Rent Appropriation and the Labor Law Doctrine of Successorship

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I. Introduction

When there is a change of corporate control in a business enterprise a question arises as to whether the new employer should be bound by the predecessor’s collective bargaining relationship with the union representing the predecessor’s employees. This is known as the successorship problem in labor law. Successorship doctrine is complex and controversial. Several commentators have attempted to reconcile Supreme Court decisions and to ascertain the assumptions underlying the Court’s opinions in this area. This

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1 The term successorship defines an employer’s legal status and obligations when that employer acquires all or part of an existing business and maintains “substantial continuity of identity in the business.” John Wiley & Sons, Inc. v. Livingston, 376 U.S. 543, 551 (1964). More generally, the term “successor” refers to an employer who acquires ownership of the business enterprise whether by stock purchase, merger or acquisition of assets.

For purposes of simplification, “successor” is used to describe an employer who obtains control of a business by virtue of a simple change in ownership.

2 E.g., J. ATLESON, VALUES AND ASSUMPTIONS IN AMERICAN LABOR LAW 160-70 (1983) (identifying the inconsistencies present in the Court’s opinions and labeling the area of successorship jurisprudence as “excruciatingly complex”); Benetar, Successorship Liability Under Labor Agreements, 1973 Wis. L. REV. 1026, 1036-37 (emphasizing national labor relations policy to balance conflicting interests by establishing rights and duties of the employment relationship rather than by automatically imposing a duty on successor employers to honor a predecessor’s union contract); Doppelt, Successor Companies: The NLRB Limits the Options—and Raises Some Problems, 20 DE PAUL L. REV. 176, 179 (1971) (arguing that successorship rules should promote stable industrial relations by not requiring employees to demonstrate continually their union desires); Morris & Gaus, Successorship and the Collective Bargaining Agreement: Accommodating Wiley and Burns, 59 VA. L. REV. 1359, 1383-85 (1973) (reconciling case law by
Article does not attempt to do this, although paradoxically, the arguments presented may lead to reconciliation of many of the Supreme Court's decisions relating to successorship. Instead, this Article examines the theoretical basis for a successorship rule.

Previous writing in this area has assumed that because successorship obligations will almost always attach if a majority of the predecessor's employees are retained, successorship doctrine's justification rests in its ability to provide a more stable regime for the expression and realization of employee preferences. We contend that the theoretical justification for successorship doctrine is not to be found in a general desire for outcomes which provide a stable reflection of employee sentiments. Instead, successorship doctrine is better explained and justified via a rent appropriation analysis. In certain settings employers and employees have incentives to enter into explicit or implicit contracts under which a part of an employee's compensation is postponed. Obviously, an employer can gain by reneging on such an agreement, thereby appropriating rents to which the employees have earned a claim. Incentives to renege greatly increase during a change in ownership. Successorship rules can control these incentives.

In addressing successorship doctrine we depart from the traditional price-fixing cartel model frequently found in the literature and present a rent-

differentiating between arbitration and NLRB proceedings); Severson & Wilcoxon, Successorship Under Howard Johnson: Short Order Justice For Employees, 64 CALIF. L. REV. 795, 843 (1976) (asserting that the Supreme Court's attempts to refine the substantial continuity of identity test instead circumscribed the successorship doctrine).


An alternative justification is that the doctrine promotes industrial peace. George, supra, at 299-300 (proposing an industrial peace justification as an alternative to the employee preference justification); Goldberg, The Labor Law Obligations of a Successor Employer, 63 NW. U.L. REV. 735, 743-45 (1969) (stating that the avoidance of industrial strife by protecting employees from employer's conduct is the basis of successorship doctrine). Because the industrial peace justification is vague and extremely flexible, it is difficult to say that it is inconsistent with the justification presented in this Article.

4 Rent represents the excess earned over the opportunity wage. The opportunity wage is the wage the worker would receive in his most rewarding alternative activity. For example, if an employee receives ten dollars for each hour of work at his present job, and would receive five dollars per hour at his highest paying alternative activity, then the rent earned by the employee equals five dollars. See generally S. FISCHER & R. DORNBUSCH, ECONOMICS 326-27 (1983) ("An economic rent is the amount of payment to a factor of production that exceeds the minimum amount that would have to be paid to get that quantity of the factor supplied to this particular use.").

5 See Campbell, Labor Law and Economics, 38 STAN. L. REV. 991, 1006-07 (1986) (defining labor unions as monopolistic entities acting to manipulate wages and
protecting union model. Using rent appropriation theory, we analyze the costs and benefits of alternative successorship rules. We conclude that successorship doctrine should be simplified and made slightly more restrictive by requiring a new employer to honor a predecessor's labor contract whenever a change of ownership occurs through a merger or purchase of stock.\(^6\) When change of ownership occurs through an asset sale, then current successorship doctrine should apply with one caveat: the substantial continuity test's requirement that a majority of the new employer's work force be former employees of the predecessor should be relaxed.\(^8\) Otherwise, a potential employer who plans to retain only a minority of the predecessor's work force gains an advantage in a contest for acquisition.\(^9\)

Those familiar with successorship doctrine will see that we are not proposing major changes. Rather, we suggest an economic justification for much of existing successorship doctrine. Thus, even though this Article sets out to describe an optimal successorship policy, it also offers a positive economic theory of current successorship doctrine.


\(^6\) Under current doctrine, if the purchase is via stock transfer and major structural changes result, there is no obligation to honor the predecessor's agreement with the union. *See infra* notes 53-92 and accompanying text.

\(^7\) See infra text accompanying notes 83-85 (defining the substantial continuity test).

\(^8\) This suggestion may be problematic due to its apparent inconsistency with section 9(a) of the National Labor Relations Act. 29 U.S.C. § 159(a) (1988) (providing that a majority of employees in the bargaining unit can determine whether to join the union). *See NLRB v. Burns Int'l Sec. Serv., Inc.*, 406 U.S. 272 (1972) (stating that when a bargaining unit remained unchanged and a majority of the employees hired by the new employer were represented by a certified bargaining agent, the NLRB correctly followed Section 9(a) by ordering the new employer to bargain with the union); *see also* Int'l Ass'n of Machinists & Aerospace Workers v. NLRB, 595 F.2d 664, 669 (D.C. Cir. 1978) (stating that a union representing a majority of the employees in an appropriate bargaining unit may compel the employer to negotiate with respect to the terms and conditions of employment applicable to the unit); *Pacific Hide & Fur Depot, Inc. v. NLRB*, 553 F.2d 609, 611-12 (9th Cir. 1977) (stating that when fewer than a majority of a successor's employees belonged to a predecessor's union and no anti-union animus was present, the purchaser was not under a duty to bargain with the union). *But see* John Wiley & Sons, Inc. v. Livingston, 376 U.S. 543, 551 & n.5 (1964) (“The fact that the Union does not represent a majority of an appropriate bargaining unit . . . does not prevent it from representing those employees who are covered by the agreement in dispute . . . .”).

\(^9\) See infra text accompanying notes 139-53 (discussing the incentives under current successorship doctrine).
view, the goal of successorship doctrine is to frame background rules that govern compliance with labor contracts when ownership is transferred. Three different rules are possible: first, a rule that requires the successor employer to honor the predecessor's labor contract; second, a rule that imposes no restrictions on the successor employer; and third, a rule that partially restricts the successor's freedom without requiring the successor to honor the predecessor's contract. We adopt the first rule and conclude that a successor employer should honor the predecessor's labor contract because of informational disparities favoring the predecessor employer and the likelihood that unions will undervalue explicit successorship clauses due to the uncertainty of their enforceability. Where ownership transfers occur through asset sales, however, we argue that such a rule should not apply because it would act as a tax on asset transfers and discourage wealth-enhancing asset transfers.  

Part II of this Article provides a brief summary and background discussion of successorship doctrine. Parts III and IV contain a simple presentation of the rent appropriation problem and its implications for successorship doctrine. Part V, examines the costs and benefits of alternative successorship rules.

II. SUCCESSORSHIP DOCTRINE

A. Background and Development

The modern successorship era began with the Supreme Court's decision in John Wiley & Sons, Inc. v. Livingston, which marked a dramatic departure from prior successorship cases. Wiley involved a small publishing company, Interscience Publishers, Inc. ("Interscience"), which merged with Wiley & Sons, Inc. ("Wiley"). As a result of the merger Interscience ceased to exist. Claiming that Wiley was obligated to recognize the rights

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10 If an asset is transferred from one use to another—for example, if the owners of a gas station decide to use part of the station's property as a parking lot—it is reasonable to infer that the new use is one in which the asset is considerably more valuable. Thus, a tax which applies to such transfers is likely to have a greater impact the more profitable (or wealth-enhancing) the transfer.

11 376 U.S. 543 (1964) (holding that the rights of employees under a collective bargaining agreement are not automatically lost by the disappearance, through merger, of the employer, and, in appropriate circumstances, the successor employer may be required to arbitrate under the contract).

12 See generally Goldberg, supra note 3, at 735 (describing the changes in successorship doctrine brought about by Wiley). Before Wiley, the NLRB and federal courts had repeatedly held that a labor contract does not survive a change in enterprise ownership.

13 Wiley, 376 U.S. at 545. Wiley employed some 300 people. About 40 of Interscience's 80 employees were covered by a collective bargaining agreement which provided for arbitration.

14 Id.
of Interscience employees under the existing agreement, the Union brought suit under section 301 of the Labor Management Relations Act\textsuperscript{15} (the "LMRA") to compel arbitration.\textsuperscript{16} These rights, the Union argued, included such things as seniority, pension contributions and severance pay.\textsuperscript{17}

Agreeing with the Union that Wiley was obligated to arbitrate regarding the alleged rights, a unanimous Supreme Court held that the arbitration provisions of a collective bargaining agreement survive a merger because employees must be protected from sudden changes in the employment relationship resulting from a regime that allows employers the unfettered right to acquire and divest themselves of business enterprises.\textsuperscript{18} Additionally, the Court stated that where a "substantial continuity of identity in the business enterprise" exists, a successor employer will be obligated to arbitrate with the union according to the terms of the bargaining agreement.\textsuperscript{19}

In \textit{NLRB v. Burns International Security Services, Inc.},\textsuperscript{20} the Supreme Court appeared to back away from Wiley and the strong presumption favoring arbitration. The dispute in Burns arose when a security contract between the Wackenhut Corporation ("Wackenhut") and Lockheed Aircraft Service Company ("Lockheed") expired.\textsuperscript{21} Under the arrangement with Lockheed, Wackenhut had provided security guards represented by the recently certified United Plant Guard Union (the "UPG").\textsuperscript{22} Lockheed solicited bids for a new security contract and eventually awarded it to Burns International Security Services ("Burns").\textsuperscript{23} Burns provided Lockheed with a unit of forty-two guards, twenty-seven of whom were former Wackenhut employees.\textsuperscript{24} Burns refused a request from the UPG for recognition, recognizing instead the American Federation of Guards which already represented other Burns employees.\textsuperscript{25}

\textsuperscript{16} Wiley, 376 U.S. at 545.
\textsuperscript{17} Id.
\textsuperscript{18} Id. at 549.
\textsuperscript{19} Id. at 550-51. The Court did not provide a test for determining "substantial continuity of identity," but found continuity in Wiley as a result of the "similarity and continuity of operation across the change in ownership [which] is adequately evidenced by the wholesale transfer of Interscience employees to the Wiley plant, apparently without difficulty." Id.
\textsuperscript{20} 406 U.S. 272 (1972) (stating that while successor employers may be bound to recognize and bargain with the incumbent union, they are not bound by the substantive provisions of a collective bargaining agreement negotiated by their predecessors but not agreed to or assumed by them).
\textsuperscript{21} Id. at 274-75.
\textsuperscript{22} Id. at 274.
\textsuperscript{23} Id. at 275.
\textsuperscript{24} Id. at 274.
\textsuperscript{25} Burns, 406 U.S. at 275-76.
The UPG alleged violations of sections 8(a)(2)\textsuperscript{26} and 8(a)(5)\textsuperscript{27} of the LMRA,\textsuperscript{28} claiming that Burns' recognition of the American Federation of Guards was unlawful, and that its failure to honor the Wackenhut contract resulted in an unlawful, unilateral change in employment conditions.\textsuperscript{29} The National Labor Relations Board (the "NLRB") determined that Burns was a successor employer and, as such, was obligated to recognize and bargain with the former Wackenhut employees' union representative.\textsuperscript{30} Relying on the Wiley decision, the NLRB further required Burns to adopt the substantive terms of the UPG's agreement with Wackenhut.\textsuperscript{31} The Supreme Court agreed with the NLRB that "where the bargaining unit remains unchanged and a majority of the employees hired by the new employer are represented by a recently certified bargaining agent there is little basis for faulting the [NLRB's] implementation by ordering the employer to bargain with the incumbent union."\textsuperscript{32}

As far as Burns' duty to bargain with the Union, the Supreme Court held that the duty arose when Burns hired a majority of holdover Wackenhut employees.\textsuperscript{33} In other words, Burns was free to establish initial terms and conditions of hiring. But, when a majority of the new work force came to consist of "holdover" employees and there was "substantial continuity" in the business enterprise, Burns became a successor and had to bargain. Notwithstanding this general rule,\textsuperscript{34} the Court noted that there may be times when it is "perfectly clear" that the successor employer intends to retain all of the predecessor's employees, and "it will be appropriate to have him initially consult with the employees' bargaining representative before he fixes terms."\textsuperscript{35}

In an apparent departure from Wiley, the Court concluded that Burns was under no obligation to assume the substantive terms of the Wackenhut-UPG contract.\textsuperscript{36} Specifically, the Court interpreted section

\textsuperscript{26} 29 U.S.C. § 158(a)(2) (1982) (providing that an employer who "dominate[s] or interfere[s] with the formation or administration of any labor organization" engages in an unfair labor practice).
\textsuperscript{28} Burns, 406 U.S. at 276.
\textsuperscript{29} Id.
\textsuperscript{30} Id.
\textsuperscript{31} Id. at 285.
\textsuperscript{32} Id. at 281.
\textsuperscript{33} Burns, 406 U.S. at 281.
\textsuperscript{34} Hereinafter, this will be referred to as the "substantial continuity of identity test."
\textsuperscript{35} Burns, 406 U.S. at 294-95.
\textsuperscript{36} Id. at 291 ("We accordingly set aside the Board's finding . . . as it rested on a conclusion that Burns was required to but did not honor the collective-bargaining agreement executed by Wackenhut.").
8(d)\textsuperscript{37} as prohibiting the NLRB from imposing substantive terms on an employer who was not a party to the contract.\textsuperscript{38} The Court distinguished Wiley, noting that, unlike Burns, that case involved a suit to compel arbitration under section 301 and that the Court had been particularly concerned with encouraging arbitration.\textsuperscript{39}

In 1973, the Court once again examined the obligations of a successor employer, this time in the context of liability for the unfair labor practices of the predecessor. In Golden State Bottling Co. \textit{v.} NLRB,\textsuperscript{40} the successor employer had purchased a beverage bottling and distribution operation with the knowledge that the predecessor had been ordered by the NLRB to rehire and compensate a former employee.\textsuperscript{41} The NLRB determined that the successor employer was obligated to rehire the individual and was jointly liable for the back pay award.\textsuperscript{42} The Supreme Court agreed, noting that industrial peace and reasonable employee expectations require that a successor with knowledge of outstanding unfair labor practices be required to remedy them.\textsuperscript{43}

One year later, the Court effectively overruled Wiley in \textit{Howard Johnson Co. v. Detroit Local Joint Executive Board, Hotel & Restaurant Employees}.\textsuperscript{44} \textit{Howard Johnson} concerned a section 301 action brought by the Hotel and Restaurant Employees Union to compel arbitration by the new owner, Howard Johnson Co., ("Howard Johnson") under the predecessor's contract.\textsuperscript{45} In reversing the Sixth Circuit's order to arbitrate, the Court determined that there was no substantial continuity of identity in the work force since the predecessor's employees did not constitute a majority of the new complement of employees, and therefore, Howard Johnson had no duty to arbitrate.\textsuperscript{46} Furthermore, the Court disavowed the distinction made in Burns between an unfair labor practice proceeding and a section 301 action.\textsuperscript{47} The

\begin{footnotesize}
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\item 29 U.S.C. § 158(d) (1988) (providing that the obligation to bargain "does not compel either party to agree to a proposal or require the making of a concession").
\item Burns, 406 U.S. at 285-87 (distinguishing a duty to bargain from agreement with a collective-bargaining contract).
\item Id. at 286 ("The present case does not involve a § 301 suit; nor does it involve the duty to arbitrate.").
\item 414 U.S. 168 (1973).
\item Id.
\item Id. at 171.
\item Id. at 184-85 ("To the extent that the employees' legitimate expectation is that the unfair labor practices will be remedied, a successor's failure to do so may result in labor unrest . . . ").
\item 417 U.S. 249 (1974).
\item Id. at 252-53.
\item Id. at 263-65. The new employer had hired a total of only 9 former employees out of the 45 required to operate the business. Id. at 252.
\item Id. at 252, 255-56 (stating that the distinction must not lead to a disregard of the fundamental policies outlined in Burns).
\end{enumerate}
\end{footnotesize}
Court did, however, suggest that the Union might have moved to enjoin the predecessor from selling its assets to Howard Johnson on the grounds that the sale constituted a breach of the successorship clause contained in the collective bargaining agreement.\textsuperscript{48}

Notably, the majority pointedly contrasted the merger in Wiley with the straightforward sale of assets in Howard Johnson.\textsuperscript{49} In prior successorship cases the Court had never treated the nature of the underlying corporate transaction as a relevant consideration. Indeed, in Golden State, the Court refused "to adopt a mode of analysis requiring the [NLRB] to distinguish among mergers, consolidations, and purchases of assets . . . so long as there is a continuity in the employing industry . . . ."\textsuperscript{50} The emphasis on the nature of the underlying transaction in Howard Johnson, however, was relatively minor and proved to be short-lived.\textsuperscript{51} Ultimately, instead of adopting transaction-specific guidelines for applying the successorship doctrine, the Court focused on whether the predecessor survived the change in control.\textsuperscript{52}

B. The Current State of Successorship Doctrine: Fall River Dyeing and Finishing Corp. v. NLRB

The Court's opinions in Burns and Howard Johnson teach that the NLRB and federal courts must apply the "substantial continuity of identity" test when determining a successor's obligation in change of ownership cases.\textsuperscript{53} This test, which examines whether there is substantial continuity between the two business enterprises, is based on the facts and circumstances of each situation.\textsuperscript{54} The NLRB considers several factors in its successorship analysis including:

which Wiley must be completely confined to its particular facts. See, e.g., George, supra note 3, at 277 (summarizing the development of the successorship doctrine and examining Fall River Dyeing & Finishing Corp. v. NLRB, 482 U.S. 27 (1987), and its contribution to successorship principles); Note, The Bargaining Obligations of Successor Employers, 88 HARV. L. REV. 759 (1975) (examining the uncertainty about what circumstances warrant imposition of the predecessor's duty to bargain upon a successor employer and when the obligations attach); Note, The Impact of Howard Johnson on the Labor Obligations of the Successor Employer, 74 MICH. L. REV. 555 (1976) (assessing the impact of Howard Johnson on the labor law obligations of successor employers).

\textsuperscript{48} Howard Johnson, 417 U.S. at 258 n.3.

\textsuperscript{49} Id. at 257 ("Wiley involved a merger . . . . In contrast, this case involves only a sale of some assets . . . .").


\textsuperscript{51} See infra note 90 and accompanying text.

\textsuperscript{52} In Wiley the employer ceased to exist because of a merger, while in Howard Johnson the predecessor survived the sale of assets. Therefore the Court reasoned, because the Union could have pursued a remedy against the surviving predecessor there was no obligation to arbitrate. Howard Johnson Co. v. Detroit Local Joint Executive Bd., Hotel & Restaurant Employees, 417 U.S. 249, 257-58 (1974).

\textsuperscript{53} See supra text accompanying notes 20-39, 44-52.

\textsuperscript{54} Fall River Dyeing & Finishing Corp. v. NLRB, 482 U.S. 27, 43 (1987).
(1) whether there has been a substantial continuity of the same business operations; (2) whether the new employer uses the same plant; (3) whether he has the same or substantially the same work force; (4) whether the same jobs exist under the same working conditions; (5) whether he employs the same supervisors; (6) whether he uses the same machinery, equipment, and methods of production; and (7) whether he manufactures the same product or offers the same services.55

The substantial continuity of identity test incorporates the requirement that there be continuity of the workforce. Thus, to satisfy the test the successor employer must have hired a majority of the predecessor's employees.56 The NLRB has adopted the "substantial and representative complement rule for fixing the moment when the determination as to the composition of the successor's work force is to be made."57 If at the moment fixed by the substantial and representative complement rule a majority of the new employer's workers had been employed by the previous employer then

56 The majority requirement can be interpreted in two ways. One method requires the successor employer to honor the predecessor's labor contract if the successor hires a majority of the previous employer's employees. The other acknowledges such an obligation only if the majority of the new employer's workers were employed by the previous employer. For example, suppose the previous employer had 30 employees and the new employer has 90 employees, 30 of whom were on the predecessor's payroll. Under the first method of determining continuity of the workforce, the new employer would have a duty to bargain. Under the second method, however, the new employer would not have a duty to bargain.


It is unclear whether suits to compel arbitration under section 301 are governed by the first or second method of interpretation. See A.B.A., The Developing Labor Law 359 (2d ed. 1983 & Supp. 1989) ("Cases brought under Section 301 have failed to clarify or confirm earlier holdings that the Howard Johnson formulation of the majority test should be applied to determine successorship in Section 301 suits.").

57 Fall River Dyeing & Finishing Corp. v. NLRB, 482 U.S. 27, 47 (1987); see also NLRB v. Jeffries Lithograph Co., 752 F.2d 459 (9th Cir. 1985) (suggesting five criteria to consider under the substantial and representative complement rule:

1) whether job classifications are substantially filled; 2) whether normal production has resumed; 3) the size of the complement of employees on the normal production date; 4) the amount of time that will elapse before a larger complement will be at work; and 5) the relative certainty of the employer's expansion.")
the successor has an obligation to bargain with the union that represented these employees."\textsuperscript{58}

The Court applied these doctrines in Fall River Dyeing & Finishing Corp. v. NLRB.\textsuperscript{59} This case concerned the Sterlingwale Corporation ("Sterlingwale"), a textile dyeing and manufacturing plant in Fall River, Massachusetts. Sterlingwale laid off all of its production employees in February, 1982 after some thirty years in business.\textsuperscript{60} The company retained a skeleton crew in order to complete remaining orders and to maintain its buildings and machinery.\textsuperscript{61} For many years, Sterlingwale's employees had been represented by the United Textile Workers of America ("the UTW").\textsuperscript{62} The most recent employment contract expired on April 1, 1982 and embodied several concessions made by the UTW in response to Sterlingwale's financial problems.\textsuperscript{63} In the summer of 1982, Sterlingwale went out of business, making an assignment for the benefit of its creditors and hiring a professional liquidator to dispose of its assets.\textsuperscript{64} A new company, Fall River Dyeing & Finishing Corporation ("Fall River"), was formed "with the intention of engaging strictly in the commission-dyeing business and of taking advantage of the availability of Sterlingwale's assets and workforce."\textsuperscript{65}

In September 1982, Fall River began operating out of its predecessor's facilities and hiring employees.\textsuperscript{66} On October 19, 1982, the UTW requested that Fall River recognize it and commence bargaining negotiations.\textsuperscript{67} Fall River refused—at this time eighteen of its twenty-one employees were former Sterlingwale employees.\textsuperscript{68} By January 1983, Fall River had hired fifty-five employees, a number sufficient to fill one shift.\textsuperscript{69} Of these, thirty-six had worked for Sterlingwale.\textsuperscript{70} By April 1983, Fall River was operating with two full shifts and, for the first time, former Sterlingwale employees were outnumbered fifty-four to fifty-three.\textsuperscript{71}

The UTW filed an unfair labor practice charge with the NLRB alleging that Fall River had violated sections 8(a)(1)\textsuperscript{72} and 8(a)(5)\textsuperscript{73} of the LMRA by

\textsuperscript{58} Fall River, 482 U.S. at 47.
\textsuperscript{59} Id.
\textsuperscript{60} Id. at 30-31.
\textsuperscript{61} Id. at 31.
\textsuperscript{62} Id.
\textsuperscript{63} Id. at 31-32.
\textsuperscript{64} Id. at 32.
\textsuperscript{65} Id.
\textsuperscript{66} Id.
\textsuperscript{67} Fall River, 482 U.S. at 33.
\textsuperscript{68} Id.
\textsuperscript{69} Id.
\textsuperscript{70} Id.
\textsuperscript{71} Id.
\textsuperscript{72} 29 U.S.C. § 158(a)(1) (1988) (providing that an employer who "interfere[s] with, restrain[s], or coerce[s] employees in the exercise of... [their guaranteed] rights" engages in an unfair labor practice).
refusing to bargain. The Administrative Law Judge (the "ALJ") determined that Fall River, as a successor employer, was obliged to bargain with the UTW if it had hired a majority of Sterlingwale employees. Accordingly, the ALJ found that the Union's demand, originally made in October, was "of a continuing nature" and was still effective in January when former Sterlingwale employees constituted a majority of the "representative complement." 

The Court of Appeals for the First Circuit enforced the NLRB's order, noting that "viewed from the employees' standpoint" there was no significant change in business operations. In addition, the court found that both the NLRB's "representative complement" rule and "continuing demand" rule were reasonable and entitled to deference.

The Supreme Court agreed that Fall River was a successor employer and that the Burns holding was not limited to situations in which a union had been recently certified. Moreover, the Court stated, a successor "is under no obligation to hire the employees of its predecessor, subject, of course, to the restriction that it not discriminate against union employees in its hiring." This approach places the potential successor in control of his destiny. The Court next examined the three basic rules the NLRB applies in successorship cases: (1) the "substantial continuity" rule for determining successorship status; (2) the "representative complement" rule for determining when an analysis of the successor's workforce should take place; and (3) the "continuing demand" rule preserving a union's demand to bargain until the "representative complement" is achieved.

The "substantial continuity" test compares the nature of the predecessor's overall enterprise with that of the successor and evaluates each enterprise
from the employees' point of view.83 "This emphasis on the employees' perspective furthers the Act's policy of industrial peace. If the employees find themselves in essentially the same jobs after the employer transition and if their legitimate expectations in continued representation by their union are thwarted, their dissatisfaction may lead to labor unrest."84 Applying the substantial continuity test, the Court compared the nature of Sterlingwale's overall enterprise with that of Fall River. Noting that Fall River continued to manufacture the same product line and that the employees worked at the same jobs and used the same machinery, the Court agreed that there was "substantial continuity" between Sterlingwale and Fall River.85

The Court next turned to the "substantial and representative complement" rule. In upholding the NLRB's application of this rule, the Court noted that the rule was designed to balance the competing interests of maximum employee participation in choosing a bargaining representative and speedy representation for desirous employees.86 Moreover, because the employer is best situated to determine when normal production has begun and most job classifications have been filled, the Court concluded that the "substantial and representative complement" rule is not overly burdensome to employers.87

Last, the Court held that the "continuing demand" rule was reasonable and, given the Union's lack of relationship with the successor, was the only practical way for the Union to trigger a duty to bargain.88 Because unions frequently will not be aware of the status of the successor's operations, many demands may be premature. The Court noted, however, that even a premature demand places "a minimal burden" on a successor who knows that the demand is only effective when a "representative complement" of employees are hired and the predecessor's employees constitute a majority of the workforce.89 The possibility raised in Howard Johnson, of analyzing successorship cases based on the nature of the underlying corporate transaction, did not affect the analysis in Fall River.90

83 Id.; see supra notes 53-57 and accompanying text.
84 Fall River, 482 U.S. at 43-44.
85 Id. at 45. The strongest argument against a finding of substantial continuity was the seven month hiatus before Fall River began operations. The Court did not recognize this fact as "determinative" and concluded that it was "only one factor in the ... calculus and ... relevant only when there are other indicia of discontinuity." Id. at 45. Thus, absent other indications of discontinuity, a hiatus in operations will not serve to defeat a claim of successorship.
86 Id. at 46-48. In applying the substantial and representative complement rule the Board generally looks to see whether the relevant job classifications are full, or substantially full, and whether the enterprise is at, or close to, normal production.
87 Fall River, 482 U.S. at 46-48.
88 Id. at 52.
89 Id.
90 See Howard Johnson Co. v. Detroit Local Joint Executive Bd., Hotel & Restaurant Employees, 417 U.S. 249 (1974); see also supra note 49 and accompanying text.
Justice Powell, joined by Justices Rehnquist and O'Connor, dissented in Fall River. Justice Powell focused on the "overwhelming" evidence of discontinuity including the long hiatus in operations and Fall River's refusal to purchase Sterlingwale's tradename, goodwill, or customer lists. Thus, the dissent suggests that where there is a lengthy interruption in production or other indicia of discontinuity this evidence should bar assertion of successor obligations.

Both the Fall River majority and dissent suggest that the application of the substantial continuity test is likely to be affected by competing functional considerations regarding the social desirability of allowing unfettered freedom to acquire and transfer businesses and the protection of employee expectations. In the remainder of this Article we explore the balance of conflicting interests and examine the theoretical basis for a successorship rule.

III. RENT PROTECTION AND THE UNION

A. A Model of the Rent Protecting Union

We present a model of the union that differs in important respects from the more traditional monopoly union model. The traditional model treats the union as a price-fixing cartel, that is, a combination of workers that uses its monopoly power to push wages above the competitive level. We provide the alternative model of a rent-protecting union, whose primary function is to protect the rent earned by employees from employer efforts to expropriate it through wage reductions.

The function of the rent-protecting union is different from that of the monopoly union. In labor markets, implicit agreements often emerge under which workers are paid, for a period of time, more than their opportunity wages. Such an agreement might be observed in settings in which workers have invested a great deal in firm-specific training.

91 Fall River, 482 U.S. at 57 (Powell, J., dissenting).
92 Id. at 59 ("I would hold that the successorship doctrine has no application when the break in continuity between enterprises is as complete and extensive as it was here.").
93 See Simons, Some Reflections on Syndicalism, 52 J. POL. ECON. 1 (1944) (constructing a traditional monopoly critique of unionism). A well known alternative to the monopoly model views the union as a provider or protector of certain work place public goods such as safety. See Freeman & Medoff, The Two Faces of Unionism, 57 PUB. INTEREST 69 (1974) (challenging the view that unions are organizations whose chief function is to raise wages and asserting that unions have significant nonwage effects which influence diverse aspects of modern industrial life); Hylton & Hylton, Rational Decisions and Regulation of Union Entry, 34 VILL. L. REV. 145 (1989) (identifying monopoly resource misallocation as the key source of social cost and the enhanced provision of work place public goods as the major source of social benefits).
94 This point, and most others concerning the economics of human capital, was originally made by Gary Becker. See G. BECKER, HUMAN CAPITAL (2d ed. 1975). The human capital literature distinguishes firm-specific training, which in the extreme case raises the worker's productivity only within his employer's firm, from general training,
might be observed in settings where loyalty or fidelity to the employer is an important characteristic, and where the employee risks losing the excess over the opportunity wage by shirking or acting in some way counter to the wishes of the employer. In such settings the employee may have “earned” a claim to a stream of rents by sacrificing earnings elsewhere to participate in specialized training, or merely by sacrificing opportunities to satisfy his desires in order to carry out the employer’s program. The employer may, under certain conditions, however, have an incentive to renege on the implicit promise to provide a stream of rents as compensation for earlier sacrifices by the employees. It is to prevent this kind of opportunism that the union exists under the rent-protecting model.

We do not assert that the rent-protecting model is the correct or most appropriate description of the union. Rather, we emphasize this alternative which raises the worker’s productivity by the same amount in all firms that could employ the worker. See Wachter & Cohen, The Law and Economics of Collective Bargaining: An Introduction and Application to the Problems of Subcontracting, Partial Closure, and Relocation, 136 U. PA. L. REV. 1349, 1362-64 (1988) (presenting a clear discussion of the relationship between wages and marginal product in a model of firm-specific training).

See Becker & Stigler, Law Enforcement, Malfeasance, and the Compensation of Enforcers, 3 J. LEGAL STUD. 1 (1974) (arguing that where detection is uncertain, corrupt law enforcement can be discouraged by raising the salaries of enforcers above what they could get elsewhere by an amount inversely related to the probability of detection and directly related to the size of bribes and other benefits from malfeasance); Lazear, Agency, Earnings Profiles, Productivity, and Hours Restrictions, 71 AM. ECON. REV. 606 (1981) (arguing that it is optimal to construct age-earnings profiles which pay workers less than the value of marginal products (“VMP”) when they are young and more than the VMP when they are old); Lazear, Why is There Mandatory Retirement?, 87 J. POL. ECON. 1261 (1979) (exploring explanations for termination of older employees rather than reduction in wages commensurate with marginal output).

See G. BECKER, supra note 94, at 26-37.

See Klein, Crawford, & Alchian, Vertical Integration, Appropriable Rents, and the Competitive Contracting Process, 21 J.L. & ECON. 297, 315-16 (1978) (suggesting that the existence of a union not only makes it more costly for a firm to cheat an individual worker in his last pay period due to strike threat, but that the union’s existence also makes it more costly for an individual worker to cheat the firm because the union has the incentive to prevent such an externality on the continuing workers); Williamson, Wachter, & Harris, Understanding the Employment Relation: The Analysis of Idiosyncratic Exchange, 6 BELL J. ECON. & MGMT. SCI. 250, 269-70 (1975) (arguing that opportunistic bargaining not only absorbs resources, but delays and possibly forgoes efficient adaptations within the internal labor market system); see also Alchian, Decision Sharing and Expropriable Specific Quasi-Rents: A Theory of First National Maintenance Corporation v. NLRB, 1 SUP. CT. ECON. REV. 235, 243-44, (1982) (“[o]ne function of labor unions is to act as agents for employees in labor contract monitoring, dispute, and negotiations’’); Lande & Zerbe, Reducing Unions’ Monopoly Power: Costs and Benefits, 28 J.L. & ECON. 297, 300 (1985) (arguing that unions may enhance the credibility of workers and ensure performance of long term contracts while also providing a credible threat against companies that attempt opportunistic behavior).
to the monopoly model because it has not been discussed or rigorously applied previously and, more importantly, because it provides a strong foundation for arguments that seek to limit the discretion of successor employers by taking into consideration the "legitimate expectations" of employees. Our model of the Rent-Protecting Union is illustrated by the following example. Assume Apple Corporation ("Apple") grows and sells apples. The employees of Apple are members of the Union of Apple Pickers (the "UAP"). The wages received by the union members total $5,500 per day. If the members of the UAP were to leave Apple and take the next best available work, they would receive a total of $1,000 per day. Apple's revenue is $8,500 per day.

Apple has invested a great deal in employee training. The total training cost, amortized, is $4,000 per day. Moreover, because Apple is the only corporation which uses the methods taught to its workers, the training is "firm-specific." Thus, following the human capital literature we will assume that the training cost is shared between the employer and the employees, with Apple's share of the amortized training cost equal to $1,000 per day, and UAP's share equal to $3,000 per day.

The "appropriable rent" earned by the union is $4,500 ($5,500 - $1,000). This is approvable by the employer because the employer can lower the amount paid to the union to any level greater than $1,000 and still retain the workers. Similarly, the approvable rent earned by the employer is $3,000 ($8,500 - $5,500 - $1,000), because the union can raise its total take to any amount less than $8,500 and still retain the work.

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98 Court opinions in this area often phrase the general problem of determining an ideal successorship rule in the form of a balancing test. See, e.g., Golden State Bottling Co. v. NLRB, 414 U.S. 168, 184 (1973) (construing the Board's order to reinstate an employee with back pay as an "equitable balance"); NLRB v. Jeffries Lithograph Co., 752 F.2d 459, 463 (9th Cir. 1985) ("If the Board and the courts failed to bind a successor to the labor law obligations of the predecessor, then the successor could deprive employees of the benefits they previously had won through collective action—a move that might disrupt industrial peace by disappointing workers' legitimate expectations ... ").

99 See G. BECKER, supra note 94, at 26-37 (defining firm-specific training).

100 Id. (stating that, in the context of firm-specific training, firms do not pay all training costs or collect all returns, but instead share both with employees).

101 Under these assumptions the union's "economic profit" is $1,500 per day ($5,500 - $1,000 - $3,000). The employer's economic profit is $2,000 per day ($8,500 - $5,500 - $1,000). Economic profit is defined generally as the difference between revenue and the opportunity cost of resources used. See R. LIPSEY, P. STEINER, & D. PURVIS, ECONOMICS 168 (8th ed. 1987). However, it is easier to understand economic profit as the amount above the minimum required to supply any service.

102 See Klein, Crawford, & Alchian, supra note 97, at 298 (defining the term "appropriable quasi-rent" and distinguishing quasi-rent from economic rent); see also supra note 4. For the sake of simplicity and clarity we will substitute economic profit for economic rent and rent for quasi-rent.
B. Opportunism and the Role of the Union

The role of the union in the above illustration is to protect the wages of the employees from opportunistic, competitive wage cutting by the employer. Because the employees earn a substantial appropriable rent the employer has an incentive to recoup part of that rent by reducing wages. If the employees were not unionized the employer's task might be facilitated. For example, the employer could inform each worker that demand conditions have recently worsened, and that only those employees who accept wage cuts will be retained. Because employees usually rely on their employer's assessment of demand conditions, this statement might be sufficient to engage employees in a round of competitive wage cutting. The employer then has a further incentive to try this maneuver repeatedly until wages are driven as low as possible. A union can prevent such wage reduction by requiring the employer to keep wages fixed and instead reduce total hours in response to a downturn in demand. In addition, the union could seek to increase employees' wages by appropriating the rent earned by the employer. For example, if the union strikes at apple-picking time the employer might be forced to accept wage demands since there is little time to find substitute employees.

The story of the employment relationship presented here depicts the phenomenon of equalizing bargaining power. Unions equalize bargaining power by overcoming the incentive structure under which each employee is compelled to undercut fellow employees and by changing the setting from one in which only the employer can appropriate rent to one in which both parties, employer and union, have this power.

IV. A Preliminary Analysis of Successorship Rules

The Supreme Court has referred to the "free transfer of capital" as a factor to be considered in shaping successorship doctrine. Although this

103 See Hart, Optimal Labour Contracts Under Asymmetric Information: An Introduction, 50 REV. ECON. STUD. 3 (1983) (emphasizing the fundamental informational asymmetry between employer and employee). According to the literature, unemployment results from an optimal, implicit contract between the employer and employee that arises in a situation in which only the employer knows the state of demand for the firm's product. The optimal contract requires the employer to lay off the employee during a downturn, thus providing a disincentive to the employer to report false demand declines in return for reduced wages.

104 See, e.g., Wachter & Cohen, supra note 94, at 1355 (making a similar hours for wages argument).

105 The claim that unions equalize bargaining power has been an important justification for labor organization. See, e.g., American Steel Foundries v. Tri-City Cent. Trades Council, 257 U.S. 184, 204 (1921) (interpreting the Clayton Act to allow a union to encourage a peaceful strike against an employer).

concept has not been carefully articulated, the Court's opinions reflect a concern that a restriction on the successor employer's freedom to hire might impede the transfer of assets to higher-valuing users and ultimately work against the employee's interests.\textsuperscript{107} For example, a doctrine which placed severe restrictions on successor employers might reduce the incentives entrepreneurs have to take over failing businesses.\textsuperscript{108}

This concern appears inconsistent with the Coase theorem.\textsuperscript{109} As long as the rule governing the successor employer is unambiguous, successorship doctrine should have no effect on the mobility of capital. A rule giving the successor employer complete freedom in hiring results in corporate transfers occurring at one price level, while a rule denying freedom to the successor leads to transfers occurring at another, presumably lower, price level.\textsuperscript{110} Furthermore, the efficient successorship rule would be observed because the parties to a corporate transfer could always contract around an inefficient successorship rule.\textsuperscript{111} Therefore, capital would be equally mobile whether the regime denies the successor employer complete freedom with respect to hiring decisions or gives the successor an unfettered right to choose his or her employees.

Since transaction costs and informational disparities are endemic to real-world markets, we will not end our analysis of the successorship problem with a statement of the Coase theorem. Instead, we present a more careful analysis of the underlying economic issues in the remainder of this Part. This analysis focuses on the issues raised by the rent-protecting model of unions discussed in the previous Part.\textsuperscript{112} We note that this model of the union, and of firms generally, is restrictive in that it excludes the role of non-human capital in production. Nevertheless, its simplicity allows us to pres-


\textsuperscript{108}See, e.g., id. ("A potential employer may be willing to take over a moribund business only if he can make changes in corporate structure, composition of the labor force, work location, task assignment, and nature of supervision.").

\textsuperscript{109}Coase, The Problem of Social Cost, 3 J.L. & ECON. 1 (1960) (arguing that in the absence of transactions costs, parties to a contract will bargain between themselves and reach an efficient arrangement irrespective of the assignment of legal rights).

\textsuperscript{110}For example, suppose provisions in the existing union contract lower the value of the firm from $25 million to $20 million. Then a successor employer who is free to ignore the provisions would be willing to pay $25 million for the firm, and one who is not would be willing to pay no more than $20 million.

\textsuperscript{111}For example, assume that inefficient provisions in the existing union contract lower the firm's value by $5 million. Assume further, that the union would allow the successor to alter these provisions in exchange for a $2 million total increase in wages. Because the provisions lower the firm's value by an amount that exceeds their value to the union, they are inefficient. Accordingly, the firm's value could be increased by $3 million if the successor transferred $2 million to the workers in exchange for the elimination of the inefficient union contract provisions. In this example, an inefficient successorship rule would require the successor employer to honor the existing contract provisions.

\textsuperscript{112}See supra text accompanying notes 100-05.
ent some of the economic issues more clearly. In Part V, we extend the discussion in several ways, including a consideration of the implications of successorship law for the transferability of capital assets.

A. Incentives Under Alternative Successorship Rules

We now return to the example of the Apple Pickers Union to examine the incentives under alternative successorship rules. To analyze these incentives, one must ask two questions: (1) how much will an interested entrepreneur offer for Apple Corporation and, (2) who, if anyone, gains or loses from the sale? The answers depend on whether the buyer has to honor the UAP's contract. Before examining these questions under current successorship doctrine, we first consider the answers that emerge under the two extreme successorship rules.

1. Requiring the Successor Employer to Honor the Predecessor's Contract

If a successorship rule requires the successor employer to honor the terms of the predecessor's labor contract, the maximum price a prospective successor will offer for Apple will not exceed the present value of an income stream providing $3,000 each day. If the market for ownership is competitive, the buyer will be forced to pay this maximum price. This answer is complicated by the prospect of a future union strike. Thus, a successor employer also will be concerned about the union's reputation. If the union cannot be trusted, the maximum price a successor will offer for Apple will fall to reflect the estimated losses from future strikes.

On the other hand, under a rule requiring the successor employer to

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113 See supra notes 99-102 and accompanying text.
114 At one extreme the successor employer must honor the union's contract with the predecessor employer; at the other extreme, the successor has no such obligation.
115 Recall that Apple's revenue is $8,500 per day and the union payroll is $5,500 per day. See supra text accompanying note 99. More precisely, the price will not exceed the present value of an income stream providing $3,000 each day for the life of the firm. See generally R. Brealey & S. Myers, Principles of Corporate Finance 10-12 (2d ed. 1984) (providing an introductory discussion of present value). For example, let us assume the firm generates income 250 days each year and that the interest rate is 10%. The maximum price offered for Apple Corporation would be $7.5 million (250 X $3,000 / .1) if the firm was expected to exist in perpetuity. Id. at 30-31 (discussing the concept of perpetuities and providing present value formulas for calculating a stream of payments in perpetuity).
116 If the buyer's bid is less than the firm's value then another potential buyer could offer a slightly higher bid and still profit from acquiring the firm.
117 For example, suppose that there is a 50% probability that the union will strike 100 days each year. If the interest rate is 10%, the loss due to strikes would equal $1.5 million (.5 X 100 X $3,000 / .1). Therefore, the maximum price offered for the corporation drops from $7.5 million to $6 million. See R. Brealey & S. Myers, supra note 115, at 30-31.
honor the preexisting union contract, the union would have an incentive to try to appropriate the employer's rent. For example, the union might strike for higher wages as soon as it learned that the predecessor was planning to sell the enterprise. Any union concerns about estranging the predecessor employer would be tempered by the knowledge of the predecessor's imminent departure. This incentive, however, would be offset by two countervailing interests: first, the predecessor employer's interest in receiving the capitalized value of any bargained-for rent under the contract; and second, the union's interest in preserving its reputation which would be tarnished by an opportunistic strike.

Another circumstance in which the union has the incentive to attempt rent appropriation arises if the successor employer tries to change the production process. Because the union's contract with the predecessor employer binds the successor, the incoming ownership would have to pay the union for the right to make changes to the existing contract. The union could use this as an opportunity to transfer part of the employer's rent to itself.

2. Not Requiring the Successor Employer to Honor the Predecessor's Contract

We now consider the case where the successor is under no obligation to honor the predecessor's union contract. Because efficient contracts differ analytically from inefficient contracts, we discuss these two possibilities separately.

118 Unions have an incentive to resist any wage reductions sought by the successor, especially where the successor is forced to face several unions. In this situation, each union has an incentive to hold out and let the other unions bear the costs of concession. This incentive to resist wage reductions is further exacerbated by a successorship rule requiring the new employer to honor the predecessor's contract.

119 But see Benson, Union Democracy and the Landrum-Griffin Act, 11 N.Y.U. REV. L. & SOC. CHANGE 153 (1982-83) (describing how union leadership is often so entrenched with pursuing its own goals that it is unresponsive to the wishes of its membership and fails to pay attention to the union's reputation); Klein, Crawford, & Alchian, supra note 97, at 314-15 n.34 (arguing that union leaders have little incentive to protect the union's reputation unless markets exist in which union leadership can be bought or sold).

120 For example, a change in the production process would include situations in which the successor employer changes work assignments.

121 Efficient alterations in the contract could benefit both parties. However, because of strategic behavior, the parties might never reach an efficient agreement. See generally A. Polinsky, AN INTRODUCTION TO LAW AND ECONOMICS 18-20 (2d ed. 1989) (discussing the problems presented by strategic behavior).

122 We assume that the union and the predecessor employer have not signed an agreement requiring the predecessor to transfer the enterprise only to a successor who will honor the union's contract.
(a) Efficient Union Contracts. Under a rule where the successor employer is not bound by the terms of the union’s contract with the previous employer, the potential for rent appropriation provides an incentive to abandon even an efficient union contract. For instance, in our example, by lowering union wages to $1,000 the successor employer can enjoy an extra $4,500 from the Apple acquisition. Thus, the successor will offer a price that will not exceed the capitalized value of an income stream promising $7,500 each day. Each sale would provide a $4,500 per day windfall to be split between the successor and predecessor employers. Because of the potential windfalls resulting from appropriating union rents (holding everything else constant), this rule will generate more frequent transfers than a rule binding the successor to the predecessor’s contract with the union.

It might be argued that the potential for rent appropriation will not necessarily provide an additional incentive to transfer an enterprise because the successor will be concerned about damaging its reputation. If rent is appropriated during a transfer, however, it is unlikely that the successor’s reputation will be harmed even if the appropriation is motivated solely by greed. The transfer of an enterprise is sometimes spurred by unfavorable events that justify concessions from all parties; it is difficult to distinguish rent-appropriating demands from those required to keep the enterprise afloat. Furthermore, in a competitive acquisition market the predecessor is most likely to benefit from any potential rent appropriation. And, because the predecessor is ending the union relationship, it will be relatively unconcerned about a potential loss in reputational capital.

Nevertheless, even if the predecessor employer is less likely to be concerned about reputation, the fear of future liability, or a lingering sense of

123 Recall that we assumed that the union’s wages are $5,500 per day. See supra text accompanying note 99. Thus, by lowering the wages to $1,000 per day, the successor employer gains $4,500 per day.

124 This figure represents Apple’s revenue of $8,500 per day less the reduced union payroll of $1,000 per day. See supra note 115 (describing a present value or capitalization calculation method). If the firm operates 250 days each year and the annual interest rate is 10%, the present value equals $18.75 million (250 × $7,500 / .1).

125 The new daily income stream of $7,500 per day less the original maximum offering price of $3,000 per day equals $4,500. See supra text accompanying notes 115-16.

126 Note, however, that in a competitive acquisition market, the windfall from rent appropriation will generally accrue to the predecessor employer. This is because the potential successor employers will attempt to outbid each other for the assets of the predecessor employer. As a result, the rent appropriation surplus will be reflected in the price paid for the successor employer’s assets.

127 See Shleifer & Summers, Breach of Trust in Hostile Takeovers, in CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES 41-42 (A. Auerbach ed. 1988) (arguing that hostile takeovers are a means of redistributing the ex post rents of employment contracts from employees to owners without violating the loyalty and trust of the incumbent employees).

128 See J. GETMAN & B. POGREBIN, LABOR RELATIONS: THE BASIC PROCESSES,
obligation to its former employees, may compel the outgoing ownership to resist a transfer that is likely to result in rent appropriation. Despite the apparent validity of this argument, it is impossible to say how prevalent such a sense of obligation or fear of liability is among firm management. Moreover, in the face of predecessor resistance a transfer can be effected through a tender offer. Indeed, several commentators have argued that rent appropriation is an important cause of much of the takeover activity observed today.

(b) Inefficient Union Contracts. An alternative approach that favors an unrestrictive successorship doctrine assumes that there are inefficient features in the contract between the union and the predecessor employer. For example, the contract might include staffing requirements which add to production costs without increasing output or enhancing efficiency. Suppose that these inefficient features reduce the value of the enterprise by $500 per day. If the successor employer has the right to ignore such provisions the firm's transfer value is increased, and, upon transfer, the potential appropriation surplus of $4,500 is increased by this $500 efficiency surplus. Thus, the maximum price the successor will offer equals the capitalized value of an income stream promising $8,000 per day ($3,000 + $4,500 + $500).

See R. Frank, Passions Within Reason: The Strategic Role of the Emotions (1988); Akerlof, Loyalty Filters, 73 Am. Econ. Rev. 54 (1983) (arguing that acting out of a sense of obligation may be consistent with rational, self-interested behavior).
In a competitive acquisition market, the benefits arising from the elimination of inefficient provisions, and the costs resulting from the failure to eliminate such provisions, will fall on the predecessor. Thus, if the predecessor employer pays for such provisions by reducing the value of the firm, one might reasonably ask how inefficient provisions could ever appear. The literature has already provided the answer—the firm's owners and managers may have different interests. Moreover, the firm's owners cannot costlessly monitor all of management's actions nor achieve perfect incentive alignment through piece rate schemes or backloading compensation.

Thus, in the course of bargaining with union representatives, management may compromise shareholder interests in order to gain contractual provisions which suit its tastes.

These observations justify allowing a successor to ignore completely the provisions of a predecessor's contract because the elimination of inefficient provisions generates surplus value, which in turn enhances the chance of buyers purchasing firms that would otherwise remain unsold. Therefore, an unrestricted successorship rule provides two distinct benefits: first, it indirectly controls agency costs by generating incentives to transfer corporations in order to eliminate inefficient contractual provisions; and second, it allows for the elimination of inefficient contract terms when such terms threaten the firm and its employees. These benefits, however, should be weighed against the costs generated by the potential for rent appropriation.

$4,500, and the efficiency surplus is $500. See supra notes 99, 102, 123 and accompanying text. Assume, as in the previous examples, that the firm operates 250 days each year and the annual rate of interest is 10%. Then the present or capitalized value of such a stream is $20 million. See supra note 115.

See O. Williamson, THE ECONOMICS OF DISCRETIONARY BEHAVIOR (1964) (postulating that managers direct firm resources to increase their own utility); Alchian, The Basis of Some Recent Advances in the Theory of Management of the Firm, 14 J. INDUS. ECON. 30 (1965) (reviewing several theories of firm management); Jensen & Meckling, Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure, 3 J. FIN. ECON. 305 (1976) (providing a formal analysis of the agency costs and who bears them); see also W. Baumol, BUSINESS BEHAVIOR, VALUE AND GROWTH (1958) (proposing that managers sacrifice profits in order to maximize sales); G. Becker, THE ECONOMICS OF DISCRIMINATION (1971) (explaining that managers sacrifice profits in order to satisfy a "taste" for discrimination); R. Marris, THE ECONOMIC THEORY OF MANAGERIAL CAPITALISM (1964) (explaining that managers sacrifice profits in order to maximize growth).

For example, the managers may prefer expensive nonmonetary benefits such as thick rugs or executive washrooms, or they may desire to associate only with workers of a given race. See G. Becker, supra note 134, at 67. The shareholders might also feel the same way if they were working within the firm, but in most cases they are concerned only with the value of their shares.

Monitoring, backloading wages, and privatization through adoption of a piece rate scheme follow the three general approaches to controlling agency costs. See Becker & Stigler, supra note 95, at 1 (examining the enforcement of legal systems).
Because the successor employer can always condition the purchase of an enterprise on the elimination of inefficient contractual provisions, there is some concern about the desirability of an unrestricted successorship rule. Because inefficient provisions reduce a firm's value, the successor employer should be willing to "buy-out" the union's inefficient provisions, in a transaction that generates wealth for all parties. This suggests that under a successorship rule which requires the successor to honor the terms of the predecessor's contract, the mere existence of inefficient contractual provisions does not necessarily mean that a successor employer will refuse to purchase an enterprise. The only costs resulting under such a rule are those the successor incurs in bargaining for the elimination of inefficient contractual provisions. These transaction costs include the cost of identifying inefficient contractual provisions and the cost of getting the union to make concessions with respect to inefficient provisions. Only the latter costs are relevant, however, because the costs of identification would most likely be incurred by the successor employer under any successorship rule.

3. Summary

Thus far, we have considered the two extremes along a continuum of potential successorship rules: a restrictive rule that requires the successor to honor the predecessor's union contract; and an unrestrictive rule that permits the successor to ignore such a contract, as well as any other union obligations. A restrictive successorship rule encourages the union to attempt appropriation of the predecessor employer's surplus. This incentive, however, is offset by the union's interest in protecting its reputational capital, and by the predecessor employer's interest in obtaining its bargained-for rent under the initial contract.

An unrestrictive successorship rule generates incentives for both the successor and predecessor to appropriate the union's rent, and thereby deny employees anticipated compensation for firm-specific training, or for forgoing opportunities to shirk at the predecessor employer's expense. Because these rent appropriating transfers discourage various investments (such as firm-specific training), an unrestrictive successorship rule increases transfer incentives and concomitantly generates social costs. Arguably, an unrestrictive successorship rule generates social benefits by encouraging corporate transfers that eliminate inefficient contractual provisions, thereby controlling

137 See Dicker, Sale of Assets, Mergers, and Acquisitions: A Management View, in Labor Law and Business Change 169, 171 (S. Estreicher & D. Collins eds. 1988) (suggesting that a purchaser may condition the sale upon obtaining a new collective-bargaining agreement); Doppelt, supra note 2, at 185 ("[A]n employer could deprive employees of valuable contractual gains, including wages, benefits, and job security accumulated only after long struggles.").

138 This is not to say that these costs are trivial. See supra notes 118 & 121 and accompanying text (describing strategic union behavior).
agency costs. This benefit, however, may also be realized, although to a lesser extent, under a restrictive successorship rule.

B. Incentives Under Current Successorship Doctrine

Current successorship doctrine instructs the NLRB to apply the substantial continuity test to determine successorship status. The key question under this test is whether a majority of the successor’s employees were employed by the predecessor. To facilitate our examination of the incentive effects of the substantial continuity test, we will assume that the courts will generally find successor status when a majority of the new employees are former employees of the predecessor.

We now return to the Apple Corporation example. Assume that the successor employer plans to operate the same business and hire the same number of employees. If the purchasing employer hires all of Apple’s employees it becomes a successor under the substantial continuity test, and therefore, has a duty to bargain with the UAP if it wishes to make any changes to the union’s contract with the predecessor. Thus, the successor employer may not be able to appropriate all of the union’s rent. The amount of rent that the successor will be able to appropriate will depend upon the outcome of the bargaining process. Accordingly, the successor’s offering price will equal the capitalized value of an income stream paying $3,000 per day—the price it would pay if it had to honor the predecessor’s contract with the union—plus the value of the union’s rent multiplied by the probability that the successor will be able to appropriate this rent.

Conversely, if the successor hires fewer than half of Apple’s employees, under the simplified substantial continuity test it will not have to bargain with the union, and it can thus appropriate the rent of the remaining employees.

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139 See supra text accompanying notes 53-57 and notes 82-85.
140 See Dicker, supra note 137, at 172-73 (stating that the most significant factor is whether a majority of the new employer’s bargaining unit employees were members of the predecessor’s unit); Estreicher, supra note 128, at 72 (“a majority of the purchaser’s employees must come from the ranks of the predecessor’s workforce”); George, supra note 3, at 279 (stating that work force continuity generally determines successorship status); see also Fall River Dyeing & Finishing Corp. v. NLRB, 482 U.S. 27, 47 (1987) (“If . . . a majority of the successor’s employees had been employed by its predecessor, then the successor has an obligation to bargain . . . .”).
141 See supra text accompanying notes 99-102.
142 See Fall River Dyeing & Finishing Corp. v. NLRB, 482 U.S. 27, 43 (1987) (setting forth the rules under the substantial continuity test); see also text accompanying notes 82-84.
143 For example, suppose the rent earned by the union is $1,000 per day. Then if the interest rate is 10%, and the firm operates 250 days each year, the present value of the stream of rents (in perpetuity) is \((250 \times \$1,000 / .1) = \$2.5\) million.

If the probability that the union’s rent can be appropriated is .5, the maximum price an acquiring employer would be willing to offer is \$7.5\ million (the present value of \$3,000 per day) plus \$1.25\ million (\(.5 \times \) the present value of \$1,000 per day).
employees. The successor employer who takes this action, however, will lose the value of the unhired majority's experience while gaining the rent appropriated from the retained minority. This is an undesirable trade-off if the employees are equally productive. For example, assume that Apple Corporation employs 100 workers, each with a post-training marginal product equal to sixty-five dollars per day. Recall that the pretraining marginal product—as reflected by the amount the employees would gross if they were to leave Apple for another firm—is ten dollars. If the successor retains only thirty employees the maximum gain is $1,350 and the minimum loss is $3,850. Thus, the potential successor will offer less than the $3,000 per day price that would be offered by an employer bound by the original contract. Therefore, an employer who plans to hire less than half of Apple's former employees is likely to lose a bidding contest to an employer planning to hire all of the employees and operate under the existing agreement.

If the employees of Apple are not equally productive, however, the substantial continuity test creates profit opportunities for the successor. For example, assuming that the new employer retains forty employees who each contribute $110 per day and refuses to hire the remaining sixty, who each contribute thirty-five dollars per day, then the appropiable rent is $1,800. The minimum loss from forfeiting the experience of the remaining sixty, however, is $1,500. In this case, it is possible for the successor to gain from retaining only a minority of the predecessor's employees and appropriating the rent earned by that minority. The potential successor, therefore, might offer a buying price that is greater than that offered by an employer who plans to hire 100% of the predecessor's employees.

Note that the successor will be held in violation of the section 8(a)(3) prohibition against discrimination of union members if the predecessor's employees prove that the successor refused to hire them solely to avoid recognizing the union. Phelps Dodge Corp. v. NLRB, 313 U.S. 177, 187 (1941). We assume, however, that the successor can find a way of hiring a minority of the predecessor's employees without revealing a discriminatory intent.

See supra text accompanying notes 98-100 (stating that if the members of the UAP were to leave Apple they would collectively receive $1,000—$10 for each of the 100 employees).

Recall that the appropiable rent is $4,500 per day. See supra note 123 and accompanying text. If there are 100 employees then the appropiable rent per employee is $45. Thus, the maximum gain from retaining 30 employees equals $1,350 (30 employees × $45 appropiated rent per employee). The minimum loss equals $3,850 (70 employees × ($65 − $10)), where $65 − $10 is the net loss in marginal product experienced by substituting an untrained worker for a trained one. Note that this is a minimum because the employer may have to train the new employees as well.

See supra text accompanying note 115.

Note that this averages to $65 per day for the 100 union members.

This figure represents 40 × $45 of appropiable rent per employee. See supra note 146.

The net productivity loss, $35 − $10, multiplied by 60 equals $1,500.
For example, suppose that the successor is able to appropriate all of the rent going to the forty high-productivity employees and suffers no more than the loss of forfeiting the experience of the sixty low-productivity employees. Then the successor will offer, at most, a price equal to the capitalized value of $3,300 per day ($3,000 - $1,500 + $1,800).\textsuperscript{151} On the other hand, if $q$ represents the probability that the employer who hires all of the predecessor's employees will be able to appropriate the rent of those employees,\textsuperscript{152} that employer will offer a price equal to the capitalized value of $3,000 + q($4,500) per day.\textsuperscript{153} If $q$ is less than or equal to seven percent, this amount would be less than the capitalized value of $3,300 per day. The employer who plans to retain only forty of Apple's 100 employees, therefore, would most likely win out in a bidding contest for Apple corporation.

As this example demonstrates, the substantial continuity test has rather predictable effects on the incentives of potential successor employers. To the extent that the successorship test can be reduced to a set of comprehensible rules, the potential successor can decide whether or not it should attempt to meet or avoid the requirements for successorship status. If the predecessor's employees are sufficiently alike with respect to productivity, the potential employer probably will not gain by setting out to evade a determination of successorship status. In such a case, anything the successor gains from appropriating the rent of the minority, it will probably lose from forfeiting the experience of the unhired majority.

If there is considerable variance in the marginal products of the predecessor's employees, however, the substantial continuity test provides a subsidy to the employer who is best able to avoid a finding of successorship status and appropriate the rent of a highly productive minority. If the subsidy is large enough, the potential successor who plans to retain only a minority of the predecessor's employees may be able to outbid profitably another potential successor who plans to retain all of the predecessor's employees and to avoid an obligation to honor the predecessor's contract with the union.

V. TOWARD AN IDEAL SUCCESSORSHIP RULE

The foregoing illustrates that current successorship doctrine is flawed. Under certain conditions, it provides an advantage in an acquisition contest to the potential acquiror who plans to retain only a minority of the predecessor employer's workforce. Whether one's interest is primarily in policing

\textsuperscript{151} In this example, $3,000 equals the original offering price, $1,500 equals the loss from forfeiting the discharged employees experience, and $1,800 equals the rent appropriated from the retained employees. See supra text accompanying notes 115 and 149.

\textsuperscript{152} Recall that an employer who hires all of the predecessor's employees will have both a duty to recognize the existing contract with the employees' union or a duty to bargain for modifications.

\textsuperscript{153} See supra text accompanying notes 115, 123 (defining the maximum offering price as $3,000 per day and the appropriable rent as $4,500 per day).
agency costs or safeguarding the jobs of workers, there seems to be little reason to defend this aspect of current successorship doctrine.

Yet, it is difficult to formulate an optimal successorship policy. One recommendation which follows from the preceding discussion suggests that the consequences under the substantial continuity test of retaining a majority of the predecessor’s employees should be relaxed, especially in cases where there is likely to be considerable variance in the skill or productivity levels of employees. The majority requirement has been effectively relaxed by courts choosing an appropriate date to measure the composition of the successor’s workforce. But, given the incentives created by the majority requirement, the better route would be to downgrade it as a requirement for successorship status. A possible, less objectionable, modification of the rule would allow for a finding of successorship status even in cases in which a majority of the successor’s employees were not former employees of the predecessor, yet where the successor has “skimmed the cream” by hiring the most skilled, most productive, or most experienced employees of the predecessor. While it may be difficult for a court to determine whether a successor retained only the more productive workers, courts could examine objective factors such as experience, tenure with the firm, and job classifications.

In this Part of the article we expand on the discussion of successorship rules presented in Part IV and consider whether successorship doctrine should constrain the successor employer more or less than it currently does. Our goal is to suggest an optimal policy based on a more restrictive successorship doctrine.

A. Rent Appropriation Versus Elimination of Inefficient Employment Arrangements: Further Considerations

As we have noted, inefficient contractual provisions can be eliminated under a rule requiring a successor to honor a predecessor’s contract. Such a rule requires the party attempting to eliminate the inefficient provisions, whether successor or predecessor, to compensate the union for agreeing to the elimination. This exchange is mutually beneficial because eliminating

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154 See supra notes 134-36 and accompanying text (identifying and defining agency costs).
155 See Fall River Dyeing & Finishing Corp. v. NLRB, 482 U.S. 27, 50-51 (1987) (stating that the employer is in the best position to know when it has hired a majority of the employees it intends to hire, and therefore knows when and if it has achieved successorship status).
156 See supra text accompanying notes 140-52.
157 As noted earlier, this proposal may be inconsistent with section 9(a) of the Act because the successor employer is required to honor the predecessor's labor contract even though only a minority of the successor's employees were represented at contract negotiations. See supra note 8.
158 See supra note 137 and accompanying text.
the inefficient provision increases the value of the firm by more than the amount expended to compensate the employees.

Although this argument is a straightforward application of the Coase theorem, there are situations in which the mutually beneficial transaction envisioned here is unlikely to take place. As an example, Oliver Williamson offers the case of a firm in an industry that regulates the entry of new competitors and prevents or discourages incumbent firms from price competition. In such an industry, managers may find that labor unrest is most easily avoided by sharing the profits that result from regulation with their employees. Such sharing is likely to involve the adoption of inefficient employment arrangements because the employees are being overcompensated to ensure industrial peace. The value of the firm's stock could be increased by eliminating these inefficient arrangements, but assume that the shareholders are not aware of these potential gains. In the absence of competitive pressures strong enough to force the managers to seek efficiency improvements, it is unlikely that the typical manager will opt out of this implicit agreement to share the benefits of regulation with labor. In such a setting, gains from eliminating inefficient contractual provisions are most likely to be realized through the intervention of an outside party who is willing to breach the implicit contract with the union. A restrictive successorship doctrine would limit such intervention because the successor employer will be bound by the predecessor's contract.

Thus, the ramifications of a restrictive successorship doctrine depend on the competitiveness of the industry in which it operates. In a competitive industry, managers will have strong incentives to seek efficiency gains regardless of the prevailing successorship rule. In an uncompetitive industry, however, gains from the elimination of inefficient contractual provisions may depend on the existence of potential successors seeking to profit by breaching inefficient agreements between the predecessor employer and its employees. Thus, in an uncompetitive industry, potential gains from the elimination of inefficient employment arrangements are less likely to be realized under a restrictive successorship rule.

Although there are uncompetitive industries, it would be a mistake to adopt a successorship doctrine whose economic justification relies on a presumed lack of competition among firms. Because it would be impractical for labor courts to determine the competitiveness of an industry or the extent to which competitive pressures may force managers to seek efficiency gains, we

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159 See supra note 109.
161 An example is the airline industry prior to deregulation.
162 See Williamson, supra note 160, at 64 (discussing the results of the breakdown of the noncompetitive environment by deregulation or by the entry of firms that are not subject to the implicit profit-sharing agreement).
assume that any successorship rule will be uniformly applied to industries with varying levels of competition. Even if it could be proven that there is little competitive pressure on managers to adopt efficient employment arrangements, it still would not be clear that an unrestrictive successorship rule would be socially desirable because the benefits of an unrestrictive successorship doctrine would have to be balanced against the social costs generated by a higher frequency of rent-appropriating corporate transfers.

Nonetheless, the perceived benefits of an unrestrictive successorship doctrine depend on whether the lack of competitive pressure to adopt efficient employment arrangements indicates that gains from the elimination of inefficient arrangements will exceed the social costs generated by rent-appropriating transfers. Although this question has not been answered empirically, relevant evidence is provided by studies of corporate profitability after a change in corporate ownership. If, as the evidence seems to suggest, corporate acquisitions do not generally yield efficiency gains, then the proposition that an unrestrictive successorship rule will result in efficiency gains that outweigh the social costs of rent appropriation seems less persuasive.

We have argued that sufficiently competitive industries will realize gains resulting from the elimination of inefficient contractual provisions even under a restrictive successorship doctrine. Conversely, it might be argued that the protection against rent appropriation provided by a restrictive successorship rule can be realized under an unrestrictive rule as well. This protection could result from the bargaining process because the union would make concessions in exchange for the insurance benefit provided by an explicit successorship clause in the collective bargaining agreement.


See supra notes 137-40 and accompanying text.

See Schwab, Collective Bargaining and the Coase Theorem, 72 Cornell L. Rev. 245, 266 (1987) (discussing two characteristics of collective bargaining in labor law that make Coasian bargaining easier to apply).

Employees will seek such insurance if they are risk averse. See generally H. Varian, Microeconomic Analysis 108 (1978). If the employees are risk averse they will pay a premium for this insurance that is greater than the expected "rent appropriation premium" that could be earned by the predecessor employer upon transfer of the enterprise. Alternatively, the employees could seek an explicit successorship clause before taking part in firm-specific training.
the applicable successorship rule is unrealistic because the union is likely to undervalue the presence of a successorship clause in a collective bargaining agreement. There are two reasons for this undervaluation: informational disparities and uncertainty about enforcement. Informational disparities between management and the union render the union unable to accurately estimate the true value of a successorship clause. Specifically, management’s superior ability to forecast changes in ownership places the union in the position of purchasing a benefit whose value is known only to the employer. To illustrate how this informational disparity leads to an undervaluation, consider the following examples. A offers to sell B an object that B has never seen, provided that B offers a reasonable price. Clearly, B’s best response is to start with a very low offer, perhaps zero dollars. If B starts with a higher offer such as ten dollars, and A immediately accepts, then B will most likely have overbid. In bargaining over an explicit successorship clause, the union is likely to be in an analogous position. The union must estimate the value of the successorship clause and avoid an initial overvaluation. Further, unless the managers credibly commit to a policy on ownership changes, almost any final price could be turned into an unfair bargain because the managers would be free to take actions that would raise the probability of a change in ownership.

The second reason that a union is likely to undervalue a successorship clause is that uncertainty exists as to whether an explicit successorship clause will be enforced. Generally, an explicit successorship clause is more likely to be enforced than the boilerplate “successors and assigns” clauses observed in many collective bargaining agreements. Explicitness, how-

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167 See infra notes 168-75 and accompanying text.
168 See E. Rasmussen, Games & Information: An Introduction to Game Theory 251-53 (1989) (arguing that an informationally disadvantaged buyer should initially bid low to avoid the “winners curse”); see also Milgrom, Auctions and Bidding: A Primer, 3 J. Econ. Persp. 3, 3-4 (1987) (analyzing the theoretical basis for the winner’s curse).
169 See Hylton & Hylton, supra note 93, at 152-59 (discussing wage concessions in exchange for safety improvements). In the case of workplace safety, improvements are usually visible, so that the problem of commitment does not normally arise. When workers purchase a promise whose value depends on management policy, however, the commitment problem seems unavoidable.

One might argue that employers will be deterred from reversing an announced policy on ownership changes by the threat of suits based on common law fraud and negligent misrepresentation claims. Such claims, however, are likely to be preempted by section 301 of the LMRA. See Dougherty v. American Tel. & Tel. Co., 902 F.2d 201, 203-04 (2d Cir. 1990) (holding that state law claims of fraud and negligent misrepresentation are preempted by section 301); see also Allis-Chalmers Corp. v. Lueck, 471 U.S. 202, 216-20 (1985) (holding that section 301 preempts an employee’s state law claim for breach of duty to act in good faith).

170 See Estreicher, supra note 128, at 68-69 (stating that explicit successorship clauses create more liability for employers than boilerplate clauses); see also In re Martin Podany
ever, does not guarantee enforcement. Courts have required that other criteria be met as well.\textsuperscript{171} Thus, the undervaluation problem created by this situation parallels that of unenforceable promises generally.\textsuperscript{172} Even if the union could arrive at an accurate estimate of the value of a successorship clause, that value would have to be discounted by the likelihood that the clause would not be enforced.\textsuperscript{173}

One might argue that because the informational disparity noted above would remain even if the successor employer were required to honor the predecessor's labor contract,\textsuperscript{174} the problem of undervaluation is a general one that cannot be completely solved by altering the background rules governing compliance with labor contracts. This, however, does not take into account the fact that the nature of the relationship between the employer and the union changes when the employer must "purchase its way around" a restrictive successorship rule. The same reasoning that suggests that a union will tend to undervalue a successorship clause when it must purchase such a clause from an informed employer, also suggests that a union will tend to overvalue such a clause when asked to sell it to an informed employer.\textsuperscript{175}

\textsuperscript{171} The predecessor employer who transfers an enterprise to a nonassuming buyer may be able to avoid liability under an explicit successorship clause. See Estreicher, \textit{supra} note 128, at 69-70, 81-85; see also United Steelworkers of Am. v. United States Gypsum Co., 492 F.2d 713, 727 (5th Cir. 1974) (holding that an arbitrator's flexibility permits him "to determine the extent to which the predecessor's labor agreement should be deemed binding on the successor"); Local 1115 Joint Bd. Nursing Home & Hosp. Employees v. B & K Investments, Inc., 436 F. Supp. 1203, 1209 (S.D. Fla. 1977) (compelling arbitration to decide what terms, if any, would apply to the successor); Crystal, \textit{Successor and Assigns Clauses: Do They Actually Require that a Purchaser Adopt the Seller's Contract?}, 1982 \textit{Lab. L.J.}, 581, 594-95 ("the purchaser's own action... and not the 'successor and assigns' provisions... will determine any obligations the purchaser may have").


\textsuperscript{173} The union will undervalue a successorship clause, but the predecessor employer will tend to overvalue it, that is, discount its cost, if it expects to sell the enterprise to a successor who can "wriggle out" of the clause. This is because the predecessor can look forward to receiving a rent appropriation premium when the enterprise is transferred. See \textit{supra} text accompanying note 125. One might infer from this that successorship clauses, although generally illusory, will be observed frequently, and even be urged upon unions by employers. The problem, however, is that if unions become aware of the potential worthlessness of successorship clauses under such a regime, they will value them even less, perhaps finding them worthless.

\textsuperscript{174} Although the informational disparity may remain, the uncertainty regarding enforcement would not remain a problem in such a case.

\textsuperscript{175} Consider the reverse of the example presented earlier. See \textit{supra} text accompanying notes 168-73. Suppose A purchases an object from B, and B does not know the object's value. B's rational strategy will be to start by asking for a very high price.
Under a restrictive successorship rule, the employer will have an incentive to provide information to the union on the value of the successorship clause and to offer a commitment with respect to a policy on ownership changes.

B. Inhibiting the Transfer of Capital Assets

In *NLRB v. Burns International Security Services, Inc.* the Supreme Court clearly stated its concerns about the effects a restrictive successorship doctrine might have on the redeployment of capital. We avoided this issue in the previous discussion, focusing instead on the issues of rent appropriation and the elimination of inefficient contractual provisions. We now expand the discussion to consider capital transferability.

The implications of successorship doctrine for the transferability of capital assets has not been adequately explained by the courts. Because of this, one might think that these implications are unimportant, but this would be a mistaken conclusion. The most restrictive type of successorship rule—one that requires the successor to honor the predecessor's contract with the union—inhibits the transfer or redeployment of capital assets by requiring the successor employer who purchases the predecessor's assets to hire the predecessor's labor force as well. This burdens the successor who planned to use the predecessor's assets in some activity which did not require all of the predecessor's workers in the capacities determined by the union's contract. Of course, labor law places burdens on employers in many instances. Why then, is a rule that requires the successor to "step in the shoes" of the predecessor socially undesirable?

1. Asset Sales

A rule requiring a successor to honor the predecessor's contract will act as a tax on the transfer and acquisition of capital by making it much harder for the predecessor to sell the assets of a firm. The predecessor will not have difficulty selling the assets to a successor who plans to use them in the same way, because the value of the assets will not be greatly affected by the requirement that the purchaser honor the predecessor's collective bargaining agreement with the union. Presumably, it will also be easier for the predecessor to sell off its assets in pieces to several firms, because it would be unlikely that a firm acquiring one of several assets of the predecessor would be deemed a successor under the doctrine. But the value of the predecessor-

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177 *Id.* at 288 ("Saddling an employer with the terms and conditions of employment contained in the old collective-bargaining contract . . . may discourage and inhibit the transfer of capital.").
178 The predecessor could contract around the rule by "buying out" the union's right to have its collective bargaining agreement pass on to the transferee. This, however, does not diminish the "tax" effect of such a rule.
179 Of course, this approach may not be feasible if production depends largely on one asset such as a printing press.
sor's assets will be sharply reduced from the perspective of a successor who plans to use these assets in an activity that does not require the same labor services as those purchased by the predecessor.  

This is potentially undesirable for two reasons. First, the rule would make the firm's assets more use-specific by taxing transfers to successors who plan to use the assets in a very different way. Because, under such a rule, it will be more difficult for a predecessor to sell his assets for full value, this would increase the sunk cost of entry into fields in which firms are required to combine capital—in the traditional form of equipment and structures—and unionized labor in order to produce. This in turn would reduce the rate of entry into manufacturing and service industries. Given the extremely important role of entry in bringing about productive efficiency in a competitive economy, this outcome should be avoided absent countervailing efficiency arguments.

The second undesirable consequence of a rule requiring the successor to honor the predecessor's contract is that it would tax wealth-creating asset transfers more heavily than transfers that create little wealth. This is because transfers of assets into alternative uses occur presumably because the assets have more value in their alternative uses. Thus, the rule would reduce the frequency with which assets are transferred into alternative uses and thereby reduce society's wealth.

One might argue with respect to corporate transfers that occur through asset sales, that a rule requiring the successor to honor the predecessor's labor contract provides an efficient form of security. Firms sometimes offer creditors an interest in capital assets, and such an arrangement is efficient if the reduction in interest paid to the secured creditor is greater than the increase in interest paid to other creditors. Similarly, an agreement between the predecessor and the union that requires a successor employer to

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180 Note that because we are considering a rule that applies to any asset transfers, this conclusion does not hinge on the new employer meeting the successorship status requirement.

181 Perhaps the most important theorem of basic microeconomics teaches that in the long run competitive equilibrium, economic profits, that is, profits in excess of the opportunity cost of capital and risk taking, are driven to zero by the entry of new firms. This process of entry guarantees that goods are produced as efficiently as possible. See R. Lipsey, P. Steiner, & D. Purvis, supra note 101, at 221-24 (arguing that competitive industry profits signal new capital's entry). Modern industrial organization literature has emphasized the importance of entry. See J. Bain, Barriers to New Competition 1-19 (1956) (examining the importance of entry and its impact on market competition and setting forth systematic theory regarding the condition of entry); W. Baumol, J. Panzar, & R. Willig, Contestable Markets and the Theory of Industry Structure 2 (1982) (arguing that the mere threat of entry can impact both firms' behavior and the general welfare).

182 See Schwartz, Security Interests and Bankruptcy Priorities: A Review of Current Theories, 10 J. Legal Stud. 1, 2 & n.7 (1981) (setting forth hypothetical examples to illustrate possible ways in which security may be efficient).
honor the predecessor's labor contract would be efficient if the traded wage reductions would more than offset the reduction in the value of the predecessor's bundle of capital assets. In this case, the agreement does not tax entry or the transfer of assets into alternative uses, and by lowering overall production costs, the rule would enhance entry.

Thus, under certain conditions, a rule requiring the successor to honor the predecessor's labor contract could serve as an efficient form of security. Indeed, although one never sees this type of express transfer of asset security interests, more explicit successorship clauses might serve this purpose. The relevant question, however, is whether the background rule should bind the successor to the predecessor's labor contract.

A background rule requiring the successor who has purchased the predecessor's assets to honor the predecessor's labor contract would be efficient if it saved transaction costs by setting initial conditions on which the relevant parties would agree, provided that they are sufficiently informed.\(^{183}\) Admittedly, this proposition generates ambiguity. In certain cases—for example when the assets are use-specific and cannot be redeployed into some other activity—a requirement that a successor honor the predecessor's labor contract would have little effect on the value of the predecessor's assets. In such cases, the wealth-maximizing contract between the predecessor and the union will contain a successorship clause.\(^{184}\) In other cases, assets may be potentially valuable if used in other ways,\(^ {185}\) so a successorship clause may lower the value of the predecessor's bundle of assets by more than the value of the insurance benefit it provides to the employees.

Additionally, when transaction costs are low, the background rule will have a distributional impact because it will force one party to make concessions in order to move away from the rule. When transaction costs are high, the rule will result in a loss of societal wealth because some parties will fail to reach efficient agreements. A background rule requiring the successor purchaser to honor the predecessor's labor contract will also, for reasons already given, tax capital asset transfers. A background rule giving the asset-purchaser freedom to ignore the predecessor's labor contract will tax unionized employees who seek insurance in the form of security in assets.

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\(^{183}\) The Coase theorem implies that the terms that would ordinarily be agreed upon by sufficiently informed parties would be efficient. Misinformed parties might, however, agree on inefficient terms. See Spence, Consumer Misperceptions, Product Failure, and Producer Liability, 44 Rev. Econ. Stud. 561, 562 (1977) (examining the use of producer liability as a means to encourage firms to improve their market performance, and arguing in favor of a two-part system of liability in which firms' liability to consumers supplements producers' liability to the state).

\(^{184}\) Such a successorship clause would likely be explicit and might be found in cases where granting a security interest in assets supports a productive investment on the part of the employees, such as investment in firm-specific human capital.

\(^{185}\) For example, the land on which a gas station sits may generate considerably more income if used as a parking lot.
Although this is ultimately an empirical issue, we doubt that a rule requiring the asset-purchaser to honor the predecessor's labor contract would be socially desirable. Given the importance of asset transfers in bringing about productive efficiency, society should be reluctant to adopt rules which tax such transfers. The background corporate law rule governing asset-purchaser liabilities which states that a purchaser of assets assumes no debts or liabilities that are not expressly transferred, reflects this reluctance. 186 If the background corporate law rule is efficient, then one might be surprised to find that a contrary rule governs the successor's obligation to honor the predecessor's labor contract—an obligation which is in relevant respects similar to a debt owed to any firm creditors.

We do not argue that firms should treat the union as they do any other creditor, or that the collective bargaining agreement should be viewed as "just another" contract. Much of labor law seems to address transaction cost issues 187 which, although general, arise with enough frequency in the labor setting to merit special treatment as a separate area in the law. 188 We doubt, however, that the relationship between an employer and a union is so different from that between a firm and a supplier of raw materials that the rule governing the successor employer's obligations to the predecessor's employees should be so radically different from the corporate law rule governing asset-purchaser liabilities.

We also note that when granting a security interest in the predecessor's

186 Authorities have recognized five exceptions to this rule: (1) Where the successor expressly or implicitly assumes the predecessor's liabilities; (2) where the transaction represents a de facto merger or consolidation; (3) where the successor is a mere continuation of the predecessor; (4) where the transaction involves a fraudulent effort to avoid the predecessor's liabilities; and (5) the "product line exception," which imposes strict tort liability on the successor for defects in products manufactured and distributed by the predecessor when the successor continues the product line. See H. HENN & J. ALEXANDER, CORPORATIONS, 967-68 (3d ed. Supp. 1983) (setting forth all five exceptions and noting that courts have divided on the existence of the fifth exception); see also Ray v. Alad Corp., 19 Cal. 3d 22, 28-30, 560 P.2d 3, 7-8, 136 Cal. Rptr. 574, 578-79 (1977) (listing all five exceptions and basing liability on the product-line exception); Manh Hung Nguyen v. Johnson Mach. & Press Corp., 104 Ill. App. 3d 1141, 1143, 433 N.E.2d 1104, 1106 (1982) (listing the first four exceptions and refusing to hold the successor corporation liable based on the fifth exception); Grant-Howard Assoc. v. General Housewares Corp., 115 Misc. 2d 704, 706-07, 454 N.Y.S.2d 521, 523 (1982) (listing all five exceptions and holding the successor corporation liable based on the second and third exceptions); Dawejko v. Jorgensen Steel Co., 290 Pa. Super. 15, 18, 434 A.2d 106, 106-07 (1981) (referring to all five exceptions and holding the successor corporation liable based on the product-line exception).

187 Some examples include strategic behavior and opportunism.

188 See Wachter & Cohen, supra note 94, at 1358 n.34 (setting forth transaction costs categories differentiating labor from capital markets); see also Williamson, Wachter, & Harris, supra note 97, at 270-73 (identifying important differences between labor and commercial arbitration).
assets supports productive endeavors, such as investment in firm-specific human capital, some of the benefits will accrue to the employer, and the employees will not need to offer substantial concessions in exchange for such an interest. In this case, the background rule which allows the successor to avoid the predecessor's labor contract will have a relatively small taxing effect on employees.

Thus, we doubt the efficiency of a background rule that requires the purchaser of assets to step in the predecessor's shoes. To ignore the problem of rent appropriation because the employer has purchased capital but not labor, however, elevates form over substance. A successor would pay a premium for control of the assets of a corporation if there was a relative certainty that the predecessor's employees could be hired at a discount. In light of this, there should be some constraints on the ability of the successor employer to appropriate the employees' rent.

Current successorship doctrine seems to provide a reasonable set of constraints upon changes in corporate ownership which occur through asset sales, although court opinions have not properly focused on the rent appropriation issue. In the absence of an explicit successorship clause, the successor who gains control through a purchase of assets should not, as a general rule, be held to the terms of the predecessor's labor contract. A successor who plans to use the employer's assets in a way that will not require the same labor services, or, more precisely, will not allow the employer to benefit from the firm-specific training of the predecessor's employees, should not be required to step into the shoes of the predecessor. On the other hand, a successor who attempts to appropriate the employees' rent by purchasing the same services from them as did the predecessor, but at a lower price, should be required to bargain with the union.

Determining whether a new employer is able to appropriate the employees' rent, and should therefore be under a duty to bargain, will not be an easy exercise. Because the courts have already determined a list of factors relevant in successorship analysis, however, it seems to be a task with which the courts can be trusted. Although no court has stated that these factors are to be used primarily to determine whether the successor employer may attempt appropriation of the employee's rent, rent appropriation theory provides the strongest argument for using such a list of factors. By focusing on the appropriation problem the courts should be able to avoid an overly rigid application of these factors.

2. Mergers and Stock Transfers

There are three reasons why we are reluctant to extend the foregoing efficiency criticisms to corporate transfers that occur through stock purchases or mergers. First, unlike the case of asset sales, the background corporate law rule governing the liabilities of a successor who merges with or

189 See supra notes 53-55 and accompanying text.
purchases the stock of a corporation requires that the successor step into the predecessor's shoes. This is the background rule because it is probably efficient. For example, if a bank that loaned a corporation one million dollars had to bear the risk that the corporation's ownership might change and that the new ownership would want to renegotiate the terms of the loan, it would obviously charge a higher rate of interest. Further, because the bank under such a regime would be exposing itself to the risk of opportunistic actions by managers, there would be no "market clearing" interest rate.

Although it is fairly easy to make out a case for the background corporate law rule governing the liabilities of a successor who gains control through merger or stock purchase, a different rule governs collective bargaining agreements. As a general matter, an entity that purchases a majority of a corporation's stock and does not make major organizational or structural alterations will be bound by the existing collective bargaining agreement.

190 See R. CLARK, CORPORATE LAW 405-06 (1986) ("Unless transferred or gotten rid of before the merger, all assets and liabilities of [the predecessor] will become assets and liabilities of [the successor], by operation of law . . . ." (emphasis in original)).

191 Just as higher tax rates increase incentives to avoid paying taxes, higher interest rates increase incentives for managers to act opportunistically. Indeed, because the firm could be taken over, a potential acquiror would have an incentive to acquire the firm in order to renegotiate the terms of its debt. But, because this would only increase rates further and increase incentives to transfer ownership, the equilibrium interest rate would be driven to infinity.

192 See Esmark, Inc. v. NLRB, 887 F.2d 739, 751 (7th Cir. 1989) ("The successorship doctrine is simply inapplicable to a stock sale transaction . . . a corporate entity remains liable after a stock sale for labor obligations which accrued prior to the sale."); EPE, Inc. v. NLRB, 845 F.2d 483 (4th Cir. 1988) (holding that an employer remained bound by collective bargaining agreement as a "continuing employer," not a successor, after 100% of its stock was purchased by another corporation); United Food & Commercial Workers Int'l Union v. NLRB, 768 F.2d 1463 (D.C. Cir. 1985) (stating that a successor may escape a duty to recognize the union only if there is genuine doubt about whether the majority of the bargaining unit supports the union); TKB Int'l Corp., 240 NLRB 1082 (1979) (holding that membership in a multi-employer bargaining unit is assumed by a stock transferee, and that the transferee is bound by that unit's collective bargaining agreements); Topinka's Country House, Inc., 235 NLRB 72 (1978) (finding a corporation to be the same employing entity after stock transfer and bound by the preexisting labor contract); see also Dicker, supra note 137, at 170 ("since the corporation remains unchanged after a stock purchase, that corporation is obligated to bargain with the preexisting union and to adhere to the existing labor agreement"); Estreicher, supra note 128, at 71 ("stock transfers that do not involve a major alteration of the predecessor's mode of operation do not ordinarily constitute a change in the identity of the employing enterprise"). See generally Bernstein & Cooper, Labor Law Consequences of the Sale of Unionized Business, 36 LAB. L.J. 327 (1985) (summarizing buyers' and sellers' duties under a successorship doctrine after Burns).

A separate but related set of cases involve the alter ego doctrine. Alter ego transactions are generally sham transactions which involve nothing more than a change in the name of the corporation. See Haley & Haley, Inc. v. NLRB, 880 F.2d 1147, 1149
When the successor institutes major alterations, however, the successor is free of the duty to honor the union's contract. It is under these circumstances that a new owner's responsibilities under the background corporate law rule differ from the labor law rule for collective bargaining agreements. Further, with respect to mergers, the Wiley court implicitly rejected the argument that the rule governing the successor's responsibilities should be the same as the background corporate law rule.

The reason for the existence of a set of background rules that treat agreements with unionized employees less generously than those with creditors of the predecessor corporation has never been explained. We posit two theo-

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193 The general labor law rule will not apply if a significant structural change is made in the enterprise after the stock transfer occurs. See John Wiley & Sons, Inc. v. Livingston, 376 U.S. 543, 551 (1964) (noting that in cases in which there is a “lack of substantial continuity of identity,” a purchaser will not be bound by a bargaining agreement); EPE, 845 F.2d at 490 (cautioning that a stock sale will not cause a corporation to be bound by a labor agreement in cases when substantial changes in an operation show that there was more than a mere substitution of ownership). When there is a substantial change in an operation, then successorship principles will govern the new owner's relations with the labor organization, and the new owner will not be bound to the collective bargaining agreement. Id. Sometimes the change may be so significant that the new owner will not be considered a successor and will have no obligations to the union or the collective bargaining agreement. Id. (citing Lauer's Furniture Stores, Inc., 246 N.L.R.B. 360 (1979)).

There is one special situation in which the general labor law rule will not apply even though no major alteration in the enterprise takes place. When the stock-purchasing party is misled by the stock-selling party with regard to the existence of a collective bargaining agreement, the purchaser will not be bound to the original employment contract. Esmark, 887 F.2d at 751 n.20 (citing MPE, Inc., 226 N.L.R.B. 519, 521 (1976) (holding that the purchaser was not bound by a labor contract because they were told that the company was between labor contracts when in fact a labor contract currently existed).

194 This is an implication of the substantial continuity test stated in Wiley. Wiley, 376 U.S. at 543.

195 The Court in Wiley states that “a collective bargaining agreement is not an ordinary contract.” Id. at 550. The Court then states that the collective bargaining agreement “calls into being a new common law—the common law of a particular industry or of a particular plant.” Id. (quoting United Steelworkers v. Warrior & Gulf Navigation Co., 363 U.S. 574, 578, 579 (1960)). This distinction between collective
ries for treating unions less generously. First, unions have monopoly power and therefore may extract inefficient or unfair concessions from employers. Current successorship doctrine enables the new ownership to rid itself of such labor agreements by structuring the transfer of ownership properly. This argument, however, does not explain why a union should be treated differently from other monopolistic entities that sell goods or services to the firm. Furthermore, competition from other firms provides sufficient incentives to the employer to eliminate inefficient labor contract provisions; the employer should not need the freedom under current successorship doctrine to ignore labor contracts in order to have sufficient incentives.

A second, closely related argument for treating unions less generously is that an employer's labor force usually constitutes a significantly larger fraction of the cost of production than do other inputs. From this perspective, it might be inferred that the monopoly power problem in the employer's relationship with the union is significantly different than that posed in the employer's relationship with other monopolistic entities. Besides having ambiguous implications, this argument contradicts the generally accepted notion of the relationship between labor's share of the cost of production and its monopoly power as measured by the elasticity of labor demand. A larger ratio of labor costs to total production costs will, under certain circumstances, imply a more elastic demand for labor, and therefore less monopoly power for the union.

As the foregoing demonstrates, there are no strong arguments for treating unionized employees less generously than creditors and other parties with whom the predecessor is legally obligated. We are inclined, therefore, to conclude that the efficiency arguments for applying the background corporate law rule to ordinary contracts ought to extend to labor contracts as well.

The second reason we are reluctant to extend the efficiency criticism of a restrictive successorship rule to corporate transfers that occur through merger or stock purchases is because by considering assets to be specific to current use, the successor who merges with or purchases a majority of the stock of a predecessor would be required to honor the labor contracts of the

bargaining agreements and ordinary contracts was well put by Archibald Cox: “In the community of the shop the collective bargaining agreement serves a function fairly comparable to the role of the Federal Trade Commission Act or National Labor Relations Act in the whole community. It is an instrument of government as well as an instrument of exchange.” Cox, *The Legal Nature of Collective Bargaining Agreements*, 57 *Mich. L. Rev.* 1, 22 (1958).

Although the Court’s distinction between collective bargaining agreements and ordinary contracts may justify different governing mechanisms, it does not explain why labor contracts should be governed by a successorship rule that is less generous than the background corporate law rule.


197 Id. at 71.
predecessor but would not see the sunk costs of entry significantly increased. Under such a regime, the predecessor can avoid the implicit tax on capital by selling the assets to a firm that has a different use for the assets and thus would not be deemed a successor. In this way the new owner would be free of the obligations imposed by the collective bargaining agreement between the predecessor and its employees. Furthermore, to the extent that such a restrictive successorship rule would support the employer's commitments to compensate workers who undertake firm-specific training—for example, by removing uncertainty over the enforceability of a "successors and assigns" clause—there presumably would be benefits that would offset the implicit tax effect.

The third reason we distinguish mergers and stock purchases from assets purchases is that the risk of a rent-appropriating transfer is greater in the case of a stock purchase. This is because by purchasing corporate shares in a tender offer, control of the corporation can be achieved without management approval. The transfer of a corporation's assets, however, cannot be accomplished without management approval. If incumbent managers actively resist efforts to transfer the wealth of employees, either out of a concern for their reputations or a genuine sense of obligation, they will be in a better position to block efforts to appropriate the employees' rent that are attempted through asset purchases. Accordingly, because of the background corporate law rule, the ease of avoidance, and the possibility of hostile takeovers, we are reluctant to extend our criticisms to mergers or stock transfers.

C. Comments on Scope

Successorship issues can arise in cases involving either a transfer of a majority of a corporation's stock, or a transfer of its assets. In NLRB v.

198 Of course, it is becoming more difficult to transfer ownership through the takeover device. As of January 1, 1989, anti-takeover statutes existed in 33 states. See Significant 1988 Court Decisions, 44 BUS. LAW. 871, 884 (1989).

Despite the rash of anti-takeover legislation, the threat of hostile takeovers is unlikely to disappear. First, many states have not passed anti-takeover legislation. Second, firms may opt out of a given state's anti-takeover protection, either voluntarily or in response to pressure from shareholders. One obvious way of opting out of state anti-takeover protection is to reincorporate in a state that lacks such protection. Moreover, in Delaware, a corporation can exempt itself from the state's anti-takeover statute by having an opt out provision in its original certificate of incorporation, or by amending the charter to include such a provision. See id. at 885.

Finally, the rash of anti-takeover legislation may not restrain takeovers as much as expected because the constitutionality of the most recent legislation, the so-called "third generation" statutes, has yet to be decided. See Hazen, State Anti-Takeover Legislation, 23 WAKE FOREST L. REV. 77, 85 (1988). By "third generation," we refer to statutes which apply to domestic and foreign corporations. See CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69 (1987) (upholding an Indiana "second-generation" statute); see also Booth, The Promise of State Takeover Statutes, 86 MICH. L. REV. 1635 (1988); Hazen, supra (discussing the generations of anti-takeover statutes).
Burns International Security Services, Inc., former Wackenhut employees were hired to work for Burns after the incumbent Wackenhut lost its contract to provide security services at a Lockheed plant. Generally, whenever firms compete for exclusive contracts, facts similar to those in Burns may be presented. This raises questions concerning whether these cases belong within the realm of successorship law. Underlying economic factors suggest that this is not a clear-cut issue.

In the context of firm-specific training, facts like those in Burns will not always present a threat of rent appropriation to the predecessor's employees. If the employees' rent reflects a return on firm-specific training, then a new competitor in an exclusive service contract ordinarily should not be able to benefit from the firm-specific human capital investments of the predecessor. For example, if the only type of firm-specific human capital possessed by a group of workers is experience using a certain type of machinery owned only by their employer, then another employer should not be able to appropriate the value of such human capital. Further, one should expect that in a regime in which new employers are not generally bound to continue paying an employee his previous wage, the employee's return on human capital investment will reflect the risk that his employer will go out of business. Thus, to the extent employees cannot command equivalent wages outside of the predecessor's firm, they will be compensated ex ante for the risk that the predecessor's exclusive contract will not be renewed.

This view of firm-specific human capital, however, is probably too limited. Training is both firm-specific and general, and thus, training may, without

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200 Note that this case is distinguishable in that only the employees are transferred between enterprises. Justice Rehnquist's dissent in Burns argues that successorship doctrine should not apply to this set of cases. Burns, 406 U.S. at 306-07.

201 See Williamson, Wachter, & Harris, supra note 97, at 256-57 (listing four types of “task idiosyncracy:” (1) equipment (because the equipment used in one firm will not be similar to that used in other firms), (2) process (because the employees fashion processes for specific contexts), (3) informal team accommodations (because mutual adaptation occurs between employees engaged in recurrent contact which becomes disturbed when membership is changed), and (4) communication (because employees develop and utilize information channels and codes that are of value only within that specific firm)).

202 To elaborate, suppose only two employers exist, A and B. A will never go out of business and pays an hourly wage of two dollars. The probability that B will go out of business is 50%. If the employees of B have a 50% probability of finding jobs with A after leaving B, then in order to attract workers B will have to offer a wage of at least three dollars (solving the equation $2 = (0.5 \times 0.5 \times 2) + 0.5 \times (\text{wage at firm B})$). The point is that if firms compete for workers who are aware of failure risks, and those workers can choose among firms with different failure probabilities, then failure risks will be reflected in wages. One could argue that these assumptions are inconsistent with our arguments concerning employee informational disparities. See supra text accompanying notes 99-111. However, we seek only to present the case against applying successorship doctrine to Burns-like fact patterns.
raising the employee's opportunity wage, raise the worker's marginal product in a competing firm. Alternatively, a new employer may replicate the predecessor employer's production process. By hiring former employees of the predecessor, the new employer may benefit from the predecessor's firm-specific human capital investments.

Thus, although rent appropriation is less likely to occur in a Burns-like fact setting than in the traditional successorship case involving the change of corporate ownership, the underlying economic considerations do not suggest that rent appropriation cannot occur in such a setting. There does not seem to be a strong economic argument for limiting the scope of successorship law to cases involving changes in corporate ownership. On the other hand, in this set of cases a rule requiring the successor to honor the predecessor's contract would be socially undesirable.

VI. CONCLUSION

Successorship doctrine can be simplified and still perform the function of preventing rent appropriation if there is a successorship rule that requires the new employer to honor the predecessor employer's labor contract. Recognizing the discouraging effect this would have on capital asset transfers, however, we propose that such a restrictive rule apply only to changes in ownership that occur through mergers or stock purchases.

With respect to corporate transfers accomplished through asset sales, much of the courts' criteria for determining successorship status should remain. The majority requirement of the substantial continuity test, however, should be relaxed under certain conditions since it provides an advantage to a potential acquiror who plans to retain only a minority of the predecessor's workforce.

Finally, no strong economic rationale seems to exist for limiting the scope
of successorship doctrine to cases which involve transfers of corporate ownership.

We have proposed a more stringent and simpler successorship doctrine. Much of our effort, however, has gone into providing a theoretical basis for a successorship rule. The problem of rent appropriation represents the starting point for such a rule. In the course of describing the problem that the relevant law attempts to control, the rent appropriation theory offers the greatest hope of clarifying and bringing consistency to successorship doctrine.