Efficiency and Labor Law

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I. INTRODUCTION

The law and economics literature, particularly that part of the literature that offers positive theories of the law, has largely ignored labor law. There are two reasons for this. One is that unions are seen as economically inefficient[1]—in the sense that society would be wealthier without them—because cartel behavior generally is viewed by economists as inefficient. The same arguments supporting the per se rule against price fixing lead economists and economically oriented lawyers to shy away from labor law as a field of study, because they take it as given that the union is an inefficient institution. The second reason labor law has not received much attention in the law and economics literature, particularly from positive theorists, is that it is seen as an area of statutory law. A large part of the law and economics literature makes a distinction between statutory and case law, arguing that the latter tends toward efficiency while the former is more often than not the product of rent-seeking efforts on the part of special interest groups.[2]

Whether in fact unions are inefficient is an open question, and is beyond the scope of this Article. Economists have taken different posi-

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1 Since there are several possible definitions of efficiency, I should state here the one I will rely on in this Article. By efficiency, I mean wealth maximizing in the Kaldor-Hicks sense. Regime A is preferred to regime B under the Kaldor-Hicks efficiency criterion if the individuals who would gain from a switch from B to A could compensate those who would lose and each individual would still prefer the switch from B to A. This notion of efficiency is fairly standard in the law and economics literature. For a nontechnical discussion of wealth maximization and the Kaldor-Hicks criterion, see RICHARD A. POSNER, THE ECONOMICS OF JUSTICE 48-87 (1981). For criticism of the Kaldor-Hicks criterion and notions of efficiency, see Kenneth J. Arrow, *Little's Critique of Welfare Economics*, 41 AM. ECON. REV. 923, 923-32 (1951); Gary Lawson, *Efficiency and Individualism*, 42 DUKE L.J. 53 (1992).

2 RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 491-507 (3d ed. 1986). Posner cites the National Labor Relations Act as an example of inefficient legislation. *See id.* at 495.

tions on the issue for a very long time.[3] Some recent empirical work suggests that unions may be efficient.[4] On the other hand, the fact that the union sector has declined significantly over the past three decades and continues to shrink is itself sturdy evidence against the hypothesis that unions enhance efficiency.[5]

Nonetheless, the view that labor law is unlikely to be economically efficient because it is statutory rather than case law is mistaken in several respects. There are no legal arenas governed purely by case law or statutory law; we generally find mixtures of the two. However, fields of law can be distinguished according to the amount of legal doctrine that flows directly from statutes rather than case law. In light of this, the better statement of the efficiency thesis is that the statutory portion sets initial conditions and distorts the path of legal doctrine, while the judge made portion tends toward efficiency. If statutes are generally the result of rent-seeking efforts, then the statutory initial conditions in any area are likely to be inefficient. The common law that develops in order to interpret and fill gaps between the statutory provisions pushes the body of doctrine in the direction of efficiency. Under this view, labor law, or any other area of law for that matter, cannot be distinguished from common law by simply categorizing it as statutory.[6]

The notion that the New Deal labor legislation which set the initial conditions for today's federal labor law may have been largely inefficient

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[3] It seems that the greater share of economists believe that unions are inefficient, generally treating them as price-fixing cartels. I cite as evidence in favor of my claim the fact that the general treatment of unions in the relatively small part of the labor law literature that examines the economics of unions is consistent with the cartel model. *See, e.g.*, Thomas J. Campbell, *Labor Law and Economics*, 38 STAN. L. REV. 991, 1106-07 (1986); Douglas L. Leslie, *Principles of Labor Antitrust*, 66 VA. L. REV. 1183, 1185-86 (1980); Richard A. Posner, *Some Economics of Labor Law*, 51 U. CHI. L. REV. 988 (1984).

For the argument that unions are inefficient price-fixing cartels, see Henry A. Simons, *Some Reflections on Syndicalism*, 52 J. POL. ECON. 1 (1944). Among economists today, Richard Freeman of Harvard University is probably the best known proponent of the view that unions are efficient. *See* RICHARD B. FREEMAN & JAMES L. MEDOFF, WHAT DO UNIONS DO? (1984). Perhaps the most prominent economist ever to argue that unions are likely to have several efficiency properties is John Stuart Mill. *See infra* notes 28-31 and accompanying text.

[4] *See, e.g.*, FREEMAN & MEDOFF, *supra* note 3, at 162-80; Charles Brown & James Medoff, *Trade Unions in the Production Process*, 86 J. POL. ECON. 355 (1978); Kim B. Clark, *The Impact of Unionization on Productivity: A Case Study*, 33 INDUS. & LAB. REL. REV. 451 (1980).

[5] As a proportion of the labor force, union membership has declined continuously from roughly 25% in 1954 to 18% in 1982. *See* MICHAEL GOLDFIELD, THE DECLINE OF ORGANIZED LABOR IN THE UNITED STATES 10-11 (1987). Paul Weiler has suggested that the decline in union membership is largely the result of illegal resistance efforts by employers. Paul Weiler, *Promises to Keep: Securing Workers' Rights to Self-Organization under the NLRA*, 96 HARV. L. REV. 1769 (1983). For a recent examination of the causes of the decline, see Robert J. LaLonde & Bernard D. Meltzer, *Hard Times for Unions: Another Look at the Significance of Employer Illegalities*, 58 U. CHI. L. REV. 953 (1991).

[6] Although Posner treats labor law as an example of inefficient statutory law, *see* POSNER, *supra* note 1, the general notion that many areas of statutory law actually are better described as common law or "quasi-common" law is discussed in RICHARD A. POSNER, THE FEDERAL COURTS 294-315 (1985).

is one that I find uncontroversial. The New Deal legislation was a reaction to the Depression. We are slowly discovering that some of the legislation of that period, such as federal deposit insurance, may have been ill-advised in many respects.[7] It would not be surprising to discover that federal labor legislation suffers from mistakes of the same order as those in the banking legislation of the New Deal period. However, I implicitly argue that the problems are not so great that we need to wipe the slate clean and start over again, as some commentators have suggested.[8]

In this Article, I examine the economic efficiency of labor law. My claim is that much of labor law seems to be efficient—in a sense that will be made precise below.[9] I approach this issue by examining the process by which labor law develops and some important areas of labor law doctrine. The central question addressed is whether the process by which labor law develops differs substantially from the common law process. I demonstrate that there are differences that have implications for the efficiency of labor law. But the differences do not seem to be so great as to make the efficiency thesis inapplicable to labor law.

In attempting to bridge two heretofore separate bodies of literature—that on the economic efficiency of the common law and the labor law literature—I have taken an approach that needs to be explained. My argument requires a critical examination of the literature on the efficiency of case law before examining the applicability of the efficiency theory to labor law. The theory itself has been presented in too disjointed a fashion to simply be applied without additional analysis. I have identi-

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[7] *See, e.g.*, Melanie S. Tammen, *The Savings and Loan Crisis: Which Train Derailed—Deregulation or Deposit Insurance?*, 6 J.L. & POL. 311 (1990) (pointing to deposit insurance provisions of the New Deal banking statutes as the major cause of the thrifts crisis). The Glass-Steagall separation between banking and commerce no longer enjoys the support it once had. Recent Treasury Department proposals for reforming the banking system include proposals for weakening or removing barriers between banking and other financial services. *See, e.g.*, *Not Just Up But Running*, ECONOMIST, June 29, 1991, at 66-68.

[8] *See, e.g.*, Richard A. Epstein, *A Common Law for Labor Relations: A Critique of the New Deal Labor Legislation*, 92 YALE L.J. 1357 (1983); Daniel J. Gifford, *Redefining the Antitrust Labor Exemption*, 72 MINN. L. REV. 1379 (1988).

An alternative view of the efficiency of labor legislation, which is not inconsistent with the position taken in this paper, is provided by Stewart Schwab. Stewart Schwab, *Collective Bargaining and the Coase Theorem*, 72 CORNELL L. REV. 245, 255 & n.42 (1987) (suggesting that the legislation may have prevented a destructive or violent revolution).

[9] The notion that large parts of labor law might be economically efficient has been suggested by two recent papers. *See* Keith N. Hylton & Maria O'Brien Hylton, *Rent Appropriation and the Labor Law Doctrine of Successorship*, 70 B.U. L. REV. 821 (1990); Michael L. Wachter & George M. 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 (1988). Probably the first paper to argue that the economic efficiency hypothesis explains much of labor law is by Wachter. *See* Michael L. Wachter, Does the NLRA System Protect Union or Firm Rent-Seeking? (Oct. 23, 1990) (unpublished manuscript, on file with author). This Article differs from Wachter's in several ways, but the most important is in its emphasis on the common versus statutory law distinction.

fied what seem to me to be the strongest reasons why the common law efficiency hypothesis may be valid as well as the most important weaknesses in the theory. My argument also requires consideration of the theory of efficient unionization, since the model of the union is at the core of any efficiency argument for labor law.

Part II sets out to clear up the confusion in the literature on efficiency, which seems to me to be necessary before any discussion of the efficiency of legal doctrine can proceed. The confusion is over the very definition of efficient law. The type of efficiency usually discussed by the positive theorists is a special type, which I refer to as "doctrinal efficiency." The claim that labor law is efficient is really a claim that it is doctrinally efficient. Doctrinal efficiency generally ignores the administrative costs of the legal process itself in defining efficiency, while operational efficiency takes administrative costs into account.

In Part III, I discuss the literature on the efficiency of unions and present a general model of efficient unionization. In order to say whether labor law is efficient, one must have a model of the union; the model will determine in large part our conclusions about the law. I claim in this Part that the strongest and most general argument for the efficiency of unions is that the union solves collective action problems in the workplace, for example, by providing certain workplace public goods.

Part IV examines the efficiency hypothesis and its application to the process by which labor law develops. The best arguments for the efficiency hypothesis are: (1) that the common law is a formalization of implicit contracts, and (2) that inefficient doctrinal rules will be litigated more frequently than efficient rules. The central difficulty shared by these arguments is that they rely on the compliance of judges with norms or traditions of the common law process. The compliance issue presents the largest potential problem for the efficiency of labor law. The problem is not necessarily present in the federal courts but exists on a large scale in the NLRB. But many of the features of the common law process which suggest that common law tends toward efficiency are observed in the labor area as well.

Part V examines several areas of labor doctrine in which economic efficiency justifications may be offered. I examine organization and business change (successorship, partial closing, relocation) law. Labor doctrine seems, generally, to be designed to deter opportunistic wealth transfers.

II. Economic Efficiency and Legal Doctrine: Preliminary Remarks

The notion that legal doctrine can be explained by or could be consistent with an economic efficiency thesis probably first was suggested by

Oliver Wendell Holmes[10] and was not revived until the 1960s with the work of Ronald Coase and Guido Calabresi.[11] Coase's work, however, did not emphasize the efficiency thesis.[12] It is more appropriate to say that Coase's work raised the stakes by requiring efficiency theorists to adopt more sophisticated arguments than those found in the externality literature.[13] Calabresi came close, but did not actually propose an efficiency thesis. In his early work, Calabresi was a critic of tort doctrine, drawing most of his insights and criticisms from the theory of externali-

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[10] In particular, the arguments presented in Holmes's lectures on criminal and tort law probably are the first examples of a positive economic analysis of the common law. *See* OLIVER W. HOLMES, JR., THE COMMON LAW 39-129 (1881). Holmes never referred to his theory as an economic efficiency theory; he used the term "convenience." *Id.* at 1-2 ("The substance of the law at any given time pretty nearly corresponds, so far as it goes, with what is then understood to be convenient. . . ."). However, given the general cost-benefit arguments appearing throughout the lectures, it is a reasonable inference that economic efficiency comes as close as any other descriptive term to what he considered his theory to be.

There were economic theories of the law before Holmes's lectures. The theories of criminal penalties presented by Cesare Beccaria and Jeremy Bentham were perhaps the first sophisticated applications of economic arguments to law. *See* CESARE BECCARIA, ON CRIMES AND PUNISHMENT (Henry Paolucci ed., 1963); JEREMY BENTHAM, AN INTRODUCTION TO THE PRINCIPLES OF MORALS AND LEGISLATION (Laurence J. Lafleur ed., 1948). However, unlike Holmes, Beccaria and Bentham devoted little time to trying to justify legal doctrine; they offered a largely normative theory of criminal punishment.

[11] Guido Calabresi, *Some Thoughts on Risk Distribution and the Law of Torts*, 70 YALE L.J. 499 (1961); R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960). The Coase paper presents an argument that is now called the Coase theorem. According to the Coase theorem, if bargaining is costless and parties are equally informed, the equilibrium outcome will be efficient, regardless of the initial assignment of property claims.

Landes and Posner have identified three "bursts" in law and economics literature, though their concern is largely with the torts literature. *See* William M. Landes & Richard A. Posner, *The Positive Economic Theory of Tort Law*, 15 GA. L. REV. 851, 852-54 (1981). The first period includes Holmes's book, and articles by Ames and Terry. *See* James B. Ames, *Law and Morals*, 22 HARV. L. REV. 97 (1908); Henry T. Terry, *Negligence*, 29 HARV. L. REV. 40 (1915). The second period includes some of the "realist" literature. The third period begins with the articles of Coase and Calabresi. However, if one is simply trying to pin down the history of the positive theory literature, *i.e.*, the literature suggesting an efficiency justification for law, it seems to me that there are only two periods, the one including Holmes's work and the modern period.

[12] Indeed, Coase himself remarked at the first meeting of the American Law and Economics Association (May 24, 1991, Champaign-Urbana, Illinois) that he saw himself as providing a theory of how law affects economic incentives rather than an economic theory of the law. His insights have been the building blocks for theorists examining both questions.

Although Coase's 1960 article did not argue that common law tends toward economic efficiency, his discussion of nuisance doctrine suggested that an efficiency theory might explain a large part of the common law. *See* Coase, *supra* note 11, at 19-22.

[13] A.C. PIGOU, THE ECONOMICS OF WELFARE (4th ed. 1946). For a survey of modern externality theory, which incorporates the work of Coase, see WILLIAM J. BAUMOL & WALLACE E. OATES, THE THEORY OF ENVIRONMENTAL POLICY 7-56 (2d ed. 1988). It should be noted that Coase presented his argument as a criticism of the Pigovian theory of externalities. Coase, *supra* note 11, at 1. A fairly obvious implication of externality theory is that the state can use appropriately set taxes and liability rules to internalize external costs. However, if transaction costs are low, the parties will have every incentive to enter into joint wealth-maximizing agreements without the help of the state.

ties.[14] The argument that legal doctrine could be explained by an economic efficiency hypothesis was not urged in a sustained fashion again until the work of Harold Demsetz[15] and Richard Posner.[16]

What is meant by efficient legal doctrine? There are two distinct notions of efficiency that appear in the literature: "operational efficiency" and "doctrinal efficiency." Operational efficiency is what most economists have in mind when they speak of efficiency. A rule is operationally efficient if it is efficient even after taking into account the administrative costs of enforcing the rule. Doctrinal efficiency generally ignores the administrative costs associated with a rule.[17] Consider the negligence rule, as defined by the Hand formula.[18] The Hand test is the standard example of an efficient rule in the law and economics literature.[19] However, the Hand formula has only been shown to be doctrinally efficient. It has not been shown to be operationally efficient.[20]

The notion of efficiency most often found in the positive theory of

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14 A complete statement of Calabresi's arguments can be found in GUIDO CALABRESI, THE COST OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS (1970). Although Calabresi's work in the torts area is largely normative, his article on property rules and liability rules is a classic in the positive theory literature. *See* Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972).

15 *See* Harold Demsetz, *When Does the Rule of Liability Matter?*, 1 J. LEGAL STUD. 13 (1972); Harold Demsetz, *Toward of Theory of Property Rights*, 57 AM. ECON. ASS'N PAPERS AND PROC. 347 (1967).

16 *See* Richard A. Posner, *A Theory of Negligence*, 1 J. LEGAL STUD. 29 (1972). Most of the modern literature on the positive economic theory of tort law has been written by Richard Posner and William Landes. *See* WILLIAM M. LANDES & RICHARD A. POSNER, THE ECONOMIC STRUCTURE OF TORT LAW (1987).

17 Although described in different terms, the distinction between doctrinal and operational efficiency is implicit in the discussion of nuisance doctrine in Richard A. Epstein, *Nuisance Law: Corrective Justice and Its Utilitarian Constraints*, 8 J. LEGAL STUD. 49, 50, 74-79 (1979). Another discussion which distinguishes between efficiency tests that take administrative costs into account and those that do not is Michelman's distinction between "utility" and "efficiency" as alternative welfare tests. *See* Frank I. Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165 (1967).

18 The Hand formula defines negligence as a failure to take care where the cost of taking care is less than the probability of the accident multiplied by the loss if the accident occurs. United States v. Carroll Towing Co., 159 F.2d 169, 173 (2d Cir. 1947).

19 The reasoning is that if the burden of precaution is less than the expected increase in the victim's loss, a potential tortfeasor should take care because such care increases society's wealth. The Hand formula imposes liability in this case, and in so doing gives the potential tortfeasor an incentive to take care.

20 *See* Keith N. Hylton, *Litigation Costs and the Economic Theory of Tort Law*, 46 U. MIAMI L. REV. 111 (1991). The reason is that the Hand test ignores the administrative costs of private enforcement activity. In order to shift injury losses to a tortfeasor a victim has to bring suit, which is costly. Thus, failure to take care generates not only a loss to a victim, but also the litigation costs that are incurred in shifting the loss to the tortfeasor. If the Hand formula were to take such costs into account, it would require the tortfeasor to take care whenever the burden of precaution is less than the injury loss plus the sum of expected litigation costs associated with a tort suit. *See* Keith N. Hylton, *Costly Litigation and Legal Error Under Negligence*, 6 J.L. ECON. & ORGANIZATION 433 (1990).

legal doctrine is doctrinal efficiency. The reason for the current methodological dichotomy in the law and economics literature, with positive theorists examining doctrinal efficiency and others examining operational efficiency, is unclear. One possible explanation is that the literature distinguishes between the common law and statutory law. Common law is largely the result of private initiative. The courts play a passive role, like bridges that are crossed occasionally. The administrative costs are treated in a manner similar to the treatment of the marginal cost of using a bridge, as if they were zero. Statutory law, on the other hand, often involves administrative agencies, and it is generally recognized that their costs should be subtracted from any estimate of the benefits of law enforcement. Another reason for the methodological dichotomy is lack of information. Data concerning the costliness of regulatory agencies or the criminal justice system are available and can be used in thinking about the net benefits provided by such publicly funded efforts. Estimates of the cost of litigation are generally not available. A third possible reason is normative. Perhaps operational efficiency should not be the goal of legal doctrine since operational efficiency can be achieved only in the world of dreams. Further, the specification of an operationally efficient rule will change with any change in the administrative costs of running the system.

The argument over the proper approach—doctrinal or operational efficiency—cannot be resolved here. In this Article, I will follow the approach of the positive theorists and let doctrinal efficiency be the standard with which to measure doctrinal rules. In other words, when considering the efficiency of a doctrinal rule, I will not attempt to take into account the rule's effects on administrative matters such as the incentive to litigate.

III. ARE UNIONS EFFICIENT?

Any discussion of the efficiency of labor law doctrine should begin with the union itself. If the union is not efficient, then the matter would seem to be settled: labor law rules protecting union organization could not possibly be efficient.[21] I will argue in this Part that no such simple conclusion can be justified on theoretical grounds.

A. The Coase Theorem Puzzle and a Solution

The question whether unions can be economically efficient has received a great deal of attention in the economics literature.[22] It is a challenging question because the Coase theorem[23] seems to suggest that a

[21] Indeed, this seems to be the gist of Posner's critique of labor law. Posner, *supra* note 3.

[22] RONALD G. EHRENBERG & ROBERT S. SMITH, MODERN LABOR ECONOMICS 485-90 (3d ed. 1988).

[23] For a definition of the Coase theorem, see *supra* note 11.

system of unions should never be necessary. All wealth-maximizing benefits that can possibly be obtained from a contract will be obtained, if transaction costs are low enough for the parties to bargain. If the employment setting meets the ideal conditions of the Coase theorem, in the sense that transaction costs are low and parties are fully informed, then unions could not possibly improve upon a regime of private contracting. In light of the Coase theorem, how can unions be justified?

The best response to the puzzle raised by the Coase theorem relies on the "public goods" or, equivalently, "free rider" problem. Richard Freeman and James Medoff have argued that there are some items, such as workplace safety, that are public goods in the sense that providing them for one worker means that they must be provided for all.[24] In such a setting, the incentive problems observed whenever a public good is involved appear. Each individual has an incentive to let someone else provide the good, so that he or she can enjoy it without incurring the expense of providing it. The result is that the regime of private contracting supplies too little of the public good.

To see how the public goods problem provides an answer to the Coase theorem puzzle, consider the following example. Suppose there are two workers who would each experience a \$100 per week benefit from additional safety at the worksite. The value of each worker's output to the employer is \$400. Finally, suppose the cost of improving safety is \$100 per week. It is straightforward to demonstrate that given any wage under a contract in which the safety enhancement is not provided, a superior arrangement can be found under which provides the safety enhancement in exchange for a lower wage for each employee. The arrangement would be superior in the sense that each party prefers it to the previous arrangement. This is consistent with the Coase theorem. To be explicit, let \$200 be the worker's weekly wage without the safety enhancement and w_1 be the worker's wage with the safety enhancement. Then the value to the employer of each contract, without safety, is \$200. The surplus earned by the employer is therefore \$400.[25] If safety is provided, the surplus going to the employer is $\$700 - 2w_1$. The value of the employment contract without safety to each employee is \$200. The value with safety is $\$100 + w_1$. Thus, if w_1 is greater than \$100 and less than \$150, both the employer and the employees will be able to improve their positions by setting up a contract under which safety is provided.

Now it remains to be shown, in this example, how a union could improve matters. Suppose the wage reduction under the new arrangement is \$50, so that the new wage under the contract providing safety would be \$150. Note that this arrangement would transfer all of the

24 Richard B. Freeman & James L. Medoff, *The Two Faces of Unionism*, PUB. INTEREST, Fall 1979, at 69, 71. Perhaps the earliest discussion of the implications of the public goods model for labor law appears in Douglas L. Leslie, *Labor Bargaining Units*, 70 VA. L. REV. 353, 354-60 (1984).

25 This is the value of output, \$800, less the wage bill, \$400.

benefit from the enhancement to the workers; the employer would not be better off. But this is a shared wage reduction only if both employees express an interest in the safety enhancement. Otherwise, the one worker who seeks the enhancement will be asked to bear the full wage reduction, which is $100. Consider the incentives of the two employees if they know that this is the likely result if either of them were to approach the employer and individually bargain for an improvement in safety conditions. Figure 1 illustrates the expected payoffs to the employees. Because it is a dominant strategy[26] for each worker to say nothing, a union could in theory improve matters by speaking as one voice for the employees.

FIGURE 1

		Employee 2	
		Propose Change	Say nothing
Employee 1	Propose change	($50, 50)	(0, 100)
	Say Nothing	(100, 0)	(0, 0)

B. The Collective Action Model

Although Freeman and Medoff stressed the notion of public goods as a theory of efficient unionization, a more general description would use the term "collective action." In the example above, the union solves a collective action problem. All public goods problems are collective action problems, but I introduce the more general term because the converse is not necessarily true; not all collective action problems can appropriately be described as public good problems. The difference is that a public good in economics is defined as an item whose consumption is nonrivalrous, and which cannot be exclusively provided. Collective action problems, however, involve any situation in which there is a conflict between the incentives of the individual, acting selfishly, and the welfare of society. Although the collective action problem can be described, by stretching terms, as a public goods problem, it encompasses situations which generally do not involve the provision of a good.[27]

26 "Say nothing" is a dominant strategy because each employee has an incentive to say nothing irrespective of the other employee's strategy.

27 The classic collective action problem is compliance with the law. Compliance with a criminal code typically is not described as providing a "good" for anyone's consumption. However, the incentive problems associated with compliance often are the same as those observed in the public goods case. In many cases, welfare is enhanced if all parties comply with the code, but if everyone complies then it may be in the interest of each individual, thinking selfishly, not to comply. This is especially likely in any situation in which enforcement agents base their activity on the general level of compliance. For example, if private parties bring negligence claims only when the general level of compliance is low enough to suggest that an accident was probably due to the tortfeasor's negligence, then in any equilibrium in which compliance is perfect, or nearly so, victims will have very weak

The description of the union as a solution to the collective action problem seems to have been first stated by John Stuart Mill in his *Principles of Political Economy*.[28] Mill offered a hypothetical in which compliance with a rule restricting work hours would enhance the welfare of workers:

> Let us suppose, what is at least supposable, whether it be fact or not—that a general reduction of the hours of factory labour, say from ten to nine, would be for the advantage of workpeople: that they would receive as high wages, or nearly as high, for nine hours labour as they receive for ten. If this would be the result, and if the operatives generally are convinced that it would, the limitation, some may say, will be adopted spontaneously. I answer, that it will not be adopted unless the body of operatives bind themselves to one another to abide by it. A workman who refused to work more than nine hours while there were others who worked for ten, would either not be employed at all, or if employed, must submit to lose one-tenth of his wages. However convinced, therefore, he may be that it is the interest of the class to work short time, it is contrary to his own interest to set the example, unless he is well assured that all or most others will follow it. But suppose a general agreement of the whole class: might not this be effectual without the sanction of law? Not unless enforced by opinion with a rigour practically equal to that of law. For however beneficial the observance of the regulation might be to the class collectively, the immediate interest of every individual would lie in violating it: and the more numerous those were who adhered to the rule, the more would individuals gain by departing from it.[29]

Mill offered this hypothetical in the course of discussing a series of cases illustrating the "limits of the laissez-faire principle."[30] However, Mill was not proposing a specific type of government intervention; he was not suggesting, for example, that governments pass laws restricting work hours. His point was that the notion of noninterference with private contractual arrangements could not be given a theoretically rigorous defense in certain cases, and that collective action problems in the workplace presented one of those cases. Obviously aware that the assumptions of his hypothetical could be unrealistic, Mill concluded that it

> serves to exemplify the manner in which classes of persons may need the assistance of law, to give effect to their deliberate collective opinion of their own interest, by affording to each individual a guarantee that his competitors will pursue the same course, without which he cannot safely adopt it

incentives, if any, to bring negligence claims. *See* Janusz A. Ordover, *Costly Litigation in the Model of Single Activity Accidents*, 7 J. LEGAL STUD. 243 (1978).

28 2 JOHN STUART MILL, PRINCIPLES OF POLITICAL ECONOMY, Book 5, ch. 11, § 12 (New York, Appleton & Co. 1870). Book 5, chapter 10, § 5 includes an interesting defense of labor unions. I am indebted to Russell Hardin for suggesting that I read Mill.

29 *Id.* § 12, at 585-86.

30 *Id.* § 12, at 558.

himself.[31]

A modern version of Mill's collective action model may be found in the recent implicit contracts literature in economics.[32] The implicit contracts literature emphasizes the problem of informational asymmetry. The employer is assumed to have more information, for example, on the state of demand in the product market, and thus the value of each unit of labor time, than does the employee.[33] In this setting, the employee is vulnerable to opportunistic efforts on the part of the employer to reduce wages by understating the demand for the firm's product. Just as the workers in Mill's hypothetical have an incentive to undercut the effective wage by working the tenth hour, in this example each employee would, in the absence of a rule preventing it, have an incentive to promptly undercut the present wage in order to hold on to his job.

Although this is not in the strictest sense a free rider problem, it is a version of the basic prisoner's dilemma that makes the union a potentially efficient institution. The union can solve the problem of opportunism if it can prevent employees from individually negotiating wage concessions, either by presenting itself as the exclusive bargaining agent, or by requiring the employer to reduce hours instead of wages in response to downturn.

Building on the work of Williamson, Wachter, and Harris[34] and of Klein, Crawford, and Alchian,[35] several commentators have recently offered models of the union in which the union's role or function is to monitor the employment relationship in order to prevent the employer from appropriating rents to which the employees have earned a claim.[36]

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[31] *Id.* § 12, at 587. Mill did not say how much "assistance of law" people will need, but his argument suggests that the law should go as far as necessary in providing a solution to the collective action problem. The collective action problem seems to have been overlooked by Epstein in his critique of labor legislation. *See* Epstein, *supra* note 8. Whether or not it is valid on empirical grounds, the collective action problem remains the strongest theoretical response to the freedom of contract argument.

[32] For a discussion of the key results of the literature, see Oliver D. Hart, *Optimal Labour Contracts Under Asymmetric Information: An Introduction*, 50 REV. ECON. STUD. 3 (1983).

[33] The value of each unit of labor time to the employer is equal to the "marginal revenue" of the firm's output multiplied by the "marginal product" of the unit of labor time. The marginal revenue of the firm's output is the increase in revenue that would result from producing an additional unit of output. The marginal product is equal to the increase in output attributable to an additional unit of labor time. *See, e.g.*, EHRENBERG & SMITH, *supra* note 22, at 56-60. Because the calculation of marginal revenue requires information on the state of demand, the employer is likely to enjoy an informational advantage in estimating it.

[34] Oliver E. Williamson et al., *Understanding the Employment Relation: The Analysis of Idiosyncratic Exchange*, 6 BELL J. ECON. 250 (1975).

[35] Benjamin Klein et al., *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J.L. & ECON. 297, 315-16 (1978).

[36] *See* Armen A. Alchian, *Decision Sharing and Expropriable Specific Quasi-Rents: A Theory of* First National Maintenance Corporation v. NLRB, 1 SUP. CT. ECON. REV. 235 (1982); George M. Cohen & Michael L. Wachter, *Replacing Striking Workers: The Law and Economics Approach, in* PROCEEDINGS OF NEW YORK UNIVERSITY 43RD ANNUAL NATIONAL CONFERENCE ON LABOR

Because monitoring has certain public good aspects, the "monitoring" or "internal labor market" model of the union is essentially a version of the collective action model.[37]

C. Asymmetric Stakes and Asymmetric Information

The collective action or public goods justification of unions, as described thus far, is in one sense incomplete. Although it suggests that the incentives for workers to comply with certain welfare-enhancing rules or to push for workplace public goods is weak, it also suggests that the incentive for the employer to adopt such enhancements should be strong, and indeed should grow stronger as the workers' incentives weaken. I will refer to this as the problem of asymmetric stakes.[38]

Consider the "safety enhancement" example discussed in the previous section. Recall that, in the example, the employees are all better off if each employee's wage is reduced by no more than $100 in exchange for the desired safety enhancement. The employer is better off if she can cut the wage bill by any amount greater than $100. There is an asymmetry in the potential gain to each worker and the gain to the employer, and the asymmetry is more pronounced as the number of workers increases. For example, suppose the employer can get the employees to agree to a $70 wage cut in exchange for the safety enhancement. Then each worker gains $30, and the employer gains $40. If there are three workers, the same agreement would allow the employer to gain $110; if ten workers, $600.

The point applies whether the example involves the provision of some workplace public good, or simply the more general problem of compliance with welfare-enhancing rules: if each worker would benefit by the regime change, the employer has a strong incentive to discover the benefit and appropriate as much of the surplus as possible, precisely in those situations in which the collective action problem arises. Thus, if employers are aware of the value of safety enhancement to each worker, and workers are reluctant to propose such enhancements because of the public goods problem, we should observe employers spontaneously providing the additional safety.

In light of the asymmetry in potential gains from a regime change, if

(Bruno Stein ed., 1990); Hylton & Hylton, *supra* note 9; Leslie, *supra* note 24; Wachter & Cohen, *supra* note 9. For a discussion of the rent-appropriation theory which is skeptical of the efficiency of unions, see Robert H. Lande & Richard O. Zerbe, Jr., *Reducing Unions' Monopoly Power: Costs and Benefits*, 28 J.L. & ECON. 297, 300-06 (1985).

37 However, I think the collective action problem should be emphasized in any model of the union. The need for monitoring by itself does not tell us why workers need to form a horizontal agreement among themselves; it only implies that someone needs to monitor the employment relationship. The union, a horizontal agreement, is necessary in the internal labor market model only because monitoring, in addition to being a private good, has important public good characteristics.

38 I am indebted to Richard Craswell for bringing this problem to my attention.

the collective action justification is to stand, without support from some altogether different argument, it requires the assumption that the employer is unable to make an across-the-board reduction in wages that reflects the benefit each employee receives from the regime change. Such reductions may be impossible for two reasons: first, heterogeneity in employee valuations of benefits, and second, imperfect information about employee valuations. In this case, the employer can make a reduction in wages that reflects the full value of safety benefits only if she can gather accurate information on employee preferences concerning safety. But if the employees know why the employer seeks such information, they will have an incentive to understate or underreport their preferences.[39]

The collective action problem, therefore, is inextricably intertwined with the problem of informational asymmetry. In the case of a welfare-enhancing change, the model requires that the employer lack information concerning employees' valuations of benefits. In the case of an attempt to appropriate rents by falsely reporting the state of product market demand, the model requires that employees lack such information.

D. Other Models

The agency cost literature[40] has provided another reason to think that, even in the absence of informational asymmetry, an employer may not take advantage of the asymmetric gains when there are workplace public goods that, if provided, would increase welfare. Usually, the workers negotiate with the managers and not with owners of the firm. The incentives of the managers may diverge from those of the owners. The managers may value their discretion more than the additional profit the company could earn by improving safety or providing some other benefit in exchange for a reduction in wages.

More than simply providing another way out of the Coase theorem puzzle, the agency cost literature provides an alternative justification for

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[39] By understating the desire for public goods, each employee would hope to push some of the cost of providing these goods on to the employees who truthfully reveal their willingness to pay. The problem of obtaining honest information on preferences is at the heart of the public goods problem. *See* Paul A. Samuelson, *The Pure Theory of Public Expenditure*, *in* 2 THE COLLECTED SCIENTIFIC PAPERS OF PAUL A. SAMUELSON 1223 (Joseph E. Stiglitz ed., 1966). Although Samuelson noted this problem in his presentation of the public goods problem, the literature emphasizing the problem of discovering willingness to pay is fairly recent. *See* Theodore Groves & Jonathan Ledyard, *Optimal Allocation of Public Goods: A Solution to the "Free Rider" Problem*, 45 ECONOMETRICA 783 (1977). For a clear discussion of the recent literature (known by economists as the "mechanism design" literature), see HOWARD RAIFFA, THE ART AND SCIENCE OF NEGOTIATION 300-09 (1982). A technically oriented discussion is provided in DREW FUDENBERG & JEAN TIROLE, GAME THEORY 243-318 (1991).

[40] The agency cost literature explains the incentives of managers to sacrifice corporate profits in order to enhance their own welfare. The problem arises because of the separation between ownership and control. *See* OLIVER E. WILLIAMSON, THE ECONOMICS OF DISCRETIONARY BEHAVIOR (1964); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

unions. Indeed, once agency costs are recognized as a reason for failure of the Coase theorem, the agency cost problem, and not the collective action problem, becomes the fundamental rationale for suggesting that unions could improve welfare.[41]

The agency cost theory of efficient unionization can be analogized to the recent theory that corporate takeovers that substitute debt for equity enhance efficiency by forcing managers to meet a rigid schedule of debt payments rather than an undefined, nonmandatory series of dividend payments; in effect, replacing a soft budget constraint with a hard one.[42] According to the arguments of Slichter,[43] and later Freeman,[44] unions enhance efficiency by forcing the managers to meet a set of demands,[45] or at least, to regularly meet and listen to the complaints of employees. This view has been at the heart of "workplace democratization" theories of unionism.[46]

The important flaw in the agency cost theory, however valid it may seem to be in empirical tests, is that it requires us to ignore the ways in which the interests of the workers diverge from those of the owner. The solution to the agency cost problem is to align the incentives of managers and foremen with those of the owner, so that all enhancements that will increase the value of the enterprise will be adopted. The agency cost model offers the union as a second best solution to the incentive alignment problem. But one important sense in which this solution may be very poor concerns the different horizons that workers and employers will consider in valuing the firm.[47] The horizon of the employees extends as far as their expected tenure in the firm, which in the vast majority of cases today will not exceed ten years.[48] The horizon of an owner extends, at least in theory, infinitely far into the future. The workers will

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41 For an analysis of unions and labor law which emphasizes the agency cost problem, see Ralph K. Winter, Jr., *Collective Bargaining and Competition: The Application of Antitrust Standards to Union Activities*, 73 YALE L.J. 14 (1963).

42 Michael C. Jensen, *Eclipse of the Public Corporation*, HARV. BUS. REV., Sept.-Oct. 1989, at 61.

43 SUMNER H. SLICHTER, THE CHALLENGE OF INDUSTRIAL RELATIONS: TRADE UNIONS, MANAGEMENT, AND THE PUBLIC INTEREST 69-73 (1947).

44 Freeman & Medoff, *supra* note 24, at 74-78.

45 A closely related literature is that on "X-inefficiency"—inefficiency that results simply from institutional arrangements that dull incentives to respond to consumers or to minimize costs. *See* Harvey Leibenstein, *Allocative Efficiency vs. "X-Efficiency"*, 56 AM. ECON. REV. 392 (1966). Applying this theory to the union setting, unions would raise productivity by breaking down over cutting through the traditional institutional arrangements which allow managers to ignore the demands of workers.

46 Winter, *supra* note 41, at 23-24.

47 *See generally* Michael C. Jensen & William H. Meckling, *Rights and Production Functions: An Application to Labor-managed Firms and Codetermination*, 52 J. BUS. 469 (1979).

48 Average tenure is roughly 6.6 years. *See* Carol Kleiman, *To Stay or not to Stay? The Question Gets Tougher*, CHI. TRIB., Feb. 26, 1989, Jobs Sect., at 1; Robert Lewis, *Tenure: A Sign of Satisfaction?*, NEWSDAY, Jan. 25, 1989, Bus. Sect., at 49.

almost always be willing to sacrifice investments that pay off far into the future in return for greater wages today. The owner's claim to the residual, however, gives her an incentive to maximize its value, taking into account all foreseeable future income.

Another theory of the union is that it exists to counteract the monopsony power of the employer.[49] Under the monopsony model the employer exerts its market power in the labor market to reduce the wage below the competitive level.[50] The monopsony model is theoretically sound, but runs into the problem, noted by several commentators, that there seem to be few monopsonists in today's labor market.[51] Employees shop for jobs among several cities and sometimes among several states. Few employers have a captive pool of employees.

A third—and perhaps oldest—recurrent theory of the union is that the union exists to correct inequality in bargaining power.[52] This theory suffers from vagueness. Every model discussed above could be described as an example of the union equalizing bargaining power. However, the fundamental problem with the verbal formula "equalize bargaining power," is that on its most general level it is inconsistent with the theory of trade. In order to increase wealth, parties must have different endowments,[53] and this suggests that the parties to a contract generally will have unequal bargaining power. Thus, the verbal formula stating the union's function as equalizing bargaining power is on its most general level self-contradictory because inequality in bargaining power is virtually a necessary condition for wealth-enhancing exchange.[54] A theory

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49 *See, e.g.*, Winter, *supra* note 41, at 25-27 (discussing monopoly power of employers).

50 If the employer could perfectly price discriminate among workers, she would go further and pay every worker the minimum amount that he would be willing to receive and hire the efficient number of employees in each skill class. However, because the monopsonist is assumed to be unable to charge different wages to employees within the same skill class, it sets a wage for each class that is below the competitive wage and hires less than the efficient number of employees.

51 *See, e.g.*, Posner, *supra* note 3, at 992.

52 *See, e.g.*, American Steel Foundries v. Tri-City Cent. Trades Council, 257 U.S. 184, 209 (1921). *See also* 79 CONG. REC. 7565 (1935) (statement of Sen. Wagner).

53 David Ricardo stated the fundamental theorem of trade, and perhaps of much of microeconomics. DAVID RICARDO, PRINCIPLES OF POLITICAL ECONOMY AND TAXATION 113-17 (Sir E.C.K. Gonner ed., G. Bell & Sons 1932) (1817). The theory is that trade increases wealth whenever one party has a comparative advantage in an area. If endowments (interpreted broadly to include goods, labor, labor productivity, capital) are equal, then no comparative advantage will exist and welfare-enhancing trade will be impossible. Since Ricardo's original proof, the literature in this area has grown substantially. For someone unfamiliar with it, the best source is an introductory text, such as RICHARD G. LIPSEY ET AL., ECONOMICS 774-79 (8th ed. 1987). Although Ricardo's theorem is usually stated in discussions of international trade, it applies to every sort of market exchange, even the employment contract.

54 I am assuming that bargaining power is determined by the value of one's endowment. This seems to be the assumption underlying the "inequality of bargaining power" justification of the union. If the assumption is rejected—*i.e.*, if we assume that bargaining power is something different, unrelated to the value of a party's endowment—then my argument loses much of its force. However, so does the justification for the union. If bargaining power has nothing to do with the value of

that suggests that the union sets itself against the fundamental reason the employment relationship is formed is one that cannot be very helpful.

IV. COULD LABOR LAW BE DOCTRINALLY EFFICIENT?

In this Part, I reexamine the traditional position in the law and economics literature that case law tends toward efficiency, while statutory law is inefficient. I also argue that the common law efficiency hypothesis is applicable to labor law.

A. Doctrinal Efficiency and the Statutory Versus Common Law Distinction

One branch of the law and economics literature has distinguished statutory and case law, arguing that the former may or may not be efficient, while the latter tends toward efficiency. The distinction can be observed in the treatment of antitrust and tort law. There is no discernable presumption in the law and economics literature that federal antitrust doctrine is economically efficient. Indeed, it is often criticized for being inefficient.[55] On the other hand, it is fairly common to see various parts of tort doctrine explained by efficiency theories.[56] Under the traditional approach, labor law is to be viewed as largely an area of statutory law and, therefore, probably inefficient.

Two general reasons can be given for the distinction between the efficiency characteristics of statutory and case law rules. One is that statutes, unlike court judgments, are the result of majority voting, and there is a large body of literature making the point that voting can produce irrational results, in the sense of being inconsistent with standards of rational decisionmaking.[57] The second reason for the distinction between statutory and common law is that statutes are thought to be generated by a process which can easily be exploited by informed, organized special interest groups.[58] Provided the majority of voters are uninformed, inter-

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a party's endowment, then on what basis can it be assumed that the employer has more bargaining power than the worker?

55 *See, e.g.*, ROBERT H. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF (1978).

56 *See, e.g.*, POSNER, *supra* note 2, at 147-98.

57 The literature begins with Condorcet's paradox, which was generalized by Arrow's Impossibility Theorem. *See* 1 KENNETH J. ARROW, COLLECTED PAPERS OF KENNETH J. ARROW, SOCIAL CHOICE AND JUSTICE 125-29 (1983).

58 This criticism of democratic processes is so old that I am reluctant to cite any source. It is implicit in Madison's description of the abuses of faction in Federalist 10. In the terms of modern economics, the gist of the criticism is that groups whose organization costs are low are able to vote as a block for special interest legislation, while groups that are unorganized and dispersed, such as consumers, will generally lose out. This is the position of the rent seeking literature and of the public choice literature generally. *See* DENNIS MUELLER, PUBLIC CHOICE II 58-95, 229-46 (1989) (survey of public choice theory); *see also* George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971).

est groups can use the legislative process to transfer wealth to themselves. They are able to do this because intelligent voting, unlike intelligent consuming, generally requires vast amounts of information.[59]

Because participation in the legislative process requires information, a type of collective action problem is observed. No voter is sufficiently concerned about a typical issue to inform himself about all of the relevant facts.[60] The informational gap can be exploited by well-organized parties. For example, a statute whose main effect is to provide a competitive advantage to one set of firms may be promoted under the guise that it will help clean up the environment.[61]

One problem with differentiating between statutory and common law is that there may be no easy distinction between the two.[62] Much of what is referred to as statutory law is the result of judicial interpretation of statutes.[63] Indeed, the gap-filling function of interpretation produces a body of law that may grow in scope to a point at which the statute becomes relatively unimportant in comparison.

It is an oversimplification to say that the standard economic criticism of statutory law applies to statutes alone. The literature recognizes the difficulty in distinguishing statutory and case law. A better description of the critique would suggest, roughly, that as the statutory component of any body of law becomes more important, or assumes a larger share of the relevant doctrine, the less likely it is that the doctrine in a

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59 The market is different in this respect: it protects the uninformed because the knowledge of informed parties gets transferred into prices. *See generally* FRIEDRICH A. HAYEK, INDIVIDUALISM AND ECONOMIC ORDER 33-56 (1948) (discussing the market's role as generator of information); F.A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519 (1945). In addition, the market provides incentives for some sellers to disclose favorable private information, and the process tends to expose sellers who wish to hide unfavorable private information. *See* J.J. Grossman & O.D. Hart, *Disclosure Laws and Takeover Bids*, 35 J. FIN. 323, 323-25 (1980). For a study of a recent example of failure in the flow of information in a nonmarket economy, see GRIGORI MEDVEDEV, THE TRUTH ABOUT CHERNOBYL (Evelyn Rossiter trans., 1991).

60 Indeed, why anyone votes is a puzzle, given that the probability that one person's vote will change the outcome of an election probably is less than that of the same person being hit by a car on the way to the polls. The voter information problem was first rigorously examined in ANTHONY DOWNS, AN ECONOMIC THEORY OF DEMOCRACY (1957). For a recent survey of the literature, see, *e.g.*, MUELLER, *supra* note 58, at 348-69.

61 The same may be said of a safety requirement. *See, e.g.*, Ann P. Bartel & Lacy Glenn Thomas, *Direct and Indirect Effects of Regulation: A New Look at OSHA's Impact*, 28 J.L. & ECON. 1 (1985) (presenting evidence that OSHA's enforcement of health and safety regulations favor large, unionized firms at the expense of small, nonunionized firms). For additional examples, see BORK, *supra* note 55, at 347-64.

62 *Cf.* GUIDO CALABRESI, A COMMON LAW FOR THE AGE OF STATUTES (1982) (treating modern American law as a dialogue between courts and legislatures).

63 And, conversely, some practices that are often described as common-law rules resulted from statutes. The best example of this is the British rule for allocating legal expenses, which is sometimes referred to as the common law practice. The British rule was the result of a series of statutes. If there was a common law practice, it was shifting the legal expenses of the plaintiff alone. *See* Comment, *Distribution of Legal Expense Among Litigants*, 49 YALE L.J. 699, 700 (1940).

given area can be explained on efficiency grounds.[64]

However, the standard economic critique of statutory law is simplistic in attempting to categorize areas of law as either statutory or common law, and then basing its efficiency judgment on that category. Virtually every area of law is a mixture of the two. A more general model would hold that statutes set initial conditions and through discrete "shifts" alter the position of a body of legal doctrine. If the rent seeking theory of legislation is valid, the initial conditions will be inefficient, and the discrete shifts will generally be in the direction of inefficiency. But the law is continuously shifted by judicial opinions which, under the efficiency hypothesis, will push it toward efficiency.

B. The Development of Efficient Legal Doctrine

How is it that case law tends toward doctrinal efficiency? One of the arguments suggesting that common law tends toward efficiency is based on a negative inference: it seems unlikely that the common law could be used to subsidize or transfer wealth to a given type of litigant.[65] One obvious reason is that common law rules seldom identify the type of litigant.[66] The rules are typically stated in a form that grants *A* a right against *B* or all others, whether or not *A* happens to be of a certain economic class. More importantly, the common law process seems to be less vulnerable to exploitation than is the legislative process since it is difficult to trace the wealth effect of common law rules.[67] Because it is hard to trace the wealth effect, it is unlikely that any party could use the process to create a subsidy for himself.[68]

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64 As a corollary, over time, as the common law component grows and statutory provisions recede in importance, an area of statutory law will move toward efficiency. One could argue that this has happened in antitrust law. Recent decisions such as Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc., 441 U.S. 1 (1979), and Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977), have introduced significant doctrinal innovations in antitrust law and have made it more sensitive to efficiency concerns.

65 A. MITCHELL POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 121-24 (2d ed. 1989); POSNER, *supra* note 2, at 499; Richard A. Epstein, *The Social Consequences of Common Law Rules*, 95 HARV. L. REV. 1717 (1982).

66 Epstein, *supra* note 65, at 1727.

67 This is Epstein's general argument, *supra* note 65; *see also* POLINSKY, *supra* note 65.

68 Consider, for example, the treatment in American courts of the doctrine of ancient lights. One view is that the American rejection of the doctrine of ancient lights reflected a desire to promote or at least not to hinder development. RICHARD A. EPSTEIN, CASES AND MATERIALS ON TORTS 581 (1990). But if parties look sufficiently forward into the future, the rule concerning the doctrine of ancient lights will not only not affect such marginal decisions as whether to build up to ten stories rather than six, but will also not affect wealth levels in any foreseeable manner. To see this, suppose there are two parties: homeowner, *H*, and developer, *D*. The value of light is worth $100 to *H*. *D's* project is worth $200. Because American courts do not recognize the doctrine of ancient lights, *H* suffers a $100 loss if *D* goes forward with a building that blocks light to *H*. Of course, if American courts recognized *H's* claim to the light passing over *D's* property, *D* would simply offer a payment of at least $100 to *H* and proceed with the project. In this sense, the assignment of the entitlement to light has no effect on development. However, the standard analyses suggest that the assignment

A second reason for the relative difficulty in exploiting the common law process to subsidize a particular interest group is that it is unlikely that any party can simply have its way with case law. Holmes made this clear in his discussion of the evolution of common law.[69] The common law process gives judges few if any opportunities to create subsidies for a particular interest group. Holmes suggested that judges are bound by precedent, and where the law or the facts are unclear the question is generally submitted to the jury, not simply decided by the judge. In Holmes's model, the jury serves as a source of information.

Pound, several years later, elaborated on the importance of the common law process.[70] Pound admitted that judges were making policy decisions, but in his view, they were not making them on a clean slate. They followed precedent and drew analogies to settled areas of doctrine. In this sense, the development of case law did not occur as if the judge sat as a Benthamite social planner, deciding in each case what rule would maximize total utility, while relying only on his own observations of relevant preferences and technology. By relying on settled doctrine judges took advantage of the social information embodied in common law rules. In this sense, the process minimized errors that would result in a regime in which judges were given a freer hand.[71]

In Holmes's model, the common law became more certain over time. In areas where the law was certain, the judge no longer submitted to the jury questions concerning the standard of conduct. This process of limiting jury discretion prevented jury decisions from muddying clear standards that had developed over time. Appellate court review further restrained or circumscribed the discretion of the jury. Thus at any moment, the discretion of the jury on matters concerning the legal standard was circumscribed, *ex ante*, by the judge's decision whether to submit a question to the jury, and *ex post*, by appellate court review of issues decided by juries.

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affects wealth levels because the developer is wealthier under the traditional American rule, and this should affect the rate at which individuals enter the developing business. But if parties look sufficiently far into the future, developers as a class would not be wealthier under the American approach to the doctrine of ancient lights. Under the American approach the value of any property purchased by the developer would be higher than under a system which recognized the doctrine of ancient lights. How much higher? The price would rise by an amount equal to the expected benefit to the developer from not having to compensate nearby homeowners for blocking light. *Ex ante*, there would be no wealth transfer between the two classes *H* and *D*.

[69] HOLMES, *supra* note 10, at 111-29. My remarks in this section refer to Holmes's series of lectures on the common law. Holmes presented a different version of his evolution argument in Oliver W. Holmes, *Science in Law and Law in Science*, 12 HARV. L. REV. 433 (1899). *See* E. Donald Elliott, *Holmes and Evolution: Legal Process as Artificial Intelligence*, 13 J. LEGAL STUD. 113 (1984).

[70] ROSCOE POUND, THE SPIRIT OF THE COMMON LAW 166-92 (1921).

[71] EDWARD H. LEVI, AN INTRODUCTION TO LEGAL REASONING 1-27 (1948). The process of reasoning by example prevented judges from going on "flights" of the sort described by Levi. *Id.* at 16-17.

Another factor which makes it unlikely that the common law process can be used to create subsidies for a particular class of litigants is that the parties themselves will tend to litigate a certain dispute or to pursue the dispute to the appellate level only in cases in which the facts concerning legal compliance are ambiguous or the legal standard itself is unclear. In any dispute in which the legal standard and the facts concerning compliance are clear, the incentive to settle will dominate. Rubin,[72] Priest,[73] and Landes and Posner[74] have presented models of common law evolution which emphasize the incentives of litigants. Efficiency in these models results largely from the behavior of litigants.[75]

Inefficient legal rules create asymmetric stakes, or at least increase the stakes of litigation, and for this reason, tend to generate litigation.[76] Thus, one class of parties who may have an incentive to litigate even though the rule is crystal clear will be those parties affected by inefficient legal rules.[77] Over time, inefficient legal rules will be the subject of litigated disputes, and these rules will be overturned more often than will efficient legal rules.

The theory that inefficient legal rules are driven out of the system because they generate more litigation than do efficient rules—the so-called differential litigation theory—is a relatively recent version of the common law efficiency hypothesis. An earlier version of the common law efficiency thesis was implicit in the arguments of Holmes and Pound, and was stated forcefully by Bruno Leoni.[78] Like Pound, Leoni argued

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72 Paul H. Rubin, *Why is the Common Law Efficient?*, 6 J. LEGAL STUD. 51 (1977).

73 George L. Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J. LEGAL STUD. 65 (1977).

74 William M. Landes & Richard A. Posner, *Legal Precedent: A Theoretical and Empirical Analysis*, 19 J.L. & ECON. 249 (1976).

75 Further refinements of Rubin's argument are provided in John C. Goodman, *An Economic Theory of the Evolution of Common Law*, 7 J. LEGAL STUD. 393 (1978); R. Peter Terrebonne, *A Strictly Evolutionary Model of Common Law*, 10 J. LEGAL STUD. 397 (1981).

76 *See* Priest, *supra* note 73, at 67; Rubin, *supra* note 72, at 53-55. An early version of this argument was articulated by Bentham, who, anticipating the Marxist-Critical Legal Studies critique, immediately noted the difficulty in proving that this process explains the law, especially statutory law. Bentham—almost in a mocking tone—noted that laws giving the husband control over all of the property in a marriage could be justified on efficiency grounds by a transaction cost argument. Giving property rights to the wife would simply force husbands to use brute force to assert control. The costs of such efforts to reallocate entitlements could be minimized by assigning them to the husband at the start. Bentham noted that in a world in which the laws were written by men, it would be impossible to determine whether this efficiency argument explained marital property rights. BENTHAM, *supra* note 10, at 259-60 n.1.

77 In the homeowner-versus-developer example discussed earlier, *supra* note 68, assigning a property right in light to the homeowner, who values it less than the developer, would give the developer an incentive to litigate in order to reverse the assignment of the entitlement.

78 BRUNO LEONI, FREEDOM AND THE LAW 59-96 (1961). *See also* Peter Aranson, *Bruno Leoni in Retrospect*, 11 HARV. J.L. & PUB. POL'Y 661 (1988); Leonard P. Liggio & Tom G. Palmer, *Freedom and the Law: A Comment on Professor Aranson's Article*, 11 HARV. J.L. & PUB. POL'Y 713 (1988) (discussing Leoni's contribution to the statutory versus common law literature).

that common-law judges did not write the law on a clean slate. Their role was closer to attempting to discover the common law, which was nothing more than a set of implicit agreements that governed social interaction. The doctrinal rules that developed through the consideration of disputes were not analogous to a code written by one person or even a committee of judges acting in collusion. Instead, these rules more closely resembled a formal statement of implicit contracts that existed in society.[79] Judges discovered the common law in the same sense that an arbitrator in a contract dispute might search for the rule that the parties would have adopted if transaction costs had not prevented them from explicitly adopting it. The body of such rules existed independently of the courts. The judges were mere "spectators"[80] who were sometimes called on to find the rule that should govern a dispute. More than simply providing an applicable rule, the existing case law helped the judge find the right answer because it could be used to discover the expectations and implicit agreements of parties in disputes similar to that before the judge.

This view of the common law as a formalization of implicit contracts also explains how it could tend toward efficiency. The implicit agreements between two parties would presumably be wealth-maximizing, for any other type of agreement could be improved upon, from the perspective of both parties, by a wealth-maximizing agreement.[81] The implicit contracts theory also seems to overlap considerably with the differential litigation theory. In an area in which a doctrinal rule had developed which was inconsistent with implicit agreements, or which had grown inconsistent over time because of changes in tastes or technology, parties would have an incentive to litigate in order to overturn the rule. A judge who sought to discover the implicit agreements would tend to replace an inefficient rule with an efficient one.

Although the differential litigation theory suggests that inefficiency

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[79] This can be seen as an economic interpretation of the classical common law theory presented in Blackstone's *Commentaries*, which took the view that the common law was based on custom and common understanding. WILLIAM BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND (Univ. of Chicago Press 1979) (1765-69). Under the economic interpretation of classical common law theory, common law is based on a system of interaction that develops spontaneously, and reflects rules that exist in equilibrium. In Hayek's terms it is a "grown" rather than "made" order. *See* 1 F.A. HAYEK, LAW, LEGISLATION, AND LIBERTY: RULES AND ORDER 35-54 (1973).

[80] LEONI, *supra* note 78, at 87.

[81] This should be obvious in the case of an agreement between two parties, with no effects on a third party. What about an agreement that does have third party effects? The argument still holds. Consider the classic third party effect problem—an agreement between two competing sellers to form a price-fixing cartel. As between two sellers, the agreement is wealth-maximizing, but cartelization reduces society's wealth. It transfers wealth from consumers to producers and causes an inefficient allocation of resources. *See, e.g.*, GEORGE J. STIGLER, THE THEORY OF PRICE 213 (rev. ed. 1952). In the case of agreements that affect three parties, the implicit contract approach would consider the interests of each of the parties. A wealth-maximizing agreement would not permit cartelization for the sole purpose of earning monopoly profits.

in the assignment of entitlements will generate litigation, it is not the only force generating litigation. Some parties may, because they have more at stake than others, have an incentive to litigate in order to reverse even an efficient assignment of an entitlement. Because of this problem, summaries of the literature on the efficiency of case law conclude that litigant behavior, by itself, seems to be insufficient to guarantee that the common law process will tend toward efficiency.[82]

The judge is the only feature of the model of evolution which can obstruct the influence of parties who invest in rent-seeking litigation. The fact that judges consider themselves bound by precedent is a feature of the common law process which suggests that special interest litigants will not be able to exploit the litigation process in order to establish rules which enrich themselves at society's expense.[83] But, once admitted, the role of precedent reveals an important weakness in the model of efficient evolution. It relies on the compliance of judges. If judges choose not to follow precedent, they will generate litigation. Interest groups will discover the weakness in the system and exploit it in order to create inefficient rules. The behavior of litigants generally is a function of the compliance rate of judges. If a larger percentage of judges refuses to follow precedent, a larger percentage of litigants will have incentives to pursue their disputes whether or not the standard of conduct is efficient.

An alternative theory of the importance of judges in the common law process is that their individual values and prejudices influence their decisions.[84] But if their discretion is sufficiently constrained, individual values should play an insignificant role in influencing the path of case law. Furthermore, if the selection of disputes for trial is not random, as Holmes, Priest and others have argued, judges will not be able to choose the issues that come before them.

C. Does Labor Law Tend Toward Doctrinal Efficiency?

The arguments suggesting that the common law tends toward efficiency generally apply to any body of judge-made law, including labor law. Consider, for example, two alternative successorship rules: one requiring the successor employer to comply with the collective bargaining agreement of the predecessor and another giving the successor unfettered freedom to hire or not hire the predecessor's employees. If parties look

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[82] *See* ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 492-96 (1988); Robert Cooter & Lewis Kornhauser, *Can Litigation Improve the Law Without the Help of Judges?*, 9 J. LEGAL STUD. 139 (1980); Paul H. Rubin, *Common Law and Statute Law*, 11 J. LEGAL STUD. 205 (1982).

[83] It is interesting that this feature was stressed by Holmes in his model of evolution. *See* HOLMES, *supra* note 10, at 111-29.

[84] *See* George L. Priest, *Selective Characteristics of Litigation*, 9 J. LEGAL STUD. 399, 407 (1980) (citing JEROME FRANK, LAW AND THE MODERN MIND (1930)).

sufficiently far into the future, the direction of the wealth effect of either rule would be difficult to determine.

It seems that the literature suggesting that case law tends toward efficiency has not accepted this "negative inference" approach as a strong defense of the efficiency of judge-made law. The more recent literature, anticipated by Holmes, stresses the common law process itself as the key reason that case law may tend toward efficiency. The question which needs to be examined is whether the process by which labor law is generated is one that fits within the framework outlined above. In other words, does the process by which labor doctrine develops suggest a tendency toward doctrinal efficiency?

Labor law doctrine is developed in both the NLRB and the federal courts. The Board has jurisdiction over disputes concerning representation matters and unfair labor practices.[85] Board orders are "appealed," through efforts to seek enforcement, to the federal appellate courts.[86] The labor statutes grant federal trial courts jurisdiction over disputes concerning the enforcement of collective bargaining agreements, that is, section 301 disputes.[87]

Labor law disputes that generally are decided in the federal courts fall within the system described by the evolutionary model of the common law. Disputes concerning compliance with a collective bargaining agreement often require courts to interpret the provisions of the agreement. Although the collective bargaining agreement resembles something more than a contract,[88] it is hard to see how disputes concerning compliance with such an agreement can escape an analysis using methods developed in contract cases. In section 301 litigation, courts interpret terms with respect to which one of the parties has superior information in favor of the relatively uninformed party.[89] This is a tradi-

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85 ROBERT A. GORMAN, BASIC TEXT ON LABOR LAW: UNIONIZATION AND COLLECTIVE BARGAINING 7 (1976).

86 *Id.* at 10.

87 *Id.* at 544. Section 301(a) of the Labor Management Relations Act, 29 U.S.C. § 185(a) (1988), provides: Suits for violation of contracts between an employer and a labor organization representing employees in an industry affecting commerce as defined in this Act, or between any such labor organizations, may be brought in any district court of the United States having jurisdiction of the parties, without respect to the amount in controversy or without regard to the citizenship of the parties.

88 For example, the collective bargaining agreement "calls into being a new common law—the common law of a particular industry or of a particular plant." United Steelworkers v. Warrior & Gulf Navigation Co., 363 U.S. 574, 578-79 (1960). "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." Archibald Cox, *The Legal Nature of Collective Bargaining Agreements,* 57 MICH. L. REV. 1, 22 (1958).

89 For example, management rights clauses are not read to exclude employer decisions from the arbitration process unless the decision at issue is specifically referred to in the clause. *See* United Steelworkers v. Warrior & Gulf Navigation Co., 363 at U.S. 584 ("[provision of agreement stating

tional approach of contract law[90] that is justifiable on efficiency grounds. Allowing a party with superior information regarding certain terms of a contract to impose his desired interpretation after the contract has been signed gives that party the power to change the terms of the contract *ex post*.[91] Unless there is some effort to control or deter such activity, the contracting process will become more expensive as parties attempt to weed out every ambiguous term, and the increased costs of contracting will make some potentially wealth-enhancing contracts unprofitable for all parties.

One could argue that, in terms of the process, the contract interpretation cases in labor law enjoy an advantage over many other legal areas in which contract interpretation is required, such as the interpretation of insurance contracts. Arbitrators, who presumably have experience and enjoy at least some respect from both parties to the conflict, generally decide such contract interpretation cases. The deference given by federal courts to the decisions of arbitrators restricts the ability of courts to impose interpretations that are far outside of the reasonable expectations of the involved parties. Thus, the treatment of section 301 disputes is quite consistent with the efficiency theorists' notions of the common law process. Disputes that do not reach arbitration may reach the federal

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that matters which are strictly a function of management shall not be subject to arbitration] must be interpreted as referring only to that over which the contract gives management complete control and unfettered discretion."); GORMAN, *supra* note 85, at 469-70.

90 *See* RESTATEMENT (SECOND) OF CONTRACTS § 201 (1981). Section 201 essentially states that where parties to an agreement have attached different meanings to a term, it is interpreted in accordance with the meaning understood by one of them if, at the time the agreement was made, that party did not know of any different meaning attached by the other, and the other either knew or had reason to know of the meaning attached by the first party. *See* Emor, Inc. v. Cyprus Mines Corp., 467 F.2d 770 (3d Cir. 1972); Frigaliment Importing Co. v. B.N.S. Int'l Sales Corp., 190 F. Supp. 116 (S.D.N.Y. 1960).

Anthony Kronman has noted that this doctrinal rule is inconsistent with cases holding an uninformed party to the terms of his bargain, such as the famous case involving the tobacco purchase at the end of the War of 1812, Laidlaw v. Organ, 15 U.S. (2 Wheat.) 178 (1817). *See* Anthony T. Kronman, *Mistake, Disclosure, Information and the Law of Contracts*, 7 J. LEGAL STUD. 1 (1978). Kronman's explanation is that the difference between *Laidlaw* and the cases in which the rule stated in § 201 of the Restatement is applied is that in the former set of cases the no-disclosure rule creates a property right in information that is costly to collect and thereby enhances incentives to acquire information.

91 As a result the relatively uninformed party will be unable to evaluate the informed party's promise. Rationally, the uninformed party would assume the worst and set the lowest possible value on the informed party's promise. But this would lead to a "lemons" problem in which the low bids of uninformed parties encourage opportunistic behavior on the part of informed parties. Although seldom put in these terms, these problems lie at the heart of theories of contract law which emphasize the problem of controlling opportunism. *See* Charles V. Goetz & Robert E. Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 YALE L.J. 1261, 1279, 1299-1300 (1980); Timothy J. Muris, *Opportunistic Behavior and the Law of Contracts*, 65 MINN. L. REV. 521 (1981). For recent discussions of the opportunism problem which use the terms of information economics, see Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87 (1989); Hylton & Hylton, *supra* note 9, at 849-52.

courts, where the terms of a collective bargaining agreement, specifically the agreement to submit disputes to arbitration, are likely to be read in favor of the relatively uninformed party. Disputes that do reach arbitration are treated deferentially in the federal courts.[92] If arbitrators, because of their experience or information concerning the disputed issues, are capable of finding and specifying joint-wealth maximizing agreements,[93] the regime under which section 301 disputes are decided should generate doctrinally efficient rules.

Consider a dispute over a decision by a firm to close down a plant or to subcontract work to another firm. Recent models of the bargaining process suggest that the arbitrator's role in this type of dispute is to distinguish efforts to opportunistically reduce the firm-specific rents earned by employees from sincere efforts to reduce production costs in order to stay afloat.[94] However, this is bound to be a complicated determination, hardly one that an uninformed jury could be trusted to decide correctly. It is quite possible that the grievance procedures encouraged by the NLRA are far superior to the mechanisms provided by traditional courts. One could argue, however, that the problem with leaving things in the hands of a single arbitrator is that the decisions will depend on the preferences or mood of each individual arbitrator, which may vary more than the preferences of a typical jury. This would suggest that the process by which labor law doctrine develops generates more uncertainty than the case law process. On the other hand, review by appellate courts of arbitrators' decisions allows the system to generate doctrinal rules that define standards; the rules have the effect of limiting the discretion of the arbitrator in the same sense that appellate decisions limit the discretion of the jury in the common law process.[95]

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92 United Steelworkers v. Enterprise Wheel & Car Corp., 393 U.S. 593, 596 (1960). "Deferential" may be an inappropriate description. In a letter commenting on an earlier draft of this Article, Judge Posner remarks that "review is more than deferential; essentially all it does is ensure that the arbitrator has not applied private notions of equity, but instead has interpreted the contract." Letter from Richard A. Posner to Keith N. Hylton (Jan. 13, 1992) (on file with author). I defer to Judge Posner's remark.

93 As in the ordinary two-party contract, the union and the employer have incentives to find agreements which maximize total wealth. *See* Stewart J. Schwab, *Collective Bargaining and the Coase Theorem*, 72 CORNELL L. REV. 245 (1987).

94 Armen Alchian, *supra* note 36, at 244-45 (discussing *First National Maintenance*); Wachter & Cohen, *supra* note 9, at 1387-95.

95 The cases making up the *Steelworkers Trilogy* (United Steelworkers v. Enterprise Wheel & Car Corp., 363 U.S. 593 (1960); United Steelworkers v. Warrior & Gulf Navigation Co., 363 U.S. 574 (1960); United Steelworkers of Am. v. American Mfg. Co., 363 U.S. 564 (1960)), although announcing a general policy of deference toward the decisions of arbitrators, include several statements defining the limits of the arbitrator's discretion. For example, in *Enterprise Wheel*, the Court noted that the arbitrator's "award is legitimate only so long as it draws its essence from the collective bargaining agreement." 363 U.S. at 597. Furthermore, the Court noted that the arbitrator would "exceed[] the scope of the submission" if his decision were "based solely upon [his] view of the requirements of enacted legislation." *Id.*

There are two important areas in which the development of labor law differs from that of ordinary case law in ways that have implications for the doctrinal efficiency thesis. The first is the Board itself, composed of members appointed to five year terms by the President. The President's ability to significantly alter the composition of the Board in the course of a single term generates a serious compliance problem: there is little to guarantee that Board members will respect the decisions of previous Boards. The greater likelihood that rules developed by an earlier Board will not be respected by future Boards generates litigation. The Board is, in fact, notorious for reversing itself on certain politically controversial issues when a new party comes into power and has the opportunity to control it.[96] Though it is impossible to measure the effects, the compliance problem probably generates an enormous amount of litigation by putting a cloud of uncertainty over even the clearest doctrinal rules.

The second sense in which the labor process diverges from the common law process is the point at which the decision to litigate is made in unfair labor practice cases. Whether an unfair labor practice charge will lead to a complaint filed with the NLRB is almost entirely within the discretion of the General Counsel.[97] This obviously differs from the common law process because in the courts, the individual plaintiff decides whether to bring suit after weighing the costs and possible rewards.

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[96] One famous line of cases in which the Board reversed itself is the *Milwaukee Spring* litigation, involving an employer's relocation decision. The first time the dispute came before the Board, the employer was found to have violated Sections 8(a)(1), (3) and (5) by deciding during the term of a collective bargaining agreement to transfer its assembly operations from a unionized plant to a nonunionized plant without the union's consent. Milwaukee Spring I, 265 N.L.R.B. 206 (1982). After three Reagan appointees joined the Board and formed a new majority, the Board made a motion for reconsideration to the circuit court reviewing the case. Upon reconsideration, the Board found that the location of the assembly operation was not an employment condition contained in the collective bargaining agreement and, therefore, that the employer committed no violation when it moved the operation after good faith bargaining with the union had produced no agreement on the issue. Milwaukee Spring Div. of Il. Coil Spring Co., 268 N.L.R.B. 87 (1984).

The employer speech cases make up another interesting line of cases. First, the Board decided to take an active role in policing election campaigns. Hollywood Ceramics Co., 140 N.L.R.B. 22 (1962). Then the Board announced that it would no longer set aside election results because of misleading campaign statements. Shopping Kart Food Mkt., Inc., 228 N.L.R.B. 1311 (1977). After a change of membership less than two years later the Board overruled *Shopping Kart* and reverted to the rule in *Hollywood Ceramics*. General Knit of California, Inc., 239 N.L.R.B. 619 (1978). Finally, the Board overruled its decision in *General Knit* and *Hollywood Ceramics* and returned to the rule of *Shopping Kart*. Midland Nat'l Life Ins. Co., 263 N.L.R.B. 127 (1982).

On the general problem of Board reversals after a change in administration, see Samuel Estreicher, *Policy Oscillation at the Labor Board: A Plea for Rulemaking*, 37 ADMIN. L. REV. 163 (1985) (thirty-one cases from early 1980s are cited as examples of reversals of Board precedent); R.S. Kaufmann, *Politicization of NLRB Doctrine: Costs Imposed by Institutional Alternatives in the Administration of the NLRA*, 4 J.L. & POL. 123 (1987); Peter D. Walther, *The NLRB Today*, 36 LAB. L.J. 803, 809-16 (1985) (listing twenty-nine Reagan era reversals).

[97] GORMAN, *supra* note 85, at 7-8; MICHAEL C. MCCLINTOCK, NLRB GENERAL COUNSEL 10-11 (1980).

The General Counsel may not file a complaint in every case in which the complainant would prefer to see one filed. And although the dearth of commentary suggests that the practice is rare, the General Counsel may proceed with litigation even when the complainant would prefer to settle.[98] In any event, the private incentives that are important in generating doctrinal efficiency in the common law process are not at work in the same manner in unfair labor practice disputes. There is at least the possibility that enforcement could be undermined through political influence or bribery. This is not generally a problem in the common law process.[99]

In unfair labor practice disputes, the forces that push legal doctrine toward efficiency are, it seems, not as strong or as reliable as those identified by the efficiency theorists examining the common law process. The instability of the Board generates rent-seeking litigation, and the decision to pursue an unfair labor dispute is, in part, in the hands of a government official rather than a private plaintiff. On the other hand, federal appellate courts review unfair labor practice decisions in which the Board seeks enforcement through a court order. Judicial review, though, may prevent private parties from using the process in order to transfer wealth.[100] Therefore, it is at least possible that the forces tending toward efficiency may predominate even in the area of unfair labor practice disputes.

Several commentators have noted that although the Board has the power to fashion rules directly, it relies on adjudication.[101] The Board's reliance on adjudication, while it has been criticized because of the fre-

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98 *See* GORMAN, *supra* note 85, at 8. The Board's rules provide that "a charge may be withdrawn, prior to the hearing, only with the consent of the regional director with whom such charge is filed." 29 C.F.R. § 102.9 (1991). On the other hand, the Board seems to have a policy of encouraging settlement. Regional directors are advised not to reject the terms of a private settlement and proceed with a complaint in instances where the dispute does not involve broad public policy issues, the proposed settlement is acceptable to all parties, and the public interest is better served by encouraging voluntary settlement of disputes than in proceeding with litigation. Texaco, Inc., 273 N.L.R.B. No. 164 (1985).

99 Indeed, the Coase theorem suggests that bribery in the private-law setting will only generate more efficient litigation decisions. For an elaboration of this argument, see Hylton, *supra* note 20, at 142.

100 One can interpret this section as arguing that judicial review controls agency costs, in the sense of preventing the Labor Board from deviating from its "proper" course. However, the agency cost theory of judicial review implicit in this discussion is different from that recently presented by Bishop. *See* William Bishop, *A Theory of Administrative Law*, 19 J. LEGAL STUD. 489 (1990). Bishop's theory suggests that federal courts reviewing decisions of the NLRB would control deviations from the purpose or intention of the relevant portion of the NLRA. The theory suggested in this discussion is that courts reviewing NLRB decisions would seek to enforce compliance with the norms of the common law process, such as respect for precedent. In other words, the view presented here emphasizes the role of federal courts in fostering reasoned decisionmaking, *see* RICHARD J. PIERCE ET AL., ADMINISTRATIVE LAW AND PROCESS 126-27 (1985), rather than examining for compliance with "legislative intent."

101 *See* Merton C. Bernstein, *The NLRB's Adjudication-Rule Making Dilemma Under the Administrative Procedure Act*, 79 YALE L.J. 571 (1970).

quency of reversals,[102] is an important feature that makes the process by which federal labor law develops similar to the common law process. Because the Board relies on adjudication rather than rulemaking, it essentially takes the sort of passive role toward generating law that common-law courts have traditionally accepted. The benefits of such an approach, which were explained by Leoni, have been underestimated in the labor law literature. An active approach such as rulemaking may generate greater clarity, but it is more vulnerable to being exploited by special interest groups. Furthermore, the clarity of rulemaking is only a short run clarity because the Board could always decide to change the rule in the future. Under this theory, a significantly larger proportion of the rules developed by the SEC, which takes an active approach toward rulemaking, is likely to be inefficient than of those generated by the NLRB.

V. Examples of Efficient Labor Law

In this Part, I will discuss several areas of labor law in which the doctrine might be understood on efficiency grounds. Again, the relevant notion of efficiency will be that of doctrinal efficiency.

A. *Organization and Representation*

In an earlier article, Maria O'Brien Hylton and I criticized doctrine governing union organization for reflecting assumptions that were in many cases inconsistent with rational union and firm behavior.[103] However, we did not aim merely to criticize the doctrine. We attempted to offer a framework for evaluating the efficiency arguments for and against certain rules, and we were careful then to point out the areas in which an efficiency case might be made for the doctrinal rules. In this Part, I will further develop the framework for evaluating efficiency justifications of the rules governing labor organization. I will start by critiquing Judge Posner's view of the rules, and will then present the general framework. The reason for critiquing Posner's discussion is twofold: 1) it is an example of the traditional "monopoly unionism" analysis, and 2) there is a risk that it will come to be seen, especially by the large body of noneconomists writing in the labor area, as "the economic view" of organization law.

1. Posner's Criticism of Organization Law.—Posner has offered a positive theory of labor law, and particularly, the rules governing union organization. He proposes that labor law can be understood as a set of rules that aim to facilitate the cartelization of the labor supply of unions.

102 *See* Estreicher, *supra* note 96.

103 Keith N. Hylton & Maria O'Brien Hylton, *Rational Decisions and Regulation of Union Entry*, 34 VILL. L. REV. 145 (1989).

Posner argues that several provisions of the NLRA seem to be consistent with this hypothesis.

There is a problem raised by Posner's theory that is common to all positive theory: it cannot be rigorously stated in the form of a critique of anything without some normative sense of what is bad or good. To say that the law facilitates cartelization means nothing without a theory that tells us whether cartelization of the labor supply of unions is bad or good. Of course, Posner offers such a theory. He argues that cartelization is bad because it raises price and reduces supply, the net effect of which is a reduction in society's wealth. However, this is only one economic theory of the effect of cartelization. An alternative, plausible theory is that efforts to create cartels are really efforts to solve collective action problems. Under this theory, unions are not always inefficient; in fact, sometimes they may be socially desirable. They may generate the social costs associated with monopoly resource misallocation, but they may also increase wealth through enhancing the provision of workplace public goods.

The reasons for questioning the underlying theory of cartelization are general ones that apply in antitrust, as well as in labor law. Posner is at least consistent in treating cartelization as an evil, whether it occurs in the labor market or in the goods market.[104] But a considerable body of research suggests that cartelization even in the goods market may have efficiency justifications.[105] If the efficiency justifications are sufficiently rigorous, they call into question standard assumptions about the benefits and harms of cartelization. If, for example, price-fixing cartels are sometimes efficient, then society could, in theory, gain by moving back to the rule of reason approach to price-fixing cartels that governed before the Sherman Act. Indeed, it is an irony that Posner, who has searched high and low for efficiency justifications of the common law, would attach himself so firmly to the position that all cartelization is evil. The common-law courts never rigorously adhered to such a position.[106] One

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104 For Posner's views on cartelization in the goods market, see Richard A. Posner, *Oligopoly and the Antitrust Laws: A Suggested Approach*, 21 STAN. L. REV. 1562 (1969).

105 George Bittlingmayer, *Decreasing Average Cost and Competition: A New Look at the* Addyston Pipe *Case*, 25 J.L. & ECON. 201 (1982); George Bittlingmayer, *Did Antitrust Policy Cause the Great Merger Wave?*, 28 J.L. & ECON. 77 (1985); George Bittlingmayer, *Price-Fixing and the* Addyston Pipe *Case*, 5 RES. L. & ECON. 57 (1983); Donald Dewey, *Information, Entry, and Welfare: The Case for Collusion*, 69 AM. ECON. REV. 587 (1979); Mark F. Grady, *Toward a Positive Economic Theory of Antitrust*, 30 ECON. INQUIRY 225 (1992).

106 On the common-law treatment of cartel agreements among firms, see DONALD DEWEY, MONOPOLY IN ECONOMICS AND LAW 157-78 (1959); Grady, *supra* note 165.

The common-law treatment of cartel agreements among workers—i.e., of labor unions—is much harder to summarize, but the evidence does not support the claim that labor unions were illegal per se. The earliest relevant American case held that labor combinations were illegal. *See* Commonwealth v. Pullis, (Case of the Philadelphia Cordwainers) (Mayor's Ct., Phila. 1806). However, in the three decades following the Philadelphia Cordwainers' case there were 18 other prosecutions of labor combinations, and in only one of those cases did the court take the same view of the illegality of labor combinations as the *Pullis* court. *See* Edwin E. Witte, *Early American Labor* would think that if the common law was efficient, Posner would take his cue from it with respect to the social desirability of unions, in particular, and of cartels, in general.

Posner notes that the rule prohibiting discrimination against union activities rules out the kind of rational predatory action that an employer, suspecting an employee to be a union organizer, would naturally engage in—firing the union sympathizer.[107] The rule prevents one type of employee, the nonsympathizer, from competing with another type, the sympathizer. Since employers cannot substitute one for the other they are prevented from minimizing production costs, and this means that consumers generally are taxed in the form of higher prices in order to subsidize union organization efforts.

There is nothing wrong with this theory of the discrimination prohibition if the underlying assumptions are correct. If unions do nothing more than raise prices and create shortages, then Posner's analysis is unassailable. However, if cartelization does not occur solely for the purpose of transferring wealth, then there may be cases in which union organization should be encouraged. In such a case, Posner's analysis would lead us to the wrong conclusion. If union organization is, on net, wealth-creating, then we should seek to remove obstacles that will prevent unionization. The discriminatory discharge is perhaps the most significant obstacle. It creates a prisoner's dilemma problem in which each employee's dominant strategy is to avoid being labeled a union organizer or sympathizer.[108]

Does it follow that with the prohibition against discrimination, unions will organize when and only when it is socially desirable? No. The fundamental problem with unionization exists with all cartelization efforts: they may involve wealth creating and rent-seeking aspects.[109] Opening the door to wealth-creating unions allows the rent-seeking types to enter also, and there seems to be no easy way to shut the door on one without also closing out the other.

The second aspect of labor law that Posner criticizes is the institutional feature of inverse seniority layoffs, which is in no sense required by labor law.[110] This is designed, according to Posner, to maintain the union's support base because it has the effect of laying off younger workers, who generally are less certain supporters of the union.[111]

Cases, 35 YALE L.J. 825, 826 (1926). The cases seem to implicitly distinguish between the legality of the combination and the legality of the methods used by the combination. *Id.* at 828. In any event, it was settled that labor unions were not illegal per se after Commonwealth v. Hunt, 45 Mass. (4 Met.) 111 (1842). Witte, *supra* at 825.

107 Posner, *supra* note 3, at 1003.

108 Hylton & Hylton, *supra* note 9, at 156-57, 197.

109 *Id.* at 168.

110 However, the practice of inverse seniority layoffs is explicitly protected in federal antidiscrimination law (Title VII) in spite of its discriminatory impact.

111 Posner, *supra* note 3, at 1006-07.

An alternative theory of the inverse seniority layoff is that it is a solution to a problem generated by informational asymmetry. If the employer knows the state of product market demand and the employees do not, the employer has every incentive to underreport the state of demand whenever workers are receiving more than their opportunity wages. If the employer reports a decline, he can then justify an effort to reduce wages. The phenomena of layoffs and of inverse seniority layoffs can be understood in this setting as an effort to force the employer to commit himself to an implicit agreement not to act opportunistically. If forced to lay off workers, including very productive ones, the employer will have a considerably weaker incentive to falsely report the state of product market demand than he would otherwise have. The inverse seniority layoff rule further reduces the employer's incentive to falsely report the state of demand because it forces the employer to first lay off workers from whom very little rent can be expropriated. Under widely accepted theories of wage profiles, the high-seniority workers are more likely to be those who are earning a substantial amount more than the opportunity wage. If the employer sets out to appropriate rents earned by the employees, the high-seniority employees, particularly those who have made substantial firm-specific human capital investments, would be the most likely targets.[112]

2. Organization and Representation Law: A Theoretical Framework.—This section proposes a theoretical framework for a set of cases concerning union organization and representation that may seem to be unconnected by any underlying theory. My claim is that the certification year rule,[113] the contract bar doctrine,[114] the requirement of exclusive representation,[115] the *Savair* decision,[116] the *Exchange Parts*[117] rule prohibiting the granting of benefits by an employer during an election campaign, and the presumption of majority status reflected in such decisions as *Pennco, Inc.*[118] and *RCA Del Caribe, Inc.*[119] can be united by a common theoretical thread. The theoretical framework offered can pro-

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112 *See* Wachter & Cohen, *supra* note 9, at 1380.

113 The election-bar rule prohibits a union election within 12 months of a preceding election. *See* National Labor Relations Act § 9(c)(3), 29 U.S.C. § 159(c)(3) (1988). The "certification year rule" refers to the Board-adopted rule declaring an election petition untimely if filed within 12 months of the certification of a union. *See* Brooks v. NLRB, 348 U.S. 96 (1954).

114 General Cable Corp., 139 N.L.R.B. 1123 (1962). For a statement, see *infra* text accompanying note 128.

115 *See* National Labor Relations Act § 9(b), 29 U.S.C. § 159(b) (1988). The exclusive representation principle was established in labor decisions before it was codified in the statute. *See* GORMAN, *supra* note 85, at 374-75 (1976) (referring to Houde Eng'g Co., 1 N.L.R.B. 35 (1934) (old series)).

116 NLRB v. Savair Mfg. Co., 414 U.S. 270 (1973).

117 NLRB v. Exchange Parts Co., 375 U.S. 405 (1964).

118 250 N.L.R.B. 716 (1980).

119 262 N.L.R.B. 963 (1982).

vide an efficiency justification for each of the rules considered in this section.

The theoretical framework for organization and representation doctrine is based on a concept known in the game theory literature as the core,[120] and more specifically, an empty core. The equilibrium of a game is in the core if it is "coalition-proof" in the sense that no subgroup has an incentive to form a coalition in order to change the existing allocation.[121] The core is empty if there is no such equilibrium. The standard example of a game in which the core is empty is the dollar-splitting game. Suppose three people each contribute $1 to the pot and decide to split the $3 among themselves by accepting the allocation rule chosen by a majority. The first two contributors may agree to divide the total evenly between themselves, taking $1.50 each and leaving the third player with nothing. The third player clearly then has an incentive to arrange a deal with either the first or second, offering to share more than $1.50 in exchange for some portion of the $3. But then the newly excluded player has an incentive to form a new coalition with one of the other two players. The process can cycle on in this fashion indefinitely.

The empty core phenomenon arises in the union setting. One can see this clearly by simply changing the descriptive terms of the dollar-splitting game. Let the total prize be the share of employer profits shared with the union, and let the players be three workers, or expand the game to four players, and let the employer be the fourth player. Suppose, for example, in a plant with three workers a majority of two agrees to form a union and to block the third from sharing in the benefits. The third then obviously has an incentive to break up the agreement by making a deal with one of the two workers in the original coalition. As this example demonstrates, the empty core problem arises whenever the union's task is merely to divide up some share of the employer's profits among the employees.

The empty core problem, however, is not limited to the case in which the union is merely transferring wealth from the employer to itself. It can arise when the union is increasing wealth by solving the sort of collective action problem stressed earlier in this Article. Suppose workers one, two, and three each value enhanced safety at $100. Suppose the across-the-board wage reduction that would make the provision of enhanced safety profitable for all parties is $30. Employees one and two would have an incentive in this case to arrange for the safety enhancement, and to have employee three's wage reduced by $90 to pay for the

120 A literature has developed known as "core theory." *See* LESTER G. TELSER, A THEORY OF EFFICIENT COOPERATION (1987); LESTER G. TELSER, ECONOMIC THEORY AND THE CORE (1978). For a discussion of core theory's implications for antitrust, see George Bittlingmayer, *The Economic Problem of Fixed Costs and What Legal Research Can Contribute*, 14 LAW & SOC. INQUIRY 739 (1989).

121 *See, e.g.*, E. MALINVAUD, LECTURES ON MICROECONOMIC THEORY 153-55 (1972).

enhancement. But once this arrangement is proposed, employee three would have every incentive to offer a side payment to employee one in order to form a new coalition which would aim to force employee two to bear the costs of the enhancement. Although all of the parties, the three employees and the employer, would be better off under an arrangement in which enhanced safety is provided, inequality in the distribution of benefits can generate a cycling problem similar to that observed in the dollar-splitting game.[122]

Although the empty core problem could arise in many settings in which the interests of three or more parties are involved, it is particularly likely in the union setting because unanimity is not required in order to obtain the union's support for a proposed alteration in working conditions. In this sense, the union's formation of preferences is analogous to the legislative process. At least in theory, there is always an incentive for some faction to attempt to redistribute wealth in its direction, even if only to defend itself from the rent-appropriating efforts of other coalitions.

As a general matter, as long as the benefits generated by unionization can be distributed unequally, the empty core phenomenon may arise. It is a problem because it leads to costly, rent-dissipating efforts to form and reform coalitions as parties attempt to consume a disproportionate share of the union benefits. The problem explains the concern for union stability, and is at the heart of the conflict between stability and employee

122 The potential for virtually endless cycling is not observed in the case in which the efficiency enhancement is "tied" to a fixed reduction in wages, so that the employees are forced to choose between the enhancement and the status quo. However, in this case the outcome will not necessarily be a Pareto improvement. Suppose workers one, two, and three value enhanced safety $100, $50, and $20, respectively. Suppose the across-the-board wage reduction that would make the provision of enhanced safety profitable for workers one, two, and the employer is $40 (and the employer refuses to consider making unequal wage reductions). Employees one and two clearly have an incentive to vote for a union if it will arrange the desired safety enhancement. Under an arrangement in which wages are reduced by $40 in exchange for safety enhancement, employees one and two receive a net benefit of $60 and $10 respectively. Employee three will suffer a net loss of $20 if the safety enhancement is adopted. By offering a side payment of $15, employee three could form a new coalition with employee two that is capable of blocking the union's effort to negotiate for safety enhancement in exchange for a $40 wage reduction. But then employee one would have an incentive to offer a side payment to two in an effort to reform the original coalition. If employee one offers a side payment greater than $20 to employee two, the original coalition will regroup, and it will be impossible for employee three to divide it. Although endless cycling is not observed in this example, the costly haggling generated by the coalition formation process is observed.

One might wonder whether an enhancement in efficiency will be blocked altogether because of the coalition formation problem. Aivazian and Callen have argued that the Coase theorem does not hold when the core is empty. *See* Varouj A. Aivaizian & Jeffrey L. Callen, *The Coase theorem and the Empty Core*, 24 J.L. & ECON. 175 (1981). Coase's response was, in essence, that if the parties look sufficiently far into the future they will see that they can all be better off under the efficient contract than under the inefficient one, and will incorporate provisions that ensure the stability of an efficient agreement. *See* R.H. Coase, *The Coase Theorem and the Empty Core: A Comment*, 24 J.L. & ECON. 183 (1981).

free choice noted in many of the labor opinions.[123]

In light of core theory, the certification year rule can be understood as a rule that eliminates, for a brief period, costly efforts to form a new winning coalition. The rule, announced in *Mar-Jac Poultry, Co.*[124] extending the certification year bar in the case of bad faith bargaining on the part of the employer can be given the same justification. In *Mar-Jac Poultry*, the successor employer refused to bargain with the incumbent union. After the union filed an unfair labor practice charge, roughly six months after the union's first request for bargaining, the employer and the union entered into a settlement agreement in which the employer agreed to bargain in good faith. After six months of bargaining, in compliance with the settlement agreement, the employer filed an election petition. The Board dismissed the petition because the certification year rule required the employer to honor a certification for a period of one year. The rule of *Mar-Jac Poultry* prevents the employer from adopting a predatory strategy of refusing to bargain with the union as long as possible within the one-year span provided by the certification year rule and then filing a decertification petition at the end of the certification year. Predation is costly, and in certain cases, should be viewed as one of the essentially rent-dissipating, redistributive efforts that organization law aims to deter.

The decision in *RCA Del Caribe*[125] overturning an earlier requirement that the employer withdraw from bargaining when a representation petition is filed by a rival union[126] is consistent with the theory presented here. A rule which requires the employer to withdraw from bargaining protects the rival union by preventing the incumbent from adjusting its position at the bargaining table in order to erode the support of the rival. On the other hand, by erasing much of the advantage of incumbency, it probably provides too strong an incentive for a rival group to file a petition.

The rule extending the presumption of majority status beyond the certification year, though shifting it down to a rebuttable presumption,[127] can also be explained as an effort to reduce the costs of coalition formation. The rule applies to the employer who wishes to withdraw recognition, but in spite of this, the coalition formation problems discussed

123 It also suggests the need for a duty of fair representation. Although the duty of fair representation is a natural extension of the arguments of this Part, I will not pursue the issue here. For a discussion of coalition formation problems and the duty of fair representation, see Mayer G. Freed et al., *Unions, Fairness, and the Conundrums of Collective Choice*, 56 S. CAL. L. REV. 461 (1983).

124 136 N.L.R.B. 785 (1962).

125 262 N.L.R.B. 963 (1982).

126 Shea Chem. Corp., 121 N.L.R.B. 1027 (1958). The rule was part of a larger set of rules requiring employer neutrality known as the *Midwest Piping* doctrine. *See* Midwest Piping & Supply Co., 63 N.L.R.B. 1060 (1945). Several circuits had rejected the rule before the NLRB reversed itself. *RCA Del Caribe*, 262 N.L.R.B. at 964.

127 Pennco, Inc., 250 N.L.R.B. 716 (1980).

above can be used to justify it. Suppose a coalition forms that wishes to displace the incumbent union. Probably the easiest route would be to simply have the employer withdraw recognition.

Although the contract bar doctrine does not seem to fit very neatly within the core theory framework, it too can be explained as a response to the coalition formation problem. The contract bar doctrine bars representation petitions filed by rival unions during the term of a contract for up to three years.[128] Once the ink on a collective bargaining agreement has dried, the precise sense in which a new coalition can be formed in order to redistribute the benefits of unionization will be clear to all parties. The incentive for rent-seeking coalition formation increases substantially the moment the terms of an agreement are set. The upper limit of three years of protection provided by the contract bar doctrine may be excessive, but it seems that some period of protection is required in order to reduce the costs of coalition formation that would follow the signing of an agreement.

The standard explanations of the rules guaranteeing the stability of union election campaign results have been that they (1) save administrative resources and avoid disruption in the worksite that would occur if elections were held too frequently, (2) encourage sober thought about the union election, (3) assure that the employer would not be encouraged to delay bargaining in the hope that employees would become disenchanted with the union, and (4) insulate the union against pressures generated by the threat of being displaced by a rival union.[129] Each of these explanations is consistent with the core theory approach described here. However, what is not apparent in this list of reasons, and is clarified by core theory, is the incentive structure that justifies the standard concerns. For example, the stated concern that there would be too much disruption at the worksite if elections were held frequently has a paternalistic flavor. One may well wonder why the workers and the employer should not ordinarily be able to judge for themselves whether election campaigns are too disruptive, and arrive at some private agreement. Core theory provides an answer to this question; a stable private agreement is unlikely precisely because of the empty core problem.

Core theory also can be used to explain the holding of *Savair*. In *Savair*, the union circulated "recognition slips" among employees before the election. An employee who signed the slip before the election became a member of the union and would not have to pay what was described at times either as an "initiation fee" or a fine. The employer filed objections to the election and subsequently refused to bargain with the union. The appeals court denied enforcement of the Board's bargaining order, and

128 General Cable Corp., 139 N.L.R.B. 1123 (1962).

129 *See* GORMAN, *supra* note 85, at 52-53.

the Supreme Court affirmed on the ground that the union's election campaign strategy interfered with "employee free choice" in the election.

Savair prohibits schemes which promise a reward to workers who vote for the union if the union wins.[130] Such conditional reward schemes set up a prisoner's dilemma incentive structure in which voting for the union is a dominant strategy for each employee, even in cases in which the union makes the employees worse off as a group.[131] In this sense, conditional reward schemes are similar in effect to the two-tiered tender offer observed in some corporate takeovers.[132] Suppose,[133] for example, that there are three employees, and that employees one and two would pay $1 to avoid union representation, while employee three would pay $1 for union representation. Obviously, given these preferences, the union would lose an election. Suppose, however, that the union promises to pay $1.50 to those who sign a recognition slip early, provided the union wins the election. If employees one and two were aware of three's preferences, they would probably see that the union would have no incentive to obtain the signature of a third employee after a second had signed. Employees one and two face two strategy choices—to sign and vote for the union or to refuse to sign and to vote against the union. For the employee who signs and votes for the union, his anticipated payoff is $1.50 if the other employee does not sign, and $0.75 if the other employee signs.[134] For the employee who refuses to sign and vote for the union, his anticipated payoff is $1 if the other employee refuses to sign and vote, and $0 if the other employee signs and votes for the union. The "sign and vote" strategy, therefore, dominates.

As Posner's discussion of organization law suggests,[135] the same analysis can be applied to yellow dog contracts.[136] The employer would presumably offer some wage or benefit improvement in exchange for

130 That is the implication of *Savair*. The Board held that conditional reward schemes such as the one offered in *Savair* violate § 8(b)(1)(A) of the National Labor Relations Act (coercion by union of employees in the exercise of organizational rights) in Teamsters Local 420 (Gregg Indus.), 274 N.L.R.B. 603 (1985).

131 Hylton & Hylton, *supra* note 103, at 194-97.

132 *See* Jonathan R. Macey & Fred S. McChesney, *A Theoretical Analysis of Corporate Greenmail*, 95 YALE L.J. 13 (1985).

133 The example below generalizes an example provided in Hylton & Hylton, *supra* note 9, at 194-97.

134 Why? Because the employer has no incentive to sign both of them up, so if each adopt the strategy of signing and voting, their expected award is only half of the prize.

135 Posner, *supra* note 3.

136 *Id.* at 1011.

The argument can be extended to provide a justification for the inalienability of organizational rights protected by Section 7 of the National Labor Relations Act. On the inalienability of organizational rights, see NLRB v. Magnavox Co., 415 U.S. 322 (1974) (an employer is not protected against an unfair labor practice finding by a union's acquiescence in a company rule banning distribution of literature); Republic Aviation Corp. v. NLRB, 324 U.S. 793 (1945) (enforcement of a broad no-solicitation rule is an unfair labor practice).

signing a yellow dog contract. However, the employer has no incentive to offer such a contract to every one of her employees; the contract will no longer be offered after fifty percent of the employees have signed. The previous example could be altered slightly to explain the incentive structure generated by the yellow dog contract.

Whether the protections provided by such rules as the contract bar doctrine and the presumption of majority status are excessive, serving to entrench the position of the incumbent union, is unclear. Core theory provides an efficiency justification for the rules, but it does not tell us whether the rules go further than necessary. This is no different from the general indeterminacy problem noted earlier. Because there are, in theory, wealth-enhancing and rent-seeking motives behind every unionization effort, it is hard to say a priori which effect will dominate. The rules protecting organization efforts reduce the entry costs of both efficient and inefficient unions.

In evaluating the conflict between stability and employee free choice, the key question is contestability, or in other words, how easy is it to remove an incumbent union?[137] If a bare majority is able to exploit unionization in order to achieve gains at the expense of the minority, then the minority has every incentive to make some concessions with a subset of union members in order to form a new majority coalition that will take their interests into account. The rules governing stability should clearly allow the incumbent union to be displaced. But they cannot allow displacement at any time because this would give rise to the cycling observed in the dollar-splitting game.

Core theory suggests that limits should be placed on the contestability of an incumbent union. The theory suggests that limits should be placed on the periods in which unions can be contested, such as the certification year rule, and perhaps that some particularly cheap forms of contesting, such as withdrawal of recognition by the employer, should be made more costly. In order to avoid entrenching incumbent unions, the blanket of rules limiting the contestability of incumbent unions should be opened in prominent spots to allow the incumbent's status to be contested. Overall, the rules governing organization and representation seem to be consistent with this model.

Assuming that the doctrines safeguarding union stability are all efficient, in the sense that they minimize the costs of coalition formation, a version of the *Exchange Parts* doctrine is justifiable on efficiency grounds. The justification relies on the theory of contestability. Denying the employer the right to offer benefits in the course of an election campaign is analogous to prohibiting an incumbent firm from offering benefits to con-

[137] By contestability, I refer to entry and exit conditions. I use this term in the same sense as the recent industrial organization literature emphasizing entry and exit conditions over structural measures of competition. *See* WILLIAM J. BAUMOL ET AL., CONTESTABLE MARKETS AND THE THEORY OF INDUSTRY STRUCTURE (1982).

sumers when a rival firm threatens to enter. In the case of competing firms, the fear is that after the incumbent offers benefits to consumers, the rival firm will disappear and the incumbent will act as an unrestrained monopolist. Such a rule can be justified only if the market is not contestable. I have argued that the same rule should in theory apply in the employer conduct cases—the offering of benefits by any party should be held to be a violation of the NLRA only in the case where the union's status is not contestable. Such a case might involve an incumbent union, given the contract bar rule and the presumption of majority status. It is unlikely to arise when there is no incumbent union, and therefore nothing to prevent the union from trying to organize.[138]

One might argue that because organization itself is costly, there is always a contestability problem. I, however, find this hard to accept. The election is conducted by the NLRB at public expense, and the only significant cost borne by the union is the cost of informing the employees of its preferences.[139]

B. Business Change

Bargaining obligations in successorship, subcontracting, and partial shutdown cases can be treated under one theoretical framework. Since some specific applications have been carried out, I will devote a larger share of my attention to the theoretical framework itself in this section. I will refer to the set of cases discussed in this section as "business change" cases.

At issue in the vast majority of these cases is the scope of the employer's duty to bargain which has traditionally been based on a theory of inherent rights.[140] According to the theory, management should not be required to bargain over issues which fall within the "core of en-

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138 Suppose, however, there is no incumbent union because the union lost the most recent election. The election-bar rule would prohibit a new election within a year after the union's loss. One might claim that the one-year election bar is a significant entry barrier. The truth of this claim is an empirical question.

139 On the mechanics of union elections, see EDWARD B. MILLER, AN ADMINISTRATIVE APPRAISAL OF THE NLRB 1-14 (rev. ed. 1980).

140 *See, e.g.,* Arthur J. Goldberg, *Management's Reserved Rights: A Labor View, in* MANAGEMENT RIGHTS AND THE ARBITRATION PROCESS 118, 123 (Jean T. McKelvey ed., 1956) ("Management determines the product, the machine to be used, the manufacturing method, the price, the plant layout, the plant organization, and innumerable other questions. These are reserved rights, inherent rights, exclusive rights which are not diminished or modified by collective bargaining as it exists in industries such as steel.").

Besides the economic theory discussed in this Article, the only other theoretical treatment of the scope of the duty to bargain seems to be the work of Michael Harper. *See* Michael C. Harper, *Leveling the Road from* Borg-Warner *to* First National Maintenance*: The Scope of Mandatory Bargaining*, 68 VA. L. REV. 1447 (1982). Harper has proposed a "product market principle" that would "exclude from compulsory bargaining all decisions that determine what products are created and sold, in what quantities, for which markets, and at what prices." *Id.* at 1450.

trepreneurial control"[141] or that traditionally have been considered management prerogatives. The theory has been criticized for failing to provide a coherent explanation of the source of inherent management rights.[142] The framework provided below provides an alternative to the inherent rights theory, but does not suffer from such logical incoherence.

The theoretical framework that applies to business change cases is based largely on research examining the situations in which an employer may pay an employee a wage that is higher than the employee's opportunity wage. The human capital literature[143] has provided one theory of wages which explains the divergence between actual and opportunity wages. If the worker and employer have invested in "firm-specific" training,[144] an optimal contract may require sharing of the costs and benefits.[145] Over the period in which the benefits of training are shared with the worker, the worker's wage will exceed the opportunity wage, which will not reflect the value of firm-specific human capital.

The second widely accepted model that explains observed differences in actual and opportunity wages was initially proposed by Gary Becker and George Stigler in an article on the economics of law enforcement, and was developed in a series of articles by Edward Lazear.[146] The problem Becker and Stigler considered was that of agency costs in law enforcement, or in other words, the possibility that the incentives of enforcers would differ from those of potential victims. Because of this incentive problem, enforcers could be bribed by potential offenders and thereby have their effectiveness compromised. Becker and Stigler discussed three general solutions to the agency cost problem in enforcement: (1) privatizing enforcement activity, (2) investing more in the monitoring of enforcers, and (3) backloading the wages of enforcers. The reason for backloading wages is that the enforcer would be deterred from accepting a bribe if he feared that he would forfeit a stream of future rents, and perhaps a pension, if caught accepting a bribe. Becker and Stigler proved that the optimal wage profile would be one that increases with tenure, whether or not the employee's productivity increased.[147]

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141 *See* Fibreboard Corp. v. NLRB, 379 U.S. 203, 223 (1964) (Stewart, J., concurring).

142 JAMES B. ATLESON, VALUES AND ASSUMPTIONS IN AMERICAN LABOR LAW 111-35 (1983); *see also* HARRY H. WELLINGTON, LABOR AND THE LEGAL PROCESS 52-90 (1968).

143 Gary Becker is responsible for most of the important insights of this literature. *See* GARY S. BECKER, HUMAN CAPITAL (2d ed. 1975).

144 Firm-specific training is training that enhances the worker's productivity only within the firm. It does not make the worker more productive to other employers. *See id.* at 26-37.

145 *Id.*

146 Gary S. Becker & George J. Stigler, *Law Enforcement, Malfeasance, and the Compensation of Enforcers*, 3 J. LEGAL STUD. 1 (1974); Edward P. Lazear, *Agency, Earnings Profiles, Productivity, and Hours Restrictions*, 71 AM. ECON. REV. 606 (1981); Edward P. Lazear, *Why is There Mandatory Retirement?*, 87 J. POL. ECON. 1261 (1979); Edward P. Lazear & Robert L. Moore, *Incentives, Productivity, and Labor Contracts*, 99 Q.J. ECON. 275 (1984).

147 Becker & Stigler, *supra* note 146, at 6-13.

The theories of wage profiles suggest that there are many situations in which an optimal wage contract may require actual wages to differ from opportunity wages. This insight, coupled with the observation that the employer will generally have an informational advantage in determining the firm-specific value of the worker's time, provides a role for the union as a monitor of the employment relationship. Monitoring is necessary because the employer has an incentive to reduce wages whenever they exceed opportunity wages. In this model, the union functions not as a rent-seeker, but as a "rent protector."[148] Wachter and Cohen have referred to this as the internal labor market model,[149] but it is also a special case of the general collective action model described in Part III of this Article. Moreover, the collective action model makes clear that one of the basic reasons that the union is necessary is that monitoring involves several public good aspects.

1. Successorship.—Successorship doctrine governs the bargaining obligations of successor employers in cases in which the ownership of a corporation changes, and it is generally consistent with an efficiency theory based on the monitoring or rent-protecting model of the union described above.[150] In change of ownership situations, the incentive for rent appropriation—to reduce wages to the level of opportunity wages—is probably greater than usual. Any reduction in wages generates a surplus that can be split between the predecessor and successor employer. If the market for acquisition is competitive, most of the surplus will go to the predecessor employer. Since the predecessor employer is exiting the employment relationship, it will usually not be concerned about the reputational effects of opportunistic wage cutting.

Because the employer will almost always know more about the prospects of a change in ownership, the optimal background successorship rule is one requiring the successor to honor the predecessor's collective bargaining agreement. Any other background rule puts the union in the position of having to estimate the value of acquiring a successorship clause, and because the union is relatively uninformed and bargains against an informed party, it will tend to undervalue a successorship clause.

Once a background rule requiring the successor to honor the predecessor's contract is established, however, other factors suggest that the rule should be relaxed in the case in which ownership change occurs through an asset sale. A rigid legal duty to honor the predecessor's agreement would act as a tax on asset transfers, particularly in cases in which the assets are being transferred to an alternative use. Such a rule

148 Hylton & Hylton, *supra* note 9, at 833.

149 Wachter & Cohen, *supra* note 9, at 1355.

150 Hylton & Hylton, *supra* note 9. The points made in this section of the text are drawn from this article.

would increase the "use-specificity" of assets, and, therefore, increase the unrecoverable or "sunk" costs of entry.[151] A superior rule would examine asset transfers and impose a duty to bargain on the successor in those cases in which rent appropriation seems to be the motive behind the transfer.

Successorship doctrine generally takes this approach to defining the bargaining obligations of a successor employer. The doctrine treats stock and asset transfers differently. In the former, the successor typically must honor the predecessor's agreement;[152] in the latter, the doctrine has generated a complicated legal test used to distinguish cases in which bargaining obligations attach from those in which they do not. The features of the test, known as the "substantial continuity" test, seem to be those that a court would examine if it were trying to identify a case in which the motive behind a transfer was rent appropriation.[153]

Successorship doctrine is not perfectly in alignment with the theory presented here. For example, if the productivity levels of employees vary substantially, the substantial continuity test provides an advantage in an acquisition contest to the employer who plans to hire and appropriate the rents of a minority of high-productivity employees.[154] Maria O'Brien Hylton and I have argued that if courts were to weaken the majority requirement in cases in which the successor employer seems to have been "skimming the cream" by hiring only the most productive or experienced workers, this problem could be avoided.[155] This solution, however, would conflict with the basic requirement of section 9 of the NLRA that the employer bargain only with the representative chosen by a majority of the employees.[156]

The logical structure of successorship doctrine is apparent in Chapter 11 reorganization cases. The Bankruptcy Code allows the debtor in possession to reject "executory contracts,"[157] which are contracts under which "performance remains due to some extent on both sides."[158] Col-

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[151] Hylton & Hylton, *supra* note 9, at 852-56.

[152] *See* Esmark, Inc. v. NLRB, 887 F.2d 739 (7th Cir. 1989); EPE, Inc. v. NLRB, 845 F.2d 483 (4th Cir. 1988); United Food & Commercial Workers Int'l Union v. NLRB, 768 F.2d 1463 (D.C. Cir. 1985).

[153] The factors considered by the NLRB in its substantial continuity test are: (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. *See* Georgetown Stainless Mfg. Corp., 198 N.L.R.B. 234, 236 (1972).

[154] Hylton & Hylton, *supra* note 9, at 844-46.

[155] *Id.* at 847.

[156] National Labor Relations Act § 9(a), 29 U.S.C. § 159(a) (1988).

[157] 11 U.S.C. § 365(a) (1988).

[158] *See, e.g.*, B. Glenn George, *Collective Bargaining in Chapter 11 and Beyond*, 95 YALE L.J. 300, 309 (1985) (citing legislative history of the bankruptcy code). *See generally* Vern Countryman,

lective bargaining agreements are included within the class of executory contracts, though it is generally more difficult for the employer to reject a collective bargaining agreement than to reject most other contracts.[159] Whether or not the collective bargaining agreement is rejected, the debtor in possession is regarded by the Board as essentially the same as the firm that filed for bankruptcy—in other words, the debtor in possession is an alter ego.[160] Thus, the debtor in possession is obligated to bargain with the union representing the firm's employees. If the reorganization fails and the firm's assets are sold to a single owner, the Board will apply the successorship test to determine whether the new owner has a duty to bargain with the union.[161]

The Board's treatment of reorganization cases is consistent with rent appropriation theory. As in the change of ownership situation, bankruptcy provides incentives for the firm to appropriate the rents of employees. First, bankruptcy is identical to the standard successorship problem when it involves a change of ownership; for example, when the firm is declared bankrupt and its important assets sold to a single owner. The firm that acquires the bankrupt firm's assets may be willing to pay a premium for them if it expects to appropriate a sufficiently large share of the rents earned by employees. Second, the reputational concerns that would ordinarily deter opportunistic behavior are weakened. A reorganization obviously may require concessions from employees. The debtor may seek to lessen reputational harm by blaming wage reductions on pressure from creditors.

Jersey Juniors, Inc.[162] illustrates the economic case for applying successorship principles in the bankruptcy area. Rhoda Lee, Inc., a retail clothing store, filed for reorganization under Chapter 11. The debtor in possession did not attempt to have the collective bargaining agreement rejected, and listed its employee benefits among the expenses that it expected to incur.[163] The reorganization was unsuccessful and the assets were sold, apparently to the highest bidder, Jersey Juniors, Inc. The owners and directors of Jersey Juniors were virtually the same as the owners and directors of Rhoda Lee (though the majority owner of Rhoda Lee owned no stock in Jersey Juniors).[164] Jersey Juniors failed to make contributions to the employee pension fund that were required by the

Executory Contracts in Bankruptcy: Part I, 57 MINN. L. REV. 439, 460 (1973) (discussing the treatment of executory contracts in bankruptcy).

159 George, *supra* note 158, at 311.

160 Nathan Yorke, 259 N.L.R.B. 819, 826 (1981); Burgmeyer Bros., Inc., 254 N.L.R.B. 1027, 1028 (1981); Jersey Juniors, Inc., 230 N.L.R.B. 329, 331 (1977) (A trustee in bankruptcy is an alter ego of the bankrupt employer).

161 *See* Blazer Indus., Inc., 236 N.L.R.B. 103, 110 (1978); *Jersey Juniors*, 230 N.L.R.B. at 332-33.

162 230 N.L.R.B. 329 (1977).

163 *Id.* at 331.

164 *Id.* at 330.

collective bargaining agreement between the union and Rhoda Lee.[165] The Board found that the new owner violated its section 8(a)(5) duty to bargain by failing to discuss with the union its decision not to contribute to the pension fund.[166]

The rent appropriation framework can easily justify the Board's decision in *Jersey Juniors.* This essentially involved a change of ownership in which the "new" owner unilaterally reduced compensation. In addition, by asserting that it would comply with the collective bargaining agreement, the debtor in possession signaled to the firms bidding on the debtor's assets that their costs would be determined in large part by the requirements of the union agreement. If the debtor in possession had rejected the union contract the bidders presumably would have based their bids on an expectation of lower operating expenses, and therefore, submitted higher bids. But the debtor, whether intentionally or not, probably reduced competition in the bidding process by asserting to the bankruptcy court that it would meet its obligations under the labor agreement.

2. *Subcontracting, Partial Shutdown, and Relocation.*—The monitoring or rent-protecting model of the union can be used to provide an efficiency rationale for the rules governing subcontracting and partial shutdown disputes. The major Supreme Court decisions in this area, *Fibreboard Paper Products Corp. v. NLRB*[167] and *First National Maintenance Corp. v. NLRB,*[168] have been examined under the monitoring framework by Alchian[169]and by Wachter and Cohen.[170] I hope to extend their analyses in this section.

In *Fibreboard,* a firm decided to engage an independent contractor to do plant maintenance work that its own maintenance employees had done for over twenty years. After notifying the union of its decision, the employer fired the maintenance employees. The Supreme Court held that the employer committed an unfair labor practice by not bargaining over the subcontracting decision.

In *First National Maintenance,* the employer terminated a maintenance contract with a nursing home and laid off the employees covered by the contract. The Court held that the employer did not have a duty to bargain over the decision to terminate the contract with the nursing home and lay off the workers employed under the contract. Because the employer in *First National Maintenance* shut down a portion of the firm's activity, it is usually described as a partial closure case.

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165 *Id.* at 331.
166 *Id.* at 334.
167 379 U.S. 203 (1964).
168 452 U.S. 666 (1981).
169 *See supra* note 36, at 244-45.
170 *See supra* note 9, at 1387-95.

Alchian first attempted to provide an economic-efficiency rationale for this set of cases.[171] After outlining a general theory of the scope of "decision sharing," Alchian argued that the *First National Maintenance* Court had reached the right conclusion.[172] Under his theory, there seemed to be no effort on the employer's part to opportunistically reduce employee rents, nor was there evidence that the employees had invested in firm-specific human capital. This suggested that the partial shutdown decision in *First National Maintenance* was not motivated by a desire to appropriate rents.

Wachter and Cohen presented a test which they used to distinguish *First National Maintenance* from *Fibreboard.* They concluded that since the total hours devoted to production were unchanged by the subcontracting decision in *Fibreboard*, the facts suggested that rent appropriation may have been the motive behind the employer's decision.[173] In *First National Maintenance*, on the other hand, the decision to shut down part of the firm's business reduced total hours and thus required the firm to suffer a loss in revenue. In addition to this there was clear evidence of a decline in demand for the firm's services. The shutdown decision, therefore, seemed not to have been an attempt to appropriate employee rents.[174]

The rule suggested by *Fibreboard* and *First National Maintenance*, stated simply, is that a duty to bargain attaches to some subcontracting decisions while generally there will not be such a requirement in partial shutdown cases. The Supreme Court has distinguished the subcontracting decision in *Fibreboard* from the partial closure decision in *First National Maintenance* by treating the former as a decision which altered the "terms and conditions" of employment and the latter as determining the "scope and direction of the enterprise."[175] Because the formula offered by the Supreme Court is vague, the Board and the federal courts are forced to rely on the fact patterns of *Fibreboard* and *First National Maintenance* in distinguishing "terms and conditions" from "scope and direction" cases.

The subcontracting and partial closure disputes should be divided into three categories: 1) subcontracting which does not require termination of employment, 2) subcontracting which requires termination of employment, and 3) partial closure, which virtually always requires termination of employment. The case of subcontracting without terminating employment, which describes neither *Fibreboard* nor *First National Maintenance*, is the clearest case in which a duty to bargain should attach. Suppose, for example, that the firm in *Fibreboard* simply reas-

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171 Alchian, *supra* note 36.

172 *Id.* at 244-45.

173 Wachter & Cohen, *supra* note 9, at 1379-82, 1387-90.

174 *Id.* at 1392-93.

175 First Nat'l Maintenance v. NLRB, 452 U.S. 666, 677 (1981).

signed the maintenance employees to some other work which was less desirable. Since this would affect the terms and conditions of employment, it would fall within the terms of section 8(d). The duty to bargain should attach because the risk of opportunism is very high in this case. If the employer subcontracts work and reassigns employees to more difficult or less desirable areas, then he has effectively reduced their compensation.

The second category involves subcontracting with termination of employment, which is what happened in *Fibreboard*. This is different from the first category of disputes because once the employer terminates the employment of the workers, he cannot appropriate their rents. The employer may reduce labor costs by contracting out work to a different set of employees, but he would also lose the value of the firm-specific experience of the previous employees.

Although the employer cannot appropriate employee rents *ex post* in the case of subcontracting with termination, he may be able to use the *threat* of subcontracting to appropriate rents. In the absence of a duty to bargain over the subcontracting decision, the fact that the employer has no such duty could give him enormous leverage in bargaining over wages. Ultimately, the employer's leverage would depend on the credibility of the threat to subcontract work. If the threat is not credible, the employees need not be concerned about the employer's threat to contract out work that has been performed by the unit. But from the perspective of the employees, who are likely to be unaware of the value of their time to the firm, the employer will seem to have a strong incentive to replace them with lower wage workers. In this sense, the presumed informational disparity at the heart of the monitoring model suggests that subcontracting can be used opportunistically.

The previous analyses have given little attention to the issue of credibility. But this seems to be the key distinction between subcontracting and closure as opportunistic stratagems. The threat to subcontract is likely to be more credible than the threat to close.

The third category includes partial closure cases. Here again, there is no risk of rent appropriation after the termination decision; the employer cannot take advantage of employees who no longer work for her. *Ex ante*, a threat of a shutdown can be used to lower wages. However, this threat seems to suffer from a credibility problem. Although the employees may not be aware of the value of their firm-specific human capital at every moment, they are bound to be aware, at least on an intuitive level, that an employer has no incentive to shut down an enterprise that is earning positive economic profits. In other words, if the employer is rational, it is unlikely to shut down part of the enterprise simply to build a reputation as a bargainer.[176]

[176] If the parties are rational, a threat to shut down that is not supported by evidence that the firm

A second aspect of the shutdown cases is that the employer will rationally close an enterprise when its economic profits[177] are negative, which means that the capital devoted to the enterprise is worth more in some alternative activity. The workers have a very different view toward the shutdown decision. The assets are worth something to them as long as they are generating wage payments. As long as they are being paid, they will have an incentive to prevent a partial or total shutdown, however efficient such a shutdown may be. This is nothing more than a restatement of the "horizon" problem noted in Part III. The market provides the residual owner with an ongoing claim to the assets—an incentive to use them in their most profitable activity. The workers receive no such signals from the market. Giving workers a right to share in closure decisions would increase the cost of such decisions and, as a consequence, make entry less desirable, leading to shrinking markets.[178] This is quite a heavy tax to place on consumers unless the countervailing efficiency justification is urgent. Yet there seems to be no urgent efficiency justification in this case.[179]

These observations suggest that the duty to bargain should move along a sliding scale across the three categories of cases. In the first category, in which the employer subcontracts out work and the work

would find it unprofitable to operate without a reduction in wages will not be credible. And if the parties are rational, the employer will not have an incentive to shut down in order to build a reputation as a tough bargainer. On the credibility of a threat to shut down in the labor bargaining context, see Hylton & Hylton, *supra* note 103, at 185-90. The more general theory of the credibility of threats is developed in Reinhard Selten, *The Chain Store Paradox*, 9 THEORY & DECISIONS 127 (1978). The theory has been applied largely in the antitrust area. *See* Frank H. Easterbrook, *Predatory Strategies and Counterstrategies*, 48 U. CHI. L. REV. 263, 284-88 (1981); Paul Milgrom & John Roberts, *Predation, Reputation, and Entry Deterrence*, 27 J. ECON. THEORY 280 (1982).

177 Economic profit is defined generally as the difference between revenue and the opportunity cost of resources used. *See* RICHARD G. LIPSEY ET AL., ECONOMICS 168 (8th ed. 1987).

178 Fewer firms will enter the market, and those firms that do enter will incur higher costs. Fewer firms will enter because the incentive to enter depends on the expected value of the future "stream" of profits. The stream is reduced by making exit more costly. Inability to exit quickly will make it harder for firms to sell assets in order to meet the claims of creditors, and this will increase borrowing costs for the firms that decide to enter the market.

The justification for not requiring bargaining over shutdown decisions is essentially the same as that for not requiring a successor who purchases the assets of the predecessor to comply with the predecessor's collective bargaining agreement. As noted earlier, such a rule would tax efforts to shift assets in alternative uses, which would reduce entry and shrink markets.

179 The justification often stated in the literature is job security. In economic terms, this is a type of insurance for which employees are willing to pay. If employees were willing to pay a sufficiently large amount for the right to share in closure decisions, we would observe such arrangements in private employment contracts. That employees are willing to pay something for job security is evident in the widespread practice of severance pay. The question, of course, is whether they are willing to pay enough to make agreements to share in closure decisions attractive to both parties. In addition to this, wages reflect termination probabilities. Firms that are likely to go out of business should, other things being equal, be forced to pay higher wages to attract employees from alternatives that are less risky. This is one reason that we should expect wages in the public sector, where termination is unlikely, to be lower than those in the private sector.

assignments of the unit employees change, the duty should be clear if there is a possibility that subcontracting will adversely affect employment conditions. In the second category, cases in which the employer subcontracts out work and the unit workers who performed the work are terminated, there should be a duty to bargain on the part of the employer if the threat of subcontracting could be used to appropriate employee rents. Note that this rule suggests that there should be some subcontracting cases in which the Board does not find a duty to bargain. The third category involves cases in which the employer shuts down a part of the enterprise and terminates the employees. Because there can be no rent appropriation after the termination decision, and because a shut down decision will generally not be credible as an opportunistic stratagem, there should generally be no duty on the part of the employer to bargain over such decisions.

Labor law doctrine is consistent with the implications of this analysis. Subcontracting decisions that alter unit work but do not adversely affect wages, hours, and conditions of employment do not give rise to a duty to bargain.[180] In the subcontracting with termination and partial shutdown categories, the efficient background rules seem to be those suggested by *Fibreboard* and *First National Maintenance*.

The emphasis here on opportunism and the credibility of a threat to appropriate rents suggests a slightly different analysis than those presented by Alchian and by Wachter and Cohen. However, the analysis should lead to the same conclusions in most cases. One case in which a different conclusion is reached is Wachter and Cohen's treatment of *Garwood-Detroit Truck Equipment, Inc.*,[181] a subcontracting case in which the Board decided that the employer was not obligated to bargain with the union. Wachter and Cohen concluded that the Board's decision is not supported by economics because the facts in *Garwood-Detroit* indicated that the wage had effectively been reduced without reducing total hours, and the firm did not suffer a loss in the value of its assets.[182]

The framework presented here suggests that the Board's decision in *Garwood-Detroit* can be justified on economic grounds. The evidence suggested that the union was unable to offer concessions that would have led the employer to continue the original arrangement.[183] A closely related point is that the decision to subcontract in *Garwood-Detroit* is different from the subcontracting decision observed in *Fibreboard*. The employer in *Fibreboard* maintained its essential form and subcontracted out its maintenance work. The employer in *Garwood-Detroit* decided to shift out of mounting and servicing truck equipment and to specialize in

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180 Fafnir Bearing Co., 151 N.L.R.B. 332 (1965).

181 274 N.L.R.B. 113 (1985).

182 Wachter & Cohen, *supra* note 9, at 1398.

183 *Garwood-Detroit*, 274 N.L.R.B. at 114.

selling truck equipment parts.[184] Although the line between subcontracting out enterprise work and shifting into a new activity generally may not be clear, the facts in *Garwood-Detroit* suggest that the employer's decision was closer to the latter.

Subcontracting that involves a shift out of certain "core" activities of the enterprise should generally be treated the same as a partial closure decision. Indeed, subcontracting out work that is part of the core of the enterprise is in some respects a more drastic or potentially more costly decision than partial closure. The firm that subcontracts core work exposes itself to the risk that the subcontractor will hold it up for a larger share of the profits, or terminate the relationship and take its customers.[185]

In terms of the underlying economics, relocation decisions generally fall somewhere between the shutdown and subcontracting decisions. Like subcontracting, they sometimes reflect an effort to reduce labor costs. They are also analogous to shutdown decisions in the sense that a relocation may involve a shift of assets into a new activity. If the firm can easily shift it assets to another location and put them to the same use with a different group of employees, then relocation may be a means of credibly threatening to appropriate employee rents. Yet irrespective of the ease with which the employer's assets can be shifted, if the new activity or use is very different from the previous use, requiring the employer to bargain raises the problems associated with taxing entry decisions observed in the successorship analysis.

The Board has applied the framework developed in *Fibreboard* and *First National Maintenance* to its relocation cases. It has therefore attempted to distinguish relocations based on an effort to reduce labor costs from those which reflect a change in the scope and direction of the enterprise. However, the Board has failed until very recently to state a general test, supported by a Board majority, which would apply to relocation decisions. The first case to present an analysis of relocation within the *Fibreboard/First National Maintenance* framework was *Otis Elevator Co.*,[186] which produced three tests. A Board plurality concluded that management decisions would fall within the scope of mandatory bargaining when they turned on labor costs, instead of reflecting a fundamental change in the scope and direction of the enterprise, regardless of whether the decision was labeled "subcontracting," "relocation," or "shutdown."[187] Member Dennis considered it crucial if "a factor over which

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[184] *Id.* at 115.

[185] Indeed, one theory of the firm is that it organizes itself primarily to control these risks. *See* MICHAEL J. TREBILCOCK, THE COMMON LAW OF RESTRAINT OF TRADE: A LEGAL AND ECONOMIC ANALYSIS 119-54 (1986) (discussing employer's incentive to minimize the risk that an employee will leave the firm and take its customers).

[186] 269 N.L.R.B. 891 (1984).

[187] *Id.* at 892.

the union has control . . . [was] a significant consideration in the employer's decision," and if "the benefit, for labor-management relations and the collective bargaining process, outweighs the burden placed on the conduct of the business."[188] Member Zimmerman concluded that bargaining should be required when the decision is "amenable to resolution through collective bargaining."[189] In subsequent relocation decisions, the Board referred to all three tests, deciding cases on the ground that the result reached would be the same under any of them.[190]

In *Dubuque Packing Co.*,[191] the Board announced a test, supported by a majority, that applies to relocation cases. Dubuque Packing Company relocated its hog kill and cut operations from its home plant in Dubuque, Iowa, to a new plant in Rochelle, Illinois. Before the move, the employer had been pressing the union for concessions on pay and an increase in the hog kill chain speed. The employer insisted that unless concessions were offered it would have to close its Dubuque plant. After proposals for concessions were rejected the employer issued a press release confirming that its Dubuque hog kill and cut departments would be closed and announcing for first time that the operations would be relocated to Illinois. When the union requested bargaining over the hog kill and cut department relocation, the employer responded that it was under no duty to bargain over its closure decision.

The Board found that the employer violated its section 8(a)(5) duty to bargain. In the course of its decision, the Board rejected the three tests of *Otis Elevator* and announced a new test for relocation decision. The new test requires the

> General Counsel to establish that the employer's decision involved a relocation of unit work unaccompanied by a basic change in the nature of the employer's operation. If the General Counsel successfully carries his burden in this regard, he will have established prima facie that the employer's relocation decision is a mandatory subject of bargaining. At this juncture, the employer may produce evidence rebutting the prima facie case by establishing that the work performed at the new location varies significantly from the work performed at the former plant, establishing that the work performed at the former plant is to be discontinued entirely and not moved to the new location, or establishing that the employer's decision involves a change in the scope and direction of the enterprise. Alternatively, the employer may proffer a defense to show by a preponderance of the evidence: (1) that labor costs (direct and/or indirect) were not a factor in the decision or (2) that even if labor costs were a factor in the decision, the union could not have offered labor cost concessions that could have changed the

188 *Id.* at 897.

189 *Id.* at 900.

190 *See, e.g.*, FMC Corp., 290 N.L.R.B. 483, 485 (1988).

191 303 N.L.R.B. No. 66 (June 14, 1991).

employer's decision to relocate.[192]

The employer violated its duty to bargain, under the *Dubuque* test, because it could not prove either that its decision reflected a change in the scope and direction of the enterprise, or that labor costs were not a factor. Indeed, the employer offered to keep operations open for the balance of the contract term if the employees made certain concessions.

The test suggested by the analysis in this section focuses on opportunism. Could the employer's threat to terminate or relocate be credible, and if so, does the evidence suggest that the employer would have had an incentive to use it opportunistically? This case seems initially not to fit within the framework of this section because the employer threatened to close rather than relocate the hog kill operations. This is substituting a generally less credible threat for a more credible one. But in this case, the threat to close was supported by evidence which should have made it credible.[193] By presenting its decision as a closure rather than relocation decision, the employer sought to avoid the bargaining obligations that would have applied.

C. The Labor-Antitrust Intersection: A Starting Point for Future Research

To my knowledge, no effort has been made to offer an efficiency theory for the labor-antitrust cases. This is understandable because the doctrine in this area is murkier than in the two previous areas discussed. The broad contours of the case law could probably be said to be consistent with the monitoring model, but this would be at too general a level to be useful. An effort to rationalize the antitrust-labor cases will require careful consideration of the holdings of many cases in this area. Since that is beyond the scope of this Article, I will restrict myself to a statement of the directions in which research should proceed in this area, and provide an example of its usefulness.

To most economically oriented commentators the fundamental problem in the labor-antitrust area is this: Could an agreement or a bargaining unit covering the workers at more than one firm ever be justified on welfare grounds?[194] The answer provided by most commentators concerned with the economics of unions has been "no,"[195] and, indeed, this seems to be the intuitively obvious answer. An agreement extending across more than one firm effectively equalizes their costs, leaving them no incentive to compete against each other. A multiemployer unit cover-

192 *Id.* at 17-18.

193 *Id.* at 4-5.

194 *See* Lande & Zerbe, *supra* note 36.

195 *Id. But see* Oliver E. Williamson, *Wage Rates as a Barrier to Entry: The* Pennington *Case in Perspective*, 82 Q.J. ECON. 85, 115-16 (1968) (suggesting that "labor peace" is a countervailing efficiency consideration).

ing all of the firms in the same product market could enforce and monitor an agreement among the firms to acts as a price-fixing cartel.

A theoretical defense of labor-antitrust can be based on the rent-protecting model of the union. Consider the case of a general contractor who employs plumbers. The competing firms *A*, *B*, and *C* each employ plumbers. *A* is nonunion; *B* and *C* are unionized. The employer could use the threat to contract out the plumbing work to appropriate the rents of its own employees. If a duty to bargain applies, the employer will not be able to do this easily. However, an alternative solution to the opportunism problem is for the union to restrict the set of firms to which the employer can contract out work. If the employer can only contract out work to the unionized firms, *B* and *C*, its ability to use the threat of subcontracting to appropriate the rents of employees will be further restricted.

Obviously, such a contractual restraint would limit competition between *A*, *B*, and *C*. Under the agreement, *B* and *C* would not have to worry about the competition of *A* in offering their services to the general contractor. This would allow *B* and *C* to charge higher prices. However, this is only part of the social cost of the collective bargaining agreement between the general contractor and its plumbers. The other part of the agreement is the reduction in social costs generated by the threat of rent appropriation. The two must be compared in assessing the social costs of an agreement restricting the general contractor's ability to subcontract. The doctrinal formula defining the nonstatutory labor exemption clearly permits such balancing of social costs and benefits. If the restriction was the product of collective bargaining, the court will balance the competing interests of the national labor policy and the policy represented by the antitrust laws.[196]

The rule suggested by the rent protecting model can be stated in a manner that weighs in favor of antitrust enforcement. All agreements restricting competition in the product market are potentially subject to the antitrust laws. The agreements that should be protected from antitrust scrutiny by the nonstatutory labor exemption are those in which the purpose of the agreement is to prevent opportunism. Under this theory, several of the labor-antitrust decisions that have confused commentators could probably be explained. *Connell Construction Co. v. Plumbers, Local 100*[197] is an example. The facts of *Connell* are given in the example of plumbers discussed above, except for one important difference. Connell, the general contractor, employed no plumbers. The contractual restraint in *Connell* had only one effect—limiting competition. That is, because Connell had no plumbers as employees, it could not have used the threat of subcontracting its plumbing work in order to appropriate the rents of

196 JULIUS G. GETMAN & BERTRAND B. POGREBIN, LABOR RELATIONS: THE BASIC PROCESSES, LAW AND PRACTICE 286 (1988).

197 421 U.S. 616 (1975).

its employees. The holding in *Connell*, which found the restraint to be "direct" in its effect on the product market, is consistent with the theory presented here.

VI. CONCLUSION

I have used labor law to reexamine a very general argument about law: that case law tends toward efficiency while statutory law is generally inefficient. The general argument has become closely associated with the law and economics literature, but it predates the burst of law and economics scholarship over the last three decades. The general view is overly simplistic because all areas of law are mixtures of case and statutory law. A more sophisticated form of the general thesis would hold that statutory law provides initial conditions, which may be inefficient, and alters the "position" of the law, while case law moves in the direction of efficiency.

Under this more general statement of the common law versus case law distinction, the hypothesis that labor law is efficient is hard to reject on theoretical grounds. The process by which labor law develops is in many respects similar to the common law process, as evidenced by the fact that several areas of labor law doctrine can be explained by efficiency theory.