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**PROPERTY, CONTRACT, AND VERIFIABILITY:  
UNDERSTANDING THE LAW'S RESTRICTIONS ON DIVIDED RIGHTS**

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## I. INTRODUCTION

The law of every jurisdiction defines a set of well-recognized standard forms that property rights can take, and burdens the creation of property rights that deviate from those standard forms. In this respect property law differs from contract law, which generally leaves parties free to craft contractual rights in any form they wish. Scholars in civil law countries have long been self-conscious about the law's constraints on property rights. Only recently, however, have those constraints received much attention, or even acknowledgement, in the literature of the common law countries.<sup>1</sup>

The principal effort to rationalize the law's limits on property rights appears in a recent article by Merrill and Smith. They argue that the best explanation lies in information costs. If individuals were left free to create property rights of any form they wish, the result would be to impose inefficiently large information costs on third parties in ascertaining the nature of the rights they are acquiring. Consequently, Merrill and Smith suggest, the law of property reduces information costs by standardizing property rights into a limited number of specified forms.

We agree that third party information costs are central to the law's regulation of property rights. Nevertheless, the Merrill and Smith analysis is not completely satisfying. The reason, we believe, is that they do not focus clearly on the central problem of *verifiability*. As a consequence, they do not offer a convincing reason for the law's different approach to contract rights and property rights.

We offer an alternative view here. Our view is, in important respects, complementary to that offered by Merrill and Smith. We differ from those authors, however, or go beyond them, in several significant respects. First, we offer a clear statement of the relevant differences— and also the relevant similarities – between contract rights and property rights. Second, we note that the law's regulation of property rights is best characterized, not as *standardization* into a discreetly limited number of well defined forms, but more accurately as a regulation of the types and degree of notice required to establish different types of rights. Third, we argue that this regulation serves principally not to ease burdens of *communication* among persons who transact in rights, but more importantly to facilitate the *verifiability* of the fact and content of communication. Finally, we note that it is not quite right to view property law as *limiting* the types of rights that can be created. Rather, it is more accurate to see property law – and, for that matter, contract law – as affirmatively providing social institutions that support the

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<sup>1</sup> See Bernard Rudden, *Economic Theory v. Property Law: The Numerus Clausus Problem*, in OXFORD ESSAYS IN JURISPRUDENCE, THIRD SERIES 239 (1987); Henry Hansmann & Marina Santilli, *Authors' and Artists' Moral Rights: A Comparative Legal and Economic Analysis*, 26 JOURNAL OF LEGAL STUDIES 95 (1997); Henry Hansmann & Ugo Mattei, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 NEW YORK UNIVERSITY LAW REVIEW 434 (1998); Thomas Merrill and Henry Smith, *Optimal Standardization in the Law of Property: The Numerus Clausus Principle*, 110 YALE LAW JOURNAL 1 (2000); Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE LAW JOURNAL 387, 422 (2000)

formation of certain kinds of relationships. Those institutions impose different patterns of costs and benefits. It is the tradeoffs between those costs and benefits that determine the types of rights for which the law can efficiently provide support.

One would expect this cost-benefit analysis to be reflected, at least crudely, in the patterns of property rights that the law in fact recognizes. And so, we argue, they are. In this respect, our essay is in the spirit of Demsetz's prominent essay on the origins of property rights. Demsetz sought to explain the conditions under which private property rights will emerge. We seek to explain the conditions under which particular *structures* of private property rights will emerge. In addition, we seek to clarify the relationship between property rights and contract rights, and to offer some insight as well into the law's regulation of contract rights – including, in particular, the remedy of specific performance.

## **II. THE REGULATION OF PROPERTY RIGHTS**

We begin by examining the differences between property rights and contract rights. With this distinction in mind, we then review the differences in the flexibility that the law permits for these two types of rights.

### ***A. Property Rights Versus Contract Rights***

The nature of property rights, and the ways in which property rights differ from contract rights, are most easily seen by focusing on claims on assets. We will return later to explore more carefully what might qualify as an “asset.” For the present, an asset can simply be considered a physical object.

A person's claim on an asset – a right to use that asset in certain ways, for example – can take the form of either a contract right or a property right. For our purposes, the attribute that distinguishes a property right from a contract right is that a property right is enforceable, not just against the original grantor of the claim, but also against other persons to whom possession of the asset, or other rights in the asset, are subsequently transferred. In the parlance of property law, the burden of a property right runs with the asset. A lease on a parcel of land is therefore a property right in our terms because a tenant can generally enforce his rights under the lease, not just against the landlord who originally granted the lease, but also against anyone to whom the landlord transfers his rights in the land. While this definition of a property right does not always track current usage of the term,<sup>2</sup> it seems the definition best suited to the problem at hand. We explore other definitions of property rights in Section X.

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<sup>2</sup> For example, a lease is generally categorized as a contract and not as a property right in the civil law, even though the tenant can generally enforce the lease against subsequent transferees of the underlying fee in the civil law just as in the common law. See BGB § 571; Italian Civil Code §1599.

## **B. Restrictions on Divided or Partial Property Rights**

A person who owns an asset is generally free to grant to other persons contractual claims on that asset of any form, including partial use rights, contingent rights, and rights to require or to prevent specified uses of the asset. The owner of an asset is not similarly free, however, to grant claims in the asset that take the form of property rights. This is most conspicuous in the civil law countries of Europe, which since the nineteenth century have adhered self-consciously to the principle that, as a general rule, all the elements of ownership of an asset must be concentrated in the hands of a single person. Only a small, closed number (“*numerus clausus*”) of specifically defined exceptions to this principle of unitary ownership are permitted.<sup>3</sup> These exceptions include, for example, co-tenancy, servitudes on real property, mortgages on real property, and security interests in personal property.<sup>4</sup> Partial property rights that do not conform to one of these specific exceptions are unenforceable. It is for this reason that European law has not generally recognized the private trust. The particular division of property rights that a trust involves, with legal title in the trustee and beneficial ownership in the beneficiary, is not among the enumerated forms of division permitted under the civil law.<sup>5</sup>

The civil law jurisdictions are not unique in this respect, however. Legal doctrine in the common law countries, including the United States, has a similar character. The particular forms of divided property rights that the common law recognizes sometimes differ from those recognized under the civil law, as illustrated by the common law’s long-standing recognition of the private trust. Moreover, the common law’s limitations on divided property rights are sometimes less rigid than those of the civil law. Nevertheless, the common law, like the civil law, provides for a limited number of forms of partial or divided property rights that can be created with relative ease, and makes it difficult to enforce rights that differ from these accepted forms.

As with the civil law, the common law’s limitations on partial or divided property rights are most obvious and familiar in the realm of real property.<sup>6</sup> Property rights for the partial use of land, for example, have long been confined to easements, real covenants, and equitable servitudes, each with its special requirements for enforceability.<sup>7</sup> Another conspicuous example today is the condominium. Though long recognized by the civil law, the condominium was not accepted into U.S. law until 1961, after which it showed its value by sweeping rapidly through the housing market.<sup>8</sup> English law, meanwhile,

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<sup>3</sup> See John Merryman, *Estate and Ownership: Variations on a Theme by Lawson*, 48 TULANE L. REV. 916 (1974).

<sup>4</sup> These four types of property rights are found, for instance, in the German Civil Code at, respectively, BGB §§ 1008 – 1011, 1018 – 1089, 1113 – 1190, and 1204-5.

<sup>5</sup> See Hansmann & Mattei, *supra* note 1.

<sup>6</sup> Merrill & Smith, *supra* note 1, offer a more extended and highly informative survey of the law’s limitations, with particular focus on the law of real property.

<sup>7</sup> An effort has now been made to unify and generalize these rules with the new RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES §§ 4.1-4.13 (2000).

<sup>8</sup> Interestingly, the condominium form was made part of U.S. law quite fortuitously, with no awareness of the great role it would subsequently play. See Henry Hansmann, “Condominium and Cooperative

continues to reject that form.<sup>9</sup>

The common law's restrictions on property rights are, however, by no means limited to the sometimes ancient and arcane features of the law of real property. Those restrictions extend to personal property as well, and are central to contemporary issues of policy.

The law of artists' rights offers illustrations that, though at present of only modest commercial significance, are particularly clear, and will be of use to us below. This is an area in which, like condominiums and in contrast to trusts, the common law has traditionally been more restrictive than the civil law in recognizing property rights. At issue is the right of artists, such as painters and sculptors, to retain rights in their works after the works themselves (or, more precisely, rights to possession of the works) have been sold. Two such rights have been of particular importance, and the focus of current efforts at reform both in the U.S. and in the European Community: the "right of integrity" and resale royalty rights.

The right of integrity is the right of a painter, sculptor, or other artist to insist that, even after she has sold one of her works, neither the original purchaser of the work nor any subsequent owner can alter or destroy the work absent the artist's permission. Continental European law began enforcing the right of integrity in the nineteenth century. American law, however, following the usual practice in common law jurisdictions, generally declined to recognize such a right.<sup>10</sup> This was in keeping with the general common-law doctrine that it is generally not possible to create "an equitable servitude on a chattel"<sup>11</sup> – in this case, a type of negative covenant held in gross (that is, personally) by the artist that would let the artist prevent the current owner of a work of art from altering it.

The U.S. rejection of a right of integrity was not casual. The desirability of adopting affirmative legislation recognizing the right was long debated. Unwillingness to recognize the right was in fact among the reasons why, for over a century, the U.S. failed to sign the Berne Convention on Copyright, which required signatory countries to recognize artists' right of integrity. The situation then changed in 1990 when the U.S., contemporaneously with finally signing the Berne Convention, adopted the federal Visual Artists Rights Act permitting artists to retain a statutorily-defined right of integrity in works they sell.<sup>12</sup>

When enacting the latter Act, however, the U.S. Congress self-consciously declined to recognize resale royalty rights for artists. This right would permit an artist to

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Housing: Transactional Efficiency, Tax Subsidies, and Tenure Choice," 20 *Journal of Legal Studies* 25 (1991).

<sup>9</sup> See Rudden, *supra* note 1.

<sup>10</sup> See Hansmann & Santilli, *supra* note 1.

<sup>11</sup> On the law's general resistance to servitudes on chattels, see Zechariah Chaffee, Jr., *Equitable Servitudes on Chattels*, 41 *HARVARD LAW REVIEW* 945 (1928); Zechariah Chaffee, Jr., *The Music Goes Round and Round: Equitable Servitudes and Chattels*, 69 *HARVARD LAW REVIEW* 1250 (1956).

<sup>12</sup> For more extensive discussion, see Hansmann & Santilli, *supra* note 1.

claim a stated percentage of the price (or of the increase in price) that her work brings in each subsequent resale of the work from one owner to the next. A number of European countries have long provided for such a “droit de suite,” and it now appears likely that the right will be extended to the European Union as a whole. Among common law jurisdictions, however, artists’ resale royalty rights are at present recognized only in the state of California. While a U.S. artist can bind the first purchaser of her work, by contract, to pay her a resale royalty, that contractual right generally cannot, outside of California, be made into a property right that will bind subsequent purchasers.<sup>13</sup>

In general, the divided or partial property rights for which the law makes explicit provision are heavily concentrated in four areas: real property (e.g., servitudes, condominiums, mortgages, future interests); intellectual property (e.g., copyright, patent, artists’ rights); security interests in personal property (e.g., chattel mortgages -- now largely consolidated, in the U.S., in Article 9 of the Uniform Commercial Code); and the law of legal entities (e.g., partnerships, business corporations, and trusts). Outside these four fields, and the specific types of property rights for which each provides, the law makes it difficult to create partial or divided rights. Rather, all rights in an asset are presumed to pass together from one owner to the next.

### III. STANDARDIZATION AND LANGUAGE

If two parties are to communicate with each other concerning property rights -- particularly for purposes of describing the rights that one person is transferring (or offering to transfer) to another -- it is helpful to have simple and clear terms to describe the various rights involved. One function served by the law of property is to provide such terms or labels. The term “copyright,” for example, is a simple label denoting a complex package of well-defined property rights that can be held by authors and their assignees. Of course, most of this kind of labeling does not require law because ordinary language, commercial usage, or privately-developed standard forms suffice. The law is particularly helpful in defining novel rights, however, as well as rights that are complex in character (such as copyright, with attributes such as an arbitrarily fixed lifespan and exceptions for fair use) and rights whose attributes are tied to publicly provided or regulated enforcement devices such as registries.

Is there is something about the utility of such labels that bears on the law’s restrictive approach to property rights? Merrill and Smith suggest that there is. They argue that, by limiting the types of property interests that will be enforced to a finite set of standard forms, the law reduces the “information processing costs” of all persons who seek to acquire property rights.<sup>14</sup> Given such limits, a potential purchaser of an asset need only determine which of the various standard packages of rights is being offered to him; he need not also incur the costs of determining whether some other, nonstandard

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<sup>13</sup> See Jeffrey Perloff, *Droit de Suite*, in Peter Newman, ed., *THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW* (1998); Henry Hansmann & Marina Santilli, *Royalties For Artists Versus Royalties For Authors And Composers*, *J. CULTURAL ECON.* (forthcoming, 2001).

<sup>14</sup> Merrill & Smith, *supra* note 1, at 27.

package of rights is being offered him, nor need he incur the “measurement costs” of ascertaining attributes of nonstandard rights that are hard to discern.<sup>15</sup>

In effect, Merrill and Smith suggest, the law is facilitating transactions by establishing an easily comprehended set of standard “building blocks” from which more complex relationships and institutions can be constructed. In this respect, property law is like a language in which there is an optimal number of basic words for mutual comprehension. More words would unnecessarily increase the costs of communication, since complex structures can be assembled from basic words as the need arises.<sup>16</sup>

The language metaphor itself, however, suggests the contrary. It is unclear why the addition of new terms to a language should reduce the communicative value of those that already exist. Similarly, the number of forms that the law defines or recognizes has little bearing on ease of communication. So long as there are clear definitions and labels for the forms most needed, the law does little harm by having simple labels for other forms that are of relatively little use. Nobody need ever use those unpopular forms, after all, or even utter their names. Thus, if two transacting persons wish to transfer an interest in land that has the characteristics of a fee simple, and they know that the term “fee simple” denotes that interest, it is a matter of some irrelevance to them whether or not there also exists another term, “fee tail,” that denotes a different package of interests.

Moreover, this “optimal standardization” view fails to explain why property law is more restrictive than contract law. Contract law provides parties with a variety of standard default terms and interpretative rules to facilitate communication. Nevertheless, contract law generally leaves parties free to deviate from those standard forms and create contractual rights of any form they wish. Yet the utility of standard contractual terms and forms is evidently not frustrated by the continuing availability of nonstandard contractual rights with unconventional and perhaps hard-to-measure characteristics.

We believe that Merrill and Smith are, at least in part, correct in focusing on the problem of assuring that the acquirer of rights understands the nature of those rights. We believe that the critical considerations lies, however, not in the problems of *communication* on which Merrill and Smith seem to focus, but rather in problems of *verification* that they leave largely unanalyzed.

#### **IV. COORDINATION, ENFORCEMENT, AND VERIFICATION**

If two persons are both to have rights in a single asset, they need some means of assuring that they share a common understanding of their respective rights. Absent such understanding, the parties may mistakenly make inconsistent uses of the asset, or underuse the asset. This is the problem of *coordination*. Moreover, even if the parties

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<sup>15</sup> *Id.* At 26.

<sup>16</sup> *Id.* at 36-8.



solve the coordination problem, each needs assurance that the other will not opportunistically assert rights that properly belong to the other. This is the problem of *enforcement*. The less effectively the parties solve the coordination and enforcement problems, the greater the scope for mistakes or opportunism, and hence the less valuable will be the rights involved, for reasons that are apparent: the parties may take costly private actions to protect their rights; investments in improving and using assets may be discouraged; privately borne risk may increase; and transactions that would otherwise take place may not occur.

Solution of both the coordination and the enforcement problems depends, in turn, on solving problems of *verification*. To solve the coordination problem, each party needs a means of verifying the nature of the other party's understanding of the parties' respective rights. To solve the enforcement problem, a third party enforcer such as a judge needs a method of verifying the parties' understanding of their respective rights.<sup>17</sup>

### **A. Verification of Contractual Rights**

For persons who deal with each other directly by contract, the contract itself is of course the principal means of solving both the coordination and the enforcement problems. The coordination problem is dealt with by means of the social convention – refined and reinforced by law – that both parties are bound by the contract so long as it meets certain conditions. The parties' mutual assent to the contract, testified to by signatures or other conventional means, is the method by which the parties signal to each other that they share a common understanding of their rights – namely the understanding expressed in the contract. In the language of economics, the contract provides a means by which the parties can assure that their respective rights are common knowledge between them. Likewise, the contract provides strong evidence of the parties' expectations to a third party enforcer.

### **B. Verification of Property Rights**

The problem of verification is more difficult in the case of property rights for the obvious reason that two or more holders of property rights in a given asset may not be in privity of contract. Thus, suppose that A sells most of his rights in an asset to B, while retaining some partial rights in the asset for himself. The common understanding between A and B, expressed in the contract of sale between them, is that A's rights will be good against any future transferee of B's interest in the asset. Subsequently B sells his rights in the asset to a third party C. How is A to verify that C in fact shares A's understanding of his rights – rather than, for example, having been misled about those rights by B, who misrepresented A's rights out of mistake or opportunism? And how is

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<sup>17</sup> In the economics literature on contracting, the term *verifiability* is generally used only in the context of enforcement, where opportunism is the problem. We extend it here to the closely related difficulties that are faced in coordination even where opportunism is absent – an issue that would generally be termed one of *observability* in the economics of contracts.

C, in turn, to verify the nature of any rights retained by A – rather than, for example, having been misled about the nature of those rights (or even their existence) by B? In short, how are both A and C to verify that C was accurately informed about the nature of the rights retained by A? And, whatever the personal understandings of A and C, how is a third party enforcer to ascertain those understandings?

A central problem of property law is to provide mechanisms for solving these verification problems – or, as it is more commonly put, to assure effective notice.<sup>18</sup> It is here that regulation of the forms of ownership serves a purpose. But the problem does not principally lie in making it easier for a party such as C to understand the description of the rights that he is acquiring. Rather, the problem lies in permitting parties such as C to *verify* that the description they have been given is accurate -- and in permitting parties such as A, and also courts, to verify that fact as well.

To solve these problems, property law employs a variety of *verification rules*. There is a strong relationship between verification rules and the types of property rights – or, we might say, the forms of ownership -- that the law is prepared to recognize. Indeed, the two are inextricably intertwined in any legal regime for property rights. That relationship is complex, and not well described as simply modulating the number of ownership forms that are permitted, as the optimal standardization view might suggest.

In exploring the relationship between verification rules and forms of ownership, we begin by using the rule of possession as a simple illustration. We then pass on to more refined property rights regimes.

### **C. The Rule of Possession**

Of all verification rules, possession is the most primitive and commonplace.<sup>19</sup> In theory, verification could be based *only* on possession. Such a strict rule of possession would be simple. It would provide that the party with physical possession holds complete property rights in the asset, and that physical transfer of the asset transfers all of those rights. Nonpossessory rights would be extinguished when the current owner transfers possession. Consequently, nonpossessory rights would not be property rights in the sense we use the term here.

The advantages of this system are obvious. It is cheap to administer, easy to

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<sup>18</sup> We are obviously not the first to remark on the important functions served by notice in the law of property. See especially Richard Epstein, *Notice and Freedom of Contract in the Law of Servitudes*, 55 S. CAL. L. REV. 1353 (1982). See also Carol Rose, *What Government Can Do for Property (and Vice Versa)*, in Mercurio and Samuels, eds., *THE FUNDAMENTAL RELATIONSHIPS BETWEEN GOVERNMENT AND PROPERTY* 209, 213 (1999). We seek, however, to offer a more systematic analysis of the problem, and of its relationship to the structure of both property rights and contract rights, than appears in the existing literature.

<sup>19</sup> See, e.g., Richard Epstein, *Possession as the Root of Title*, 13 GEORGIA LAW REVIEW 1221 (1979). Epstein notes, as we echo here, that much of the legal attraction of a rule of possession lies in the ease with which it can be administered and enforced. *Id.* at 1222-1224.

explain, and generally unambiguous. But its disadvantages are equally clear. It can support only a single form of ownership that encompasses all useful rights in the object – a simple unitary property right. Thus, a pure rule of possession would preclude a wide range of valuable divided property rights, including leases, bailments, security interests, and future interests. The great utility of divided rights such as these, in which at least one of the rightsholders is not in possession at any given time, has forced all legal systems to supplement possession with other verification rules.<sup>20</sup>

## V. THE RANGE OF ALTERNATIVE PROPERTY RIGHTS REGIMES

When two or more persons both have property rights in the same asset – and particularly when some of the rights involved are nonpossessory – the verification problem becomes more complex, with the consequence that more complex verification rules are called for. To illustrate more clearly what is involved, we return to the example of the artist’s right of integrity. We use this example because it is simple, because a wide variety of verification rules could quite plausibly be employed for the right, and because in fact an unusual variety of such rules can actually be seen in various jurisdictions today.. We also use this example because the value of the right involved is subject to debate (the merits of which we touch on later in the essay), which helps to highlight the tradeoffs involved in deciding whether the law should accommodate such a right.

We proceed by examining a series of four stylized types of property rights regimes that might be applied to the artist’s right of integrity. As we will see, these regimes are not really discreet from one another. Rather, they differ principally in matters of degree. The reason is that the underlying problem is one of verification, which is itself a matter of degree.

### A. *Fixed Rights, No Contracts*

We begin with regimes in which the structure of rights is mandatory and cannot be altered even by contract. Such regimes might take, among others, either of the following two forms:

- (1a) No Right of Integrity. Any effort by an artist to retain a right of integrity is unenforceable, in the sense that an owner of a work of art must always have full rights over the work, including the right to alter or destroy the work. Even a contract between the artist and the current owner of the work that purports to give the artist the right to prevent that owner from altering or destroying the work is unenforceable.

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<sup>20</sup> There is also the problem of what constitutes a transfer of possession. If theft is not to constitute a valid transfer, for example, then the law must recognize a nonpossessory right in the victim of the theft – thus making a truly pure rule of possession even more unattractive.

- (1b) Mandatory Right of Integrity. An artist always retains an unwaivable standard-form right of integrity whose terms are set by law. Even a contract between the artist and the current owner of the work, in which the artist seeks to waive his right to object to specific alterations by that owner, is unenforceable.

These regimes have the advantage of offering a strong, simple, and low-cost solution to the verification problem. So long as all persons involved simply know the legal rule, there is no room for confusion between artists and owners of artwork as to what rights are possessed by each. A judge always knows, too, that artists and owners of the artist's work share that knowledge.

Why might the law go so far as not to recognize even a contractual rearrangement of these rights? Presumably out of concern that, owing to mistake or opportunism, the parties' signatures on a contract would not provide adequate verification of the parties' understanding of their rights. In particular, regime (1a) might be chosen because of concern that a purchaser of a work of art might not understand the meaning of the rights the artist is retaining. Or regime (1b) might be chosen because of concern that an artist might not comprehend the nature of the rights he will be (understood as) giving up. In fact, apparently for the latter reason, regime (1b) is explicitly the regime that governs the artist's right of integrity in France.<sup>21</sup> Regime (1a) has apparently been adopted nowhere, presumably reflecting greater trust in the contracting skills of collectors than in those of artists.

While these two regimes are similar in permitting no flexibility in structuring rights, they of course differ in the character of the rights they support, the first providing for a single unitary form of ownership and the second providing for divided property rights. Which of the two might be more efficient depends on at least two factors. The first, of course, is the value of permitting the artist to maintain some control over the treatment of his work. The second is the cost of spreading knowledge of the rule.

## **B. Contractual Rights Only**

Another approach to the verification problem is to provide for specified property rights as the default, and then permit individual artists and collectors to vary those rights by contract, but not otherwise. Again, we offer two alternative regimes as examples:

- (2a) Artist's Right only by Contract. A right of integrity is not affirmatively prohibited, but is enforceable only if the current owner of the work has explicitly agreed to be bound by the right.

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<sup>21</sup> In practical effect, this does not mean that an artist cannot consent to acts that would violate his right of integrity, but rather than he cannot bind himself to such a waiver -- that is, he cannot enter into an enforceable agreement not to change his mind in the future and seek a judicial remedy for the violation. See Federic Poullard-Duhan, *Moral Rights in France, Through Recent Case Law*, 145 RIDA at 126 (1990); A. Strowel, *Droit D'Auteur et Copyright: Divergences et Convergences* 497-98 (1993).

(2b) Artist's Right by Presumption with Contractual Waiver. All works of art are subject to a standard-form right of integrity. The right can be waived by the artist, but a waiver can be granted only to a specific owner of the work for specific alterations and is not transferable to subsequent owners.

Regime (2a) characterized most states of the U.S. prior to 1990. Regime (2b) is that found in Italy.<sup>22</sup> These two regimes, like regimes (1a) and (1b), differ from each other in terms of the property rights they assume as the default. Indeed, regimes (2a) and (2b) differ, respectively, from regimes (1a) and (1b) only in permitting deviation from the default rights assignments by means of contract.

Consider, in particular, the difference between regimes (2a) and (1a). Regime (2a), unlike regime (1a), is not a simple prohibition on an artist's ability to maintain control over the treatment of his work by those who possess it. Rather, regime (2a) leaves it open to the artist to seek to establish such control by contractual means. By adding the rules of contract law as a social means of verification, greater flexibility in the control of assets is permitted. In fact, with the tools of contract, the artist can construct any particular variation he chooses on the right of integrity – permitting some alterations of the work, for example, and preventing others.

Like regime (1a), however, regime (2a) still does not permit an artist to retain a right of integrity that is a property right in the sense that, once established, that right will bind future transferees of the work. Rather, under (2a) an artist can do no more than extract a contractual commitment from an individual owner of the artist's work to grant rights in the work to the artist.

This does not mean that an artist has no way to bind successive purchasers of his work not to alter or destroy that work. Rather, the artist can seek to accomplish that result through a series of contractual commitments. For example, an artist might put in his contract of sale, when he sells a work to the first purchaser, a clause committing the purchaser to (a) respect a right of integrity of a form specified in the contract, and (b) to resell the work only to persons who, prior to completion of the sale, enter into a similar contractual commitment with the artist.<sup>23</sup> This approach would be awkward, but might be reasonably effective. The incentive of each subsequent owner of the work to honor the

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<sup>22</sup> See Hansmann & Santilli, *supra* note 1.

<sup>23</sup> A variant on this approach would be to require each owner of the work, upon resale of the work, to insert terms in their own contract of sale that would commit the purchaser both to respect the artist's right and to impose the same terms by contract on any person to whom he then sells the work – with the terms of all these subsequent contracts to provide explicitly that the artist is to be a third party beneficiary of the contractual clauses in question, with the right of enforcement. The terms might also commit the parties to send copies of all subsequent contracts to a designated gallery representing the artist, to simplify enforcement. This approach would work in the civil law countries and in the U.S., where contracts can be enforced by third party beneficiaries, but not in England, where they cannot.

In this respect, we note that a legal system's willingness to grant enforcement powers to third party beneficiaries is also at heart a question of the verification systems it will recognize, and consequently involves efficiency concerns of much the sort we explore here.

commitment to honor the restriction on resale might be enhanced by a provision for substantial liquidated damages (e.g., fifty percent of the sale price) in case of breach. To add further to the viability of this approach, the artist might (in the case of a painting, for instance) attach a notice to the back of the work stating the terms of the initial contract. An artist – or a group of artists or an artists’ association -- might also obtain contractual commitments from galleries that deal in their work not to broker resales of the work that do not commit the purchaser to the specified terms.

We will term this approach a *contractually-structured* right of integrity. (We use the term “contractually structured right” rather than “contract right” here to emphasize that what makes the artist’s right effective against subsequent purchasers of his work is a *system* of related contracts.) That approach, particularly if pursued by a large number of artists and accompanied by substantial publication and monitoring (e.g., through an artists’ association), could be quite effective in giving artists the desired degree of continuing control over their works. In fact, an effort at establishing just such a contractually-structured artist’s right was seriously promoted in the early 1970s. The right involved was not the right of integrity, but rather the artist’s resale royalty right, which involves the same set of actors and transactions.<sup>24</sup>

We see, then, that even if contract law is the only accepted set of verification rules, it is nevertheless possible to construct a right in an asset that will bind subsequent purchasers of other rights in the asset – that is, that will have the characteristics of a property right, as we use the term here. The parties will, however, generally need to work much harder to accomplish this result than is necessary where the law permits the enforcement of a conventional legally-defined property right. The importance – or unimportance – of this distinction can be illustrated with our next set of regimes.

### **C. *Property Rights by Labeling***

Let us now turn to regimes in which the presence or absence of rights in an asset, as between two parties, is verified by means other than universal presumption, as in regimes of type (1a) and (1b), or explicit contracting, as in regimes of type (2a) and (2b).

1. (3a) Artist’s Right by Labeling. An artist has the power to impose a legally-defined standard-form right of integrity upon the first sale of a work by attaching an appropriate symbol to the work itself. Any person who acquires a work bearing that symbol is bound by the right, which can be enforced against them directly by the artist.
  
- (3b) Artist’s Right by Presumption with Transferable Waiver. An artist is presumed to have retained a standard form right of integrity, and any purchaser of the artist’s work is bound by that right, unless the artist has stipulated in a standard-form

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<sup>24</sup> The contract was drafted and promoted by New York lawyer Robert Projansky. See Robert E. Duffy, ART LAW: REPRESENTING ARTISTS, DEALERS, AND COLLECTORS 282-84 (1977); John Henry Merryman & Albert E. Elsen, LAW, ETHICS, AND THE VISUAL ARTS 4-144 (1979).

written instrument that he has waived the right. Such a waiver is transferable with the work of art.<sup>25</sup>

We know of no jurisdiction that has chosen regime (3a). A regime very like (3a) was, however, long used in the U.S. to establish an author's copyright (by putting the mark "©" on copies of the author's work). Regime (3b) has been employed in the U.S. since 1990, and is also explicitly the legal regime in England.<sup>26</sup>

It is instructive to compare regime (3a), which permits an artist to retain a right of integrity that has the form of a "formal" property right, with regime (2a), which permits only the creation of a contractually-structured right of integrity. The practical distinction between the two regimes is, in the end, only one of degree. Affixing the symbol to the work in regime (3a) is very much like putting the appropriate clauses in the contract of sale under a contractually-structured right of the type we described above. Both are understood to bind the first purchaser to respect the artist's right. Both are also understood to bind the first purchaser to sell the work to subsequent purchasers subject to the same right -- in the one case, by putting the appropriate clauses in the contract of sale, and in the other by refraining from removing the telltale symbol before selling the work. Both, consequently, leave scope for the first purchaser or subsequent purchasers, either opportunistically or by mistake, to sell the work free of the artist's right -- in the case of the contractually-structured right, by failing to extract the appropriate contractual commitment, and in regime (3a) by removing the symbol.

Thus, regimes (2a) and (3a) are not sharply distinct. Just how close the two regimes are depends on the detailed rules of interpretation that flesh them out. Suppose, for example, that regime (2a) is in effect. Artist A sells a painting to collector B, extracting from B contractual commitments of the type described above under the contractually-structured approach. B (or some other subsequent purchaser) then sells the work to C without extracting from C the requisite contractual commitments. C, however, knows of the contractual terms between A and B, and knows that B is clearly breaching his contract by reselling to C free of such terms. If A subsequently sues C for interference with the right of integrity as specified in the original contract terms with B, will a court dismiss the action -- or might it give A a remedy against C, perhaps on a theory of tortious interference with contract? The more willing the courts are to give A a cause of action in such cases, the closer regime (2a) looks to regime (3a).

Conversely, suppose that, under regime (3a), artist A sells a painting to B with the symbol affixed, but B removes the symbol before reselling to C. And suppose that C was aware that B (or some intermediate owner in the chain of title) had removed the symbol. Would a court then permit C to interfere with the rights that A had sought to

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<sup>25</sup> Regime (3b) as described here is not the exact dual, or inverse, of regime (3a), which would be a system in which a symbol is put on the painting by the artist if he does *not* choose to retain the right. Thus, if the standard-form waiver were required to be affixed to the back of the work, (3b) would be more literally the inverse of (3a). But the difference is not very meaningful. One need be less concerned about separation of the label from the work in regime (3b) than in regime (3a), since with the former but not the latter the current owners of the work have an incentive to make certain the label remains in evidence.

<sup>26</sup> See Hansmann & Santilli, *supra* note 1.

retain (i.e., alter or destroy the work), on the grounds that the requirement for notice in the form of the symbol is a strict one? If so, then of course regime (3a) moves closer to regime (2a).

To the extent that regimes (2a) and (3a) differ in practice, the choice between the two regimes offers a tradeoff between the costs and the effectiveness of verification. A contract containing a statement of the artist's rights, and signed by the current owner of the work, is strong evidence that the owner had effective notice of the right. It may well be stronger evidence to this effect than is the existence of a symbol attached to the work, whose precise significance may be unknown to some purchasers, or which a purchaser might even overlook. The symbol approach, on the other hand, requires far less effort on the part of the artist to assure that subsequent purchasers will respect his right. Another central issue in determining whether regime (3a) might be more efficient than regime (2a) is whether the standard-form right represented by the symbol will be sufficiently popular and valuable to justify the costs of educating artists, galleries, and collectors as to its meaning (since without such knowledge, there may be room for many errors in coordination and enforcement).

In short, the difference between a legal regime that only gives parties discretion to adjust their relationships by contract, and a legal regime that also gives parties discretion to establish property rights, is ultimately quantitative rather than qualitative. The rules of contract law and the rules of property law are just two different means of coordinating parties' expectations and giving evidence of those expectations to a third party enforcer – that is, of permitting both parties and a judge to verify the parties' expectations (or, in more familiar but less precise terms, of providing notice). And, at the margin, the two types of rules merge into each other.

And what about the choice between regimes (3a) and (3b)? As with regimes (2a) and (2b), regimes (3a) and (3b) differ only in placing of the burden. The first regime in each pair -- regimes (2a) and (3a) -- require that parties who wish to establish the artist's right take affirmative steps to opt into it, while the second regime in each pair -- regimes (2b) and (3b) -- require that parties who do *not* want the right take similar steps to opt out of it. An important consideration in choosing between the (a) and the (b) regimes, then, is whether the right is likely to have substantial value for a large percentage of the works of art covered by the regime. Another consideration, so far as the labeling regimes (3) are concerned, is how practical it is to affix a symbol to the relevant works of art, or to keep track of a waiver.

In principle, either regime (3a) or (3b) could support, not just the presence or absence of a single standard-form right of integrity, but also of an infinite variety of individually tailored rights regimes. For example, under regime (3a), the artist might be permitted to attach to the work itself – e.g., the back of a painting – a statement of the particular terms of the integrity right that she retains. Thus, the artist might require that the work be displayed in a particular type of frame, or that the work be maintained or cleaned in particular ways at regular intervals. Or the possibilities could be extended to other types of rights that might interest an artist. For example, an artist might, by such a



labeling method, retain the right to have access to the work on reasonable conditions to photograph it, or might retain the right to insist that the work be made available for up to 90 days within each four years for exhibitions in museums or galleries. Likewise, under regime (3b), partial waivers might be permitted, permitting the work to be altered in some ways but not others.

Whatever the plausibility of such variable-right labeling regimes for artists' rights, such regimes are familiar in other contexts. A common approach is not to place the detailed terms of the right on the label itself, but rather to use the label to indicate the presence of another document – often a contract – that gives the detailed terms of the partial right. For example, the ancient Greeks placed a heavy rock on land to indicate the presence of a mortgage;<sup>27</sup> to determine the terms of the mortgage, one presumably had to turn to the contract between the owner and his creditor. Similarly, modern commercial aircraft that (as is common) are leased often bear a physical plaque indicating this fact; again, resort must be made to the borrower and the lender to determine the precise terms of the lessor's rights, which could vary substantially.

The obvious difficulty with such variable-rights labeling regimes is the potential for loss or alteration of the label, and the uncertainty of rights that this possibility engenders. Hence variable-rights regimes often use registries as verification devices.

#### ***D. Property Rights by Registry***

Our final hypothetical regimes, therefore, involve registries.

- (4a) Property Rights by Registry. A public registry for works of art is established. An artist may register individual works there, and file a notice that the work is subject to a right of integrity. The artist can tailor that right as she chooses, so long as the right remains within the legally specified parameters of a "right of integrity." A purchaser of a work is bound by the terms of the registered right, whether the person has consulted the registry or not.
- (4b) Artists' Rights by Presumption; Variable Waiver by Registry. A public registry for works of art is established. An artist is presumed to retain a standard-form right of integrity. Partial or complete waivers of the right are valid if registered.

As we have progressed through the four types of regimes, the difference between the dual (a) and (b) regimes has become less significant. This is because the importance of the presumed regime decreases as costs of deviating from that regime decrease. With registry regimes such as (4a) and (4b), the practical difference between the dual regimes may be insignificant.

While establishing a registry simply to support the right of integrity might well seem fanciful, registries for works of art in general are not. Such registries are, in

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<sup>27</sup> M.I. Finley, *Economy and Society in Ancient Greece* 64, 70-71, 73, 258 n.7 (1981).

principle, relatively easy to construct, and have been seriously proposed as a means of inhibiting theft (which is to say, to provide a verification system to support the nonpossessory property rights of victims of theft). Art registries would also improve substantially the enforceability of the artists' resale royalty rights that seem about to spread to the European Union as a whole. Once an art registry is established to serve other purposes such as these, the cost of extending it to cover the right of integrity would be quite modest. In any event, an important reason why we have used the right of integrity for illustration is precisely because it is debatable whether the value of the right is sufficient to justify the costs of an adequate verification regime.

A registry permits great flexibility in the structure of the rights that can be created. As with labeling regimes, there are two ways in which this can be accomplished. One is to provide for registry of the particular terms of the right. The other is to have the holder of the right – in our example, the artist – place in the registry only an indication of the presence of a right, whose terms are contained in a separate nonregistered document (such as the artist's contract of sale with the first purchaser of the work). A conspicuous example of the latter approach is provided by security interests under U.S. law. To be enforceable, a secured interest must generally be registered. Only the name and address of the holder(s) of the security interest, and a description of the burdened property, need be placed in the registry, however. The detailed terms of the interest, which may include highly individualized and complex covenants, are contained in the contract between the owner of the property and the creditor who holds the security interest. To verify the precise terms of the interest, resort must be had to that contract – which, like contracts in general, is itself a very effective verification device, bearing the explicit witness of both holders of divided rights in the asset in question.

In short, a registry regime such as (4a) offers flexibility in the structure of rights, highly reliable verification, and low cost of establishing rights. On the other side of the ledger, it involves relatively high costs of two types. The first is the cost of establishing and maintaining the registry. The second is the cost imposed on all art purchasers of either searching the registry (or not searching and remaining uncertain concerning the scope of their rights).

Cost tradeoffs of similar character underlie choices among property regimes in general. We now examine those tradeoffs in more general terms.

## **VI. CHOOSING AMONG PROPERTY REGIMES**

### ***A. Cost Tradeoffs***

In examining the costs and benefits of alternative property regimes, it is helpful to distinguish three categories of costs that vary from one rights regime to another.

User Costs. First, there are the user costs of establishing rights, by which we mean the costs borne by persons who to establish relationships governed by

those rights. In the case of the right of integrity, these are the additional costs borne by an artist, and by those who purchase that artist's works, that are incurred when the artist retains a right of integrity. In regime (2a), these are the costs of writing and enforcing the series of contracts involved in constructing a contractually-structured right. In regime (3a), these are the costs to the artist of affixing a label to his painting, plus the costs to purchasers of his painting of checking for the presence of the mark.

Nonuser Costs. Second, there are the costs that a rights regime imposes on persons who enter into relationships that are *not* governed by the rights in question. In regime (1a), these costs are effectively zero: artists and patrons who do not wish to be governed by an artist's right of integrity need incur no expense to understand their rights. They are assured, with no need for investigation or precaution, that there is no such enforceable right between them. In regime (4a), in contrast, purchasers of art who do not wish to be governed by a right of integrity, or whose artist did not choose to retain such a right, must consult a registry to verify their understanding of their rights.

System Costs. Third, there are general costs of establishing and maintaining a rights regime that do not vary with the types of rights created under it. With regime (1b), for example, these are the costs of educating the relevant portions of the public about the existence of a mandatory artist's right of integrity. With regime (4a), these costs include not just the costs of educating the public, but also the costs of establishing and maintaining a registry.

A choice among alternative property rights regimes involves a tradeoff among these different types of costs. In particular, a property rights regime with relatively low user costs commonly involves relatively high nonuser costs, or high system costs, or both. Thus, as we move among our alternative artists' rights regimes from (1a) to (2a) to (3a), the costs to an artist and his patrons of establishing a standard-form right of integrity decrease, while the costs borne by artists and patrons who choose not to have such a right increase, as do system costs. Likewise, as we move from (3a) to (4a), the user costs of establishing a nonstandard right of integrity decrease, while nonuser costs and system costs both increase. And as we move from the (a) to the (b) regimes of each type, user costs decrease and nonuser costs increase, while system costs remain relatively constant.

## ***B. The Overall Efficiency Calculus***

From an efficiency point of view, the objective in choosing a property rights regime should be to maximize the aggregate value of assets to rightsholders less the aggregate user, nonuser, and system costs induced by the rights regime. This means that it is efficient to adopt a new property rights regime that lowers the user costs of establishing a particular property right only if the resulting aggregate reduction in user costs, plus the increase in the aggregate value of assets that results from more extensive use of the

rights in question, exceeds the increase in the sum of nonuser costs and system costs.

That cost-benefit test is most likely to be met for rights that have high value to their users and will be used frequently under the new regime. In contrast, a property rights regime that imposes substantial costs on nonusers of the right, and has large system costs, is obviously not worth adopting just to facilitate creation of a right that will have little value and will be infrequently used. It is for this reason that artists' rights, such as the right of integrity and resale royalty rights, have been controversial. There is room for reasonable debate as to whether there are many situations in which the value to artists of retaining those rights exceeds the concomitant diminution in value to the purchasers of the artists' work,<sup>28</sup> and hence whether property rights regimes that facilitate retention of those rights are efficient.

### **C. Why Restrict the Enforceability of Property Rights?**

We see, then, why the law might, as it does, take a restrictive approach to the enforcement of property rights. What we observe is not that the law positively forbids the creation of certain kinds of property rights. Rather, the law applies different verification rules to different types of rights. There is only a limited range of property rights – and, in particular, divided property rights – whose enforceability is supported by relatively liberal verification rules. The reason is that the rules that simplify verification for any given type of property right come at a price. That price typically consists of higher verification costs for other types of rights, or higher system costs, or both. Permitting strangers to maintain, with ease, complicated and highly individualized relationships concerning use of assets is often costly. Those costs often cannot practically be placed upon the participants in those relationships. Nor, for reasons of efficiency, should they be. The costs involved are likely to be in large part fixed costs (such as system costs) that, if charged to individual users, will result in inefficient underusage of the rights.

## **VII. THE COSTS OF CREATING ADDITIONAL RIGHTS**

Merrill and Smith suggest that, as the number of property rights that the law recognizes increases, the costs of recognizing those rights will also increase, while the marginal utility of further rights will decrease. Consequently, there will be an optimal number of property rights, determined by the point at which the marginal cost of adding another right just equals the marginal benefit.

The observed pattern of property rights does not fit this description, however, at least if we think in terms of the specific content of rights. Rather, the pattern we observe is highly discontinuous. At one extreme, the law effectively mandates a single standard form for a partial property right. The artist's right of integrity in France and Italy is an

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<sup>28</sup> On the utility of the right of integrity, see Hansmann & Santilli, *supra* note 1. On the utility of resale royalty rights, see Perloff, *supra* note 13; Hansmann & Santilli, *supra* note 13.

example, as is the artist's resale royalty right. At the other extreme, and much more commonly, the law establishes verification rules that support a *class* of property rights, defined by the subject matter of the right. Within the class, individual rightsholders have substantial freedom to structure their individual rights as they wish among an indefinite number of potential alternatives. Leaseholds, real covenants, security interests, and copyright are familiar examples. Between these two extremes we find very little.<sup>29</sup> In particular, it is hard to identify any class of assets for which the law establishes a closed finite number of well-defined standardized forms as the Merrill and Smith analysis might suggest.

The reason for this pattern is apparently that, once a verification system has been established that is adequate to support more than one type of partial right in a given category of assets, there is little additional cost involved in extending that system to accommodate a broad range of individually-styled rights as well. Potential acquirers of assets of the relevant type must make inquiry in any case to verify which particular property rights, if any, are in the hands of some third party. The costs of making that inquiry are not importantly affected by adding to the number of potential rights. The reason is that which we discussed in Section III when commenting on Merrill and Smith's language analogy: adding terms to a system of communication does not diminish the communicative value of the terms that are already available.

These points are well illustrated by considering the rights contained in the civil law's "numerus clausus" itself. None of the dozen or so rights included in that closed number have precisely defined content. Rather, they are all *classes* of rights, such as the mortgage, co-ownership, the real covenant, the personal servitude in land, the usufruct, and the right of pledge on moveable property. The specific content of any particular right within one of these classes must be specified by the rightsholders who create the right.

Nor does the concept of standardization seem to explain well why the law makes provision for only a limited number of classes of divided property rights, such as those included in the numerus clausus. The problem with recognizing new classes of property rights is commonly that they involve a new set of verification rules, and these rules are costly. To be sure, information costs are an important part of the costs of establishing a verification system. But those information costs are, in substantial part, fixed costs involved in informing individuals about the new verification *system* – such as the existence of a presumed right, or the meaning of a symbol, or the existence of a registry – and not costs borne by individuals in determining which of several alternative property rights they are acquiring in any particular case. The costs of existing verification systems are not, in general, importantly affected by adding new ones. Thus, the value of making provision for condominiums, much less for copyright or for security interests in personal property, is not reduced by the presence or scope of pre-existing provisions for creating servitudes in land, or vice-versa, as the optimal standardization view would suggest.

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<sup>29</sup> It is difficult to find even a clear example of a regime of a labeling regime of type (3a), where the label designates a single standard-form right. Rather, labeling regimes tend to take the variable-rights form exemplified by security interests.

## VIII. THE DISUTILITY OF DIVIDED PROPERTY RIGHTS

We have emphasized that, because verification is more costly for property rights than for contractual rights, the law is understandably more sparing in providing verification rules for property rights than for contractual rights. Only where property rights have a specially high value – which is to say, only where there is special value in having a right in an asset bind subsequent transferees of other rights in the asset – is it worthwhile to provide an effective verification system.

We will return in the next section to examine the special value that property rights offer in those situations in which the law in fact provides for them. First, however, we want to consider briefly the question of whether divided property rights have some special *dis*advantages that divided contractual rights in assets do not have. If such disadvantages exist, they offer another reason, beyond the high verification costs for property rights, for the law's reluctance to enforce a broad range of property rights.

### A. *Coordination Costs and Internalization*

When two or more persons share rights in a single asset, some costs may of course be incurred that would not be incurred when all rights are in the hands of a single person. In particular, the holders of divided rights will face the transaction costs of coordinating their uses of the asset – including the possibility of strategic bargaining – and, to the extent that coordination fails, they will face the costs of putting the asset to conflicting uses. We will refer to these costs, collectively, simply as *coordination costs*.

The original owner of an asset – say, an artist who has produced a painting – will generally internalize the coordination costs that result from dividing rights in that asset, since the value of the divided rights will reflect those coordination costs. An owner therefore has an incentive to divide rights in an asset only if the sum of the values of the divided rights exceeds the value of a unified right, even after accounting for coordination costs. One might therefore conclude that, in choosing a legal regime for property rights, the coordination costs of divided rights are irrelevant. But that is not true. Coordination costs will be internalized only *given* the existence of the property rights regime, and the verification rules that are at its core. If the coordination costs for a given class of divided rights are sufficiently high, the net value of those rights may, as a consequence, be too low to justify the system costs and nonuser costs of establishing the necessary verification rules.

Contractually divided rights bring coordination costs just as do divided property rights. Yet, despite those costs, the law generally does not restrict the types of assets in which divided contractual rights will be enforced. But is it possible that coordination costs for divided property rights in an asset are for some reason higher than for divided contractual rights, and that this helps explain the law's unwillingness to establish low-

cost verification systems only for particular types of divided property rights?

In many respects, the answer is no. The coordination costs faced by two holders of rights in the same asset need not depend on whether those persons are the original rightsholders who created the division of rights by contractual dealings between themselves, or whether one (or both) of them is a subsequent transferee of those rights. There is, however, one type of coordination cost that is specific to divided property rights as opposed to divided contractual rights. We turn to that next.

## ***B. Retransfer Externalities***

Suppose that A sells most rights in an asset to B, while retaining a partial property right in the asset for himself. B subsequently receives an offer from C to purchase B's rights. Coordination costs between A and C will, however, be substantially higher than those between A and B. So long as the transaction costs of further dealings between A and B are sufficiently high, B will have no incentive to consider these additional costs that will be imposed on A. Rather, B will have an incentive to sell his rights in the asset to C so long as the price offered by C just exceeds B's value for those rights. Thus, B's ability to retransfer his rights in the asset expands the scope of potential coordination costs between A and B by adding *retransfer externalities* to those costs – where by “retransfer externalities” we mean the costs imposed on A by B's decision to transfer his rights in the asset to a third party.

Retransfer externalities may arise because a subsequent transferee of partial rights in an asset will put that asset to uses that involve more intense conflict with those of the other rightsholder. Or they may arise because transactions with the subsequent transferee will for reason – such as the location or character of the transferee – be unusually costly. Retransfer externalities may be particularly significant if a party such as B has the right to *redivide* his rights in the asset among two or more persons. Redivisions of rights in a single asset may cause the transaction costs of coordinating uses – and particularly of reassembling the rights in the asset into a single person's hands – to grow exponentially, with a large fraction of those costs being borne by rightsholders other than the person who decides to further redivide.

The potential for retransfer externalities means that divided property rights bring some inefficient incentives that are not present with contractually divided rights. Like other coordination costs, the expected value of retransfer externalities should be internalized by an original owner of full rights in an asset at the time that rights are first divided. Nonetheless, as we have suggested above, the fact that costs are internalized does make them less important for our purposes. The potential for retransfer externalities makes divided property rights more costly than divided contract rights, all other things held equal. And this argues against providing verification systems for property rights as liberally as is done for contract rights. Of course, other things may not be equal. In particular situations, property rights have advantages over contract rights that more than compensate not just for potential retransfer externalities, but also for the

higher costs of the verification systems that property rights typically require. We now turn to some of the most conspicuous of those situations.

## **IX. MAJOR CLASSES OF DIVIDED PROPERTY RIGHTS**

A property rights regime must coordinate the expectations that persons have prior to interacting with each other. Consequently, the choice of a property rights regime must also be made prior to the point at which individuals interact, and therefore must be made socially. It is not a choice that can be left to the decisions of individual actors pursuing individual transactions – or, as it might be put, left to the market. This means that there is no invisible hand to assure that the most efficient among the available property rights regimes will be adopted.

Moreover, for the reasons explored above, adoption of a legal regime that facilitates the recognition of a new class of property rights will generally involve a shift in wealth to the users of those rights from nonusers of the rights and from society at large (or whoever bears the system costs for the new rights). Legal reforms that promote new property rights, or abolish old ones, are therefore likely to be influenced strongly by the relative influence of different interest groups.

Consequently, there is no reason to expect existing legal regimes for the recognition of property rights to conform to a high standard of rationality. Nonetheless, at a rough overall level, it is reasonable to expect that the efficiency considerations described above to be reflected in the law of property rights.

With this in mind, we survey here four of the most prominent classes of divided property rights: security interests, legal entities, intellectual property, and coordinating rights in real and personal property. With respect to each of these classes, we offer a conjecture about why the utility of the right merits the social cost of the verification rules that are necessary to support it.

### **A. *Security Interests***

A security interest is a contingent ownership right in an asset that permits the holder of the interest to take physical possession of an asset and sell it to a third party upon the nonpayment of a debt. A security interest is a property right in our sense because, to a greater or lesser degree, it is enforceable against subsequent transferees of the asset, or of other security interests in the asset.

The ability to grant a security interest has particular value because it permits a debtor to use her asset for two purposes simultaneously, as a factor of production and as a means of bonding her agreements to repay debts or perform contractual obligations more generally. How is notice of an existing security interest to be given to persons who wish to acquire the asset, or establish their own security interest in the asset?



Where, as with most personal property in most societies, possession suffices to evidence ownership, security interests in specific assets for the benefit of specific creditors are infeasible. But there is a second-best kind of security interest that remains workable, and that is commonly adopted in legal systems everywhere. In effect, the law simply presumes, as a default rule, that *all* of a person's creditors are granted a security interest in *all* of the person's assets, and that those security interests will all have equal priority. Thus, every time a person enters into a contract, she is presumed to grant to her promisee a security interest in all her property as a bond for performance. Failure to perform will result in a money judgment that can be satisfied out of any of her assets.

This rule substantially mitigates the notice problem among creditors. Any potential creditor can assume that all of a debtor's assets are burdened with potential claims by all of that person's creditors that will limit the security interest that the potential creditor can obtain in those assets. To assess the value of the security interest he can obtain in the debtor's assets, the potential creditor must therefore determine the creditor's overall level of debt. But that is all he need do; he need not seek to discover if specific arrangements concerning specific assets have been made with specific creditors. There remains, of course, a problem of debtor opportunism: the debtor may take on subsequent debt that will dilute the value of the earlier creditors' claim on the debtor's assets. But this lien of uncertain and shifting value is still far better than none at all, which is the only feasible alternative without a verification system that is much more refined – and much more costly.<sup>30</sup>

And what about the debtor's ability to sell assets to a third party? The law deals with this by making the creditors' lien a floating lien, from which assets are released upon their sale by the debtor and to which assets are added upon their acquisition by the debtor. This solution also leaves room for debtor opportunism, since it leaves open the possibility that a debtor facing insolvency will sell important assets and then spend the proceeds. But a fraudulent conveyance doctrine can avoid some of the worst abuses of this sort, and for the rest, it is a necessary accommodation to the high costs of establishing a more refined verification system.

Where verification rules that are more effective than mere possession can be established at reasonable cost, security interests that grant priorities to specific creditors in specific assets, or in a designated pool of assets, become workable. Thus, today we have an elaborate system of security interests under Article 9 of the Uniform Commercial Code that utilizes a system of public registries. And of course mortgages giving specific creditors prior liens on real estate have long been available owing to the existence of registries for land.

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<sup>30</sup> The problem of debtor opportunism in taking on subsequent debt might be dealt with by making the default system of priorities a first-in-time rule rather than a pro rata rule. That this has not been the system chosen perhaps reflects the difficulties of determining the relative dates of claims, or perhaps is an accommodation to the fact that foreclosure on a lien may often take place outside of bankruptcy, in a proceeding to which other, earlier creditors are not parties.

Yet registries, too, are not costless systems of verification, and hence the law continues to place restrictions on the kinds of security interests that can be created even if they are registered. Article 9 of the Uniform Commercial Code provides an illustration.<sup>31</sup> In general, Article 9 permits a creditor to take a security interest in virtually all of a debtor's property, including after-acquired property, that is prior to the claims of all other creditors so long as the security interest is appropriately filed. An important exception to this freedom has been made, however, for purchase-money security interests in the debtor's after-acquired property. A vendor who takes such an interest and files it will have a claim prior to that of all other creditors, including prior creditors who were granted a security interest in all after-acquired property and had duly filed that interest. Why does the law thus limit the debtor's freedom to assign security interests as he wishes? Might not some debtor judge correctly that, in his particular circumstances, it is worthwhile to commit himself not to assign first-priority purchase-money security interests to future vendors?

Indeed, there may well be such cases. But they are likely to be relatively rare. In most situations, it is to the mutual benefit of a debtor and his current creditors to permit the debtor to purchase needed inputs in the future, subject to a purchase-money security interest that is restricted to those inputs. Consequently, by mandating that purchase-money security interests always trump previously filed security interests in after-acquired property, the law imposes only very modest costs. That same rule, however, presumably results in substantial cost savings, since it effectively permits a debtor to assure a vendor costlessly that the debtor has not previously alienated his right to grant the vendor a purchase-money security interest. By virtue of the rule, there is no need for a vendor to search the registries for previously filed security interests in order to verify a debtor's assertions to this effect. Thus, by limiting the types of property rights that can be created even when notice of those rights can be provided through a registry, the law facilitates the formation of other more useful forms of property rights. By this means, the total value of property rights – the value of the rights created less the user-borne and the non-user-borne costs of the verification system – is increased.

## ***B. Legal Entities***

Like the law of security interests, organizational law -- that is, the law establishing legal entities such as partnerships, corporations, and trusts – plays a vital role in enhancing the ability of businesses to obtain credit and bond their contractual obligations. Organizational law permits the owners of a business to partition off the assets used in the business into a separate pool, distinct from the owners' personal assets, for purposes of pledging those assets to creditors. In part, this partitioning serves to permit the owners' personal creditors to be given a prior or exclusive security interest in the owners' personal assets – that is, to establish the limited liability that characterizes some, but not all, legal entities. Of greater interest to us here, however, is just the reverse of this. By forming a business as a legal entity that holds title to assets in its own name, the owners of the business are able to give business creditors a prior

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<sup>31</sup>We are indebted to Barry Adler for suggesting this example.

claim, over the owners' personal creditors, in all the assets used in the business. Creditors who contract with the entity are given the equivalent of a floating lien on the firm's business assets, much as unsecured personal creditors of an individual are given a floating lien on the personal assets of that individual.<sup>32</sup>

As we explain at length elsewhere, the ordinary tools of contract law, even when supplemented with the modern law of secured interests, are insufficient to give business creditors a floating lien of this sort.<sup>33</sup> Organizational law produces the result by establishing a default rule to the effect that, when the formalities of establishing a legal entity have been complied with, creditors who are dealt with in the name of that entity will be given a prior claim on assets held in the name of the entity. This rule provides a relatively simple means by which the prior lien of business creditors over personal creditors can be verified. At the same time, the rule, following the usual tradeoff of verification rules, increases verification costs for the personal creditors of business owners, since it places on personal creditors the burden of determining which of an individual's assets are held in the individual's own name and which, instead, are held in the name of a business (and hence potentially subject to prior claims).

This tradeoff is worthwhile because, without the power to give business creditors first claim on business assets, it would be extremely difficult to construct large-scale private organizations of any type, including in particular the huge business corporations that dominate modern economies.

Of course, verification that depends on ownership by fictional legal entities has substantial limitations. In the first instance, it suffers from the same problems, described above, that limit the kinds of security interests that can be given by individuals in the absence of a registry. Would-be creditors can assess the value of the overall pool of assets in which they have a contingent claim – which are all assets held in the name of the firm – but they cannot identify the names or numbers of competing creditors who have parallel claims in the same assets. Nevertheless, as long as accounting procedures are well developed, creditors can crudely assess their credit risks by balancing the aggregate indebtedness of the borrower against its assets.

A more important limitation on a notice system based on entity ownership is ambiguity about precisely which assets are entity assets and which assets remain – or have become – the personal assets of owners or managers. Particularly in small firms, the boundaries between personal and business property are porous, which decreases the attraction, both to the creditors of the firm and to the creditors of the firm's owners, of

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<sup>32</sup> See Hansmann & Kraakman, *supra* note 1, at 417-23.

<sup>33</sup> The problem, in essence, involves creating a particular type of floating lien over all of the organization's assets. The lien must float in three respects: with respect to subsequently acquired assets; with respect to subsequently contracted debt to already existing creditors, and with respect to subsequently contracted debt to new creditors. UCC Article 9 will permit a lien to float in the first two respects, but not the third: to add a new creditor to the group of secured creditors requires a new filing under Article 9, listing the new creditor by name. Moreover, the modern law of secured interests also will not permit creation of the "liquidation protection" shield that organizational law permits, but rather only simple priority of claims. *Id.*

providing credit. This arguably helps to explain why the corporate form was initially extremely rigid and adapted to large but not small firms at the turn of the 20<sup>th</sup> century. The larger the firm, the easier it is to segregate the assets of the entity from those of its owners. In addition, the importance of separating the assets of the firm for notice purposes can explain the careful protection of creditors' rights in early corporation statutes (and in the statutes of emerging economies today). More recently, advances in accounting procedures, corporate law, and monitoring by private creditor services have increased the security of the creditors of legal entities and made the ownership of assets by the entity less malleable. This presumably helps to explain why the corporation and similar limited liability entities have now become the legal forms of choice for small firms as well as large ones.

### **C. Coordinating Rights in Real and Personal Property**

The law's provision for servitudes in land (which in the common law has traditionally been fragmented into the separate rules for easements, real covenants, and equitable servitudes) makes it much simpler to establish partial rights in real property than in personal property. Part of the reason for this is that the registries developed for verifying other interests in land are available to record these other interests as well, hence avoiding many of the additional system and nonuser costs that effective verification of these rights would otherwise require. But another reason is that the spatial fixity of individual parcels of real property causes the value of those parcels to be necessarily dependent on the uses made of neighboring parcels. Without the ability to create servitudes that run with both the burdened and the benefited property, owners of neighboring parcels would be forced to recontract one of the parcels changed hands, with all the potential for inefficient holdup that such recontracting would involve.

Moveable property, by virtue of its defining characteristic, generally does not expose its owners to these problems in coordinating uses. But that is not always the case. For example, the strongest arguments for recognizing the artists' rights we have discussed here – the right of integrity and resale royalty rights – are based on the need for coordination. The value of one work by, an artist generally depends heavily on the quantity and quality of the artist's other works. A painting by Picasso has value, not just (or even primarily) because of its individual qualities, but because of its association with the artist's entire *oeuvre*. The destruction or alteration of individual works can therefore damage the artist's overall reputation, and thus decrease the value of the artist's other works as well. Hence there is some reason to permit an artist to serve as the guardian for the value of his work as a whole by letting him retain a right of integrity. Likewise, as the artist produces new works of quality, the value of his pre-existing works increases. A resale royalty right permits an artist to capture part of that value, and hence can provide the artist with more efficient incentives for continued production.<sup>34</sup>

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<sup>34</sup> Perhaps more importantly, the resale royalty right may also serve the related purpose, for a young artist, of providing a credible signal to purchasers of his work that he has the will and the capacity to continue to produce strong work in the future. See Hansmann & Santilli, *supra* note 13.

## ***D. Intellectual Property***

We have said that the typical effect of adopting a verification system to facilitate creation of a particular divided property right is to lower costs to users of that right while increasing both system costs and costs borne by nonusers of the right. Legal rules providing for recognition of intellectual property differ from this pattern. In effect, those rules of law increase costs of all three types: not just nonuser and system costs, but user costs as well.

Consider copyright as an example. Copyright law permits the creation of divided property rights in the sense that it allows the right to copy a book to be separated from the right to possess a physical copy of the book and use that copy for all purposes except for making a copy. But copyright law was not necessary to permit the owner of a copy of a book to sell the right to copy the book while retaining the rights to possess the book and make other uses of it. Absent copyright law, the owner of a book could give to someone else the ability to copy the book simply by letting that person borrow the book long enough to copy it. A would-be copier would have no difficulty verifying that the owner had the right to permit copying; all owners of copies of the book had that right. With the introduction of copyright law, however, it becomes more difficult for a would-be copier to verify that the owner of a book could grant the right to copy it. Mere possession is no longer enough; documentation that the owner has the copyright must also be checked.

In short, users of the right to copy bear higher costs of transactions in rights to copy after the introduction of copyright. With the introduction of copyright, system costs also go up. And nonuser costs also go up mildly, since persons who have no interest in making copies will often still have an interest in knowing whether the price they are paying for written material includes the right to copy it.

But the reason for copyright law, of course, is not to reduce the costs to users of the right to copy, but almost the reverse: to create an artificial monopoly in that right in order to encourage the creation of new texts. If copyright is efficient, it is because the value of those new texts exceeds the increase in user, nonuser, and system costs that copyright engenders.

## **X. OTHER DEFINITIONS OF PROPERTY RIGHTS**

We have taken here, as the defining characteristic of a property right in an asset, the ability of the rightholder to enforce that right against third party transferees of other rights in the asset. There are of course alternatives to this view of property rights as rights whose burden “runs” with the asset. We examine three of those alternatives here. Each of those alternative definitions captures an important dimension of the meaning of

the term “property” as that word is sometimes used in ordinary language and in the law. And each has its advantages for particular purposes. We believe that our own definition of a property right, however, is far more useful in understanding the strong pattern we observe in the law’s approach to divided rights in assets.

### **A. *Rights Good Against All the World***

First, we consider the conception of property that Merrill and Smith emphasize in a series of recent articles. Under their view, the distinguishing feature of a property right is that it is an in rem right which is “good against all the world” in that it permits its holder to exclude all other persons from using the asset in question.<sup>35</sup> The advantage of such a right, Merrill and Smith emphasize, is that it gives an owner discretion to assign use rights in the asset. By contrast, contract rights are more limited in this view. They bind only small numbers of determinate individuals, and they serve primarily to regulate – or “govern” -- the use of an asset.

Although this view of property may have important analytical utility for some purposes, it does not appear of much use in explaining either the limited number of partial property rights or the distinction between property and contract.

We can return to the artist’s right of integrity as an illustration. Consider two alternative regimes, both of which recognize an artist’s right of integrity that runs with the work of art. In regime (X), the right is enforceable only against the current owner of the work. In regime (Y), the right is also understood to give the artist a cause of action, not only against the current owner of the work, but also against any third party who intentionally damages the work. Under the definition we are working with here, the artist has a property right in the work under both regimes (X) and (Y). Under the Merrill and Smith definition, in contrast, the artist would evidently be considered to have a property right in the work only under regime (Y).

We see advantages and disadvantages of both regimes (X) and (Y). Either would be a sensible means of implementing a right of integrity. Yet, whichever of these two regimes we consider, the policy question of whether to permit the right to run with the work of art remains more or less unaffected: our extended discussion of the costs and benefits of alternative verification rules for a right of integrity applies more or less equally to both regimes (X) and (Y). And that policy question, we believe, is the important one in understanding the pattern of divided rights for which the law makes provision. Drawing strong distinctions between regimes such as (X) and (Y) does not seem to offer important insight in this regard.

Nor does the criterion of “good against all the world” serve as a strong criterion for distinguishing property rights from contract rights, either as a matter of logic or as a matter of observed practice. As a matter of practice, contract rights, like property rights, may be thought of as “good against all the world” in as much as a third party who

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intentionally interferes with contractual rights commonly faces liability for tortious conduct to the holder of the contract right.<sup>36</sup> As for logic, let us return to the example of artists' rights. Suppose that the law does not permit artists to retain a right of integrity that runs with the property, but does permit an artist to contract with a current owner for a right to prevent that owner from altering the painting, with either of the following variants: (V) if the painting is tortiously damaged by a third party, only the owner of the painting, and not the artist, will be able to bring suit against the tortfeasor; the artist has a right, if at all, only against the owner for any injury suffered; (W) the artist will have a right to sue third party tortfeasors for damage to the painting. Under the Merrill and Smith view, as we understand it, the artist has a property right in the painting under arrangement (W) but not under arrangement (V). But we see no particular reason why the law should not allow the artist and the current owner to choose between these two regimes. And thus we do not see the distinction between these two regimes as helpful in understanding the law's regulation of the types of rights that persons are capable of constructing.

In general, unless a person wishes to purchase an asset, they have no need to investigate the way in which property rights in the asset are divided. If they wish to buy into the asset, they must learn who currently owns it. But in all other circumstances, third parties need to know only one thing to show respect for a stable set of property rights: that the asset, and all of its attendant use rights, belongs to other persons and not to them. Thus, if a person is to avoid trespassing on land, it is sufficient that person know that they own no rights in the land. It is a matter of some irrelevance whether or not rights in the land have been carved up among other persons to include a fee tail, an easement, or a mortgage. Conversely, whether or not the law recognizes the fee tail has little to do with relations with potential tortfeasors.

## **B. Alienable Rights**

A second possible defining feature of property rights is that they are alienable to third parties. But this feature also seems to us unhelpful in addressing the patterns we observe in the law's recognition of divided rights. In general, whether or not a right is alienable has little correlation with those patterns. Nor does logic suggest it should have.

A good example, again, is afforded by the right of integrity. Many jurisdictions that recognize that right make it inalienable. Inalienability has the great advantage of making verification of the right much easier; with such a rule, a purchaser of a work of art knows with certainty that the artist, and only the artist, holds a right of integrity in the work. Thus, inalienability can serve to support the feature that we consider key: the running of the burden. And inalienability can also serve other purposes, such as the protection of third party rights. But for the concerns at hand here, it is only an ancillary feature of rights.

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<sup>36</sup> Restatement (Second) of Torts § 766B. To be sure, negligent, as opposed to intentional, interference with contractual rights will generally not lead to liability, *id.* § 766C, in contrast to the situation with interests in land. But that distinction does not alter the basic issue.

### **C. *Rights That Can Be Specifically Enforced***

Yet a third view of property rights might take, as an important defining feature, that they are rights that can be specifically enforced. Yet this characteristic, too, seems to bear only a tangential relationship to the question at issue here – namely, the law's conservative approach to recognizing property rights.

To begin with, contract rights can frequently be specifically enforced. The common law, to be sure, confines specific performance to particular circumstances, but the civil law does not – and it is of course the civil law that is most self-conscious about restricting the recognizable forms of property rights.

There is also no necessary connection between the feature that we take here to define a property right in an asset – namely, the running of the burden – and the remedy of specific performance. Again, consider our running example: the artist's right of integrity. The law could provide that this right is enforceable by injunction, or only by damages. There are arguments for either approach. In favor of specific performance, for example, is the relative difficulty for a third party such as a court to assess appropriate damages. In favor of a damages-only remedy, on the other hand, is the fact that the right of integrity is most likely to be of serious importance in situations that involve site-specific art, where a specific performance remedy could give an artist enormous holdup power. Indeed, for the latter reason, a right of integrity might serve efficiency better if specific performance were not generally to be permitted as a remedy for interference with the right.

## **XI. VERIFIABILITY AND SPECIFIC PERFORMANCE IN CONTRACT**

Although property rights need not involve specific performance, the problems of verifiability that underlie the law's conservative approach to property rights may also help explain why specific performance is a disfavored remedy for contractual breach in the common law.

Why would a promisor breach an executory contract? One likely reason is that the promisor has, out of mistake or opportunism, committed the same performance to another purchaser. Promisees concerned about facing nonperformance for such a reason might therefore, if the law would permit it, insist on contractual terms giving them the right to specific performance. The incentive to insist on such terms, moreover, would be reinforced by the knowledge that other conflicting promisees would be likely to do so. But then if, for the same reasons of mistake or opportunism, a promisor commits the same performance to two or more promisees, each of which has contracted for specific performance, things stand more or less as they would have in the absence of such contractual clauses. For, at best, one party will get the performance, and the other will get damages.



The result is that permitting parties to contract for specific performance runs the risk of creating something of an arms race, in which clauses providing for specific performance become routine in contracts, yet contracting parties in general end up no more secure than they were in the absence of those clauses. The underlying problem is that a promisee cannot verify that no previous promisee has already been given a right of specific performance, nor can a promisee assure that notice of his own right of specific performance will be given to future promisees. If there were a registry of some sort for rights of specific performance, the problem might not arise. But of course such a registry does not exist, and would be impractical for contracts in general.

In short, the problem with granting rights of specific performance is much like the problem, discussed earlier, of granting security interests in personal property when possession is the principal means of verification. The only solution is to treat everyone alike. For security interests, that means that all contracting parties get a shared security interest in all of the promisor's property. For the right of specific performance, it means that no promisee gets the right, but rather that all get only a right to damages. In fact, the parallel between the two situations is even more apparent when we recognize that a right of specific performance is in important respects a security interest.

We do not wish to make too much of this potential rationale for the common law's reluctance to recognize a right of specific performance. Other issues are clearly involved. Moreover, the civil law, as we have already noted, does not share the common law's aversion to specific performance. Our discussion here, rather, is principally intended to further illustrate the uncertain boundary between contract rights and property rights, and the relevance of verification for rights of both types.

## **XII. WHAT IS AN ASSET?**

In exploring the ability of two or more persons to hold divided rights in a single asset, we have, to this point, taken for granted the notion that there exist identifiable "assets" in which one can obtain full (undivided) property rights. It remains to ask how the law determines what constitutes a single "asset" for purposes of establishing property rights.

The latter question, however, is essentially the same as the one we have been addressing. To say that two persons hold divided rights in the same asset is little different from saying that the two persons own undivided rights in distinct assets.

Suppose, for example, that A, who owns an acre of land in fee simple, divides the land into two equal adjoining parcels and sells one of the parcels in fee simple to B. Do A and B now each have undivided ownership of distinct assets? Or do they have divided ownership rights in a single asset? The law and ordinary language both generally conceptualize the situation in the former fashion. But, as our discussion in Section X suggests, it could equally well be viewed the other way. The two parcels are, after all,

irrevocably adjoining, and the uses made of one will commonly affect, to a greater or lesser degree, the value of the other.

Now suppose that A, instead of conveying to B the exclusive rights to half an acre, conveys to B the exclusive rights to use the full acre on Saturdays and Sundays, keeping for A the rights to use the land on Monday through Friday. Do A and B now own divided rights in a single asset, namely the acre of land? Or do they each own a separate asset – the land on weekdays and the land on weekends, respectively?

The question for the law is the same in either case: what are the conveyable boundaries of an asset? And this question, as we have argued, reduces to yet another question: what are the *verifiable* boundaries of an asset? A simple labeling system (e.g., fences) is adequate to support division of property rights in land along physical boundaries, at least if backed up by some nuisance law to set the default rules concerning conflicting uses of adjoining parcels. Division in terms of continuous intervals of time (e.g. leases, life estates) requires a registry for clear verifiability if the intervals are to be of long duration, and requires as well some more elaborate default rules as to the responsibilities of the interval owners to each other. Once a registry is in place, moving from continuous intervals to time shares, as in our weekday-weekend rights example, involves only modest increases in the system costs and the nonuser costs of verification, consisting mostly of the system costs of establishing yet more elaborate default rules concerning coordination between interval owners. The fact that U.S. law did not offer explicit recognition of time shares in real estate until relatively recently, when a number of states adopted legislation to that effect, presumably reflected low demand for the form rather than high costs of establishing adequate verification rules.<sup>37</sup>

### **XIII. AMBIGUITY CONCERNING RECOGNIZABLE PROPERTY RIGHTS**

Although time shares in real estate are now generally well recognized in U.S. law, time shares in personal property are not. It therefore remains problematic whether, for example, A could sell to B the weekend rights in A's heirloom watch, while retaining the weekday rights for himself, and succeed in giving B a property right – i.e., a right enforceable against subsequent transferees of A's interest in the watch. That is not to say that it is absolutely clear under U.S. law that A could *not* give B a weekend property right in the watch.<sup>38</sup> Rather, it presumably remains open to a court to decide that, in a particular case, a third party purchaser of A's interest in the watch had sufficient notice of B's interest to bind him to respect B's right. Or, better put, a court might find that there

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<sup>37</sup> Merrill & Smith, *supra* note 1, at 34, suggest that the law restricts definitions of property rights with respect to "legal dimensions" of assets, which are more difficult for acquirers to "measure" than are "physical attributes." We feel it more accurate to say that the law is concerned with the *physical* dimensions of assets that are difficult for all parties concerned to *verify*.

<sup>38</sup> See, e.g., David R. Dubord, *Time-share Condominiums: Property's Fourth Dimension*, 32 ME. L. REV. 181, 211-12 (1980).

was sufficient evidence that both A and C shared the expectation that C would respect A's right.

This is perfectly sensible. There is no particular reason to have a true *numerus clausus* in the sense of a formal doctrine that explicitly limits the types of property rights that can be constructed to a small well-defined set, and requires that all other rights be based on explicit contracts. If, even without benefit of specific affirmative legislation, the relevant parties can coordinate their own expectations to the effect that a given right will run with an asset, and can signal those expectations to a court with sufficient clarity, a refusal to enforce the right may simply sanction opportunism and frustrate the parties' original intentions, with no compensating advantage in reducing either system costs or costs borne by nonusers of the right.

Thus, it is not surprising that the common law has no formal doctrine equivalent to the civil law's *numerus clausus* and accompanying unitary theory of property rights, or that the efforts to rationalize strict adherence to the doctrine in the civil law seem highly formalistic, or that there is reason for skepticism as to just how closely the civil law adheres to a strict *numerus clausus* in practice.

## **XIV. CONCLUSION**

Although the common law as well as the civil law recognize only few forms of divided property rights, both regimes allow great freedom in constructing divided contractual rights in assets. At bottom, this difference arises from the relative ease of aligning the interests of multiple claimholders by contract, as compared to the costs, both social and private, of aligning the expectations of multiple holders of divided property rights who are not in privity with one another, and of providing evidence of those expectations to a court.

This difference between contract and property is quantitative rather than qualitative. Even without property law, it is possible with sufficient effort to fashion nonpossessory property rights – to give notice to third-party buyers -- with the ordinary tools of contract. Property law simply reduces the costs that users of those rights must bear in making them effective. Yet reducing costs for the users of property rights commonly increases costs for nonusers of the rights, including the public at large. An efficient system of law will support divided property rights only when the result is to reduce social costs overall. While existing legal systems may meet only a rough standard of efficiency in this respect, the limited sets of divided property rights they recognize surely reflects, in general terms, the fact that the value of such rights is often too small to justify the costs engendered by the legal rules needed to support them.