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Collective Bargaining and the Coase Theorem

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COLLECTIVE BARGAINING AND THE COASE THEOREM

Stewart J. Schwab †

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The dominant vision of labor law scholars is that management and labor are involved in an incessant tug of war. The major goal of labor law is to reduce the conflict, and thus promote “industrial peace.” In creating new rules, the National Labor Relations Board and reviewing courts¹ typically justify their decisions by appealing to industrial peace or related national goals, rather than the partisan interests of management or labor.² The Board exists to regulate the

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¹ I refer to the National Labor Relations Board (the Board) without differentiating between the Board and courts. I will use both Board and court opinions to illustrate my argument.

² See, e.g., *First Nat'l Maintenance Corp. v. NLRB*, 452 U.S. 666, 680-81 (1981) (“[T]he Act is not intended to serve either party’s individual interest, but to foster in a neutral manner a system in which the conflict between these interests may be resolved.”); see also Farmer, *The NLRB: Its Past, Present and Future*, 23 TENN. L. REV. 112, 112 (1954) (“We have no license to abuse our position by lending the power and pres-

inevitable warfare which underlies the labor market.

This vision of warfare and the need for Leviathan differs dramatically from the basic law and economics vision of parties bargaining peacefully over a contract. Like "industrial peace" is for labor lawyers, "efficiency" is the ever-present term for law and economics scholars. But law and economics scholars have a much rosier view of parties' ability to achieve efficient bargains without intrusive government regulation. They see legal rules as the starting point for bargaining, but believe the parties will reach an efficient bargain *regardless* of where the law places the parties initially.

The law and economics perspective has important implications for labor law. This article explores how far the Coase Theorem³—the centerpiece of law and economics scholarship—can be pushed in labor law.⁴ My thesis is that the Coase Theorem applies to a large and important class of labor law issues. In this class, arguments based on industrial peace are misplaced, because the law cannot promote industrial peace when the Coase Theorem applies.

Specifically, industrial-peace arguments are irrelevant when the

tige of our Government to help industry or labor." (Farmer is ex-NLRB chairman)); Note, *Collective Bargaining as an Industrial System: An Argument Against Judicial Revision of Section 8(a)(2) of the National Labor Relations Act*, 96 HARV. L. REV. 1662, 1676 n.87 (1983) ("When partisans of management or labor criticize labor policy, they generally frame their arguments in terms of lack of Board neutrality or impartiality." (citing Bok, *Reflections on the Distinctive Character of American Labor Law*, 84 HARV. L. REV. 1394, 1451-52 (1971))).

³ The Coase Theorem has many formulations and has spawned an enormous literature. See Zerbe, *The Problem of Social Cost in Retrospect*, 2 RES. L. & ECON. 83, 84 (1980). Simply put, it predicts that absent transaction costs, parties will reach efficient bargains regardless of initial legal entitlements. Although the article never articulates a precise theorem, the theorem comes from Coase, *The Problems of Social Cost*, 3 J.L. & ECON. 1 (1960).

⁴ Law and economics scholarship, while penetrating almost every legal discipline, has been slow to invade labor law, and, in particular, law review writings on labor law. See Hansmann, *The Current State of Law-and-Economics Scholarship*, 33 J. LEGAL EDUC. 217, 224-25 (1983) (noting "conspicuous" absence of law and economics scholarship in labor law); Posner, *Some Economics of Labor Law*, 51 U. CHI. L. REV. 988, 989 (1984) ("Yet despite abundant opportunity, there has been relatively little writing in an economic vein about the particulars of labor law . . ."). Professor Douglas Leslie has made an important contribution on the economic theory of unions and the structure of bargaining units. Leslie, *Labor Bargaining Units*, 70 VA. L. REV. 353 (1984). Professor Leslie has also introduced economic theory into the second edition of his labor law casebook. D. LESLIE, *CASES AND MATERIALS ON LABOR LAW* (2d ed. 1985). In addition, Professor Thomas Campbell has used the concept of union as lawful monopolist to critique the regulation of employer and union economic weapons. Campbell, *Labor Law and Economics*, 38 STAN. L. REV. 991 (1986). Professor Alchian has applied relational contract theory to the issue of mandatory subjects of bargaining. Alchian, *Decision Sharing and Expropriable Specific Quasi-Rents: A Theory of First National Maintenance Corporation v. NLRB*, 1 SUP. CT. ECON. REV. 235 (1982). Recent articles in a symposium also apply economics to labor law. Symposium, *The Conceptual Foundations of Labor Law*, 51 U. CHI. L. REV. 945 (1984).

parties can bargain away benefits the law provides one side or the other. Allowing parties effectively to rewrite the law constricts the law's power to promote industrial peace. This class of cases is large and growing. It includes all situations where unions can waive bargaining rights⁵ or where legal rules establish mere rebuttable presumptions for construing contracts.⁶ In short, industrial peace is an irrelevant goal in most cases where an established bargaining relationship exists.

To illustrate the argument, I focus on the controversial⁷ *Mil-*

⁵ The Supreme Court decision in *Metropolitan Edison Co. v. NLRB*, 460 U.S. 693 (1983), is a recent example. There, the Court held that the company violated NLRA § 8(a)(3), 29 U.S.C. § 158(a)(3) (1982), by singling out union officers for discipline after a wildcat strike. The Court emphasized, however, that the company could have disciplined the officers more severely than the rank-and-file if the contract explicitly permitted such discipline. See also *NLRB v. City Disposal Sys.*, 465 U.S. 822 (1984) (individual employee's assertion of collective bargaining right is concerted activity under NLRA § 7, 29 U.S.C. § 157 (1982), but employer can negotiate clause limiting methods of asserting right); *NLRB v. J. Weingarten, Inc.*, 420 U.S. 251, 257 (1975) (NLRA § 7 gives unionized employees right to union steward at investigatory meeting that may lead to disciplinary action; Board subsequently held in *Prudential Ins. Co.*, 119 L.R.R.M. (BNA) 1073 (1985), that union can waive *Weingarten* right). For a general discussion of waiver cases, see *THE DEVELOPING LABOR LAW* 640-50 (C. Morris 2d ed. 1983).

⁶ The classic, important *Steelworkers Trilogy*—setting forth the presumption of arbitrability—is in the class of cases under analysis here. *United Steelworkers v. American Mfg. Co.*, 363 U.S. 564 (1960); *United Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574 (1960); *United Steelworkers v. Enterprise Wheel & Car Corp.*, 363 U.S. 593 (1960). Cases interpreting no-strike clauses are also in this class. For example, see *Indianapolis Power & Light Co.*, 273 N.L.R.B. 1715 (1985), *enforcement denied sub nom.* *Local Union 1395, IBEW v. NLRB*, 797 F.2d 1027 (D.C. Cir. 1986), where the Board reversed the long-standing presumption that a no-strike clause excludes the promise not to engage in sympathy strikes. The Board will now find that a union breaches a no-strike clause if it engages in a sympathy strike, unless the contract specifically allows sympathy strikes or extrinsic evidence demonstrates that the parties intended to allow sympathy strikes.

⁷ See *Unions Face New Hurdles, Threats After Milwaukee Spring Ruling*, 2 Employee Rel. Weekly (BNA) 131 (Feb. 6, 1984) (union representatives see *Milwaukee II* as “corruption of labor law” that “will promote a kind of blackmail”); *NLRB Hears Argument on Removal of Unit Work to Nonunion Plant*, 1 Employee Rel. Weekly (BNA) 111 (Sept. 26, 1983) (management attorney criticizes *Milwaukee I* as “inconsistent with the economic realities of the marketplace”); *MacNeil/Lehrer News Hour: NLRB Angers Labor* 9,11 (PBS television broadcast, Jan. 24, 1984) (transcript no. 2172 on file at *Cornell Law Review*) (management attorney calls *Milwaukee II* of “critical importance to business”; union attorney says *Milwaukee II* “gives employers another way to try to attack the standard of living of American workers”). The affirmance of *Milwaukee II* by the D.C. Circuit continued the controversy. See *N.Y. Times*, June 20, 1985, at A25, col. 1 (“decision with far-reaching implications” that will “clearly hurt unions”).

As often happens, the legal debate has outlasted the factual controversy. Although the Milwaukee Spring division ultimately won the right to relocate work, apparently no relocations occurred. According to company sources, a union wage concession resolved the controversy. In the end, workers lost no jobs at the unionized plant and the company transferred no assembly line work to the nonunion plant. *Milwaukee Spring II Upheld*, Lab. L. Rep. (CCH) No. 696, at 1, 2 (June 21, 1985).

waukee Spring cases⁸ and on *NLRB v. J. Weingarten, Inc.*⁹ In *Milwaukee I & II*, the Board first prohibited and then allowed a company to relocate bargaining-unit work during the contract term. In *Weingarten*, the Court prohibited an employer from denying an employee's request that her union representative be present at an investigatory interview that could result in disciplinary action. The policy arguments in *Milwaukee I & II* and in Justice Powell's dissent in *Weingarten* center on industrial peace and related national goals. My thesis suggests that the Board and Court had no power to affect industrial peace in these cases. Arguments based on industrial peace were therefore specious.

Abandoning industrial peace as the rhetoric of decision making would have important consequences. It may well change our conception of the proper role of the Board and the "neutrality" of our labor laws. One can easily envision far-reaching social consequences if Board decisions openly declared: "We again accept management's [labor's] position in this case because we have a distributive goal of favoring management [labor], and we need not consider any other issues because we cannot influence them." Nevertheless, to the extent that the costless¹⁰ Coase Theorem applies to collective bargaining, this type of Board opinion is appropriate because the Board cannot promote "industrial peace."

The balance of this article examines the extent to which the Coasean vision applies to collective bargaining. I proceed in six stages. First, I demonstrate that industrial peace is substantially equivalent to the law and economics conception of efficiency. Part II applies the Coase Theorem to collective bargaining. I show that the Board, in establishing rights or setting presumptions of contract interpretation, cannot affect efficiency or industrial peace if the union and management remain free to bargain.¹¹ Part III considers

⁸ *Milwaukee Spring Div.*, 265 N.L.R.B. 206 (1982) (*Milwaukee I*), *rev'd on reh'g*, 268 N.L.R.B. 601 (1984) (*Milwaukee II*), *aff'd sub nom. UAW v. NLRB*, 765 F.2d 175 (D.C. Cir. 1985).

⁹ 420 U.S. 251 (1975).

¹⁰ The Coase Theorem assumes the absence of transaction costs. This article often describes the theorem as the "costless Coase Theorem" to emphasize its assumption of no transaction costs.

¹¹ Law and economics scholars may find it implausible to apply the Coase Theorem, with its assumption of zero transaction costs, to collective bargaining. An alternative model of relational contracts may ultimately prove equally useful in examining the effect of labor law on collective bargaining. This model emphasizes the amorphous nature of contracts between parties in long-term relationships and the difficulties of changing terms. See generally I. MACNEIL, *THE NEW SOCIAL CONTRACT: AN INQUIRY INTO MODERN CONTRACTUAL RELATIONS* (1980); Goetz & Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089 (1981); Goldberg, *Relational Exchange: Economics and Complex Contracts*, 23 AM. BEHAV. SCI. 337 (1980). Some of this literature applies the relational contract model in a general way to labor contracts. See M. OLSON, *THE LOGIC OF*

the major criticisms of Coasean analysis. Without denying the general force of the criticisms, I suggest that the Coase Theorem may be more appropriately applied to labor negotiations than to many other contexts. Part IV examines *Weingarten*, and suggests the criticisms have even less force in that situation than in *Milwaukee I & II*. Part V examines what legitimate policy arguments are left decision makers once industrial peace is rejected as beyond their grasp. Part VI examines normative mimic-the-market implications of the Coase Theorem if transaction costs are significant.

I

INDUSTRIAL PEACE AND EFFICIENCY

In January 1982, during the second year of a three year collective bargaining agreement with the United Auto Workers, the Milwaukee Spring Division of the Illinois Coil Spring Company lost a major contract. To alleviate the resulting financial difficulties, the company asked the union for midterm concessions on wages and other contract items.¹² When the union refused the company's request, the company began transferring work to its non-unionized plant and laying off union workers at Milwaukee Spring. The union filed an unfair labor practice charge.

The Board's problem was that the contract did not expressly declare whether the company could transfer work during the contract term to avoid paying the union wage. The contract contained the usual array of clauses that hinted at the parties' intent—wage and benefit provisions, a union recognition clause, a management rights clause,¹³ an arbitration clause, and a zipper clause¹⁴—but the

COLLECTIVE ACTION (1965); Williamson, Wachter & Harris, *Understanding the Employment Relation: The Analysis of Idiosyncratic Exchange*, 6 BELL J. ECON. 250 (1975). In a pioneering article, Professor Leslie has used the relational contract model to examine the detailed Board rules governing appropriate bargaining units. Leslie, *supra* note 4; see also Note, *An Economic Case for Mandatory Bargaining over Partial Termination and Plant Relocation Decisions*, 95 YALE L.J. 949 (1986).

Rather than adopt the relational contract model, this article applies the costless Coase Theorem to collective bargaining. It is important to see what insights basic Coasean analysis can shed on labor law, before investigating more complex models of collective bargaining.

¹² The company's assembly labor costs at the unionized Milwaukee Spring plant were \$8 an hour in wages and \$2 an hour in fringe benefits. In contrast, at the company's non-unionized McHenry plant, assembly labor costs were \$4.50 an hour in wages and \$1.35 an hour in fringe benefits. *Milwaukee I*, 265 N.L.R.B. at 207.

¹³ The management rights clause provided:

Except as expressly limited by the other Articles of this Agreement, the Company shall have the exclusive right to manage the plant and business and direct the working forces.

These rights include, but are not limited to, the right to plan, direct and control operations, to determine the operations of services to be performed in or at the plant or by the employees of the Company, to estab-

contract contained no precise language on relocation. Thus, the Board faced a classic "gap" problem.¹⁵

In *Milwaukee I*, the Board held that the transfer violated sections 8(a)(1), 8(a)(5), and 8(d) of the National Labor Relations Act.¹⁶ The Board noted that the company would clearly violate the Act if it reduced contract wages during the contract term. The Board refused to condone the transfer of work to reduce labor costs, because the company could thereby " 'achieve by indirection that which [it could not] achieve by direct means under Section 8(d) of the Act.' "¹⁷ Only if the union expressly waived its statutory right to object could the company transfer work.¹⁸

In its brief before the Seventh Circuit,¹⁹ the *Milwaukee I* Board justified its decision by looking to the policies underlying section 8(d). Congress designed section 8(d) "to stabilize industrial relations by fostering collective bargaining agreements binding upon employers, unions and employees alike."²⁰ The Board emphasized

lish and maintain production and quality standards, to schedule the working hours, to hire, promote, demote, and transfer, to suspend, discipline or discharge for just cause or to relieve employees because of lack of work or for other legitimate reasons, to introduce new and improved methods, materials or facilities, or to change existing methods, materials or facilities.

Id. at 209-10.

¹⁴ A zipper clause "purports to close out bargaining during the contract term and to make the written contract the exclusive statement of the parties' rights and obligations." R. GORMAN, *BASIC TEXT ON LABOR LAW: UNIONIZATION AND COLLECTIVE BARGAINING* 471 (1976).

¹⁵ See Farnsworth, *Disputes over Omission in Contracts*, 68 COLUM. L. REV. 860 (1968) (when confronted with gap in agreement, courts generally attempt to predict how parties would have allocated risk had they considered contingency); Hillman, *An Analysis of the Cessation of Contractual Relations*, 68 CORNELL L. REV. 617, 627-28 (1983) ("Contracting parties may fail to consider and plan for contingencies that will arise because of the limitations of the human mind and imagination in anticipating the future . . .").

¹⁶ Section 8(a)(1), 29 U.S.C. § 158(a)(1) (1982), makes it an unfair labor practice to interfere with employees' § 7 rights to form unions, bargain collectively, and engage in other concerted activities. See 29 U.S.C. § 157 (1982). Section 8(a)(5), 29 U.S.C. § 158(a)(5) (1982), makes a company's refusal to bargain collectively with the union an unfair labor practice. Section 8(d), 29 U.S.C. § 158(d) (1982), defines the duty to bargain in good faith: "[W]here there is in effect a collective-bargaining contract . . ., the duty to bargain collectively shall also mean that no party to such contract shall terminate or modify such contract, unless [certain conditions are met]."

¹⁷ *Milwaukee II*, 268 N.L.R.B. at 610 (Zimmerman, Member, dissenting) (quoting Los Angeles Marine Hardware Co., 235 N.L.R.B. 720, 735 (1978), *enforced*, 602 F.2d 1302 (9th Cir. 1979)). Zimmerman's dissent expressed this rationale more clearly than did *Milwaukee I*.

¹⁸ *Milwaukee I*, 265 N.L.R.B. at 209.

¹⁹ The company sought review of *Milwaukee I* in the Seventh Circuit. After a change in Board membership, the Seventh Circuit before decision granted the Board's request to remand the case to the Board. After the Board reversed itself in *Milwaukee II*, the union petitioned for review in the District of Columbia Circuit. For a procedural description of the case, see *UAW v. NLRB*, 765 F.2d 175, 178-79 (D.C. Cir. 1985).

²⁰ Brief for the National Labor Relations Board at 10, *Milwaukee Spring Div. v.*

that industrial stability depends “ ‘upon the binding nature of collective bargaining agreements.’ ”²¹ The policy rationale of *Milwaukee I*, then, is that the Board furthers industrial stability by presuming, absent an express clause to the contrary, that a company cannot transfer work midterm to avoid the contract’s terms.²²

In *Milwaukee II*, the Board again analyzed the issue in terms of industrial peace, but reversed its prior decision. The Board concluded that, absent an express work-preservation clause in the contract, allowing the company to transfer work best served the national interest. As the Board argued in its *Milwaukee II* brief,²³ “ ‘[T]he purpose of the Act is to encourage labor/management peace by resolving differences through collective-bargaining and to stabilize *agreed upon* conditions during the term of a [contract].’ ”²⁴ By shifting the content of its industrial peace rationale—from the need to enforce binding contracts, to the need to enforce only express terms—the Board reversed itself, yet used industrial peace to justify both results.

NLRB, 718 F.2d 1102 (7th Cir. 1983) (No. 82-2736) (citing *United Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 578 (1960)); *see also* *Textile Workers Union v. Lincoln Mills*, 353 U.S. 448, 454 (1957) (“ ‘Statutory recognition of the collective agreement as a valid, binding, and enforceable contract is a logical and necessary step. It will promote a higher degree of responsibility upon the parties to such agreements, and will thereby promote industrial peace.’ ” (quoting S. REP. NO. 105, 80th Cong., 1st Sess. 17 (1947), *reprinted in* 1 NLRB, LEGISLATIVE HISTORY OF THE LABOR MANAGEMENT RELATIONS ACT, 1947, at 407, 423 (1948))).

²¹ Brief for the National Labor Relations Board, *supra* note 20, at 10 (quoting *NLRB v. Keystone Steel & Wire*, 653 F.2d 304, 307 (7th Cir. 1981)).

²² Chairman Van de Water, author of the opinion, has explained the *Milwaukee I* rationale as based on a fundamental principle of contract law that one party to a bargain cannot unilaterally act to deprive the other party of the benefit of the bargain. Van de Water, *Influences of the National Labor Relations Board in the Early Years of the Reagan Administration*, 36 LABOR L.J. 867, 869 (1985); *cf.* Summers, *Collective Agreements and the Law of Contracts*, 78 YALE L.J. 525, 569-70 (1969) (contract principle of good faith and fair dealing relevant to whether employer can contract out work). This rationale is articulated neither in *Milwaukee I* and *II* nor in any supporting briefs.

²³ Brief for the National Labor Relations Board at 23, *UAW v. NLRB*, 765 F.2d 175 (D.C. Cir. 1985) (No. 84-1106).

²⁴ *Id.* at 27 (quoting *Boeing Co. v. NLRB*, 581 F.2d 793, 798 (9th Cir. 1978)). The *Milwaukee II* Board also argued that the promotion of frank and honest discussions between labor and management provided a separate justification for its decision. *Id.* at 35-37. Under *Milwaukee II* management would have no incentive to disguise its true motive when the move is an effort to lower labor costs. Member Zimmerman, dissenting in *Milwaukee II*, rejected this argument. He acknowledged that *Milwaukee I* could induce an employer to disguise its true reasons for leaving; an employer could transfer work for any reason other than to reduce labor costs. Nevertheless, Zimmerman insisted that an employer considering relocation to reduce labor costs would admit that labor costs motivated the move in hopes of persuading the union to accede to a reduction, enabling the employer to avoid the disruption of moving. Zimmerman concluded that the Board should not undermine the congressional policy against continuous bargaining (as reflected in NLRA § 8(d)) merely because some violators of the Act may avoid punishment. 268 N.L.R.B. at 612.

The policy arguments in *Milwaukee I & II* typify those advanced in labor law cases. Each side frames its arguments in terms of industrial peace, claiming that its result promotes peace. Labor lawyers and the Board generally minimize the distributive effect of a decision on labor or management, preferring to speak in “neutral” or “national” terms: furthering “industrial peace” and the “free flow of commerce,”²⁵ promoting “the collective-bargaining process,”²⁶ or aiding some other national labor law goal that transcends the interests of labor or management.²⁷ The primacy of industrial peace as a policy goal is emphasized in the Senate report for the 1935 Wagner Act: “The first objective of the bill is to promote industrial peace.”²⁸ Industrial peace is a goal throughout labor law,²⁹ but re-

²⁵ See, e.g., *First Nat'l Maintenance Corp. v. NLRB*, 452 U.S. 666, 674 (1981) (“A fundamental aim of the National Labor Relations Act is the establishment and maintenance of industrial peace to preserve the flow of interstate commerce.”).

²⁶ See, e.g., *Emporium Capwell Co. v. Western Addition Community Org.*, 420 U.S. 50, 62 (1975) (goal of national labor policy is to minimize “industrial strife” by encouraging collective bargaining); *Fibreboard Paper Prods. Corp. v. NLRB*, 379 U.S. 203, 211 (1964) (bargaining over contracting out work “would promote the fundamental purpose of the Act by bringing a problem of vital concern to labor and management within the framework established by Congress as most conducive to industrial peace”).

²⁷ See, e.g., *Complete Auto Transit, Inc. v. Reis*, 451 U.S. 401, 424 (1981) (Powell, J., concurring) (NLRA “intended to further broader national interests than those of either labor or management”); *Ozark Trailers, Inc.*, 161 N.L.R.B. 561, 568 (1966) (In enacting NLRA, Congress determined “that, despite management’s interest in absolute freedom to run the business as it sees fit, the interests of employees are of sufficient importance that their representatives ought be consulted in matters affecting them, and that the public interest, which includes the interests of both employers and employees, is best served by subjecting problems between labor and management to the mediating influence of collective bargaining.”); Klare, *Judicial Deradicalization of the Wagner Act and the Origins of Modern Legal Consciousness, 1937-1941*, 62 MINN. L. REV. 265, 319-20 (1978) (“union conduct would not be judged solely against the backdrop of competing employer and employee interests, but against the public interest in industrial peace as well”).

²⁸ S. REP. NO. 573, 74th Cong., 1st Sess. 1 (1935), reprinted in 5 NLRB, LEGISLATIVE HISTORY OF THE NLRA 2300, 2300 (1935); see also J. ATLESON, VALUES AND ASSUMPTIONS IN AMERICAN LABOR LAW 111 (1983) (“The most commonly expressed goal of the Wagner Act was the achievement of industrial peace.”).

²⁹ See, e.g., *NLRB v. Financial Inst. Employees Local 1182*, 106 S. Ct. 1007, 1016 (1986) (“The basic purpose of the National Labor Relations Act is to preserve industrial peace.”); *NLRB v. City Disposal Sys.*, 465 U.S. 822, 836 (1984) (individual employee claiming contract right engaged in “concerted” activity because claim “breathes life . . . into the entire process envisioned by Congress as the means by which to achieve industrial peace”); *Brooks v. NLRB*, 348 U.S. 96, 103 (1954) (employer’s good faith doubt of union’s continuing majority support is insufficient reason to refuse to bargain, for “refusing to bargain with the formally designated union is . . . inimical to” “underlying [statutory] purpose of . . . industrial peace”); *NLRB v. Local 1229, IBEW*, 346 U.S. 464, 476 (1953) (employee properly fired for disloyal acts, because “[n]othing would contribute less to the Act’s declared purpose of promoting industrial peace and stability” than requiring employer to finance such activities); *J.I. Case Co. v. NLRB*, 321 U.S. 332, 338 (1944) (individual contracts generally must yield to less advantageous collective bargain because “advantages to individuals may prove as disruptive of industrial peace as disadvantages”); *NLRB v. Jones & Laughlin Steel Corp.*, 301 U.S. 1, 42 (1937) (experience

ceives particular attention in cases dealing with work preservation and plant relocation.³⁰

The term "industrial peace," unfortunately, has become a buzz word for any argument relying on the national interest distinct from the narrow aims of labor or management. As a result, the term has become so vague and overused in labor law³¹ that it provides little guidance to disputants or decision makers. This article suggests that industrial peace can be equated with the economic notion of efficiency. Efficiency occurs when resources flow to their most valued uses, so that society obtains the maximum output from its resources: in short, an efficient system maximizes the overall social pie. To complete this connection between industrial peace and efficiency requires further analysis of the content of the term industrial peace.

One might initially characterize industrial peace as tranquil relations between labor and management. More concretely, industrial peace may mean the absence of strikes. Labor law, however, has never sought to prevent all strikes.³² Indeed, the NLRA specifically preserves and protects the right to strike.³³ In urging industrial

shows that employees' right to collective bargaining is often necessary for industrial peace).

³⁰ *E.g.*, *Fibreboard Paper Prods. Corp. v. NLRB*, 379 U.S. 203, 211 (1964) (Act obliges employer to bargain collectively with union regarding replacement of members with employees of independent contractor; mandating such bargaining "promote[s] the fundamental purpose of the Act by bringing a problem of vital concern to labor and management within the framework established by Congress as most conducive to industrial peace"); *First Nat'l Maintenance Corp. v. NLRB*, 452 U.S. 666 (1981) (company need not bargain with union when it decides to close part of its operations, because national interest in industrial peace would not be furthered by making this topic mandatory subject of bargaining). *First National Maintenance*, the latest Supreme Court word on the duty to bargain over plant closings, is not directly relevant to *Milwaukee Spring's* decision to transfer, rather than cease, operations. The parties in *Milwaukee I & II* stipulated that a company must bargain over the decision to transfer work to reduce labor costs. The Board, in *Otis Elevator Co.*, 269 N.L.R.B. 891, 894 (1984), later declared that "[h]ad the parties [in *Milwaukee I & II*] not stipulated, we would have so held" that the decision was a mandatory subject of bargaining.

³¹ Charles Fried describes the "vast, ponderous, powerful, but threadbare middle view" of labor law policy arguments in this way: "Built up of formulas repeated until they have become platitudes, this view proclaims such values as equalizing the bargaining power of labor and management, forming a partnership of labor and management, instituting industrial democracy, and, at every turn, preserving industrial peace." Fried, *Individual and Collective Rights in Work Relations: Reflections on the Current State of Labor Law and Its Prospects*, 51 U. CHI. L. REV. 1012, 1017 (1984).

³² See A. COX, *LAW AND THE NATIONAL LABOR POLICY* 12 (1960) ("[N]o one supposed that strikes would be eliminated [by the Wagner Act]."); cf. J. ATLESON, *supra* note 28, at 7 ("The right to strike is granted because the threat to withdraw labor power, or its actual withdrawal, is the only employee action that will make collective bargaining effective, and collective bargaining, in turn, will encourage 'industrial peace.'").

³³ NLRA § 13, 29 U.S.C. § 163 (1982). Section 13 reads: "Nothing in this subchapter, *except as specifically provided for herein*, shall be construed so as either to interfere

peace, then, Congress had a broader aim than simply limiting strikes. Ultimately, Congress desired to maintain a capitalist economy and to promote smooth and efficient commerce.³⁴ It determined that optimal labor policy would leave labor relations to private, collective bargaining between labor and management.

Protected and promoted by the national government, collective bargaining is intended to prevent fundamental, perhaps violent, upheaval in our industrial system.³⁵ Undoubtedly strikes will occur because they are a necessary element of private collective bargaining.³⁶ But a system in which private parties write their own contracts in accordance with their private interests will also promote the free flow of resources to those who value them most highly. Putting resources to their most valued use is the essence of an efficient economy.³⁷ It thus seems natural to equate the goal of industrial peace with the goal of an efficient economy where capital and labor flow freely.³⁸

with or impede or diminish in any way the right to strike, *or to affect the limitations or qualifications on that right.*" (Taft-Hartley amendments in italics).

³⁴ The Act's declaration of policy illustrates the concern for an efficient economy. Section 1, as amended, refers to the efficient flow of commerce 10 times, concluding: "It is declared to be the policy of the United States to eliminate the causes of certain substantial obstructions to the free flow of commerce and to mitigate and eliminate these obstructions when they have occurred . . ." 29 U.S.C. § 151 (1982).

In enacting § 1 Congress primarily sought to convince the Supreme Court that the Act was a constitutional use of Congress's powers under the commerce clause. *See* 1 J. GROSS, *THE MAKING OF THE NATIONAL LABOR RELATIONS BOARD* 144 (1974) (Section 1 was revised "to emphasize the effect of labor disputes on interstate commerce and to de-emphasize the mere economic effects which had been rejected by the court." (quoting Philip Levy of Board's Legal Division)). Beyond this immediate concern, Congress was concerned with national goals beyond the partisan interests of labor and management. *See supra* notes 25-28 and accompanying text.

³⁵ *See* Klare, *supra* note 27, at 273-74 ("[T]he more sophisticated sectors of the business community recognized that government intervention in the private sector was essential to rationalize the chaos of a market economy, to enhance the stability, predictability, and security of the competitive capitalist system, and to provide a stable political environment in which the corporations could get on with the business of making reasonable profits." (footnote omitted)); *id.* at 282 ("[I]ndustrial warfare clearly promoted other undesirable conditions, such as political turmoil, violence, and general uncertainty.").

³⁶ *See* A. Cox, *supra* note 32, at 12 ("Freedom to strike, the threat of a strike, and possibly a number of actual strikes are indispensable parts of a national labor policy based upon the establishment of wages, hours, and other terms and conditions of employment through private collective bargaining.").

³⁷ Critical legal theorists object to this definition of efficiency, but agree that it is the one commonly used by contemporary labor lawyers. *See* Lesnick, *The Consciousness of Work and the Values of American Labor Law* (Book Review), 32 *BUFFALO L. REV.* 833, 856 (1983) ("An alternative consciousness would see efficiency as seeking to maximize something more than the quantity of things that exists in the world, and freedom as something more than permission to compete with one another for scarce resources.").

³⁸ For an example of equating the free flow of commerce with a national goal in a different context, see Note, *The Propriety of Section 10(j) Bargaining Orders in Gissel Situa-*

Many critics see unions as inefficient monopolies of labor supply,³⁹ and question the efficiency of a system that promotes collective bargaining. The corollary question is whether the primary goal of a system that fosters unions—industrial peace—could possibly be equated with efficiency. Others have emphasized that unions can promote efficiency, either as countervailing powers against employers' monopsony power⁴⁰ or as institutions that solve collective goods problems in the workplace.⁴¹ Under this view, a system promoting collective bargaining could well be primarily concerned with efficiency.

Even under the former view, however, Congress in establishing collective bargaining could be seen as making a metadecision about efficiency: our industrial system will not survive without collective bargaining.⁴² If unions are necessary for the system to survive, one can comfortably equate the goal of industrial peace with the goal of efficiency.⁴³

Congress's decision to use collective bargaining as the method of achieving industrial peace has important consequences. This article stresses the limited role of legal rules in furthering industrial peace. Because collective bargaining allows private parties to contract around legal rules, decision makers cannot promote the system's efficiency, or industrial peace, by adopting a particular rule. Recognizing this limit on the applicability of the industrial peace justification for various legal rules, future decision makers must justify in other ways the rules they have chosen. Using *Milwaukee I & II*

tions, 82 MICH. L. REV. 112, 118 n.27 (1983) ("Congress equated the public interest with the free flow of commerce . . .").

³⁹ J. HIRSHLEIFER, PRICE THEORY AND APPLICATIONS 380-82 (3d ed. 1984); Friedman, *Labor Unions and Economic Policy* (labor unions and enterprise monopolies have similar effects, often exaggerated), in LABOR AND THE NATIONAL ECONOMY 22 (W. Bowen ed. 1965); Lazear, *A Microeconomic Theory of Labor Unions*, in NEW APPROACHES TO LABOR UNIONS 53 (J. Reid ed. Supp. 2, 1983).

⁴⁰ See R. LIPSEY & P. STEINER, MICROECONOMICS 347 (5th ed. 1979) ("Because a wage-setting union has the effect of turning the employer into a price taker in the labor market, the union facing a monopsonist can duplicate the competitive results."); F.M. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 306-12 (2d ed. 1980) (discussing countervailing power and consumer prices). The classic statement of countervailing power is by J.K. GALBRAITH, AMERICAN CAPITALISM: THE CONCEPT OF COUNTERVAILING POWER (1952).

⁴¹ See Leslie, *supra* note 4, at 359 ("A union can reduce its membership's cost of" securing collective goods.). For an appraisal of the efficiency effects of unions generally, see R. FREEMAN & J. MEDOFF, WHAT DO UNIONS DO? (1984).

⁴² One way of viewing this proposition is that Congress made two decisions: First, collective bargaining was necessary to avoid violent revolution against the industrial system; and second, we should strive for the next best result of efficiency constrained by the existence of unions.

⁴³ See Fried, *supra* note 31, at 1022 ("It has been suggested more than once that our system of labor law must and does serve the concerns of efficiency and productivity.").

as the focal point, Parts II and III illustrate this limit on the role of legal rules and the consequent irrelevancy of the industrial peace rationale in this class of cases.

Obviously, I drastically oversimplify labor law by claiming that all labor law rules are designed to promote industrial peace. Proponents of the original Wagner Act emphasized that collective bargaining would also further industrial democracy, so that workers could have a voice in controlling their working life.⁴⁴ The Taft-Hartley amendments emphasized the freedom of workers to reject collective bargaining.⁴⁵ But these alternate societal goals have been overshadowed by the concern for industrial peace. Although usually secondary to industrial peace,⁴⁶ valid distributional goals remain present in labor law. Distributional goals, as opposed to societal goals, directly favor labor or management, and only secondarily promote a societal goal like industrial peace. Part IV discusses the most prominent distributional goals in labor law: equalizing bargaining power and maintaining management's reserved rights. Under the costless Coase Theorem, the law can only affect distribution. Thus, only distributional goals, as opposed to industrial peace, are relevant in determining and justifying legal rules.

II

COLLECTIVE BARGAINING UNDER THE COASE THEOREM

In this section I sketch the reasoning behind the costless Coase Theorem's prediction that labor and management will bargain to the same, efficient result regardless of the Board's rules on initial entitlements or contract interpretation.⁴⁷ I then examine whether

⁴⁴ See 1 J. GROSS, *supra* note 34, at 16 (Sen. Wagner wrote that program would "make America safe for industrial democracy" (quoting letter from Sen. Robert F. Wagner to Marion Smith (Oct. 22, 1933))); Gross, *Conflicting Statutory Purposes: Another Look at Fifty Years of NLRB Law Making*, 39 INDUS. & LABOR REL. REV. 7, 10 (1985) (Sen. Wagner "considered the advancement of economic and social justice, rather than the reduction of industrial strife, to be the primary objective of the Wagner Act."); Keyserling, *The Wagner Act: Its Origin and Current Significance*, 29 GEO. WASH. L. REV. 199, 218 (1960) (Sen. Wagner "valued the measure . . . as an affirmative vehicle for the economic and related social progress to which his life-long efforts were devoted."). For a modern-day call for industrial democracy, see Hyde, *Democracy in Collective Bargaining*, 93 YALE L.J. 793 (1984).

⁴⁵ The Taft-Hartley Act amended § 7 of the NLRA to state expressly that employees "have the right to refrain from any or all of such activities." NLRA § 7, 29 U.S.C. § 157 (1982); see Gross, *supra* note 44, at 13 ("The 1947 Declaration of Policy, coupled with a passage added in 1947 to section 7 that affirms workers' right to refrain from engaging in collective bargaining, has been interpreted to mean that free choice and individual rights are at least as important as the right to collective bargaining.").

⁴⁶ See Dripps, *New Directions for the Regulation of Public Employee Strikes*, 60 N.Y.U. L. REV. 590, 594 (1985) ("Since [the Great Depression], 'industrial harmony' has replaced 'equality of bargaining power' as the primary justification of our labor law.")

⁴⁷ I emphasize that the Coase Theorem predicts only that the parties will bargain to

the Board's rules affect distribution. I proceed by using a simplified model of the Milwaukee Spring contract negotiations as an example.

A. Effect of *Milwaukee I & II* on Efficiency

The protagonists are a company and union ready to negotiate (or renegotiate) a three year collective bargaining contract.⁴⁸ The company seeks the lowest possible wage, but will profit from any wage less than \$10 an hour.⁴⁹ The company also wants the right to transfer work to its non-union plant if market conditions change and the contract wage proves unprofitable. The company is willing to pay up to \$600,000 (or \$1 an hour per worker) for this right.⁵⁰ Essentially, the company wants insurance that the three-year contract will not unduly tie its hands.⁵¹

The union seeks the highest possible wage for its members. To remain viable, however, the union must secure a contract that provides better conditions than the non-union alternative of employment-at-will at \$6 an hour. Workers want job security as well as high wages. Indeed, the union would give up as much as \$2 an hour (or \$1.2 million over the life of the contract) to obtain this security. On these assumptions, the union values security (i.e., a "stay" clause) more than the company values the right to relocate produc-

an efficient outcome. The Theorem does not analyze the process by which the parties reach agreement. Indeed, Professor Regan criticizes the Coase Theorem because "it reaches a conclusion about the result of individuals' economic behavior without any model of how individuals behave." Regan, *The Problem of Social Cost Revisited*, 15 J.L. & ECON. 427, 428 (1972). He thus considers the Coase prediction of efficient bargains an "a priori" claim. *Id.* For an examination of the *process* of labor negotiations, see R. WALTON & R. MCKERSIE, *A BEHAVIORAL THEORY OF LABOR NEGOTIATIONS* (1965).

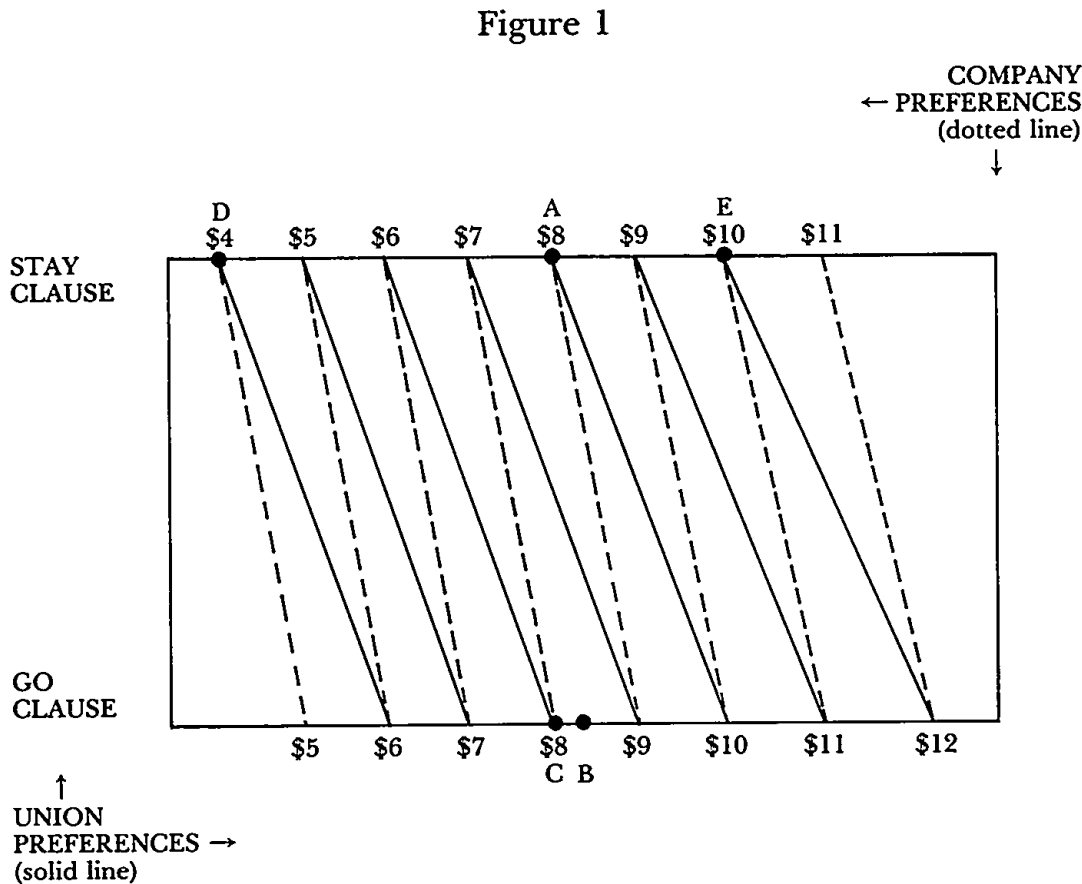
⁴⁸ A Bureau of National Affairs survey found that 80% of labor contracts in manufacturing industries and 78% of contracts in nonmanufacturing industries are of three-year duration. 2 *Collective Bargaining Negot. & Cont. (BNA)* 36:1-2 (1966). Collective bargaining contracts rarely exceed three years, in part because the Board's contract-bar rules only protect the incumbent union from rivals for three years. See [2 Labor Relations] *Lab. L. Rep. (CCH)* ¶ 2730.69 (1972).

⁴⁹ Assume that labor is the only input in the production process and that the firm employs 100 workers. The work force produces 1,000 widgets an hour, and the company can sell as many widgets as it makes for \$1 each. Under these assumptions, revenues will exceed costs as long as the wage is less than \$10 an hour. More generally, the \$10 wage could be characterized as the point at which the firm makes only normal profits.

⁵⁰ If the firm hires 100 employees for three years and each employee works 40 hours a week, 50 weeks a year, then the firm purchases 600,000 hours of labor. Each \$1 an hour wage increase costs the company \$600,000 over the life of the contract. Ignoring the discounted present value of future payments simplifies the analysis without sacrificing its insights.

⁵¹ For simplicity, I reduce the negotiations to two contract terms: the wage and the right to relocate.

tion (i.e., a "go" clause). Figure 1 sketches the preferences.⁵²



The protagonists confront two separate issues: whether to include a go clause or a stay clause in the contract; and what wage to pay. To benefit, bargainers must resolve both issues.⁵³ The costless Coase Theorem predicts that rational bargainers will resolve the first issue by putting the highest-valued clause in the contract because this maximizes the total value of the bargain.⁵⁴ The parties will reach this solution regardless of their initial entitlements. The Theorem does not firmly predict how the parties will resolve the second issue—dividing the surplus created by the bargain.

The Coasean result occurs in the following manner. The union

⁵² Because the stay/go clause is an either/or situation, the parties will be at either the top or the bottom of the box and cannot stop in the middle.

⁵³ In general, bargainers must decide who gets which item and how to divide the surplus created by the bargain. Professor Cooter terms this process a "bargaining game," a game in which "production is contingent upon agreement about distribution." Cooter, *The Cost of Coase*, 11 J. LEGAL STUD. 1, 17 (1982).

⁵⁴ The parties may include an explicit stay/go clause in the contract, or they may leave the contract silent on this issue and rely on the interpretation of *Milwaukee I* or *II*. In either case, the highest valued clause becomes part of the contract.

enters negotiations with labor for sale. In addition, under *Milwaukee I* the company cannot transfer work to avoid the contract wage unless the agreement includes an express go clause. The union can sell this *Milwaukee I* right to the company, but recall that the company values this right less than the union does. Suppose the parties tentatively agree on a wage rate of \$8 an hour (point A in Figure 1). The company then offers to raise the wage to \$8.50 in exchange for a go clause (point B). The union will reject this offer because it will not trade its implicit stay clause for less than a \$2 an hour increase in wages. Only a wage above \$10 would induce the union to move from \$8 and its implicit *Milwaukee I* stay clause. The company similarly will reject any counteroffer by the union because the largest wage increase the company will accept for a go clause is \$1 an hour. Therefore, the company will prefer the original \$8 an hour to \$10 an hour with a right-to-go clause. In effect, when bargaining under *Milwaukee I* (which presumes a stay clause), once the parties tentatively agree on a wage no other contract can benefit both parties.⁵⁵ In sum, given the assumed preferences of the parties and the rule established in *Milwaukee I*, the Coase Theorem predicts that the contract will include a stay clause and have a wage somewhere between \$4 and \$10 an hour.⁵⁶

Alternatively, suppose the parties bargain under *Milwaukee II*. Under this rule, the company can move unless the contract specifies otherwise. Again, suppose the parties tentatively agree on a wage of \$8 an hour (point C), with an implicit go clause. The union would accept a wage as low as \$6 accompanied by a stay clause. The company would accept a stay clause if wages were below \$7. Room for trade exists. Suppose the union suggests lowering the wage to \$6.50 in exchange for a stay clause. The company will accept this proposal (perhaps haggling to reduce the wage to \$6), and the contract will contain an explicit stay clause. Thus, under both *Milwaukee I* and *II* the contract will require the company to stay during the contract term.

⁵⁵ The Coase Theorem predicts that the parties will move to a point on the contract curve (the set of Pareto-optimal points from which it is impossible to move and make one party better off without making the other party worse off). The Coase Theorem does not predict the point on the contract curve at which the parties will rest. In Figure 1, the contract curve is the top of the Edgeworth box between points D and E. To the left of point D, employees prefer to work in a non-unionized firm, whereas to the right of point E, the company prefers to shut down.

⁵⁶ The Theorem does not predict a precise wage figure. Any wage between \$4 and \$10 an hour will be efficient because it lies on the contract curve. An efficient outcome occurs when the parties have exhausted all potential gains to trade, i.e., no further trade makes one party better off without making the other party worse off. Again, whether a party is better off from a trade depends solely on that party's evaluation of the trade, given its preferences.

Nothing inherent in work relocation makes a stay clause more or less efficient than a go clause. By definition, the efficient outcome depends solely on the relative valuations of labor and management.⁵⁷ In the above example, the stay clause is efficient because the union values it more than the company values a go clause. If relative preferences of the company and the union are reversed, so that the company values a go clause more highly, the Coase prediction is also reversed. Under either *Milwaukee I* or *II*, the contract would allow the company to move during the contract term, the now-efficient outcome.

The Coase Theorem thus predicts that, in the absence of transaction costs, *Milwaukee I* or *II* cannot affect job security or the mobility of capital during the contract term. Instead, the parties' preferences determine the contract terms. Recall that, in justifying *Milwaukee I*, the Board proclaimed that the result promoted industrial peace by fostering contract stability. If contract stability means that the company should not be able to transfer work during the contract term, the Coase Theorem demonstrates that the Board's decision is irrelevant. Regardless of the Board's holding, the company will stay only if the union values a stay clause more than the company values mobility.

Some commentators support *Milwaukee II* by arguing that it ensures capital mobility and the free flow of commerce,⁵⁸ a goal expressed in section 1 of the NLRA. Rubbish, says the Coase Theorem. Again, only the preferences of the parties, not the rule of law, determine whether the company may leave during the contract

⁵⁷ See *supra* note 56. If the collective bargaining contract creates third-party externalities, the efficient outcome also depends upon the relative valuations by these third parties to a stay/go clause. This article assumes that no such externalities exist.

⁵⁸ See, e.g., W. WENDLING, *THE PLANT CLOSURE POLICY DILEMMA* 71 (1984) ("*Milwaukee Spring II* . . . , which mandates bargaining over relocation but permits relocation during the contract if the bargainers reach impasse, is more consistent with maintaining profitable operations and employment."); Brown, *Current Developments at the NLRB: Unilateral Management Decisions During the Term of a Collective Bargaining Agreement*, 10 *EMPLOYEE REL. L.J.* 134, 139 (1984) (*Milwaukee II* is "consistent with the underlying purpose of the NLRA [sic] to promote collective bargaining as a means of preserving industrial peace. That policy does not and should not insulate employees covered by collective bargaining agreements from the marketplace realities that require reorganization or relocation."); Isaacson, *Reconsidering Milwaukee Spring: Going Forward by Looking Backward*, 9 *EMPLOYEE REL. L.J.* 389, 391 (1983-84) ("In the last analysis, the wisdom of the Board's position on the work removal issue must be judged by its impact on the vitality and competitiveness of the American economy. In that regard, *Milwaukee Spring [I]* comes up a loser; it can only sap the vitality and blunt the competitiveness of the American economy. In tampering with the long-established right of employers to make major entrepreneurial decisions, the Board, purportedly to save jobs over the short term, will negatively affect the long-term viability of companies with a genuine need to divert work.").

term. The law simply cannot affect the efficiency of contracts.⁵⁹

Others have suggested that *Milwaukee II* may lead to more strikes and that the choice of a legal rule can thus affect industrial peace.⁶⁰ Under *Milwaukee II* the union cannot rely on the law to prevent the company from transferring work. Instead, goes the argument, the union must bargain and perhaps strike to preserve jobs. If a Board decision in a case like *Milwaukee II* affects the rate of strikes, then the Board also affects industrial peace. Justifications based on "industrial peace" would then be relevant. The argument, however, is unconvincing. True, under *Milwaukee II* the union must demand a stay clause. But under *Milwaukee I* the company could insist on a right-to-leave clause. Either scenario could lead to impasse and a strike or lockout.⁶¹ As argued below,⁶² the collective bargaining relationship minimizes this possibility.

B. Distributional Impact of *Milwaukee I* & *II*

If law has such a limited effect, one may wonder why the parties feel so strongly about the choice of legal rules and why the decision generates such controversy.⁶³ So far, I have suggested that the Board rule cannot affect the long-run efficiency of the collective bargaining agreement. The rule will, however, have a short-run and possibly a long-run distributional effect.

In the short run, a shift in the legal rule creates windfall gains and losses to parties in the midst of a contract. This applies to both the litigated contract⁶⁴ and other contracts with similar clauses interpreted in light of the new rule.⁶⁵ For example, when *Milwaukee II* overruled *Milwaukee I*, employers under existing contracts without

⁵⁹ Changing the interpretation of contract silence creates short-run inefficiencies until parties who relied on the former law can insert clauses responsive to the new legal interpretation.

⁶⁰ "United Auto Workers attorneys, calling *Milwaukee Spring II* 'a very serious piece of mischief,' [predicted] that the decision would undermine industrial peace since a union's bargaining strategy in the future would have to include demands for work preservation clauses, demands that workers would be inclined to strike over." Marcus, *The NLRB and Milwaukee Spring: The Duty to Bargain over Plant Closings and Relocations*, 55 OKLA. B.J. 709, 714 (1984) (quoting Wall St. J., Jan. 25, 1984, at 3, col. 4).

⁶¹ This assumes that the stay clause is a mandatory subject of bargaining. See *infra* note 94.

⁶² See *infra* notes 95-98 and accompanying text.

⁶³ See *supra* note 7.

⁶⁴ See Demsetz, *Wealth Distribution and the Ownership of Rights*, 1 J. LEGAL STUD. 223, 224 (1972) ("There can be little doubt that a specific court decision will alter the distribution of wealth between the contending parties; that, after all, is the main motivation for litigation.").

⁶⁵ *Id.* at 229 ("[T]he essential condition for a reassignment of rights to alter the distribution of wealth is that the persons whose activities interact must have engaged in these activities through contractual obligations whose terms are incongruous in light of the new rule of liability.").

express relocation clauses became better off and employees became worse off. Employers who had not bargained for an express relocation clause were suddenly free to transfer work during the contract term with no simultaneous adjustment of the wage. Conversely, workers no longer were protected by an implicit stay clause. The Board rule thus directly affected the distribution of welfare in the short run.

The more difficult question is whether a Board decision changing the legal rule permanently alters the distribution of wealth. Recall the bargaining example discussed above. Under *Milwaukee I*, the union had two things to sell: labor and its security entitlement. The example suggested that the final contract might include an \$8 wage and a stay clause. Under *Milwaukee II*, the union has only its labor to sell and must bargain for job security. In that situation, I suggested that the final contract might include a \$6.50 wage and an explicit stay clause. Because *Milwaukee II* gives the company more bargaining chips, the parties might settle upon a lower wage than under *Milwaukee I*, even if the stay clause will appear in the contract under either Board rule. Professor Coase asserted in his original article that entitlements affect the distribution of welfare between the parties, at least in a tort setting.⁶⁶ That analysis might suggest that wages will be lower under *Milwaukee II* because the union must "buy" the company's right to leave by agreeing to lower wages.

Later analysts, however, have suggested that in a contract setting where all terms are negotiable, initial entitlements should not affect distribution.⁶⁷ When a legal rule regulates only one term of a multifaceted bargain and allows parties voluntarily to reassign the entitlement, the law's power over the distribution of wealth between the parties is limited. For example, if the parties previously relied on silence in the contract, presuming that courts would construe it in a particular way, then the parties can simply include an express clause in their next contract if the law changes its interpretation of

⁶⁶ Coase, *supra* note 3, at 2-8.

⁶⁷ Professor Demsetz illustrates the point with an example involving industrial accidents. Suppose that employers in a competitive labor market initially are not liable for industrial accidents. Workers will demand a wage that compensates them not only for the value of their labor, but also for the expected costs of accidents suffered on the job. Assume that the parties agree to a wage of \$10 an hour, a wage that includes \$2 an hour to cover expected accident costs. If the liability rule changes, and employers must compensate employees for their on-the-job injuries, then the wage rate will be reduced to \$8 an hour. Neither the workers nor the firms will be worse off, because the employees receive \$8 an hour in wages and \$2 an hour in accident insurance coverage provided by the employer. Thus, there is no redistribution of wealth. Demsetz, *supra* note 64; Demsetz, *When Does the Rule of Liability Matter?*, 1 J. LEGAL STUD. 13, 22 (1972) [hereinafter Demsetz, *Rule of Liability*]; see also D. LESLIE, *supra* note 4, at 370-72 (distribution of wealth is not affected by initial assignment of entitlements because parties will bargain until entitlements are in hands of those who value them most).

silence. This reestablishes the original allocation of entitlements and leaves the distribution of wealth undisturbed.

A non-unionized, competitive labor market most clearly shows law's inability to affect the distribution of wealth.⁶⁸ First, suppose a competitive labor market operates under a *Milwaukee I*-like rule.⁶⁹ If the individual worker's contract says nothing about job security, the firm cannot replace the worker during the contract term with someone willing to work for less.⁷⁰ If workers value job security more than employers value the freedom to change workers, the parties will not alter the presumption of job security. Suppose the equilibrium wage is \$6.⁷¹ Firms earn normal profits with wages at this level and there is no net increase or decrease in the number of firms or workers.

Now suppose the legal entitlement shifts to a *Milwaukee II*-like rule, so that firms may replace employees with cheaper workers if they so desire. Workers must bargain to obtain the same job protection as before. Initially, workers may have to work for a lower wage to induce firms to waive their right to terminate. Employees are now worse off and firms are better off. But with the same job protection and lower wages, firms would make excess profits. These profits induce new firms to enter the market. Competition for workers generated by entering firms eventually raises the wage to its previous level of \$6. When equilibrium is restored, the position of workers is the same as it was originally (with job security and a \$6 wage) and firms are once again earning normal profits. The change in legal rule did not alter the long-term distribution of wealth in the competitive market.

⁶⁸ Professor Leslie has shown an analogous example that, given a competitive plumber market, a law requiring households to give plumbers a free cup of coffee does not change the net cost to households of plumbers' services. The money wage households are willing to pay plumbers decreases by an amount just equal to the cost of providing coffee. D. LESLIE, *supra* note 4, at 370.

⁶⁹ In a competitive labor market, a single union does not bargain with a single employer. Rather, numerous employers and employees buy and sell labor. Each worker has an individual contract specifying the wage and the contract duration, and possibly restricting the conditions under which an employer may discharge the employee during the contract term in order to hire another worker at a lower wage. I earlier assumed that an individual contract in a non-union labor market could not provide job security, because *Milwaukee I & II* applies only to collective bargaining contracts. Thus, this section refers to a *Milwaukee I*-like rule, rather than a *Milwaukee I* rule.

⁷⁰ In this example, replacing the original worker with someone willing to work for less is analogous to relocating production in *Milwaukee I & II*.

⁷¹ I assume that each worker values a stay clause more than any firm values a go clause. A more complex market might have two sorts of firms distinguished by the kind of employment contract they offer. Firms that value a go clause highly would offer employment without job security and attract workers who care little about a stay clause. Firms that attach little value to a go clause would employ workers who value a stay clause.

In a unionized setting, the question remains whether initial entitlements affect the distribution of wealth. For example, suppose under *Milwaukee I* a strong union threatened a crushing strike and thereby obtained a high wage, capturing most of the company's extra-normal profits. After *Milwaukee II* the same strong union will threaten the same crushing strike and obtain a high wage plus an express clause counteracting the *Milwaukee II* rule. Under this view, then, the initial legal entitlement affects neither efficiency nor distribution.⁷²

On the other hand, the legal rule will have a long-term effect on wealth distribution of the parties if it affects their relative bargaining strength.⁷³ This view has some merit in labor negotiations because, unlike the participants in competitive markets,⁷⁴ the company and the union cannot easily turn elsewhere if negotiations break down.⁷⁵ Even a strong union cannot go elsewhere if a company refuses to

⁷² This situation differs from one where the legal rule fixes one aspect of the bargain and does not allow the entitlement holder to waive the entitlement. In that case, the legal rule may create inefficiencies that may leave both sides worse off. The classic example is a housing code that mandates a specific level of habitability. This law prevents landlords from offering low rent/low quality housing, which arguably hurts tenants as well as landlords. Compare Ackerman, *Regulating Slum Housing Markets on Behalf of the Poor: Of Housing Codes, Housing Subsidies and Income Redistribution Policy*, 80 YALE L.J. 1093 (1971) with Komesar, *Return to Slumville: A Critique of the Ackerman Analysis of Housing Code Enforcement and the Poor*, 82 YALE L.J. 1175 (1973). See also Heskin, *The Warranty of Habitability Debate: A California Case Study*, 66 CALIF. L. REV. 37 (1978); Markovits, *The Distributive Impact, Allocative Efficiency, and Overall Desirability of Ideal Housing Codes: Some Theoretical Clarifications*, 89 HARV. L. REV. 1815 (1976).

⁷³ For a general discussion of the factors influencing relative bargaining power in the collective bargaining process, see Leap & Grigsby, *A Conceptualization of Collective Bargaining Power*, 39 INDUS. & LAB. REL. REV. 202 (1986).

⁷⁴ The parties may be bargaining under competitive constraints. For example, a firm in a competitive product market will be disadvantaged if its labor costs exceed those of its competitors. As long as labor costs are within this cap, the firm and its unionized work force are free to negotiate the components of labor costs (e.g., whether the firm will promise high wages or job security). See Weiler, *Striking a New Balance: Freedom of Contract and the Prospects for Union Representation*, 98 HARV. L. REV. 351, 375 (1984) ("Within the limits of what is judged to be an appropriate and affordable increase in global compensation, the negotiators of a labor contract must grapple with a broad range of concerns of both workers and management, and must fashion a web of rules that will govern relations in the workplace for the next two or three years.").

⁷⁵ See M. STONE, *MANAGERIAL FREEDOM AND JOB SECURITY* 4 (1964) (Unlike other contracts, "labor and management can never escape one another; both are under obligations imposed by law, by self-interest, and by the very nature of their relationship to bargain until they do reach agreement."); Cox, *The Legal Nature of Collective Bargaining Agreements*, 57 MICH. L. REV. 1, 3 (1958) ("In fact neither the employer nor the employees collectively have the freedom to disagree which characterizes typical contracts between business firms and individuals. Sooner or later the employer and employees must strike some kind of a bargain."); Summers, *supra* note 22, at 530 ("Selection of a majority union establishes a bargaining relationship which is compulsory for both the employer and all individual employees."); Weiler, *supra* note 74, at 366 (labor law assumes that employer and union must eventually reach some contract). Nonetheless, almost one quarter of first-contract negotiations fail to reach agreement. See Cooke, *The Failure*

waive its entitlement without some compensation. Because the union has few, if any, employment alternatives, it may sign a contract that implicitly allocates the entitlement to the company, or it may reduce its demands on other contract terms in exchange for the entitlement. This implies that a party bargains from a stronger position when it holds the entitlement.⁷⁶

Ultimately, whether the assignment of entitlements affects the long-run relative welfare of unions and firms is not the primary focus of the Coase Theorem. The Theorem is primarily a prediction that unions and firms will negotiate an efficient bargain regardless of the assignment of entitlements. The Theorem does not predict whether initial entitlements alter the distribution of the surplus from bargains. Until empirical studies reveal more about actual bargaining results, one should remain somewhat agnostic about the long-run distributive effects of initial entitlements.⁷⁷

to *Negotiate First Contracts: Determinants and Policy Implications*, 38 *INDUS. & LAB. REL. REV.* 163, 164 (1985).

⁷⁶ Professor Leslie, while accepting the argument that legal entitlements will not affect distribution in competitive markets, suggests that legal entitlements will sometimes affect distribution in "the special case of union/management collective bargaining." D. LESLIE, *supra* note 4, at 371. Suppose, suggests Leslie, the union's valuation of the entitlement exceeds its minimum settlement point had the Board not awarded it this entitlement. If managers cannot injure the union and thereby force the union to give back the asset, the Board's decision will redistribute wealth from managers to the union.

⁷⁷ Indeed, the efficiency prediction of the Coase Theorem should likewise not be accepted as dogma, but rather as a hypothesis capable of empirical testing. Some experimental evidence supports the Coase Theorem. See Harrison & McKee, *Experimental Evaluation of The Coase Theorem*, 28 *J.L. & ECON.* 653 (1985) (efficient outcomes reached in over 97% of experimental trials designed to test various aspects of Coase Theorem); Hoffman & Spitzer, *The Coase Theorem: Some Experimental Tests*, 25 *J.L. & ECON.* 73 (1982) [hereinafter Hoffman & Spitzer, *Experimental Tests*] (subjects in two- and three-person bargaining games reached efficient outcomes in nearly 90% of trials even though one person held entitlement enabling that person to control outcome of experiment); Hoffman & Spitzer, *Entitlements, Rights and Fairness: An Experimental Examination of Subjects' Concepts of Distributive Justice*, 14 *J. LEGAL STUD.* 259 (1985) (subjects in experiment where cooperation was possible consistently chose efficient outcomes even though one party was entitled unilaterally to choose suboptimal outcome that guaranteed that party larger reward); Hoffman & Spitzer, *Experimental Tests of the Coase Theorem with Large Bargaining Groups*, 15 *J. LEGAL STUD.* 149 (1986) (experimental bargaining with large number of parties and imperfect information resulted in efficient outcome in over 90% of trials regardless of which party held entitlement). A more skeptical view is taken by Ellickson, *Of Coase and Cattle: Dispute Resolution Among Neighbors in Shasta County*, 38 *STAN. L. REV.* 623 (1986).

Some econometric studies by labor economists examine whether collective bargaining agreements are in fact efficient. See Ashenfelter & Brown, *Testing the Efficiency of Employment Contracts*, 94 *J. POL. ECON.* S40 (Supp. 1986) (unable conclusively to reject hypothesis that collective bargaining agreements are efficient; although, based upon preliminary evidence, agreements appear inefficient); MaCurdy & Pencavel, *Testing Between Competing Models of Wage and Employment Determination in Unionized Markets*, 94 *J. POL. ECON.* S3 (Supp. 1986) (hypothesis that contract negotiations between union and management lead to efficient outcomes cannot be rejected on basis of econometric evidence); Pencavel, *The Tradeoff Between Wages and Employment in Trade Union Objectives*, 99

III CRITICISMS OF THE COASE MODEL

Industrial peace justifications for labor law are irrelevant only if the Coase Theorem is correct in predicting that the parties will reach an efficient contract regardless of the Board rule. If the Coase Theorem is false or incomplete, decisions such as *Milwaukee I* and *II* can affect efficiency. This section outlines the major criticisms of the Coase Theorem and assesses their force in the context of labor negotiations.

I stress at the outset that my point is not that the Coase Theorem applies in all circumstances, but only that it may be more valid in labor negotiations than in many other contexts. Two characteristics of collective bargaining distinguish it from many other bargaining situations to which Coasean analysis has been applied. First, the extensive government regulation of labor negotiations—capsulized in the duty to bargain in “good faith”—may minimize the transaction costs of bargaining. Second, the parties in collective bargaining have little alternative to bargaining with one another. Once the Board has certified a union as the bargaining representative, a company cannot simply leave if negotiations become difficult. Although individual employees can quit work, they cannot negotiate with the employer, either individually⁷⁸ or in small groups.⁷⁹

A. Transaction Costs

The most fundamental criticism of the Coase Theorem is that the assumption of zero transaction costs is inaccurate in most settings. As Coase himself emphasized,⁸⁰ initial entitlements can affect final results if bargaining is costly. When transaction costs exceed the gains from trade, bargainers will not trade resources to their most valued use.

Obviously the Coasean assumption of *zero* transaction costs is stylized, but the Coasean prediction will often remain accurate with a less extreme assumption. Specifically, transaction costs will not im-

Q.J. ECON. 215 (1984) (potentially most inefficient outcome is not reached in collective bargaining, but not all collective bargaining leads to efficient outcome); H. FARBER, THE ANALYSIS OF UNION BEHAVIOR 42 (National Bureau of Economic Research Working Paper No. 1502, 1984) (Upon review of existing studies, “there is little . . . that provides convincing evidence on the efficiency of labor contracts . . .”).

⁷⁸ See *J. I. Case Co. v. NLRB*, 321 U.S. 332 (1944).

⁷⁹ See *Emporium Capwell Co. v. Western Addition Community Org.*, 420 U.S. 50 (1975) (employees may not bargain separately with employer and thereby circumvent their elected union representatives even when minority employees are bargaining over discriminatory employment practice issues).

⁸⁰ See Coase, *supra* note 3, at 15 (“[T]he assumption . . . that there were no costs involved in carrying out market transactions . . . is, of course, a very unrealistic assumption.”).

pede efficient bargaining whenever the difference in values that the union and company place on an item exceeds the costs of bargaining over the item.⁸¹ For example, under the *Milwaukee I* and *II* scenarios discussed earlier, the company valued a go clause at \$1 an hour while the union valued the stay clause at \$2 an hour, an aggregate difference of \$600,000 over the life of the contract. As long as the costs of bargaining over a stay/go clause are less than \$600,000, an efficient bargain will result, and the contract will have a stay clause.⁸²

Bargaining costs are likely to be lower in labor negotiations than in many other settings. The largest impediment to reaching an efficient agreement, according to many scholars, is coordinating the desires of multiple parties.⁸³ The common example used for this proposition is that of homeowners bargaining with a factory over air or water pollution.⁸⁴ In a typical labor negotiation, only two parties bargain.⁸⁵ Thus, the most substantial transaction cost is absent

⁸¹ See Woj, *Property Rights Disputes: Current Fallacies and a New Approach*, 14 J. LEGAL STUD. 411, 412 (1985) ("Where a legal right is vested in the party who values it the least, a value-maximizing exchange will occur only if the difference in the valuation of the right between the two parties is greater than the level of transaction costs . . .").

Although transaction costs do not always impede efficient bargains, the initial legal entitlement allocation does affect efficiency when transaction costs exist. If the law assigns the initial entitlement to the party that values it most highly, the costs of bargaining to transfer the right are not incurred, a more efficient result. Nevertheless, the Coasean prediction that the entitlement will go to its most highly valued use remains true as long as transaction costs are less than the difference in the parties' valuations.

⁸² The existence of transaction costs may affect the division of the surplus created by the bargain. Recall that the Coase Theorem does not predict how the parties will divide the surplus. Under *Milwaukee II*, where the union must buy a stay clause from the company, the union may bear the burden of the transaction costs in the form of a lower wage.

⁸³ See Calabresi, *Transaction Costs, Resource Allocation, and Liability Rules—A Comment*, 11 J.L. & ECON. 67, 68 n.5 (1968) ("By transaction costs, I have in mind costs like those of getting large numbers of people together to bargain, and costs of excluding free loaders."); Coase, *supra* note 3, at 18 ("[T]here is no reason why, on occasion, . . . governmental administrative regulation should not lead to an improvement in economic efficiency . . . particularly . . . when . . . a large number of people are involved and in which therefore the costs of handling the problem through the market or the firm may be high."); Daly, *The Coase Theorem: Assumptions, Applications and Ambiguities*, 12 ECON. INQUIRY 203, 205 (1974) ("A general consensus seems to exist that market internalization is least likely when the number of parties involved in the externality relationship is large.").

⁸⁴ See, e.g., A.M. POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 12-14 (1983).

⁸⁵ The union speaks with a single voice when negotiating with management. The union negotiator, however, must quell and merge diverse interests among the rank and file, and often must submit the tentative contract to the rank and file for ratification. See generally Burke & Rubin, *Is Contract Rejection a Major Collective Bargaining Problem?*, 26 INDUS. & LAB. REL. REV. 820, 833 (1973). Multiemployer bargaining complicates the bargaining process. See Leslie, *supra* note 4, at 415 ("Because multiemployer bargaining requires the consent of both union and managers, it is something of a puzzle that it is so common.").

when a union and a company bargain.

Other features of labor negotiations reinforce the proposition that transaction costs are low in collective bargaining. First, the specific term at issue (in *Milwaukee I & II*, the stay/go clause) is but one item of many on the bargaining table. Once the parties are assembled, the marginal cost of discussing an additional item is small.⁸⁶ Second, in many cases the parties have established a stable, long-term relationship. Accumulated good will discourages the parties from bargaining too aggressively over one item in one contract. The parties may value long-term cooperation more highly than any individual contract term. Third, the representatives of the union and the company are typically experienced, skilled negotiators, able to recognize and react swiftly to cues that agreement or compromise is possible.

B. Strategic Behavior

I have argued that the one-on-one bargaining of labor negotiations lowers transaction costs. This bilateral monopoly⁸⁷ can, however, create incentives for strategic behavior that may produce an inefficient contract.⁸⁸ In a competitive market, an equilibrium price is set by the bargaining of many individual parties.⁸⁹ In a bilateral

⁸⁶ See Cross, *Negotiation as a Learning Process* ("Multidimensional negotiations may actually come to settlement earlier than undimensional ones," because "the flow of information between the negotiators is greatly increased."), in *THE NEGOTIATION PROCESS* 29, 52 (I. Zartman ed. 1978).

⁸⁷ Bilateral monopoly occurs when there is one seller and one buyer, and neither is able to go elsewhere if negotiations break down. See, e.g., W. BAUMOL, *ECONOMIC THEORY AND OPERATIONS ANALYSIS* 207 (1961) (bilateral monopoly defined as "single purchaser without competitors buying from a monopolist seller"); J. HENDERSON & R. QUANDT, *MICROECONOMIC THEORY: A MATHEMATICAL APPROACH* 223 (3d ed. 1980) ("It is not possible for the [single] seller to behave as a monopolist and the [single] buyer to behave as a monopsonist at the same time."). Collective bargaining is often a prime example of bilateral monopoly. See Leslie, *supra* note 4, at 364 ("Unionization of a firm having monopsony power in the labor market creates a bilateral monopoly."). A union certified by the NLRB has one year from the date of certification before a rival union can attempt to organize the workers or the members can attempt to decertify the union. The workers are thus locked into their representatives for that year. In addition, workers often have difficulty changing jobs. Once they have acquired firm-specific skills, alternative jobs seem less attractive. Similarly, firms may not have attractive alternatives to negotiating with the certified union. Among other things, fixed capital investments may impede mobility. Of course, an article whose major example involves bargaining over a firm's right to move should not overemphasize the firm's immobility.

⁸⁸ Some writers treat strategic behavior as an element of transaction costs. However, the term "transaction costs" is not well standardized in the literature. Cooter, *supra* note 53, at 16. I separate the concepts for clarity. Strategic behavior can occur even when the costs of communicating, transferring the right, and enforcing the bargain are negligible. For discussions of the possible elements of transaction costs, see *id.* and Calabresi, *supra* note 83.

⁸⁹ See *supra* notes 69-71 and accompanying text.

monopoly, no clear price exists, enabling a party through threats or lies to capture for itself most of the gains from trade. To gain a larger share, one party may threaten destructive behavior.⁹⁰ As long as the other side recognizes the threat, however, the parties can negotiate based on the fear of destructive behavior without anyone having to carry out the threat.⁹¹ Thus, bluffs and threats by themselves do not cause inefficiency. Only when strategic behavior actually prevents trade will it prevent efficient contracts.

Inefficiency does occur, however, when one side cannot back down after its bluff is called, and the parties fail to transfer the item to its most valued use.⁹² Indeed, commentators often cite labor strikes as an example of strategic behavior leading to inefficient bargaining.⁹³ For example, suppose *Milwaukee II* controls (that is, silent agreements are presumed to include a go clause) but the union values a stay clause more than the company values the right to go. The Coase Theorem predicts that the company will trade the *Milwaukee II* right to the union. Suppose the company takes a tough bargaining stance, however, insisting on the rock-bottom wage of \$4.01 in exchange for its right to a go clause. The union may call the company's bluff by striking.⁹⁴ A strike is usually inefficient because em-

⁹⁰ See Mumez, *The "Coase Theorem": A Reexamination*, 85 Q.J. ECON. 718, 720 (1971) (Although the initial assumption of no transaction costs implies that threats can be communicated without costs, "the economic incentive for inventing a threatening production needs to be recognized. . . . It is difficult to believe that, given this possibility for gain, real resources would not be used for development of credible plans for threatening processes. Hence, there is a strong case for believing that resource use would be distorted in a Coase-unregulated environment, even if bargains for abstention themselves were consummated costlessly.").

⁹¹ Professor Jaffe makes this point in response to Professor Mumez's argument that real resources will go into producing threats. "Thus, in an economy without legal liability, we would expect the individuals to pay and receive bribes based on the *potential* to invent tools that make threats credible. No resources would actually be employed to the invention of these implements. All actual production would be devoted to socially valuable activities." Jaffe, *The "Coase Theorem": A Reexamination—Comment*, 89 Q.J. ECON. 660, 661 (1975).

⁹² See Cooter, *supra* note 53, at 20 (when sincere threat is taken as bluff, inefficient outcome occurs); Regan, *supra* note 47, at 429 ("[W]henever a threat is carried out, the outcome . . . will be sub-optimal . . .").

⁹³ Consider the poetic paragraph of Nobel laureate J.R. Hicks in his classic work on labor:

Weapons grow rusty if unused. . . . The most able Trade Union leadership will embark on strikes occasionally, not so much to secure greater gains upon that occasion (which are not very likely to result) but in order to keep their weapon burnished for future use, and to keep employers thoroughly conscious of the Union's power.

J.R. HICKS, *THE THEORY OF WAGES* 146 (2d ed. 1963).

⁹⁴ The union can lawfully strike in support of its position only if the clause in dispute is a mandatory subject of bargaining. R. GORMAN, *supra* note 14, at 496-98. The Board has declared that the decision to relocate because of labor costs is a mandatory subject of bargaining. *Otis Elevator Co.*, 269 N.L.R.B. 891 (1984). If the union's pro-

ployees on the picket line would prefer to be working for a wage/stay clause package that the company is willing to pay. For a time, at least, the parties are avoiding an efficient bargain by struggling to divide the spoils of a surplus-creating agreement.

Even when a strike occurs, the Coase prediction of efficient bargains may be accurate. If the parties resolve the strike by including the most valued clause in the contract, efficiency will result despite the strategic behavior. For example, in *Milwaukee I* and *II*, the Coasean prediction of efficiency occurs when the parties agree to a stay clause, whether or not the union "wins" the strike. Suppose, as in the initial *Milwaukee I* and *II* example, the union values the stay clause more than the firm values the go clause. If the firm bluffs that it will never accept a stay clause, the union may counteroffer with a rock-bottom wage. As a result, the strike is averted but the firm gains nearly the entire surplus from the trade. Alternatively, if the union strikes and prevails, the firm will agree to a stay clause and also pay high wages. In each scenario, the stay clause exists, fulfilling the Coasean prediction. Only if the initial bluff ("I will never agree to a stay clause") is called, and the parties cannot transform the issue into a tradeoff with other items ("I will agree to a stay clause only in return for a rock-bottom wage"), will strategic behavior prevent the parties from agreeing on the higher-valued stay clause.

Despite the obvious presence of strikes,⁹⁵ labor negotiations may have less problems with strategic behavior than do many other bargaining situations under bilateral monopoly. A major purpose of labor law is to prevent the breakdown of negotiations and encourage agreement. Unlike most other bargainers, labor negotiators are under a statutory duty to bargain in good faith. The parties cannot burn bridges or engage in other absolutist tactics, but must remain flexible.⁹⁶ One can question the effectiveness of the Board

posed clause will prevent the company from moving during the contract term for reasons other than labor costs, the clause may be only a permissible subject of bargaining and thus not subject to a strike.

⁹⁵ As argued above, some level of strike activity is necessary in our system of collective bargaining and thus is consistent with the goals of industrial peace and metaefficiency. See *supra* note 36 and accompanying text. Even if one regards all strikes as absolutely inefficient, their quantitative importance is minor. For example, in the United States in 1980, strikes caused the loss of only .14% of total working days. *Labor-Management Data*, MONTHLY LAB. REV., Apr. 1982, at 107 (table 37). For a discussion of the significance of strikes in the American economy, see Weiler, *supra* note 74, at 367-71.

⁹⁶ See, e.g., *NLRB v. General Elec. Co.*, 418 F.2d 736 (2d Cir. 1969) (finding company's strategy of Boulwareism, or painting itself into a corner on all bargainable matters, to violate duty to bargain in good faith), *cert. denied*, 397 U.S. 965 (1970); *NLRB v. Reed & Prince Mfg. Co.*, 205 F.2d 131, 134-35 (1st Cir. 1953) ("[T]he employer is

in mandating good faith negotiations,⁹⁷ but even the Board's incomplete supervision of the good faith requirement may make strategic behavior less problematic in labor negotiations than in other bilateral monopoly contexts.⁹⁸

In addition to the short-term inefficiency caused by threats, strategic considerations can create inefficiencies by inducing negotiators to lie,⁹⁹ even if lying shrinks the overall size of the pie.¹⁰⁰ To create the maximum surplus, parties must reveal their true preferences to ensure that every item goes to the party who values it the most. But if one party convincingly underrepresents the value it attaches to an item, it may capture a larger share of the surplus. Returning to the *Milwaukee II* example, suppose the union convinces the company that it would trade, at most, \$1.50 in wage reduction for a stay clause. In fact, the union is willing to accept a \$2 wage reduction to obtain a stay clause. Having been duped, the company is unlikely to demand \$1.75 for its go clause, even though the union would, if pressed, accept such a demand. In general, then, a trade-off exists between revealing true preferences to create maximum societal surplus, and lying in order to grab the largest possible portion

obliged to make *some* reasonable effort in *some* direction to compose his differences with the union, if § 8(a)(5) is to be read as imposing any substantial obligation at all.”).

Some empirical evidence supports the effectiveness of Board orders to bargain in good faith. One survey revealed that, after a Board finding of bad faith and a remedial order, unions and employers established a successful bargaining relationship in 75% of the cases. P. ROSS, *THE GOVERNMENT AS A SOURCE OF UNION POWER* 180-230 (1965); see also McCulloch, *The Development of Administrative Remedies*, 14 LAB. L.J. 339, 348 (1963).

⁹⁷ Many labor scholars question whether the good faith bargaining requirement has had any effect on a recalcitrant employer not wishing to settle with the union. See LABOR STUDY GROUP, *THE PUBLIC INTEREST IN NATIONAL LABOR POLICY* 82 (Committee for Economic Development 1961) (“Basically, it is unrealistic to expect that, by legislation, ‘good faith’ can be brought to the bargaining table.”). See generally Cox, *The Duty to Bargain in Good Faith*, 71 HARV. L. REV. 1401 (1958) (good faith requires that employers negotiate sincerely, it does not require reasonable concessions); Gross, Cullen & Hanslowe, *Good Faith in Labor Negotiations: Tests and Remedies*, 53 CORNELL L. REV. 1009 (1968) (imposition of good faith requirement of little value to aggrieved parties).

⁹⁸ Cooter postulates a dichotomy between the Coase Theorem and its polar opposite, the Hobbes Theorem. The Coase Theorem assumes that the parties will reach an efficient bargain unless transaction costs are high. The Hobbes Theorem assumes that parties' worst threats against each other will materialize unless a third party exists to coerce both of them. Accordingly, the Hobbes Theorem suggests that the role of law is to maximize the likelihood of efficient bargains by restricting the threats which the parties can make against each other. Cooter, *supra* note 53, at 18-19. If labor law fulfills the role envisioned by the Hobbes Theorem, the question becomes whether, given that the NLRB encourages bargains including those that contract around individual Board holdings, the Coase prediction is plausible.

⁹⁹ I distinguish a threat from a lie: a threat is a statement about the consequences if the other side does not give the threatening party what it honestly wants; a lie falsely states what the party wants.

¹⁰⁰ Professor Saraydar has introduced an interesting mathematical model demonstrating this effect. See Saraydar, *Bargaining Power, Dissimulation, and the Coase Theorem*, 139 ZEITSCHRIFT FÜR DIE GESAMTE STAATSWISSENSCHAFT 599 (1983).

of the surplus.¹⁰¹ If parties follow the latter strategy, they may contradict the Coasean prediction that parties always reach efficient bargains.

The critical question, though, is whether the choice of legal rule affects parties' incentive to lie. Professor Leslie suggests Board rules might have this effect.¹⁰² For example, under *Milwaukee I* the union has an initial entitlement to a stay clause. It may be able to understate its valuation of a stay clause and still retain it. Under *Milwaukee II* the union must purchase a stay clause and in the process may be forced to reveal its true valuation of job security. If job security is a factor throughout the contract, the union may be forced to forego a stay clause in order to preserve the strategic advantage of understating its preferences on job security. Under this "preference exposure theory,"¹⁰³ the Board rule may affect efficiency.

Two factors mitigate the problem of strategic lying in labor negotiations. First, labor law attempts to minimize strategic tactics by prohibiting lying during contract negotiations.¹⁰⁴ Second, tradeoff between maximum surplus and maximum share occurs only when the parties bargain over items that they can divide between them. In labor negotiations, many contract terms are either/or choices. For example, in *Milwaukee II*, if the union understates its preferences so that a go clause appears more valuable than a stay clause,¹⁰⁵ it has destroyed any incentive to bargain. No surplus is created, mooting the fight over dividing it.¹⁰⁶

¹⁰¹ For a more general discussion of the tension between maximizing mutual gain (the integrative bargaining problem) and maximizing one's share (the distributive bargaining problem), see R. WALTON & R. MCKERSIE, *supra* note 47, at 161-83.

¹⁰² D. LESLIE, *supra* note 4, at 373.

¹⁰³ *Id.*

¹⁰⁴ See *NLRB v. Truitt Mfg. Co.*, 351 U.S. 149, 152 (1956) ("Good-faith bargaining necessarily requires that claims made by either bargainer should be honest claims."). Labor law's prohibition on lying during contract negotiations can be overstated. The rule is useful in giving the union information to evaluate the credibility of management's claims about the impact of wages or other monetary items on profitability. However, the rule is less useful in helping the union evaluate the company's valuation of nonmonetary items. Thus the value the company places on the freedom to avoid union wages during the contract term if other opportunities arise cannot easily be verified. An important example is the statement "we will never agree to that," which never carries a disclosure duty, even if it is a lie.

¹⁰⁵ If *Milwaukee I* is the controlling law (i.e., the union has the initial entitlement), the union has an incentive to overstate its valuation of a stay clause while the company has an incentive to understate its valuation of a go clause.

¹⁰⁶ The union may initially understate the value it places on a stay clause in order to detect the minimum price the company is willing to demand for relinquishing its *Milwaukee II* right. Alternatively, the union may initially overstate the value of a stay clause in order to determine the maximum price the company will pay for the union's *Milwaukee I* right. But the union will not gain from lying if a go clause appears in the contract. Un-

C. The Invariance Thesis

The Coase Theorem, as I have described it, predicts not only that bargainers will reach an efficient result (the efficiency thesis), but also that bargainers will reach the same efficient result (the invariance thesis), regardless of the distribution of initial entitlements. At least six scholars have supported the invariance thesis¹⁰⁷ and as many have rejected it.¹⁰⁸ The critics argue that the efficient outcome depends on initial entitlements. They would say that, in our example, the parties may value the stay clause more highly under *Milwaukee I* even though the same parties may value the go clause more highly under *Milwaukee II*. Even if the efficient bargain occurs under both rules, the contract under *Milwaukee I* will have a stay clause and the contract under *Milwaukee II* will have a go clause.

The invariance thesis is not crucial to the main argument presented here.¹⁰⁹ If the efficiency thesis is accurate, and union and management will reach an efficient result regardless of initial entitlement, the Board cannot affect efficiency or promote industrial peace. Unless the invariance thesis is also true, however, the Board's rule will affect the percentage of contracts with stay clauses. If the Board cares about stay clauses for some nonefficiency reason, it would be justified in considering the effect of its decision on final

less the union is caught in its initial lie, it will not mislead the company into rejecting a stay clause.

The analysis differs if intermediate solutions are possible. Intermediate solutions in the *Milwaukee I* and *II* cases may include a contractual promise by the company to give severance pay or 90 days notice before transferring work. See W. WENDLING, *supra* note 58, at 106-18. In this scenario, the union may want to understate the value of a stay clause (e.g., "we only need 75 days notice rather than 90 days"), thereby producing a less than optimal stay clause but capturing more of the surplus.

¹⁰⁷ Demsetz, *supra* note 64; Demsetz, *Rule of Liability*, *supra* note 67; Frech, *Pricing of Pollutions: The Coase Theorem in the Long Run*, 4 BELL J. ECON. & MGMT. SCI. 316 (1973); Gifford & Stone, *Externalities, Liability and the Coase Theorem: A Mathematical Analysis*, 11 W. ECON. J. 260 (1973); Starrett & Zeckhauser, *Treating External Diseconomies—Markets or Taxes?*, in STATISTICAL AND MATHEMATICAL ASPECTS OF POLLUTION PROBLEMS 65 (J. Pratt ed. 1974).

¹⁰⁸ Bramhall & Mills, *A Note on the Asymmetry Between Fees and Bribes*, 2 WATER RESOURCES RES. 615 (1966); Cooter, *supra* note 53; Regan, *supra* note 47; Schulze & d'Arge, *The Coase Proposition, Information Constraints, and Long Run Equilibrium*, 64 AM. ECON. REV. 730 (1974); Tybout, *Pricing Pollution and Other Negative Externalities*, 3 BELL J. ECON. & MGMT. SCI. 252 (1972).

Guido Calabresi initially challenged the invariance thesis, but later supported it. Compare Calabresi, *The Decision for Accidents: An Approach to Nonfault Allocation of Costs*, 78 HARV. L. REV. 713, 730-31 (1965) with Calabresi, *supra* note 83, at 68.

¹⁰⁹ Economists are often not interested in the invariance claim, because the fundamental economic question is whether a certain market or legal rule will be efficient. The economist leaves to others the decision of which of several efficient outcomes to favor. The Board is one of the "others" who, in establishing a rule, must choose between efficient outcomes. If the alternatives are each efficient, the Board must use nonefficiency criteria for its choice.

outcomes. It is thus worth exploring whether the invariance thesis of the Coase Theorem is valid in labor negotiations.

The invariance thesis is subject to two basic attacks. The first, which is less valid here, emphasizes that in the long run resources may switch toward the activity that the legal rule favors. The second, which is more troubling in the context of labor relations, argues that legal rules can influence the way a union or management values various clauses in the contract.

1. *Long-Run Effects of Legal Rules*

The first criticism of the invariance thesis emphasizes that, in the long run, competitive markets cause resources to switch to activities earning extra-normal profits.¹¹⁰ Suppose that under a particular legal rule the market reaches a competitive equilibrium, meaning that the marginal firms are not earning profits.¹¹¹ In Coase's classic example of farmers and ranchers,¹¹² marginal farmers and ranchers are earning no profits. If the initial entitlement allows ranchers to graze their cattle on unfenced land, some farmers may pay ranchers not to graze cattle in their unfenced cornfields. When the legal rule changes and prevents grazing in cornfields, a rancher will no longer receive these payments but instead must pay the farmer for the corn damaged by his cattle. In the short run, changing the entitlement leaves land use unaffected. Ranchers will pay to graze on farmland only if the benefit from grazing exceeds the damage to the corn. Critics of the invariance thesis argue, however, that over time resources will shift from ranching to farming. Only ranchers previously earning rents sufficient to cover the necessary payments to farmers will remain as ranchers.¹¹³ Marginal ranchers, unable to make these payments, will leave the industry. In addition, after the entitlement switches to farmers, they will earn additional profits as they receive payments rather than make them. In the long run, the extra-normal profits will induce landowners to switch to farming to cash in on the favorable legal rule. Such a reallocation would invalidate the invariance prediction of the Coase Theorem that legal entitlements do not affect resource allocation.

In an insightful article, Professor Frech has explained that the

¹¹⁰ For a brief, general discussion, see Zerbe, *supra* note 3, at 88-89.

¹¹¹ Inframarginal firms may be earning rents on factors that other firms cannot replicate (e.g., excellent farm land).

¹¹² *E.g.*, Coase, *supra* note 3, at 2-8.

¹¹³ *But see* Nutter, *The Coase Theorem on Social Costs: A Footnote*, 11 J.L. & ECON. 503, 507 (1968) (justifying invariance claim by suggesting that ranchers would simply enjoy lesser rents, but would still prefer ranching to farming, after entitlement switches to favor farmers). As Professor Regan noted, however, assuming rents sufficient to cover payments creates a special case. Regan, *supra* note 47, at 433.

divergent views on the invariance thesis result from commentators' analyzing dissimilar things.¹¹⁴ The invariance thesis is valid when examining shifting property entitlements because such shifts will not induce entry, but not when examining shifting rules of liability, which will induce entry. The significant distinction is that property entitlements include the right to exclude others from sharing the entitlement. Therefore, new firms will not benefit from the shift. Under liability rules, anyone harmed by the conflicting use, including entrants, can collect damages. Therefore, new firms will enter the market when a liability entitlement shifts and existing firms are making extra-normal profits.¹¹⁵

Because legal rules concerning collective bargaining contract interpretation are more akin to property rights than liability rules, the invariance critics' argument does not apply to labor negotiations. The NLRA grants a specific union an exclusive right to bargain for the workers in a particular unit. Once a union is in place, rival unions cannot organize the unit in order to benefit from a switch in legal rule. For example, *Milwaukee I* grants a stay clause only to unions that have organized a unit and signed a contract with the company. After *Milwaukee I*, unions may attempt to organize non-union firms to benefit from *Milwaukee I*. But only if *Milwaukee I* enhances the power of unions—a proposition about which I earlier expressed doubt—will the legal rule affect the entry of unions. Without entry, this criticism of the Coase Theorem is inapplicable.

2. *Wealth Effects and Backward Steps*

The second criticism of the invariance thesis emphasizes that legal rules influence the parties' valuations of contract clauses. If so, the legal rule affects which clause is the most highly valued, or efficient, clause. When the legal rule changes, the efficient outcome changes. In support of this criticism, Professor Kelman argues that initial legal entitlements affect the values that bargainers place on goods¹¹⁶ because people treat "opportunity cost" income differ-

¹¹⁴ Frech, *The Extended Coase Theorem and Long Run Equilibrium: The Nonequivalence of Liability Rules and Property Rights*, 17 *ECON. INQUIRY* 254 (1979); see also Zerbe, *supra* note 3, at 87-90 (sense in which Coase Theorem is true depends on underlying assumptions about allocation of property rights).

¹¹⁵ In the rancher/farmer example, a rule preventing grazing in cornfields is a liability rule if the court will award damages to any farmer, including a new entrant. The rule is a property right if the court will award damages only to farmers in existence when the rule was enacted or to persons who bought the right to collect damages from one of those farmers. See Frech, *supra* note 114, at 265-66. Frech draws his distinction of property and liability rules from Calabresi & Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 *HARV. L. REV.* 1089 (1972).

¹¹⁶ Kelman, *Consumption Theory, Production Theory, and Ideology in the Coase Theorem*, 52 *S. CAL. L. REV.* 669 (1979). Kelman's argument is a general one and does not specifically

ently from "received" or "realized" income. If Kelman's armchair psychology is correct, a union with an implicit stay clause under *Milwaukee I* will demand more from the company to waive its right than it will be willing to pay the company to obtain a stay clause under *Milwaukee II*.¹¹⁷ Thus, Board decisions may affect the parties' valuation of the stay or go clause and ultimately influence the percentage of stay or go clauses in contracts.

The standard response to this argument is that, to the extent Kelman is correct, he has identified wealth effects.¹¹⁸ *Milwaukee I* gives the union a valuable entitlement to keep or sell. Thus, workers are wealthier under *Milwaukee I* than *Milwaukee II*, and wealthier workers are able and willing to pay more for job security than are poorer workers.¹¹⁹ After reducing Kelman's argument to an observation about wealth effects, his critics note that wealth effects are often insignificant.¹²⁰

Even when wealth effects are significant, the invariance thesis may hold if the entitlement, as often occurs in labor law, is an either/or choice. For example, in the *Milwaukee I & II* situation, the contract either gives the company the right to go or requires it to

refer to labor negotiations. According to Kelman, parties demand more to release something they already have than they are willing to pay to purchase something new. Kelman's criticism goes well beyond the Coase Theorem, for he attacks the general economic assumption that people equate foregone opportunity costs with out-of-pocket costs.

¹¹⁷ *Id.* at 678-95; see also Note, *Subjects of Bargaining Under the NLRA and the Limits of Liberal Political Imagination*, 97 HARV. L. REV. 475, 489 n.70 (1983) (Different bargaining outcomes occur if "a union demanded more to be 'bought out' than it offered in 'concessions,' . . . over a particular decision. If the union is powerful enough to back up its bargaining demands through a strike or a threat of strike, this divergence of offer and asking prices seems likely."). Economists refer to this phenomenon as the difference between compensating and equivalent variations. See Zerbe, *supra* note 3, at 85.

¹¹⁸ See Spitzer & Hoffman, *A Reply to Consumption Theory, Production Theory, and Ideology in the Coase Theorem*, 53 S. CAL. L. REV. 1187, 1198-99 (1980). Spitzer and Hoffman add that asymmetrical information and risk aversion may also explain why people sometimes treat realized and opportunity-cost income differently.

¹¹⁹ In technical terms, if job security is a normal good, a worker will buy more of it as her income increases. At some point, as a consumer's wealth increases, most normal goods become inferior goods. In the *Milwaukee I & II* example, very wealthy workers may be less concerned with job security than others are and therefore demand less. The discussion in the text assumes that unionized workers are willing to pay more for job security as their income increases—i.e., that job security is a normal good in their income range.

¹²⁰ Many Coase Theorem analysts include an obligatory footnote waiving away the problem of wealth effects. See, e.g., Demsetz, *Rule of Liability*, *supra* note 67, at 15 n.3. A parable in the law and economics literature frequently used to demonstrate the significance of wealth effects is that of two people in the desert with one barrel of water. Who will drink most of the water depends on who has the initial right to the water. Mishan, *Pareto Optimality and the Law*, 19 OXFORD ECON. PAPERS (n.s.) 255 (1967). For less important entitlements, presumably the wealth effects are smaller.

stay; the company cannot go a little way.¹²¹ In an either/or situation, wealth effects must substantially change the parties' valuations before a switch in legal rule alters the most valued or efficient outcome. Suppose that under *Milwaukee I* the union values the stay clause more highly than the company values a go clause. Under *Milwaukee II*, if Kelman is correct, the union will value the stay clause (that it now does not have) less than it did before. Nevertheless, the union may still value the stay clause more than the company values a go clause. If so, the legal rule does not alter the efficient outcome even though the rule affects the parties' valuations. When the difference in the parties' valuations is large, changes from wealth effects are unlikely to affect bargaining outcomes.

Beyond wealth effects, Kelman's argument is troubling in another way. His assertion that a union demands more to relinquish a right than it will pay to obtain a right sounds similar to the rallying cry of many unions, "No Backward Steps."¹²² Under this strategy, once the union receives an entitlement, it will not relinquish it even in return for higher wages. Thus, if *Milwaukee I* controls, the union will never agree to sell its stay clause. Under *Milwaukee II*, according to this logic, the union may refuse to buy a stay clause by agreeing to lower wages. If the union follows a "no backward steps" policy, a change in the legal rule might affect the outcome of contract negotiations. The invariance thesis of the Coase Theorem would then be wrong.

Whatever its strength in the abstract, the practical force of the "no backward steps" argument is limited. First, this strategy may be a bargaining tactic rather than an ultimatum. The union's supposed intransigence may simply represent a gambit intended to obtain a higher price for waiving its legal right. Second, the union may not consider agreeing to a pro-management relocation clause under *Milwaukee I* a backward step. The only thing traded away is an implicit, unwritten right to a stay clause. Prior contracts may have consistently given the firm these rights. Prior contracts, rather than initial legal entitlements, may be the benchmark for determining whether union negotiators have made backward steps. Third, the union can emphasize the gains in higher wages or other benefits in return for not insisting on its legal entitlement.¹²³ The more these

¹²¹ Intermediate solutions might exist. See *supra* note 106.

¹²² See S. ALINSKY, JOHN L. LEWIS: AN UNAUTHORIZED BIOGRAPHY 368 (1949) (John L. Lewis often used "no backward steps" phrase during 1920s).

¹²³ Cf. Miner, *Concession Bargaining*, 59 CHI.-[]KENT L. REV. 981, 982 (1983) ("Although much attention has been focused upon wage and benefit concessions made by the unions, frequently such concessions were trade offs in order for the union to make substantial inroads into areas heretofore considered sacrosanct by management."). Professor Leslie suggests that a union may be unable to point to a specific quid

factors reduce the vitality of the “no backward steps” strategy, the less likely the strategy is to change the union’s valuation when legal rules change. If the union does not reevaluate terms after legal rules change, the invariance thesis holds.

D. Imperfect Information Problems

Many formulations of the Coase Theorem require that bargainers have perfect information,¹²⁴ including knowledge of available alternatives, prices, and, most critically, of each other’s preferences.¹²⁵ Many critics of the Coase Theorem think it unrealistic to assume that bargainers have the perfect information required by the Theorem. Certainly in the *Milwaukee I & II* situation an assumption of perfect information is unrealistic. The stay/go clause is essentially an insurance clause. The company wants to ensure that a currently affordable wage bargain will not prove restrictive in the future. Similarly, the union wants a stay clause to insure against an uncertain future. Because insurance clauses are predicated on future uncertainty, bargaining with perfect information is impossible.

Perfect information, however, is an unnecessary assumption that makes the Coase prediction uninteresting.¹²⁶ If each side knew how much the other valued each item, bargaining would be infinitely simpler. Searching and signalling about synergies would evaporate. Parties would know almost automatically what clauses to put in the contract. Parties would only bargain over dividing the surplus from trade, and bluffing and lying would be impossible. The central Coasean prediction that parties search for and achieve an efficient bargain (i.e., the bargain that awards each item to the person who values it most highly) would become tediously pro forma. As long as the parties have sufficient information about alternatives to make informed choices, the Coase Theorem predicts that the parties will find the highest valued use for each item.

pro quo received in return for relinquishing a statutory entitlement. Under his “batch” theory, a contract proposal containing many terms is presented to one party, and that party returns a counterproposal suggesting many changes. In fact, there may be no one item that is traded for another. Therefore, the union negotiators may hesitate to relinquish entitlements because of the difficulty in identifying precisely what they received in exchange. D. LESLIE, *supra* note 4, at 372.

¹²⁴ E.g., Zerbe, *The Problem of Social Cost: Fifteen Years Later*, in *THEORY AND MEASUREMENT OF ECONOMIC EXTERNALITIES* 29 (S. Lin ed. 1976).

¹²⁵ See, e.g., Hoffman & Spitzer, *Experimental Tests*, *supra* note 77 (perfect knowledge of each party’s production and profit or utility functions is necessary assumption of Coase Theorem).

¹²⁶ See Coleman, *Efficiency, Exchange, and Auction: Philosophic Aspects of the Economic Approach to Law*, 68 CALIF. L. REV. 221, 223 n.6 (1980) (The assumption of perfect knowledge “trivializes the theorem and is stronger than necessary. One need assume only that the relevant parties have substantial relevant information. Additional pertinent information is revealed once actual negotiations are underway.”).

In general, the labor laws are designed to alleviate the problem of inadequate information. When a firm justifies its bargaining position during negotiations by claiming an inability to pay, it may be required to substantiate its claim through financial disclosures.¹²⁷ This rule stems from labor law's explicit requirement of good faith bargaining. Whether a union negotiating nonmonetary items, such as a work transfer clause, can demand information on costs and profits is less clear.¹²⁸

Nevertheless, lack of information may impede efficient labor negotiations. One complication from imperfect information arises when one side's valuation depends on the other side's behavior. In the *Milwaukee I & II* context, for example, the union may be less able than the company to assess the likelihood that the company will find more attractive opportunities elsewhere during the three-year contract. This informational asymmetry may prevent the parties from agreeing on the most efficient clause. Suppose, for a given likelihood that outside opportunities will arise during the three-year contract,¹²⁹ a union values job protection more than the company values flexibility. In such a case, the efficient contract would contain a stay clause. Because the union cannot independently assess the likelihood of leaving, however, it must evaluate the stay clause based on the company's behavior. The union knows that a company will accede to a minimal wage reduction for a stay clause only when the company is unlikely to leave. In such a situation, the union may discount the value of such a stay clause and reject it. Such an outcome undermines the Coasean prediction that parties will always make efficient contracts.¹³⁰

¹²⁷ See *NLRB v. Truitt Mfg. Co.*, 351 U.S. 149 (1956). *But cf.* *Washington Materials, Inc. v. NLRB*, 803 F.2d 1333 (4th Cir. 1986) (company claiming union proposals would hurt its competitive position not claiming inability to pay and therefore not required to disclose financial records).

¹²⁸ Compare *Bohemia, Inc.*, 272 N.L.R.B. 1128 (1984) (employer under no duty to divulge information about non-union plant when union had shown no objective basis, beyond its good faith suspicion, that employer was transferring work there) with *Walter N. Yoder & Sons v. NLRB*, 754 F.2d 531 (4th Cir. 1985) (union entitled to company information after establishing sufficient evidence to support reasonable belief that company was operating non-union shop that was mere alter ego of parent company). See generally *Bartosic & Hartley, The Employer's Duty to Supply Information to the Union—A Study of the Interplay of Administrative and Judicial Rationalization*, 58 CORNELL L. REV. 23 (1972) (examines emerging employer obligation to provide information to employee's bargaining representative).

¹²⁹ The company can accurately estimate this likelihood, but the union has difficulty doing so. This creates the informational asymmetry.

¹³⁰ Economists call this a "lemons" problem, first described by Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488 (1970). See W. Samuelson, *Bargaining Under Asymmetric Information*, 52 ECONOMETRICA 995 (1984), for an analysis of how inefficient bargains may result from one side having information that cannot be verified by the other side. Samuelson concludes, "The presence of asymmet-

This asymmetrical information problem can be overstated, however. The critical question is whether the placement of the legal entitlement exacerbates the problem. In the *Milwaukee I & II* situation, the value each party places on a stay/go clause depends on its assessment of the economic health of the industry. The union's assessment may depend on signals it receives from management. But whether the parties negotiate under the shadow of *Milwaukee I* or *II* should not affect their valuations. If not, the invariance thesis that the legal rule does not affect whether a contract will contain a stay or go clause remains accurate, even though the parties have different amounts of information.

IV

AN EASIER EXAMPLE—*NLRB v. J. WEINGARTEN, INC.*

The *Milwaukee I & II* example presses the limits of Coasean analysis. Specifically, the wealth effects and imperfect information problems pose difficulties. This section applies the Coase Theorem to another important, controversial labor law decision. Here, however, the Coasean prediction holds more clearly.

In *NLRB v. J. Weingarten, Inc.*¹³¹ an employee was accused of theft. She asked that a union representative be present when the store manager interrogated her. After the manager refused her request, the union filed a section 8(a)(1) charge. The Board found an

ric information may preclude the attainment of mutually beneficial agreements, even though profitable exchanges are known to be available ex post." *Id.* at 1004; *see also* Riordan, *Uncertainty, Asymmetric Information and Bilateral Contracts*, 51 *REV. ECON. STUD.* 83 (1984) (considers bilateral monopoly with uncertain and asymmetrical information and concludes that contracts can be implemented by truthful sequential revelation mechanism).

¹³¹ 420 U.S. 251 (1975). The legal development of the *Weingarten* doctrine has been troubled and controversial. The Board has rescinded its extension of *Weingarten* to the non-union setting. *See* *Sears, Roebuck & Co.*, 274 N.L.R.B. 230 (1985), *rev'g* *Materials Research Corp.*, 262 N.L.R.B. 1010 (1982). Circuit courts have been equally troubled. *See, e.g.*, *E.I. Du Pont de Nemours & Co. v. NLRB*, 724 F.2d 1061, 1065 (3d Cir. 1983) ("[T]he logic and reasoning of *Weingarten* carry equal force in the non-union context."), *vacated upon NLRB motion*, 733 F.2d 296 (3d Cir. 1984); *ITT Lighting Fixtures Div. v. NLRB*, 719 F.2d 851 (6th Cir. 1983) (*Weingarten* applies to non-union employee's request for fellow worker, at least in workplace with history of union organizing or other group activity); *E.I. Du Pont de Nemours & Co. v. NLRB*, 707 F.2d 1076 (9th Cir. 1983) (request of single non-union employee not concerted activity, but may trigger *Weingarten* right if employee acts as part of group); *NLRB v. Columbia Univ.*, 541 F.2d 922, 931 (2d Cir. 1976) (refusing to enforce Board's unexplained extension of *Weingarten* to interview after completed investigation, but noting that NLRA's protection of concerted activities applies equally to unionized and non-unionized workers). Similar controversy has surrounded the proper remedy for a *Weingarten* violation. *See* *Taracorp Indus.*, 273 N.L.R.B. 221, 223 (1984) (Board will not order back pay and reinstatement for *Weingarten* violations), *overruling* *Kraft Foods, Inc.*, 251 N.L.R.B. 598 (1980). Whether the union could waive its *Weingarten* right has also troubled the Board. *See infra* note 136.

unfair labor practice,¹³² but the Fifth Circuit denied enforcement.¹³³ The Supreme Court considered whether the employee had engaged in protected concerted activity under section 7 of the NLRA by asking for a union representative at an investigatory interview that she reasonably believed might result in discipline. The Court held that the request was protected concerted activity and that the employer committed an unfair labor practice by denying it.¹³⁴ Justice Powell dissented, arguing that an employer, can choose any method to investigate and discipline an employee, unless it agrees in a collective bargaining contract to abide by restrictive procedures.¹³⁵

Weingarten can be viewed as establishing a rebuttable presumption that unionized employees are entitled to have their shop steward present at investigatory interviews that might lead to discipline. A contract clause waiving this entitlement rebuts the presumption.¹³⁶ So viewed, the case fits neatly into a Coasean analysis. The Coase Theorem predicts that the *Weingarten* holding does not affect whether unionized workers will have the right to a shop steward at investigatory interviews. If the union values this right more than the company values the freedom to conduct interviews without the steward, the contract will acquiesce (explicitly or through silence) with the *Weingarten* rule. If Justice Powell's result had obtained a majority, the contract would contain an express clause around that holding.¹³⁷

This Coasean prediction is subject to the same criticisms discussed in the *Milwaukee I & II* context. First, if transaction costs exceed the gains from trade, the *Weingarten* decision may affect whether workers have the right to a shop steward. Again, though, labor negotiations probably have lower transaction costs than do many other negotiations. Labor negotiations lack the free-rider and holdout problems prevalent in multiple party negotiations. Further, because the parties are also bargaining over other issues, the marginal costs of negotiating the *Weingarten* right are likely to be small.

¹³² 202 N.L.R.B. 446 (1973).

¹³³ 485 F.2d 1135 (5th Cir. 1973).

¹³⁴ 420 U.S. at 260.

¹³⁵ *Id.* at 273-75 (Powell, J., dissenting).

¹³⁶ Justice Powell noted that the majority in *Weingarten* did not indicate whether the union could waive its initial *Weingarten* right. *Id.* at 275 n.8. After initial hesitation, the Board has now held that a union may waive an employee's right to be represented at an interview the employee reasonably believes might result in discipline. *Compare* Prudential Ins. Co., 251 N.L.R.B. 1591, 1592 (1980), *enforcement denied*, 661 F.2d 398 (5th Cir. 1981) *with* Prudential Ins. Co., 119 L.R.R.M. (BNA) 1073 (1985).

¹³⁷ The Coasean analysis applies analogously when the company values the right more highly than the union does. In that situation, the contract would waive the *Weingarten* right. If Justice Powell's position were the rule, the parties would not write around the rule. For ease of exposition, I assume throughout that the union values the *Weingarten* right more highly than the company values a reverse-*Weingarten* right.

Finally, the either/or nature of the right means that transaction costs will not prevent an efficient trade unless they exceed the difference in the parties' valuations of the right.

Second, the strategic bargaining problems—bluffs and lies—match those in *Milwaukee I & II*, and labor law's duty to bargain in good faith mitigates them in similar ways. Again, as in *Milwaukee I & II*, the either/or choice limits the inefficiencies from lying. The union may have strategic reasons to understate its valuation of the *Weingarten* right. But as long as the union signals that it values the right more highly than the company does, this undervaluation will not cause the union to waive the *Weingarten* right. Finally, unlike *Milwaukee I & II*'s high-stakes stay/go clause, the parties are less likely to risk a major strike or loss of good will over a relatively minor issue such as *Weingarten*.

Third, the argument that wealth effects invalidate the Coase Theorem has less force in the *Weingarten* situation. The right to transfer work may be so important that the wealth effects of *Milwaukee I* or *II* change bargaining outcomes. Certainly the threat of transfer distresses unions in many industries. In situations with less dramatic wealth effects, the invariance thesis is more likely to hold. For example, the *Weingarten* right to a union steward at disciplinary interviews, although important, is probably not so significant that union members would value the right differently if Justice Powell's dissent were the rule.

Finally, *Weingarten* involves relatively minor imperfect information problems. Unlike in *Milwaukee I & II*, where the union had difficulty evaluating the likelihood that the company would move, in the *Weingarten* situation the union can more easily evaluate the right to have a steward present at disciplinary interviews. The union can base such a valuation on its first-hand knowledge of the frequency and results of disciplinary interviews. Conversely, the one-shot nature of a work transfer exacerbates the difficulty of valuing the *Milwaukee I* or *II* right. If the Coasean analysis has validity in difficult cases like *Milwaukee I* and *II*, it is a fortiori of considerable utility in simpler cases like *Weingarten*.

In sum, the Coase Theorem can be applied with some confidence to *Weingarten*. The Supreme Court decision should not affect whether unionized workers have the right to a union representative at investigatory interviews. Rather, that right depends on whether the company or the union values it more highly. Because the *Weingarten* rule cannot affect efficiency, justifications for it based on industrial peace are misplaced.

V

PROPER ARGUMENTS IN THESE CASES

Despite these criticisms of the Coase Theorem as applied to collective bargaining, this article's central argument remains viable. In cases like *Milwaukee I* and *II*, or *Weingarten*, the power of the law to affect collective bargaining contracts is constricted by the parties' ability to bargain around Board rules. Therefore, decision makers should not justify their result by citing national policy arguments such as industrial peace. Instead, arguments justifying the distributional consequences of the decision are appropriate. As discussed earlier, legal rules in this area have short-run and perhaps long-run distributional consequences.

One legitimate argument would emphasize equalizing the bargaining strength of labor and management. This goal, like the broad goal of industrial peace, is articulated in section 1 of the NLRA.¹³⁸ Because this goal specifically requires that decision makers openly favor the weaker party, traditionally unions,¹³⁹ I distinguish it from a "national policy" like industrial peace.

The Supreme Court explicitly relied on the goal of equal bargaining strength in *Weingarten*.¹⁴⁰ The Court held that an employer violates the NLRA by denying an employee's request for a union representative at an investigatory interview that might result in discipline. Speaking for the Court, Justice Brennan reasoned that requiring a lone employee to attend an investigatory interview "perpetuates the inequality the Act was designed to eliminate, and bars recourse to the safeguards the Act provided 'to redress the perceived imbalance of economic power between labor and management.'" ¹⁴¹ Because this section 1 goal is not neutral, the Court often downplays it.¹⁴² Nevertheless, in the class of cases at issue

¹³⁸ "[R]estoring equality of bargaining power between employers and employees" is an express goal of the Act. 29 U.S.C. § 151 (1982).

¹³⁹ Congress wrote the "equality" goal in neutral terms, calling on the Board to "restor[e] equality of bargaining power between employer and employees." *Id.* Conceivably, the Board could explicitly favor management under this goal. In reality, however, employees are consistently recognized as the weaker party, and the Board following this goal will systematically favor employees.

¹⁴⁰ 460 U.S. at 262; *see also* *NLRB v. City Disposal Sys.*, 465 U.S. 822, 835 (1984) (relying on "a congressional intent to create an equality in bargaining power between the employee and the employer throughout the entire process of labor organizing, collective bargaining, and enforcement of collective-bargaining agreements").

¹⁴¹ 420 U.S. at 262 (quoting *American Ship Bldg. Co. v. NLRB*, 380 U.S. 300, 316 (1965)).

¹⁴² Indeed, the Supreme Court has often emphasized that the Board should not regulate economic weapons under the guise of promoting bargaining equality. *See, e.g.*, *NLRB v. Insurance Agents Int'l Union*, 361 U.S. 477, 490 (1960) ("Our labor policy . . . does [not] contain a charter for the National Labor Relations Board to act at large in equalizing disparities of bargaining power between employer and union."); *NLRB v.*

here,¹⁴³ a distributional rationale such as promoting equality is the only appropriate justification for the Board to give.

Decisions under the Act also have recognized a distributional goal that systematically favors management. The protection of "management rights" is never explicitly stated in the Act, but is universally acknowledged by the Board and courts.¹⁴⁴ Justice Powell, dissenting in *Weingarten*, relied on this management rights rationale. He emphasized that "[t]he power to discipline or discharge employees has been recognized uniformly as one of the elemental prerogatives of management."¹⁴⁵ Unless limited by statute or the collective bargaining agreement, argued Justice Powell, employers can discharge employees at will and use any process they choose in deciding whether to fire an employee. Under Coasean analysis, "inherent management rights" is a relevant rationale for setting initial presumptions. The rationale is not based on a societal efficiency goal over which the law has no power, and thus offers a justification that honestly recognizes the consequences of the decision.

Justice Powell also used the industrial peace goal to defend his position.¹⁴⁶ Because the union can waive its *Weingarten* right in negotiating the contract, the industrial peace argument is improper. All *Weingarten* establishes is the initial positions from which the parties are free to bargain: the Coase Theorem predicts that the

Brown, 380 U.S. 278, 283 (1965) ("We begin with the proposition that the Act does not constitute the Board as an 'arbiter of the sort of economic weapons the parties can use in seeking to gain acceptance of their bargaining demands.'" (quoting *Insurance Agents*, 361 U.S. at 497)); *American Ship Bldg. Co. v. NLRB*, 380 U.S. 300, 310 (1965) ("[T]he Act's provisions are not indefinitely elastic, content-free forms to be shaped in whatever manner the Board might think best conforms to the proper balance of bargaining power."); see also *supra* note 2 and accompanying text.

¹⁴³ See *supra* notes 5-6 and accompanying text.

¹⁴⁴ For example, the Supreme Court, in *NLRB v. Mackay Radio & Tel. Co.*, 304 U.S. 333, 345 (1938), thought that the management "right to protect and continue his business" during a strike, never explicitly mentioned in the Act, obviously allowed an employer to hire permanent replacements for the strikers. The Court has also recognized by implication the "employer's right to control the use of his property" in holding that the employer could bar nonemployee union organizers from its property. *NLRB v. Babcock & Wilcox Co.*, 351 U.S. 105, 110 (1956) (citing *LeTourneau Co.*, 54 N.L.R.B. 1253, 1260-61 (1944)). See generally J. PHELPS, *MANAGEMENT RIGHTS AND THE ARBITRATION PROCESS* (1956); G. TORRENCE, *MANAGEMENT'S RIGHT TO MANAGE* (rev. ed. 1968).

¹⁴⁵ 420 U.S. at 273 (Powell, J., dissenting).

¹⁴⁶ "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 the adjustments and agreements which the Act in itself does not attempt to compel." *NLRB v. Jones & Laughlin Steel Corp.*, 301 U.S. 1, 45 (1937). The National Labor Relations Act only creates the structure for the parties' exercise of their respective economic strengths; it leaves definition of the precise contours of the employment relationship to the collective-bargaining process.

Id.

Supreme Court decision will not affect whether employees may have a union representative present at an investigatory interview. Only

if the union values this right more than the company values the right to interview without a union representative will the contract give employees this right. Thus, the Supreme Court decision does not affect industrial peace either by allowing the parties to bargain freely (because *Weingarten* allows parties to negotiate over this matter) or by granting employees the right to a union representative at the interview (because *Weingarten* does not affect whether the contract will give employees this right).

Returning to the *Milwaukee I* and *II* decisions, this analysis requires that the Board use distributional rationales in deciding whether to presume a stay or go clause. Thus, the following decisions would be honest ones:

Chairman Van de Water (*Milwaukee I*): We are asked today to set an initial presumption in interpreting a collective bargaining agreement: Does the agreement allow the company to move during the contract term? We realize that the agreement contains no clause directly on point. Now we could dredge up boilerplate about industrial peace and vigorous commerce being furthered by our reading into the contract a no relocation clause. But our individual decision cannot affect industrial peace or vigorous commerce, because the parties can reverse our decision by writing an express clause into the contract. Our decision can only force one side to make concessions to get its preferred clause into the contract. Section 1 of the NLRA directs the Board to alleviate the "inequality of bargaining power between labor and management." In a work-transfer situation, labor is weak and vulnerable. Therefore, we hold that every contract has an implied no relocation clause unless the contract expressly indicates otherwise.

Chairman Dotson (*Milwaukee II*): We are asked today to set an initial presumption in interpreting a collective bargaining agreement: Does the agreement allow the company to move during the contract term? We realize that the agreement contains no clause directly on point. Now we could dredge up boilerplate about industrial peace and vigorous commerce being furthered by our reading into the contract a relocation clause. But our individual decision cannot affect industrial peace or vigorous commerce, because the parties can reverse our decision by writing an express clause into the contract. Our decision can only force one side to make concessions to get its preferred clause into the contract. The decision to transfer work is a traditional management prerogative. We should interpret all collective bargaining contracts as maintaining traditional management prerogatives unless specifically waived. Therefore, we hold that every contract has an im-

plied right-to-go clause unless the contract expressly indicates otherwise.

VI

CODA: NORMATIVE IMPLICATIONS OF THE COASE THEOREM

If the costless Coase Theorem applies to cases such as *Milwaukee I* and *II* and *Weingarten*, the Board cannot affect the efficiency of collective bargaining agreements. This article suggests that the Coasean prediction does apply to these cases, despite several criticisms and qualifications. Thus, because the Board has no influence over efficiency, it should concern itself exclusively with distribution arguments. If transaction costs, strategic bargaining, or some other impediment prevents labor negotiators from reaching efficient bargains, however, the Board rule may very well affect efficiency. The question then becomes what relevance does the preceding analysis have for the Board and courts?

Some scholars have extrapolated from the Coase Theorem a normative policy prescription to promote efficiency.¹⁴⁷ For example, Judge Posner has suggested that when market failure prevents parties from reaching efficient bargains, the proper role of law is to "mimic the market."¹⁴⁸ Under a mimic-the-market approach the Board should construe ambiguous or silent contracts as containing the most typical clause. In this way, the Board minimizes the costs to parties of contracting around a Board decision. To continue the *Milwaukee I* and *II* example, suppose transaction costs prevent the parties from bargaining to the efficient outcome, and the Board desires to mimic the market. Then, the Board should determine whether costless bargaining would have resulted in a stay or go clause and award the entitlement accordingly.

One way the Board can decide which party values the entitlement most highly (and thus would have obtained the entitlement in a costless market) is to look at actual contracts.¹⁴⁹ The Board in

¹⁴⁷ The shift from a positive description of the effect of rules to a normative prescription for what rules should be is an important one. Until this coda, this article has analyzed the Coasean positive description that a Board rule will not affect the efficiency of contracts. If transaction costs are significant, parties cannot write around an inefficient Board rule and the positive description fails. The normative analysis argues that, in this case, the Board should promote efficiency by mimicking the market.

¹⁴⁸ E.g., Posner, *Statutory Interpretation—In the Classroom and in the Courtroom*, 50 U. CHI. L. REV. 800 (1983); Posner, *Utilitarianism, Economics and Legal Theory*, 8 J. LEGAL STUD. 103 (1979).

¹⁴⁹ Richard Epstein argues that when dealing with a gap in contract language the best rule of construction is that which "reflects the dominant practice in a given class of cases." Epstein, *In Defense of the Contract at Will*, 51 U. CHI. L. REV. 947, 951 (1984). Seeing the prevalence of employment-at-will contracts, Epstein uses this rule of construction to argue that courts should not abandon the employment-at-will doctrine be-

Milwaukee II did note the frequency of work-preservation clauses in collective bargaining agreements. The Board argued from this that it should not imply a work-preservation clause in every contract.¹⁵⁰ Statistics cited by the Board in *Milwaukee II* suggest that somewhat less than one-third of collective bargaining agreements have clauses limiting management's right to transfer work.¹⁵¹ The more pertinent statistic is the percentage of contracts that contain work-preservation clauses where work preservation is truly at issue.¹⁵² When this exceeds fifty percent, the normative mimic-the-market rule suggests that the *Milwaukee I* rule is the appropriate presumption.

The mimic-the-market justification has some support in labor law.¹⁵³ Both the mimic-the-market theory and labor law seek to promote efficiency. In a world of costly transactions, efficiency is promoted by awarding an entitlement to the party who values it most highly and would have obtained it but for the transaction costs. But efficiency is hardly the only legitimate justification for decisions in a non-Coasean world. Distributional goals, also articulated in the Act, are equally legitimate. If transaction costs are substantial in labor bargaining so that legal entitlements affect efficiency, both efficiency and fairness are relevant justifications for Board rules.

cause doing so would force the majority of firms and workers to contract out of the decision.

¹⁵⁰ *Milwaukee II*, 268 N.L.R.B. at 609. The Supreme Court has also looked to the common practice in collective bargaining to determine whether an issue should be a mandatory subject of bargaining. See *First Nat'l Maintenance Corp. v. NLRB*, 452 U.S. 666, 684 (1981) (fact that contracts rarely give union right to participate in decisions altering scope of enterprise weighs against mandatory bargaining); *Fibreboard Paper Prods. Corp. v. NLRB*, 379 U.S. 203, 211-12 & 212 n.7 (1964) (widespread use of clauses providing some limitation on subcontracting used as indication that subject should be mandatory).

¹⁵¹ *Milwaukee II*, 268 N.L.R.B. at 603 (quoting *Ozark Trailers, Inc.*, 161 N.L.R.B. 561, 570 (1966) (citing M. CHANDLER, *MANAGEMENT RIGHTS AND UNION INTERESTS* 217 (1964))).

¹⁵² The difficulty of determining the "true" behavior of the parties illustrates a difficulty in implementing the mimic-the-market norm.

¹⁵³ This is not the place to assess fully the merits of mimic-the-market as an appropriate goal in labor law. Several symposia have been devoted to the general question of the ethics of pursuing efficiency. See *Symposium on Efficiency as a Legal Concern*, 8 HOFSTRA L. REV. 485 (1980); *A Response to the Efficiency Symposium*, 8 HOFSTRA L. REV. 811 (1980); see also *ETHICS, ECONOMICS, AND THE LAW*, 24 NOMOS (J. Pennock & J. Chapman eds. 1982); *Change in the Common Law: Legal and Economic Perspectives*, 9 J. LEGAL STUD. 189 (1980); *The Place of Economics in Legal Education*, 33 J. LEGAL EDUC. 183 (1983).