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THREE STORIES AND THEIR MORALS

By

Robert B. Bennett, Jr.*

Fundamentally, the common law tradition is a collection of stories.¹ Stories also become the law professor's stock in trade. We tell

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¹ *Accord*, Kathryn Abrams, *Hearing the Call of Stories*, 79 CALIF. L. REV. 971 (1991) (fitting "feminist narratives" within the context of legal scholarship); Mark A. Clawson, *Disruptions of Literature: Telling Stories: Romance and Dissonance in Progressive Legal Narratives*, 22 LEGAL STUD. FORUM 353, 357 (1998) ("Legal education teaches students that storytelling skills are the stock-in-trade of the legal profession. Legal arguments are created, much like a simple fable, from the stock elements of facts and law."); Nancy Cook, *Speaking in and About Stories*, 63 U. CIN. L. REV. 95, 95 (1994) ("Law professors tell war stories to their students, clients tell stories to lawyers; lawyers, in turn, provide judges and juries with stories on behalf of clients. The courts ultimately relate stories through judicial opinions."); Nancy Levit & Allen Rostron, *Law Stories: Tales from Legal Practice, Experience and Education: Calling for Stories*, 75 UMKC L. REV. 1127, 1127 (2007) ("Storytelling is a fundamental part of legal practice, teaching, and thought."); Christine Metteer Lorillard, *Stories that make the Law Free: Literature as a Bridge Between the Law and the Culture in Which it Must Exist*, 12 TEX. WESLEYAN L. REV. 251, 255 (2005) ("Legal stories fall within the general description of narrative, but with a different end: the law is about prioritizing stories, choosing one story over another. The law seldom hears only one side of the story. In the law, two or more storytellers explain what happened

students stories or have them read stories in the form of cases or hypothetical situations and help them discern the morals to the stories—i.e., what the stories mean in the context of business or in their business lives.² In a sense, that is what the Socratic Method is all about: analyzing stories in the form of cases and discerning their greater meaning.³ In this paper I will relate three true stories⁴ within

to them and how it felt, and ask another to stand for a moment in their shoes. Legal storytellers, then, use stories rhetorically, in an attempt to persuade others to accept their version of what has happened in the world, or to change another's views or understanding about world events.”); Sandra Craig McKenzie, *Storytelling: A Different Voice for Legal Education*, 41 KAN. L. REV. 251, 251 (1992) (“Lawyers are storytellers, using stories as a means of solving problems for clients. Although lawyers tell stories in a variety of settings, the quintessential example of legal storytelling occurs in the courtroom, where two lawyers meet to tell opposing stories about ‘what really happened on the night of June 12th’. . . . The judge’s opinion is the final version of the story, distilled from the versions told by the opposing lawyers.”); Kim Lane Scheppelle, *Legal Storytelling: Foreword: Telling Stories*, 87 MICH. L. REV. 2073, 2075 (1989) (“To make sense of law and to organize experience, people often tell stories. And these stories are telling.”). *But see* David R. Culp, *Law School: A Mortuary for Poets and Moral Reason*, 16 CAMPBELL L. REV. 61, 61 (1994) (“The study of law will train you for many different fields, but it will not train you to embark upon one endeavor: It will not equip you to become a poet.”).

² See generally, Beryl Blaustone, *Teaching Evidence: Storytelling in the Classroom*, 41 AM. U. L. REV. 453 (1992) (discussing how she uses short stories based upon the life of John Wigmore to review the Federal Rules of Evidence); Peter T. Wendel, *Great Property Cases: Using Property to Teach Students to “Think Like a Lawyer.” Whetting Their Appetites and Aptitudes*, 46 ST. LOUIS L.J. 733 (2002).

³ The use of the “Socratic Method” or the “case method” is generally credited to Christopher Langdell, Dean of the Harvard Law School in the 1870s. For a discussion of the case method and its development and criticism, see W. Burlette Carter, *Reconstructing Langdell*, 32 GA. L. REV. 1 (1997); E. Allan Farnsworth, *Casebooks: Contracts Scholarship in the Age of the Anthology*, 85 MICH. L. REV. 1406 (1987); David D. Garner, *The Continuing Vitality of the Case Method in the Twenty-First Century*, 2000 BYU EDUC. & L.J. 307 (2000); Cynthia G. Hawkins-Leon, *The Socratic Method—Problem Method Dichotomy: The Debate Over Teaching Method Continues*, 1998 BYU EDUC. & L.J. 1 (1998); Elizabeth J. Samuels, *Stories Out of School: Teaching the Case of Brown v. Voss*, 16 CARDOZO L. REV. 1445, 1446-48 (1995). Note that some, like

the context of just-in-time production management and develop their morals or implications for business and business lawyers.

STORY 1: THE DEFECTIVE COMPONENTS

Once upon a time,⁵ when I was still practicing law in Charlotte, North Carolina,⁶ I got a call from an agitated client.⁷ This client was one of

Professor McKenzie, would quibble with my characterization of the story aspects of the case method, focusing on Langdell's pursuit of "science" in legal education through use of the case method; *see, e.g.*, McKenzie, *supra* note 1, at 259-62.

⁴ Although we normally associate morals with Aesop's Fables, with apologies to "Dragnet," all of these stories are true--or true enough; the names have been changed to protect the innocent.

⁵ This is the way fairy tales usually begin, but all of the parties in my stories may or may not live "happily ever after." *See, also*, Jennifer Howard, *From 'Once Upon a Time' to 'Happily Ever After': Fairy-tale scholars explore the nuanced history of the genre*, CHRONICLE REV., May 22, 2009, at B6 (discussing recent scholarship regarding the origins and dissemination of fairy tales); Scheppele, *supra* note 1, at 285 ("Storytelling can be seen as a deeply patterned activity. English speakers know when they hear 'once upon a time' that a story is about to begin. 'And they live happily ever after' is clearly an ending.").

⁶ I practiced for eleven years for the Charlotte, North Carolina, law firm of Horack, Talley, Pharr & Lowndes, P.A., who now disavow any knowledge of my actions, though its members hasten to point out that if they ever knew me, the statute of limitations has run. Because the key events in the first two stories took place in North Carolina and because the UCC is in flux with respect to some of the issues discussed, cites herein are to the North Carolina version of the UCC and other statutes.

⁷ It is worth emphasizing that this is how nearly all lawsuits begin, with a call from a client who tells a story—or at least his version of it. Classifications of law—and the law itself—are abstractions developed by lawyers to categorize and help resolve disputes which come to lawyers and courts in the form of stories. Consider the famous quote from Oliver Wendell Holmes:

The life of the law has not been logic: it has been experience.
The felt necessities of the time, the prevalent moral or political theories, intuitions of public policy, avowed or unconscious, even the prejudices which judges share with their fellow-men, have had a good deal more to do than the syllogism in

the sales managers for a warehouser and distributor of high grade metal components. The company acquired the metal products from major metals processors and would sell these products as a “middleman” to manufacturers throughout the southeastern United States [hence, we will refer to my client as “MM, Inc.”]. Among its customers was a fabricator of airline seats [“SeatCo”] to which it sold high grade aluminum tubular rods manufactured by a huge aluminum manufacturing company [“AlCo”]. SeatCo would take the rods and bend them to form a frame for the airline seat, to which it would attach the other seating material.

MM, Inc. had just gotten a call from an irate officer of SeatCo about the latest delivery of tubular aluminum rods. As SeatCo began bending the rods to form the airline seats, the rods broke instead of bending. MM, Inc. immediately called AlCo to find out how that could be possible. AlCo admitted that if the aluminum was incorrectly or insufficiently processed, it would result in rods that were insufficiently malleable for the intended purpose. It admitted that the rods were defective and promised to replace them. However, because of the necessary fabrication time, the earliest that the replacement rods could be delivered was six weeks later. SeatCo had some rods from an earlier shipment on hand, but only enough to keep its factory operating for a few days. For the remainder of the six weeks, SeatCo was facing a complete factory shutdown for want of aluminum tubes.

determining the rules by which men should be governed. The law embodies the story of a nation's development through many centuries, and it cannot be dealt with as if it contained only the axioms and corollaries of a book of mathematics.
OLIVER WENDELL HOLMES, *THE COMMON LAW* 5 (Howe Ed. 1964).

MM, Inc. called me to find out if it had risk of liability for the sale of the faulty aluminum rods and the consequent shutdown of the production line. I told the sales manager that SeatCo could and probably would sue MM, Inc. if SeatCo had to shut down its production line for the better part of six weeks. Moreover, SeatCo had strong chances of success in its suit because the delivery of the defective tubes probably breached warranties of merchantability⁸ and fitness for a particular purpose⁹ under the Uniform Commercial Code.

⁸ N.C. GEN. STAT. § 25-2-314 (2009) provides:

Implied warranty: Merchantability; usage of trade

(1) Unless excluded or modified (G.S. 25-2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.

(2) Goods to be merchantable must be at least such as

(a) pass without objection in the trade under the contract description; and

(b) in the case of fungible goods, are of fair average quality within the description; and

(c) are fit for the ordinary purposes for which such goods are used; and

(d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and

(e) are adequately contained, packaged, and labeled as the agreement may require; and

(f) conform to the promises or affirmations of fact made on the container or label if any.

(3) Unless excluded or modified (G.S. 25-2-316) other implied warranties may arise from course of dealing or usage of trade.

⁹ N.C. GEN. STAT. § 25-2-315 (2009) provides:

Implied warranty: Fitness for particular purpose

Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or

However, I was not too concerned about ultimate liability for the consequential damages resulting from the shutting down the factory for two reasons. First, to be liable for consequential damages, a court must conclude that the shutdown of the factory was a foreseeable consequence of the delivery of the faulty materials.¹⁰ Second, even if

modified under the next section [G.S. 25-2-316] an implied warranty that the goods shall be fit for such purpose.

¹⁰ The original precedent on foreseeability of losses for breach of contract was *Hadley v. Baxendale*, 9 Ex. 341; 146 E. R. 145 (1854). In *Hadley v. Baxendale*, the plaintiffs were millers in Gloucester. The crankshaft of their steam engine which powered the mill broke and they arranged with the firm of W. Joyce & Co. of Greenwich to produce a new shaft using the old shaft as a model. The plaintiffs entered into a contract with the defendants to transport the old shaft to be repaired. In the first count of their complaint, the plaintiffs claimed that the defendants promised delivery within two days. In the second count, the plaintiffs alternatively claimed that the shaft was to be delivered "within a reasonable time." The shaft was not delivered for a period of seven days; as a result, the plaintiffs argued that they were thereby prevented from working their steam mill, were unable to supply their customers, had to buy flour for some of their customers, were compelled to pay wages, and suffered lost profits. They sought 300£ as compensatory damages. Trial was held before Judge Crompton at the Gloucester Assizes. At trial, the evidence showed that the plaintiffs' servant told the defendants' clerk that the mill was idled and that the shaft must be sent immediately and "that a special entry, if required, should be made to hasten its delivery." The delivery "was delayed by some neglect." The defendants countered that the damages were too remote to hold the defendants liable. Judge Crompton left the issue of damages to the jury which returned a verdict of 50£. On appeal, the Court of Exchequer agreed with the defendants and reversed, granting the defendants a new trial. In that decision, Baron Alderson stated:

We think the proper rule in such a case as the present is this: where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e. according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties at the time they made the contract, as the probable result of the breach of it.

Applying the principle that he had enunciated, he argued that the only special circumstances communicated to the defendant were that the article to be carried was a broken mill shaft and that the plaintiffs were millers. He was unwilling to acknowledge that this conveyed adequate knowledge of the special circumstances to the defendant. He reasoned that the plaintiff might have another millshaft (which the court hinted was a common precaution at the time) or there might be other problems at the mill. In either event, the production of the mill would not be solely dependent on the timely delivery of the millshaft and, therefore, "the loss of profits here cannot reasonably be considered such a consequence of the breach of contract as could have been fairly and reasonably contemplated by both the parties when they made this contract." Alderson argued that had the defendant known of the special circumstances of the contract, he could have provided for the breach with special terms.

The legacy of *Hadley v. Baxendale* finds its way into the UCC in N.C. GEN. STAT. § 25-2-715 (2) (2009), which defines "consequential damages" resulting from the seller's breach which "include (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting *had reason to know* and which could not reasonably be prevented by cover or otherwise; and (b) injury to person or property proximately resulting from any breach of warranty." (Emphasis added.) For a discussion of *Hadley* in its historical context, see Richard Danzig, *Hadley v. Baxendale: A Study in the Industrialization of the Law*, 4 J. LEGAL STUD. 249 (1975); and A. W. B. Simpson, *Innovation in Nineteenth Century Contract Law*, 91 L. Q. REV. 247 (1975). For a discussion of the history of the foreseeability requirement, see Robert B. Bennett, Jr., *Just-In-Time Purchasing and the Problem of Consequential Damages*, 26 UCC L.J. 332, 340-49 (1994).

Hadley has found its way into the jurisprudence of the former British colonies and remains the subject of vigorous intellectual debate. See, e.g., B.E. Adler, *The Questionable Ascent of Hadley v. Baxendale*, 51 Stan. L. Rev. 1547 (1998-9); Wayne Barnes, *The Boundaries of Contract in a Global Economy: Hadley v. Baxendale and Other Common Law Borrowings From the Civil Law*, 11 TEX. WESLEYAN L. REV. 627 (2005); Thomas A. Diamond & Howard Foss, *Consequential Damages for Commercial Loss: An Alternative to Hadley v. Baxendale*, 63 FORDHAM L. REV. 665 (1994); Jason Scott Johnston, *Strategic Bargaining and the Economic Theory of Contract Default Rules*, 100 YALE L. J. 615 (1990); Peter Linzer, *Hadley v. Baxendale and the Seamless Web of the Law*, 11 TEX. WESLEYAN L. REV. 225 (2005); Joe Spurlock II et al., Panel Discussion: *Hadley v. Baxendale: Still Crazy After All These Years*, 11 TEX. WESLEYAN L. REV. 707 (2005); Andrew Tettenborn, *Foreseeability and Damages: Hadley v. Baxendale: Contract Doctrine or Compensation Rule?*, 11 TEX. WESLEYAN L. REV. 505 (2005); Andrew Tettenborn, *Hadley v. Baxendale Foreseeability: a Principle Beyond Its Sell-by Date?*, 23 J. CONTRACT L. 120

a court concluded that the shutdown was foreseeable, MM, Inc. chances in a third party suit against AlCo would be strong.¹¹ AlCo had also breached the warranty of merchantability and fitness for a particular purpose in its sale to MM, Inc.¹² and had probably also been negligent in its manufacturing. In fact, AlCo had already admitted that it was at fault. Further, because of its knowledge of its own production schedule, it would have been in a better position than MM, Inc. to anticipate the consequences of a delivery of defective aluminum rods. Also AlCo was a solvent defendant, well able to pay any damages that might be awarded. That meant that MM, Inc.'s ultimate legal risk was likely to be comparatively small.

(2007); Jennifer O'Reilly & Robert B. Bennett, Jr., *A Comparative Review of Contract Damages In Australia and the United States*, in 31 PROC. TRI-STATE ACAD. LEGAL STUD. BUS. 1 (2007).

Probably because of its compelling story, The cases applying Hadley are legion; *see, e.g.*: *Globe Refining Company v. Landa Cotton Oil Company*, 190 U.S. 540, 23 S. Ct. 754 (1903); *Hendricks & Associates, Inc. v. Daewoo Corp.*, 923 F.2d 209 (1st Cir. 1991); *Hampton by Hampton v. Federal Exp. Corp.*, 917 F.2d 1119 (8th Cir. 1990); *Rardin v. T & D Mach. Handling, Inc.*, 890 F.2d 24 (7th Cir. 1989); *Nyquist v. Randall*, 819 R.2d 1014 (11th Cir. 1987); *Van Moorlehem v. Brown Realty Co.*, 747 F.2d 992 (10th Cir. 1984); *American Anodco, Inc. v. Reynolds Metals Co.*, 743 F.2d 417 (6th Cir. 1984); *Western Industries, Inc. v. Newcor Canada Ltd.*, 739 F.2d 1198 (7th Cir. 1984); *Troxler Electronic Laboratories, Inc. v. Solitron Devices, Inc.*, 722 F.2d 81 (4th Cir. 1983); *Evra Corp. v. Swiss Bank Corp.*, 673 F.2d 951 (7th Cir. 1982); *Pemberton v. Ovatech, Inc.*, 669 F. 2d 533 (8th Cir. 1982); *Hector Martinez and Co. v. Southern Pac. Transp. Co.*, 606 F.2d 106 (5th Cir. 1981); *Luick v. Graybar Elec. Co., Inc.*, 473 F.2d 1360 (8th Cir. 1973); *W.L. Green Industries, Inc. v. Western Intertrading, Ltd.*, 1992 WL 122785 (S.D.N.Y., 1992); *Anna Ready Mix, Inc. v. N. E. Pierson Const. Co., Inc.*, 747 F.Supp. 1299 (S.D.Ill., 1990).

¹¹ N.C. GEN. STAT. § 1A-1, Rule 13 and 14 (2009) permit a party to bring a third party claim against "a person not a party to the action who is or may be liable to him for all or part of the plaintiff's claim against him."

¹² See notes 8 and 9 *supra*.

The sales manager breathed an audible sigh of relief. I said, “Don’t relax too soon.”

“What do you mean?”

“Well, I thought that SeatCo was your single biggest customer,” I said.

“It is,” he said.

“How do you think that the officers at SeatCo are going to react if they have to shut down the factory for six weeks? They are going to be looking for scapegoats. Even if AlCo makes the company financially whole, are they going to want to rely on you in the future? Are you still going to have a customer?”

“Oh, [expletive deleted].”

My client got off the phone with me and immediately took a series of steps to insure that SeatCo would not have to shut down the factory. First, he found some rods from an earlier shipment in stock in the warehouse and shipped them to SeatCo. Then he went into the “spot market” and bought some rods from his competitors and shipped them to SeatCo. He even bought some excess inventory from his other customers and delivered them to SeatCo in his personal car. Ultimately he was able to scrape together enough inventory to keep SeatCo running until AlCo could produce another shipment of conforming rods. These were probably not profitable transactions because of the additional costs of the spot purchases and the small deliveries, but MM, Inc. was able to avoid the far greater costs associated with litigation and, more importantly, it was able to keep

its largest customer. In other words, the parties lived happily ever after.

STORY 2: INTRODUCTION OF JUST-IN-TIME MANAGEMENT

Once upon a time, at roughly the same time as SeatCo was running into its difficulties, I had dinner with my brother who was then working for a big textile company ("MillCo") that bought raw materials and produced and dyed fabrics and carpeting for the automotive industry. He related to me excitedly how MillCo was a pioneer in this new industrial process called Just-in-Time production management ("JIT"). As he then described it, the principle behind JIT was to reduce inventory and inventory costs throughout the industrial process.¹³ "We have gotten this down to a science," he bragged. "We

¹³ This is somewhat of an oversimplification, but it does adequately capture one of the principal end results. JIT refers to a number of management techniques which attempt to eliminate waste in production, including waste resulting from overproduction, waste of employee time, waste in transportation, waste in processing, inventory waste, waste of movement and waste resulting from defective products and other quality control problems. The name, JIT, conveys the central philosophy: producing goods in exactly the quantity needed and sending them to where they are needed, when they are needed. The goal of the manufacturer is to reduce inventory at every stage of the manufacturing process, from the time the raw materials or component parts are delivered to the factory until the finished goods are shipped to the buyer. Goods are "pulled" through the system by market demand rather than "pushed" by production capacity. The ideal lot size for a given product would be one. For a summary of JIT, as well as a discussion of some of the legal issues inherent in the use of third party suppliers, see Bennett, *supra* note 10, at 332-39. For a more detailed look at JIT and its implementation, see, e.g., ROBERT W. HALL, ZERO INVENTORIES (1983); ROBERT W. HALL, ATTAINING MANUFACTURING EXCELLENCE (1987); ROBERT W. HALL ET AL., MEASURING UP: CHARTING PATHWAYS TO MANUFACTURING EXCELLENCE (1991); MASAOKI IMAI, KAIZEN: THE KEY TO JAPAN'S COMPETITIVE SUCCESS (1986); TAIICHI OHNO, TOYOTA PRODUCTION SYSTEM: BEYOND LARGE-SCALE PRODUCTION (1988) (English Translation of

get small daily deliveries of materials and we just take materials from the loading dock directly to the production line.”

“Let me ask you,” I said. “What happens if you go out to the loading dock and nothing is there?” Thinking of my recent experience with MM, Inc., I added, “Or what happens if the stuff on the loading dock doesn’t meet specifications?”

[Silence, followed by horrified stare.]

STORY 3: THE MANAGEMENT CONSULTANT

Once upon a time, I was having dinner recently with a management consultant from the world’s most prestigious—and expensive—management consulting firm (“McFirm”). This consultant for McFirm was a specialist who worked with manufacturing companies throughout Germany. We were sharing information about our jobs when he asked about my research. I mentioned that among the areas that I researched were the legal issues surrounding JIT.

“What legal issues are there?”

“Well, for example, when the manufacturer uses outside suppliers, contract issues come into play.”

1978 Japanese Work); KIYOSHI SUZAKI, *THE NEW MANUFACTURING CHALLENGE: TECHNIQUES FOR CONTINUOUS IMPROVEMENT* (1987); RICHARD J. SCHONBERGER, *JAPANESE MANUFACTURING TECHNIQUES: NINE HIDDEN LESSONS IN SIMPLICITY* (1982); JAMES P. WOMACK ET AL., *THE MACHINE THAT CHANGED THE WORLD: THE STORY OF LEAN PRODUCTION* (1990); JAMES P. WOMACK & DANIEL T. JONES, *LEAN THINKING: BANISH WASTE AND CREATE WEALTH IN YOUR CORPORATION* (2003).

With typical German candor (or bluntness) he responded, "That doesn't sound very exciting."

"What happens if the supplier doesn't deliver, or if the supplier delivers late, or if the supplier delivers nonconforming goods?"

[Long silence] That doesn't happen.¹⁴ If it did happen a time or two, the supplier would lose a customer."¹⁵

"Are you sure that would be the result? And the only result?"

"Sure. If a delivery is late, the factory would have to shut down."¹⁶

¹⁴ In fact, it does happen; James R. Freeland, *A Survey of Just-In-Time Purchasing Practices in the United States*, 32/2 PRODUCTION & INVENTORY MGMT. J. 43, 47 (1991) ("Some 33% of the responding companies reported they had experienced downtime over the past year because of poor supplier performance for JIT-purchased parts. Nearly half of the downtime occurrences was the result of late deliveries, and most of the rest were caused by quality problems. Thus, JIT can apparently cause some downtime."); Glenn Walberg, Note, *Everything Old is New Again: Reaching the Limits of INDOPCO's Benefits With the Just-In-Time Management Philosophy*, 38 WM. & MARY L. REV. 1257, 1260-65 (1997) (differentiating between "pragmatic" and "romantic" approaches to JIT, arguing that the romantic approach seeks a revolution in the workplace which is more likely to result in adverse consequences including disruption of manufacturing operations.).

¹⁵ This may be a practical extralegal resolution of such a problem between the parties. The actual legal rules are a trifle more complicated and would depend upon whether there was a written contract, what its terms were and the effect of course of dealing, course of performance and usage of trade. For a contract which apparently included just such a provision, see *Windsor Mold Inc. v. Express Molding International Inc.*, 130 A.C.W.S. (3d) 86 (Ontario Sup. Ct. 2004), *aff'd*, 140 A.C.W.S. (3d) 285 (2005).

¹⁶ *Id.* at ¶ 24 ("All parties understand the concept of 'Just in Time' in this industry and that under no circumstances would a supplier ever want to cause a halt in production because of the high costs that would be incurred. I am satisfied that everyone knew that this was a very important issue.").

I could not resist: “Sounds pretty exciting to me.” I persisted: “Assuming that the factory does shut down, whose problem do you think that is?”

“Unless the manufacturer has done something wrong, like ordered the wrong goods, or ordered in the wrong sequence, or put the wrong date on the order, it is the supplier’s problem. The supplier has the responsibility to deliver the parts to the manufacturer’s loading dock on time; then it becomes the manufacturer’s problem.”¹⁷

¹⁷ Of course, among other things, this assumption reverses the normal UCC default rule that title and risk of loss normally pass when goods are delivered by the seller to a common carrier. N.C. GEN. STAT. § 25-2-308(a) (2009) (“Unless otherwise agreed (a) the place for delivery of goods is the seller’s place of business or if he has none, his residence”); N.C. GEN. STAT. § 25-2-401(2) (2009) (“Unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods, despite any reservation of a security interest and even though a document of title is to be delivered at a different time or place; and in particular and despite any reservation of a security interest by the bill of lading

(a) if the contract requires or authorizes the seller to send the goods to the buyer but does not require him to deliver them at destination, title passes to the buyer at the time and place of shipment; but

(b) if the contract requires delivery at destination, title passes on tender there.”); N.C. GEN. STAT. § 25-2-504 (2009) (“Where the seller is required or authorized to send the goods to the buyer and the contract does not require him to deliver them at a particular destination, then unless otherwise agreed he must

(a) put the goods in the possession of such a carrier and make such a contract for their transportation as may be reasonable having regard to the nature of the goods and other circumstances of the case; and

(b) obtain and promptly deliver or tender in due form any document necessary to enable the buyer to obtain possession of the goods or otherwise required by the agreement or by usage of trade; and

(c) promptly notify the buyer of the shipment.

Failure to notify the buyer under paragraph (c) or to make a proper contract under paragraph (a) is a ground for rejection only if material delay or loss ensues.”).

"I am not sure that it is always that simple. How do you know that to be the result?"

"That is what the contracts always provide," he said.

"Have you seen the contracts on this point?"

"Yes."

"What if there is no written contract?"

"There are always written contracts;¹⁸ it would be crazy not to have a written contract."¹⁹

The same default rule is found under German law. BGB § 269 (2007), available in English translation at http://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html; NIGEL G. FOSTER, GERMAN LEGAL SYSTEM & LAWS 254-55 (1993).

¹⁸ In fact, a survey of United States JIT purchasing practices disclosed that forty percent of respondents did not use formal written contracts in the JIT purchase of parts. Freeland, *supra* note 14, at 46 (The author of this survey did observe that although the percentage having contracts did not differ much from those who did not purchase their materials on a JIT basis, those purchasing JIT having contracts were more likely to have a more inclusive contract. *Id.* at 49.). The results of this empirical study are generally consistent with the results of Stewart Macaulay's famous empirical study, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55, 58 (1963). and other attempts to look at actual business practices. Professor Jennings makes the same point in her inimitable style:

While standing before an audience of purchasing managers involved in international sales transactions, the author was humiliated. After the announcement of the seminar's coverage (offer, acceptance, consideration, and damages), one purchasing manager raised his hand and said, "Heck, I haven't used a contract since 1989." The remaining thirty-nine managers confirmed this statement. Adapting quickly, the author soon realized that basic contract law is basically irrelevant. If this were a scholarly piece, the premise would be

Although I agreed completely with this latter suggestion, I had to point out that empirical research suggested that there was often not a written contract in the JIT contract situation.²⁰ “Whose problem is it if there is no written contract?”²¹

[Long silence and then a shrug.]

phrased as follows: Courts (and laws) have failed to comprehend the problems contracting parties face, ergo parties have resorted to developing relationships with each other in lieu of reliance on the law.

Marianne M. Jennings, *The True Meaning of Relational Contracts: We Don't Care About the Mailbox Rule, Mirror Images, or Consideration Anymore--Are We Safe?*, 73 DENV. U.L. REV. 3, 3 (1995).

¹⁹ However, his contention that parties, at least in Germany, always deal with this issue is consistent with Marburg University Professor Schanze's argument contention that firms would opt for “thick contracts” when choosing to outsource key production inputs; Erich Schanze, *Beyond Contract and Corporation: The Law and Economics of Symbiotic Arrangements*, in LAW AND ECONOMICS: METHODOLOGY AND APPLICATION 113 (Thomas Ruis & Ruth Neilsen, eds., 1998).

²⁰ See note 18 *supra*. See, e.g., *Crawford Packaging Inc. v. W.E.T. Automotive Systems Ltd.*, 145 A.C.W.S. (3d) 75, ¶ 61 (Ontario Sup. Ct. 2006) (“The precise contours of the agreement can only be pieced together from the discussions had between Messrs. Crowe and Schieck on the part of Crawford and such W.E.T. staff as Roger Hudson, the then purchasing manager and his assistants, Diane Kerr and Lou-Anne Chadwick. In other words, no single piece of paper -- or contract document -- reflects the agreement that was put together.”); *Geneva Pharm. Tech. Corp. v. Barr Lab., Inc.* 201, 281-82 (S.D.N.Y. 2002), *aff'd in part and rev'd in part*, 386 F.3d 485 (2004) (“Invamed claims that a well-established custom in the industry was to rely on implied, unwritten supply commitments. Defendant Sherman affirmed under oath that ‘the predominant practice is for these commitments not to be embodied in formal legal documents.’” Citations omitted.).

²¹ Robert B. Bennett, Jr., *Trade Usage and Consequential Damages: the Implications for Just-in-Time Purchasing*, 46 AM. BUS. L. J. 179 (2009).

THE MORALS: IMPLICATIONS FOR BUSINESS

One moral for legal scholars is that by listening to business professionals and asking questions until a blank horrified stare is the result, a scholar can develop a research agenda²²—and probably become a pariah at any social function.

A common thread of the stories is that legal practitioners must think comprehensively about the legal and business effects of business practices or policies,²³ because often the business practitioners may

²² In addition to the current article, see Bennett, *supra* note 10 and Bennett, *supra* note 21.

²³ See, e.g., Kenneth M. Rosen, 2007 *Survey of Books Related to the Law: Corporate Law: Mickey, Can You Spare a Dime? Disneywar, Executive Compensation, Corporate Governance and Business Law Pedagogy*, 105 MICH. L. REV. 1151, 1154 (2007) (“Moreover, [law] students sometimes fail to realize that good business lawyering involves the provision of the type of counsel that can only be achieved through a deep understanding of clients’ business model.” Citations omitted); Harold A. Segall, *An Executive’s Lesson in the Law from a Typical Business Encounter*, 23 FORDHAM URB. L. J. 257, 257-58 (1996) (“A good commercial lawyer focuses not on a legal problem per se, but on the legal aspects of a business problem”). See also, Sandra M. Huszagh & Fredrick W. Huszagh, *Symposium: Business Lawyering and Value Creation for Clients: Lawyers as Exchange Engineers in Commerce: An Empirical Overview*, 74 OR. L. REV. 147, 147 (1995) (arguing that increased lawyer involvement in the commercial context is inevitable); John Mixon & Gordon Otto, *Continuous Quality Improvement, Law, and Legal Education*, 43 EMORY L. J. 393 (1994) (describing key characteristics of continuous quality improvement as propounded by W. Edwards Deming and their implications for law and legal education); Theresa M. Neff, Note: *What Successful Companies Know that Law Firms Need to Know: The Importance of Employee Motivation and Job Satisfaction to Increased Productivity and Stronger Client Relationships*, 17 J. L. & HEALTH 385 (2002/03) (pointing out that lawyers often do not concern themselves enough with the business aspects of their practices); Alina Dizik, *Law Firms Embrace Business School 101: As Recession Bites, More Attorneys Attend Management Training and Take Mini-M.B.A. Courses*, WALL ST. J., May 20, 2009, at B5 (noting the need for lawyers to better understand their clients’ businesses).

not. In fact, it is not uncommon for business practitioners to completely ignore legal issues inherent in their business practices or policies until it is too late.²⁴ Business faculty are often not much better. When I first began research exploring the legal issues of JIT, I found literally hundreds of books, articles and case studies on JIT.²⁵

²⁴ For a fascinating discussion of this phenomenon, among others, and the implications for teaching contract law in law schools, see Robert M. Lloyd, *Making Contracts Relevant: Thirteen Lessons for the First-Year Contracts Course*, 36 ARIZ. ST. L.J. 257, 262 (2004):

One of the shortcomings of most contracts casebooks is that too many of the cases involve contracts in which the principals should have involved lawyers in the deal, but didn't. When you teach these cases, you can ask why the parties didn't get their lawyers involved until too late. In most of the cases, we can't identify the precise reason that these particular parties chose not to involve their lawyers, but we can talk about some of the common reasons business people want to keep lawyers out of their deals. Lawyers cost money. They slow down the deal, not only by insisting on dealing with contingencies the parties would rather ignore, but also by not always dropping whatever else they are doing in order to give this deal their undivided attention. Involving lawyers spoils the interpersonal chemistry between the parties, and, worst of all, lawyers kill deals by their over-meticulous concern with "legalistic" niceties.

²⁵ See, e.g., sources cited in note 13 *supra*; JOHN E. SCHORR, PURCHASING IN THE 21ST CENTURY (1992); Yohannan Abraham et al., *Just-in-time: Supplier-side Strategic Implications*, INDUS. MGMT. & DATA SYS., May-June 1990, at 12; Phillip W. Balsmeier, *Just-in-Time: Implications and Applications for Purchasing*, 21 ARK. BUS. & ECON. REV. 28 (1988); Paul A. Dion et al., *Buyer Experiences with JIT: Some New Roles for Buyers*, 28 MID-ATLANTIC J. BUS. 113 (1992); Cornelia Droege & Richard Germain, *The Just-in-Time Inventory Effect: Does it Hold Under Different Contextual, Environmental, and Organizational Conditions?*, 19 J. BUS. LOGISTICS 53 (1998); Jeffrey H. Dyer et al., *Strategic Supplier Segmentation: The Next "Best Practice" in Supply Chain Management*, 40 CAL. MGMT. REV. 57 (1998); Marshall L. Fisher et al., *Making Supply Meet Demand in an Uncertain World*, HARV. BUS. REV., May-June 1994, at 83; Paula J. Haynes & Marilyn M. Helms, *An Ethical Framework for*

None of them addressed any of the potential legal issues. Obviously one explanation for the lack of sensitivity to legal issues is the insufficiency of legal education in schools of business.²⁶

Purchasing Decisions, 29/1 MGMT. DECISION 35 (1991); Robert H. Hayes & Gary P. Pisano, *Beyond World-Class, The New Manufacturing Strategy*, HARV. BUS. REV., Jan.-Feb. 1994, at 77; Cynthia Karen Swank, *The Lean Service Machine*, HARV. BUS. REV., Oct. 2003, at 123; Marvin W. Tucker & David A. Davis, *Key Ingredients for Successful Implementation of Just-in-Time: A System for All Business Sizes*, BUS. HORIZONS, May-June, 1993, at 59; Peter Turnbull et al., *Buyer-Seller Relations in the UK Automotive Industry: Strategic Implications of the Japanese Manufacturing Model*, 13 STRATEGIC MGMT J. 159 (1992); James P. Womack & Daniel T. Jones, *From Lean Production to the Lean Enterprise*, HARV. BUS. REV., Mar.-Apr. 1994, at 93; Paul H. Zipkin, *Does Manufacturing Need a JIT Revolution?*, HARV. BUS. REV., Jan.-Feb. 1991, at 40.

Numerous case studies of specific companies have appeared; see, e. g., Bill Costantino, *Cedar Works: Making the Transition to Lean*, in BECOMING LEAN: INSIDE STORIES OF U.S. MANUFACTURERS 303 (Jeffrey K. Liker, ed., 1998)[hereinafter BECOMING LEAN] (Cedar Works); Michael R. Grant, *EOQ and Price Break Analysis in a JIT Environment*, 34/3 PRODUCTION & INVENTORY MGMT. J. 64 (Summer, 1993) (Arizona Instrument); Vinod Kapoor, *Becoming a Just-in-Time Vendor*, 21 QUALITY PROGRESS 56 (1988) (Westinghouse); Vinod Kapoor, *Converting to JIT: One Plant's Experience*, 34 PRODUCTION ENGINEERING 42 (1987) (Westinghouse); Jeffrey K. Liker & Keith Allman, *The Donnelly Production System: Lean at Grand Haven*, in BECOMING LEAN, *supra*, at 201 (Donnelly); Gren Manuel, *Tightening the Supply Chain*, 267 ENGINEER 64 (1988) (Hewlett-Packard); Lee H. North, *Beyond just-in-time: The UCLA Medical Center Experience*, 15/3 HOSPITAL MATERIAL MGMT Q. 36 (1994); and Matthew J. Zayko et al., *Implementing Lean Manufacturing at Gelman Sciences, Inc.*, in BECOMING LEAN, *supra*, at 247 (Gelman Sciences, Inc.); Susan Zimmerman, *How JIT buying works when you're the supplier*, PURCHASING, Feb. 7, 1991, at 42 (Industrial Powder Coatings).

See *Supply Chain Challenges: Building Relationships*, HARV. BUS. REV., July 2003, at 65, for a discussion of current issues in supply chain management.

²⁶ See, e.g., Robert A. Prentice, *The Case for Educating Legally-Aware Accountants*, 38 AM. BUS. L.J. 597 (2001); George J. Siedel, *Commentary: Six Forces and the Legal Environment of Business: The Relative Value of Business Law Among Business School Courses*, 37 AM. BUS. L.J. 717 (2000).

JIT is a complex business tool that brings undeniable benefits with it. The storage, handling and finance costs associated with inventory can be considerable. Moreover, inventory becomes a “sunk cost” which reduces the flexibility of the manufacturer to make changes in output to meet alteration in demand.

Like many business tools, it brings some risks and costs as well. Arguably those risks, including the legal risks, have been underappreciated as JIT became a fad which companies rushed to adopt—or were forced to adopt. The risk of legal liability has been almost completely ignored. To fully maximize the benefits of JIT, companies must completely eliminate inventory from the industrial process, including work-in-process inventory and inventory which is held by suppliers. However, inventory serves a buffer function, preventing the shutdown of the production line if a problem occurs. Reducing or eliminating inventory increases the risk of a production shutdown.²⁷ Obviously, this risk increases if suppliers are at distant locations, in times of labor unrest, or if there are long lead times for production of components or intervening practical or legal impediments, like national borders with customs inspections. Hence, entering into a JIT arrangement should involve a careful balancing of inventory minimization and risk. When dealing with third party suppliers, it also involves allocating the rewards and the risk of

²⁷ In Ohno’s analysis, the possibility of production stoppages was anticipated—even embraced. He argued that a shut-down merely revealed the problems which could then be resolved. OHNO, *supra* note 13, at 7 (“Stopping the machine when there is trouble forces awareness on everyone. When the problem is clearly understood, improvement is possible.”). See, also, Phred Dvorak, *Ups and Downs Whipsaw Supply Chains*, WALL ST. J., May 18, 2009, at A1 (noting that different supplier lead times for production of component parts may lead to shortages in the supply chain if suppliers do not accurately forecast demand).

stoppages between the parties. Such allocations of risks are generally enforceable.²⁸

The allocation of the benefits and risks should be the product of detailed discussion between the parties²⁹ which should lead to a written contract.³⁰ However, if JIT is viewed through the prism of traditional contract analysis, the result is likely to be disappointment for both parties. The metaphor of the so-called “prisoner’s dilemma” is instructive. The prisoner’s dilemma is an abstraction of the situation where two parties each have the option to cooperate with each other or pursue their respective individual interests (i.e., defect) where the rewards for cooperating are modest and the rewards for

²⁸ N.C. GEN. STAT. § 25-2-303 (2009).

²⁹ See Lloyd, *supra* note 24, at 270-71:

It's not really an oversimplification to say that the lawyer's job is to identify the risks in the deal and attempt to shift them to someone else. I say "attempt" because that someone else we're trying to stick with the risks has a lawyer who is trying to do exactly the same thing to us. A simple economic model of the transaction is this: The parties tentatively agree on the price and then the price is adjusted up or down as the parties identify and allocate risks. If the buyer assumes a particular risk, the price is adjusted upwards. If the seller assumes one, it is adjusted downwards.

Lloyd argues that in real life, price adjustments rarely occur as a result of risk-shifting, but are more the product of trading of “markers” between the lawyers, or uneven risk allocation reflects uneven negotiating ability. For a discussion of this kind of economic analysis in the context of JIT, see Bennett, *supra* note 21, at 193-97.

³⁰ See, generally, Scott J. Burnham, *How to Read a Contract*, 45 ARIZ. L. REV. 133 (2003) (though concerned with contract reading, Professor Burnham provides a number of issues to think about when drafting contracts); Christina L. Kunz, *Teaching First-Year Students How to Read and Edit Contract Clauses*, 34 U. TOL. L. REV. 705, 712-13 (2003); James P. Nehf, *Writing Contracts in the Client's Interest*, 51 S.C. L. REV. 153 (1999); Harold A. Segall, *Drafting: An Essential Skill*, 30 FORDHAM URB. L.J. 751 (2003).

defecting are great, but only at the expense of the other party. It draws its name from the dilemma faced by two prisoners who are arrested for committing a crime. If both cooperate in their declarations of innocence, they both have a small chance to go free; if one agrees to testify against the other, the defector receives beneficial treatment compared to the other prisoner; but if both agree to confess, the benefits of implicating the other are lost.³¹ Applied to business or contracts, the prisoner's dilemma is a reflection of reality. Often opportunistic behavior of one party can be richly rewarded in business—at least in the short run. Of course, opportunistic behavior frequently results in loss of trust or in retaliation by the aggrieved party.³² Note that this is inconsistent with the theoretical notion encountered in contract remedies that a contract breach is a morally neutral event.³³ The parties are not likely to view this as a morally

³¹ For a discussion of the prisoner's dilemma and its application to business, see, MANUEL G. VELASQUEZ, *BUSINESS ETHICS: CONCEPTS AND CASES* 38-41 (6th Ed. 2006). See also, RICHARD DAWKINS, *THE SELFISH GENE* 202-233 (Rev. ed. 1989), (describing in detail the prisoner's dilemma and related research and arguing that life often presents prisoner's dilemma the survival of species may be dependent upon cooperation, which may seem to run counter to immediate self-interest).

³² This tendency is noted in VELASQUEZ, *supra* note 31, at 41; Robert E. Scott, *The Death of Contract Law*, 54 U. TORONTO L. J. 369, 382-84 (2004). There is some indication in the literature that parties will punish defectors, even if there is no benefit to them, a phenomenon which Professor Ernst Fehr calls "altruistic punishment." See Sharon Begley, *Science Journal: Vengeance Is Mine, Sayeth the Lord --But Scientists Differ*, WALL ST. J., Oct. 15, 2004, at B1.

³³ Professor Campbell makes the point that breach should not be viewed as a "amoral or immoral failure by the breaching party" strongly and cogently, but I argue with a marked disregard of the reality of human interactions; David Campbell, *Symposium: The Common Law of Contracts as a World Force in Two Ages of Revolution: A Conference Celebrating the 150th Anniversary of Hadley v. Baxendale: Foreseeability and Damages: The Relational Constitution of Remedy: Co-operation as the Implicit Second Principle of Remedies for Breach of Contract*, 11 TEX. WESLEYAN L. REV. 455, 455-57 (2005). Professor Macaulay gently takes him to task for this and other departures from the real world of business in Stewart Macaulay, *Renegotiations*

neutral event and will retaliate. The retaliation may take the form of litigation or refusal to deal in the future. The threat of retaliation means that opportunistic behavior is ill-advised when the parties expect to have repeated dealings.³⁴ When the parties expect repeated dealings, cooperation is the best business strategy. Arguably, cooperation in this context means an express sharing of the risks of the elimination of the buffer inventory.

In JIT arrangements, there are situations where either party might reap supernormal rewards through opportunistic behavior.³⁵ For

and Settlements: Dr. Pangloss's Notes on the Margins of David Cambell's Papers, 29 CARDOZO L. REV. 261 (2007).

³⁴ See Jeffrey M. Lipshaw, *Contingency and Contracts: A Philosophy of Complex Business Transactions*, 54 DEPAUL L. REV. 1077, 1080 (2005):

I do not intend to demonstrate, for example, that there are no insights from economic analysis of law in the world of complex deals. Indeed, I believe it is a fundamental truth that people act in their own interest, and that as to aspects of the deal process, they are primarily rational actors. But I also believe it is a fundamental truth that something compels us to regard others with a sense of honor, obligation, and responsibility. What I will argue is that both truths are apparent on a regular basis, regardless of the governing law or rational actor economics in complex commercial arrangements. Human beings do not check at the office door their impulse to find ways to make sense of why things go wrong in the world and to impose order on the chaos - whether through contract, personal relationships, self-deception, economic analysis, or moral philosophy. Contracts are one way to deal with contingency. Submitting disputes to a judge when we disagree is another. Neither is exclusive.

³⁵ Uri Benoliel notes the same issues in the manufacturer/distributor relationship including the opportunity for opportunistic behavior and argues that the relationship should be viewed as a reciprocal fiduciary relationship. Uri Benoliel, *Rethinking the Distributor-Manufacturer Relationship: A Marketing Channels Perspective*, 45 AM. BUS. L. J. 187 (2008).

example, proponents of JIT advise a manufacturer to rely on one supplier as a sole source for parts,³⁶ in contrast to earlier thinking which advised multiple sourcing, to protect manufacturers from unreliable suppliers and to allow the manufacturer to “play suppliers off against each other” to receive preferential pricing. The idea behind single sourcing is to give the parties the incentive to improve and integrate their processes in order to make the overall manufacturing process leaner and more efficient. By moving to sole sourcing, particularly if the component is a specially manufactured good, the manufacturer becomes more vulnerable to problems affecting the supplier³⁷ or to opportunistic behavior of the supplier.³⁸

³⁶ See, e.g., *Mixon & Otto*, *supra* note 23, at 398.

³⁷ In *R171 Enterprises Ltd. v. Sunrise Construction Ltd.*, 45 B.C.L.R. (4th) 125, 45 C.L.R. (3d) 68, 141 A.C.W.S. (3d) 1072, ¶¶ 79-123 (B.C. S.C. 2005), the Court had to apportion the losses resulting from a fire which destroyed the factory of a sole source JIT supplier. The manufacturer only had two days’ supply of the component on hand and the supplier had an additional two days’ supply. Following the fire, it took the supplier 12 weeks to become operational again. The Court noted:

79 The fire that engulfed the plant and offices of Crown West Steel was a disaster with far-reaching consequences. Not only was the business and undertaking of Crown West Steel brought to an abrupt halt, but prospectively so to was the truck manufacturing business of Western Star. Crown West Steel was the main supplier of frame rails to Western Star, and Western Star kept no significant inventory of frame rails on hand, applying the “just in time” inventory method, which finely dovetailed the productive capacity of Crown West Steel to the supply need of Western Star. Thus, two businesses were very much at risk, as well as were their employees and the families of their employees.

³⁸ See, e.g., recent Canadian cases involving this situation, *Windsor Mold Inc. v. Express Molding International Inc.*, 130 A.C.W.S. (3d) 86 (Ontario Sup. Ct. 2004), *aff’d*, 140 A.C.W.S. (3d) 285 (2005) (involving a sole supplier who refused to make JIT deliveries unless disputed invoices were paid by the manufacturer); *Faurecia Automotive Seating Canada Inc. v. VSA, LLC*, 140

The manufacturer may be unable to quickly cover if the supplier does not deliver, delivers nonconforming goods, or becomes insolvent. Conversely, sole sourcing raises the business stakes for the supplier. To the extent a single manufacturer becomes a greater part of the supplier's business, the supplier becomes vulnerable to opportunistic behavior by the manufacturer.³⁹ One example is when Jose Ignalio Lopez de Arriortua, the head of purchasing for General Motors, demanded that all of its suppliers reduce their prices by as much as twenty percent or more if they wanted to retain GM's business.⁴⁰ A more contemporary example is Wal-mart, though not a manufacturer, which allegedly uses its market dominance to extract price and other contract concessions from its suppliers.⁴¹ To be successful in a long

A.C.W.S.(3d) 469 (Ontario Sup. Ct. 2005) (involving a sole supplier under a JIT contract who refused to make further shipments unless the manufacturer agreed to make five changes to the contract).

³⁹ See, e.g., a recent Canadian case, *L & L Tool Inc. v. General Motors Corp.*, 132 A.C.W.S. (3d) 9 (Ontario Sup. Ct. 2004) (involving a claim by a supplier under a JIT contract that GM caused its bankruptcy by providing noncomplying raw materials, by demanding unnecessary express shipping expense, and by delaying payments).

⁴⁰ Alan L. Adler, *GM's Lopez uses tough medicine to restore ailing automaker's health*, INDIANAPOLIS STAR, Oct. 4, 1992, at B1; Erle Norton, *Balking U.S. Automotive Suppliers Talk Of Giving Up Business With Car Maker*, WALL ST. J., Nov. 2, 1992, at A8; Joseph B. White & Neal Templin, *Harsh Regimen*, WALL ST. J., Sept. 9, 1992, at A1 ("For months GM has been shredding supplier contracts and demanding price cuts of 20% or more."); Joseph B. White, *GM's Lopez Says He Will Accelerate, Expand Cost-Cutting Despite Criticism*, WALL ST. J., Sept. 30, 1992, at A5. This opportunistic behavior had short term rewards—at least for Lopez. He was hired away to perform similar magic for Volkswagen. General Motors sued Lopez and Volkswagen for theft of trade secrets. A cynic might wonder what is so secret about dominating and abusing suppliers, particularly when played out on the front pages of newspapers. The parties ultimately agreed to settle the civil suit. Robin Meredith, *VW Agrees to Pay G. M. \$100 Million in Espionage Suit*, N.Y. TIMES, Jan. 10, 1997, available at NYTimes.com.

⁴¹ See, e.g., Anthony Bianco et al., *Is Wal-mart Too Powerful?*, BUS. WK., Oct. 6, 2003, available at

term relationship,⁴² the parties in a JIT contract are going to have to forego opportunities for opportunistic behavior.⁴³

Although the parties to a JIT contract do not plan to ever rely on a written contract,⁴⁴ they should explicitly agree on expectations and allocation of risk in a JIT arrangement, even if there may be no enforceability problems with an oral agreement under the applicable statute of frauds.⁴⁵ The business relationship envisioned by a JIT supply contract is complicated enough,⁴⁶ but when the legal risks are

http://www.businessweek.com/magazine/content/03_40/b3852001_mz001.htm; Charles Fishman, *The Wal-mart You Don't Know*, FAST COMPANY, Dec. 2003, available at <http://www.fastcompany.com/magazine/77/walmart.html>.

⁴² I use the word “relationship” consciously, intending to invoke the rich, developing literature on relational contracting. For a general overview, see Richard E. Speidel, *Relational Contract Theory: Unanswered Questions: A Symposium in Honor of Ian R. Macneil: The Characteristics and Challenges of Relational Contracts*, 94 NW. U. L. REV. 823 (2000). For a more jaundiced and humorous view of relational contracting, see Jennings, *supra* note 18.

⁴³ See, e.g., Huszagh & Huszagh, *supra* note 23, at 155 (emphasizing the importance of trust, equity, responsibility and commitment in relational exchanges).

⁴⁴ See, e.g., Lloyd, *supra* note 24, at 263 (“When the neophyte lawyer negotiates and drafts her first contract, she usually expects that the client and its business partner will use the contract to guide their business relationship. The experienced business lawyer knows better. The more likely scenario is that the contract will be stuffed in a file drawer and pulled out only when there is a dispute. Even then, the parties are likely to consult the contract only when they’ve tried to resolve the dispute amicably and are threatening litigation.”).

⁴⁵ Although most JIT contracts would involve contracts for the sale of goods in excess of \$500 and would normally require a writing under N.C. GEN. STAT. § 25-2-201 (1) (2009), disputes would often be subject to the exceptions for specially manufactured goods, N.C. GEN. STAT. § 25-2-201 (3) (a) (2009), or with respect to goods which have been accepted or payment received, N.C. GEN. STAT. § 25-2-201 (3) (c) (2009), or where a confirmatory memorandum has been sent—possibly creating a “battle of the forms” problem, N.C. GEN. STAT. § 25-2-201 (2) (2009).

⁴⁶ They are complicated enough that it will be difficult to comprehensively set forth the rights and obligations of the parties, and the written contract will

considered, the parties do not want to leave the potential problems for retroactive allocation by the courts.⁴⁷ As my McFirm business consultant opined, the parties would have to be crazy to proceed without a written contract.⁴⁸ Moreover, this is a particularly poor type

always be supplemented by course of performance, course of dealing and trade usage. See Bennett, *supra* note 21. The literature on relational contracting is pertinent. Professors Bird and Charters succinctly summarize relational contract theory as follows:

A well-established body of literature, called relational contracting, holds that any agreement is governed in part by numerous external relationships and factors outside the four corners of the contract. Relational contract theory is supported by four fundamental principles. First, most transactions are surrounded by complex relationships between the parties. Second, these relationships are necessary to fully understand such transactions. Third, essential relational elements exist between parties that can significantly affect the nature of an agreement. Fourth, a contextual examination of these relational elements produces a more complete understanding of the relevant agreement.

Robert C. Bird & Darren Charters, *Good Faith and Wrongful Termination in Canada and the United States: A Comparative and Relational Inquiry*, 41 AM. BUS. L. J. 205, 244 (2004).

⁴⁷ Note that Professor Scott makes a contra point summarizing empirical experimental results:

In the absence of a legally enforceable obligation, reciprocal fairness—operating alone—generates high levels of cooperative behavior. But once the exchange is subject to a legally enforceable claim, the evidence shows that voluntary reciprocity declines and the overall level of cooperation declines as well. These experimental results suggest that explicit legal incentives and self-enforcing reciprocity may well be in conflict with one another. In short, legal enforcement may ‘crowd out’ behavior based on reciprocal fairness.

Scott, *supra* note 32, at 388.

⁴⁸ See also, Scott, J. Burnham, *Contractual Relations in Small Business: Do the Benefits of a Custom-Made Contract Outweigh the Costs*, 7 J. SMALL &

of business arrangement to leave to a “battle of the forms” between contradictory order forms and bills of lading or invoices.⁴⁹ Note that most of the default terms under the Uniform Commercial Code can be varied by agreement of the parties.⁵⁰

EMERGING BUS. L. 425 (2003) (arguing that generally the benefits of a custom-made contract outweigh the potential costs, even for small businesses).

⁴⁹ The so-called “battle of the forms” problem normally occurs where the buyer uses an order form with one set of standard provisions on the back and the seller responds with an “acceptance” in the form of an acknowledgment of order or invoice with a separate set of standard provisions on the back. The legal results to a battle of the forms have been determined, quite unsatisfactorily, by N.C. GEN. STAT. § 25-2-207 (2009). The National Conference of Commissioners on Uniform State Laws has proposed an abandonment of the current formula in favor of one that will be no more helpful. *See* National Conference of Commissioners on Uniform State Laws, Proposed Amendments to Uniform Commercial Code Article 2—Sales, § 2-207, *available at* <http://www.law.upenn.edu/bll/archives/ulc/ucc2/annual2002.htm>, which resolves the battle of the forms problem as a jump ball with the court as referee. As proposed Official Comment 3 notes:

3. By inviting a court to determine whether a party “agrees” to the other party’s terms, the text recognizes the enormous variety of circumstances that may be presented under this section, and the section gives the court greater discretion to include or exclude certain terms than original Section 2-207 did. In many cases, performance alone should not be construed to be agreement to the terms in another’s record by one that has sent or will send its own record with additional or different terms. Thus a party that sends a record (however labeled or characterized, including an offer, counteroffer, acceptance, acknowledgment, purchase order, confirmation or invoice) with additional or different terms should not be regarded as having agreed to any of the other party’s additional or different terms by performance. In that case, the terms are determined under paragraph (a) (terms in both records) and paragraph (c) (supplied or incorporated by this Act). Concomitantly, performance after an original agreement between the parties (orally, electronically or otherwise) should not normally be construed to be agreement to terms in the other’s record unless that record is part of the original agreement.

⁵⁰ N.C. GEN. STAT. § 25-1-302 (a) (2009).

A recent Canadian case, *Crawford Packaging Inc. v. W.E.T. Automotive Systems Ltd.*, is illustrative.⁵¹ A long term, JIT supply contract fell apart and the court was left trying to sort out the resulting dispute between the parties by piecing together documents—or parts thereof, course of dealing, course of performance, and conflicting testimony of the parties. The defendant sought to argue that all order forms contained a reference to terms and conditions on the back which should determine its contractual obligation. However, the purchasing manager admitted that the orders went out by fax, perhaps without the standard terms and conditions.⁵² In its finding of facts, the Court noted:

It is a curious feature of this case that neither side was able to produce a complete original or even a true copy of any of the purchase orders which were issued. The plaintiff's witnesses denied that Crawford ever received a copy of the purchase orders with a reverse side of any kind and said they were unaware of the terms and conditions. Mr. Tong insisted that W.E.T. would send out complete copies to the supplier but conceded his company could not produce any original purchase order or duplicate.⁵³

Though the defendant tendered what it said were the standard terms and conditions, the Court noted skeptically:

First Ex. 5 contains eight pages of single-spaced print and includes 25 separate paragraphs. While the

⁵¹ 145 A.C.W.S. (3d) 75, ¶ 61 (Ontario Sup. Ct. 2006).

⁵² *Id.* at ¶ 37.

⁵³ *Id.* at ¶ 69.

purchase documents in the record do say that they are "[s]ubject to the terms and conditions specified on the reverse side" (emphasis added.), I find it impossible to believe that the eight page document (Ex. 5) could have been squeezed onto the reverse side of any of the purchase documents. In short, I am not satisfied that Ex. 5 and its terms was ever communicated to the plaintiff and, additionally, I am not satisfied that the defendant ever relied on it in its dealings with the plaintiff.⁵⁴

It is clear that these standard terms and conditions were not designed to provide for the special problems associated with a JIT supply arrangement and it is also unlikely that they would agree in total with the forms or understanding of the supplier.⁵⁵

Among the critical contract terms that the parties should explicitly agree on is what events or conditions will constitute an event of default under the contract and the remedies upon default. The most common problems which would concern manufacturers would be a late delivery or the delivery of nonconforming goods. Either problem could have the result of stoppage of production of the manufacturer and consequential damages if the manufacturer exhausts its buffer inventory. Obviously, the seller would not want to assume liability for consequential damages in any case, but particularly if the source of the problem is out of the control of the seller. Hence, the seller will want to include a "force majeure clause." A force majeure clause typically excuses a party from liability for events or conditions outside of its control, excluding delayed performance resulting from

⁵⁴ *Id.* at ¶ 85.

⁵⁵ *Id.* at ¶ 86-87.

events such as wars, riots, natural disasters, strikes, problems with infrastructure or common carriers, or government restrictions.⁵⁶ The exact parameters of the excusing conditions are often heavily negotiated and may be a good litmus test for the cooperative risk-sharing inclinations of the parties. Likewise, it will be particularly important for the seller to limit remedies and particularly to disclaim liability for consequential damages.⁵⁷ Disclaimers of liability for

⁵⁶ Thomas Lundmark cites what he says is a typical force majeure clause:

14.11 FORCE MAJEURE. Neither party shall lose any rights hereunder or be liable to the other party for damages or losses (except for payment obligations) on account of failure of performance by the defaulting party if the failure is occasioned by war, strike, fire, Act of God, earthquake, flood, lockout, embargo, governmental acts or orders or restrictions, failure of suppliers, or any other reason where failure to perform is beyond the reasonable control and not caused by the negligence, intentional conduct or misconduct of the nonperforming party has exerted all reasonable efforts to avoid or remedy such force majeure; provided, however, that in no event shall a party be required to settle any labor dispute or disturbance.

Thomas Lundmark, *Verbose Contracts*, 49 AM. J. COMP. L. 121, 127-28 (2001) (citations omitted).

⁵⁷ N.C. GEN. STAT. § 25-2-719 (2009) provides:

Contractual modification or limitation of remedy

(1) Subject to the provisions of subsections (2) and (3) of this section and of the preceding section [G.S. 25-2-718] on liquidation and limitation of damages,

(a) the agreement may provide for remedies in addition to or in substitution for those provided in this article and may limit or alter the measure of damages recoverable under this article, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of nonconforming goods or parts; and

(b) resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.

consequential damages are likely to be enforceable, where, as in the case of JIT contracts, the parties are merchants and, hence, of more equal bargaining power.⁵⁸ Because of the time constraints of operating in a JIT environment, the selling supplier may have no practical ability to cure if it delivers nonconforming goods. This would be especially problematic in a case like MM, Inc.'s discussed above where there is a long lead time required in order to fabricate replacement goods.

If the buying manufacturer concedes on issues related to force majeure and consequential damages, it risks being put in an untenable position if the supplier does not deliver conforming goods in a timely manner and it has to shut down its production line, even if arguably it is not the seller's fault, as it was not MM, Inc.'s fault above, but the fault of its supplier—which would be the subject of disclaimer in many force majeure clauses.

Likewise, in the event of default, the parties should give some consideration to the remedies available to the parties. The parties

(2) Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this chapter.

(3) Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not.

⁵⁸ N.C. GEN. STAT. § 25-2-719 (3) (2009). See Lloyd, *supra* note 24, at 267-70 ("Students are amazed when I tell them that it is virtually unheard of for a sophisticated party, or even a party only moderately sophisticated, to prevail on an unconscionability argument." *Id.* at 267.)

should explicitly consider nonjudicial resolution of disputes—which would be consistent with the relational nature of the contract.⁵⁹

Another legal alternative is for the parties to agree upon a liquidated damages formula that would be due upon a late or defective delivery.⁶⁰ As long as the liquidated damage formula does not penalize the supplier and represents a reasonable expectation of the damages that the manufacturer would suffer, it is likely to be enforceable.⁶¹ To the extent that the liquidated damage formula includes a consequential damages component, it would be transferring considerable risk to the supplier.⁶²

⁵⁹ See also, Huszagh & Huszagh, *supra* note 23, at 155-57 (noting that the lawyer has a role to play in creating, maintaining and terminating exchange relationships). See also, Mixon & Otto, *supra* note 23, at 417-20 (arguing that American law is moving in a Deming oriented direction by encouraging and facilitating alternative dispute resolution and by “softening” the competitive model of contract law with the “doctrines of good faith, mitigation of damages, unconscionability, and relational contract law through which courts resolve contract disputes in a reasonable, sometimes paternalistic way.”).

⁶⁰ Richard A. Epstein, *Beyond Foreseeability: Consequential Damages in the Law of Contract*, 19 J. LEGAL STUD. 105, 114-21 (1989) (Epstein is sharply critical of traditional consequential damages analysis and concludes: “The plaintiff whose level of recovery is fixed in advance has a powerful incentive to mitigate his loss.”).

⁶¹ N.C. GEN. STAT. § 25-2-718 (1) (2009) (“Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.”). But, see Larry A. DiMatteo, *A Theory of Efficient Penalty: Eliminating the Law of Liquidated Damages*, 38 AM. BUS. L.J. 633 (2001) (taking a close look at the law of liquidated damages and arguing that liquidated damage provisions ought to be enforceable without this special scrutiny if they were part of the basis of the bargain).

⁶² In one case, the court noted as an aside that the contractual liability to the supplier under a just in time supply contract for General Motors for downtime on the manufacturer’s assembly line “ran as high as \$25,000 per minute of

A more reasonable contractual alternative might be to effectuate the business expectations of my McFirm consultant and to provide that if the supplier is late for a certain period, or a certain number of times within a given time frame, the manufacturer has the option to terminate the supply contract. A provision of this sort would give the supplier considerable incentive to perform in a timely manner but would not saddle it with all of the risks of the elimination of buffer inventory. Such a provision would also benefit the manufacturer by removing any ambiguity regarding what breaches would constitute a material breach under the Uniform Commercial Code's provisions with respect to installment contracts.⁶³

downtime." *NLRB v. Vemco, Inc.*, 989 F.2d 1468, 1472 (6th Cir. 1993) (note omitted).

⁶³ N.C. GEN. STAT. §§ 25-2-601; 25-2-612 (2009). N.C. GEN. STAT. § 25-2-612 provides:

(1) An "installment contract" is one which requires or authorizes the delivery of goods in separate lots to be separately accepted, even though the contract contains a clause "each delivery is a separate contract" or its equivalent.

(2) The buyer may reject any installment which is nonconforming if the nonconformity substantially impairs the value of that installment and cannot be cured or if the nonconformity is a defect in the required documents; but if the nonconformity does not fall within subsection (3) and the seller gives adequate assurance of its cure the buyer must accept that installment.

(3) Whenever nonconformity or default with respect to one or more installments substantially impairs the value of the whole contract there is a breach of the whole. But the aggrieved party reinstates the contract if he accepts a nonconforming installment without seasonably notifying of cancellation or if he brings an action with respect only to past installments or demands performance as to future installments.

Hence, without an agreement of the parties in advance, the courts would have to resolve whether a breach substantially impaired the value of the whole contract. The traditional explanation of the departure from the "perfect tender" rule in § 2-601 is that this provision represents the Code's attempt to preserve contractual relationships.

The parties may want to agree upon a variety of business techniques to reduce potential problems with the JIT arrangement. For example, the manufacturer may want the supplier to locate his facility near its plant to avoid delays resulting from transportation related problems. Alternatively, the supplier could warehouse a small buffer inventory of parts near the manufacturer to allow it to quickly cure in the event of a late or nonconforming delivery. Of course, either of these alternatives raise the commitment costs of the supplier and make the supplier more vulnerable to opportunistic behavior of the manufacturer.⁶⁴

From a business perspective, the manufacturer will want to carefully evaluate the risk of sole-sourcing, particularly if the goods are specially manufactured to the manufacturer's specification. Sole sourcing of specially manufacturer goods would drastically limit a manufacturer's ability to cover in the event of defective performance by the supplier. For example, in the auto industry, there would be much less risk in sole sourcing a generic product, like tires, than there would be in sole sourcing an engine part which was designed for a particular car.

⁶⁴ See, e.g., *Crawford Packaging Inc. v. W.E.T. Automotive Systems Ltd.*, 145 A.C.W.S. (3d) 75, ¶ 61 (Ontario Sup. Ct. 2006), where the supplier agreed to warehouse a three month supply of inventory and to deliver it to the manufacturer on a daily basis. The manufacturer ultimately terminated the supply contract without notice, leaving the supplier with \$50,000 of inventory, leading to the lawsuit.

CONCLUSION

As Oliver Wendell Holmes observed, the life of the law is experience,⁶⁵ i.e., stories. It is my hope that the stories presented and analyzed in this article emphasize the importance of lawyers developing a better understanding of business problems and of business practitioners developing a better understanding of law, and the use of contracts as a means of allocating risk. Both groups may not recognize the risk of consequential damages as a “bet the firm” risk for a supplier entering into a JIT supply arrangement. Hopefully these stories and their morals highlight these risks and the importance of cooperative behavior between manufacturers and their suppliers.

⁶⁵ Note 7 and accompanying text *supra*.