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# THE ACQUISITION OF FISHER BODY BY GENERAL MOTORS\*

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## ABSTRACT

It is commonly said that in 1926 General Motors was led to acquire its supplier of automobile bodies, Fisher Body, because Fisher Body held up General Motors. It is claimed that Fisher Body did this by locating its body plants far away from the General Motors assembly plants and by adapting inefficient methods of production, thus increasing both the cost of producing bodies and the profits of Fisher Body under its cost-plus contract. This tale is factually incorrect. What General Motors acquired in 1926 was the 40 percent of the shares of Fisher Body that it did not already own. Furthermore, Fisher Body did not locate its plants far away from the General Motors assembly plants. It is also most implausible, for many reasons, that the Fisher brothers would have used inefficient methods of production. There is no evidence that a holdup occurred.

## I. THE PREVAILING VIEW

THE prevailing view of the events that led to the acquisition of Fisher Body by General Motors is that Fisher Body, which had a 10-year contract to supply bodies to General Motors, held up General Motors by adopting inefficient production arrangements (which increased Fisher Body's profits under its cost-plus pricing arrangement) and by refusing to locate its plants near the General Motors assembly plants. This led to a situation that was "intolerable" and that was brought to an end by General Motors acquiring Fisher Body. This consensus has come about because of the general acceptance of the account presented in an article by Benjamin Klein, Robert G. Crawford, and Armen A. Alchian and elaborated in subsequent articles by

\* At the meeting of the International Society for New Institutional Economics in 1997, I announced that the generally accepted version of the events leading to the acquisition of Fisher Body by General Motors was, in my view, wrong and that I was writing a paper on the subject. This led to my learning that Robert Freeland had also written a paper dealing with the Fisher Body-General Motors case. Freeland covers a wider range of topics than I do. I confine myself to the question of whether Fisher Body held up General Motors prior to the acquisition. Where there is an overlap in our papers there appears to be no substantial difference in our interpretation of events. This is also true of the independently written paper by Ramon Casadesu-Masanell and Daniel F. Spulber, which examines the relations between General Motors and Fisher Body in great detail.

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Klein.<sup>1</sup> As a result, the Fisher Body–General Motors case has been used as the standard example of a holdup in innumerable articles and books.<sup>2</sup> As Klein has said, this case is “[p]erhaps the most extensively discussed example in the economic literature of a hold-up due to the presence of specific investments.”<sup>3</sup> Joel Trachtman, speaking of opportunistic behaviour, refers to the “classic example of Fisher Body and General Motors.”<sup>4</sup> What economists have come to believe happened is well described in a recent article by Keith J. Crocker and Scott E. Masten: “GM and Fisher Body initially agreed to a ten year contract for the sale of metal auto bodies. Unanticipated increases in the demand for automobiles in the early years of the contract, however, led to frictions over price on sales exceeding those covered in the contract and the refusal of Fisher to locate production facilities closer to GM. Eventually, the tension between the two became intolerable and, by 1926, GM had acquired Fisher.”<sup>5</sup> I believe that the prevailing view gives a completely false picture of the events leading to the acquisition of Fisher Body by General Motors. There was no holdup. The situation never became “intolerable.”

## II. MY VISIT TO THE UNITED STATES

In 1931, I was awarded a Sir Ernest Cassel Travelling Scholarship by the University of London. I decided to go to the United States for the year 1931–32, to study what I termed “lateral and vertical integration” in industry. What led me to choose this subject was that we seemed to lack any theory that would explain why production was organized in these different

<sup>1</sup> Benjamin Klein, Robert G. Crawford, & Armen A. Alchian, Vertical Integration, Appropriate Rents, and the Competitive Contracting Process, 21 *J. Law & Econ.* 297 (1978); Benjamin Klein, Vertical Integration as Organizational Ownership: The Fisher Body–General Motors Relationship Revisited, 4 *J. L. Econ. & Org.* 199 (1988), reprinted in *The Nature of the Firm: Origins, Evolution, and Development* 213 (Oliver E. Williamson & Sidney G. Winter eds. 1993); Benjamin Klein, Why Hold-Ups Occur: The Self-Enforcing Range of Contractual Relationships, 34 *Econ. Inquiry* 444 (1996); Benjamin Klein, Hold-Up Problem, in 2 *The New Palgrave Dictionary of Economics and the Law* 241 (Peter K. Newman ed. 1998).

<sup>2</sup> For some books using the Fisher Body–General Motors case as an example of a holdup, see Jean Tirole, *The Theory of Industrial Organization* 3 (1997); Dennis W. Carlton & Jeffrey M. Perloff, *Modern Industrial Organization* 18 (1994); Oliver E. Williamson, *The Economic Institutions of Capitalism* 114–15 (1985); and Martin Ricketts, *The Economics of Business Enterprise* 200 (1994).

<sup>3</sup> Klein, *Hold-Up Problem*, *supra* note 1, at 241.

<sup>4</sup> Joel P. Trachtman, *The Theory of the Firm and the Theory of the International Economic Organization: Toward Comparative Institutional Analysis*, 17 *Nw. J. Int'l L. & Bus.* 470, 521 (1996–97).

<sup>5</sup> Keith J. Crocker & Scott E. Masten, *Regulation and Administered Contracts Revisited: Lessons from Transaction-Cost Economics for Public Utility Regulation*, 9 *J. Regulatory Econ.* 5, 25 (1996).

ways. I set out to find this theory. Although I visited universities, in the main I tried to find the answer to my question by visiting businesses and industrial plants.<sup>6</sup> At one stage, I considered the part that asset specificity might play in bringing about vertical integration. In a letter to my friend, Ronald Fowler, dated March 24, 1932, I said:

Suppose the production of a particular product requires a large capital equipment which is, however, specialized insofar that it can only be used for the particular product concerned or can only be readapted at great cost. Then the firm producing such a product for one consumer finds itself faced with one great risk—that the consumer may transfer his demand elsewhere or that he may exercise his monopoly power to force down the price—the machinery has no supply price. Now this risk must mean that the rate of interest paid on this capital is that much higher. Now, if the consuming firm decides to make this product this risk is absent and it may well be that this difference in capital costs may well offset the relative inefficiency in actual operating.<sup>7</sup>

Later, when I went to Chicago and discussed this analysis with Jacob Viner, he thought it was sound. But in the meantime I had discussed it with businessmen, and they were unimpressed. As I said in a letter to Fowler, dated May 7, 1932, "My queries about the form of contracts for products requiring large capital equipment has shown me that contractual arrangements can be made to avoid this risk. Thus, the consuming firm may buy the particular equipment itself even though it is in another company's plant. There are a number of other contractual devices which tend to get over this difficulty."<sup>8</sup> Unfortunately, I do not say in my letter what these other contractual devices were. My discussions with businessmen made me sceptical of the practical importance of asset specificity in bringing about vertical integration. When I visited the Ford Motor Company and General Motors in Detroit, it was with the belief that asset specificity of itself was not generally an important reason for vertical integration. In Detroit, I visited Ford and one of its suppliers; my recollection is that it was Kelsey-Hayes Wheel. At Ford I interviewed someone in the purchasing department (I thought the head) and "discussed the problems connected with contracting for supplies, purchasing schedules and the like for about an hour and a half."<sup>9</sup> I also visited General Motors. Unfortunately, I say nothing in my correspondence

<sup>6</sup> For a fuller account of my visit to the United States, see my lectures: R. H. Coase, *The Nature of the Firm: Origin, Meaning, Influence*, 4 *J. L. Econ. & Org.* 3 (1988), reprinted in Williamson & Winter eds., *supra* note 1. In later citations to these lectures, I will confine myself to citation of the book.

<sup>7</sup> Coase, *supra* note 6, at 43.

<sup>8</sup> *Id.* at 45.

<sup>9</sup> *Id.* at 44.

with Fowler other than that I paid them a visit. My recollection is that I was told that the reason for the acquisition of Fisher Body was to make sure that the body plants were located near the General Motors assembly plants.

After visiting Detroit, I went on to Chicago. While there I went to see the plant in Milwaukee of A. O. Smith, a producer of automobile frames whose main customer was General Motors. These heavy frames were then shipped to Michigan, hundreds of miles away. This led me to wonder why the location of the Fisher Body plants near the General Motors assembly plants was considered to be so important. There was also the problem of asset specificity. General Motors was the main customer of A. O. Smith, and much of the equipment in the latter's highly automated plant was specific for General Motors's automobiles. All of this suggested to me that contractual arrangements were able to handle the asset specificity problem in a satisfactory manner. In preparation for my lectures at Yale in 1987, I gathered more information about the relations between A. O. Smith and General Motors. I discovered that harmonious relations between them had continued for many decades. I had not made a similar investigation of the Fisher Body case. So I said that, although the problem could usually be handled in a satisfactory manner by contractual arrangements, as in the A. O. Smith case, "it seemed likely that this situation did sometimes lead to integration, and the acquisition of Fisher Body by General Motors might well have been an example of this."<sup>10</sup>

When my lectures were published in the *Journal of Law, Economics, and Organization*, I was surprised to find an article by Klein replying to my remarks, largely relying on what he claimed happened in the Fisher Body-General Motors case. I will be discussing Klein's views later. But I should make one comment now. He states that "Coase claims that before writing his classic paper he explicitly considered opportunistic behavior as a motive for vertical integration, in particular as it applied to the General Motors-Fisher Body case, and explicitly rejected it."<sup>11</sup> This is not an accurate account of the evolution of my ideas. Some carelessness in my writing may have been responsible for the misunderstanding. I had explicitly considered the problem of asset specificity before I visited General Motors. When I found, as a result of discussions with businessmen, that the problem could usually be satisfactorily solved through contractual arrangements—for example, the purchase of dies—I had concluded that vertical integration would not normally be the solution chosen. When I discussed with an exec-

<sup>10</sup> *Id.* at 46.

<sup>11</sup> Klein, Vertical Integration, in Williamson & Winter eds., *supra* note 1, at 213.

utive of General Motors why they had acquired Fisher Body, I was told that it was to make sure that the body plants were located by the assembly plants. A subsequent visit to A. O. Smith made me sceptical about the need to locate the plants by the assembly plants, while the intimate and harmonious relations between A. O. Smith and General Motors strengthened my view that the asset specificity problem would normally be handled satisfactorily without vertical integration. My conclusion was that though the situation in the Fisher Body–General Motors case may have been as Klein described, it was an exceptional case. However, since the publication of my lectures and Klein’s commentary, I became interested in finding out what exactly had happened in the Fisher Body–General Motors case. It soon became apparent that Klein’s account was misleading, and I decided to make a more thorough investigation to discover what had happened. In 1996, with the aid of Richard Brooks as research assistant, I began to gather information on the events leading to the acquisition of Fisher Body by General Motors. A very different picture of these events emerged from that presented by Klein, Crawford, and Alchian.

### III. FISHER BODY AND GENERAL MOTORS

The tale of Fisher Body is the tale of the Fisher brothers. Fred (the eldest) had worked in his father’s wagon and carriage business in Ohio but, in 1902, went to Detroit to work at the C. R. Wilson Carriage Works (which also made automobile bodies). There he was joined by five Fisher brothers. In 1907, he became superintendent. In 1908, the Fisher Body Company was formed, with Fred as its head and his five brothers occupying various positions in the firm. Shortly afterward, Louis Mendelssohn and Aaron Mendelssohn (hereafter referred to as the Mendelssohns) made a substantial investment in the firm. The business was very successful. Their automobile bodies were not simply an adaptation of carriages but were designed with the special needs of automobiles in mind. Although most automobiles in those days were open, the Fisher brothers realized that there would be a demand for closed bodies. They built 150 closed bodies for Cadillac in 1910. The same year, they formed the Fisher Closed Body Corporation, and in 1912 they created the Fisher Body Company of Canada. In 1916, the three companies were merged to form the Fisher Body Corporation.<sup>12</sup> It was the largest body builder in the industry.<sup>13</sup> It made bodies for all the leading

<sup>12</sup> This account of the tale of the Fisher brothers is based on Arthur Pound, *The Turning Wheel* 288 (1934); and Testimony of Lawrence Fisher, Trial Transcript, Vol. 2, at 958–1007, *United States v. Du Pont*, 126 F. Supp. 235 (N.D. Ill. 1954).

<sup>13</sup> Pound, *supra* note 12, at 291.

automobile manufacturers: Cadillac, Buick, Hudson, Chalmers, Studebaker, Chandler, Cleveland, and, of course, Ford.<sup>14</sup> Concerned that the two largest automobile makers, Ford and General Motors, might make their own bodies, thus leaving them to supply the smaller manufacturers that were left, the Fisher brothers considered entering the automobile business, and they set up in 1913 or 1914 the Hinckley Motor Company. They developed an engine, but to conceal their real objective they manufactured a truck engine that was used in World War I.<sup>15</sup> However, in November 1917, General Motors made a contract with them "to purchase substantially all their output at cost, plus 17.6 per cent."<sup>16</sup>

General Motors was formed by William C. Durant. He had made a fortune in the carriage business and then decided to enter the automobile business. In 1904, he acquired the Buick Motor Company. In 1908, he formed the General Motors Corporation. Durant's approach was to grow by buying existing enterprises. He acquired several automobile companies—Olds (now Oldsmobile), Oakland (now Pontiac), and Cadillac—as well as firms producing parts and accessories. However, as Alfred Sloan has said, Durant "could create but could not administer."<sup>17</sup> In 1910, a downturn in sales resulted in Durant being unable to pay his employees or suppliers. General Motors was saved by a bank loan, but the bankers took over the management of the corporation, a task they carried out, as Sloan said, "efficiently though conservatively."<sup>18</sup> Durant, if a poor manager, was extremely enterprising. He formed a partnership with Louis Chevrolet and established the Chevrolet Motor Company. This prospered, and, using Chevrolet stock to acquire General Motors stock, Durant had, together with his own holdings, sufficient stock to be able to wrest control from the bankers in 1915.<sup>19</sup> In 1917, Durant formed a syndicate to buy General Motors stock with the aim of raising or maintaining its price (perhaps to facilitate the merging of Chevrolet and General Motors). However, the price of General Motors stock fell, and Durant found himself in financial difficulties.<sup>20</sup> Pierre du Pont, who had a personal investment in General Motors and who played a part in the events leading to the bankers' control of General Motors, was approached but was unwilling to advance any money at that time.<sup>21</sup> There was a sugges-

<sup>14</sup> Testimony of Lawrence Fisher, at 964, *Du Pont*, 126 F. Supp. 235.

<sup>15</sup> *Id.* at 991-92.

<sup>16</sup> Alfred D. Chandler, Jr., & Stephen Salsbury, *Pierre S. du Pont and the Making of the Modern Corporation* 465 (1971).

<sup>17</sup> Alfred P. Sloan, Jr., *My Years with General Motors* 4 (1964).

<sup>18</sup> *Id.* at 8.

<sup>19</sup> Chandler & Salsbury, *supra* note 16, at 440-42.

<sup>20</sup> *Id.* at 448.

<sup>21</sup> *Id.* at 449.

tion that Fisher Body might take over General Motors since Fisher Body could raise money from the banks, but nothing came of this.<sup>22</sup> Finally, Durant, with the assistance of John Raskob, who was an executive at Dupont, approached the Dupont Company itself. They finally agreed to invest \$25 million in General Motors. As part of the arrangement, it was agreed that du Pont would be in charge of the finances of General Motors while Durant would be responsible for its operations.<sup>23</sup>

#### IV. THE ACQUISITION OF STOCK IN FISHER BODY BY GENERAL MOTORS

In 1917, as we have seen, Durant made a contract with Fisher Body by which General Motors would buy substantially all their output at cost plus 17.6 percent. This did not, however, remove General Motors's concerns over the future supply of bodies. The situation, as General Motors saw it, has been described by Alfred D. Chandler and Stephen Salsbury: "The postwar expansion plans convinced Durant and the Finance Committee of the absolute necessity of having an assured control over General Motors' largest and most critical supplier. They simply could not afford to have the Fishers fail to renew their contract on acceptable terms. Any doubts . . . were quickly resolved when [it was] learned that automobile manufacturers in Cleveland (undoubtedly Willys-Overland) had opened negotiations to form a partnership with the Fishers in which they (the Fishers) would control."<sup>24</sup> This account is essentially correct except that I would not give the same weight to the Cleveland negotiations in leading to the purchase of Fisher Body stock by General Motors. I will give the details.

In 1918, Durant sent Walter Chrysler to see Lawrence Fisher. Chrysler had been president of Buick and was working with Durant in New York. Later, of course, he would set up his own automobile company. Chrysler explained that the "closed body situation with General Motors was a very serious one . . . that [Durant] wanted to build plants in Flint and Lansing and Pontiac" and that he "wanted to enter into a deal with [the four younger Fisher brothers] to come with General Motors and set up [the] organization . . . to handle their closed body business." Lawrence Fisher replied that they "couldn't split the Fisher brothers."<sup>25</sup> It is not clear why Durant made this proposal. He must have known that the Fisher brothers would want to be treated as a unit. Possibly, the proposal was merely a way of sounding out the Fisher brothers about joining General Motors. At any

<sup>22</sup> Testimony of Lawrence Fisher, at 1006-7, *Du Pont*, 126 F. Supp. 235.

<sup>23</sup> Chandler & Salsbury, *supra* note 16, at 450-56.

<sup>24</sup> *Id.* at 465.

<sup>25</sup> Testimony of Lawrence Fisher, at 987-88, *Du Pont*, 126 F. Supp. 235.

rate, some months later, early in 1919, Durant got in touch with Fred Fisher (the eldest brother). At a meeting in New York, Durant made the same argument as had Chrysler. He said that he wanted to talk "about bringing the Fisher brothers into General Motors." Fred and Lawrence Fisher listened but gave no answer. As Lawrence Fisher said, "We were not interested at the time." Durant, however, was persistent and raised the question again about 2 months later. The situation with regard to bodies had become "more acute." In the meantime, Fisher Body received a very large order for closed bodies from Ford. The Fisher brothers this time decided to consider seriously the possibility of joining General Motors, and they talked with their associates, the Mendelssohns, who had a substantial stake in Fisher Body.<sup>26</sup> From the negotiations that followed, in which Pierre du Pont played a major role, an agreement emerged in September 1919. A complicating factor was that Fisher Body had made a tentative agreement with Willys-Overland in Cleveland to form a company to build automobile bodies. Fisher Body would own 51 percent of the shares and would provide the management. General Motors wanted this arrangement dropped, and this was done.<sup>27</sup>

The agreement between Fisher Body and General Motors was composed of the following elements:

1. The authorized common stock of Fisher Body, consisting of 200,000 shares, would be increased to 500,000 shares. General Motors would purchase 300,000 shares at \$92 per share.

2. The 300,000 shares owned by General Motors together with 35,000 owned by the Fisher brothers would be deposited in a voting trust. The trust was to last for 5 years, and there were four trustees, two named by Fisher Body and two by General Motors. The trustees named by Fisher Body were Fred Fisher and Louis Mendelssohn and by General Motors, Durant and Pierre du Pont. No action of the voting trustees would be valid unless unanimous. This meant, in effect, that for 5 years the General Motors shares could not be voted in any way not desired by Fisher Body.

3. There would be 14 directors of Fisher Body, seven to be nominated by the Fisher-Mendelssohn interests and seven by General Motors. Although General Motors owned 60 percent of the shares, they would be able to nominate only 50 percent of the directors.

4. An executive committee of Fisher Body would be created that would have complete charge of operations, except finances. This committee would consist of seven members, two nominated by General Motors and five by

<sup>26</sup> *Id.*, at 989-91.

<sup>27</sup> Letter from Pierre S. du Pont to Fred I. Fisher (September 11, 1919), Gov't Trial Ex. No. 425, *Du Pont*, 126 F. Supp. 235.

the Fisher-Mendelssohn interests. The finance committee would consist of five members, three nominated by General Motors and two by the Fisher-Mendelssohn interests.

5. It was provided that, for 5 years, at least two-thirds of the net earnings would be distributed as dividends until they should reach at least \$10 per share.

6. A 5-year employment contract was entered into with the four younger Fisher brothers. However, the two older brothers had an employment contract with Fisher Body that ended in 1926. The Fisher brothers wanted this contract to be modified so that the employment contracts of all the Fisher brothers would end in 1924. Durant did not like this change but finally agreed to it. The result was that all the Fisher brothers had the option of terminating their employment in 1924. The reason the Fisher brothers wanted this was that they were not sure how the partnership with General Motors would work out and wanted to be free, if it proved unsatisfactory, to enter the automobile business or to make some other business arrangement. When the arrangement was described by counsel as a "trial marriage," Lawrence Fisher agreed.

7. The Fisher brothers were to have paid to them, in addition to their salaries, 5 percent of the net profits of Fisher Body for 5 years.

8. General Motors agreed to give to Fisher Body such of its closed body business as Fisher Body was able to handle. The 1917 arrangements for pricing were to continue. The price to be paid by General Motors would depend on the grade of the work, but the average net profit to Fisher Body was to be 17.6 percent on cost. Durant had wanted this figure reduced to 15 percent but in the end agreed to 17.6 percent. It was, however, stipulated that General Motors could not be charged more than was charged to other customers for like products.

9. The contract for the supply of bodies would last 10 years; that is, it would end in 1929.

10. It was agreed that Fisher Body would be free to work for customers other than General Motors.

The result of this agreement was that Fisher Body would be able to operate for 5 years essentially as an independent firm, notwithstanding that DuPont owned 60 percent of the common stock.<sup>28</sup> Even after 1924, the Fisher brothers would have considerable independence in running the Fisher Body Corporation.

<sup>28</sup> This account of the 1919 agreement is based on Gov't Trial Ex. Nos. 424-30, *Du Pont*, 126 F. Supp. 235; Defendant's Ex. No. 101, *Du Pont*, 126 F. Supp. 235; and Lawrence Fisher's discussion of the agreement in Testimony of Lawrence Fisher, Trial Transcript, Vol. 2, *Du Pont*, 126 F. Supp. 235. See also Chandler & Salsbury, *supra* note 16, at 465.

## V. EVENTS LEADING TO THE COMPLETE OWNERSHIP OF FISHER BODY BY GENERAL MOTORS

In November 1920, Durant resigned as president of General Motors. This came about as the result of a crisis in his personal finances. After the slump in automobile sales in September 1920, Durant attempted to stabilize the price of General Motors stock by purchasing its stock on margin. Unable to meet the margin calls when the price fell and owing \$20 million or perhaps more, he was rescued by the Dupont Corporation and J. P. Morgan. The bankers concluded that Durant was "totally incompetent to manage the corporation." Pierre du Pont concurred. As a result, he agreed to become president of General Motors.<sup>29</sup>

General Motors was dissatisfied with the 1919 arrangement. It had solved an immediate problem but had brought about an unsatisfactory long-term relationship with Fisher Body. The Fisher brothers tended to concentrate on their body-building business, and while they were efficient and their bodies were of high quality, they paid less attention to the needs of General Motors than General Motors would have liked. The result was that Pierre du Pont and later Alfred Sloan, who succeeded him as president of General Motors, were anxious to bring the Fisher brothers into a closer relationship with the General Motors organization.

In 1921, Fred Fisher was made a director of General Motors and in 1922, he was appointed a member of the executive committee of General Motors, as Chandler and Salsbury put it, "to ensure better communication with the Fisher Body Company."<sup>30</sup> Later in their book, Chandler and Salsbury were more explicit. It was hoped that placing Fred Fisher on the executive committee would "get him further involved in making the broad decisions about production, products design, output and pricing of General Motors products that inevitably affected the work of his own organization."<sup>31</sup> This attempt to bring about a closer relationship between Fisher Body and General Motors seems to have had some success. Lawrence Fisher, in his testimony in the Dupont antitrust suit, described Fred Fisher, although on the Fisher Body payroll, as devoting most of his time to his work with General Motors.<sup>32</sup> By 1922, the Fisher brothers seem to have given up the idea that they might sever their connection with General Motors at the end of the 5-year period.<sup>33</sup> The "trial marriage" appears to have been a success. In fact,

<sup>29</sup> Chandler & Salsbury, *supra* note 16, at 482-91.

<sup>30</sup> *Id.* at 526.

<sup>31</sup> *Id.* at 576.

<sup>32</sup> Testimony of Lawrence Fisher, at 1003, *Du Pont*, 126 F. Supp. 235.

<sup>33</sup> Gov't Trial Ex. No. 328, *Du Pont*, 126 F. Supp. 235.

when, in 1924, their employment contracts expired, Charles and Lawrence Fisher joined Fred Fisher on the board of directors and the executive committee of General Motors, while Fred was also appointed to the finance committee. In 1925, Lawrence Fisher was made head of Cadillac, one of General Motors's most important divisions.

From 1924 on, it seems to have been understood that ultimately Fisher Body would probably merge with General Motors. Pierre du Pont, in a letter to Fred Fisher in July 1924, said this:

I hope that you and your brothers will feel that Fisher Body and General Motors are really one and that the whole effort is so worthwhile and full of opportunity that you will take chances on associating yourselves permanently with the development. I see no trouble from awaiting the development of a contract between the two companies in order to determine relative values of shares, but so far, I have had some difficulty in picturing the situation whereby the Fisher brothers may stick together as a unit in the General Motors Corporation. However, we will straighten it out some way if we give constant attention to the matter.<sup>34</sup>

General Motors was anxious to acquire the 40 percent of the stock of Fisher Body that it did not own. Quite apart from the desire to bring the Fisher brothers even more closely into the General Motors organization, it was also concerned that the minority holding, through death or in some other way, might fall into other hands with whom it might be difficult to deal.<sup>35</sup> The Mendelssohns and the Fisher brothers, for their part, were not anxious to sell their stock holdings to General Motors. The Mendelssohns were satisfied with their investment in Fisher Body and had no desire to change it to an investment in General Motors. The Fisher brothers still wanted to operate as a family firm, in which desire, as Chandler and Salisbury tell us, "they were emphatically supported by their strong-willed mother."<sup>36</sup> The Fisher brothers also thought that the price proposed by General Motors was too low. There were difficult negotiations. Finally, Fred Fisher and Pierre du Pont came to an agreement.

In May 1926, the Fisher Body Corporation was dissolved. General Motors acquired all of its assets and assumed all of its obligations and liabilities. In the notice sent out to the stockholders of Fisher Body it was stated that "Messrs. Fisher, Mendelssohn and other large shareholders, as well as all of the officers and directors of Fisher Body, approve and recommend

<sup>34</sup> Letter from Pierre du Pont to Fred Fisher (July 28, 1924) (Longwood Manuscripts, Group 10, Series A, Papers of Pierre S. du Pont, Hagley Museum & Library, Greenville, Del.) (hereinafter Longwood Manuscripts).

<sup>35</sup> Chandler & Salisbury, *supra* note 16, at 576-77.

<sup>36</sup> *Id.* at 576.

this plan as being in the best interest of the stockholders.” The notice also explained why they had concluded that it was in the best interest of the stockholders to accept the General Motors’ offer:

As the contract made with General Motors in 1919 has but a relatively short term remaining, your officers and directors have given serious thought to the future prospects of Fisher Body. In 1929, a new contract must be negotiated, or General Motors will be free either to build its own bodies or purchase them elsewhere. In view of these facts and in order to fully ascertain and provide for the conditions which might have to be met by Fisher Body upon the expiration of the present contract, many conferences have been had with officials of General Motors, and as a result of such conferences your Board of Directors received the offer [from General Motors].<sup>37</sup>

Stockholders of Fisher Body received two-thirds of a share of General Motors stock for each share of Fisher Body they owned. William Fisher was made head of the Fisher Body division and joined his three brothers on the board of directors of General Motors. In a letter to William Fisher welcoming him to the board, Pierre du Pont said that the “Fisher Body–General Motors combination is proving a very happy one, I think one of the best moves that has been made.”<sup>38</sup> In a letter written to Pierre du Pont in January 1927, Fred Fisher referred to their disagreement over the value of Fisher Body stock: “If you recall my remarks made at the time you and I closed [the] transaction between General Motors and Fisher Body Corporation, I made the statement that there was considerable hidden value in regard to inventory and unabsorbed overhead.” He then goes on to argue that the figures produced for the subsequent period by the accounting division of General Motors indicated that he had been correct.<sup>39</sup>

It will have been noticed that in my account of the events leading to the acquisition of Fisher Body by General Motors, there has been no mention of either a holdup or the relations between Fisher Body and General Motors becoming intolerable. Indeed, it is ludicrous to suppose that the Fisher brothers, occupying the most senior positions in the General Motors organization, would have engaged in the practices injurious to General Motors that are described by Klein or, if they did, that they would have been ap-

<sup>37</sup> Notice to Stockholders of Fisher Body Corporation (May 17, 1926), Gov’t Trial Ex. No. 855, *Du Pont*, 126 F. Supp. 235.

<sup>38</sup> Letter from Pierre du Pont to William A. Fisher (February 15, 1927) (Longwood Manuscripts).

<sup>39</sup> Letter from Fred Fisher to Pierre du Pont (January 19, 1927) (Longwood Manuscripts).

pointed, reappointed, or given important additional responsibilities in the General Motors organization.

## VI. THE BASIS FOR THE PREVAILING VIEW

The prevailing view about what happened in the Fisher Body–General Motors case was set out by Klein in the article “Hold-Up Problem” in the *New Palgrave Dictionary of Economics and the Law*. This is what he says:

The [cost-plus] contract adopted by Fisher Body and General Motors was, like all contracts, not complete. What is unusual about this case, however, is that Fisher took advantage of the contractual incompleteness to hold up General Motors. Fisher was able to hold up General Motors because, after the parties signed their contract, the demand for closed automobiles increased dramatically. Fisher took advantage of the contractual incompleteness in the face of the large demand increase for automobile bodies to adopt an inefficient, highly labour-intensive production process. From Fisher’s point of view there was no economic reason to make capital investments when, according to the contract, they could instead hire a worker and put a 17.6 percent upcharge on the worker’s wage. In addition, Fisher used the contract to locate its body producing plants far away from the General Motors assembly plant. There was no economic reason for Fisher to locate their plant close to the General Motors assembly plant when according to the contract, they could profit by locating their plant far away from the General Motors plant and put a 17.6 percent upcharge on their transportation costs. The result was automobile bodies that were highly profitable for Fisher to produce, but very costly for General Motors to purchase.<sup>40</sup>

In the previous section, I said that given what we know about the relations of General Motors and the Fisher brothers, it was most improbable that the tale told by Klein was true. But can one show that, in fact, it was untrue? In the case of the location of the body plants, it is, I believe, very easy to show this. Richard Brooks examined the location of Fisher Body plants in the period 1921–25. No new body plants were built in the period 1919–21. In 1922, two body plants were built, one near the General Motors truck and Oakland plant in Pontiac, Michigan, and the other near the Chevrolet plant in St. Louis, Missouri. In 1923, body plants were built by Fisher Body in Flint, Michigan, near the Buick and Chevrolet plants; in Lansing, Michigan, near the Olds plant; in Janesville, Wisconsin, near the Chevrolet plant; in Oakland, California, near the Chevrolet plant; and in Buffalo, New York, near the Chevrolet plant. An assembly plant was also built near the Chevrolet plant in Cincinnati, Ohio. In 1925, a body plant

<sup>40</sup> Klein, Hold-Up Problem, *supra* note 1, at 241–42.

was built in Tarrytown, New York, near the Chevrolet plant there. What is clear is that Klein's statement that Fisher Body located its plants "far away" from the General Motors assembly plants is completely untrue.<sup>41</sup>

The source on which Klein relies is Sloan's deposition and testimony in the Dupont antitrust case. Sloan made two references to the building of body plants by Fisher Body in the pages cited by Klein. In the first, Sloan was asked by counsel whether in the period before the acquisition there was a problem "to do with the location of the plants?" Sloan answered: "Yes . . . where there was a chassis assembly plant there had to be next to it a Fisher Body plant. . . . And the Fisher brothers . . . rather questioned the desirability of their putting up large amounts of capital to establish these assembly plants."<sup>42</sup> In the second, counsel asked Sloan what he was referring to when he spoke of "a problem of assembly." He answered: "What I meant by that was that we were establishing throughout the country assembly plants . . . and where we had a chassis assembly plant, we had to have a Fisher Body assembly plant, but the Fisher Body Corporation was unwilling to put in an investment in these assembly plants. That handicapped us considerably."<sup>43</sup> It is evident that what Sloan was referring to was not a dispute over whether the Fisher Body plants should be located near the General Motors assembly plants but one over which organization should put up the capital required to do it. I know how this was handled in the case of the Fisher Body plant built near the Tarrytown Chevrolet plant. The cost was borne by General Motors.<sup>44</sup> No doubt this also happened for many of the other Fisher Body plants. Nor would this be surprising. My investigations in 1931-32 had taught me that it was normal for the expenditures for capital equipment dedicated to the use of one customer to be borne by that customer. That this was sometimes done by General Motors in financing the building of Fisher body plants is made clear in a memorandum

<sup>41</sup> Fisher Body did have two plants "far away" from the General Motors assembly plants, but they hardly support Klein's thesis. In 1925, Fisher Body acquired a body plant in Fleetwood, Pennsylvania, as a result of its acquisition of the Fleetwood Body Corporation. And in 1924, it acquired a plant in Memphis, Tennessee, as part of the operations of the Fisher Lumber Corporation. It is described by Pound as a "wood working plant." See Pound, *supra* note 12, at 298-99.

<sup>42</sup> Deposition of Alfred P. Sloan, at 189-90 (April 28, 1952), *Du Pont*, 126 F. Supp. 235.

<sup>43</sup> Testimony of Alfred P. Sloan, at 2912 (March 9, 1953), *Du Pont*, 126 F. Supp. 235. I should add that I fully accept Sloan's view that it was less costly to place the body plants near the assembly plants. The scepticism I felt about this after I visited the A. O. Smith plant ignored the difference in the cost of shipping bodies and frames or the possibility that economies of scale were more important in the production of frames than bodies. This error is perhaps excusable in an undergraduate, which I was at the time.

<sup>44</sup> See Minutes of the Executive Committee of General Motors (October 24, 1923) (General Motors' Law Library, Detroit, Mich.).

recording a discussion in 1922 among Pierre du Pont, two top executives of General Motors, and Fred Fisher on the Chevrolet assembly program. It records that "Fred Fisher suggested that these plants [to produce closed bodies] be built in Chevrolet property and leased to the Fisher Body Company." Again, after Fred Fisher had said "that possibly \$5,000,000 for additional working capital and sundry improvements will be needed . . . but this can be taken care of by current borrowing," the memorandum states that after discussion, "it was agreed that it would be better for the Fisher Company not to issue further senior securities. To that end it would be better for General Motors Corporation to own the assembly plants, leasing them to the Fisher Company."<sup>45</sup> It is not without interest that it was Fred Fisher who suggested that the body plants be built on Chevrolet property.

While I had no doubt that the account given earlier about the location of the body plants was correct, it left me with a puzzle. I remembered being told, by an executive in General Motors in 1932, that the reason for the acquisition of Fisher Body was to make sure that the body plants were erected near the General Motors assembly plants. I found the solution to the puzzle in Robert Freeland's paper. He tells us that in late 1925, General Motors, as part of its expansion plan, wanted to close the Fisher Body plant in Detroit and build a new body plant in Flint, Michigan, near its assembly plant. The Fisher brothers objected. They wanted to expand their Detroit plant. There may have been a difference of opinion about the relative costs of handling the problem in these different ways, but, no doubt, even more important was that Fisher Body had customers other than General Motors, and it would have been less costly to supply them from Detroit rather than from Flint, a consideration that would not be present in the case of General Motors. It also has to be remembered that Fisher Body had large stockholders (the Mendelssohns) and perhaps others who had no interest in the fortunes of General Motors. No doubt there were other factors that influenced Fisher Body. The dispute ended when Fisher Body was acquired by General Motors. In November 1926, a new body plant went into operation in Flint, and in 1927 the Detroit plant was closed down.<sup>46</sup> It was undoubtedly this episode, which had happened only 5 or 6 years before, that the executive at General Motors had in mind when he told me in 1932 that the reason for the acquisition of Fisher Body was to make sure that the body plants were located next to the General Motors assembly plants.

<sup>45</sup> For an account of Fisher's finances in connection with the Chevrolet assembly program, see Longwood Manuscripts, file 624, box 1.

<sup>46</sup> Robert F. Freeland, *Creating Holdup through Vertical Integration: Fisher Body Revisited*, in this issue, at 33.

Klein's other point is that Fisher Body adopted "an inefficient, highly labor-intensive production process." There is no mention of this in the Sloan testimony that Klein cites. I have argued in the previous section that, given the positions occupied by the Fisher brothers in the General Motors organization, it is most improbable that they would act in this way. There are other considerations that lead to the same conclusion. Fisher Body was supplying bodies to automobile manufacturers other than General Motors, and an inefficient production process would reduce their own profits from this business and make it less likely that they would secure it. Furthermore, since in many, perhaps most, cases, General Motors paid for the building of the body plants (which it also owned), it is most improbable that they would have been willing to do this for a plant using an inefficient production process. General Motors was not lacking in engineering talent. Furthermore, to the extent that Fisher Body was paying the capital costs, it needs to be remembered that General Motors nominated a majority of the members of the finance committee of Fisher Body, which would have had to approve such expenditures. I could say more, but there is little point in an extensive discussion of an improbable tale for which there is no supporting evidence.

The erroneous statement of the facts in the Fisher Body–General Motors case has misdirected the attention of economists and has stood in the way of the development of a more solidly based treatment of the problem of asset specificity. The view that I formed in 1932 and discussed in my Yale lectures was that the asset specificity problem was normally best handled by a long-term contract rather than by vertical integration and that "the propensity for opportunistic behavior is usually effectively checked by the need to take account of the effect of the firm's actions on future business."<sup>47</sup> This reexamination of the Fisher Body–General Motors case has not caused me to change my mind. It is true that I have said nothing about the role of reputation in the events discussed. However, I have no doubt that concern for their reputation would also have deterred the Fisher brothers from engaging in the kind of practices described by Klein.

I have not discussed human specificity. I leave the treatment of this subject to Freeland and others. However, I hope that those engaged in these studies will have some regard for the facts.

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<sup>47</sup> Coase, *supra* note 6, at 71.

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