades have involved attempts to cut costs and raise productivity. In the area of labor, cost reductions were to be achieved by automating, shifting production to low-wage sites (underdeveloped countries and the southern United States), and extracting pay concessions from the existing work force. In some cases the automakers have moved to alter the work process by utilizing group work and participatory decision making. New compensation mechanisms such as profit-sharing have also been introduced.[21] Relations with suppliers have similarly been reoriented, with the manufacturers attempting to develop longer-term, more cooperative arrangements with external supplier firms, while at the same time pressing more firmly for cost reductions and quality improvement.[22]

16. Cited at M. Keller, *Rude Awakening: The Rise, Fall, and Struggle for Recovery of General Motors* 51 (New York: Morrow, 1989) ("Keller, *Rude Awakening*").

17. See K. Hoffman & R. Kaplinsky, *Driving Force: The Global Restructuring of Technology, Labour, and Investment in the Automobile and Components Industries* 182–83 (Boulder, Col.: Westview Press, 1988) ("Hoffman & Kaplinsky, *Driving Force*"); S. Tolliday & M. Zeitlin, "Introduction: Between Fordism and Flexibility," *in* S. Tolliday & M. Zeitlin, eds., *The Automobile Industry and Its Workers* 16–17 (New York: St. Martin's Press, 1987).

18. See "Global Joint Ventures and Affiliations for 1991," *Automotive Industries*, Feb. 1991; D. Quinn, "Dynamic Markets and Industrial Innovation," Research Paper no. 1, Berkeley Roundtable on the International Economy, 42–43 (1989) ("Quinn, 'Dynamic Markets'").

19. Dan Luria notes: "In terms of car models . . ., the US auto consumer now chooses among 162, much more than the 100 offered in 1973. It should be noted, however, that the number of models offered by the big three domestic automakers barely changed, rising from 62 to 63, and that it actually declined for two of the three. In fact, the main reason for the growth in models offered is the explosion in variety available at the dealerships of Asia-based ('Japan' and 'other') firms, where model count rose from 14 in 1973 to 57 in 1988, accounting for 70% of the total increase in models." See Luria, "Automation, Markets, and Scale: Can Flexible Niching Modernize US Manufacturing?," 4 *Int'l Rev. Appl. Econ.* 127, 141 (1990).

20. See Quinn, "Dynamic Markets" at 21.

III. LITIGATION IN THE AUTO INDUSTRY

A. The Overall Picture

Given the dramatic increase in competition, instability, and uncertainty in the American automobile industry beginning in the early 1970s, we could expect a rise in litigation in the industry during this time. Both the number of serious disputes between firms and the tendency of firms to resolve disputes through litigation should have increased, as heightened competition and declining performance reduced each party's margin of tolerance for error and eroded existing mechanisms of dispute resolution as well as incentives for long-term continuing relations.

As noted earlier, there is no single data source we can draw upon to get an accurate picture of litigation rates and trends in the automobile industry. We have utilized three sources here. First, we checked the LEXIS litigation database for reported federal and state court suits in which Ford and General Motors were parties. We looked at four time periods, each consisting of a year and a half from January to the following June. The years covered were 1960–61, 1970–71, 1980–81, and 1989–90. The findings do suggest an increase in litigation. There were 84 cases in 1960–61, 180 in 1970–71, 460 in 1980–81, and 629 in 1989–90.[23] We stress again the potential for diver-

21. "Where Employees Are Management," *Bus. Week* 66 (Special issue on "Reinventing Management," 1992); H. Katz, "Automobiles," *in* D. Lipsky & C. Donn, eds., *Collective Bargaining in American Industry* (Lexington, Mass.: D. C. Heath, 1987); L. Turner, "Are Labor-Management Partnerships for Competitiveness Possible in the U.S.? The Auto Industry Examined," Working Paper 36, Berkeley Roundtable on the International Economy (1988); Hoffman & Kaplinsky, *Driving Force* 187–98; Keller, *Rude Awakening*, chs. 6 & 10; C. Scherrer, "Governance of the Automobile Industry: The Transformation of Labor and Supplier Relations," *in* J. Campbell, J. R. Hollingsworth, & L. Lindberg, eds., *Governance of the American Economy* (Cambridge: Cambridge University Press, 1991) ("Scherrer, 'Governance'"); Womack, "US Automobile Industry" (cited in note 12).

22. See sec. III.C below.

23. Of the 1,428 reported cases, 92 involved multiple opinions in the same case. These were counted only once to produce 1,336 distinct reported cases. Twelve cases involved both the manufacturer asserting a creditor's remedy (e.g., GMAC repossessing a car) and a breach of warranty claim as the consumer tried to resist. Five cases involved both a creditor's remedy

gence between trends in reported cases and trends in the actual number of suits filed. However, lawyers who work for the major American automobile manufacturers indicated to us that the general trend suggested by these numbers is accurate.

Our second source is the database of federal litigation involving Fortune 500 companies. Included in this database are 27 firms with Standard Industrial Classification (SIC) codes of 3711–3715, which covers the auto manufacturers as well as a number of supplier firms. Cases were tabulated for each of the 22 years from 1970 to 1991 inclusive. Again the data indicate an increase in litigation, as figure 3 shows. Total litigation involving these

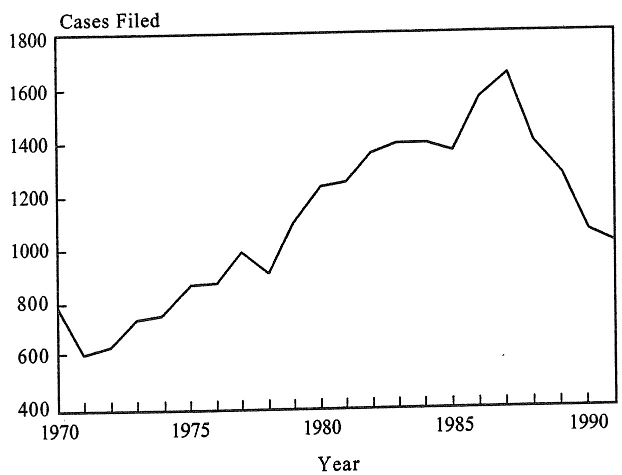

Fig. 3. Federal court litigation for Fortune 500 automotive firms, 1970–1991. Source: WISRAND Database on Corporate Litigation.

companies roughly doubled between 1970 and 1987. It then declined by about 40% between 1987 and 1991. The aggregate increase from 1970 to 1991 was about 28%.

We also ran the category "contracts, general" in this database for filings against General Motors, Ford, Chrysler, and American Motors for the years 1970 to 1991.[24] We removed all cases involving the credit divisions of each manufacturer since these typically involve repossessions of cars in disputes against consumers rather than intercorporate litigation. The trends in this category are displayed in figure 4. After a slight decline in the early

and a dealer asserting a claim in response. These 17 cases are all counted twice, increasing the total number of cases recorded to 1,353.

24. The overwhelming number of cases involve Chrysler, Ford, and GM. Little would be changed if we omitted AMC.

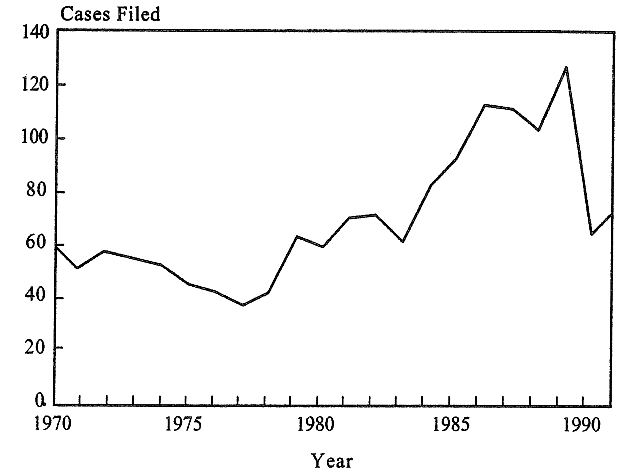

Fig. 4. Contracts filings with auto manufacturer as defendant, 1970–1991. Source: WISRAND Database on Corporate Litigation.

1970s, there was a steady and substantial increase between 1977 and 1989, followed by a sharp decline between 1989 and 1990. The fact that litigation did not begin to increase until the mid 1970s, according to these figures, may seem to contradict our expectations. We suspect that it merely represents a lag between changing economic conditions and the response by auto firms (see the discussion in section II.A.3 above).

Our third source of data is our survey of automotive supplier firms. Twenty-seven percent of the respondents to the survey reported an increase in litigation between 1980 and 1990, while fewer than 10% reported a decrease.

Overall, then, the available evidence suggests a growth in litigation in the automobile industry since the early 1970s, followed by a decline beginning in the mid- to late 1980s. In the remainder of this article we explore the possible sources of these trends. We might expect some litigation among the major American, European, and Japanese manufacturers themselves as they seek to guard and invade markets. To the extent that intercorporate litigation figures prominently in this rise, however, we would expect litigation between auto manufacturers and their suppliers and dealers to account for a substantial portion. There are many of these relationships, and expectations and reliance have been disrupted by economic shocks. We also know from other work that relations with dealers have involved changes in the legal system since the 1930s. Litigation in these areas is the subject of the next three sections. Section III.E then discusses the apparent recent decline in intercorporation litigation.

B. Suits among the Major Manufacturers

The major automobile manufacturers seldom sue each other. Each of the American automakers has entered into one or more joint ventures with foreign auto firms. While some of these ventures have been very successful, others have not. In some instances, such as the General Motors-Daewoo venture, the parties were in sharp dispute.[25] In all such cases to date, however, rather than litigate, one partner has bought out the other. Chrysler filed an unsuccessful antitrust action against GM and Toyota to stop their joint venture to produce automobiles at a plant in California.[26] After losing the suit, Chrysler turned to its own joint venture with Mitsubishi. Intellectual property claims are another potential source of litigation between auto producers. Few have actually been filed, however. When the head of General Motors' purchasing department moved to a similar position at Volkswagen in early 1993, GM sued Volkswagen for theft of trade secrets. One informant suggested to us that suits against competitors might be coming under the Superfund legislation, which requires large firms to clean up pollution at industrial sites. Under the act, one firm can be ordered to clean up the entire site and may then sue others to contribute to paying the enormous costs.[27]

C. Supplier Relations and Litigation

1. *The Traditional Relationship*

Given a stable and expanding market and limited competition during the early postwar period, the automakers' strategy regarding their supplies of parts, components, materials, and equipment was guided by two main goals: assured supply and low price. These concerns were reflected in their decisions about the degree of internal versus external sourcing, multiple versus single sourcing for purchased supplies, and the form of contract used with external suppliers.

In the very early days of the U.S. auto industry, during the first decade of the 20th century, automakers bought almost all the supplies for the cars they manufactured.[28] During this period they were little more than "assemblers," performing the task of assembling engines, wheels, bodies, and other components purchased from independent suppliers into finished motor vehicles. By the 1920s the manufacturers began to integrate vertically, making their own supplies. General Motors acquired the capacity to produce bodies, electrical components, carburetors, radiators, and the like. Ford produced fewer components, but extended further backward in raw materials such as steel, glass, and rubber. Backward integration among the manufacturers continued steadily, accelerating in the post–World War II period, until by the 1960s each of the big three produced at least some of its own engines, stampings, transmissions, frames, brakes, and a majority of many other components. According to one estimate, in 1963 about 78% of most parts shipments originated from plants owned by the manufacturers.[29] As the largest of the three, GM was the most highly integrated, with Ford next and Chrysler the least.[30] Of course, some components were still purchased entirely from outside suppliers.

The logic underlying the decision to integrate vertically was straightforward. As Charles Sabel and his collaborators have put it:

> As long as markets were expanding and products and production technologies changing in well defined ways at a slow pace, firms had strong incentives to keep most production under their direct control. If production runs were long, the costs of designing subassemblies, and of building product specific equipment to produce them could easily be amortized. The assembler thus captured the value added in the subassembly operation, protected its proprietary technologies and designs, and assured itself of reliable supplies of key components at predictable prices and quality standards regardless of external market fluctuations. Bureaucratic supervision of a captive supplier was a sure way to avoid dependence on the manufacturer of crucial product-specific components.[31]

For most components, the automakers pursued a strategy of "tapered integration," in which they produced a certain share (perhaps 50%) of their needs for each particular component and outsourced the rest. Again, the benefits of such a combined strategy are obvious. Buying supplies rather than making them provided a product without the need to invest additional capital in buildings, machines, and a trained work force. At the same time, it gave the manufacturer a yardstick that could be used to measure the efficiency of its own division making the same item. Outsourcing also increased the manufacturer's chance of benefiting from technological innovation.

25. See D. Darlin & J. B. White, "Failed Marriage: GM Venture in Korea Nears End, Betraying Firm's Fond Hopes," *Wall St. J.*, 16 Jan. 1992, at A1, col. 6.

26. Chrysler Corp. v. General Motors Corp. & Toyota Motor Corp., 596 F.Supp. 416, 589 F.Supp. 1182 (D.D.C. 1984).

27. See B. J. Feder, "In the Clutches of the Superfund Mess," *N.Y. Times*, 16 June 1991, sec. 3, at 1, cols. 2–6.

28. A typical automobile these days has around 15,000 parts.

29. Scherrer, "Governance" at 217.

30. An estimate by William Abernathy suggests that in 1965 the ratio of value added to sales was .52 for GM, .40 for Ford, and .37 for Chrysler. See Abernathy, *The Productivity Dilemma: Roadblock to Innovation in the Automobile Industry* 37 (Baltimore: Johns Hopkins University Press, 1978).

31. C. Sabel, H. Kern, & G. Herrigel, "Collaborative Manufacturing: New Supplier Relations in the Automobile Industry and the Redefinition of the Industrial Corporation" (unpub. MS., Massachusetts Institute of Technology, 1989).

For both wholly and partially outsourced components the automakers preferred to deal with several suppliers per component. Reliance on a single supplier was generally avoided.[32] In most cases the manufacturers had at least two and often more suppliers for each component. The rationale for multiple sourcing was twofold: to assure supply by avoiding dependence on a single source and to impose competition on suppliers, which would induce technological advance, higher quality, and lower prices.

The auto manufacturers' needs and wants regarding their purchase of supplies were several. Of course, they wanted the best possible quality at the lowest possible price. In addition, mass production techniques rely on a steady flow; the key to productivity lies in keeping the assembly line running. Hence, the automakers needed supply delivery to be guaranteed. The easiest way to avoid stopping assembly lines would be to produce large quantities of parts far in advance of need, but this would increase costs because of the possibility of waste and the loss of the use of funds thus devoted to inventories.

The auto manufacturers accommodated these various concerns in an imaginative piece of transaction architecture called a "blanket order."[33] Coupled with the suppliers' great desire to do business with the automobile manufacturers, the blanket order system ensured that parts would arrive at the assembly plants at the right time, and that the suppliers would take the risk of scrapped parts caused by fluctuations in demand. Moreover, the system gave the assemblers substantial leverage to ward off price increases caused by the suppliers' increased costs.

The contract worked as follows: Some time before the beginning of the model year, the manufacturer would issue a blanket order to a supplier of, for example, bumpers designed specifically for one of the manufacturer's models. The blanket order stated a number of "agreements," one of the most important being the price per unit. This price was computed on the basis of an estimated number of units to be ordered, and would not be increased if fewer were actually ordered. Thus, the manufacturer made the supplier run the risk of not even recovering its cost of producing the items actually shipped to the manufacturer in the event that the manufacturer used substantially fewer than the estimated number. Moreover, the blanket order did

32. "The exceptions have been (1) cases in which economies of scale required it and funds limitations precluded in-house production, and (2) cases in which a replacement market supplier was willing to offer large price concessions on original equipment. The Independents' purchases of automatic transmissions were an example of the first. Ford's and Chrysler's purchases of electrical equipment from single suppliers were an example of the second. Also, a supplier firm will occasionally hold a key patent on an item. If this is an optional item for car buyers, the companies may tolerate a single supplier situation." White, *Automobile Industry* 84–85 (cited in note 10).

33. The following discussion draws on S. Macaulay, "The Standardized Contracts of United States Automobile Manufacturers," *International Encyclopedia of Comparative Law* 18, 18–22 (1974) ("Macaulay, 'Standardized Contracts'").

not oblige the manufacturer to take and pay for any of the parts described in it. That obligation came only when the manufacturer sent the supplier documents called "releases."

This type of contract gave a supplier little legal protection if the manufacturer ended up needing fewer than the anticipated volume of goods, or in the event of a dispute with a manufacturer. Typically, the manufacturer reserved 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 it had spent in performance before the buyer's notice of cancellation plus the profit it would have made had it been allowed to complete its production. Most blanket order cancellation clauses, however, excluded a right to profit except as to those parts completed before cancellation. Thus, even when a contract was formed by a release, the supplier's rights in most situations would be minimal. The manufacturer gained a practical commitment from the supplier to meet the demands of its assembly line. It retained maximum flexibility by making no commitment to buy any parts until a release was given and making only a very limited payment if it wished to cancel after one was sent.

2. *New Directions*

The relationship between U.S. automakers and their suppliers has changed markedly since 1980, but that transformation has been double-edged. On the one hand, the manufacturers have moved toward more cooperative, long-term associations with suppliers. At the same time, they have attempted to increase their leverage and control over supplier firms.

Although hard data are difficult to come by, the auto assemblers have clearly increased their reliance on independent suppliers for parts and components.[34] This move was spurred in part by a realization that it is impossible for a single company to stay at the technological forefront of thousands of parts and components, and partly by a desire to cut costs. In 1985, United Auto Workers (UAW) members in manufacturer component divisions earned on average $20 per hour, including benefits; independent parts plants paid between $5 and $13 per hour for similar work.[35]

34. Scherrer reports: "In the early 1980s the Big Three announced that they would substantially reduce their vertical integration, and by 1985, about 47% of their parts were bought from outside suppliers. . . . GM increased its third-party sourcing from about 15 to 30%, and planned to buy 80 percent of the parts (not value) for its new Saturn car from outside suppliers." See Scherrer, "Governance" at 220 (cited in note 21). See also "Doing It All Yourself . . . and Ensuring Worldclass 'Underperformance,'" *Industry Week*, 4 Jan. 1988.

35. S. Helper, "Strategy and Irreversibility in Supplier Relations: The Case of the US Automobile Industry," 65 *Bus. Hist. Rev.* 781 (1991). Scherrer, "Governance" at 222, reports

With this heightened reliance on external suppliers has come a move toward greater cooperation between manufacturers and suppliers. This has a number of aspects, including increased reliance on single sourcing, utilization of long-term contracts with suppliers, heightened supplier involvement in component design, and implementation of just-in-time delivery.

According to purchasing executives at Ford and General Motors, 98% of their auto parts purchased from outside suppliers are now single-sourced.[36] Other estimates put the figure at around 60%.[37] Regardless of which is more accurate, this represents a marked change from the pattern of the 1960s, when the automakers used multiple sources whenever possible.

A number of these suppliers are now given long-term contracts with the manufacturer, rather than the traditional one-year arrangement. Again, however, estimates vary. In 1985, according to one source, 30% of GM's and 70% of Ford's contracts with external suppliers were multiyear.[38] Another recent survey indicates that only 20% of the automakers' supplier contracts are multiyear.[39] In a 1989 survey of 453 U.S.-based automotive supplier firms, Susan Helper found that the average contract length had doubled during the previous five years, from 1.2 years to 2.3 years.[40] The legal staff for one of the big three assemblers estimated that in 1975 their firm had about 10 long-term contracts, whereas today it had more than 1,200. In our survey of supplier firms, only 18% had at least one multiyear contract with an automotive purchaser in 1980, whereas 57% said they had one as of 1990.

There is also evidence of increased coordination between suppliers and the manufacturers in design and delivery. Sixty-six percent of the supplier firms surveyed by Helper reported that they now participate at least equally with the purchaser in product design.[41]

Finally, a growing number of suppliers now provide just-in-time delivery of parts and components, whereby orders are placed by the purchaser only a few days, or even hours, in advance of when they are needed. To function effectively, this arrangement requires intimate communication and coordination between supplier and buyer. The result, typically, is fewer misunderstandings and surprises. We were told: "You spot problems early and fix things. You do not wait until a part or a machine is delivered and discover that it doesn't work."

At the same time, there is substantial indication that these moves toward greater cooperation have been accompanied by attempts on the part of the automakers to consolidate their leverage vis-à-vis suppliers. *Automotive Industries* reported in 1985: "Although the majority of the suppliers we interviewed say their relationships with automakers have improved, most also complain that there is more rhetoric than actual cooperation taking place."[42] Instances of suppliers investing time and money to become a long-term "partner" with an assembler, only to see the automaker shift the order to a lower-cost competitor, still occur.[43] And in many cases institution of just-in-time delivery merely represents an attempt by the assembler to shift the costs of inventory onto suppliers. Often there is little coordination of the supply schedule; the manufacturer simply expects the supplier to keep the excess inventory.[44] Maryann Keller, a prominent industry analyst, noted in 1992:

> [T]he reality for the auto parts supplier has changed very little in the last ten years—except that a lot of costs have been transferred onto them. Suppliers know that the process the automakers adopt is still based on getting the lowest possible price, often without considering the value of long-term relationships or the expenses assumed by suppliers.[45]

Similarly, a thorough study by MIT's International Motor Vehicle Program concluded that, overall, "no fundamental change has occurred in the adversarial, power-based relationship between assemblers and suppliers."[46]

One indicator of considerable tension in this relationship is the response to a question in our survey of automotive supplier firms. We asked: "If your primary automotive customer found a supplier who could produce your product with roughly equivalent quality but for a lower price, would they be more likely to switch to that other supplier or to work with you to help you reduce your costs?" Sixty percent of the respondents replied that the customer would probably switch; only 40% said the customer would probably work with them.[47] Another sign of the heightened pressure facing

that the wage differential between supplier and assembler firms grew from an average of 12% in 1963 to 24% in 1974, to 48% in 1983.

36. "Betting on a Single Source," *Industry Week*, 1 Feb. 1988, at 34.

37. M. Cusumano & A. Takeishi, "Supplier Relations and Management: A Survey of Japanese, Japanese-Transplant, and U.S. Auto Plants," 12 *Strategic Mgmt. J.* 563, 568 (1991).

38. Helper, 65 *Bus. Hist. Rev.*

39. Cusumano & Takeishi, 12 *Strategic Mgmt. J.* 570.

40. S. Helper, "How Much has Really Changed between U.S. Automakers and Their Suppliers?" 15 *Sloan Mgmt. Rev.* 19 (Summer 1991).

41. *Id.* at 18. See also D. Woodruff, "Ford Has a Better Idea: Let Someone Else Have the Idea," *Bus. Week*, 30 April 1990, at 116–17; Hoffman & Kaplinsky, *Driving Force* 244–52 (cited in note 17).

42. "Supplier-Side Economics: The Silent Majorities Speak," *Automotive Indus.* 56, 57 (Dec. 1986).

43. See Woodruff, *Bus. Week*, 30 April 1990, at 117; Hoffman & Kaplinsky, *Driving Force* 238–44, 308–9 (cited in note 17).

44. Helper, 15 *Sloan Mgmt. Rev.*; J. Womack, D. Jones, & D. Roos, *The Machine That Changed the World* 160 (New York: Rawson Associates, 1990) ("Womack *et al.*, *Machine*").

45. M. Keller, "Problems with Partnerships," *Automotive Indus.* 9, 9 (Jan. 1992).

46. Womack *et al.*, *Machine* 160.

47. Helper asked a similar question in her survey. Of the respondents, 31% said their customer would help match the competitor's efforts, while 39% indicated that their customer

suppliers is that the U.S. automotive parts industry lost an estimated 100,000 jobs during the 1980s.[48]

Recent developments at General Motors offer the most vivid illustration of the limited nature of the shift in manufacturer-supplier relations.[49] In June 1992, GM brought in a new supplier management team from its European division, headed by J. Ignacio Lopez. Lopez proceeded to rip up all existing supplier contracts, reopen bidding on contracts already established for the 1993 model year, and demand immediate price reductions of up to 20%. According to one report: "Suppliers that had invested in developing new products for GM were shocked to see the carmaker passing their blueprints around to competitors, asking if anyone could build the products for less."[50] In spite of its actions, GM maintained that it is committed to developing long-term, cooperative relationships with its suppliers, and that price now ranks third behind quality and service as a criterion for supplier selection.[51]

3. *More Litigation?*

Given the increase in competition, uncertainty, and instability characterizing the automobile industry in the period since 1973, there is good reason to expect a rise in assembler-supplier litigation during the past two decades. The automakers have been under considerable pressure to restructure, cut costs, innovate more rapidly, dramatically improve quality, and so on. These pressures should lead to a significant increase in demands the automakers place on suppliers, hence to a greater frequency of contractual disputes. At the same time, these shifts have likely decreased the assemblers' margin of tolerance—that is, their ability to take a long-term view of their relationships with suppliers, and thus to cooperate with them in working out solutions to problems (to pursue a voice strategy rather than one of exit). In short, we should expect that (1) suppliers have faced increasingly stringent demands, many of which they would likely be unable to comply with sufficiently; and (2) manufacturers have become more willing to drop

would likely switch to a rival as soon as technically feasible. See Helper, 15 *Sloan Mgmt. Rev.* 19.

48. Z. Schiller, "GM Tightens the Screws," *Bus. Week*, 22 June 1992, at 30.

49. *Id.*; J. Treece, "The Lessons GM Could Learn for Its Supplier Shakeup," *Bus. Week*, 31 Aug. 1992; "Balking U.S. Automotive Suppliers Talk of Giving Up Business with Car Maker," *Wall St. J.*, 2 Nov. 1992.

50. Treece, *Bus. Week*, 31 Aug. 1992, at 29.

51. Within a year Lopez had moved to Volkswagen, where he instituted a similar system. See J. Templeman, "How Many Parts Makers Can Stomach the Lopez Diet?" *Bus. Week*, 28 June 1993.

suppliers unable to satisfy their needs.[52] All else being equal, this should lead to more litigation from both sides.

The same logic should apply to relations between first-tier and second-tier suppliers. With the manufacturers breathing down their necks, first-tier suppliers would have to increase pressure on their own suppliers and would be less willing to tolerate subpar performance. Here too, litigation ought to increase.

On the other hand, there has been an important counteracting force at work. As just noted, since the early 1980s the big three U.S. manufacturers have moved to alter their relations with suppliers in the direction of a more long-term, cooperative partnership. To the extent this new practice marks a genuine shift in the relationship, it likely reduces the likelihood of litigation between assemblers and their top suppliers.

Then again, as a result of the move toward sole sourcing, many suppliers have been dropped, which might provoke suits. Furthermore, as noted earlier, many suppliers view the shift to more cooperative relations as a partial, half-hearted one. In a number of instances, automakers have cut off suppliers with whom they had begun to forge a long-term tie in favor of price considerations. A lawyer for one of the automakers admitted:

> Long-term continuing relationships have become even more important, and the pressures to work out matters to continue them are much greater. However, remember that you may settle a dispute without litigation and still not use the other party as a supplier again. Settlement doesn't guarantee preservation of the relationship. There was a problem, and if the automaker thinks that this suggests a better supplier can be found, it will do so. A great deal will turn on the supplier's attitude and how the controversy was handled.

Based on these considerations, we expect an increase in assembler-supplier litigation during the latter 1970s and the 1980s, with a slowing of the rate of increase or a decline in the frequency of litigation by the late 1980s.

52. But shouldn't we expect the automakers, as profit-maximizing firms, to already have been "squeezing" suppliers as much as possible? We think not. Certainly there is evidence that the big three manufacturers structured their relationships with suppliers to their advantage during the "golden" years preceeding the early 1970s. But given the healthy, stable market share and profits the automakers enjoyed during those years, they were probably guided at least to some extent by a desire for stability and regularity in their dealings with suppliers (and dealers, employees, and so on), and for this they needed to establish reputation. Although their leverage permitted it, there is thus reason to expect the automakers not to have squeezed suppliers as hard as possible during this time. Conversely, reputation may only be valuable in a stable economic environment; as that environment becomes less stable—more competitive, more uncertain, with different players—we should expect departures from satisfying reputational requirements. See A. Okun, *Prices and Quantities: A Macroeconomic Analysis* 134–82 (Washington: Brookings Institution, 1981); Williamson, *Economic Institutions* (cited in note 3).

4. *Findings*

Our findings suggest that there has never been, nor is there now, much litigation between manufacturers and suppliers in the auto industry. As a preliminary step, we searched the LEXIS litigation database for General Motors and Ford for the years 1960, 1970, 1980, and 1990.[53] This search turned up only eight cases of litigation between these firms and automotive suppliers, only two of which represented contractual disputes of the type we are interested in here.[54]

Lawyers working for the big three automakers told us that litigation between their firm and an automotive supplier is extremely rare. None of the 15 suppliers we interviewed had ever been involved in a suit against an auto manufacturer. All said that such litigation would be extremely unlikely and that to their knowledge this holds for the supplier industry as a whole. Only 11% of the 150 respondents to our written supplier survey indicated that they had been involved in litigation with an automotive customer, and only 7% had litigated more than once.

Several of the supplier firms we interviewed reported having been involved in litigation with their own suppliers, one or two times each. Only 13% of the respondents to our written supplier survey said they had litigated against a supplier; 10% had done so more than once.

There is, however, some indication that the rate of litigation increased during the 1980s. As noted earlier, 27% of the respondents to our survey reported a rise in litigation between 1980 and 1990, while fewer than 10% reported a decrease.

5. *Explanation*

Why is there so little purchaser-supplier litigation in the auto industry? Part of the reason is that the business executives involved do not believe in handing over control to third parties. We were told:

> Most [auto] executives . . . think that turning a problem over to any third party shows a failure on the part of the business people involved. . . . Litigation with a supplier represents a situation where both sides have fumbled the ball. Those involved just didn't have the guts to sit down and solve a problem.

53. The WISRAND database of federal litigation involving the Fortune 500 companies is not in a form such that we can pull out litigation filed between auto manufacturers and their suppliers.

54. Many of the six other cases involve determinations of responsibility for product liability. The actual plaintiff is an injured buyer of a car or his or her insurer.

Several of the automakers and many of their large suppliers are part of the 600 major corporations that have signed a pledge drafted by the Center for Public Resources. It states that the signers will consider negotiation and other forms of alternative dispute resolution before going to court.[55] An official of an auto manufacturer told us that occasionally his firm finds another signatory that threatens litigation. "The manufacturer points out the pledge. The other firm always has apologized and started talking."

Perhaps more important, there are two features of purchaser-supplier relationships in the auto industry that may help explain this finding. First, selling to the auto manufacturers is extremely lucrative. Even if a supplier firm is treated poorly, it may be financially worthwhile for the company to live with it in order to maintain the relationship. Even if an order is unfairly canceled or the entire relationship is severed by the automaker, the supplier firm has a strong incentive to "grin and bear it" in the hope of resuming the relationship at some later point.[56]

A number of the supplier firms we interviewed advanced this as a large part of the reason why litigation between suppliers and the automakers is so infrequent. Our written survey of automotive suppliers produced a similar finding. We asked those who had seldom or never been involved in litigation with their customers why this was so. (Each respondent was allowed to check no more than two reasons.) By far the most common response, mentioned by 79%, was "No reason to sue; disputes are not serious or costly enough to go to court." This is consistent with our expectation that the bulk of disputes are handled by means other than litigation. However the next most frequent response, checked by 37%, was "Litigation would permanently sever a lucrative business relationship." Also, in several of the limited number of litigated cases we have come across in our interviews and database checks, the supplier filing the suit was bankrupt. Under these circumstances litigation serves as a salvage operation. There is little concern with long-term continuing relations; hence the supplier has little to lose by suing.

Second, the automakers are immensely powerful. This power stems in part from the lucrativeness of a relationship from the supplier's point of view and in part from the extreme concentration in the auto industry.[57] Because of their strength and leverage, transactions usually are governed by

55. See M. Galen, A. Cuneo, & D. Greising, "Too Many Lawyers and Too Much Litigation: Here's a Better Way," *Bus. Week*, 13 April 1992, at 60.

56. Macaulay wrote in 1974: "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." Macaulay, "Standardized Contracts" at Law 21 (cited in note 33).

57. Only within the past decade have foreign-based (mostly Japanese) automakers begun production in the United States, and even so their purchases from U.S. suppliers accounted for less than 5% of American auto parts sales as of 1993. See J. Treece, "U.S. Parts Makers Get More Mileage Out of Japan," *Bus. Week*, 12 April 1993, at 74.

written contracts drafted by the auto manufacturers and accepted by their suppliers. These contracts are the statutes of a private government. They give suppliers little or no legal recourse in the case of a dispute.

In spite of shifts toward longer-term contracts and greater cooperation between the automakers and their suppliers, the blanket order remains the predominant form of contract in the industry. In our supplier survey we attempted to gauge the prevalence of the blanket order by asking if this was the type of contract used by most of the supplier's automotive customers in 1980 and 1990. Fifty-six percent responded positively for 1980, and 70% did so for 1990. In other words, the blanket order contract became *more* common during the 1980s. Most of those who responded "no" were either equipment producers or small firms (with fewer than 50 employees). For both of these types of firm, orders typically would be so irregular that a blanket order would not be appropriate.

Suppliers sometimes attempt to use their own purchase order contracts, but the manufacturers, for obvious reasons, tend to prefer their own. And they generally have their way in the "battle of the forms." As a lawyer for one of the automakers put it: "We usually have most of the marbles."[58]

As relationships with a few suppliers have become more important in recent years, some automobile manufacturers have changed their blanket order contracts to provide suppliers more security. However, the rights given suppliers still are, at best, uncertain. For example, one major American automobile manufacturer uses multiyear supplier contracts with many difficult-to-apply provisions. Most significantly, the manufacturer "may terminate its purchase obligations . . . without further liability" if certain things happen. They include (1) the quality of seller's supplies deteriorates; (2) seller does not remain competitive in quality and delivery with other responsible suppliers or potential suppliers; or (3) buyer can substitute supplies of significantly advanced design or processing. The manufacturer must outline its reasons for termination, and the supplier has a right to cure its defaults. The contract also calls for price reductions over the life of the agreement. This is a greater commitment than found on older blanket orders. Nonetheless, the standards all call for judgments. Except in extreme situations, the result of any lawsuit applying them would be uncertain. Lawyers for this auto manufacturer said that the language was not intended to be defensive. They saw it as creating a fair and balanced framework for

58. However, a lawyer for one of the largest automotive suppliers noted with amusement:

> The negotiations take place on the auto manufacturer's purchase order calling for X% of its requirements, which it [the supplier] then acknowledges by [its own] form which will have inconsistent terms and conditions. We never reach a total agreement with both firms signing a single document. [The supplier] doesn't want to reach such an agreement because it will then be bound to the [auto manufacturer's] terms. If it came to that, a manufacturer could say, "if you want our business, sign our form." Rather a lot is left open.

settling disputes. "It is a way to head off a messy divorce; it is a settling [and not a litigating] device." An official for a large automotive supplier, however, felt that, despite the uncertainty of legal rights, blanket orders involve a moral commitment. "The manufacturers have long histories with their suppliers. People live up to commitments, and you know that you will be treated fairly."

Pro-Par Industries, Inc. v. General Motors Corp.[59] suggests that some suppliers would disagree. The case illustrates many of the problems that face a supplier claiming rights under a blanket order. It is one of the very few reported cases where a supplier sued an auto manufacturer. The appellate court affirmed a summary judgment in favor of GM in a three-paragraph opinion. It says only: "there was no genuine issue of material fact to support appellant's allegations that GM had agreed to purchase any fixed amount or specified percentage of its 1989 estimated requirements for parts numbered 892 and 126 in GM's invitation to bid to Pro-Par."[60]

We can reconstruct the dispute from the briefs and record. As always, much remains unclear, but we can establish several things in this concrete example. GM sent its "Request for Quotation" form to Pro-Par and several other suppliers, seeking bids. The form stated in large type: "This is not an order." In smaller type it said: "We reserve the right to accept or reject your quotation." It stated: "QUOTING CONTRACT REQUIREMENTS 8-1-80 THRU 7-31-81." It then stated an "Est. Annual Volume" for each of the parts for which quotations were asked. The document provided in very small type but in the middle of the form:

> Vendor agrees to sell and vendee agrees to purchase at the price and upon and subject to the terms and conditions on the face and reverse side hereof approximately the percentage shown of the vendee's requirements of the items listed for shipments during the period from 8/1/80 to 7/31/81. % indicates the approximate percentage of the requirements that this contract covers.

59. 884 F.2d 580 (6th Cir. 1989).

60. The case also illustrates how slowly the American legal system moves and how difficult it is to litigate against a major corporation. The "approximate requirements contracts" were made in early 1980, covering GM's requirements of various screw machine parts from August 1980 to July 1981. GM did not order all the parts which Pro-Par expected to supply during this period. Pro-Par sued GM in November 1984. GM moved for summary judgment in 1986, and the trial court granted partial summary judgment in 1987 and then modified its opinion in 1988. Pro-Par filed notice of appeal to the Sixth Circuit in July 1988, and the court issued its short opinion in 1989.

It is hard to judge the case on a cost-benefit basis for Pro-Par because we may be too influenced by hindsight. (Pro-Par got only a $3,000 settlement to end certain claims not appealed to the Sixth Circuit.) Nonetheless, the record makes it clear that tangling with GM calls for much costly legal work. The case involves difficult questions under UCC § 2-306, governing requirements contracts, the parol evidence rule, and promissory estoppel. Pro-Par's lawyer did a good job in defeat, but GM's briefs are very well done. Its lawyers know the cases, use the favorable law review writers, and make good policy arguments.

These estimates were based on past sales of the products for which parts were to be supplied, although nothing on the form states the basis on which GM's purchasing department made the estimates. Pro-Par alleged: "In developing its bid for each part, Plaintiff [Pro-Par] took into account multiple fixed and variable costs to fulfill the estimated annual volumes. . . . Once these costs were computed for furnishing the estimated annual volume, Plaintiff divided these costs by the estimated annual volume and arrived at a piece part price."

Pro-Par further stated:

> Once Plaintiff obtained a number of one-year contracts with the Defendant . . . Plaintiff grew rapidly. Additional machinery was purchased to service those contracts. Additional employees were added to operate the machinery on multiple shifts, such employees amounted to as many as thirty-six. [Pro-Par had only 4 to 5 people running machines before these contracts]. . . . With these one-year contracts, Plaintiff was almost completely "booked" in the sense that it had the capacity to service all of Defendant's contracts, but very little capacity left to offer other vendees. Plaintiff had reserved 98.6% of its machinery and manpower to serve these contracts [with Delco].

Pro-Par's officials also testified that they assumed that if they did a good job, the Delco contracts would be renewed beyond just one year.

GM disappointed Pro-Par's expectations when it ordered far fewer parts than Pro-Par had anticipated. GM said that it did not place orders because it had no requirements. It did not need any of one part because of the 1981 automobile recession. GM's Delco Division did not order another part because Buick gave the contract for the product in which the part was to be used to an outside supplier. That supplier did buy parts from Pro-Par, but it did not buy as many as GM had estimated it would order.

Pro-Par wanted the court to construe the total contract as including the stated estimates as a commitment. Under this reading, General Motors promised to buy its approximate requirements but promised or represented that they would fluctuate around the estimates. The trial court rejected this theory with a plain meaning/parol evidence approach. The words used in GM's printed form document made no such commitment, and the court refused to look outside the document for additional commitments. It did not consider whether GM reasonably could expect Pro-Par to read and understand provisions printed in fine print and stated in lawyers' language.[61]

61. Plaintiff also wanted to apply promissory estoppel to the estimates. This doctrine protects reliance on promises which do not form contracts. The court said that there must be an express representation or a promise for that doctrine to apply, but GM's estimate was just an opinion. On appeal, the Court of Appeals did not consider the point.

Why did Pro-Par sue General Motors? Its losses are clear. It did not get the orders it had anticipated when it made the contract. It had set the per-part price on the assumption of larger production runs. It had made investments based on its anticipation of orders. It had devoted its plant to General Motors production and had not looked elsewhere for business. Most significantly, at the time of the litigation Pro-Par was going through bankruptcy. Thus, the case is a salvage operation, with little concern with long-term continuing relations.

Why did Pro-Par think that more was involved than just the luck of the game? Why didn't its officials think that it assumed the risk that GM would have no requirements? First, Pro-Par was an inexperienced auto supplier. It existed only two or three years before this deal. People who ran it had experience in other industries but not with blanket order or approximate requirements contracts purchasing.

Pro-Par's people suspected that GM-Delco had acted in bad faith: Pro-Par's general manager had left to form his own company, and GM placed business with him quickly. Mrs. Crompton took over as President of Pro-Par after the contracts were made. She testified: "There's something there with Delco, I can't put my finger on it, but there is some reason, there has to be some reasoning that they would, you know, deliberately take a small company like us, give us all this work knowing we were a new company, and get us, you know, we go out and purchase the equipment to run this, these jobs, and then the work is gone, I mean there has to be some explanation for it, there's something there. What it is, I don't know." She also testified that she thought that Delco's Purchasing Agent "had an instant dislike to me. . . . You know, it was hard to get work from Delco, we were the preferred supplier, but they didn't want anything to do with us, it was that way because it was because of me, because of a woman being in there."

When considering a motion for summary judgment, a court interprets the facts most strongly for the party resisting the motion. Even so, the Pro-Par case illustrates how the blanket order system wards off judicial supervision of GM's private government. Courts treat suppliers as if they had taken the risk of making capital investments and pricing based on no commitments to buy the quantities estimated.

D. Dealer Relations and Litigation

1. *The Traditional Relationship*[62]

Independent dealerships arose almost simultaneously with the emergence of mass automobile production itself in the United States. By 1906

62. Our discussion in this section and the next draws on S. Macaulay, *Law and the Balance of Power: The Automobile Manufacturers and Their Dealers* (New York: Russell Sage

there were 1,545 dealers, and by 1913 Ford alone had almost 7,000 dealers.[63] These retailers provided the capital for their own facilities and had to pay cash for their cars. In turn they received a discount off the list price as their margin.

The franchise system offered a number of advantages to manufacturers as compared to operation of their own stores at the retail level. The automaker avoided having its capital tied up in showrooms and garages; instead this burden was passed on to a dealer. Moreover, a dealer who had invested his or her own money in the business had incentives that would not work as forcefully on an employee managing a sales branch owned by the manufacturer. In particular, the dealer would want to maximize sales in order to maximize his own return.

The same factors that gave the manufacturers leverage over their suppliers—the financial lucrativeness of a relationship and industry concentration—enabled them to largely dictate the terms of the relationship with their dealers. This was reflected in the contracts used. 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. It specified 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. It also permitted either party to terminate the relationship at will. The dealer had no contract rights that could be enforced in court. As one federal court put it:

> It appears that the plaintiff (dealer) has been disappointed in its expectations and has been dealt with none too generously by the defendant (manufacturer); but while we sympathize with its plight, we cannot say from the evidence before us that there has been a breach of binding contract which would enable it to recover damages. While there is a natural impulse to be impatient with a form of contract which places the comparatively helpless dealer at the mercy of the manufacturer, we cannot make contracts for parties or protect them from the provisions of the contracts which they have made for themselves. Dealers doubtless accept these one-sided contracts because they think the right to deal in the product of the manufacturer, even on his terms, is valuable to them; but after they have made such contracts, relying upon the good faith of the manufacturer for the protection which the contracts do not give, they cannot, when they get into trouble, expect the courts to place in the contracts the protection which they themselves have failed to insert.[64]

Foundation, 1966); Macaulay, "Standardized Contracts" at 23–25. See also White, *Automobile Industry* ch. 9 (cited in note 10).

63. L. White, "The Automobile Industry," *in* W. Adams, ed., *The Structure of American Industry* 140 (New York: Macmillan, 1982).

64. Ford Motor Co. v. Kirkmeyer Motor Co., 65 F.2d 1001 (4th Cir. 1933).

The automaker 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 that could not easily be put to any other use. In addition, dealers were sometimes coerced to purchase old or hard-to-sell types of cars, parts, and accessories from the manufacturers.

2. *New Developments*

Three important developments have altered the manufacturer-dealer relationship. First, 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. The most successful of these statutes required manufacturers who contracted with 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 it 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" by threatening or attempting to cancel the dealer's franchise; (3) "unfairly, without due regard to the equities of said dealer and without just provocation" canceled the franchise of a dealer. These statutes created bargaining power for the dealers to offset, to some degree, the manufacturers' advantages.[65]

While many of the state statutes were effective, some were not. In a few cases, state supreme courts declared them unconstitutional. 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.

In 1954 the National Association of Automobile Dealers sought help from Congress. 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.

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

65. Wis. Stat. § 218.01 (1994).

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."

Despite the hopes of its supporters, however, the federal legislation has had only a minimal substantive impact on the manufacturer-dealer relationship. 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 few have won judgments that were not reversed by the appellate courts. 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.

Automobile dealer trade associations returned to the states, and today all states regulate manufacturer-dealer relations.[66] Manufacturer representatives can have their licenses canceled for coercion or franchise cancellations that violate the statutes. Moreover, in about half the states dealers are given a private cause of action to enforce their rights created by these statutes. We were told that a great deal of bargaining in the shadow of these laws takes place. Perhaps most significantly, many states have provisions limiting the right of manufacturers to establish new dealerships.[67] The Wisconsin statute, for example, provides that if a manufacturer proposes to open a new dealership "within the relevant market area of an existing enfranchised dealer," it must notify both the dealer and the state regulatory agency. The dealer may protest. If it does, the agency must determine whether there is good cause for permitting the establishment of the proposed dealership.[68] The statute creates a balancing test and lists eight factors to be considered.[69]

The second important shift in the relationship between manufacturers and dealers has been an increased turn to private government to resolve disputes. The manufacturers began to encourage the use of mediation and arbitration after the passage of the various state statutes and the federal Dealers Day in Court Act. While they have worked hard to limit the impact of this legislation, the automakers also have pushed alternative dispute resolution mechanisms for their own merits.

66. See S. Macaulay, "Long-Term Continuing Relations: The American Experience Regulating Dealerships and Franchises," in C. Joerges, ed., *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* 179, 197–203 (Baden-Baden: Nomos Verlagsgeselllschaft, 1991) ("Macaulay, 'Long-Term Continuing Relations'").

67. For a challenge to these statutes, see C. N. Anderson, "American Motors Sales Corp. v. Peters: Green Light to Territorial Security for Automobile Dealers," 63 *N.C.L. Rev.* 1081 (1985); R. P. Rogers, "The Effect of State Entry Regulation on Retail Automobile Markets," Bureau of Economics Staff Report to the FTC (1986).

68. Wis. Stat. § 218.01(f)(1).

69. *Id.* at § 218.01(f)(2).

General Motors, in the wake of the national hearings in the mid 1950s, appointed a retired federal judge to hear disputes with dealers. GM franchises were renewed in 1990. As part of this process, three different procedures regarding the use of alternative dispute resolution were created. Buick and Cadillac dealers are required to go through a joint mediation system, but decisions are nonbinding. After they have used the system, they can take a dispute to court. Chevrolet, Oldsmobile, and Pontiac dealers can "elect to take the dispute to binding arbitration if [the Chevrolet, Oldsmobile or Pontiac] Division also agrees to arbitrate." The arbitrators do not apply federal or state dealer protection laws. Rather, the franchise provides: "In reaching its decision, the Arbitration Board shall consider general concepts and principles of law and equity so that the decision will achieve a fair and just result without modifying the terms of the Dealer Agreement." Arbitration is binding, and dealers cannot then go to court or a state administrative agency. Finally, dealers for the new Saturn division must go through a mediation and arbitration process. Decisions are final; these dealers are not permitted to sue or assert their rights under state dealer protection statutes.[70] The Saturn franchise agreement was challenged by a state agency in Virginia, but a federal court upheld it because Saturn was a new company.[71] All new dealers can decide whether they want a franchise which comes with the compulsory arbitration system. The arbitration system is governed under the Federal Arbitration Act, which apparently preempts all the state dealer protection regulation.[72]

The Saturn provision requiring arbitration is currently unique among auto dealer franchises. In the early 1980s, Chrysler attempted to institute

70. Section 5A of the Saturn franchise states: "Franchisor and Dealer acknowledge that, at the state and federal levels, various courts and agencies would, in the absence of this Article 5, be available to them to resolve claims or controversies which might arise between them. Franchisor and Dealer agree that it is inconsistent with the [Saturn] Mission and Philosophy for either to use courts or government agencies to resolve such claims or controversies."

71. See Saturn Dist. Corp. v. Williams, 905 F.2d 719 (1990).

72. Southland Corp. v. Keating, 465 U.S. 1 (1984); Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, 473 U.S. 614 (1985). See, e.g., R. E. Speidel, "Arbitration of Statutory Rights Under the Federal Arbitration Act: The Case for Reform," 4 *Ohio St. J. Dis. Resol.* 157 (1989); B. A. Atwood, "Issues in Federal-State Relations under the Federal Arbitration Act," 37 *U. Fla. L. Rev.* 61 (1985); Note, "Arbitrability of Disputes under the Federal Arbitration Act," 71 *Iowa L. Rev.* 1137 (1986).

Since the late 1980s, the National Automobile Dealers Association (NADA) has lobbied for legislation that would allow dealers and others subject to arbitration clauses in franchise contracts to decide not to arbitrate once a dispute has arisen. Also, under NADA's proposal, a court could vacate an arbitrator's award if the court found "the arbitrator disregarded, misapplied, or misinterpreted State law." The American Arbitration Association opposed the bill. See D. T. Kurylko, "NADA Seeks Federal Law to Ban Binding Arbitration," *Automotive News*, 25 Sept. 1989, at 4. Despite bipartisan support and hearings, this legislation remains in committee. The manufacturers have backed away from demanding mandatory arbitration in their franchises, and this has meant that legislators have not seen action as necessary. Indeed, while the entire lobbying effort may not have produced a statute, it may have been a factor in limiting the manufacturers' attempt to impose mandatory arbitration on the dealers.

binding arbitration of any disputes arising out of or in connection with the interpretation or performance of a dealer franchise "including, but not limited to, . . . disputes under rights granted pursuant to the statutes of the state in which DEALER is licensed."[73] Many Chrysler Corporation dealers protested vociferously. Chrysler backed down and made acceptance of the provision a choice for the dealer.[74] The company had not arbitrated any dealer cases as of early 1992.

Ford established a two-step system of resolving disputes in 1956, again voluntary for dealers. First, disputes are taken to the Ford Dealer Policy Board. It consists of three executives who devote their full time to its activities and do not have operating responsibilities. They report directly to the Board of Directors. They hear and investigate about 100 complaints a year.[75] Often the Policy Board gives a dealer a second chance to meet requirements or arranges to have someone buy out a dealer at a favorable price. Then, if a dispute remains unresolved, it can be taken to arbitration. Very few cases have been taken to such arbitration. The Dealer Policy Board has been effective, but if it cannot resolve the problem, most dealers prefer to go to court.

Nissan has a Policy Review Board which can hear "[a]ny protests, controversies or claims by Dealer (whether for damages, stay of action, or otherwise) with respect to any termination or the settlement of accounts of Dealer with Seller after termination." Volvo dealers may take claims regarding unjust termination of a franchise to the American Arbitration Association (AAA), where an arbitrator determines whether termination would accord with the standards of the federal Dealers Day in Court Act. Under a Saab franchise, disputes about good cause for termination "may be settled by arbitration [under AAA procedures] if Dealer and SAAB shall mutually agree thereto." Since 1987, Toyota has had an in-house ADR system for resolving disputes between its dealers about allocations of its best-selling cars and creating new dealerships.[76]

73. The Chrysler franchise called for Chrysler and the dealer each to appoint an arbitrator, and the two arbitrators thus selected were to appoint a third. The franchise stated: "It is the intent and desire of DEALER and CMC to hereby and forever renounce and reject any and all recourse to litigation before any judicial or administrative forum and to accept the award of the arbitration panel as final and finding, and subject to no judicial or administrative review."

74. "NADA considered a victory Chrysler's decision to indefinitely extend the original 18-month moratorium on mandatory binding arbitration in franchise agreements." E. Lapham, "NADA: Politics and Promos," *Automotive News*, 20 June 1988, at 1. Since 1987, Chrysler has let dealers who sign franchise agreements decide whether they want binding arbitration to settle disputes. About four dealers have chosen the option; most have rejected it. S. G. Wedde, "Franchise Gray Areas Codified," *Automotive News*, 26 July 1993, at 18.

75. See *Automotive News*, 26 July 1993, at 18.

76. R. Garrity, "ADR to Become Bigger than Ever," *Mich. Lawyers' Weekly*, 13 April 1992, at 19.

The trend toward alternative dispute resolution continued in revisions of the Wisconsin Statutes in 1993.[77] However, here arbitration was not used as a device to ward off state dealer protection regulation via the federal Arbitration Act. A General Motors lawyer said,"we hope that the statutory results here will be used as models in other states." The Wisconsin Automobile and Truck Dealers Association (WATDA) explained the origins of the negotiations that led to significant changes in the law:

> WATDA had included in the 1992 State Budget [provisions stating that] manufacturers are liable to dealers for treble damages when they cancel or fail to renew a dealer's franchise without "just provocation," even if the cancellation is due to a nondiscriminatory withdrawal from the market. Manufacturers wished to eliminate the onerous treble damage remedy or even an actual damage remedy in these situations. In the interest of achieving consensus on the other vital issues, WATDA was willing to consider a change which would require manufacturers to compensate dealers only for their actual damages in nondiscriminatory cancellations and only for statutory termination benefits where a line make is completely withdrawn from the market to avoid economic loss.

Representatives of Chrysler, Ford, General Motors, and Toyota as well as recreational vehicle and motorcycle manufactures held more than 27 full days of meetings over a five-month period with the WATDA. They arrived at a consensus proposal which was presented to the Wisconsin Legislature. It passed, and the Governor signed it. Some of the 30 pages of amendments served manufacturer interests, some dealer interests.

Perhaps the most interesting change dealt with dispute resolution. After the legislation took effect, before a dealer can begin an administrative or judicial proceeding to assert rights under the Wisconsin statute, it must demand mediation. Mediation does not prevent using these other means of dispute resolution unless it is successful. A WATDA staff attorney said, "in many instances, the mediation will achieve the desired result: a resolution acceptable to both parties. In the cases where mediation works, both parties will have save much time and expense." Moreover, the statute creates a voluntary arbitration program. Disputes between manufacturer and dealer will be arbitrated before a panel consisting of a representative of the manufacturer and the dealer as well as a neutral party. The arbitration panel is "bound by the laws of this state," and so arbitration will not cost a dealer its rights under the Wisconsin dealer protection statutes. The Chairman of WATDA commented:

77. The relevant statute is Wisconsin Statutes, § 218.01(lr), (1bm (1) (2a) (2b) (3)), (36d), <7m<a>, <b>, <c>, <d>, <7r>> (1994); amendments are reported in AB (1993, 565). All quotes in this and the next three paragraphs are from M. A. Gerrard, "How Your New Mediation-Arbitration Program Works," *Dealer Point*, Summer 1993. *Dealer Point* is a publication of the Wisconsin Automobile and Truck Dealers Association (WATDA).

> I'm amazed that our Wisconsin association [together with the manufacturers] will administer a program for mediation or arbitration, and the manufacturers will support it. Dealers don't want to sue manufacturers, and I'm sure that it's true the other way. But now we seem to have a new way to get at problems "in the family," so to speak. It's a great idea!

The General Motors representative said: "We will jointly run the ADR program in Wisconsin, and we will use the consensus project for any new legislative desires in years to come."

The manufacturers and the Wisconsin auto dealers contracted with Resolute Systems, a firm offering dispute resolution services, to conduct mediation and arbitration under the statute. During the first nine months the program was in operation, they conducted four mediations dealing with disputes about a termination, an objection to the creation of a new dealer in the territory of an established dealer, and payments for warranty work. In each case the mediation settled the dispute.

Some dealers throughout the nation have been very pleased with the change to dispute resolution through mediation. For example, Jacobs reported:

> Gregory L. Greenwood, owner of a car dealership in Youngstown, Ohio, claimed that Chevrolet owed him more than $100,000 worth of bonuses through its dealer incentive program. But Chevrolet refused to pay the incentive to Greenwood Chevrolet due to an intricacy in their agreement. After six months of exchanging nasty letters, parent company General Motors gave Greenwood the option of arbitrating the dispute. That meant he could have an impartial panel of three people hear and decide his case outside of court. They jointly chose the panel, which included a Chevrolet dealer, a Chevrolet factory representative and a professional arbitrator from Endispute, Inc., a Washington, DC, company that offers such services.
>
> Greenwood and Chevrolet chose a day for the hearing and met on neutral ground. Within nine hours, the panel had reached a decision, awarding Greenwood about one-third of the money. Although he was not totally satisfied with the size of the award, Greenwood still believes he's "several hundred per cent ahead," because arbitration cost less than one-tenth of what he would have spent on full-fledged litigation.
>
> What's more, Greenwood and General Motors were able to resolve the dispute in confidence, preserving their working relationship, rather than sacrifice it to the adversarial forces of a protracted and public legal battle. "I'm not just here for the next two weeks. I'm here for a long time," says Greenwood, a second-generation automobile dealer. "It felt good to resolve the case in a noncombative way."[78]

78. J. Jacobs, "Keeping It Out of Court: Alternative Dispute Resolution," 81 *Mgmt. Rev.* 54 (1992).

Finally, a third shift has occurred in the manufacturer-dealer relationship. Over the course of the past 40 years the number of auto dealerships in the United States has declined steadily. In 1949 there were 49,000 dealerships. The number fell to 34,000 in 1960 and 27,000 in 1970. By the mid-1980s there were only 20,000 dealerships.[79] This trend has several causes. One is simply improved transportation. There is no longer a need for a dealership in every rural area and small town, as people can more easily get to the nearest city to purchase a new car. More important, beginning in the 1960s the manufacturers attempted to reduce the number of dealerships, finding it more efficient to deal with fewer but larger dealers who order cars and parts in large quantities and on a regular basis. In addition, heightened competition and greater sales volatility in the past 20 years have forced many dealerships out of business.

The decline in the number of dealerships and larger size of those remaining appears to have increased dealers' leverage vis-à-vis the automakers somewhat. Each particular dealer is now more important to the manufacturer, because its sales are greater and there are fewer nearby alternative dealers on whom the manufacturer can rely in the case of a dispute.

The rise in imports may have increased the number of franchises somewhat, but many of the European and Japanese carmakers have preferred to utilize existing dealerships, rather than establish new ones. In fact, it is now common for dealers to franchise with several automakers rather than just one—for example, with Buick, Honda, BMW, and Volvo. The rise of such "megadealers" has a similar effect as the fall in the number of dealerships; it increases the leverage of the dealer in its relationship with each particular manufacturer.

3. *More Litigation?*

Our expectations with regard to manufacturer-dealer litigation are similar to those described above for suppliers. The general point, again, is that heightened competition, uncertainty, and instability are expected to cause the automakers to demand better performance from their dealers and to reduce their margin of tolerance for subpar results. Manufacturers reduce dealer percentages, pressure them to sell more cars, and cancel more dealerships. All else being equal, more lawsuits should ensue.

Several considerations lead us to predict more litigation between manufacturers and dealers than between manufacturers and suppliers. First, deal-

79. T. Marx, "The Development of the Franchise Distribution System in the U.S. Automobile Industry," 59 *Bus. Hist. Rev.* 465, 468 (1985). According to Spinella, "the number of dealer principals tumbled from 45,000 to 17,000 between 1950 and 1987, with the prospect of only 14,000 dealership owners by 1991." A. M. Spinella, "The Dealer Dimension," *Ward's Auto World*, May 1988, at 53.

ers have greater legal leverage vis-à-vis manufacturers, at least formally, than do supplier firms. The Dealers Day in Court Act requires manufacturers to act in "good faith" in their relations with dealers and specifies a variety of things the former are not permitted to do. As noted above, relatively few dealers have succeeded in winning cases filed under the legislation. Nevertheless, the law, along with complementary state statutes, is significant because it gives dealers legal rights—something suppliers for the most part do not have. Dealers often have at least some chance of success.

Second, when a dealer franchise is canceled, it is canceled permanently. There is virtually never an opportunity to resume the relationship several months or years down the road. Indeed, a canceled dealer is unlikely to remain in business at all. Only a few canceled dealers are able to continue in business representing another manufacturer. Hence, the financial incentive to "grin and bear it" that suppliers face does not apply to dealers.

As with suppliers, however, there are mitigating factors to consider, relating to the changes in the industry. One has to do with the change in the nature of dealerships, which is partly a function of the influx of imports and the consequent appearance of "megadealers." Increasingly during the past decade, dealers have come to hold franchises with a Japanese and/or European manufacturer as well as one of the American assemblers. In addition, the number of dealerships in the United States has declined dramatically. This trend toward concentration means that a higher percentage of dealerships are big ones, with greater leverage in their relationships with the American auto manufacturers. Presumably, the manufacturers would be less likely to cancel or harass such franchises, hence resulting in less litigation. On the other hand, almost half of the current dealerships are still single-site operations.[80] And increased leverage could make dealers less fearful, and more financially capable, of suing when disputes do arise. On the whole, though, we believe this change should temper the otherwise increasing incidence of litigation.

A second mitigating factor is the manufacturers' push for alternative dispute resolution and arbitration as a means of settling disputes with dealers. While binding arbitration has not been a requirement for dealerships until Saturn, most of the sources we interviewed indicated that various forms of ADR nevertheless have become important mechanisms for resolving disputes.

All things considered, we have reason to expect: (1) more litigation between the automakers and dealers than we found for suppliers; and (2) an increase in litigation since the early 1970s, followed by a slowing of the rate of increase or a decline.

80. Womack *et al.*, *Machine* 171 (cited in note 45).

4. *Findings*

We used the WESTLAW database and the Business Franchise Digest to search for manufacturer-dealer litigation from 1955 to 1990. This gives us a good picture of reported federal and state court cases between General Motors, Ford, Chrysler and their dealers. (Again we must emphasize that the discrepancy between reported and actual cases may be severe.) As figure 5 indicates, there is a noticeable increase in the period after 1972. Between

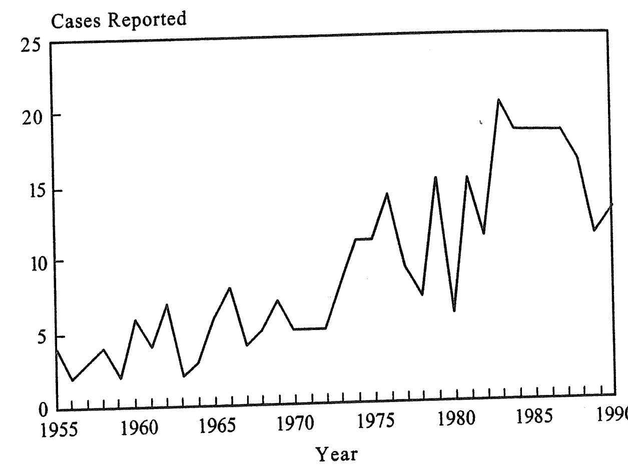

Fig. 5. Reported auto manufacturer-dealer litigation, 1955–1990. Source: WESTLAW; Business Franchise Digest.

1955 and 1972 there were an average of 4.4 cases per year, while between 1973 and 1990 the average rate increased to 13.2. Since the number of dealers declined by about half between the mid-1950s and the early 1990s, the incidence of litigation per dealer increased even more. Thus, there is some indication of a rise in the litigation rate between auto dealers and manufacturers, which is consistent with our predictions. As with the overall litigation trends, shown in figures 3 and 4, there appears to have been a decline beginning in the late 1980s.

Still, if the reported cases are any indication of actual instances of manufacturer-dealer litigation, not very much occurs.

Consistent with this impression are the results of a recent survey of dealer trade association officials in each state. The survey, which was conducted by Ivette E. Rivera, Senior Legislative Representative of the National Automobile Dealers Association, asked for information regarding the frequency of manufacturer-dealer disputes and the means through which disputes are resolved. The findings are presented in table 2.

TABLE 2
Automobile Manufacturer-Dealer Disputes in 49 States[a]

State	Estimated Cases per Year	Estimated Cases Appealed per Year	Dispute Resolution Process	Type of Court Appeals from Administrative Decision
AL	Very few reach court	—	Court	[b]
AZ	0–1	0–1	Admin. law judge	Limited to review of record
AR	1	0	Commission	Limited[c] to review of record
CA	Protests 102; petitions 23	25%	Admin. hearing (board) must exhaust admin. remedies before court	Limited[c] to review of record
CO	0	—	Uusually resolved between two parties/ court	[b]
CT	2	Less than 1	Agency	Limited to review of record
DE	2	—	Commission	Full appeal
FL	8–10	5	Admin. hearing	Limited[c] to review of record
GA	0–5	Only 3 cases ever reported	Admin. review (new)/court	Limited to review of record
HI	0	—	Usually resolved between two parties	—
ID	0	—	Usually resolved between two parties	Full appeal
IL	6–10	—	Voluntary arbitration/court	[b]
IN	1–3	—	Usually resolved between two parties/ board (minor disputes)	Full appeal
IA	3	Less than 1	Reg. hearings (maj)/court	Limited to review of record
KS	8–10	1–2	Admin. hearing arbitration	Limited[c] to review of record
KY	5 or less	Unknown	Commission	Full appeal
LA	10–12	5–6	Admin. hearing	Limited[c] to review of record
ME	0–1	—	Court	[b]
MD	5	1	Admin. law judge/court	Limited to review of record
MA	Unknown	—	Court	[b]
MI	0–5	2	Court	[b]
MN	1	—	Court	[b]
MS	3	Less than 1	Commission/court	Limited to review of record
MO	3–4	—	Court	[b]
MT	0–1	—	Dept. of Justice/court	Limited to review of record
NE	6 or less	1	Board/court/arbitration	Limited to review of record
NV	1	—	Hearing/court	Limited[c] to review of record
NH	Rare	—	Court/arbitration	[b]
NJ	6–10	Rare	Court (maj)/admin. hearing (commission)	[d] / Limited[c] to review of record
NM	0–5	Less than 1	Court	[b]
NY	Unknown	3–4	Court	[b]
NC	6–majority settled before hearing	2	Admin. hearing (maj)/court	Limited[c] to review of record
ND	1–2	—	Court	[b]
OH	15	10	Admin. hearing (board)	Limited[c] to review of record
OK	1–3	1	Commission	Limited[c] to review of record
OR	5	—	Court	[b]
PA	12 filed—most settled before hearing	2–3	50% admin. hearing (board), 50% court	Limited[c] to review of record
RI	1	1	Commission	Limited to review of record

State	Estimated Cases per Year	Estimated Cases Appealed per Year	Dispute Resolution Process	Type of Court Appeals from Administrative Decision
SC	1	—	Court	[b]
SD	1	0	Court/agency	Limited
TN	2	1	Admin. hearing commission (maj)/court	None since 1987/Limited[c] to review of record
TX	20	2–3	Admin. hearing commission	2–3 / Limited[c] to review of record
UT	0	0	Court	[b]
VT	0	0	Court	[b]
VA	10	Rare	Admin. hearings	Limited to review of record
WA	0–1	1 (5 years ago)	Admin. hearings/court	Limited to review of record
WI	15	6–7	75% Admin. hearing (agency)/25% court	Limited[c] to review of record
WV	0	0	Court	[b]
WY	0–1	0–1	Hearings/court	Full appeal

SOURCE: Ivette E. Rivera, National Automobile Dealers Association.

[a]Alaska does not have a state motor vehicle franchise law and was therefore not included in the survey.

[b]There is no administrative hearing process in this state, so any dispute would be initiated in the judicial system.

[c]This state has a judicial appeal from the administrative hearing process under what is generally known as the Substantive Evidence Rule. The court reviews the record to determine whether or not the administrative decision is to be upheld or overturned. Typically no new evidence is permitted and the appellants' burden to overturn the administrative decision is very high.

[d]There is no administrative hearing process for termination cases in New Jersey. Other disputes are handled as shown.

5. *Explanation*

As with suppliers, the contract is the point of departure for understanding litigation patterns between manufacturers and dealers. While it is true that federal and state legislation provides dealers with greater legal leverage vis-à-vis the automakers than suppliers have, this by no means implies that they possess overwhelming power.

The manufacturers have taken many steps that make a dealer's lawsuit difficult to bring and win. Many franchises provide that litigation must be brought before a court sitting where the manufacturer's home office is located. Dealers located in states distant from that home office would have to assume the costs and inconvenience of managing litigation away from their place of business.

The Ford Dealer Franchise imposes a number of obligations on dealers. They must make sufficient sales and follow Ford's sales methods. The franchise then provides that the dealer acknowledges each of his (still rarely her) responsibilities is reasonable and failure to fulfill any of them would be a material breach. It continues by attempting to ward off dealers' rights under the federal Dealers Day in Court Act and many of the state statutes. It provides:

> The Dealer agrees that if the Company or any of its representatives (i) request the Dealer to fulfill any of such responsibilities, (ii) believes that any such failure, occurrence or event is occurring or has occurred and advises the Dealer that, unless remedied, such failure, occurrence or event may result in Company termination or nonrenewal of this agreement, (iii) gives the Dealer notice of termination or nonrenewal, or terminates or fails to renew this agreement, because of any such failure, occurrence or event, then *such request, advice, notice, termination or nonrenewal shall not be considered to constitute or be evidence of coercion or intimidation, or threat thereof, or to be unreasonable, unfair, undue or unjust or to be not in good faith.* (Emphasis added)

We cannot be sure whether such a clause in a form contract would block consideration of the fairness of Ford's actions in a particular case. Nonetheless, any dealer considering litigation would have to be prepared to overturn this language. At a minimum, the clause increases the costs of litigation, costs a canceled dealer often cannot pay.

Under the franchise, dealers must appeal any controversy to the Policy Board within 15 days. Such an appeal is a "condition precedent to the Dealer's right to pursue any other remedy available under this agreement or otherwise available under law. The Company but not the Dealer, shall be bound by the decision of the Policy Board."[81] Ford wants dealers to raise problems immediately so that they can be resolved. It does not want problems saved to be used as bargaining entitlements in a termination proceeding.

If a dealer is terminated, it may demand that Ford purchase or accept return of vehicles, parts, signs, and special tools and equipment. But clause 23 of the franchise states that exercise of such a right will cost the dealer the chance to litigate claims under the various dealer protection statutes:

> If dealer fails to return the form stating such election within such thirty (30) days, the Dealer shall be deemed to have elected to accept such benefits. Upon the Dealer's election to accept any of such [repurchase or return] benefits, or upon the Dealer's demand of any such benefits upon any termination or nonrenewal by the Dealer, the Company shall be released from any and all other liability to the Dealer with respect to all relationships and actions between Dealer and the Company.[82]

The clause forces the terminated dealer to decide whether to take the sure benefits it provides or to risk losing them if litigation proves to be unsuccessful.

When Toyota renews a dealer franchise, the document purports to wipe out all prior claims, including those arising under a dealer protection statute. It states:

> Because the success of the relationship between DISTRIBUTOR [Toyota] and DEALER depends upon the mutual understanding, cooperation, trust and confidence of both DISTRIBUTOR and DEALER, each party hereby releases the other from any and all claims, causes of action or otherwise that it may have against the other for money damages arising from any event occurring prior to the date of execution of this Agreement, except for any accounts payable by one party to the other as a result of the purchase of any Toyota Products.[83]

81. In DeValk Lincoln Mercury, Inc. v. Ford Motor Co., 811 F.2d326 (7th Cir. 1987), the court upheld the Dealer Policy Board appeal as a condition precedent to claims under the Dealer's Day in Court Act or based on breach of contract or fraud. It further held that substantial performance would be insufficient and the franchise's provision against waivers blocked any claim that the condition had been waived. Note that in Rea and 22 Ford, Inc. v. Ford Motor Co., 497 F.2d 577 (3d Cir. 1974), the court found that taking a case to the Dealer Policy Board was not a prerequisite to bringing suit for violation of the Dealers Day in Court Act. The court remarked: "In light of the Act's purpose, it may be that a dealer should not be denied the opportunity to pursue his statutory cause of action because of a failure to invoke a contractual grievance procedure."

82. This provision also is upheld in DeValk Lincoln Mercury, Inc. v. Ford Motor Co., 811 F.2d 326 (7th Cir. 1987). Among other things, the court refused to find the clause to be "unconscionable." "Ford is entitled to a valid exercise of its corporate power in offering dealers a choice of either electing benefits in exchange for a release of liability or of declining benefits altogether." The court cites five other cases to this effect.

83. Honda's and Volkswagen's franchises contain similar provisions.

The Volvo franchise attempts to prevent the possibility of jury sympathy for a local dealer. It provides:

> Distributor and Dealer both acknowledge and agree that any controversy which may arise under this agreement or the relationship established thereby would be based upon difficult and complicated issues and therefore the parties agree that any lawsuit growing out of such controversy will be tried in a court of competent jurisdiction by a judge sitting without a jury.

Dealers may have to jump other hurdles to assert their rights. Most simply, they may not be able to find an experienced lawyer to handle their case. While the auto manufacturers all have many lawyers experienced in handling suits brought by dealers, there are few lawyers expert in this area who represent dealers in such litigation.[84]

Dealers may be dissuaded from pursuing litigation because the potential payoffs are outweighed by the potential costs. Dealers have won suits on the basis of unfair conduct by the manufacturer, but the success ratio is very low. And the costs to a dealer threaten to be enormous. Quick decisions are rare, and the investment needed to finance a suit can be substantial. A dealership which has just lost a franchise probably cannot afford to retain a lawyer on a fee-for-services basis. It is hard to find an experienced business lawyer willing to take a case against an auto manufacturer on a contingent fee. Even lawyers who take a case on a contingent fee may be more interested in a quick token settlement than in all the work needed to ward off

84. Silver Chrysler Plymouth, Inc. v. Chrysler Motors Corp., 518 F.2d 751 (2d Cir. 1975); 496 F.2d 800 (2d Cir. 1974); 370 F.Supp. 581 (E.D.N.Y. 1973), suggests part of the difficulty. It involved an attempt by Chrysler to get the dealer's lawyer disqualified for a conflict of interest. The dealer's lawyer, Schreiber, had worked briefly for Kelley, Drye, Warren, Clark, Carr & Ellis—an 80-member Wall Street firm that had long represented Chrysler in matters related to dealers. Following graduation from the Columbia University Law School, Schreiber worked for Kelley, Drye. After about 32 months, he left to establish his own practice in White Plains, N.Y. A year later, he joined Hammond, a senior lawyer with a national reputation for representing auto dealers, to form a two-person firm.

Chrysler failed to disqualify the lawyer. Kelley, Drye failed to produce the time records which would show Schreiber's assignments. However, the former Kelley, Drye associate in charge of Chrysler dealer suits offered an affidavit saying that Schreiber "did not work directly or indirectly on Chrysler dealer litigation, with the possible exception of researching a few specific points of law that may have been involved in a dealer case." Schreiber's own statement stressed how little contact he had with Chrysler.

The trial court decided that "the disqualification of plaintiff's counsel is not warranted." He quoted Judge Charles Clark: "the dangers of using legal ethics as a club to protect monopolists or harass complainers . . . suggest care and concern lest we go too far." The Second Circuit affirmed. Both courts' opinions distinguish Motor Mart, Inc. v. SAAB Motors, Inc., 359 F.Supp. 156 (S.D.N.Y. 1973). There the lawyer had represented Saab on a regular basis for five years, and he had drafted the basic dealer agreement used by Saab. He was involved extensively with Saab's legal relations to its dealers. The Saab court held that this lawyer was disqualified and could not represent a Saab dealer against SAAB. Chrysler failed to disqualify Schreiber, but the lesson of the two cases is that a lawyer cannot learn about dealer cases by representing too many manufacturers.

motions for summary judgment and to prepare for trial. One dealer we interviewed successfully litigated a case against a manufacturer for wrongful termination and was awarded over a million dollars. However, 10 years passed between the beginning of the dispute and his receipt of the compensation, during which time the dealer suffered severe financial and emotional strain. Moreover, the recovery reflected only a portion of what the dealer saw as his actual losses. It is difficult to prove the profits a dealership would have made had it not lost a franchise. This case is not necessarily representative of the actual costs borne by all dealers seeking to win against a manufacturer in court. Nonetheless, the potential costs are steep in light of the low probability of a significant recovery.

Because dealers have significant legal rights vis-à-vis the automakers, the latter work very hard to avoid liability for bad faith or coercion. Most have instituted dealer improvement programs, under which a dealer is informed if it is not satisfying the company, various kinds of help are given, and step-by-step goals are set to get the dealer back on track. This procedure, which can sometimes last for several years, creates a formal record of manufacturer attempts to aid the dealer in working out whatever problems exist. Just being singled out for this unwanted attention is itself a sanction which dealers seek to avoid.[85] Another component of this strategy is the use of Consumer Satisfaction Indexes, based on consumer evaluations of dealer performance. In many franchises, a bad Satisfaction Index can be grounds for termination.

Another reason for the relative lack of litigation is the existence of alternative means of dispute resolution. The existence of the various statutory rights gives dealers some power to bargain in the shadow of the law. Manufacturers create careful records of defective performance, tell the dealers about the problems, and give dealers an opportunity to cure their defaults. Manufacturers often try to arrange for a successor dealer to buy out the existing one on favorable terms after attempts at cure have failed. The manufacturer will locate a potential buyer and sometimes help finance the purchase. For some dealers—particularly those under financial strain—this may come as a relief, and is clearly preferable to litigation or even arbitration.

Manufacturers have pushed very hard to encourage dealers to make use of available alternative dispute resolution mechanisms instead of going to court. Given the potentially high costs of litigation, the attraction of ADR is obvious from the dealer's point of view if there is reasonable chance of gain. Dealers of course have complaints about company-run programs, but these programs are understandably seen as the best course of action in certain circumstances. They may be particularly worthwhile in dealing with

85. See M. Krebs, "GM Maps Franchise for the '90s," *Automotive News*, 3 April 1989, at 1. See also *Automotive News*, 13 March 1989, at 1.

disputes that do not involve termination, such as warranty work and promotional chargebacks. Unfortunately, we have not been able to obtain any hard data on the incidence of manufacturer-dealer alternative dispute resolution.

In addition, in many cases manufacturers can avoid having to terminate a franchise by simply letting the dealership die. This tactic appears to have become more prominent over the past 20 years, as the frequency and severity of downturns in the auto market have increased. The period from 1979 to 1983, for example, witnessed a sharp drop in the number of dealerships, due to the second oil shock and ensuing recession. In Wisconsin a quarter of the existing franchises disappeared in those four years, dropping the number of dealerships from 1,000 to 750.

Finally, the change in the nature of dealerships noted above may have worked to decrease the number of severe disputes between manufacturers and dealers. There are fewer dealerships with which disputes could arise, and many of those that remain have greater leverage vis-à-vis the manufacturers than did their predecessors.

E. Why the Recent Decline in Litigation?

Several of our data sources suggest that intercorporate litigation in the automobile industry began to decline in the late 1980s (see figs. 3–5 above). How can we account for this? One possibility is that the degree of competition, uncertainty, and instability encountered by automotive firms decreased beginning in the mid-1980s, easing pressures and thereby encouraging a return to more noncontractual handling of disputes. One trend seemingly consistent with this interpretation is the drop in the import share of U.S. auto sales starting in 1987 (see fig. 2 above). However, as we noted earlier, this trend is misleading; it mainly reflects a shift by Japanese automakers away from car imports in favor of production within the United States. On the whole, we see no evidence of declining competition in the auto industry during the mid- to late 1980s.

A more likely cause of declining litigation rates is that, after a decade or so of rising intercorporate litigation, firms responded by creating new mechanisms of dispute resolution aimed at avoiding lawsuits. As we stated earlier (sec. I above), this is to be expected. Given that firms are strategic actors, and that litigation is often viewed as a less-than-optimal means of handling disputes, we assume that sudden increases in the frequency of lawsuits between firms should occasion efforts to reverse such a trend. Among the most important efforts by U.S. automakers have been the shifts toward cooperative, long-term partnerships with a smaller base of suppliers and toward greater use of mediation and arbitration with dealers. These alterations in governance strategies appear to have contributed to a reduction in intercorporate litigation among automotive firms.

IV. CONCLUSION: SO WHAT?

The automotive sector has faced disruptive changes since the 1960s. There has been an upward trend in intercorporate litigation, but the amount of litigation still is small in light of the number of transactions involved in the industry. Those we interviewed differed about whether business people had become more willing to litigate and bargain in the shadow of the law. One major firm's officials averred that firms in the auto industry are more cooperative today. They pointed to joint ventures among auto manufacturers. They noted that manufacturers buy components and raw materials from far fewer suppliers. This means everyone has more to lose if things go wrong. Greater efforts are made to solve problems with dealers long before the stage of litigation or use of state rights.

Lawyers and officials of other manufacturers and suppliers disagreed. One experienced lawyer said that the change in the industry will not show up in litigation statistics. Business people have heard about the alleged litigation explosion and they have read about huge verdicts which have received wide publicity. He continued:

> People will negotiate with their legal rights in mind. Big firms can assess claims in light of legal rights. If they face a good claim, firms will solve the problem without going to court. You will get a letter saying that the other firm has lost $X because of your delays or changes you've made in the part ordered. Our legal staff will say that we are vulnerable, and the business people will negotiate to resolve the problem in light of this advice. This is where we see the big change in attitudes; filing a law suit is only a small part of what is happening.

Those factors that create disputes with the potential for litigation also create incentives to manage situations to avoid disputes, resolve them without litigation, or to control litigation. Major automobile manufacturers and large auto suppliers hire large staffs of talented lawyers. Business people see the risks of legal problems as great enough that they listen more to their lawyers. All firms try to manage their disputes and litigation to minimize risk. One major firm's legal department tries to move its practice "into the boardroom" and acts proactively with the firm's business executives. It emphasizes that the firm is in the automobile and not the litigation business. It stresses that it is cheaper to do it right in the first place than to defend questionable decisions after the fact. The contract clauses we have reviewed in both the supplier and dealer areas and the alternative dispute resolution

structures in the dealer area are only examples of the many steps taken by all firms' business lawyers to control disputes and the risks involved in litigation.

We can anticipate that something similar will happen in other sectors of the economy where we have seen significant increases in the amount of litigation. We may well see such increases followed by sharp decreases as firms cope and seek more cost-effective ways of dealing with disputes.

In view of all these efforts to avoid and control litigation in the automotive sector, why do we see any? The economy clearly affects litigation rates. One firm has looked at newly filed cases plotted on a map of the United States which indicates local economic conditions. The correlation appears to be strong. One of its lawyers told us:

> When times are good, people overlook things or work them out. When times are bad, your back is to the wall. You no longer can play for the long term. . . . Legal rights are an asset, and the one winding up a business must assert them.

Also, the amounts involved in disputes today may be huge. Firms cannot give away what would be necessary to settle such cases because executives are accountable to bankers or stockholders. This puts great pressure on the lawyers to be cautious; they do not want to be blamed for a major loss. It is easier to let a court assume responsibility for resolving a dispute than to accept a settlement which some audience may see as not enough.[86]

This coping with potential and actual disputes can be viewed in more than one way. On one hand, we can view such things as contract drafting, mediation/arbitration systems, and ceasing to deal with those who cause problems as only an expression of choice in the service of efficiency. Those with legitimate power in a capitalist society can use it to legislate in the private governments which they control. Indeed, the manufacturers' efforts may lessen the cost of transportation or produce better products for consumers. And they promise to cut the costs to the public of resolving disputes before courts or administrative agencies.

But on the other hand, such coping also removes disputes from a public forum, and thus from public norms. These norms often were put in place to influence or control the exercise of private power. Of course, they may reflect no more than the power of a lobby and traditional American anti–big business ideology. However, some of them attempt to vindicate the actual expectations of those who deal with auto firms.

86. For a more thorough and formal discussion of some of the incentives and calculations involved, see R. D. Cooter & D. L. Rubenfeld, "Economic Analysis of Legal Disputes and Their Resolution," 27 *J. Econ. Lit.* 1067 (1989); G. L. Priest & B. Klein, "The Selection of Disputes for Litigation," 13 *J. Legal Stud.* 1 (1984).

> Franchisees . . . argue that there are relational norms. . . . Franchisees claim that neither party should do anything to imperil the relationship and call on the norm of solidarity. They challenge the franchisor's role integrity. The franchisors may talk of pursuing a collective good, and their officials' actions usually match this image. However, when franchisors want to eliminate dealers or revise business strategy, the trusted partner turns into a bargaining adversary playing hardball. This violates the tacit rules of the game. Finally, franchisees see mutuality as their right. In Macneil's terms, again, the "parties must divide the exchange surplus so that each gains appropriate but not necessarily equal returns."[87]

Insofar as we value such relational contract concerns, the manufacturers' private legislation undercuts them.

This is an area where economic considerations will predominate. It may be that the best public norms can do is affect to some extent the decisions of those with power. Bargaining in the automobile industry includes incentives to look to the long-term and honor both legal and other commitments. Perhaps extralegal sanctions are sufficient reinforcement for pro-social behavior in manufacturer-supplier relationships, and perhaps legal regulation of manufacturer-dealer relationships serves to reinforce this tendency and discourage short-term decisions.

87. Macaulay, "Long-Term Continuing Relations" 197–203 (cited in note 66). The quotation is from P. J. Kaufmann & L. W. Stern, "Relational Exchange Norms, Perceptions of Unfairness, and Retained Hostility in Commercial Litigation," 32 *J. Conflict Resol.* 534 (1988), an empirical test of Macneil's theories. See I. Macneil, *The New Social Contract* (New Haven, Conn.: Yale University Press, 1980).