



4-1-1973

Case Comments

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Recommended Citation

Charles P. Chritton & Thomas L. Poscharsky, *Case Comments*, 48 Notre Dame L. Rev. 978 (1973).

Available at: <http://scholarship.law.nd.edu/ndlr/vol48/iss4/12>

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CASE COMMENTS

LABOR LAW—SUCCESSOR'S BARGAINING OBLIGATION UPHELD—SUCCESSOR NOT BOUND BY PREDECESSOR'S CONTRACT TERMS—SUPREME COURT EMPHASIZES FREEDOM OF CONTRACT IN DETERMINING A SUCCESSOR EMPLOYER'S LABOR OBLIGATIONS.—In early 1967 the National Labor Relations Board (hereinafter Board) determined that the Wackenhut Corporation security force at Lockheed's Los Angeles airport facility was an appropriate collective bargaining unit. An election followed and the United Plant Guard Workers of America, Local No. 162 was certified as the unit's bargaining representative. Within a month, a three-year collective bargaining agreement was negotiated and signed with Wackenhut.

Lockheed's service contract with Wackenhut was due to expire on June 30, 1967 and in May Lockheed called for bids on its next contract. The bid announcement included information on Local No. 162's recent certification and current contract with Wackenhut. Wackenhut and various competitors submitted bids and at the conclusion of the bidding the contract was awarded to Burns International Detective Agency, Inc.

The contract with Burns was to take effect July 1, 1967. During June, Burns hired twenty-seven former Wackenhut employees and transferred fifteen of its own employees to provide the Lockheed security, but on different employment terms than listed in the Wackenhut agreement. On July 12, after Burns had started to perform its contract, the Wackenhut union, Local No. 162, demanded that Burns recognize it as the bargaining representative for the employees at the Lockheed terminal. In addition to recognition, the union demanded that Burns adopt the terms of its Wackenhut agreement. Both demands were refused by Burns.

Local No. 162 then filed an unfair labor practice charge with the Board stating that it was the certified representative of the security employees at the Lockheed installation, and alleging Burns' refusal to bargain. In December, a Board trial examiner found that the security force employed by Burns at the Lockheed terminal was a proper collective bargaining unit (despite the fact that Burns had similar security forces throughout the Los Angeles area organized and represented by a single union) and also found that Local No. 162's certification survived the change in employers. Furthermore, the examiner found that the employing industry remained unchanged under Burns, that Burns was a successor employer and, as such, it had committed the alleged unfair labor practice. The examiner's remedy ordered Burns to recognize and bargain with Local No. 162, and to assume and give retroactive effect the terms of the collective bargaining agreement the local had negotiated with Wackenhut.¹

In April of 1969, the Board upheld the trial examiner's findings and order. Additionally, it ruled for the first time that a successor employer was bound by the terms of its predecessor's collective bargaining agreement.² The ruling was appealed to the United States Court of Appeals for the Second Circuit which held that Burns was a successor employer and was bound by the National Labor Re-

¹ William J. Burns Int'l Detective Agency, Inc., 182 N.L.R.B. 348 (1970).

² *Id.*

lations Act³ to recognize and bargain with Local No. 162 but that Burns could not be held to the terms of the collective bargaining agreement negotiated by its predecessor.⁴

Both Burns and the Board filed a petition for certiorari to the United States Supreme Court. Burns challenged both the trial examiner's finding that its Lockheed force was a proper bargaining unit and the Board's bargaining order. The Board maintained that the doctrine of successorship required Burns to assume the terms of the Wackenhut agreement.

With four justices dissenting, the Supreme Court *held*: because the bargaining unit remained appropriate⁵ and the local's certification survived the change in employers, Burns had a duty to bargain with Local No. 162. Moreover, upholding the determination of the Court of Appeals, it found no precedent which could be a basis for imposing Wackenhut's contract terms on Burns. *NLRB v. Burns International Security Services, Inc.*, 406 U.S. 272 (1972).

I. Historical Development of Elements In The Burns Question

The National Labor Relations Act (hereinafter Act) seeks to promote industrial peace by establishing and protecting employee collective bargaining rights.⁶ While establishing collective bargaining rights and mandating that both employer and employee must bargain collectively,⁷ the Act expressly provides that the existence of these rights and duties should not operate to force bargaining concessions from either party.⁸ Thus the Act manifests congressional intent to adopt collective bargaining as a preferred means for avoiding industrial strife while maintaining freedom of contract for all bargaining parties.⁹ These two principles represent competing and opposite interests and tension between the two naturally resulted as collective bargaining rights were developed and extended.¹⁰

3 29 U.S.C. §§ 151-68 (1970).

4 *William J. Burns Int'l Detective Agency, Inc. v. NLRB*, 441 F.2d 911 (2d Cir. 1971).

5 *Burns Int'l Security Serv., Inc. v. NLRB*, 404 U.S. 822 (1971) granted certiorari limited to the question of Burns' bargaining duty. Although Burns in its petition had challenged the unit finding made by the Court of Appeals, certiorari was not granted on this issue.

6 29 U.S.C. § 151 (1970).

7 29 U.S.C. §§ 158(a)(5), (b)(3) (1970).

8 29 U.S.C. § 158(d) (1970).

9 S. REP. No. 573, 74th Cong., 1st Sess. 12 (1935). "The committee wishes to dispel any false impression that this bill is designed to compel the making of agreements or to permit governmental supervision of their terms."

Remarks by Senator Walsh reflect the same emphasis on freedom of contract, 79 CONG. REC. 7659 (1935):

[T]hat the bill requires no employer to sign any contract, to make any agreement, to reach any understanding with any employee or group of employees. . . .

. . . .
A crude illustration is this: The bill indicates the method and manner in which employees may organize, the method and manner of selecting their representatives or spokesman, and leads them to the office door of their employer with legal authority to negotiate for their fellow employees. The bill does not go beyond the office door. . . .

10 Stern, *Binding The Successor Employer to Its Predecessor's Collective Agreement Under the NLR Act* 45 TEMPLE L.Q. 1, 2 (1971), documents the friction between these two aspects of national labor policy.

In general, national labor policy has developed along two avenues—suits to enforce or appeal from Board orders as provided in the Act,¹¹ and suits for contract enforcement as provided for in Section 301 of the Taft-Hartley Act.¹² Board regulatory power is limited by the Act provisions which preserve freedom of contract in labor contract negotiations and this limitation has been carefully observed in suits to enforce or appeal from Board bargaining orders. By contrast however, in contract enforcement suits, which do not involve Board regulatory power, the focus on freedom of contract has been less apparent. In these cases primary consideration has been given to the benefits of arbitration and protection of collective bargaining rights. This emphasis was especially notable in *John Wiley & Sons, Inc. v. Livingston*¹³ which held that a successor employer, although not a party to its predecessor's contract, was bound by an arbitration clause in that contract. Interpretations of this holding introduced confusion in evaluating the relative priority and scope of collective bargaining rights vis-à-vis freedom of contract.¹⁴ This confusion introduced by the *Wiley* decision underlies the *Burns* case.

Insuring each party's freedom of agreement to contract terms has been a hallmark of Supreme Court decisions under the Act. In fact, this freedom has been given added meaning by the Court interpretations that allow each party to bring its economic power to the bargaining table and negotiate and agree within the leverage of that power.¹⁵ The fundamental theory of the Act was examined and held constitutional in *NLRB v. Jones & Laughlin Steel Corp.*¹⁶ There the Court noted:

The theory of the Act is that free opportunity for negotiation with accredited representatives of employees is likely to promote industrial peace and may bring about adjustments and agreements which the Act itself does not attempt to compel.¹⁷

11 29 U.S.C. §§ 160(e),(f) (1970).

12 29 U.S.C. § 185 (1970).

13 376 U.S. 543 (1964).

14 Each of the following decisions held, consistent with *Wiley*, that a succeeding employer was bound by an arbitration clause in its predecessor's contract. However, each decision contained language that indicated *Wiley* was being read broadly and that successor employers could be bound by terms other than arbitration clauses. In *United States Gypsum Co. v. United Steelworkers*, 384 F.2d 38, 44 (5th Cir. 1967), cert. denied 389 U.S. 1042 (1968) the court noted: "In the ordinary course of events, a collective bargaining agreement entered into by the union and the employer will be binding on the employer, or his successor until it expires." Likewise, in *Wackenhut Corp. v. International Union, U.P.G.W.*, 332 F.2d 954, 958 (9th Cir. 1964), where the court also indicated that the contract was binding on a successor employer. In *United Steelworkers v. Reliance Universal, Inc.*, 335 F.2d 891, 895 (3rd Cir. 1964), the court enforced an arbitration clause against a successor and noted that the prior contract was binding insofar as it was a basic guide for the arbitrator. Stern, *supra* note 7, at 20-23 discusses the application and extension of the *Wiley* holding reflected in these cases.

15 *NLRB v. Insurance Agents' Int'l Union, AFL-CIO*, 361 U.S. 477, 489 (1960). See also *Publishers Ass'n v. NLRB*, 364 F.2d 293, 295 (2d Cir. 1966). However, use of economic power is not unlimited: *NLRB v. Crompton-Highland Mills, Inc.*, 337 U.S. 217 (1949) held that an employer may not unilaterally raise wages during negotiations without prior bargaining on the amount of the increase. 29 U.S.C. § 158(a) (1970) prohibits other employer activity that would undermine collective bargaining rights; likewise employee organizations may not use their economic power in ways forbidden by 29 U.S.C. § 158(b) (1970).

16 301 U.S. 1 (1937).

17 *Id.* at 45.

This concept has been honored by the Court even where its application allowed an employer the right to bargain for a management rights clause, the use of which could arguably avoid his duty to bargain. The Court upheld the employer's right to predicate his agreement to an arbitration clause on a demand for a management functions clause, which would remove work schedules (a mandatory bargaining subject) from arbitration, thereby leaving resolution of work schedule disputes completely at the discretion of management.¹⁸ Even where the Court recognizes the existence of a labor practice that has potential to frustrate the national goal of promoting collective bargaining, if the Board reacts to that threat by fashioning a remedy which requires agreement to substantive contract terms, the Court, while sympathetic with the desired end, will not enforce the Board's order. In *H. K. Porter Co., Inc. v. NLRB*,¹⁹ the Board had determined that the only reason the employer insisted upon exclusion of a check-off clause was to prevent the concluding of a collective bargaining agreement and ordered the employer's agreement to the clause as an appropriate remedy. While it recognized the employer's conduct as unfair, the Court refused to enforce a remedy which deprived the employer of his freedom to contract.²⁰

Notwithstanding the restrictions that freedom of contract imposes on the Board's enforcement power delineated in the *Porter* case, the Court, in exercising its jurisdiction under Section 301 of the Taft-Hartley Act, has accorded the freedom of contract doctrine a less emphatic role.²¹ The landmark decision of *Textile Workers Union v. Lincoln Mills*²² held that Section 301(a) of the Taft-Hartley Act²³ was a congressional mandate for federal courts to fashion a body of substantive law in enforcing labor contracts. Development of enforcement principles has not necessarily been limited by the terms of the Act, but has been drawn from the entire fabric of national labor policy.²⁴ The enforcement policies

18 *NLRB v. American Nat'l Ins. Co.*, 343 U.S. 395, 407-09 (1952).

19 397 U.S. 99 (1970).

20 *Id.* at 107-08. Where the Court stated: It is implicit in the entire structure of the Act that the Board acts to oversee and referee the process of collective bargaining, leaving the results of the contest to the bargaining strengths of the parties. It would be anomalous indeed to hold that while § 8(d) prohibits the Board from relying on a refusal to agree as the sole evidence of bad-faith bargaining, the Act permits the Board to compel agreement in that same dispute.

21 Wellington, *Freedom of Contract and the Collective Bargaining Agreement*, 112 U. PA. L. REV. 467, 478 (1964). This author contrasts the Court's approach under § 301: "But whereas freedom of contract has . . . dominated the law of the duty to bargain, it has been the noble quest for industrial peace that has captured the law of contract enforcement."

22 353 U.S. 448 (1957).

23 29 U.S.C. § 185(a) (1970):

(a) Suits for violation of contracts between an employer and a labor organization representing employees in an industry affecting commerce as defined in this chapter, 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.

24 *Textile Workers Union v. Lincoln Mills*, 353 U.S. 448, 456-57 (1957) where the Court noted:

The question then is what is the substantive law to be applied in suits under § 301(a)? We conclude that the substantive law to apply in suits under § 301(a) is federal law, which the courts must fashion from the policy of our national labor laws. . . . The range of judicial inventiveness will be determined by the nature of the problem. . . . Federal interpretation of the federal law will govern, not state law. (Citations omitted.)

applied when arbitration clauses are at issue are of special importance in the *Burns* decision. Collective bargaining agreement terms are viewed as guidelines rather than precisely stated obligations,²⁵ and arbitration is viewed as a desirable alternative to strikes where agreement terms are disputed.²⁶ Based on these two considerations the Supreme Court has developed contract interpretation policies which submit contract disputes to arbitration whenever possible.²⁷ Its willingness to find an implied agreement to arbitrate beyond the four corners of the contract and to submit disputes to an arbitration process which often turns on the application of trade practices can be viewed as an indirect limitation²⁸ on the very same freedom of contract so clearly espoused in unfair labor practice cases.

In *John Wiley & Sons, Inc. v. Livingston*,²⁹ relied upon by the Board in its *Burns*³⁰ decision, this national preference for arbitration coupled with a need to protect collective bargaining rights was held to be a significant enough consideration to impose an arbitration clause on a succeeding employer, despite the fact that he was not a party to his predecessor's labor contract. The *Wiley* case involved Interscience Publishers Inc., a unionized employer, which merged with Wiley & Sons, a nonunion employer. Wiley did not assume the Interscience collective bargaining agreement, but a majority of the forty Interscience employees covered by the agreement joined a pre-existing group of three hundred Wiley employees. Wiley afforded all the new employees the same rights and benefits as their own employees enjoyed. However, the union which had represented the Interscience employees brought a contract enforcement suit under Section 301 of the Taft-Hartley Act to compel Wiley's arbitration of vested rights due to transferred Interscience employees. The action was based on an arbitration clause in the Interscience contract. The Court held that under federal labor policy, merger does not necessarily terminate all rights of employees covered by a collective bargaining agreement and that Wiley, as a successor employer, was bound by the arbitration clause in its predecessor's agreement. This finding was based on the following reasoning:

The objectives of national labor policy, reflected in established principles of federal law, require that the rightful prerogative of owners independently to rearrange their business and even eliminate themselves as employers be

25 *United Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 578 (1960): "The collective bargaining agreement states the rights and duties of the parties. It is more than a contract; it is a generalized code to govern a myriad of cases which the draftsmen cannot wholly anticipate." In addition, the Court noted that contracts which include arbitration clauses in fact include a variety of unspecified trade practices because arbitrators will rely on such trade practices in making their awards.

26 *Id.* at 578.

27 *Local 174, Teamsters v. Lucas Flower Co.*, 369 U.S. 95 (1962) held that when an agreement includes an arbitration clause, a no-strike clause will be implied on the part of the union. *United Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582 (1960) held that when determining if a dispute is arbitrable within a given arbitration clause, in the absence of language specifically excluding the dispute from arbitration, federal courts are directed to give the benefit of any doubt to an interpretation that will include the dispute within the clause.

28 Wellington, *supra* note 18, at 494. The author gives a full explanation of the indirect limitations on freedom of contract resulting from federal enforcement of arbitration clauses.

29 376 U.S. 543 (1964).

30 *William J. Burns Int'l Detective Agency, Inc.*, 182 N.L.R.B. 348 (1970).

balanced by some protection to the employees from a sudden change in the employment relationship. . . .

[T]he impressive policy considerations favoring arbitration are not wholly overborne by the fact that Wiley did not sign the contract being construed. . . .³¹

The Board paralleled *Wiley* reasoning in *Burns* and ruled that the policy considerations promoting collective bargaining rights were significant enough to impose the terms of a predecessor's labor agreement on an unconsenting successor employer.³² Thus, the tension between collective bargaining rights and freedom of contract was highlighted on the *Burns* facts and the relative priority and accommodation between these competing interests was the basic question before the Court.

II. Burns' Duty to Bargain

The thrust of the Board ruling was to establish Burns' duty to bargain required by the doctrine of successorship.³³ The Board found that an appropriate unit had been certified under Wackenhut, that Burns had hired as a majority of its work force the same employees to do the same work at the same worksite, and that the nature of the employing industry remained unchanged after the change in employers.³⁴ In the Board's view, these facts were sufficient to establish Burns as a successor employer, and under the doctrine of successorship, successor employers are required to bargain with their predecessor's union. The Board thus found that Burns was required to bargain with Local No. 162.

Implicit in the Board's reasoning were the more specific factors required by the Court to establish a duty to bargain. The Court upheld the Board's bargaining order, but established Burns' bargaining obligation on a more precise basis. The Court held that when Burns chose to hire former Wackenhut employees as a majority of its own work force the choice carried with it an obligation to recognize and bargain with the union certified to represent those employees.³⁵ Two elements were identified as a basis for this obligation—the finding that an appropriate bargaining unit had survived the change in employers and that the majority of employees hired by Burns were represented by a recently certified bargaining agent.³⁶ As noted by the dissent, the Court carefully declined to adopt the language of successorship.³⁷ The majority opinion made no attempt to evaluate a change in the employing industry, a test prevalent in successorship findings, but rather established a bargaining duty on the continued existence of an appropriate bargaining unit and a presumption of union majority status which follows recent certification.

The Court did not hear argument on the appropriateness of the Burns

31 *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543, 549-50 (1964).

32 *William J. Burns Int'l Detective Agency, Inc.*, 182 N.L.R.B. 348, 350 (1970).

33 *Id.* at 354.

34 *Id.* at 353-54.

35 *NLRB v. Burns Int'l Security Serv., Inc.*, 406 U.S. 272, 278 (1972).

36 *Id.* at 281.

37 *Id.* at 296.

bargaining unit,³⁸ rather, it simply accepted the unit ruling made by the Court of Appeals.³⁹ In developing its finding of successorship, the Board only indirectly established the continued appropriateness of the Burns unit. Burns, however, challenged the unit appropriateness in the Court of Appeals, which resolved the matter in favor of the Board. The Board had argued that the community of interest necessary to establish an appropriate unit had been demonstrated by several facts.⁴⁰ Under Burns the Lockheed security force was managed by a full-time supervisor with power to hire and fire. The group was physically separated from other Burns employees in the Los Angeles area and the Lockheed group was paid a higher wage than other Los Angeles area security groups employed by Burns.⁴¹ This argument was consistent with Board policy for determining single location units of multiple location employers adopted in *Haag Drug Co., Inc.*:⁴²

Absent a bargaining history in a more comprehensive unit or functional integration of a sufficient degree to obliterate separate identity, the employee's "fullest freedom" is maximized, . . . by treating employees in a single [location] . . . as . . . an appropriate unit.⁴³

Noting the latitude of the Board's discretion in unit findings, the Court of Appeals upheld the Board's finding that Burns' Lockheed force was an appropriate unit even though employees at other Burns locations were represented by a single bargaining representative.⁴⁴ The Supreme Court accepted this unit holding and developed it as a necessary element in establishing a duty to bargain.

In the Court's analysis, the appropriate unit finding was joined with a presumption that the union maintained its majority status after the change in employers had been completed. Board certification of a bargaining representative produces an almost conclusive presumption that majority status of the union continues for a reasonable time.⁴⁵ This reasonable time is usually held to be at least a year, reflecting the limitations on Board directed elections manifest in Section 9 of the Act.⁴⁶ This presumption survives despite employee change of

38 *Id.* at 277.

39 *Id.* at 278.

40 *William J. Burns Int'l Detective Agency, Inc., v. NLRB*, 441 F.2d 911, 914 (2d Cir. 1971).

41 *Id.*

42 169 N.L.R.B. 877 (1968).

43 *Id.* at 877.

44 29 U.S.C. § 159(b) (1970) gives the Board discretion in making unit determinations. *A.F. of L. v. NLRB*, 308 U.S. 401 (1940) held there would be no direct review of the Board's unit determinations, rather appropriate review of unit determinations would be available to employers if and when the Board found it necessary to enforce a bargaining order. An exception to the above doctrine was recognized in *Leedom v. Kyne*, 358 U.S. 184 (1958) where the Board had violated an express statutory limitation regulating its power to define units including professional employees. The unit finding in *Burns* was consistent with prior Board rulings. *Heublein, Inc.*, 119 N.L.R.B. 1337 (1958) had demonstrated that in unit findings it was immaterial that no separate units had been established at other of the employer's plants.

45 *Brooks v. NLRB*, 348 U.S. 96 (1954).

46 29 U.S.C. § 159 (1970). Subsection 159(c)(3) does not allow the Board to direct an election in any unit within which an election has been held in the preceding twelve months. Subsection 159(e)(2) does not allow the Board to direct an election to rescind a union security agreement negotiated between a union and employer in any unit within which an election has been held in the preceding twelve months.

heart⁴⁷ and even where a large employee turnover is evident.⁴⁸ The theory reflects a need to establish stable bargaining conditions upon which each side can rely and avoid the uncertainty that would beset the bargaining process if repeated challenges to the bargaining authority of a certified representative were allowed. The presumption, first announced by the Court in a case involving only one employer,⁴⁹ has been applied to succeeding employers. *NLRB v. Armato*⁵⁰ demonstrated that a change in ownership will not necessarily destroy this presumption. In *Armato* the Court of Appeals for the Seventh Circuit held there was no reason to believe employees would desire a change in bargaining agents simply because of a change in owners, and therefore it enforced a bargaining order against a succeeding employer who had purchased the business shortly after a bargaining representative had been certified. The Board has viewed the application of this presumption to succeeding employers as essential if collective bargaining rights are to be meaningful. This position was clearly established in *Maintenance, Inc.*:⁵¹

It would be virtually impossible for employees to achieve collective-bargaining rights in an employing industry which is periodically subject to a possible change of employers if with every change the employees must again resort to the Board's processes in order to demonstrate anew their desire to be represented. . . .⁵²

The *Burns* Court endorsed the extension of this presumption to succeeding employers where a "majority of the employees hired" by the succeeding employer "are represented by a recently certified bargaining agent."⁵³ The presumption, accompanied by the finding that an appropriate bargaining unit continued to exist, was enough in the Court's view to bring *Burns* within the bargaining mandate of Section 8(a)(5) of the Act.⁵⁴

It is critical to note that the Court endorsed the presumption of majority status only where a majority of the successor's employees were formerly represented by the union that seeks recognition. In the normal case where only the original employer is involved, the presumption continues for a year regardless of actual majority. The requirement that at least a majority of the new group have been previously represented, while not insuring that these are the same individuals

47 *Brooks v. NLRB*, 348 U.S. 96, 103 (1954). Shortly after an 8 to 5 vote designating a representative, 9 employees indicated that they no longer wanted union representation.

48 *See NLRB v. John S. Swift Co., Inc.*, 302 F.2d 342, 345 (1962) which held that, absent other evidence of probative value, the presumption continues even after the certification year, despite the fact that a majority of the originally certified unit have terminated their employment.

49 *Brooks v. NLRB*, 348 U.S. 96 (1954).

50 199 F.2d 800 (7th Cir. 1952).

51 148 N.L.R.B. 1299 (1964).

52 *Id.* at 1302.

53 *NLRB v. Burns Int'l Security Serv., Inc.*, 406 U.S. 272, 281 (1972). But it is not clear from this holding or the holdings cited by the *Burns* Court if the majority of the predecessor's employees present in the succeeding employer's work group also have to have been a majority of the predecessor's employees. Whether a minority of the predecessor's employees that constitute a majority of the successor's employees will be sufficient to carry the presumption is not answered.

54 29 U.S.C. § 158(a)(5) (1970) provides that it shall be an unfair labor practice for an employer to refuse to bargain collectively with the representatives of his employees.

that authorized the representative, does provide a general check against imposing representation where it is certain that a majority of the group have never assented to union representation. In developing this concept, the Court endorsed and clarified lower court holdings that the presumption of union majority could be correctly applied to succeeding employers.⁵⁵

55 The following chart lists successorship cases cited by the *Burns* Court or this comment. The chart illustrates the relationship between the number of transferred employees and the size of the predecessor's and successor's work forces.

<i>Successorship</i>	Date of Certification	Date of Successor Takeover	No. of employees in predecessor's unit	No. of employees in successor's unit	No. of predecessor's employees in successor unit
NLRB v. Burns Int'l Security Serv., Inc., 406 U.S. 272 (1972).	Mar 1967	Jul 1967	....	42	27
NLRB v. Zayre Corp., 424 F.2d 1159 (5th Cir. 1970).	Apr 1966	Jun. 1966	69	85 (by Jul)	65
Tom-A-Hawk Transit, Inc. v. NLRB, 419 F.2d 1025 (7th Cir. 1969).	1938	Feb. 1968	24	24	14
NLRB v. McFarland, 306 F.2d 219 (10th Cir. 1962).	Mar 1960	Mar 1960	16	14-24	9*
NLRB v. Auto Ventshade, Inc., 276 F.2d 303 (5th Cir. 1960).	1950	May 1957	13	7	6*
NLRB v. Lunder Shoe Corp., 211 F.2d 284 (1st Cir. 1954).	Oct. 1950	Jun. 1951	250	250	100-175
NLRB v. Armato, 199 F.2d 800 (7th Cir. 1952).	Oct. 1949	Jul 1950 lease Aug 1950 new Corp.	25	6 (by Jul) 25 (by Sep)	6* 8
NLRB v. Blair Quarries, Inc., 152 F.2d 25 (4th Cir. 1945).	Oct. 1943	Jun. 1944	60	60	60
<i>No Successorship</i>					
Lincoln Private Police, Inc., 189 N.L.R.B. No. 103 (Apr. 12, 1971).	Nov 1969	May 1970	Feb. 70-144 May 70-92	66	61
NLRB v. John Stepp's Friendly Ford, Inc., 338 F.2d 833 (9th Cir. 1964).	Oct. 1961	May 1962	12	8	3
NLRB v. Downtown Bakery Corp., 330 F.2d 921 (6th Cir. 1964).	Apr 1960	May 1961	....	....	all Here dissolution of multi-employer bargaining unit, where

By establishing Burns' duty to bargain on the combined facts of an appropriate unit, a majority of old employees, and recent certification, the Court distilled and applied the central elements of the successorship doctrine developed by various Courts of Appeals and the Board. This doctrine seeks to promote continuity of collective bargaining rights during the disruptive period that accompanies a change in ownership.⁵⁶ Cases which have involved successorship determination have considered continued unit appropriateness and the presumption of majority status only indirectly and have focused specifically on the unchanged character of the employing industry. The early decision of *NLRB v. Colten*⁵⁷ reflected this approach in holding that, despite the change in ownership form rendered by the death of one of the partnership partners, the "nature of the employing industry" was essentially unchanged and the surviving partner was obliged to continue to bargain collectively with the employees' representative. The doctrine was given significant impetus by the holding in *John Wiley & Sons, Inc. v. Livingston*,⁵⁸ which, as noted earlier, held that even though the successor, Wiley, had not been a party to its predecessor's labor contract it was nevertheless bound by an arbitration clause in the agreement. Further, it will be recalled that the *Wiley* Court reached this result by emphasizing the need to protect collective bargaining rights of employees from sudden changes in the employment relationship⁵⁹ where there was substantial continuity of identity in the business enterprise before and after the change.⁶⁰

Subsequent successorship decisions, although not extending the successor's obligation to assumption of contract terms, have used the "substantial continuity

separate elections established the unit, showed that the majority of this group favored another representative and provided a basis for employer's good faith doubt of majority status.

*NLRB v. Alamo White
Truck Serv., Inc.*, 273
F.2d 238 (5th Cir. 1959)

Jun. 1957	.....	12 mechanics	7	7*
		3 parts men		

Here it was certain that the five mechanics not hired were all union supporters and the presumption of majority status failed.

* Indicates that the same supervisor was also retained.

Chart Summary

1. In all cases finding a duty to bargain successor employers have on the day of takeover hired as a majority of their work force employees who were also employees of the predecessor.
2. In most cases finding a duty to bargain, the majority of the successor's employees have also been a majority of the predecessor's work force. A notable exception is *NLRB v. Armato* where the court stated "[T]he fact that they (employees) found themselves fewer in number than before warrants no implication that they no longer desire representation."
3. The examples under "no successorship" illustrate several points. Where less than a majority of the successor's employees were predecessor's employees, as in *NLRB v. John Stepp's Friendly Ford, Inc.*, the presumption of union majority status could not be applied and successorship was defeated. *NLRB v. Alamo White Truck Serv., Inc.* and *NLRB v. Downtown Bakery Corp.* demonstrate that the presumption can be overcome by an independent showing that the transferred employees did not favor representation at the time the election was held in their unit. *Lincoln Private Police, Inc.* shows that even where the presumption is appropriate successorship could be defeated by a showing that the employing industry had undergone significant change.

56 *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543, 549 (1964).

57 105 F.2d 179 (6th Cir. 1939).

58 376 U.S. 543 (1964).

59 *Id.* at 549.

60 *Id.* at 550-51.

of identity” test to impose a duty to bargain. The facts of corporate merger, sale of assets, lack of dealing between predecessor and successor, lack of assumption of business contracts, or the non-use of predecessor’s equipment have not been controlling in a finding of successorship.⁶¹ Rather, the determinations have focused on the employees and any change in their employment circumstances relative to the work they perform. Thus, successorship has been established when the same product lines, department organization, employee identification and job function remained unchanged because there was not a significant change in the employing industry.⁶² Such findings have been made despite the facts that the new employer had altered management policies or that a larger bargaining unit was equally appropriate. Thus, the factual inquiry required by successorship focused upon the nature of the employing industry rather than the identity of a specific employer; and this way the doctrine developed a duty to bargain if the employing industry was found unchanged rather than making specific unit and majority status determinations.

Although the *Burns* Court avoided adopting the successorship doctrine per se, the requirements it set forth for establishing a succeeding employer’s duty to bargain—unit appropriateness plus continued presumption of majority status—were elements of the successorship test. Successorship was defeated where unit appropriateness or majority status could not be shown⁶³ and to that extent the two tests are similar. Under the successorship doctrine, however, the “nature of the employing industry” tended to become a single all-inclusive test. Thus without specific appraisal of continued unit appropriateness or majority status, a bargaining duty would be upheld if the employing industry continued unchanged. Conversely, the duty could be avoided without further inquiry, on a showing of change in the employing industry.⁶⁴ The Court did not ignore this factor but viewed it as part of the unit determination:

It would be a wholly different case if the Board had determined that because *Burns*’ operational structure and practices differed from those of Wackenhut, the Lockheed bargaining unit was no longer an appropriate one.⁶⁵

The net result is that the Court based a successor’s bargaining duty on the same fundamentals the Act requires to generate any bargaining duty.⁶⁶ In so doing, the Court avoided the language and elements of the successorship doctrine that were superficial and that could only foster future confusion and distortion of the bargaining duty mandated by the Act.

61 See *NLRB v. Zayre Corp.*, 424 F.2d 1159 (5th Cir. 1970); *Tom-A-Hawk Transit, Inc. v. NLRB*, 419 F.2d 1025 (7th Cir. 1969); *S. S. Kresge Co. v. NLRB*, 416 F.2d 1225 (6th Cir. 1969); *NLRB v. McFarland*, 306 F.2d 219 (10th Cir. 1962).

62 *E.g.*, *NLRB v. Zayre Corp.*, 424 F.2d 1159 (5th Cir. 1970).

63 See *NLRB v. John Stepp’s Friendly Ford, Inc.*, 338 F.2d 833 (9th Cir. 1964).

64 *NLRB v. Alamo White Truck Serv., Inc.*, 273 F.2d 238 (5th Cir. 1959).

65 *NLRB v. Burns Int’l Security Serv., Inc.*, 406 U.S. 272, 280 (1972) (footnote omitted).

66 29 U.S.C. § 159(a) (1970) requires that a bargaining agent be designated by a majority of the employees in a unit appropriate for such purposes and 29 U.S.C. § 158(a)(5) directs employers to bargain with employee representatives that meet these requirements.

Four Justices dissented from the holding that Burns had a duty to bargain.⁶⁷ They argued that both the unit status and union majority findings resulted from a conclusion of successorship⁶⁸ and that as developed in *Wiley*, successorship could not be established from only a "naked" transfer of employees but required in addition, a transfer of assets or contractual dealings between predecessor and successor.⁶⁹ The dissent questioned whether the unit and majority status findings could withstand analysis when deprived of the successorship reasoning.⁷⁰

The *Burns* majority, however, based neither of these findings on successorship. As noted above, the unit appropriateness had been specifically argued and upheld in the Court of Appeals on independent grounds. Further, the dissent's call for mathematical proof of union majority status⁷¹ ignored the recognized necessity of applying a presumption of majority status after certification. Adoption of the presumption was necessary to effectuate the policies of the Act⁷² and the dissent argument requiring exact proof was inconsistent with Court precedent on bargaining duties.

The dissent's argument that successorship should not be imposed without a transfer in assets between employers ignored the contrasting facts in *Wiley* and *Burns* and the fact that the majority opinion in *Burns* eschewed the successorship doctrine. The dissent believed that the factors which developed Wiley's duty to arbitrate were not controlling where a significant lack of continuity in the business under the successor would make unreasonable the imposition of his predecessor's contract terms.⁷³ But *Wiley* developed a duty to arbitrate under a predecessor's contract terms whereas *Burns* developed a duty to bargain. The dissent's *Wiley* analogy concluded with a bargaining duty controlled by a transfer of assets between employers.⁷⁴ However, this requirement misdirects the bargaining duty analysis.

Under the Act, bargaining rights arise when an appropriate group of employees vote to be represented at the bargaining table.⁷⁵ Bargaining rights are a function of the employee group and the creation of the rights has little relation to the assets of the employer. Therefore to require that survival of the rights depends on an exchange of assets between employers, even where the character of the employee group remains largely unchanged, seems inconsistent with the nature of bargaining rights. The *Burns* majority made the bargaining duty of a successor turn only on characteristics of the employee group required by the Act. The dissent's focus on assets introduced a spurious factor which paralleled the employing industry test so carefully avoided by the majority.

The dissent's objection to imposing a bargaining duty where there has

67 *NLRB v. Burns Int'l Security Serv., Inc.*, 406 U.S. 272, 296 (1972).

68 *Id.* at 297-98.

69 *Id.* at 304, 307.

70 *Id.* at 299.

71 *Id.* at 297. The dissent argued that many of the 27 Wackenhut employees hired by Burns might have voted against a union during the election and that together with the 15 new members in the Burns unit who never voted it was possible that a majority of the Burns unit did not favor a union.

72 *Brooks v. NLRB*, 348 U.S. 96 (1954).

73 *NLRB v. Burns Int'l Security Serv., Inc.*, 406 U.S. 272, 301 (1972).

74 *Id.* at 307.

75 29 U.S.C. § 159 (1970).

simply been a transfer of employees highlights the unanswered questions of *Burns*. Assuming that an appropriate bargaining unit survives the change in employers where there has only been a "naked transfer of employees," when is it valid to apply a presumption of majority status to the bargaining agent that seeks to represent the employees of the succeeding employer? Recent union certification was relied upon to uphold the presumption in *Burns*. However, in citing *Tom-A-Hawk Transit, Inc. v. NLRB*⁷⁶ with approval, the *Burns* Court affirmed the application of the presumption where only employees were transferred and certification was long standing. The *Burns* decision established that the transferred workers must be at least a majority of the successor's work force before bargaining can be required. Even with this limitation, however, there are at least two cases where application of the *Burns* rationale is uncertain: first, where, although the predecessor ceases to exist, the succeeding employer is long established, operates from a single location and may or may not be unionized; second, where both the predecessor and the succeeding employer continue to operate but the successor has, as a majority of his work force, employees hired away from the predecessor. In the second instance it is probable that the transfer of employees will take place over a longer period of time with only a few employees hired at any one time. Where the transfer of employees is subtle the concern expressed by the *Burns* dissent seems warranted and may be controlling in future litigation.⁷⁷

III. Successor's Change in Employment Terms Not a Refusal to Bargain

A duty to bargain requires that an employer make no unilateral changes in employment terms without first bargaining to impasse.⁷⁸ The basis of this rule is that such changes undermine the effectiveness of a union's bargaining authority. Unilateral employer conduct dilutes membership confidence in the union's ability to negotiate and ignores representative status which the Act confers on certified representatives.⁷⁹ In *Overnite Transportation Co., Inc.*, the employer purchased a unionized trucking operation and retained all equipment and employees. On the first day of operation the employer put into effect its own lower wage scale without offering the union an opportunity to bargain.⁸⁰

⁷⁶ 419 F.2d 1025 (7th Cir. 1969).

⁷⁷ The dissent urges that where competitive efforts result in the successor's expansion and need for more employees—for instance when new contract awards increase a successor's production—requiring union recognition as a result of hiring an experienced work force would inhibit the flow of commerce. The dissent cited *Lincoln Private Police, Inc.*, 189 N.L.R.B. No. 103 (Apr. 12, 1971), a case decided by the Board after *Burns*, as support for its position that no bargaining duty should result where only employees are transferred. In *Lincoln*, the Board did not find a duty to bargain even where a majority of the successor's employees were represented by a union under the predecessor employer. This holding was based on the fact that under the new employer the employing industry had changed sufficiently with the result that *Lincoln* was not a successor. In light of the *Burns* holding, however, it would seem that if the change in the nature of the employing industry which the Board found controlling cannot be used to show the inappropriateness of the new unit, then the Board will be required to decide the case differently.

⁷⁸ *NLRB v. Katz*, 369 U.S. 736, 743 (1962).

⁷⁹ *Id.* at 744.

⁸⁰ 157 N.L.R.B. 1185 (1966).

The Board applied the unilateral change doctrine and ruled that a successor's duty to bargain included the injunction to refrain from unilaterally changing the benefits presently enjoyed by the employees until such change is justified by a bargaining impasse.⁸¹

Citing *Overnite* as precedent, the Board decision implied that when Burns initiated operations under different terms than Wackenhut it had taken unilateral action violative of the bargaining duty.⁸² *Burns* approved the Board action in *Overnite* but made a careful distinction—it is only a unilateral change in terms after the bargaining duty itself is clearly established that violates the Act.⁸³ That is, where facts clearly indicated that the new employer planned to retain all the predecessor's employees, the Court found it appropriate that the successor consult the employee's bargaining representative before fixing his employment terms.⁸⁴ However, where the bargaining duty is only nascent at the time an employer must fix his terms, fixing terms different from his predecessor could not be a violation of the bargaining duty. Burns was receiving applications from several sources and entertained the possibility that some of their present employees might be transferred to augment newly hired employees. Their relationship with the union was uncertain during the hiring process and at no time until the hiring was complete was there any obligation to bargain with the union. Therefore the implementation of employment terms offered during the hiring period before Burns' bargaining duty was apparent could not have been a failure to bargain⁸⁵ and the Court properly refused to enforce the Board order to make the employees whole for losses suffered by Burns' refusal to adopt Wackenhut's contract terms.⁸⁶

This holding is consistent with the theory that supports the unilateral change doctrine and in practical terms seems best suited for promoting industrial peace. It would be unfeasible to require an employer to go through a hiring phase that may never result in a duty to bargain and deny him the ability to offer definite employment terms while taking applications. Industrial peace, in some measure, is geared to employee expectations and seems a more likely result from the Court approach. A more realistic opportunity for industrial peace is provided when an employee accepts new terms at the outset with a new employer where a later established bargaining duty and subsequent negotiation may improve those terms, than by requiring that employees be paid at the previous, higher rate for several months while a bargaining duty and bargaining terms are determined. The higher rate may well be inconsistent with the new employer's economic posture, with the prospect that wage negotiations will fail and wages could be reduced after several months of employment. The Court's position takes advantage of employee expectations in a change-over situation characterized by a re-hiring process and thus improves the opportunity for industrial peace.

81 *Id.*, enforced 372 F.2d 765 (4th Cir. 1967), cert. denied, 389 U.S. 838 (1967). See also, *Harold W. Hinson v. NLRB*, 428 F.2d 133 (8th Cir. 1970).

82 *William J. Burns Int'l Detective Agency, Inc.*, 182 N.L.R.B. 348, 349-50 (1970).

83 *NLRB v. Burns Int'l Security Serv., Inc.*, 406 U.S. 272, 294 (1972).

84 *Id.* at 294-95.

85 *Id.* at 295.

86 *Id.* at 295-96.

IV. No Duty to Accept Predecessor's Contract Terms

Echoing *Wiley* language that raised national labor policy supporting arbitration above the requirement of privity, the Board in *Burns* determined that national interest in promoting collective bargaining rights could achieve the same result:⁸⁷

The question . . . narrows to whether the national labor policy embodied in the Act requires the successor employer to take over and honor a collective-bargaining agreement negotiated on behalf of the employing enterprise by the predecessor. We hold that, absent unusual circumstances, the Act imposes such an obligation.⁸⁸

The Board combined the *Wiley* rationale with the employing industry test produced by the successorship doctrine to overcome *Burns*' lack of consent to the contract terms. The key is that a contract existed with the employing industry and, in effect, was deemed to have been negotiated on behalf of all employers in that industry who might later employ the contracting employees.⁸⁹ In so extending the duty of a successor employer, the Board elected to insure collective bargaining rights at the expense of an equally important aspect of national labor policy—freedom of contract. This election of values was clearly apparent when the Board cited Section 8(d) of the Act as statutory authority for its findings. The section emphasizes collective bargaining as a device for equalizing the bargaining relationship, but the Board ignored provisions of the same section which give equal weight to the policy that neither party engaged in collective bargaining is compelled to agree to any proposal.

The Supreme Court refused to adopt the Board's reading of the Act and nullified the Board's overzealous endorsement of collective bargaining rights insofar as that endorsement reduced freedom of contract.⁹⁰ The Court upheld this freedom and the need for collective bargaining agreements that reflect the

87 *William J. Burns Int'l Detective Agency, Inc.*, 182 N.L.R.B. 348, 350 (1970) where the Board found:

The impressive policy considerations favoring the maintenance and adherence to existing collective-bargaining agreements are not wholly overborne by the fact that *Burns* has not signed the contract here in issue. Nor can a holding that *Burns* is obligated to honor and adhere to the express terms of the contract readily be equated with compelling *Burns* to agree to a bargaining proposal or make a concession it is unwilling to make. Indisputably, there is a contract. That contract covers the employees of the employing industry which *Burns* took over; it was negotiated on behalf of the employing enterprise by *Wackehut*, *Burns*' predecessor. That contract is reasonably related to *Burns* through its takeover of *Wackehut*'s Lockheed service functions and its hiring of *Wackehut* employees. We find, therefore, that *Burns* is bound to that contract as if it were a signatory thereto, and that its failure to maintain the contract in effect is violative of Section 8(d) and 8(a)(5) of the Act. (Footnotes omitted.)

88 *Id.* at 350. *But see* *Emerald Maintenance, Inc.*, 188 N.L.R.B. No. 139 (Mar. 5, 1971). Here the Board found that applications of its *Burns* rule would be inappropriate where competitive bids for government contracts could not include estimates of wage increases. The Board reasoned that imposition of the rule here would result in less arm's-length collective bargaining.

89 *William J. Burns Int'l Detective Agency, Inc.*, 182 N.L.R.B. 348, 350 (1970). This same reading of *Wiley* was evident in several lower court cases. *See* note 11, *supra*.

90 *NLRB v. Burns Int'l Security Serv., Inc.*, 406 U.S. 272, 291 (1972).

unaided economic strength of the respective parties as fundamental requirements of the national labor relations scheme.⁹¹ The Court based its refusal to uphold the Board squarely on the language of the Act:

Section 8(d) of the Act expressly provides that the existence of such bargaining obligation "does not compel either party to agree to a proposal or require the making of a concession."⁹²

Citing *H. K. Porter Co., Inc. v. NLRB*,⁹³ the Court continued:

This bargaining freedom means both that parties need not make any concessions as a result of government compulsion and that they are free from having contract provisions imposed upon them against their will.⁹⁴

By refusing to enforce the Board's ruling ordering assumption of the contract terms the *Burns* Court distinguished *Wiley's* application. While the Board had read *Wiley* as an opportunity to expand and protect collective bargaining rights in change-over situations, the Supreme Court characterized the *Wiley* decision as a "limited accommodation between the legislative endorsement of freedom of contract and the judicial preference for peaceful arbitral settlement of labor disputes."⁹⁵ The "limited accommodation" was possible in *Wiley* where enforcement of an arbitration clause was sought under Section 301 and substantial continuity of the business enterprise was reflected by a merger of predecessor and successor. But *Burns* clearly indicates that while limited accommodations with freedom of contract are possible at the will of the Court, no abridgment of this freedom by Board process will be tolerated.

Furthermore the *Wiley* decision was couched in broad terms and Board reliance upon it to extend contract terms to successors was not unreasonable. *Wiley* had emphasized that federal law controlled⁹⁶ in establishing *Wiley's* duty to arbitrate. However, the *Burns* Court noted *Wiley's* obligation dealt only:

[W]ith a merger occurring against a background of state law that embodied the general rule that in merger situations the surviving corporation is liable for the obligations of the disappearing corporation.⁹⁷

91 *Id.* at 287-88. Explaining the need to preserve freedom of contract for bargaining parties the court wrote:

Preventing industrial strife is an important aim of federal labor legislation, but Congress has not chosen to make the bargaining freedom of employers and unions totally subordinate to this goal. When a bargaining impasse is reached, strikes and lockouts may occur. This bargaining freedom means both that parties need not make any concessions as a result of Government compulsion and that they are free from having contract provisions imposed upon them against their will.

. . . Strife is bound to occur if the concessions that must be honored do not correspond to the relative economic strength of the parties.

92 *Id.* at 282.

93 397 U.S. 99 (1970).

94 *NLRB v. Burns Int'l Security Serv., Inc.*, 406 U.S. 272, 287 (1972). *Contra*, Brief for Board at 11, which uses the link provided by a contract with the employing industry to distinguish *Porter*. Stern, *supra* note 7, at 26-27 gives a cogent argument in support of the Board's use of *Wiley* doctrine and distinguishes *Porter* because a contract exists with the employing industry.

95 *NLRB v. Burns Int'l Security Serv., Inc.*, 406 U.S. 272, 286 (1972).

96 *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543, 548 (1964).

97 *NLRB v. Burns Int'l Security Serv., Inc.*, 406 U.S. 272, 286 (1972) (citations omitted).

Thus *Burns* was easily distinguished because nothing indicated *Burns* was assuming the obligations of the contract⁹⁸ or assumption of its predecessor's financial obligations. *Burns* was further distinguished because it involved no arbitration and was an unfair labor practice proceeding rather than a contract enforcement suit.⁹⁹

In denying enforcement of the Board's order, the Court catalogued economic ills that would follow from the adoption of the Board's ruling.¹⁰⁰ The Court viewed Board action in *Burns* as inconsistent with Board rules in other areas,¹⁰¹ and noted the need for exceptions already recognized by the Board.¹⁰² In the Court's analysis these reasons demonstrated the impractical weakness of a rule requiring successors to assume the terms of their predecessor's labor contract.

The Court's distinction between its power to fashion national labor policy in contract enforcement suits and thereby protect employees' collective bargaining rights during changes in the employee-employer relationship by imposing arbitration terms on unconsenting employers, and the Board's lack of power under the Act to implement similar protection in the same circumstances illustrates the curious, but unavoidable difference in results based on form. Whatever the importance of vested rights protected in *Wiley*, the immediate effect of a lower salary is a far more "sudden" and detrimental change in the employment relationship. Yet this circumstance must go unprotected because the action was brought in the context of an unfair labor practice and the Board, in handling its cases, is clearly controlled by the definitions and limitations of the Act.

The irony of this result is not adequately explained by the Court's reference to the difference between labor practice proceedings and Section 301 enforcement suits. Perhaps a more straightforward explanation, reading *Wiley* and *Burns* together, is that arbitration terms were imposed on *Wiley* because it was found to have assumed the contract during merger. The "substantial continuity of business" test as applied in *Wiley* therefore amounts to only a characterization of that assumption rather than an independent test that imposes contract terms on a succeeding employer. Absent merger or facts which demonstrate intent to assume its predecessor's contract terms, a successor cannot be bound by those terms.

98 *Id.* at 287.

99 *Id.* at 285.

100 *Id.* at 287-88. The Court felt that the ultimate effect of enforcement would discourage and inhibit the transfer of capital and would shackle successors with hiring, discharge, and seniority provisions that could effectively impede needed adjustments in business practices.

101 *Id.* at 284. After the *Burns* ruling the Board declined to impose existing contract terms on a successor union. *General Dynamics Corp.*, 184 N.L.R.B. No. 71 (July 24, 1970) held that a certified representative that followed a decertified union was not bound by the terms of a current contract negotiated between the decertified union and the employer. Also a prior Board ruling, *Randolph Rubber Co., Inc.*, 152 N.L.R.B. 496 (1965), permitted a successor employer that did not assume the contract of its predecessor to refuse to bargain based on a good faith doubt of union majority status. After *Burns*, however, this result would not be possible because the normal contract bar rules announced in *Oilfield Maintenance Co., Inc.*, 142 N.L.R.B. 1384, 1387 (1963), would apply and the contract imposed on the successor would bar a good faith challenge for a three year period.

102 NLRB v. *Burns Int'l Security Serv., Inc.*, 406 U.S. 272, 290 (1972). The Board had made exceptions to its *Burns* ruling in *Emerald Maintenance, Inc.*, 188 N.L.R.B. No. 139 (Mar. 5, 1971), and *Davenport Insulation, Inc.*, 184 N.L.R.B. No. 114 (Aug. 18, 1970).

Conclusion

It is apparent from *Burns* that an employer's decision to hire a majority of its work force from a predecessor's bargaining unit, where that unit remains appropriate for collective bargaining, will generate a duty to bargain collectively with the unit's present bargaining representative. The employees' designation of a given representative is not disturbed by a change in employers and the Court correctly rejected arguments that would limit continuation of bargaining rights to only those instances where assets are exchanged between employers. Even where there is only a "naked transfer of employees," if the factors that normally allow the exercise of collective bargaining rights exist, then those rights should persist despite a change in employers. The strength of the Court's evaluation of a successor's bargaining duty is its focus on the bargaining duty requirements set forth in the Act. Thus a successor's bargaining duty is consistent with the statutory mandate which requires all employers to bargain collectively with representatives chosen by their employees.

Absent any voluntary assumption of contract terms and any asset transfer which might imply an assumption of contract obligations in general or provide a basis for enforcement of an arbitration clause in particular, a succeeding employer is not bound by the contract terms of its predecessor. The contract holds no obligation for the successor, and its refusal to accept the terms where it is otherwise fulfilling its bargaining obligation, will not be a violation of the Act. In reaching this result the Court upheld congressional intent that sought to implement collective bargaining while not interfering with the bargaining leverage of either party. The Board had clearly distorted the language of the Act by establishing a more burdensome duty for successor employers. The Court, in overruling the Board, leaves the successor employer free to negotiate whatever terms its bargaining strength and business needs dictate. The soundness of the *Burns* decision is that it is consistent with the limitations of the Act and prior decisions defining the bargaining duty. By requiring no more from successor employers than the bargaining standard applied to employers in general it has maintained a uniform policy for all employers.

Charles P. Chritton

FEDERAL ESTATE TAXATION—LIFE INSURANCE—§ 2042—BROAD FIDUCIARY POWERS ACQUIRED, RATHER THAN RETAINED, BY AN INSURED OVER LIFE INSURANCE POLICIES DO NOT CONSTITUTE INCIDENTS OF OWNERSHIP UNDER § 2042(2) UNLESS THE INSURED CAN EXERCISE THEM FOR HIS OWN ECONOMIC BENEFIT.—Hector R. Skifter more than three years prior to his death assigned all of his interests in nine insurance policies on his life to his first wife, Naomi. Naomi died testate less than a year after this transfer. Under her will, her residuary estate, which included the nine insurance policies, was to be placed in trust. The income from the residuary trust was to be paid to their daughter, Janet, for life and, upon Janet's death, there were provisions for the distribution of the remaining principal to other persons.

Under Naomi's will Skifter was appointed executor and trustee of the residuary trust. As trustee he was authorized in his absolute discretion to pay over the whole or any part of the trust principal to Janet, whether or not such payment resulted in the termination of the trust. Hector was also given broad powers of management and control over the trust corpus. None of these powers, however, could have been exercised for his own benefit. In 1964 Skifter died and the Chase Manhattan Bank, in its capacity as successor trustee, collected a total of \$121,923.52 in proceeds from the nine insurance policies on his life. The Commissioner of Internal Revenue determined that these proceeds were includable in Skifter's gross estate under § 2042 (2) of the Internal Revenue Code,¹ since, under the terms of Naomi's trust, Skifter possessed incidents of ownership in the assigned policies.

The Tax Court disagreed with the Commissioner and ruled in favor of the estate.² On appeal the Court of Appeals for the Second Circuit affirmed and *held*: broad fiduciary powers acquired by the insured long after he had divested himself of all interest in the policies, and which the insured could not exercise for his own benefit, are not an "incident of ownership" within the intended scope of § 2042(2). *Estate of Skifter v. Commissioner*, 468 F.2d 699 (2d Cir. 1972).

Section 2042 of the Internal Revenue Code is a specific statutory section for the inclusion of insurance proceeds in the gross estate of the insured.³ Since 1954 insurance proceeds have been includable under § 2042(2) only if the insured possessed any of the "incidents of ownership" in the insurance policies at the time of his death. Although this section is not exclusive and any of the other nine sections dealing with the gross estate (§§ 2033-2041) might require inclusion, only under this section are proceeds includable as "insurance."⁴

1 INT. REV. CODE OF 1954, § 2042 provides:

Proceeds of Life Insurance.

The value of the gross estate shall include the value of all property—

(1) RECEIVABLE BY THE EXECUTOR.—To the extent of the amount receivable by the executor as insurance under policies on the life of the decedent.

(2) RECEIVABLE BY OTHER BENEFICIARIES.—To the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person. For purposes of the preceding sentence, the term "incident of ownership" includes a reversionary interest (whether arising by the express terms of the policy or other instrument or by operation of law) only if the value of such reversionary interest exceeded 5 percent of the value of the policy immediately before the death of the decedent. As used in this paragraph, the term "reversionary interest" includes a possibility that the policy, or the proceeds of the policy, may return to the decedent or his estate, or may be subject to a power of disposition by him. The value of a reversionary interest at any time shall be determined (without regard to the fact of the decedent's death) by usual methods of valuation, including the use of tables of mortality and actuarial principles, pursuant to regulations prescribed by the Secretary or his delegate. In determining the value of a possibility that the policy or proceeds thereof may be subject to a power of disposition by the decedent, such possibility shall be valued as if it were a possibility that such policy or proceeds may return to the decedent or his estate.

2 *Estate of Hector R. Skifter*, 56 T.C. 1190 (1971).

3 If the decedent owns insurance on the life of another, the replacement value of the policy upon the date of his death is includable under § 2033 as property in which the decedent owned an interest at the date of death. *See* B. BITTKER & L. STONE, *FEDERAL INCOME ESTATE AND GIFT TAXATION* 1237 (4th ed. 1972).

4 For example, if the insured should die within three years of an assignment of the incidents of ownership, the proceeds might be included in the insured's gross estate as a

In the last several years an impressive array of cases has dealt with life insurance in almost every conceivable estate tax context.⁵ It appears that the Internal Revenue Service is using every possible opportunity to test the scope of the "incidents of ownership" test under § 2042.⁶ Large amounts of tax revenue are at stake at the present time and the rapid growth rate of life insurance coverage promises greater revenue production in the future. In 1971 over 1.5 trillion dollars of life insurance was in force in the United States and approximately 7.4 billion dollars of benefit payments were made to beneficiaries.⁷ These figures represent an increase of 139% and 107.3%, respectively, between 1961 and 1971.⁸ In 1971 the amount of coverage in force increased 7.3% over 1970.⁹ One of the areas in which the Internal Revenue Service has recently sought to apply § 2042(2) is in the area of incidents of ownership held by the insured as a fiduciary. *Skifter* and one other recent decision, *Estate of Fruehauf v. Commissioner*,¹⁰ are the only cases which have dealt directly with this issue. An examination of the trial and appellate court opinions in *Fruehauf* and *Skifter* demonstrates that a conflict exists among the circuits and within the Tax Court concerning the congressional purpose and intended scope of the incidents of ownership test of § 2042(2).

In *Fruehauf*, the decedent's wife had applied for, paid for, and owned six insurance policies on the decedent's life. Mrs. Fruehauf predeceased her husband and the policies passed to a residuary trust created by her will which named her husband as life income beneficiary and appointed him executor and cotrustee. The trust instrument empowered the trustees to sell, assign or surrender any of the policies for their cash surrender value if they determined it advisable to do so. The Commissioner, after Mr. Fruehauf's death, determined that these powers were incidents of ownership under § 2042. The executor of his estate argued that the powers acquired by the insured over the policies on his life were not includable in his gross estate for two reasons. First, the executor focused on the language of Treasury Regulation § 20.2042-1(c)(2) and contended that this regulation should be interpreted as limiting incidents of ownership to the right of the insured or his estate to receive the economic benefits of the policies. The Tax Court felt that there was no merit to this argument, characterizing the right to the economic benefits of the policy as "merely one of the several incidents of owner-

transfer of property in contemplation of death under § 2035. Treas. Reg. § 20.2042-1(a)(2) (1958).

5 Articles dealing with recent estate tax developments in the life insurance area include: Simmons, "Incidents of Ownership"—Some Haunting Reminders, 57 A.B.A.J. 815 (1971); Eliasberg, *Life Insurance: Recent Estate Tax Developments*, 48 TAXES 399 (1970); Subcommittee of Committee on Estate and Tax Planning, *Recent Federal Estate Tax Developments Involving Life Insurance*, reprinted in 5 REAL PROP., PROBATE & TRUST J. 202 (1970); Subcommittee of Committee on Estate and Tax Planning, *Life Insurance and Federal Estate Tax: Recent Developments*, reprinted in 5 REAL PROP., PROBATE & TRUST J. 401 (1970).

6 A recent Tax Court case exemplifies the attention given to life insurance in the estate tax context. The Internal Revenue Service unsuccessfully argued that a veto power over any attempted alienation of an insurance policy owned by a business partner to fund a cross-purchase buy-sell agreement was an incident of ownership. Howard F. Infante, 39 P-H Tax Ct. Mem. ¶ 70,206 (1970).

7 INSTITUTE OF LIFE INSURANCE, LIFE INSURANCE FACT BOOK 7 (1972).

8 *Id.*

9 *Id.*

10 427 F.2d 80 (1970).

ship."¹¹ In support of its view the court cited *United States v. Rhode Island Hospital Trust Co.*, in which the Court of Appeals for the First Circuit had addressed the same argument:

Plaintiffs seize on Section 20.2042-1(c)(2) of the Treasury Regulations on Estate Tax, which says ". . . the term 'incidents of ownership' is not limited in its meaning to ownership of the policy in the technical legal sense. Generally speaking, the term has reference to the right of the insured or his estate to the economic benefits of the policy." Plaintiffs urge that there must be "a real control over the economic benefits." To this there are two answers. First, it is clear that the reference to ownership in the "technical legal sense" is not abandoned and supplanted by reference to "economic benefits." Second, the regulation goes on to list illustrative powers referred to by Congress in its reports. All of these are powers which may or may not enrich decedent's estate, but which can affect the transfer of the policy proceeds.¹²

The second contention of the executor in *Fruehauf* was that the term "incidents of ownership" did not include powers exercisable only in a fiduciary capacity. In support of the argument the petitioners relied on two prior Tax Court decisions, *Estate of Newcomb Carlton*¹³ and *Estate of Bert L. Fuchs*,¹⁴ which had distinguished powers held in a fiduciary capacity. However, the Tax Court failed to follow these decisions, relying again on *Rhode Island Hospital Trust*, where, after examining the background of § 2042, the court held that the relevant question to ask with respect to this statute was: "Did he [the insured] have a capacity to affect the disposition of the policy if he had wanted to?"¹⁵ In implementing this approach the court analogized to cases under what is presently § 2038 which had held that the capacity in which a power to alter, amend, revoke or terminate was reserved is irrelevant.¹⁶ Since capacity had been held immaterial for purposes of § 2038, the court reasoned that it was illogical to hold capacity as a relevant factor under § 2042, stating that "[t]here is no doubt at all but that sections 2038 and 2042 are parts of a tax pattern to make includable in the gross estate property over which the decedent held various powers affecting beneficial enjoyment."¹⁷ Four judges concurred as to the result in *Fruehauf*, but only because the power could be exercised by the insured so as to benefit himself in his individual capacity as life income beneficiary.¹⁸

In both *Carlton* and *Fuchs* the Tax Court, in holding insurance proceeds not includable, had distinguished prior cases on the ground that the fiduciary powers could not be exercised for the insured's benefit in his individual capacity. In *Carlton* the insured had placed several insurance policies in a trust reserv-

11 *Estate of Harry R. Fruehauf*, 50 T.C. 915, 919 (1968).

12 355 F.2d 7, 11 (1st Cir. 1966).

13 34 T.C. 988 (1960), *rev'd on other grounds*, 298 F.2d 415 (2d Cir. 1962).

14 47 T.C. 199 (1966).

15 355 F.2d at 11.

16 Section 2038 requires the inclusion of any property in which the decedent possesses at his death a power to alter, amend, revoke or terminate even though the decedent has made a transfer of the property prior to his death. The addition of the language "in whatever capacity exercisable" in 1954 has removed any question of capacity under § 2038.

17 50 T.C. at 926.

18 *Id.*

ing the right to appoint a successor trustee, including himself. The Commissioner argued that had he appointed himself a cotrustee he would have possessed broad powers to deal with the policies which would constitute incidents of ownership. In support of this argument the Commissioner relied upon *Estate of Myron Selznick*,¹⁹ where the reservation by the grantor of the right to cancel policies he had placed in an irrevocable trust was held to be an incident of ownership. The Tax Court distinguished this case on the fact that Selznick, in addition to this reserved right, was the life income beneficiary of the trust which would have permitted him to receive income from the investment of the cash surrender value had he cancelled the policies.²⁰ In *Carlton*, however, the court made it clear that this was not the case:

Any control that decedent would have acquired over the insurance policies had he appointed himself cotrustee would have been control over the policies jointly with the corporate trustee as trustee only and such control would be solely for the benefit of the trust. Such control as trustee would not constitute incidents of ownership in the insurance policies in decedent except in his capacity as trustee for the benefit of the trust.²¹

In *Fuchs* the decedent was one of three business partners who had funded an oral buy-sell agreement with life insurance. It was agreed that each partner was to own and be the beneficiary of policies on the life of the other two partners so that the insured would not possess any incidents of ownership in the policies. One group of these policies was mistakenly issued naming the insured rather than the designated beneficiary as owner, so that the insured possessed the incidents of ownership under the policy. Although a trust was not involved, the Tax Court likened the position of the decedent to that of a trustee and stated: "Decedent merely had the . . . power to affect trust proceeds. We do not believe that this type of naked power alone is sufficient to bring the insurance proceeds within decedent's gross estate."²² The Tax Court concluded that the partnership agreement effectively prevented the decedent from using or disposing of the policies so as to receive the economic benefits therefrom, "or to procure any other satisfactions which are of economic worth."²³ In support of this view that § 2042 requires inclusion only if economic benefits can flow to the insured, the Tax Court cited Treasury Regulation § 20.2042-1(c)(2), focusing on the same language as the executor in *Fruehauf* had done. *Fuchs* and *Carlton* clearly provide a basis for the distinction drawn by the concurring opinion in *Fruehauf*. Both cases, at least in dicta, recognized fiduciary capacity as a relevant distinction and, more importantly, in both cases the lack of ability to benefit economically from the alleged incident of ownership was controlling.

The Court of Appeals for the Sixth Circuit affirmed *Fruehauf* on appeal, but explicitly rejected the majority's broad *per se* rule that fiduciary powers possessed by an insured are incidents of ownership.²⁴ The court of appeals chal-

19 15 T.C. 716 (1950), *aff'd per curiam*, 195 F.2d 735 (9th Cir. 1952).

20 34 T.C. at 996.

21 *Id.*

22 47 T.C. at 204.

23 *Id.* at 206.

24 427 F.2d at 85.

lenged the Tax Court's reliance upon cases which held that fiduciary capacity is inconsequential under § 2038. The § 2038 analogy was deemed inappropriate because § 2038 deals with the possession of a power by a "transferor."²⁵ Under § 2042, however, the insured need only be a mere "transferee" (as in *Fruehauf*) since no transfer is required by this section. The appellate court cited *Fuchs* and *Carlton*, stating: "We believe that the Tax Court in this case ignored what it had clearly recognized in these prior cases, i.e., the fundamental nature of the fiduciary relationship."²⁶ The court implicitly rejected *Rhode Island Hospital Trust*, without discussing it, by adopting the approach of the concurring opinion. As in the concurring opinion, the only apparent justification for making this distinction based on the decedent's ability to exercise the fiduciary powers for his beneficial enjoyment was the approach of *Carlton* and *Fuchs*.

In *Skifter*, the Tax Court did not focus on *Carlton* and *Fuchs*, although it recognized that its result found "some support" in both cases.²⁷ The *Fruehauf* opinion was distinguished on the ground that *Skifter's* power to dispose of the policies and terminate the trust in favor of the life income beneficiary could not be exercised so as to be of benefit to himself.²⁸ Since *Fruehauf* had been able to benefit himself, the Tax Court in *Skifter* determined that the issue before the court was a novel one. In deciding this issue the court tried to discern the intent of Congress by looking to the legislative history of § 2042. Particular significance was placed upon the Senate Committee Report concerning the elimination of the premium payment test.²⁹ By eliminating the premium payment test the court felt that Congress had refused to accept the notion that life insurance was inherently testamentary in character. For this reason the court stated:

[I]t seems inconceivable to us that Congress would have intended the proceeds to be included in the insured's gross estate in such circumstances merely because the third-party owner of the policy had entrusted the insured with fiduciary powers that were exercisable only for the benefit of persons other than the insured.³⁰

As in *Fuchs*, the Tax Court relied upon the language of Treasury Regulation § 20.2042-1(c)(2) which states that "[g]enerally speaking, the term [incidents of ownership] has reference to the right of the insured or his estate to the economic benefits of the policy."³¹ However, the court admitted that it was

25 *Id.* at 84.

26 *Id.* at 85.

27 56 T.C. at 1197.

28 *Id.*

29 S. REP. No. 1622, 83rd Cong., 2d Sess. 124 (1954). The premium payment test, eliminated in 1954, required the inclusion in the gross estate of the insured the proportion of the proceeds attributable to premium payments made by the insured even though he had divested himself of all the incidents of ownership in the policies.

30 56 T.C. at 1197.

31 Treas. Reg. § 20.2042-1(c) provides in part:

(c) *Receivable by other beneficiaries.* * * *

(2) For purposes of this paragraph, the term "incidents of ownership" is not limited in its meaning to ownership of the policy in the technical legal sense. Generally speaking, the term has reference to the right of the insured or his estate to the economic benefits of the policy. Thus, it includes the power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to revoke an assignment, to pledge the policy for a loan, or to obtain from the insurer a loan against

troubled by the broad language of Treasury Regulation § 20.2042-1(c)(4)³² which appeared to cover precisely the fact pattern before the court and would require the inclusion of the proceeds even though the decedent had no beneficial interest in the trust. Instead of invalidating the regulation, the court simply refused to apply it on the grounds that the Congressional Committee Report appeared “to suggest an effort to treat life insurance in the same manner as other property owned by the decedent or transferred by him during his lifetime.”³³

This approach was adopted and expanded upon by the Court of Appeals for the Second Circuit in *Skifter*. Speaking for the court, Judge Lumbard first noted as “significant” the fact that the “reference point” of Treasury Regulation § 20.2042-1(c)(2) is the right to the economic benefits of the policy, and that *Skifter* was unable to derive for himself any economic benefits from the policies.³⁴ Judge Lumbard next examined the Senate Finance Committee Report dealing with the elimination of the premium payment test and reached a conclusion similar to that reached by the Tax Court, namely, “that Congress intended § 2042 to parallel the statutory scheme governing the interest and powers that would cause other types of property to be included in a decedent’s estate.”³⁵ The court felt that this inference was supported by the fact that at the time of the elimination of the premium payment test § 2042(2) had been amended to provide that the term “incidents of ownership” include a 5% reversionary interest similar to that required under § 2037.³⁶

Admitting that this legislative history was “hardly conclusive on the matter,”³⁷ the court proceeded to try to discern whether *Skifter*’s fiduciary power would require the inclusion of the proceeds in his gross estate under any of the other inclusion sections. *Skifter*’s power as transferee was not includable under § 2036 since that section applies only to powers retained by the grantor. There would have been a “powerful argument” under § 2041 that this was an incident of ownership if it could have been exercisable for *Skifter*’s benefit, or for the benefit of whomever *Skifter* selected, since *Skifter* would then have had the equiv-

the surrender value of the policy, etc. Similarly, the term includes a power to change the beneficiary reserved to a corporation of which the decedent is sole stockholder.

* * * * *

(4) A decedent is considered to have an “incident of ownership” in an insurance policy on his life held in trust if, under the terms of the policy, the decedent (either alone or in conjunction with another person or persons) has the power (as trustee or otherwise) to change the beneficial ownership in the policy or its proceeds, or the time or manner of enjoyment thereof, even though the decedent has no beneficial interest in the trust. Moreover, assuming the decedent created the trust, such a power may result in the inclusion in the decedent’s gross estate under section 2036 or 2038 of other property transferred by the decedent to the trust if, for example, the decedent has the power to surrender the insurance policy and if the income otherwise used to pay premiums on the policy would become currently payable to a beneficiary of the trust in the event that the policy were surrendered.

32 *Id.*
 33 56 T.C. at 1199.
 34 468 F.2d at 702.
 35 *Id.*
 36 *Id.*
 37 *Id.*

alent of a power of appointment.³⁸ Judge Lumbard had a harder time dismissing the possibility that Skifter's fiduciary powers would be includable under § 2038. A literal application of the language of this section requires only that the decedent have at any time made a transfer of property where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, in whatever capacity exercisable, "without regard to when or from what source the decedent acquired such power,"³⁹ to alter, amend, revoke or terminate. Although the emphasized language would appear to indicate that § 2038 would apply, even when a power was acquired under the circumstances present in *Skifter*, the court felt it was significant that this language had been added in response to *White v. Poor*,⁴⁰ and had been applied strictly to the facts of that case. In *White* the settlor, after establishing a trust, was subsequently appointed as successor trustee. Although at his death he possessed a § 2038 power to terminate the trust, the Supreme Court refused to include the trust proceeds in his estate since he had not retained the power at the time of the transfer.⁴¹ Even though § 2038 was potentially applicable, the court in *Skifter* distinguished the case before it on the ground that *White* had only been applied where the decedent had created the power in someone else at the time of the transfer and later acquired the power, whereas *Skifter* had not created the trust but had merely acquired the power under his wife's will.⁴² Since none of the other parallel statutory sections would require the inclusion of property subject to the same powers as *Skifter* possessed, the court held that § 2042 was not applicable to *Skifter*. The court affirmed the Tax Court's determination that Treasury Regulation § 20.2042-1(c)(4) should be applied only to reservations of trust powers *created by the transferor* and which the transferor possessed as trustee.⁴³

This inference, that Congress did not intend to produce divergent estate tax treatment between life insurance and other types of property, is unwarranted. The premium payment test required that the proportion of the proceeds represented by any direct or indirect payment of premiums by the decedent be included in his gross estate regardless of whether he possessed any incidents of ownership at his death. Under this test the insured could never remove from his gross estate that portion of the proceeds attributable to premiums paid by him. Congress sought only to change this result, justifying the change as "merely putting life insurance on a par with other property which may be given away free from estate tax if the gift is not made 'in contemplation of death.'" ⁴⁴ Judge Lumbard sought to bolster this inference by the fact that Congress, at the time of the elimination of the premium payment test, explicitly provided that a reversionary interest was an incident of ownership and that Congress treated it "in a manner closely paralleling the treatment that § 2037 gives to reversionary in-

38 *Id.* at 703.

39 INT. REV. CODE of 1954, § 2038.

40 296 U.S. 98 (1935).

41 *Id.* at 102.

42 468 F.2d at 704.

43 *Id.* at 705.

44 H.R. REP. No. 1337, 83d Cong., 2d Sess. 14 (1954).

terests in other property.⁴⁵ The fact that Congress merely adapted an existing set of rules for determining whether a reversionary interest exceeded 5% rather than develop an entirely new body of rules cannot be given any substantial weight. In addition to the 5% requirement, § 2037 requires two elements not required by § 2042; a transfer by decedent and a survivorship requirement.⁴⁶ The legislative history shows that Congress was aware of this divergence in requirements when it adopted these valuation rules for purposes of § 2042.⁴⁷ If this was a question of first impression, the court, under its approach in *Skifter*, would have had to read these additional requirements in so as to at least give life insurance policies estate tax treatment that parallels the treatment given to other types of property. The dangers of such an approach are apparent from the necessity of the court to qualify its opinion with regard to the coverage of § 2038. This approach offers little as long as there are open questions and uncertainty in the parallel statutory areas.

The conflict among the circuits, as to whether the incidents of ownership test has reference to any of the bundle of rights resulting from the insurance contract which give the insured the ability to affect the beneficial enjoyment of the proceeds, or only to powers of economic worth to the insured, is still unresolved. It would appear that the Court of Appeals for the Second Circuit in *Skifter* would support the latter view since it noted as significant the emphasis

45 468 F.2d at 702.

46 INT. REV. CODE OF 1954, § 2037 provides:
Transfers Taking Effect at Death.

(a) GENERAL RULE.—The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time after September 7, 1916, made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, if—

(1) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and

(2) the decedent has retained a reversionary interest in the property (but in the case of a transfer made before October 8, 1949, only if such reversionary interest arose by the express terms of the instrument of transfer), and the value of such reversionary interest immediately before the death of the decedent exceeds 5 percent of the value of such property.

(b) SPECIAL RULES.—For purposes of this section, the term "reversionary interest" includes a possibility that property transferred by the decedent—

(1) may return to him or his estate, or

(2) may be subject to a power of disposition by him,

but such term does not include a possibility that the income alone from such property may return to him or become subject to a power of disposition by him. The value of a reversionary interest immediately before the death of the decedent shall be determined (without regard to the fact of the decedent's death) by usual methods of valuation, including the use of tables of mortality and actuarial principles, under regulations prescribed by the Secretary or his delegate. In determining the value of a possibility that property may be subject to a power of disposition by the decedent, such possibility shall be valued as if it were a possibility that such property may return to the decedent or his estate. Notwithstanding the foregoing, an interest so transferred shall not be included in the decedent's gross estate under this section if possession or enjoyment of the property could have been obtained by any beneficiary during the decedent's life through the exercise of a general power of appointment (as defined in section 2041) which in fact was exercisable immediately before the decedent's death.

47 "In determining whether such interest exceeded 5 percent, this section provides rules essentially the same as prescribed in section 2037 for determining whether, in the case of certain transfers, the decedent retained a reversionary interest in the transferred property." S. REP. NO. 1622, 83d Cong., 2d Sess. 473 (1954).

on the right to the economic benefits of the policies in Treasury Regulation § 20.2042-1(c)(2); its conclusion comports with the views of the Court of Appeals for the Sixth Circuit in *Fruehauf*. The Tax Court has also supported the latter view in the *Fuchs*, *Carlton* and *Skifter* decisions. On the other hand, the Court of Appeals for the First Circuit clearly expressed its support of the former view in *Rhode Island Hospital Trust*, which was followed by the Tax Court in *Fruehauf*.

The approach of *Rhode Island Hospital Trust* adopted by the Tax Court in *Fruehauf* appears to be the correct one. The incident of ownership doctrine originated with *Chase National Bank v. United States*.⁴⁸ In this case the constitutionality of the predecessor of § 2042(2) was upheld as a transfer tax since the insured had incidents of ownership in the insurance at his death. The Treasury Department and the lower federal courts drew the negative inference from the case that unless the insured possessed some incident of ownership the tax would be invalid as a form of direct taxation without apportionment.⁴⁹ *Rhode Island Hospital Trust* cites *Chase National Bank* as authority that Congress was attempting to tax the power to affect the transfer of the policy proceeds.⁵⁰ This reliance appears to be justified for in *Chase National Bank* the Supreme Court stated:

A power in the decedent to surrender and cancel the policies . . . is by no means the least substantial of the legal incidents of ownership, and its termination at his death so as to free the beneficiaries of the policy from the possibility of its exercise would seem to be no less a transfer within the reach of the taxing power than a transfer effected in other ways through death.⁵¹

The Tax Court in *Fuchs* and *Skifter* and the Court of Appeals for the Sixth Circuit in *Fruehauf* based their holdings upon the language of Treasury Regulation § 20.2042-1(c)(2) emphasizing "the right to . . . the economic benefits of the policy." This regulation was based upon the House Committee Reports of the 77th Congress which, in enacting the predecessor of § 2042(2), realized that no explanation of the term "incidents of ownership" had been given in the statute. The Committee stated:

There is no specific enumeration of incidents of ownership, the possession of which at death forms the basis for inclusion of insurance proceeds in the gross estate, as it is impossible to include an exhaustive list. Examples of such incidents are the right of the insured or his estate to the economic benefits of the insurance, the power to change the beneficiary, the power to surrender or cancel the policy, the power to assign it, the power to revoke an assignment, the power to pledge the policy for a loan, or the power to obtain from the insurer a loan against the surrender value of the policy. Incidents of ownership are not confined to those possessed by the decedent

48 278 U.S. 327 (1929).

49 C. LOWNDES & R. KRAMER, FEDERAL ESTATE AND GIFT TAXES 274 (2d ed. 1962); 1 FED. EST. & GIFT TAX REP. ¶ 1670.46 (1971).

50 355 F.2d at 10.

51 278 U.S. at 335.

in a technical legal sense. For example, a power to change the beneficiary reserved to a corporation of which the decedent is sole stockholder is an incident of ownership in the decedent.⁵²

The regulation under the 1939 Code adopted this language verbatim,⁵³ and it was only after the passage of the 1954 Code that the Treasury Department rephrased the regulation emphasizing the right to the economic benefits of the policy which resulted in the inference that it was the intention of Congress to include only powers of economic worth to the insured. An examination of the regulation's origin and the prior regulation seriously undermines the strength of this inference. Certainly this inference should not be used to limit the application of Treasury Regulation § 20.2042-1(c)(4), which was added by the Treasury Department at the same time that Treasury Regulation § 20.2042-1(c)(2) was rephrased.

Section 2042(2) taxes a power to affect the beneficial enjoyment of the insurance proceeds possessed by the insured at his death. In light of this approach, the analogy drawn by the Tax Court to the lack of distinction with regard to capacity in § 2038 is a valid one. This analogy is not dependent upon the fact that *Fruehauf* was a transferee rather than a transferor. The attempt to distinguish on this point by the Court of Appeals for the Sixth Circuit is devoid of merit. Section 2042(2) merely requires that the insured be in possession of an incident of ownership at the time of his death. This is supported by the fact that Treasury Regulation § 20.2042-1(c)(4) explicitly requires the inclusion of proceeds in both the *Fruehauf* and *Skifter* fact patterns. Until there is some clarification of this conflict among the circuits either by the Supreme Court or, preferably by legislative action, the responsibility is upon the estate planning bar to avoid exposing clients to this situation by making certain that the insured will not be given any powers over the policy, as fiduciary or otherwise, should the insured survive the owner.

Thomas L. Poscharsky

52 H.R. REP. NO. 2333, 77th Cong., 2d Sess. 1942-2 CUM. BULL. 491.

53 Treas. Reg. 105, § 81.25, T.D. 5239, 1943 CUM. BULL. 1091.