Onerous Property: Why the Business Corporation is Missing from Property Theory

Amnon Lehavi[♣]

Abstract

Property theory is thriving. Having been long dominated by a disintegrative approach building up on the *bundle of rights* concept, scholars are now reexamining essentialist models of property, with the right to exclude featuring prominently as property's prospective core. These theories study various resources, from land to intellectual property, to pinpoint such an essence.

Oddly enough, largely missing from these accounts is the most prominent source of wealth in today's world: the business corporation. While corporate law theory is increasingly looking beyond the *nexus of contracts* theory to illuminate the firm's proprietary foundations, property theory has yet to fit the business corporation into its newly integrative framework.

This paper argues that the deficiency is not merely a coincidence. In many ways, the business corporation undermines the paradigms of current property theory. To start with, Berle and Means's underlying notion of divorce of ownership from control in the business corporation seems antagonistic to the owner's right to exclude or to 'set the agenda' for the resource. In addition, while property theory recognizes the need to pool together resources and overcome collective action problems, conventional models of property governance, such as residential community associations, seem alienated from the power relations and vertical authority within the business firm. Specifically, the setting of a majority shareholder enjoying a control premium alongside owing fiduciary duties to dispersed minority shareholders is allegedly at odds with the horizontal governance assumption in property theory. It even may be unfavorably viewed as reminiscent of obsolete modes of status-based stratification in property, going back to feudalism.

This inconvenience does not, however, release property theory from accounting for the core nature of the business corporation. Moreover, the paper argues that once we move from a model of substantive essentialism to one that identifies the institutional and structural traits of property, then the business corporation becomes a much better fit for current property jurisprudence.

Keywords: control, corporation, corporate governance, incomplete contracts, legal realism, power, property, transaction costs.

JEL Codes: D23, G32, K11, L14, L21.

This version: July 15, 2012.

[♣] Professor, Radzyner School of Law, and Academic Director, Gazit-Globe Real Estate Institute, Interdisciplinary Center (IDC) Herzliya. For helpful comments and suggestions, I thank Greg Alexander, Hanoch Dagan, Nestor Davidson, Avihay Dorfman, Amir Licht, Tom Merrill, Hari Osofsky, Henry Smith, Maribel Sáez Lacave, Molly Van Houweling, Giorgio Zanarone, and participants at the Workshop on Economics of Institutions and Organizations, CUNEF, Madrid, and the 2012 Property Works in Progress conference at Fordham Law School.

Table of Contents

I. Introduction: Berle and Means on Property

In 1932, at the height of the Great Depression and the outset of the New Deal, Adolf Berle and Gardiner Means published *The Modern Corporation & Private Property*,[1] which has since been the seminal authority for analyzing the business corporation. One can hardly overstate the tremendous impact that this work has had on academic and public discourse about corporate governance, securities markets, and the broader institutional organization of market economies.[2]

[1] ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION & PRIVATE PROPERTY (rev'd ed. 1991, with a new introduction by Murray Weidenbaum & Mark Jensen).

[2] *See* William W. Bratton, *Berle and Means Revisited at the Turn of the Century*, 26 J. CORP. L. 737 (2001) (surveying the work's tremendous impact over the decades since its publication, even after some of its premises became increasingly criticized as of the early 1980s). Eighty years after its publication, the work continues to be one of the most cited works in corporate governance research. *See* Boris Durisin & Fulbio Puzone, *Maturation of Corporate Governance Research, 1993-2007: An Assessment*, 17 CORP. GOVERNANCE: AN INT'L. REV. 266 (2009).

Notwithstanding, a focal point of this work, as well as of its 1967 revised edition,[3] has been a vigorous analysis of the major transformation that the corporation entails for the institution of property. The central thesis is one of a changing paradigm concerning both the general concept and specific content of private property. According to Berle and Means, while the classical institution of property and its allegedly fixed *proprietas* (the legal relation of the owner to the property) are not entirely obsolete, these remain relevant only to *consumption property* -- those assets that the owner uses and manages for personal consumption or as an individual source of revenue. Although changing market forces and technological innovations also affect consumption property, such as cars or homes, the underlying rationales of individual control and "live and let live" continue to guide the ordering of property rights and duties for such assets.[4]

But in modern economy, the truly significant form of property is what Berle and Means term *productive property*, i.e. "property devoted to production, manufacture, service or commerce." A major part of this increasingly dominant form of production is based on *collective capitalism*, in which numerous members of the general public each contribute a certain amount of capital, but this capital is then aggregated into a corporate entity that engages in production and concentrates the power of decision-making over corporate assets in the hands of the management. Productive property thus has two distinctive aspects: first, managerial-productive (management), and second, passive-receptive (stock and security ownership).

In sharp contrast to consumption property, the *proprietas* for productive property should be subject to an "over-all political determination as to the kind of civilization the American state in its democratic processes has decided it wants."[5] The commercial corporation is not merely a

[3] The 1967 revised version, which included an updated preface by Adolf A. Berle, has been reprinted in the 1991 revised version. All references in this paper are thus made to the 1991 edition, cited in *supra* note 1.
[4] *Id.* at xxiv-xxviii.
[5] *Id.* at xxiii.

technical vehicle for production; it is an essential socio-economic institution, a modern way of organizing social and political life. As Berle and Means put it, the corporate system "bids fair to be all-embracing as was the feudal system at the time."[6] Thus, unlike consumption property, which may focus on individual autonomy, the content of productive property must be premised in public-political deliberation and can be justified only by resorting to core societal values.

These features of productive property have dramatic implications for the rights and duties of the corporate entity exercised by the corporation's management, as well as for the traits of the passive property owned by each of the individual stock and security holders.

Regarding the corporate entity, Berle and Means suggest that taxation is particularly justified because firms derive their profits not only from their own operations, but also from their market positions and "increasingly from techniques resulting from state expenditures of taxpayers' money."[7] Moreover, at least for widely-held corporations -- as opposed to corporations closely held by an individual or small group -- the corporation should be viewed as a *quasi-public* entity. This means that the corporation should be subjected to at least some rules applying to governmental entities, including those duties that derive essentially from the Bill of Rights. Thus, while consumption property is at its core an "expression of personality, guarded from invasion," other property "devoted to production and commerce is not."[8]

The analysis of the passive property of shareholders is no less dramatic. Stockholders do not contribute effort, work, or risk to income generated. Moreover, the value of their shares traded in stock markets has practically no link to the "business operations of the companies whose shares

[6] *Id.* at 10.
[7] *Id.* at xxviii.
[8] Id. at xxix. In addition, Berle and Means argue that antitrust laws and other regulation ensuring free competition are particularly befitting the quasi-public corporation. *Id.*

are the subject of trading."[9] If this is the case, why should they be entitled to the profits of the industrial system either in dividends or in increased market values resulting from undistributed corporate gains? Why recognize any sort of property rights for shareholders beyond mere liquidity of shares?

The answer is found in social grounds, which attach value to "individual life, individual development, individual solution of problems, individual choice of consumption and activity." But the "privilege to have income and a fragment of wealth without a corresponding duty to work for it cannot be justified except on the ground that the community is better off--and not unless most members of the community share it." To meet this goal, the law should encourage an even wider distribution of stocks, either through tax policy or some other device. [10] Thus, "the corporate system, accompanied by reasonably enlightened tax policies and aided by continuously growing productivity, can achieve whatever redistribution the American people want."[11]

One may be quite surprised by the apparently radical analysis of property in what otherwise is considered a text establishing conventional wisdom for many aspects of the business corporation (most notably, the management-shareholder agency problem). It seems clear enough why subsequent mainstream corporate theory, otherwise devoted to a free market approach, has downplayed Berle and Means's broader analysis of property. But it remains a bit puzzling as to why property theory has not given more attention to Berle and Means's account of how the business corporation is pivotal for the "changing content of property."[12]

This deficit is especially remarkable given the era in which *The Modern Corporation & Private Property* was originally published. The 1920s and 1930s featured the ascent of legal

[9] *Id*. at xxxiii-xxxiv.
[10] *Id.* at xxxv-xxxxvi.
[11] *Id.* at xxxvi.
[12] *Id.* at xxiv.

realism, with property serving as a focal point of interest for this school. A notable example is Morris Cohen's 1927 essay on *Property and Sovereignty*, [13] in which Cohen likened private property to a state-backed form of private sovereignty over others. Viewed this way, capitalism, with its rhetoric of free markets and individual choice, is not entirely detached from feudalism, in which "ownership of the land and local political sovereignty were inseparable."[14]

Cohen believed that the "recognition of private property as a form of sovereignty is not itself an argument against it,"[15] but that it does require giving good justifications for property rights, ones that often would justify placing limits on the right of property. In this and other respects, Berle and Means's argument about the need to justify the institution of property for productive assets and to tie such burden to redistributive purposes could have offered significant tailwind for the legal realist view of property. The case of the commercial corporation could have been instrumental in arguing that private property is not a natural phenomenon detached from politics.

This was not the case, however. Morris Cohen's work focused almost primarily on land. Subsequent works, published after Berle and Means's book, have also looked to types of assets that are usually associated with consumption property or with individual endeavors: land, chattels, copyrighted materials, etc. Interestingly, in one of the best known articulations of property by a legal realist, Felix Cohen's 1954 *Dialogue on Private Property*, the Socratic-style dialogue does start with commercial property. At the outset of the *Dialogue*, when the professor asks one of the students what distinguishes the American form of government from the Soviet one, the two engage in a brief discourse about the different ways in which decisions are taken in the United States Steel Corporation vis-à-vis a heavy industry plant in the Soviet Union.[16] But

[13] Morris R. Cohen, *Property and Sovereignty*, 13 CORNELL L.Q. 8 (1927).
[14] *Id.* at 9.
[15] *Id.* at 14.
[16] Felix S. Cohen, *Dialogue on Private Property*, 9 RUTGERS L. REV. 357, 357-59 (1954).

once the *Dialogue* moves to a conceptual and normative analysis of private property in the U.S., the discussion shifts back to various types of consumption property. Property rights in land receive their fair share, as do chattels (mules in Montana) and intellectual works (songs).[17]

Accordingly, when the *Dialogue* examines whether private property rights boil down to a right of exclusion, the essay follows up on Morris Cohen's account by stating that property is something to which the following label is attached: *"Keep off X unless you have my permission, which I may grant or withhold. Signed: Private citizen. Endorsed: The state."*[18] The critical analysis that follows focuses once again on individually-owned consumption property. Thus, while productive property has served to distinguish a capitalist system of government from a communist one, it does not play a similar role in reconstructing the concept of private property.[19]

The business corporation has failed to play a pivotal role in property theory in subsequent decades as well, including in the 1960s, when Adolf Berle published a revised version of *The Modern Corporation & Private Property*. Charles Reich's 1964 *The New Property*,[20] regarded as a leading progressive text on property, should have allegedly relied extensively on Berle and Means's redistributive agenda and on their critical analysis, by which the right to enjoy passive income from the quasi-public business corporation cannot rely merely on formal stockholding.

---

[17] *Id.* at 359-70.
[18] *Id.* at 374.
[19] An exception during that period is found in Francis S. Philbrick, *Changing Conceptions of Property in Law*, 86 U. PENN. L. REV. 691 (1938). Arguing that the use of neither private property nor the property of ordinary or "natural" persons poses serious problems of adjusting law to changing social conditions, Philbrick identifies such a challenge "in connection with property for power, and therefore primarily with industrial property." *Id.* at 726. In a relatively brief discussion, Philbrick points, first, to the sheer size and wealth of corporations, referring to Berle and Means's account by which two hundred non-banking corporations control nearly half of all corporate wealth and most of the industry in the country. He equates the accumulation of wealth in corporations to the private inheritance of "vast fortunes," viewing both phenomena as instigating fierce debates about the abolishment of inheritance and the redistribution of wealth more generally. Philbrick then moves to the jurisprudential adjustment that corporations require in view of the separation of control from management. Observing critically that "no public duties, direct or indirect, rest upon the managers," he suggests applying trust law to corporations so that stockholders "who own the property" would be considered beneficiaries, and those who control but not own as trustees. *Id.* at 726-28. Philbrick, however, does not address Berle and Means's broader agenda of the more fundamental changes that the business corporation implies for both the private and public aspects of property.
[20] Charles A. Reich, *The New Property*, 73 HARV. L. REV. 733 (1964).

The gist of Reich's argument is that in the modern state, government distributes largess in the form of money, benefits, services, contracts, franchises, and licenses on a "vast, imperial scale."[21] Reich, however, vehemently opposes what he deems to be the underlying governmental philosophy and conventional legal doctrine by which "the wealth that flows from government is held by its recipients conditionally, subject to confiscation in the interest of the paramount state." He depicts this approach as one of "new feudalism," in which society moves back to being status-based, with individuals holding their wealth conditionally, subject to obligations owed to the government or to the public, with such obligations increasing "at the will of the state."[22]

To preserve what Reich views as the "essence" of the legal institution of property, namely the "creation and protection of certain private rights of wealth of any kind," and in particular the maintenance of "independence, dignity and pluralism in society by creating zones within which the majority has to yield to the owner," Reich calls to recognize a legal *right* of individuals to governmental largess. This is "most urgently needed with respect to benefits like unemployment compensation, public assistance, and old age insurance," essential to preserve the self-sufficiency of the individual and to allow him to be a "valuable member of a family and a community." Just like traditional property, which originated from the state but gradually developed into a system of private rights, so does the "new property" call for a change in the paradigms of property.

Reich's discussion seems like a perfect fit for Berle and Means's property analysis of the commercial corporation. The two works depict, respectively, government benefits and the corporation as establishing a new political and institutional organization of society, one in which the concept of liberty and the preservation of the individual's role should not rely merely on

[21] *Id.* at 736.
[22] *Id.* at 768-71.

formal ownership, but must be reevaluated to ensure core objectives of distribution of wealth and a new demarcation of the private and public spheres in property.

The corporation plays, however, only a negligible role in Reich's analysis. Reich refers briefly to Berle and Means in suggesting that "multiple ownership of corporations helped to separate personality from property, and property from power," and argues that New Deal reforms took away some of the power of large corporations in favor of government power (although corporations may still share power with government). But otherwise, Reich sees the corporation as meeting a similar fate to that of individuals in its subjection to government control, such that, for example, the "company that is heavily subsidized or dependent on government contracts is subjected to an added amount of regulation and inspection, sometimes to the point of having resident government officials in its plant."[23] Organizations, just like individuals, also need property to secure a zone protected from government power. In this respect, the corporation as an economic institution does not challenge the fundamental concepts of property.

What can we make of the general approach of twentieth-century property scholars to the business corporation, before setting out to explore contemporary property theory? What accounts for their little interest in what Berle and Means identified as the new front in property law?

While trying to extract the meaning of past omissions is obviously largely speculative, one possible answer is that those who wished to undermine conventional wisdom behind property, as did some of the legal realists, sought to shake the allegedly stable foundations of "classical" property such as land and chattels rather than to focus on the relatively new phenomenon of the business firm. Thus, for example, Morris Cohen's depiction of private property as a form of sovereignty over others, one that equates the seemingly nonhierarchical institution of private

[23] *Id.* at 756.

property to ancient regimes of subjection and power (e.g. feudalism), obviously has more rhetorical force when it undermines private property in land or chattels. If one is convinced by these arguments for consumption theory -- the safe haven of conventional wisdom in classical property theory -- then surely productive property is not entitled to deference from societal intervention. Under this account, the lack of interest in corporations is simply a matter of a more effective dedication of attention to core resources.

Another reason for the general disregard for the business corporation might have stemmed from an ideological discomfort. With the business corporation being viewed throughout most of the twentieth century as the epitome of market economy and capitalism, property theorists with a critical or redistributive ideological agenda may have felt uneasy about even incorporating the business firm into the heart of property discourse. While nowadays ideas such as corporate social responsibility (CSR) have gained enough currency to contest the immediate association of the business corporation with the sole purpose of maximizing shareholders' gains,[24] the ideological flare of commercial corporations over much of the twentieth century has been such that many property theorists simply disassociated themselves from this field of inquiry. It may also have been the case that Adolf Berle's position, following his famous scholarly exchange with E. Merrick Dodd during the 1930s, has been understood as one of supporting shareholders' supremacy over the interests of other stakeholders in the firm.[25] While this reading of Berle's work may be considered erroneous in retrospect,[26] it may further explain why progressive writers

[24] For the evolution and current landscape of CSR, see Archie B. Carroll, *Corporate Social Responsibility: Evolution of a Definitional Construct*, 38 BUS. & SOC. 268 (1999).
[25] *See* A.A. Berle, Jr., *Corporate Powers as Powers of Trust*, 44 HARV. L. REV. 1049 (1931); E. Merrick Dodd, Jr., *For Whom are Corporate Mangers Trustees?* 45 HARV. L. REV. 1145 (1932); A.A. Berle, Jr., *For Whom Corporate Managers are Trustees: A Note*, 45 HARV. L. REV. 1365 (1932).
[26] *See* Amir N. Licht, *The Maximands of Corporate Governance: A Theory of Values and Cognitive Styles*, 29 DEL. J. CORP. L. 649, 690-98 (arguing that Berle and Dodd differed not so much on the underlying values that corporate law should promote, but rather on the feasibility of implementing such normative ideals in the real world).

of his time further distanced themselves from Berle and Means's work. Under this account, the lack of attention by property theorists has been one of overt ideological alienation.

Neither of these traits can be said to typify contemporary property theory, especially the school of "new formalism" or "new essentialism," which is the focus of interest in this paper. While obviously not indifferent to normative considerations, the new wave of property theory seeks to offer an all-embracing theory that would identify core concepts of property across different types of resources and forms of property organization. It thus has no methodological or ideological reason to disregard the business corporation. And yet, as the paper shows, the corporation continues to play a negligible role in property theory.

The rest of the paper seeks to explore this puzzle. Part II identifies the main features of current property theory, focusing on writings that promote an essentialist view of property. Part III offers a discussion of contemporary corporate theory. It demonstrates how corporate theory has gradually shifted from a contract-based analysis of the corporation to one that investigates the role that property rights play in the structure of the firm.

Part IV shows that this integrative effort in corporate theory is unmatched by property theory. It argues that this tension could be attributed to certain features of the business corporation that may be viewed as undermining the newly-phrased paradigms of property theory. *First*, the focus of current property theory on control over resources as an inherent feature of ownership seems at odds with the idea of separation of ownership from control in the publicly-traded corporation. *Second*, while property theory recognizes the need to pool together resources and to overcome collective action problems, it is generally alienated from the inherent power relations and vertical authority within the firm. Specifically, the typical scenario of a majority shareholder enjoying a control premium alongside owing fiduciary duties to dispersed minority shareholders is in

tension with what I call the "horizontal governance assumption" in property theory. *Third*, and related, in advocating an essentialist view of the property while being committed to liberal ideas, current property theory may view the inherent power relations within the firm as reminiscent of obsolete modes of status-based stratification in property, going back -- again -- to feudalism.

Part V argues that this inconvenience cannot release property theory from accounting for the core nature of the business corporation. It shows that once we move away from a model of substantive essentialism to one that identifies the institutional and structural traits of property, then the business corporation becomes a much better fit for current property jurisprudence.

II. Property Theory: From Bundle of Rights to New Essentialism

The current landscape of property theory should be understood against the backdrop of the apparent dominance of the bundle of rights approach throughout much of the twentieth century. The bundle of rights theory should be seen more accurately, though, as a bundle of property theories that shared a negation of "Blackstonian" classical property theory, but did not offer a shared understanding of how property should be analyzed and what role it could play.

Briefly, the starting point of post-essentialism is attributed to Wesley Hohfeld's work on *Fundamental Legal Conceptions as Applied in Judicial Reasoning*.[27] Hohfeld had set out to challenge the centuries-old *in rem*/*in personam* dichotomy, by which property rights are quintessentially *in rem* (against the asset), as opposed to contractual and obligatory rights that are *in personam* (against persons). Delineating the attributes of *in personam* rights through a breakdown of *jural opposites* and *jural correlatives* (using the dyads of right-duty, privilege-no

[27] Wesley Newcomb Hohfeld, Some *Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 23 YALE L.J. 16 (1913); Wesley Newcomb Hohfeld, *Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 26 YALE L.J. 710 (1917).

right, power-liability, immunity-disability), Hohfeld argued that the same typology could apply to *in rem* rights, save only to an indefinite number of persons bound by such legal relations.

Some legal realists followed Hohfeld's analytical path by explaining how property entails sets of rights and duties among persons, but others honed in on this conceptual breakdown to argue for a normative breakdown of the moral basis of the classical view of property. Under this account, "property" is not a natural right but rather a creature of the state, and moreover, has no pre-fixed content. As Daniel Klein and John Robinson portray this stream of the literature, the "bundle formulation tends to suggest that property depends on its being created, defined, recognized, and validated by the state--the maker and keeper of the implied list."[28] As Greg Alexander observes, the realists' normative view of the bundle of rights emphasized the implicit use of coercive power in socio-political relations dressed in the legal concept of property rights.[29] As such, property is not a neutral institution, as classical liberalism may have depicted it, but rather the result of overt public -- thus political – decision-making. The construction of property must be subjected to a broad socio-political debate that also addresses redistribution and social justice. From a legal perspective, this means that the state could decide to re-comprise the list that makes up the bundle, or to reallocate rights and duties within it, without categorically "infringing" or "violating" a prefixed right of private property.[30]

Thomas Grey's 1980 *The Disintegration of Property* is considered by many as the epitome of the bundle of rights approach to property, one that negates any essential or inherent core to the

[28] Daniel B. Klein and John Robinson, *Property: A Bundle of Rights: Prologue to the Property Symposium*, 8 ECON. J. WATCH 193, 195 (2011).
[29] GREGORY S. ALEXANDER, COMMODITY & PROPRIETY: COMPETING VISIONS OF PROPERTY IN AMERICAN LEGAL THOUGHT 1776-1970 (1997). Alexander commands the realists' incorporation of social relations into the heart of property theory, while criticizing them for automatically opting for extensive government regulation, rather than trying to implement an alternative, republican democracy ideal of property and society. *Id.* at 350-51.
[30] *See generally* BARBARA FRIED, THE PROGRESSIVE ASSUALT ON LAISSEZ FAIRE (1998).

institution of property.[31] But although Grey connotes the "decline of property as a central category of legal and political thought,"[32] he neither follows a nominalistic approach that undermines any systematic sense to the way in which such interpersonal legal relationships are structured, nor sees the "collapse of property" as pronouncing the ultimate victory of a socialist or redistributive ideology.

Quite the contrary, the bundle of rights approach is "intrinsic to the development of a free-market economy into an industrial phase."[33] Modern economies seeking to better enjoy the advantages of division of labor and economies of scale do so through a series of "free economic transactions, with the state playing only its classical liberal, neutral, facilitative role. Proprietors subdivide and recombine the bundles of rights that make up their original ownership, creating by private agreements the complex of elaborate and abstract economic institutions… particularly the financial institutions and the industrial corporations." This systematic restructuring of legal relations can be seen therefore as "entirely *internal* to the capitalist market system"[34]

According to Grey, while the traditional concept of private property as thing-ownership served as a moral justification for capitalism at the outset, capitalism as it is currently understood can be morally defended based on "its capacity to protect material well-being and its tendency to protect personal liberty."[35] Somewhat counter-intuitively, Marxism is undermined by the pragmatic dissolution of the category of "all-or-nothing ownership" and the fragmentation of legal control over resources into particularized entitlements. The most striking example is the large publicly-held corporation. Beyond the separation of ownership and control and their

[31] Thomas C. Grey, *The Disintegration of Property, in* PROPERTY: NOMOS XXII 69 (J. Ronald Pennock & John W. Chapman eds., 1980).
[32] *Id.* at 82.
[33] *Id.* at 74.
[34] *Id.* at 75-76 (emphasis in the original).
[35] *Id.* at 78.

division between shareholders and managers, other classes of stakeholders such as directors, bondholders, suppliers, government regulators, or labor unions all may have "some of the legal powers that would be concentrated in the single ideal thing-owner of classical property theory."[36]

Thus, although considered and often quoted by many as the quintessential text advocating the bundle of rights approach, Grey's analysis actually disputes much of the jurisprudential and normative assumptions that drove earlier invocations of this theory. It actually depicts the disintegrated institution of property as largely a bottom-up phenomenon, evolving as actors in the free market seek to design new institutions that allow for a more effective control of assets to increase private gains. As such, although the classical concept of property disintegrates, the ordering of legal relations becomes even better structured, equipped to address the contemporary challenges of the industrial economy. And while the particular allocation of the bundle may change among distinctive assets based on the most efficient mix in the particular case, the overall structure of primary economic institutions, be they financial institutions or industrial corporations, adheres to a broad scheme that is far from being arbitrary or purely political.

In some respects, Grey's work aligns itself, both conceptually and normatively, with the economic analysis of law -- which has played a central role in re-conceptualizing property as a legal institution that becomes intermingled with contracts or torts.[37] Property relations are viewed as an interpersonal set of legal rules that apply to specific uses or decision-making powers.

This view is prominently expressed in the entitlements literature, inspired by Ronald Coase's 1960 *The Problem of Social Cost*[38] and established in Guido Calabresi and Douglas Melamed's

[36] *Id.* at 80.
[37] *See* Thomas W. Merrill & Henry E. Smith, *What Happened to Property in Law and Economics?*, 111 YALE L. J. 357
[38] Ronald H. Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1 (1960).

seminal work.[39] Looking at the classic case study of a polluting factory vis-à-vis adversely affected neighbors, Calabresi and Melamed do not attach great value to merely inquiring who the formal owner is. They look rather for the optimal allocation of specific uses and powers by offering a menu of potential entitlements and remedies and by suggesting several criteria for choosing from this menu. They further break down the sets of interpersonal legal relations by introducing two types of entitlement protection: a *liability rule*, which may require a party to transfer the entitlement for court-determined compensation, and a *property rule*, which requires the consent of the entitlement holder for any such transfer by granting injunction in her favor.[40]

Following this lead, law and economics scholars have sought to advance sophisticated formulas for making the most efficient pick from the broad menu of entitlements and remedies.[41] A notable example is Ian Ayres's analysis of liability rules as legal options and his further development of a broad set of "put" and "call" options to help courts decide property disputes.[42]

This school thus shares the bundle of rights general approach by breaking down property rights into increasingly smaller fragments of entitlements, which are *in personam* in nature. But at the same time, it argues for inherent systematicity -- rather than arbitrariness -- in the design of such schemes based on the underlying goal of allocative efficiency and the methodological techniques employed to achieve them. Moreover, by portraying courts as typically entrusted with such legal design, this literature shifts this legal field away from the realm of overt political decision-making. Finally, being generally sympathetic to free market economy, this economic

[39] Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972).
[40] *Id.* at 1096-1115.
[41] *See* Amnon Lehavi, *Intergovernmental Liability Rules*, 96 VA. L. REV. 929, 960-62 (2006).
[42] IAN AYRES, OPTIONAL LAW: THE STRUCTURE OF LEGAL ENTITLEMENTS 1–38 (2005).

analysis seems to share Grey's suggestion that the contemporary design of legal entitlements could be seen as "inherent to the capitalist market system."

At the same time, and unlike Grey, this stream of economic analysis reverts back to focusing on "classical" resources--land, chattels, and intellectual property, while nearly disregarding the business corporation. This probably should be attributed to the same motive that drove legal realists: challenging the hard core of conventional wisdom, that of consumption property.

Enter new essentialism. Over the past few years, a growing number of scholars have been seeking to re-integrate property by suggesting core principles for property, and most prominently for the concept of "ownership" that has been so heavily downplayed by bundle of rights theorists.

Most influential is probably the work of Thomas Merrill and Henry Smith. In a long series of papers, Merrill and Smith advocate a new essentialist approach to property, by arguing that *in rem* rights are qualitatively different from *in personam* ones even if the boundaries between property law and contracts or torts are not always clear-cut, and that different legal systems -- including the Anglo-American one -- continue to embrace a *numerus clausus* principle for property forms in contrast to the practically infinite variations of *in personam* relations.

The chief rationale for this inherent nature of property rights lies in principles of efficient legal design, aimed at saving the prohibitive systemic costs that a bundle approach would entail. Property rights, say Merrill and Smith, "are not typically broken down into long lists of discrete rights and privileges. Instead, the rights of property owners are 'lumpy'."[43] An advantage of starting out with the right to exclude as the baseline conception of property, per Merrill and Smith, is that "it permits us to protect a wide range of interests in use, without requiring outsiders

[43] THOMAS W. MERRILL & HENRY E. SMITH, PROPERTY 6-7 (2010).

like officials or judges to know much about those uses…. By delegating the 'gatekeeper' right (the right to exclude) to the owner, the owner can select among these uses without the law having to spell out all potential use-rights or interests at all." The switch from the core strategy of *exclusion* to a more fine-grained *governance* strategy, allocating particular uses, is reserved only to "selected situations of major resource conflicts" such as in easements, nuisances, or zoning.[44]

According to Merrill and Smith, the right to exclude as the core of property also has an underlying normative justification in that it is embedded in a fundamental moral perspective that is typical at least of the American populace and its legal system.[45] But the two co-authors slightly diverge on whether exclusion is indeed a value in and of itself or merely a practical device.

Merrill, as a self-proclaimed essentialist, views the right to exclude as *the* normative foundation stone of ownership, especially in legal relations between owner and "strangers," arguing that the "right to exclude is a necessary condition of identifying something like property."[46] While other incidents or sticks of property rights often exist, these can be "added or subtracted as social conditions dictate without the bundle losing its identification of property" -- but this is not so with regard to the right to exclude, the *sine qua non* of property. Smith, however, views the right to exclude as a "means to an end, and the ends in property relate to people's interest in using things."[47] Exclusion, says Smith, "is not a value at all: it is a rough first cut -- and only that -- at serving the purposes of property."[48] Exclusion is thus a matter of legal architecture, a strategy that serves as a shortcut over the more complete set of legal relations that typify the alternative use-specific *governance* strategy.

---

[44] *Id.*
[45] Thomas W. Merrill & Henry E. Smith, *The Morality of Property*, 48 WM. & MARY L. REV. 184, 1853-58 (2007).
[46] Thomas W. Merrill, *The Property Prism,* 8 ECON. J. WATCH 247, 248-49 (2011).
[47] Henry E. Smith, *Property as the Law of Things,* 125 HARV. L. REV. 1691, 1704 (2012) (hereinafter: Smith, Law of Things).
[48] *Id.* at 1705.

Other essentialist variations have been promoted in current literature. James Penner focuses on the right to exclude as stemming from the core normative principle of the owner's right to use.[49] Larissa Katz identifies the exclusive position of the owner not in the right to exclude but rather in the right to 'set the agenda' for the resource, so that "ownership, like sovereignty, relies on a notional hierarchy, in which the owner's authority to set the agenda is supreme, if not absolute, in relation to other individuals."[50] Eric Claeys defines property as "a right securing an interest in determining exclusivity of use of an asset external to the owner's person,"[51] viewing the right to exclude as a consequence of the right of exclusive use-determination.[52] Adam Mossoff refers to property rights as "integrated rights of possession, use, enjoyment, and disposal, which implies a logical corollary that such rights are secured formally by making them exclusive against others" but that do not always come down to a clear-cut right to exclude.[53] For Claeys or Mossoff, what truly matters is the beneficial use of assets, while effectively coordinating use interests or liberty interests of different owners. Property schemes thus may be premised in basic design principles that do not necessarily boil down to straightforward exclusion, but rather focus on governance schemes, such as in the case of riparian water rights.[54]

It should also be noted that some of the new essentialists are not antagonistic to the bundle of rights concept, but interpret it differently. Richard Epstein attributes the genesis of the bundle of rights approach to Roman law ideas of "incidents" of ownership, including rights of use, fruits,

---

[49] J. E. PENNER, THE IDEA OF PROEPRTY IN LAW 68-74 (1997).
[50] Larissa Katz, *Exclusion and Exclusivity in Property Law*, 58 U. TORONTO L. J. 275, 278 (2008).
[51] Eric R. Claeys, *Bundle-of-Sticks Notions in Legal and Economic Scholarship*, 8 ECON. J. WATCH 205, 208 (2011).
[52] *Id*. at 211.
[53] Adam Mossoff, *The False Promise of the Right to Exclude*, 8 ECON. J. WATCH 25, 255, 262 (2011).
[54] *See, respectively*, Eric R. Claeys, *Exclusion and Private Law Theory: A Comment on Property as the Law of Things*, 125 HARV. L. REV. F. 133, 140-42 (2012); Mossoff, *supra* note 53, at 258-62.

and abuse.[55] He identifies Tony Honoré's modern analysis of the "incidents of ownership"[56] as practically synonymous with the bundle of rights. For Epstein, the "bundle" simply explicates on the various inherent attributes of ownership.[57] Other essentialists, such as Smith, have been more persistent in rejecting the bundle of rights idea, even as a purely analytical concept, arguing that it misconceives the basic structure of property as a holistic, even if modular, legal construct.[58]

Despite the variations, all of these writers share some essentialist view of property. Property is not an empty concept; it has an inherent substantive core. As such, and although variations may exist among different types of resources in the implementation of such core principles, these theories seek to be comprehensive. Their underlying normative basis should serve to explain the re-integrated concept of property across the plethora of resources that are the object of rights.

And once again, a gap emerges. This stream of scholarship too focuses on "classical" resources, i.e. land, chattels, and intellectual property. And while this scholarship studies various types of property organizations, from marital property to common interest communities, once again missing is the most prominent form of property organization: the business corporation. In somewhat of an exception, Smith devotes in his 2012 *Property as the Law of Things* one paragraph to Berle and Means, but then views corporations as simply one form of "entity property," without elaborating on what distinguishes firms from other such entities.[59]

One could hardly suspect an ideological aversion of these writers to business corporations or to anything associated with free markets and capitalism as a potential explanation for the

---

[55] Richard A. Epstein, *Bundle-of-Rights Theory as a Bulwark against Statist Conceptions of Private Property*, 8 ECON. J. WATCH 223 (2011)
[56] TONY HONORÉ, *Ownership, in* MAKING LAW BIND: ESSAYS LEGAL AND PHILOSOPHICAL 161, 161-84 (1987).
[57] Epstein, *supra* note 55, at 224-25.
[58] *See* Henry E. Smith, *Not Just a Bundle of Rights*, 8 ECON. J. WATCH 279 (2011).
[59] Smith, Law of Things, *supra* note 47, at 1721-22. Accordingly, in THOMAS W. MERRILL & HENRY E. SMITH, PROPERTY: PRINCIPLES AND POLICIES (2007), the chapter on "Entity Property" encompasses 135 pages (pp. 684-829), but the overwhelming majority of them are devoted to possessory rights such as leases in land, with only three pages devoted to "corporations and partnership" (pp. 826-29).

omission of business corporations, as could have been the case with other contemporary scholars committed rather to a progressive, realist, or critical agenda. [60] For the new essentialists, the alternative explanation suggested in part I, that of "a "more effective dedication of attention," could explain the attraction of re-conceptualizing property rights in the classics: land, chattels, intellectual property. But as I suggest in the following parts, there may be yet another explanation. It could be the case that the business corporation simply does not fit in smoothly with how the core of property is depicted in the new essentialism school. The shadow of Berle and Means may still be looming over property theory.

III. Theory of the Firm: From Contract to Property?

There are interesting parallels between the change of orthodoxies in property theory and the trajectory of corporate theory dealing with the nature of the firm. This part does not fully address the discourse within corporate theory, but focuses on the decline and re-emergence of theories of the corporation that resort to concepts of property as opposed to contractual models of the firm.

[60] One such stream of property literature studies different versions of "property and social relations." Probably the only contemporary author who has been committed to a progressive agenda in this respect and who also has devoted attention to business corporations is Greg Alexander. See ALEXANDER, *supra* note 29, at 342-51 (discussing Berle and Means's work as a realist critique that ties the business corporation to its broader social context). Other writers committed to such an agenda have focused on classical resources. In promoting a "property and personhood" theory, Margaret Radin makes the case that a tenant who has lived long enough and in good behavior in a house so that her personhood has become embedded in the home should be granted special rights, such as a permanent tenure, vis-à-vis the landowner. MARGARET JANE RADIN, *Property and Personhood, in* REINTERPRETING PROPERTY 36, 57-59 (1993). Joseph Singer constructs a more general theory of property and social relations, calling to contextualize property doctrine according to "the social context in which the conflict arose" and focusing on social situations involving trust or long-term dependency such as between employer-employee, landlord-tenant, friends, or neighbors. JOSEPH WILLIAM SINGER, ENTITLEMENT: THE PARADOXES OF PROPERTY 134-39 (2000). Hanoch Dagan calls to construct a relatively limited number of "property institutions" that seek to generalize typical kinds of personal relations, from the family up to distant parties in the market, but he too does not focus on business corporations. HANOCH DAGAN, PROPERTY: VALUES AND INSTITUTIONS 69-74 (2011).

While the conceptualization of property, and specifically of the term "property rights," by corporate theorists has been quite different from the one that typifies property theorists, the discussion entails important insights for property jurisprudence. As the analysis shows, two "proprietary" features of the firm, as promoted in current corporate theory, are of special interest to property discourse. *First*, the "boundary" of the firm, which finds expression also -- but not only -- in the analysis of the corporation's separate legal entity. *Second*, the structure of the allocation of powers and priorities among different stakeholders in the firm, which cannot be explained merely by explicit or implicit contractual arrangements, but rather by organizational mechanisms, including both vertical control and rules of priority among distant parties. Taken together, these features may aid in reconstructing a richer framework of the *in rem* nature of property rights, one that is built on structural and institutional components rather than on an attempt to extract a single substantive criterion for property such as the right to exclude. This richer analysis is instrumental in explaining why the business corporation should not be viewed as inapplicable to property theory, but rather as a central form of property organization.

A. "Nexus of contracts" and its Discontent

In a seminal 1976 paper formulating the notion of the corporation as a nexus of contracts,[61] Michal Jensen and William Meckling argue that although the literature of economics has been replete with reference to the "theory of the firm," it has actually produced a theory of markets in which firms are primary actors, but it has not yet opened the "black box" of the single firm. The firm is thus assumed to operate with the purpose of maximizing profits or present value, but the

[61] Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

theory has yet to explain "how the conflicting objectives of the individual participants are brought into equilibrium so as to yield this result." [62]

In an attempt to open up the box and expose the inner workings of the firm, Jensen and Meckling refer first to the works of Ronald Coase, who identified in his 1937 classic *The Nature of the Firm* the business corporation as internally controlled by authority and direction of resources rather than by market exchanges. According to Coase, the boundaries of the firm are defined by the range of exchanges that the owner-entrepreneur chooses to conduct within the organization rather than through the market, likening firms (following D.H. Robertson) to "islands of conscious power in this ocean of un-conscious cooperation."[63]

Jensen and Meckling frame Coase's analysis of the firm -- discussed in more detail in Part IIIB1 -- as embedded in "property rights" (a term that Coase himself does not use). This means, according to Jensen and Meckling, that the "specification of individual rights determines how costs and rewards will be allocated among the participants in any organization."[64] But, they argue, because the "specification of rights is generally affected through contracting (implicit as well as explicit), individual behavior in organizations, including the behavior of managers, will depend upon the nature of these contracts."[65] What is conceptualized as property is thus broken down effectively to the specific details of the numerous contracts that make up the firm. Needless to say, for property theorists, Hohfeld's analysis immediately comes to mind.

Jensen and Meckling follow the footsteps of an influential 1972 paper by Armen Alcihan and Harold Demsetz.[66] Alchian and Demsetz depict the Coasean view of the firm being governed by

---

[62] *Id.* at 308.
[63] Ronald H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937).
[64] Jensen & Meckling, *supra* note 61, at 310.
[65] *Id.*
[66] Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972)

power and authority as a "delusion." The firm "has no power of fiat, no authority, no disciplinary action any different in the slightest degree from ordinary market contracting between any two people."[67] Since "neither the employer nor the employee is bound by any contractual obligations to continue their relationship," the employer is continuously involved in renegotiation of contracts with its workers on terms that must be acceptable to both parties.[68] The only difference between the firm and the market lies "in a *team* use of inputs and a centralized position of some party in the contractual arrangements of all other inputs. It is the centralized contractual agent in a team productive process--not some superior authoritarian directive or disciplinary power."[69]

Jensen and Meckling voice sympathy to Alchian and Demsetz's analysis but argue that the focus on joint input production "is too narrow and therefore misleading." This is so because "contractual relations are the essence of the firm, not only with employees but with suppliers, customers, creditors, and so on." The private corporation, like other forms of organizations, is merely a legal fiction that serves as a nexus for contractual relationships. "Viewed this way," they argue, "it makes little or no sense to try and distinguish those things that are 'inside' the firm… and those things that are 'outside' of it."[70]

In the years that followed, the nexus of contracts approach became the new orthodoxy in analyzing nature of the firm. Very much like the case of the bundle of rights in property theory, the nexus of contracts scholarship entails both analytical and normative aspects.

The *analytical* approach to the nexus of contracts has sought to explain the way in which business organizations can be seen as constructed of an intertwined set of contracts. Some contracts are "real" in the sense that they are either explicitly negotiated between the different

[67] *Id.* at 777.
[68] *Id.*
[69] *Id.* at 778.
[70] Jensen & Meckling, *supra* note 61, at 315.

stakeholders -- such as in the articles of incorporation -- or implicitly adopted but nevertheless priced by the different market actors, as is the case with the corporation management's investment decisions that are priced by investors-shareholders through the price of the share.[71]

But real contracts have their limits. High information costs, inevitable cases of ambiguity, and other factors make it impracticable to cover every consistency in the corporate contract. Courts are required to fill the gaps and clarify the ambiguities, as is the case with other settings governed by (incomplete) contracts. The nexus of contracts approach thus views the role of corporate law as one of providing a set of default rules "available off-the-rack so that participants in corporate ventures can save the costs of contracting."[72] As Frank Easterbrook and Daniel Fischel suggest: "corporate law--and in particular the fiduciary principle enforced by courts--fills in the blanks and oversights with the terms that people would have bargained for had they anticipated the problems and been able to transact costlessly in advance."[73]

This analytical framework has encountered growing skepticism in current literature. The incompleteness of real contracts has been argued to stem not only from the cost of drafting but also from the cost of enforcement, given problems of verification. It has also been suggested that corporate law provisions are not necessarily more cost-saving than the provision of standard forms of contracts by professional organizations, as is the case with commercial transactions.[74]

Moreover, the fact that many of the provisions in corporate law are *mandatory rules* (such as the ones governing insider trading and tender offers) challenges the analytical view of the

---

[71] FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 15-22 (1991).
[72] *Id.* at 34.
[73] *Id.*
[74] John Armour & Michael J. Winchop, *The Proprietary Foundations of Corporate Law*, 27 OXFORD J. LEGAL STUD. 429, 434-35 (2007).

corporation as merely a nexus of contracts.[75] Some nexus of contracts theorists argue that these rules are not really mandatory since they could be "easily--and legally--sidestepped, or they pose nonbinding constraints because there is no burning demand to deviate from them,"[76] while others dispute this depiction of corporate law as being factually incorrect.[77]

Probably more intriguing is the *normative* debate about the contractarian view of the firm and the extent to which corporate law should be mandatory and based on some sort of coercion or paternalism through top-down ordering. Stephen Bainbridge, one of the notable advocates of the nexus of contracts approach, argues that the rights of different stakeholders, including those of the firm's shareholders, are established through bargaining, even if through off-the-rack default rules of corporate law, which such a contractarian account resting "on the presumption of validity as free market society accords voluntary contracts."[78] The practical necessity of concentrating decision-making powers in the board and senior management stems from the high costs of explicitly phrasing ex ante all contractual provisions and of ex post enforcing implicit contracts.[79] Under this version, the dynamic rewriting of the corporate contract and its enforcement through internal fiat and concentrated decision-making comfortably fits in with corporate law's role to facilitate forms of contractually-based private ordering.

In contrast, Melvin Eisenberg argues that even if we understand the nexus of contracts metaphor as dealing not only with legally enforceable mutual promises but more broadly with "reciprocal arrangements," corporate law cannot automatically yield to the concept of the firm as strictly a matter of private ordering based on contracts. Some top-down mandatory rules may still

---

[75] *See* Melvin A. Eisenberg, *The Conception that the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm*, 24 J. CORP. L. 819, 823-25 (1999).
[76] Roberta Romano, *Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Law*, 89 COLUM. L. REV. 1599, 1599 (1989).
[77] Eisenberg, *supra* note 75, at 823-24.
[78] STEPHEN M. BAINBRIDGE, THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE 32-33 (2008).
[79] *Id.* at 38-45.

be required. This is especially so when private ordering creates adverse third-party effects. Given the "frequent interdependence of individuals and groups who are interested in the corporation but are not parties to a given arrangement," our evaluation of the necessity of mandatory rules in corporate law must be based on a rule-by-rule analysis, and not on sweeping deference to contract.[80]

Before setting out to review more broadly the re-emergence of proprietary conceptions as a response to the discontent with the pure contractarian model, it is interesting to observe the opposite directions that the nexus of contracts approach has taken in moving from the analytical to the normative realm, as compared with the transition that the bundle of rights analysis underwent when it was given a normative flavor. The normative take on the bundle of rights picture has served, at least among prominent legal realists, an ideology of de-canonizing the holistic concept of property so as to facilitate more government intervention in the content of property norms and the allocation of rights. In the normative version of the nexus of contracts literature, the opposite goal is promoted: vindication of a hands-off, free market approach. This juxtaposition evokes interesting insights about whether this "taxonomic contest" between contract and property entails any pre-dictated normative implications. I argue that it does not: Part V will set out to explain why articulating "property" structures and institutions should not impose an inherent substantive content.

B. Exploring the Proprietary Nature of the Firm

As the previous section already indicated, the nexus of contracts approach has not lacked critics even during the era in which it gained dominance in conceptualizing the business firm.

[80] Eisenberg, *supra* note 75, at 824-25.

Very much like the case of the bundle of rights approach in property theory, critics have argued that the differences between firms and markets is not simply a matter of quantity (i.e. the scope of contractual arrangements), but rather one of quality.

Even as a matter of mere positive observation, there is something about the typical organizational structure of the business firm that cannot be explained merely as either a written or unwritten contract. Somewhat similar to Smith and Merrill, whose current terminology describes the rights of property owners as "lumpy" rather than a mere cluster of interests, so Eisenberg has argued that many or most contracts in the corporation are "sticky."[81] This stickiness or lumpiness may be said to apply both to the boundaries of the firm and to the alignment of decision-making powers within it. As for the boundaries of the firm, the nexus of contracts theory is criticized for being intellectually incoherent "because it cannot mean either that the corporation consists of the core at which reciprocal arrangements overlap, or that the corporation consists of all reciprocal arrangements that are linked to each other or to something."[82] As for the way in which decisions or actions are regularly taken in the firm, it makes little sense to depict each one of them as a discrete form of new or renegotiated contract between all relevant parties.

On both points, Coase's view of the firm has regained currency among many scholars as more accurately portraying the business corporation. Firms emerge as complex organizations with a hierarchical decision-making structure because this is sometimes viewed as a superior mechanism over market transactions. The possibility of exercising authority and directing resources through fiat is what makes the business corporation a persistent phenomenon in today's economy. Accordingly, the boundary of the firm is defined by the firm itself when it

[81] *Id.* at 827-28.
[82] *Id.* at 830-831.

decides which economic activities would be carried out within the organization and which would rely on market transactions. While Coase cared little for property terminology, his view and the scholarship that followed came to reincorporate "proprietary foundations"[83] in the corporation.

1. Williamson, Hart on Vertical Integration and Residual Control

Interestingly, the reintroduction of property concepts into the corporate theory literature has been initiated by economists. Economists often have a different idea in mind than lawyers when they talk about property, [84] and many of them have not used explicit property terminology at the outset, as was the case with Coase's *Nature of the Firm*. But it is the work of several prominent economists who were followed by corporate law scholars that came to be known and articulated as a "property right approach" to analyzing the business corporation.

One such milestone was the work of Oliver Williamson, one of the founders of New Institutional Economics. In *The Economic Institutions of Capitalism*, Williamson observes that unlike the contract-based concept of economic institutions, the property rights literature (which he attributes to Coase, Alchian, and Demsetz) emphasizes that "ownership matters."[85] Once the "legally sanctioned structure of property rights is respected" and "human agents discharge their jobs in accordance with instructions," it is assumed that asset utilization will "track the purposes of its owners."[86] This assumption does not hold in the agency (i.e. contract-based) literature, in which "principals contract in full awareness of the hazards that contract execution by agents

[83] Armour & Winchop, *supra* note 74.
[84] *See* AMNON LEHAVI, THE CONSTRUCTION OF PROPERTY: NORMS, INSTITUTIONS, CHALLENGES, Ch. 1 (unpublished manuscript, on file with author).
[85] OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM 26-27 (1985).
[86] *Id.*

poses." The question of ownership matters little, but the future holds no surprises for the parties because "all of the relevant contracting action is packed into ex ante incentive alignments."[87]

Williamson is driven by a focus on a "transaction costs economics" approach, which studies different forms of economic organizations by examining the "comparative costs of planning, adapting, and monitoring task completion under alternative governance structures."[88] In deciding whether to manufacture a product in-house or through market transactions, a firm must take into account not only the *ex ante* costs of writing up a contract, but also those involved with the execution stage. The latter costs may be substantial, especially when the product or asset in question is developed and designated for a specific use, or when the development process is subject to uncertainty, which requires "adaptive, sequential decision-making."[89] The parties may find themselves held up in a dispute about the surplus or future decisions, with no party being able to easily identify the other as breaching the contract and to verify this to a court. As a matter of institutional design, it may make sense to move to a regime of *unified governance* or *vertical integration*. This is so because "where a single ownership entity spans both sides of the transaction, a presumption of joint profit maximization is warranted."[90]

Transaction cost economics thus agrees with the property rights approach that "ownership matters." But what truly matters is not the mere legal status of ownership that relies on centralized enforcement, but the fact that unified governance within the firm is a private ordering mechanism that grants institutional support to "adaptive, sequential decision-making."[91]

---

[87] *Id.* at 27-28.
[88] *Id.* at 2.
[89] *Id.* at 56.
[90] *Id.* at 78.
[91] *Id.* at 29.

Oliver Hart and others have formalized these basic insights into an explicit "property rights approach," arguing that "ownership is a source of power when contracts are incomplete."[92] When a contract does not specify all aspects of asset usage in every consistency, and decisions have to be taken about missing usages, it is the owner of an asset who has residual control rights over it. Ownership therefore goes beyond the right to residual income -- an attribute that has been the focus of Yoram Barzel's work on the economics of property rights[93] -- to apply to the right of residual control.[94] This concept of ownership therefore lies at the basis of the firm and accordingly defines its borders. Assets, broadly defined, that come under the unified governance and ownership of the economic organization of the business corporation, are distinguished from those that are governed and controlled by two parties engaged in a contract.

2. Hansmann and Kraakman on Asset Portioning

In a notable contribution to corporate theory, Henry Hansmann and Reinier Kraakman argue that "at its essential core, organizational law is property law, not contract law."[95] This dramatic departure from the nexus of contracts theory is premised, somewhat like Williamson or Hart, not on a formalistic analysis of the corporation and other standard-form organizations, but rather on promoting the goal of effective institutional design. While contracts naturally play a major role in the everyday dealings of the firm, contracts themselves -- however carefully planned -- do not suffice to provide institutional support for the range of economic activities that typify businesses.

[92] OLIVER HART, FIRMS, CONTRACTS, AND FINANCIAL STRUCTURE 29 (1995).
[93] YORAM BARZEL, ECONOMIC ANALYSIS OF PROPERTY RIGHTS 309 (1997).
[94] HART, *supra* note 92, at 30.
[95] Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387, 440 (2000).

For a firm to effectively engage in contractual relations with other actors, it must have, first, a well-defined decision-making authority, and second, the ability to bond its contracts credibly, i.e. to assure other parties that it would perform its contractual obligations. Such bonding usually requires that there exist "a pool of assets that the firm's managers can offer as satisfaction for the firm's obligations." In legal entities, as opposed to natural persons, these "bonding assets" are distinctive from assets owned by the firm's managers or owners, such that the firm's creditors have a claim on those assets that is separate from the claims of the owners' personal creditors.

Hansmann and Kraakman view this "asset partitioning" as the core defining characteristic of a legal entity, and the essential role of organizational law as one of establishing this separation. Asset partitioning thus has two components: first, designating a separated pool of assets that are associated with the firm and are distinct from the personal assets of the firm's owners and managers. Second is assigning creditors with priorities in the distinct pools of assets that result from the formation of the legal entity. The assignment of such priorities can take two forms: (1) "affirmative" asset portioning, which assigns to the firm's creditors a claim on the firm's assets that is categorically prior to the claims of the personal creditors of the firm's owners, and (2) "defensive" asset portioning, which does the opposite; granting to the owners' personal creditors a claim on the owners' separate personal assets that is prior to the claim of the firm's creditors.[96] This latter is regularly achieved, in its strongest fashion, through the limited liability corporation.

The essence of organizational law lies, according to Hansmann and Kraakman, in *affirmative* asset portioning. This portioning could not effectively be achieved only by contract or even through a standard application of the proprietary mechanism of secured transactions.

This is so because given the default rules of obligations law -- by which all creditors have an equal-priority claim to the entire pool of assets in case of default -- an entrepreneur would be

[96] *Id.* at 393-94.

practically unwilling and unable to credibly promise to business creditors a priority over the business assets. The entrepreneur would be unwilling to do so because the costs of obtaining such consent from past and future personal creditors would be prohibitive, and he would be unable to do so because this compliance could not be monitored or bonded: any contractual promises for priority would be valueless when the entrepreneur is insolvent and assets are distributed under bankruptcy rules. Needless to say, this problem is exacerbated when the enterprise is made up of multiple owners. To ensure their priority, business creditors would have to constantly assess and reassess the personal creditworthiness of each one of the owners.[97]

Establishing a categorical priority through standard security interests is also of limited value. While the law of security transactions allows for a floating lien covering both present and future assets by type, such blanket pledges usually require some sort of a description of the type of assets that would be covered under the lien. Moreover, to allow for such a blanket lien that would award priority to business creditors, the identity of the creditors would have to be spelled out in advance -- such constraint being impracticable for a dynamic long-term business.[98]

It is here that the organizational law's mechanism of establishing a separate legal entity comes into play. Permitting the firm itself to be the owner of assets provides a simple means for identifying which assets are considered business assets as opposed to personal assets. It also enables the clear ability to distinguish business creditors from personal creditors: the former are those whose dealings are with a formally organized firm rather than with the individual directly.[99] And through affirmative asset portioning, which grants this discernible group of creditors (present and future) a categorical priority with regard to a discernible group of

[97] *Id.* at 401-03.
[98] *Id.* at 417-20.
[99] *Id.* at 408-09.

resources (present and future), that organizational law allows for what a nexus of contracts system could not have achieved.

It thus becomes clear why the core of the business corporation as an economic organization lies in property concepts. The separate legal entity identifies the boundaries of the firm, with such boundary-setting serving an instrumental goal of allowing for an effective organization of its business activity. In one sense, the business corporation could be viewed as a notional *res*, an object of property rights, a conceptual carved-out piece of the world for which a distinctive set of rights and duties could be aligned. In another sense, the firm as a legal entity could be viewed as an agent, a subject of property rights, holding entitlements in various assets. While both conceptions have some force, I would suggest that the firm, with its boundaries so defined, could be seen as a "nexus of property" or "property micro-cosmos," a notional space within which rights and duties can be structured so as to have an *in rem* effect.

The business corporation thus allows for the allocation of a feasible set of legal powers and priorities, one which governs not only parties that can be said to be tied by contract or a "reciprocal arrangement," but also relations among distant parties. Those distant parties could each be tied to the firm but not directly to one another, such as with the firm's secured creditors vis-à-vis the firm's regular suppliers or employees. Other distant parties, such as the owners' personal creditors, could be seen as located outside the firm. The organizational and legal structure of the business corporation thus enables the construction of a system of property powers and priorities over assets, the boundaries of which are defined by the firm's boundaries.

3. Armour and Winchop on Joint, Sequential Ownership

A different type of focus on property in recent corporate theory is offered by John Armour and Michael Whincop.[100] While Hansmann and Kraakman seek to delineate the outer bounds of the firm, mainly to distinguish between internal and external creditors, Armour and Winchop examine the property structure of legal interests held by different stakeholders within the firm.

Accordingly, the concept of undivided ownership, as formulated by Williamson or Hart, seems more relevant to the firm's boundaries. But the structure of entitlements allocated *within* the firm is premised in sharing schemes, which have both contractual and property elements.

Distinguishing between the content and the scope of such entitlements, Armour and Winchop argue that some types of sharing schemes cannot rely on contracting only, but also must have an effect on third parties. This is necessary to create a more credible commitment among the firm's co-holders of entitlements not to behave opportunistically.[101] Viewed in these terms, it becomes clear why agency or trust law, as applied to corporate law doctrines, can actually be seen as incorporating property elements. To sustain such sharing schemes, these doctrines must legally prevent attempts to sell or pledge the corporate assets through unauthorized actions.[102]

Obviously, putting innocent third parties at risk of losing in such contests may entail substantial costs, meaning that any such proprietary mechanisms must balance the effectiveness of shared control arrangements with the negative externalities imposed on third parties.

One strategy to do so could be to apply a *numerous clausus* principle, which would limit the types of sharing arrangements that could be constructed within the firm, thus limiting the nearly

[100] Armour & Whincop, *supra* note 74.
[101] *Id.* at 442-44.
[102] *Id.* at 449-53.

unbounded freedom that parties would have under a pure contractual model. A second mechanism would be one of selective enforcement, by which potential conflicts between third parties and stakeholders with competing claims would be governed by context-specific rules such as the common law doctrine of apparent authority or the equitable rule of bona fide purchaser.[103] Yet another technique prevalent in property doctrines is one of effective notice or publicity, often attained through a registration system that substantially lowers search costs.

As Armour and Whincop show, all of these property mechanisms can be detected in corporate law doctrines, and they serve to govern not only sharing arrangements among shareholders, but also other types of legal relations among stakeholders in the firm.

Thus, for example, the legal relations among shareholders and the firm's creditors are typically based on the debt contract and governed by a contract-based sharing scheme that can be portrayed as one of "sequential sharing" -- by which the shareholders retain control unless some verifiable contingency such as default on the loan occurs whereupon the creditors take control. But these relations must also be governed by property doctrines that apply to third parties. The security interests that creditors regularly receive in the firm's assets grant them legal priority over third parties in case of asset alienation contrary to the terms of the debt contract, or upon insolvency. In addition, doctrines such as "fraudulent convenience law," otherwise known in English law as "transactions at an under-value" allow creditors to set aside against third parties certain eve-of-insolvency transactions that harm their interests.[104]

Finally, the legal relations among different creditors are also governed by what are essentially property doctrines, setting forth priorities and preferences between such distant

[103] For the application of these rules in traditional property law, see Menachem Mautner, *"The Eternal Triangles of the Law:" Toward a Theory of Priorities in Conflicts involving Remote Parties*, 90 MICH. L. REV. 95 (1991) (formulating a theory for dealing with these different variations of property conflicts, which he dubs also as "legal accidents" based on Guido Calabresi's work).
[104] *Id.* at 453-55.

parties in cases of conflicting claims to collateral interests in the corporation's assets during the life of the firm or upon insolvency.[105] Naturally, for the latter type of relations, reliance on a pure contractual model of the firm would be of little value, since no "reciprocal arrangements" could be said to apply to different creditors that have no contractual privity among them.

It is here that a property structure seems especially essential to prioritize rights to the firm's assets. The sharing model adds an important brick to the construction of the firm's "property micro-cosmos," by examining the property structure of the firm's inner workings alongside the conception of its outer boundaries as discussed in previous sections.

IV. Paradigm Lost: Why the Corporation Challenges Property Theory

A. Right to Exclude versus Separation of Ownership and Control

As Part II has indicated, the new essentialism school in property theory has been trying to extract the core meaning of property through a two-stage methodological move: (a) focusing attention on the right of ownership as the paradigm of property rights, and (b) identifying substantive incidents that are the *sine qua non* of ownership, and hence of property in general. The substantive essence has been typically identified as the right to exclude (whether this has an intrinsic value or an instrumental one for promoting the right to use), or as the right to exclusive decision-making about the uses to which the resource would be put.[106]

It is therefore clear why the literature on the theory of the firm, starting with Berle and Means and continuing up to the current writing on the proprietary foundations of the firm, poses a

[105] *Id.* at 454-55.
[106] *See* text accompanying *infra* notes 43-53.

challenge to the "essence" of property, and more broadly to the paradigms upon which new essentialism is based.

First is the issue of ownership. The underlying paradigm of "owner" in the new essentialism school is one of a single, natural person. One can naturally understand the appeal of opting for such a paradigm, especially when trying to promote a normative-substantive principle such as the right to exclude, relying also on moral ideas about autonomy or personality. While this literature is not explicitly antagonistic to the possibility of ownership by an artificial legal entity, the working assumption is one of a monolithic body, which exercises its right to exclude vis-à-vis strangers or other external circles such as neighbors. In this respect, it does not matter -- at least conceptually -- that the copyright to a certain song vests with a recording company and not with a real person. The same goes for the ownership of Blackacre or any sort of chattel.

But as Part III has demonstrated, where the business corporation is concerned, it makes little sense to settle only for the outer bounds of the firm in examining the issue of ownership. It is the inner circles of the firm within which the question of ownership becomes even more challenging. This is especially so because current literature on corporations argues that it *does* make sense to speak about property rights within the firm, since the firm is not merely a nexus of contracts.

One option would be to say that the owners of the firm are the shareholders. This would make life easier for the new essentialism school, because it would fit in nicely with a relatively straightforward model of co-ownership, in which an identified number of parties share pro rata the same kind of rights and duties and otherwise have an equal legal standing (though, as I show in Section B below, this is often not the case even if we opt for the shareholders-as-owners model). While such co-ownership requires internal governance mechanisms to overcome

collective action problems, this view of the firm would still clearly distinguish owners from non-owners.

But there is on obvious tradeoff here. Given the way that the business corporation works both as an economic organization and as a legal institution, shareholders do not enjoy, definitely not in full, the core substantive rights that are associated with ownership. This is so both with respect to the right to exclude, which makes little sense as far as shareholders are personally concerned, and also with the slightly softer version of the right to exclusive decision-making. The separation of ownership from control in the business corporation results not only from the organizational necessity to entrust decision-making with agents (management) but also from legal principles that limit shareholders, in their personal capacity, from appropriating the assets of the firm or otherwise directly setting the agenda for such assets.

It should be noted here that the question of the separation of ownership and control in the business corporation is more contextual and contingent than assumed by Berle and Means. There is an obvious difference between a widely-held public corporation, a closely-held corporation in which a single or small number of persons hold most shares, and a corporation in which a person or small number of people do not reach the nominal majority threshold but hold a substantial-enough block of shares to indirectly control the corporation by controlling the firm's institutions, mainly the identity of the board of directors and senior management. The question as to whether Berle and Means's model of separation is "really a myth"[107] thus depends on empirical-contextual observation that offers diverging answers across and within different economies. There are certainly many firms in which some shareholders can be said to effectively control the

[107] Brian Cheffins & Steven Bank, *Is Berle and Means Really a Myth?* 83 BUS. HIST. REV. 443 (2009).

firm – but as I show in Section B, this poses a different sort of challenge for current property theory.

That said, is there an alternative way to define "ownership" of the firm? Another strategy would be to follow Armour and Winchop's model of shared ownership, which encompasses not only joint ownership by shareholders, but also sequential ownership by shareholders and creditors.

This broader definition of ownership has a reverse tradeoff from the shareholders-as-owners model. It identifies more parties that have a practical and formal power of control over the firm's assets as "owners" (although management is still not captured under this broader definition, but rather is depicted as sharing with shareholders by being contractually delegated some power of control). But on the other hand, this alternative picture departs from conventional co-ownership. Owners are different not only in number but also in class, and they certainly cannot be said to be motivated by the same goals in setting forth the "agenda" for the corporation's assets.

Such a fragmented picture of ownership is not foreign to property scholars, definitely not to Anglo-American lawyers who are versed in the estate system in land. The estate system, with its fragmentation of rights both among different types of entitlements (i.e., holders of different present possessory interests) and along the time horizon (i.e. holders of future interests) has traditionally distinguished the Anglo-American property system from the continental system with its apparently unified "box of ownership."[108] But it is due to the growing dominance of fee simple absolute in land that Anglo-American jurists have also started to view single ownership as the practical and legal paradigm of ownership, one that conforms to standard ownership in chattels or intellectual property. Having to go back to fragmented conceptions with a historic feudal ring to it creates an understandable aversion. But it is simply at odds with the fact that

[108] *See* John Henry Merriman, *Ownership and Estate*, 48 TUL. L. REV. 916, 927 (1974).

constructing complex schemes of fragmented "ownership" often proves to be an efficient way for contemporary institutional design. This is clearly demonstrated by the dominance of various types of multi-owner organizations including business corporations or various kinds of trusts that are increasingly viewed in the literature as a form of shared ownership.[109]

Moving to the substantive core principles of ownership in the corporation, it seems clear enough that a straightforward "right to exclude" does not seem to be the core of the business corporation, whether one speaks of the corporation as an asset in itself, as formal owner of assets, or as a "property micro-cosmos" as I have suggested. The same doubts arise in regard to the alternative substantive core feature of ownership, that of exclusivity of decision-making or of setting the agenda for assets. Once we look beyond the corporate entity to examine who it is within the firm that *exclusively* makes the decisions about assets that are formally owned by the corporation, it is clear that no single person or class of persons can be identified as such, even if some persons are otherwise identified as owners.

This obviously does not point to chaos or to systemic ambiguity within the corporation. The rules guiding the corporation, made up of the corporation's private ordering contractual documents (articles of incorporation, debt convents, etc.) and corporate law's set of rules (be they mandatory or default rules) create a clear structure of decision-making within the corporation. But this structure typically does not follow the "owner decides" paradigm that guides current property scholarship. Control is not only separated, at least to some extent, from formal ownership of assets or the corporation's shares, but is also divided among several persons and institutions (general assembly of shareholders, board of directors, audit committees, senior management). Order and hierarchy in decision-making is thus maintained, and it can be

[109] *See, e.g.*, Joshua Getzler, *Plural Ownership, Funds, and the Aggregation of Wills*, 10 THEORETICAL INQ. IN LAW 241 (2009) (analyzing the trust fund as the "most developed and interesting form of plural ownership").

conceptualized as setting a property structure of powers and priorities that bind third parties, but this proprietary model of decision-making simply does not follow from the core of ownership.

I definitely do not argue that the focus of contemporary property theory on ownership is entirely misplaced. "Ownership" is an institution that certainly matters in many property contexts. In many such settings, ownership is indeed meaningful to efficiently carve out the world to allow for efficient economic activity, attainment of social-moral values, and a general sense of order. As for substantive principles, the right to exclude of course plays a prominent role for many types of assets in various contexts. Accordingly, in many cases, the set of legally enforced powers and priorities are invested and consolidated in a single person or group of equal co-owners. But it is not the same thing as arguing that the institution of property is inherently defined by "ownership" and that the *sine qua non* of property is the right to exclude or the exclusive right of decision-making invested in the person identified as "owner." As the business corporation shows, the institution of property accommodates other organizational modes and underlying content of substantive norms, in a manner that undermines the new essentialism.

B. Vertical Authority versus Horizontal Governance

Another source of tension between contemporary property theory and corporate theory on the nature of the firm can be identified as one of "vertical authority" versus "horizontal governance."

As discussed in Part III, Coase, Williamson, Hart and others have shown how the firm is governed not only by consent, but also by fiat. This is attained through a hierarchal structure and vertical integration of assets and actions. Power and decision-making thus have clear vertical components alongside horizontal axes of legal relations that otherwise exist within the firm.

This verticality typifies not only the managerial strata. It can also characterize relations among shareholders. In those corporations whose shares are not widely held, but dominated by a single or small group of organized shareholders who own a majority of the shares or otherwise hold a big enough block of shares to effectively control the firm's institutions, we speak of "dominant," "controlling" or "majority" shareholders. The practical and legal relations of this group of shareholders with other shareholders can be typified as vertical and not only as horizontal. I dub these respective groups "majority shareholders" and "minority shareholders" -- though, as mentioned, the block held by the "majority" is often less than 50 percent of the shares.

The verticality in the majority-minority relations has several features. As a practical matter, majority shareholders not only dominate voting in the general assembly, but also control the composition of the board by appointing the majority of board members. For some types of decisions, in order to protect against minority abuse, simple majority voting will not do. Certain types of decision, such as mergers, divisions, and similar transactions, typically require special majority.[110] Other actions may require that the general assembly or other corporate institutions be divided into sub-classes, so that decisions such as on transactions between the corporation and a controlling shareholder acting in a personal capacity receive a certain threshold level of support among minority shareholders, independent directors, or other non-majority actors.[111]

But there is a deeper sense in which the relations among majority and minority shareholders can be typified as vertical and not as horizontal. On the one hand, controlling shareholders are legally entitled to enjoy the "control premium" upon selling the controlling block of shares to a third party. The majority shareholder's practical power to control the corporation is not

[110] *See* Ed Rock et al., *Significant Corporate Actions, in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 131, 133-37 (Reinier R. Kraakman et al. eds., 2004).
[111] *Id.* at 118-28.

considered a corporate asset, so that she does not have to share with other shareholders the added value or "premium" she receives for the shares as reflection of the shares' control potential.[112] The legal validation of the control premium may be viewed as establishing a tiered system among the shareholders, by which one class of shareholder enjoys a better claim to the value of its property interest in the shares upon sale than do other groups of shareholders. To the extent that shareholding represents "ownership" there is some sense in which the corporate structure facilitates statuses of upper-class and lower-class shareholders.

On the other hand, a majority shareholder is a fiduciary with respect not only to the corporation, but also to minority shareholders. The fiduciary obligation requires the majority shareholder to use her power to protect "the entire community of interests in the corporation" and it entails duties of loyalty, honesty, and good faith toward the minority.[113] What this means is that one class of shareholders (one might say co-owners) owes certain duties to another class of shareholders (other co-owners) that are not reciprocal by nature. These duties may thus be viewed as reflecting the upper status that majority shareholders enjoy within the corporation, while subjecting them to certain legal duties that filter down the vertical structure.

This concept of vertical relations among co-owners does not sit comfortably with the type of co-ownership or "limited common property"[114] regimes that have been the focus of interest in contemporary property literature. Influential works, such as Elinor Ostrom's 1990 *Governing the*

[112] William Meade Fletcher, *Sale of Controlling Share—Recognition of Premium for ontrolling Stock*, FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS, § 5805.10 (current through Feb. 2011).
[113] Francis C. Amendola et al., *Dominant, Controlling, or Majority Shareholders*, 18 C.J.S. CORPORATIONS §378 (updated through Sep. 2011).
[114] Carol M. Rose, *The Several Futures of Property: Of Cyberspace and Folk Tales, Emission Trades and Ecosystems*, 83 MINN. L. REV. 129, 139 (1998).

Commons,[115] have inspired voluminous writing on co-ownership forms, spanning from a re-evaluation of ancient commons regimes,[116] to a discourse on modern forms of common property.

Probably most prominent of the current forms investigated in property scholarship is the range of residential planned communities, including homeowners associations, condominiums, and cooperative housing, that have boomed across the U.S. and many other countries around the world over the past few decades.[117] These various forms of co-ownership have mostly developed not to secure a communitarian view of property ownership, but quite the other way around: validating and preserving private interests of homeowners through sophisticated governance regimes of reciprocal rights and duties among co-owners or co-governors of the community.[118]

The core of the community property governance typically lies in the conditions, covenants, and restrictions included in the planned community's governing documents. These servitudes typically control and regulate commonly-owned amenities, as well as the use of privately-owned housing units. Beyond these upfront set provisions, the community-based governance of collective and private properties has a dynamic dimension. This is because the community institutions have power not only to enforce the terms of the declaration, but also to make managerial decisions, promulgate rules, and amend the declaration without a need for unanimous homeowners' consent.[119] At its core, the property structure of such planned communities is

---

[115] ELINOR OSTROM, GOVERNING THE COMMONS: THE EVOLUTION OF INSTITUTIONS FOR COLLECTIVE ACTION (1990).
[116] *See, e.g.*, Carol Rose, *The Comedy of Commons: Custom, Commerce, and Inherently Public Property*, 53 U. CHI. L. REV. 711 (1986); Henry E. Smith, *Semicommon Property Rights and Scattering in the Open Fields*, 29 J. LEGAL STUD. 131 (2000).
[117] *See, e.g.,* COMMON INTEREST COMMUNITIES: PRIVATE GOVERNMENTS AND THE COMMON INTEREST (Stephen E. Barton & Carol J. Silverman eds., 1994); EVAN MCKENZIE, PRIVATOPIA: HOMEOWNERS ASSOCIATIONS AND THE RISE OF RESIDENTIAL PRIVATE GOVERNMENTS (1994).
[118] *See* Henry Hansmann, *Condominium and Cooperative Housing: Transactional Efficiency, Tax Subsidies, and Tenure Choice*, 20 J. LEGAL STUD. 25, 26-30 (1991); Michael H. Schill, Ioan Voicu, and Jonathan Miller, *The Condominium versus Cooperative Puzzle: An Empirical Analysis of Housing in New York City*, 36 J. LEGAL STUD. 275, 282-86 (2007).
[119] RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES §§ 6.2-6.14 (2000).

measured in its ability to facilitate a sustainable collective action. A successful construction of co-ownership or co-governance scheme facilitates both establishment and management of common amenities (such as streets, parks, and sport facilities), as well as the control of intra-neighborhood externalities resulting from the heterogeneous uses of privately-owned units.[120]

These reinvigorated forms have fascinated property theorists, who have explored the way that co-ownership or co-governance property mechanisms could be used to solve both "commons" and "anticommons" tragedies.[121] On the face of it, the business corporation could have been a perfect addition to this literature in exploring the nature of co-ownership or co-governance.

But it might be that the business corporation and the planned residential community are viewed as based on two different paradigms that cannot be easily squared. While the business corporation has a strong component of vertical authority and multi-class governance, the discussion of planned communities is derived from an assumption of "horizontal governance."

This means that the various co-owners or co-governors are presumed to be of equal -- horizontal -- status, who bundle together to solve commons or anticommons problems in a purely reciprocal manner. While the need to overcome collective action problems of holdout, free riding, etc. may sometimes require the community to make collective decisions based on majority voting, the assumption here seems to be that the majority would be an ad hoc one, based on an independent consideration by each one of the co-owners or co-governors of the specific decision at hand. The majority is not predetermined or automatically formed by block voting.

---

[120] *See* Amnon Lehavi, *Mixing Property*, 38 SETON HALL L. REV. 137, 160-66 (2008).
[121] *See, e.g.*, LEE ANNE FENNELL, THE UNBOUNDED HOME: PROPERTY VALUES BEYOND PROPERTY LINES 45-64 (2009) (analyzing commons and anticommons dilemmas in residential settings); Francesco Parisi et al., *Commons and Anticommons*, 25 INT'L REV. L. & ECON. 578, 585–86 (2006).

Accordingly, no homeowner or group of homeowners is supposed to enjoy a control premium or to be placed in a categorically-superior position to other homeowners in the community.

This implicit assumption may explain the deferential approach that planned residential communities enjoy when majority-based decisions are being contested before courts. For example, in *Villa De Las Palmas Homeowners Ass'n v. Terifaj*,[122] the California Supreme Court upheld a majority-approved amendment to the condominium's declaration, imposing a no-pet restriction. The court viewed use restrictions as "crucial to the stable, planned environment of any shared ownership arrangement," holding that "all homeowners are bound by amendments adopted and recorded subsequent to purchase." In this specific case, this has meant that the statutory-based deferential standard, according to which the covenants and restrictions in the declaration shall be enforceable "unless unreasonable," applies equally to later amendments.[123]

This is definitely not to say that doctrinal jurisprudence or theoretical scholarship on common property is romantic or naïve. In the context of residential community associations, a substantial number of commentators have criticized these organizations as a "secession of the successful," "government for the nice," etc., but this has referred mostly to exclusionary measures employed toward outsiders, while assuming general homogeneity within the group.[124]

In other contexts, such as marital property, authors have definitely identified power disparities that exist between spousal co-owners, as a matter of social practice or ill-designed

---

[122] 90 P.3d 1223 (Cal. 2004).
[123] *Id.* at 1232-34.
[124] *See, respectively*, Sheryll D. Cashin, *Privatized Communities and the "Secession of the Successful": Democracy and Fairness beyond the Gate*, 28 FORDHAM URB. L.J. 1675 (2001); Paula A. Franzese, *Privatization and its Discontents: Common Interest Communities and the Rise of the Government for "The Nice,"* 37 URB. LAW. 335 (2005). Overt mechanisms may include gates and fences physically isolating the community. EDWARD J. BLAKELY & MARY G. SNYDER, FORTRESS AMERICA: GATED COMMUNITIES IN THE UNITED STATES (1997). Formal sorting of community members is achieved by associational provisions that set up, for example, age restrictions or bans on convicted sex offenders. Other exclusionary measures are informal, operating mainly through the price mechanism or through a strategic choice of the type of common amenities that would be set up within the CIC. *See* Lior Jacob Strahilevitz, *Exclusionary Amenities in Residential Communities*, 92 VA. L. REV. 437 (2006).

law.[125] But here too the working assumption has been that the law does not explicitly validate a "control premium" in favor of one co-owner or an otherwise vertical structure of co-ownership.

In this respect, the business corporation poses a challenge. Being based on hierarchy, fiat, and vertical authority, as well as on block voting and organized majority action – even if somewhat restricted by corporate law rules – the property structure of the business corporation seems to be at odds with the paradigm of "horizontal governance" in the common property literature. While this friction definitely could be resolved in conceptualizing the overall structure of the institution property, such disparity also may help to explain why the business corporation has not been featuring prominently in contemporary property theory.

C. Organizational Structure as Status-Based Stratification?

The hierarchical structure of the business corporation may create uneasiness among the new essentialism school in property theory in an even broader sense. It may be viewed as undermining the liberal bedrock against which this property literature has sought to reintegrate the institution of property. If it is to be successful in making the case for the owner's right to exclude or enjoy exclusivity in setting the agenda of the resource as the essence of property, this literature must first face the basic critique that has been voiced by the legal realists and later by critical legal theorists -- by which property is far from being neutral or inherently liberal. New essentialists have thus devoted much effort to delineate the proper societal limits on the right to exclude or to set the agenda for the resource, while emphasizing the free choice and autonomy that the institution of property fosters in liberal democracies.

[125] Carolyn J. Frantz & Hanoch Dagan, *Properties of Marriage*, 104 COLUM. L. REV. 75, 91-94 (2004).

There is something about the aforementioned analysis of the business corporation that may be deemed as threatening to throw property back to the jaws of a status-based critique, and in particular to the term that has become so pejorative in the property literature: feudalism.

I have already shown how often legal structures, ordering entitlements to assets, have been condemned as covert forms of feudalism. Morris Cohen did so in his depiction of the institution of private property. Charles Reich likened government's control of benefits and largess to the subjection of citizens to a new form of feudalism. Berle and Means referred to feudalism in a more subtle manner, by saying that the corporate system "bids fair to be as all-embracing as was the feudal system in its system"[126] without directly attributing feudal traits to the corporation.

While I generally view such equation of the corporation with a feudal system as somewhat superfluous, even for a closely-held corporation, it may be understandable why so much discussion about "vertical integration," "hierarchy," "fiat," "decree," and so forth in analyzing the property features of the business corporation is unpleasant to the ears of those who advocate the right to exclude or exclusive decision-making while being committed to a liberal agenda. In this respect, the private corporation seems once again to undermine the paradigms that guide the design of new essentialism in property.

V. Property and the Business Corporation Revisited

The key to resolving the tension between the current focus of property scholarship and the theory of the firm lies, first, in restating a general theory of property that is comprehensive enough to encompass the variety of resources and property organizations rather than adhering only to what any may call the "Blackacre paradigm." Section A offers a brief account of the

[126] BERLE & MEANS, *supra* note 1, at 8-9.

general contours of such a theory, one which focuses on the structural and institutional traits of property rather than trying to extract a single substantive criterion such as the right the exclude. Section B moves to show how the business corporation fits in well with such a theory of property and how it could fertilize the theoretical discussion of other assets and property organizations.

A. From Substantive Essentialism to Institutional-Structural Analysis

I have elsewhere presented in detail my structural and institutional account of the essence of property.[127] Here I briefly address three structural principles: third party applicability; constraints on opting out for private ordering; and the public-private interplay. I also discuss concisely the institutional features of property norm-making in view of the abovementioned structural features.

1. Third Party Applicability

The first structural trait is one of third party applicability. I use the term interchangeably with the more familiar *in rem* term, but in both cases I seek to capture the broad applicability that a certain set of legal powers of priorities has over broad sections of affected persons, rather than simply trying to reestablish the Roman-law style direct link between "person" and "thing."

The standard list of rights that are typically enumerated in legal systems as property rights, i.e. ownership, lease, mortgage, easements, etc., possesses a quality of general applicability toward an undefined class of persons or third parties. in setting forth a set of legal powers and priorities in regard to assets. These sets of legal powers and priorities in regard to assets do not simply break down to bilateral legal relations among specifically defined parties, although,

[127] *See* LEHAVI, *supra* note 84, Ch. 1.

obviously, property relations may be combined with contracts or torts, such as when a landowner sues another in nuisance or when neighboring landowners sign a contract to create an easement such as a right-of-way.

Unlike contractual relations, parties affected by property legal powers and priorities may not have privity or prior explicit legal relations among them and are often "strangers" that find themselves *ex post facto* entangled in a clash of competing claims over an asset. Beyond the fact that such parties are usually not enumerated and identifiable to one another in advance, they often turn out to be more heterogeneous in their epistemological, cultural, and social attributes, as compared to typical contractual counterparts. This means that for property law to function properly in creating, allocating, and enforcing such *in rem* rights, it must facilitate broad-based understanding about the way in which property rights and duties are structured and defined.

Property rights reveal their true complexity not in the relatively distinct asset-owner versus non-owner setting, but rather in cases in which numerous actors affected by the property regime diverge from one another in the particular set of powers and priorities they hold with respect to the resource. One can think about a piece of land that is simultaneously the object of different types of property rights: the land is owned by someone, leased by another, mortgaged in favor of a third, and subjected to an easement or servitude (e.g., right-of-way) in favor of a fourth party.

Likewise, property reveals its complex nature in scenarios of a good faith purchaser of voidable or void title; conflicting transactions; and other types of "legal triangles" where, due to the wrongdoing of an intermediary "villain," parties that are not in contractual privity find themselves asserting simultaneous claims to the same asset, and property law is required to *prioritize* the claims.[128] Bankruptcy and similar scenarios also vividly exemplify the

[128] Mautner, *supra* note 103.

distinctiveness of property rights: in such settings, rights recognized as holding property traits (typically, secured interests) have a categorical preference over contractual or obligatory rights, with a further internal ranking occurring within each one of the different categories. The legal institution of property is thus typified by ranking different legal interests relating to the asset, and determining the ways in which superior rights will be validated vis-à-vis inferior rights or claims.

2. Constraints on Opting Out

A second qualitative-structural difference between property and other legal fields that regulate relationships among persons concerns the parties' ability to opt out for private ordering.

In a purely contractual setting, parties who are displeased with the default rules of contract law can relatively easily opt out by resorting to private ordering mechanisms. These arrangements can deviate from contract law's default rules regarding the content of the parties' obligations, as well the procedure, evidence, and forum for dispute resolution. Contract law traditionally includes few restrictions if any on the power of the parties to do so.

Property is different. To the extent that the law sets up certain requirements for a party to qualify as a "good faith purchaser" or to register a mortgage so that it would have a binding effect on third parties, legal actors are much more constrained in their practical ability to privately circumvent such norms. This is in fact one of the underlying reasons for the *numerus clausus* principle: this structural principle limits parties in exercising their transactional freedom to shape legal relations, if they wish their rights to have a broad binding effect on third parties.[129]

[129] For a survey of current literature on the *numerus clausus* principle, see Nestor M. Davidson, *Standardization and Pluralism in Property Law*, 61 VAND. L. REV. 1597, 1599, fn. 3 (2008). For this principle's more stringent version in the European civil law system, see BRAM AKKERMANS, THE PRINCIPLE OF NUMERUS CLAUSUS IN EUROPEAN PROPERTY LAW (2008).

This definitely does not prohibit any form of private ordering, but it does put at the least a practical cap on the ability of parties to legally bind others with whom they have not transacted.

In addition, while it is theoretically possible for parties to entirely opt out of the legal regime by regulating their relationships solely through self-enforcing (informal) norms, as Robert Ellickson suggests in *Order without Law*,[130] this is practically restricted to small-scale, close-knit groups and would definitely not fit property relations involving remote parties. In this respect as well, the bundle of rights view, which narrows down property to bilateral bargaining relations, simply comes up short in depicting the full scope of legal property ordering.

As section B shows, the business corporation serves as a quintessential example for the implications that the limits on opting out for private ordering have on the structuring of legal powers and priorities. These structural limits also have normative implications, especially when the legal ordering includes mandatory rules. The compulsory nature serves not only to ensure that affected parties are well informed about the way in which legal relations are constructed within the firm, but also to create a mechanism through which the substantive interests of affected parties could be taken into account in what is otherwise a "property micro-cosmos."

3. The Public-Private Interface

Another structural aspect of property law concerns its distinctive public/private interface. The challenge faced by legal systems in designing the institution of property is one of simultaneously delineating the permissible borders of government intervention with property rights, while at the same time defining the scope and nature of property rights vis-à-vis the spectrum of third parties.

[130] ROBERT C. ELLICKSON, ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES (1990).

Although the task of drawing the lines between public-constitutional legal norms and those controlling private conduct is well familiar in many other fields of law, property does seem to introduce a special challenge. The very use of the same term, "property," in the private law field and the public-constitutional realm, is not merely a matter of historical accident or conceptual confusion. While the general, mostly liberal arguments in favor of differentiating between government conduct and private conduct may apply for property, any attempt to hermetically separate the two realms of property law would be both impractical and normatively awkward.

Thus, in a number of cases, the U.S. Supreme Court actually made cross-references between the public law and private law of property. This was done, for example, in several takings cases, in which the Court considered the power to exclude as "one of the most treasured strands in an owner's bundle of property rights[131]--referring as it did to the terminology of private common law jurisprudence, thereby allegedly equating a taking to a case of private encroachment.

On the other hand, the Supreme Court has shunned a complete osmosis of the public and private in property. This was done (or more accurately, not done) in the aftermath of the seminal *Shelley v. Kraemer* case.[132] By refusing to further apply, let alone extend the holding in *Shelley* to other settings of private property disputes, the U.S. court has refrained from embracing a full-scale public-private integrative platform for the law of property.[133]

---

[131] *See* Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419, 436 n.12 (1982) (referring to Pruneyard Shopping Ctr. v. Robins, 447 U.S. 74 (1980), which discussed the private property rights of a shopping mall that banned the handing out of antiwar pamphlets).

[132] In Shelley v. Kraemer, 334 U.S. 1 (1948), the U.S. Supreme Court invalidated a restrictive covenant that had been signed and recorded by thirty property owners in a neighborhood in St. Louis, and which provided that the properties would be leased or sold to whites only. The Missouri state courts, based on state common law property principles, upheld the restrictive covenant. The constitutional anchor, through which the Court invalidated this measure as an infringement of the Fourteenth Amendment's Equal Protection clause, was to view the state judicial decrees upholding the restrictive covenants as constituting "state action," since the trial court was exercising the "full coercive power of government" to deny black petitioners "the enjoyment of property rights in premises which petitioners are willing and financially able to acquire and which the grantors are willing to sell." *Id.* at 844-46.

[133] By viewing judicial rulings in private law settings as "state action" that consequently implicates the Bill of Rights, the *Shelley v. Kraemer* case could have led to fuller-scale osmosis of public and private in property. But this has not happened to date, for the practical and normative reason that the Supreme Court wishes to maintain a sphere

The result is one of constant tension between public and private in property, a dilemma which is regularly addressed by other legal systems around the world.[134] As Section B shows, the business corporation, as an economic organization of "collective capitalism," entails important lessons for trying to structure the interplay between the two facets of property, even if one is not necessarily sympathetic to Berle and Means's normative conclusion by which the publicly-traded business corporation should be viewed as a "quasi-public" and subjected to public law duties.[135]

4. The Role of Norm-Making Institutions

The aforementioned structural features of property are inevitably tied to institutional considerations, namely, deciding which collective norm-making institutions should be entrusted with the role of designing the sets of legal powers and priorities that make up property doctrines for different kind of resources and property organizations. This relates to the question: how do such processes of decision-making tie in with the possibility -- even if limited -- of private ordering of property rights by bottom-up bodies such as corporations or planned residential communities?

While a full-scale discussion of institutional norm-making is outside the scope of this paper, one issue that is of particular interest in the property context concerns the relations among legislatures and courts in the design of property norms. This is especially so in view of the

---

of private activity that is not subjected to constitutional scrutiny, even if the borders between "private" and "public" are often blurry and ambiguous. *See* Mark D. Rosen, *Was Shelley v. Kraemer Incorrectly Decided? Some New Answers*, 95 CAL. L. REV. 451, 458-70 (2007).

[134] *See, e.g.,* GREGORY S. ALEXANDER, THE GLOBAL DEBATE OVER CONSTITUTIONAL PROPERTY 188-91 (2006) (studying the horizontal effect of constitutional rights on private law in the South African and German systems, and calling to embrace similar ideas in American property law); FUNDAMENTAL RIGHTS AND PRIVATE LAW IN THE EUROPEAN UNION, Vol. 2, 279-321 (Aurelia Colombi Ciacchi et al. eds., 2010).

[135] BERLE & MEANS, *supra* note 1, at xxviii-xxxi, 312-13.

tension between stability and dynamism, and the unique role that norm-making institutions must play in accommodating the two in property law.

To start with, the aforementioned structural traits of property -- third party applicability, constraints on opting out for private ordering, and complex public-private interplay -- mean that for property law to function properly, it must facilitate broad-based understanding about the legal regime and ensure a sufficient level of stability and security in the delineation of property rights.

Merrill and Smith link these requirements to the *numerus clausus* principle as a key ingredient for establishing a standard list of rights, one that can be disseminated and understood by the general public with clarity and relatively low information costs.[136] As an institutional matter, they argue that the legislature is typically in a superior position to do so. They tie this to what they deem to be the general advantages of legislation over case law in securing clarity, universality, comprehensiveness, stability, prospectivity, and implicit compensation.[137] Under this view, property is a field of law that should be developed chiefly by legislative norm-making.

Legislation definitely plays a key role in designing property law or in making "dramatic" changes to it. But the role of courts in lawmaking is far from negligible, and the inevitable need for dynamism in designing property over time often may be properly met by courts.

To understand the institutional implications of dynamism in property, consider first that like the often incomplete nature of contracts, property doctrines too may be incomplete and require dynamic content-filling over time. Even the most careful design of property norms by upfront legislation cannot anticipate and regulate in advance all potential frictions that may arise with respect to the delineation of property rights (e.g. which types of conflicting uses in neighboring lands would amount to wrongful nuisances, or which uses of copyrighted work by non-owners

[136] *See* Thomas W. Merrill & Henry E. Smith, *Optimal Standardization in the Law of Property: The Numerus Clausus Principle*, 110 YALE L.J. 1 (2001).
[137] *Id.* at 60-66.

should count as an infringement). Moreover, dynamism in property may be the result of broad-based changes in ideologies, values, or technological, economic, and institutional innovations. Finally, dynamism in property may also be the result of a "substantive" jurisprudential approach, one that looks to connect the application of legal norms to their underlying values and goals.

One dominant strategy for dealing with dynamism or incompleteness of norm-making is by initially designing some legal norms as relatively open-ended "standards" rather than as clear-cut "rules."[138] Legal standards are prevalent throughout the law, including in property doctrine, although they are somewhat under-theorized among property scholars. "Reasonableness" and "abnormality" are prevalent in nuisance doctrine;[139] "abuse of rights" standards limit the exercise of otherwise-valid property rights;[140] the "fair use" list of legislative standards distinguishes permissible uses from infringement of copyrighted materials;[141] and the "public use" provision in the Fifth Amendment sets the boundaries of legitimacy in taking private property.[142]

I suggest that a legal standard should be analyzed chiefly as an *institutional* mechanism. A standard promulgated in a constitution or a statute is a provision that delegates the giving of fuller norm-content over time to other decision-makers, chiefly courts. At the same time, this institutional delegation does not mandate that the legal norm remain vague all the way down to the case-specific inquiry. The judicial enterprise of filling standards with content is one of balancing the court's institutional ability for dynamism and promotion of substance-based jurisprudence with the need to preserve a sufficient amount of predictability, certainty, and

---

[138] *See* Louis Kaplow, *Rules versus Standards: An Economic Analysis*, 42 DUKE L. J. 557, 559-62 (1993).
[139] *See* Restatement (Second) of Torts §822 (1979); Robert C. Ellickson, *Alternatives to Zoning: Covenants, Nuisance Rules, and Fines as Land Use Controls*, 40 U. CHI. L. REV. 681, 731-32 (1973).
[140] *See, e.g.*, Joseph M. Perillo, *Abuse of Rights: A Pervasive Legal Concept*, 27 PAC. L.J. 37, 40-47 (1995); Michael Byers, *Abuse of Rights: An Old Principle, A New Age*, 47 MCGILL L.J. 389 (2002).
[141] Under U.S. law, the determination of whether "the use made of a work in a particular case is a fair use" rests on the consideration of four factors: (1) the purpose and character of the use; (2) the nature of the copyrighted work; (3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and (4) the effect of the use on the potential market for the copyrighted work or on its value. 17 U.S.C.A. § 107.
[142] U.S. CONST., amend. V, § 4.

future-looking guidance among the indefinite and heterogeneous members of the general public.[143] If successful in addressing dynamism in property in such manner, courts can engage in judicial lawmaking without undermining property's aforementioned structural features.

B. The Corporation as a Nexus of Property

Once the weight of conceptualizing property shifts from an attempt to extract a single normative criterion to a broader-based structural and institutional analysis, it becomes clear why the business corporation would fit this framework well and could further illuminate both analytical and normative issues that pertain to other resources or property-based organizations.

I have suggested earlier that while one could see the corporation entity itself as *res* -- an object of rights which is pro rata owned by shareholders -- or as the subject of property rights that owns assets as a stand-alone legal entity, a more systematic way to conceptualize the corporation would be one of a "property micro-cosmos" or "nexus of property."

This means that the economic and legal structure of the corporation defines a set of legal powers and priorities to the corporate assets. Some of these powers and priorities are based in contractual arrangements, such as the articles of incorporation, executive employment agreements, or debt covenants.

Other powers and priorities are based on top-down norms in corporate law and related legal fields such as bankruptcy or equity. Some of these top-down norms serve to order legal relations between stakeholders that do not otherwise have contractual privity -- such as relations among different creditors, or between individual shareholders or directors and creditors. Other

[143] See Amnon Lehavi, *The Dynamic Law of Property: Theorizing the Role of Legal Standards*, 42 RUTGERS L. J. 81, 125-27 (2010).

complementary norms apply to parties whose relations are initially based on contract, such as among shareholders. This additional layer of norms may stem from the inherent incompleteness of contractual norms, such as the inability to spell out in advance all the contingencies that distinguish legitimate majority decisions from abuse of the minority shareholders. It could also be used to promote broader goals and values that intervene with the freedom of stakeholders to contract about powers and priorities, such as rules that favor employees or other vulnerable stakeholders in the event of distribution of the corporation's assets upon dissolution.

It is important to note that this additional set of legal powers and priorities to direct the corporate assets is not synonymous with the Coasean account of "fiat" and "authority" or with Williamson's depiction of "vertical integration." The Coase-Williamson account is instrumental in featuring one of the property foundations of the corporation: the alignment of decision-making powers down the management or production chain in view of the self-enforcing nature of unified governance.

But other rules, such as those applying to apparent authority, bona fide purchase, or fraudulent convenience of the corporation's assets, go beyond these self-enforcing mechanisms. Such rules are essential to decide competing claims between otherwise distant parties that find themselves entangled in a clash over conflicting claims to rights in the corporation's assets.

The chief legal mechanism that allows for the construction of the firm's "property micro-cosmos" is the corporation's separate legal entity. The separate legal entity defines the boundaries of both the assets located within this socio-economic organization and those of the organization itself. It allows the conceptual and formal carving out of assets and the setting up of a system of powers and priorities that apply also to third parties and thus have an *in rem* feature.

The degree to which the boundaries of the "property micro-cosmos" are hermetic depends on the specific design attributes of the separate legal entity. As for affirmative asset portioning, the degree of separation of the firm's creditors from the shareholders' personal creditors depends on the type of priority awarded to the firm's creditors (relative or exclusive) in the firm's assets, and on the level of protection awarded against the ability of personal creditors of a shareholder to force liquidation of corporate assets upon exhausting the shareholder's personal assets.[144]

As for negative asset portioning, the degree of separation depends on whether the corporation is set up as a limited liability company, so that the firm's creditors cannot generally make claims to shareholders' personal assets, and on what exceptions to limited liability may be carved ex post through doctrines such as "piercing the corporate veil."[145] A relatively weak form of separation does not entirely undermine the *in rem* nature of powers and priorities, though it definitely challenges the ability to set clear boundaries of "within" and "outside" the corporation.

Importantly, the business corporation as a property micro-cosmos is both quantitatively and qualitatively distinctive from the paradigmatic single-owner picture of property. As the previous parts have shown, this is so not only with respect to the internal governance of the corporation, but also externally, in view of the multi-layered structure of stakeholders including multiple groups of "outsiders." The fact that the publicly-traded corporation regularly has a large number of shareholders, whose identity constantly changes with the rapid trade in the securities market, and that shareholders may further be divided into certain classes, including majority shareholders, non-controlling institutional investors, and dispersed minority shareholders, also implicates those who are located "outside" of the firm. Since each one of the multiple shareholders has its own set of personal creditors and other interested parties, the particular

[144] Hansmann & Kraakman, *supra* note 95, at 394-97.
[145] Gerard Hertig & Hideki Kanda, *Creditor Protection, in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 71, 92-94 (Reinier R. Kraakman et al. eds., 2004).

design of negative and affirmative asset portioning in the firm -- e.g., whether a limited liability corporation would nevertheless allow the piercing of the firm's veil by imposing personal liability on shareholders -- distinguishes the business corporation from single-owner or even more traditional cases of co-ownership (such as in joint tenancy in land). The business corporation thus cannot simply be reduced to governance on the inside and straightforward exclusion on the outside. Yet the firm's structure is one embedded in property relations, no less than in the case with the allegedly-paradigmatic single-owner property. The micro-cosmos of the corporation simply calls for a more intricate design of legal powers and priorities in regard to assets.

The constraints on opting out for private ordering also play out significantly in the business corporation. While the corporation is definitely embedded in a thick web of contracts, it must also be governed by rules that extend the powers and priorities in the corporate assets, so that they would apply to third parties. This is where the variety of top-down legal mechanisms, from the separate legal entity and limited liability to rules about apparent authority, bona fide purchase, or fraudulent convenience, come into the picture. They are necessary to complement private ordering so as to grant a true property feature to the set of powers and priorities.

But the constraints on opting out for private ordering may also be normative, not only functional. This is the role that mandatory rules, such as those governing tender offers and insider trading, play in the context of the corporation. While these rules could be justified on the basis of unequal bargaining power among parties that may otherwise be parties to contract (e.g. majority versus minority shareholders), the broader-based justification for the constraints on opting out for private ordering lies in the protection of vulnerable third parties: employees,

suppliers, creditors, and even society in general. More broadly, as I have indicated elsewhere,[146] property rights are not natural rights and cannot be constructed solely through private decision-making. Property regimes, and property rights that emanate from them, are the result of conscious decisions by the state's authorized entities to designate resources as objects of property and to create a certain set of legal powers and priorities to them. The role of the state is thus not only to ex post enforce and validate sets of rights that have been created privately, but also to initially legitimize, through a process of public reasoning, organizational structures within which legal entitlements with broad third-party effects would be created.[147]

The third structural trait of property, namely the unique public-private interplay, is also instrumental for understanding the property micro-cosmos of the business corporation. This is especially so with respect to the publicly-traded business corporation, in view of the enormous number of members of the public (practically everyone) who hold a stake in corporations either as direct shareholders or indirectly through institutional investors. Even if one is not immediately taken by the normative aspect of Berle and Means's notion of "collective capitalism," by which property rights of shareholders in the corporation can be justified only by broad societal redistribution of wealth, it is clear enough that no other resource or nexus of property implicates such a broad membership of "insiders" (i.e. parties who formally hold a stake in the corporation's assets). To the extent that property must be designed to consider both private law and public law aspects, even if one does not aspire for harmony among these two realms, then the business corporation may play a central role in addressing this structural trait.

Finally, as for the institutional characteristics of norm-making in property, I have already shown the prominent role that top-down legislation and regulation play for both functional and

[146] Amnon Lehavi, *The Property Puzzle*, 96 GEO. L. J. 1987, 1993-1996 (2008).
[147] *Id.* at 1995-96.

normative reasons in constructing the nexus of property in the business corporation. But the set of norms applying to legal powers and priorities in the corporation also demonstrates the chief role that courts play in norm-making. Courts do so by filling initially vague legal standards with content over time so as to add a substantial layer of property norms that could not have been adequately designed by private ordering or through ex ante hard-edged rules.

Thus, while detailed rules can effectively be used to govern agency problems relating to the control of the corporate assets in matters such as tender offers, it is impracticable to govern all types of complex intra-corporate relations through ex ante legislation. Self-dealing or conflicted transactions in the corporation's assets involving controlling shareholders are a quintessential example. Trying to regulate in advance all prohibitions and exemptions is liable to result in the inefficient codification of loopholes on the one hand and unnecessary rigidity on the other.[148]

What most legal regimes do to resolve this tension is to set up legal standards applying "fiduciary" duties and "fairness" norms through which such transactions could be governed ex post while creating thicker content for future transactions in the corporation's assets. Most U.S. courts adopt the "entire fairness" or "intrinsic fairness" test for evaluating self-dealing transactions by controlling shareholders, as well as the "duty of loyalty" aimed at controlling management conflicts and limiting self-interested managerial diversion of resources.[149] It is only through the gradual process of filling these initially vague norms with content by judicial decisions that the various stakeholders in corporations would get a better sense of the set of powers and priorities to the corporation's assets that forms the full-scale nexus of property.

---

[148] Henry Hansmann & Reinier Kraakman, *Agency Protection and Legal Strategies, in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 21, 23-24 (Reinier R. Kraakman et al. eds., 2004).
[149] Hertig & Kanda, *supra* note 145, at 114-18, 126-27.

Conclusion

Eighty years ago, Berle and Means invited readers to reconsider the fundamental traits of property law and offered a far-reaching normative agenda for reconstructing this legal institution. They did so from an unconventional spot -- that of the business corporation -- which up to that time was seen as a locus of pure private organization embedded in the invisible hand of the market.

Numerous generations of property theory scholarship have largely declined this invitation, while engaging in de-canonizing and re-canonizing the classics: land, chattels, intellectual property, etc. Somehow, the business corporation has not seemed to fit well the paradigms of property, especially by those who advocate a new essentialist approach. But this oversight can no longer be maintained. The business corporation is simply a too important nexus or micro-cosmos of legal powers and priorities to resources to remain outside the main gate of property theory.

Once we move from attempts to extract a single normative criterion for all types of resources and property settings to an alternative concept of property that is based on identifying the structural and institutional features of property, it becomes evident that the business corporation holds a key spot in understanding what property is. The business corporation offers important insights that may be hard to come by if one only sticks to the Blackacre paradigm.

One such insight concerns the preoccupation of new essentialism with the right of ownership and its attempt to extract the meaning of property through this specific type of right. Ownership is obviously a key legal institution. It often allows for the creation of a solid sense of order, both formally and practically, in setting legal powers and priorities to resources. But ownership does not stand alone, and once we understand that ownership is always entangled in a broader set of legal power and priorities, it makes perfect sense to have different versions of ownership, even

for a certain resource or within the same type of property organizations. Thus, it is clear enough that ownership in land is not equal to ownership of a share, and that ownership of a controlling share is not equal to that of a minority share: this is so with respect to the power of decision-making, the priorities with regard to residual income or revenue, and so forth. But it may still make sense to use the term "ownership" as a relative term, one that is helpful in setting forth legal powers and priorities, without sticking to an all-or-nothing approach.

The same goes for the *numerus clausus* principle and the tension between rigidity and dynamism in property. The economic and legal organization of the corporation demonstrates that there are different ways to draw boundaries and to control their rigidity without collapsing them altogether, just as there may be different variations to order the internal set of legal powers and priorities within these boundaries. It makes sense to talk about "property" even if it deviates from the Blackacre paradigm or does not otherwise boil down to a single normative Holy Grail.