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The Right to Include

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THE RIGHT TO INCLUDE

Daniel B. Kelly*

ABSTRACT

Recent scholarship has created renewed interest in the “right to exclude.” Many contend that, because owners have a right to exclude, private property has a tendency to promote individualism and exclusion. But, as I will argue, property can promote sociability and inclusion by providing owners with various ways of including others. Owners can assert their “right to include” by waiving exclusion rights, dividing existing rights by contracts or property forms, and creating new co-ownership arrangements. Inclusion is socially beneficial insofar as it enables sharing and exchange, facilitates financing and risk-spreading, and promotes specialization. Yet inclusion may entail costs, including coordination difficulties, strategic behavior, and conflicts over use. To mitigate such costs, the law authorizes not only informal and contractual inclusion but also inclusion through various forms of property like easements, leases, and trusts. By providing owners with a range of options by which to include others, these forms help to ensure that an owner’s private incentive to include converges with the socially optimal level of inclusion. Each form not only binds third parties but also provides owners and those they may include with a unique mixture of anti-opportunism devices, such as mandatory rules, fiduciary duties, and supracompensatory remedies. Understanding how the law promotes the social use of property provides insights into debates over the property/contract interface, numerus clausus, and the right to exclude itself.

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INTRODUCTION

This Article contends that the ability of owners to “include” others in their property is a central attribute of ownership and fundamental to any system of private property. Too easily overlooked in debates about the right to exclude, or the rights of others to be included, is that owners frequently include others in the use, possession, and enjoyment of their property. The ability to include others—by waiving the right to exclude, dividing existing rights by contract or recognized forms of property, or creating new rights and forms—is critical for coordinating economic activities and organizing social relationships.

Owners include others in different ways, with different legal implications. Much inclusion is informal, e.g., a dinner invitation or a gratuitous license, in which an owner decides not to enforce or to waive the right to exclude. With *informal inclusion*, social norms, rather than law, usually govern the parties’ interactions. Inclusion also may be contractual, e.g., an agreement not to withdraw a waiver or license. With *contractual inclusion*, the parties have legal remedies, typically damages, if the owner breaches by revoking a waiver or if the nonowner breaches by exceeding the scope of a license. In addition to waiving exclusion informally or contractually, owners may rely on property forms that facilitate inclusion. With *proprietary inclusion*, each form not only binds third parties to a particular division of property but also provides the original parties with a unique mixture of anti-opportunism devices, such as mandatory rules, fiduciary duties, and supracompensatory remedies.

In the absence of contracts or property forms, an owner’s private incentive to include others might be socially suboptimal. Although some types of inclusion might still occur, parties would include others too little, fearful of opportunism and conflicts over use. To combat such fears and increase cooperation, the law authorizes formal devices like contracts and recognized forms of property by which owners may include others. As a result, both contracts and property forms can function as assurance mechanisms, minimizing the risk of strategic behavior and conflicts over use.

This Article contends that, due to the risk of opportunistic behavior, a proliferation of forms helps to ensure that the private incentive to include others converges with the socially optimal level of inclusion. The law facilitates cooperation because each form of inclusion entails different costs

and benefits, and owners may choose among these various forms in deciding whether, and under what circumstances, to include others in their property.

Generally, informal inclusion (e.g., gratuitous licenses or nonenforcement) is less costly than formal inclusion because it relies on social norms rather than law. However, if there is a danger of “high-value opportunism,”¹ informal inclusion may provide parties with too little certainty. If an owner decides to withdraw a license or to enforce her rights, the nonowner may have no legal remedy. Therefore, while including others via waiver or nonenforcement is, as Robert Merges contends, an important “flip side” of exclusion,² informal inclusion, by itself, is inadequate to maximize the social use of property.

Contractual inclusion (e.g., formal waivers of exclusion or intellectual property licenses) can be more costly than informal inclusion, but contracts provide more certainty and deter many kinds of opportunism.³ If an owner withdraws a contractual waiver or terminates a license, the licensee may sue for breach. Conversely, if a licensee exceeds the scope of an inclusion, the owner may sue the licensee to vindicate the owner’s rights. Knowing that legal remedies are available, both parties may be less inclined to act strategically, both at the outset and during performance of the contract.

Owners also may include others using various property forms, what this Article calls “proprietary inclusion.” These property forms, from easements and leases to trusts and corporations, are often similar to contracts in many ways. But the forms may provide even more certainty and protection against opportunism. Specifically, because property rights are in rem and “run with the land,” property forms can provide greater certainty than informal or contractual inclusion for successive owners and users. Moreover, while contracts deter certain types of opportunism, property forms can provide additional protection through a greater reliance on mandatory rules and fiduciary duties. Finally, unlike contracts, which rely primarily on compensatory damages, property forms often entail supracompensatory remedies like specific performance and injunctions, punitive damages, and restitution, which may help to deter strategic behavior.

¹ See Eric A. Posner, *A Theory of Contract Law Under Conditions of Radical Judicial Error*, 94 NW. U. L. REV. 749, 761 (2000) (defining high-value opportunism as “opportunism that cannot be deterred by the threat of (nonlegal) retaliation”).

² ROBERT P. MERGES, JUSTIFYING INTELLECTUAL PROPERTY 296 (2011).

³ See Posner, *supra* note 1, at 762; see also *infra* Part III.B.

A handful of legal scholars have mentioned inclusion and hinted at its importance.⁴ But they have not yet developed a theory to justify an owner's right to include,⁵ or compared various forms of inclusion, including contractual and proprietary inclusion, in detail.⁶ To fill this gap, this Article systematically analyzes the right to include by assessing the benefits and costs of inclusion. It then compares a number of institutional arrangements by which owners may include others: from nonenforcement and waiver of the right to exclude, to contracts and various forms of property.

The prior literature does emphasize two social dimensions of property: how using property may generate social costs,⁷ and how owning property may entail social obligations.⁸ This Article highlights another social dimension of property, one that is often overlooked. Namely, ownership can be inclusive, rather than exclusive; it can facilitate cooperation, not just result in conflict; and it frequently promotes human sociability, not atomistic individualism.

Part I surveys recent debates about exclusion and then distinguishes the nonowner's right to be included from an owner's right to include. Part II discusses why it is difficult to achieve the benefits of inclusion—sharing, exchange, financing, risk-spreading, and specialization—while preventing opportunism and other costs of inclusion. Part III compares the ways in which owners may include others: informal, contractual, and proprietary inclusion. In distinguishing among these alternative forms of inclusion, Part III explores why each of the forms is instrumental in facilitating the social use of property.

⁴ See MERGES, *supra* note 2, at 295 (“[T]he supposedly exclusive right of property is actually bound up with various forms of inclusion.”); THOMAS W. MERRILL & HENRY E. SMITH, *PROPERTY: PRINCIPLES AND POLICIES* 449 (2d ed. 2012) (“[I]t is important not only to be able to exclude other persons from the thing, but also to be able to include other persons in the use and enjoyment of the thing . . .”); J.E. PENNER, *THE IDEA OF PROPERTY IN LAW* 75 (1997) (“[U]nderstanding the social use of property . . . must be as fundamental to understanding property as understanding the way in which property excludes.”).

⁵ Cf. James Penner, *Ownership, Co-ownership, and the Justification of Property Rights*, in *PROPERTIES OF LAW* 166, 166 (Timothy Endicott et al. eds., 2006) (arguing that “justification of ownership *per se* depends upon the premise that property will generally be shared or co-owned”).

⁶ Cf. Gregory S. Alexander, *Governance Property*, 160 U. PA. L. REV. 1853, 1856–57, 1860 (2012) (delineating several types of “governance property” but noting the analysis “provides only a brief look at . . . some of the major [governance property] institutions in modern society”).

⁷ See R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 1 (1960); see also J.J. Laffont, *Externalities*, in 3 *THE NEW PALGRAVE DICTIONARY OF ECONOMICS* 192–93 (Steven N. Durlauf & Lawrence E. Blume eds., 2d ed. 2008) (discussing how production and consumption can create negative externalities).

⁸ See, e.g., Gregory S. Alexander, *The Social-Obligation Norm in American Property Law*, 94 CORNELL L. REV. 745, 746–48 (2009); Hanoch Dagan, *The Social Responsibility of Ownership*, 92 CORNELL L. REV. 1255, 1255–56 (2007); Joseph William Singer, *Democratic Estates: Property Law in a Free and Democratic Society*, 94 CORNELL L. REV. 1009, 1048 (2009).

Each form plays a unique role in deterring opportunism and facilitating cooperation. Part IV suggests that understanding an owner's right to include others helps to illuminate several recent debates in property theory.

I. EXCLUSION AND INCLUSION

A. *Excluding Others from Property*

One justification for property is that, by creating exclusive rights, property promotes the efficient use of resources.⁹ This justification has several aspects. First, property may provide individuals with incentives to work.¹⁰ Without property rights, the private incentive to work may diverge from what is socially optimal because a person considers that her output may be taken.¹¹ By contrast, with property rights, a person receives the output she produces and has an incentive to work the optimal amount.¹² Second, property provides incentives to maintain and improve things.¹³ If a person obtains the gains of maintaining and improving her property, she will do so consistent with what is socially optimal.¹⁴ Third, without a right to exclude, a person will devote resources to prevent the taking of her things, and other parties will waste their time and money attempting to take these things.¹⁵ In short, exclusion is said to promote the optimal use of resources and to prevent wasteful disputes.¹⁶

Historically, in analyzing property, many jurists have emphasized the role of exclusion. For example, William Blackstone's understanding of property—as a right to a thing good against the world—involves a robust concept of

⁹ See Harold Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV. (PAPERS & PROC.) 347, 356 (1967).

¹⁰ STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 11 (2004).

¹¹ *Id.* at 11–15 (providing numerical examples).

¹² *Id.* at 15.

¹³ *Id.* at 16.

¹⁴ See *id.* at 16–18; Dean Lueck & Thomas J. Miceli, *Property Law*, in 1 HANDBOOK OF LAW AND ECONOMICS 183, 192 (A. Mitchell Polinsky & Steven Shavell eds., 2007) (“[P]rivate ownership . . . creates incentives for optimal asset maintenance and investment.”).

¹⁵ See SHAVELL, *supra* note 10, at 20.

¹⁶ See Demsetz, *supra* note 9, at 348, 354–56 (describing the evolution of property rights and arguing that a “primary function of property rights is that of guiding incentives to achieve a greater internalization of externalities”); Robert C. Ellickson, *Property in Land*, 102 YALE L.J. 1315, 1322–32 (1993) (discussing advantages of individual ownership and arguing that “the parcelization of land is a relatively low-transaction-cost method of inducing people to ‘do the right thing’ with the earth’s surface”).

exclusion.¹⁷ For Blackstone, property was useful for preventing disputes as well as providing incentives to work.¹⁸ Given Blackstone's influence on American law, this understanding of property—as a right to a thing good against the world—was predominant among lawyers and judges until the early twentieth century.¹⁹ Understanding property as a thing is also consistent with how most nonlawyers conceptualize ownership.²⁰

As Thomas Merrill and Henry Smith have observed, this idea of property declined during much of the twentieth century.²¹ The writings of Wesley Hohfeld,²² and the advent of legal realism,²³ contributed to its decline and to the rise of a competing view—the idea of property as a “bundle of rights.”²⁴ Ultimately, as Merrill and Smith explain, the bundle-of-rights view became “a kind of orthodoxy” in law schools.²⁵ Moreover, Ronald Coase and other early figures in law and economics “did not question the realists’ conception of property as a contingent bundle of rights.”²⁶ Even with the ascendancy of this

¹⁷ See 2 WILLIAM BLACKSTONE, COMMENTARIES *2 (describing “the right of property” as “that sole and despotic dominion which one man claims and exercises over the external things of the world, in total exclusion of the right of any other individual in the universe”).

¹⁸ See *id.* at *7–8.

¹⁹ On the views of other theorists, in addition to Blackstone, see SHAVELL, *supra* note 10, at 22 & n.13, discussing Hobbes, Locke, and Bentham; and Thomas W. Merrill & Henry E. Smith, *What Happened to Property in Law and Economics?*, 111 YALE L.J. 357, 360–64 (2001), discussing Hobbes, Smith, and Bentham.

²⁰ See BRUCE ACKERMAN, PRIVATE PROPERTY AND THE CONSTITUTION 98–100 (1977) (stating that laypersons view property as thing ownership); Thomas C. Grey, *The Disintegration of Property*, in PROPERTY 69, 69 (J. Roland Pennock & John W. Chapman eds., 1980) (“Most people, including most specialists in their unprofessional moments, conceive of property as *things* that are *owned* by *persons*.”).

²¹ See Merrill & Smith, *supra* note 19, at 364–66.

²² On Hohfeld, see J.E. Penner, *Hohfeldian Use-Rights in Property*, in PROPERTY PROBLEMS: FROM GENES TO PENSION FUNDS 164–74 (J.W. Harris ed., 1997); and Joseph William Singer, *The Legal Rights Debate in Analytical Jurisprudence from Bentham to Hohfeld*, 1982 WIS. L. REV. 975, 986–94, 1056–59. For earlier analysis of Hohfeld, see generally Walter Wheeler Cook, *Hohfeld's Contributions to the Science of Law*, 28 YALE L.J. 721 (1919); and Max Radin, *A Restatement of Hohfeld*, 51 HARV. L. REV. 1141 (1938).

²³ On legal realism, see generally Brian Leiter, *Legal Realism*, in A COMPANION TO PHILOSOPHY OF LAW AND LEGAL THEORY 261, 261–79 (Dennis Patterson ed., 1996).

²⁴ On property as a bundle of rights, see ACKERMAN, *supra* note 20, at 26–29; Grey, *supra* note 20, at 69–71; Merrill & Smith, *supra* note 19, at 360–66; and J.E. Penner, *The “Bundle of Rights” Picture of Property*, 43 UCLA L. REV. 711 (1996). Although “Hohfeld did not use the metaphor ‘bundle of rights’ to describe property,” Hohfeld’s legal “theory of jural opposites and correlatives,” coupled with his analysis of in rem rights, “provided the intellectual justification for this metaphor, which became popular among the legal realists in the 1920s and 1930s.” Merrill & Smith, *supra* note 19, at 365.

²⁵ Merrill & Smith, *supra* note 19, at 365.

²⁶ *Id.* at 366; see also Emily Sherwin, *Two- and Three-Dimensional Property Rights*, 29 ARIZ. ST. L.J. 1075, 1078 (1997) (“[F]rom Hohfeld and Coase it is an easy step to say that property rights are simply rights, to which the term ‘property’ adds nothing at all.”).

bundle-of-rights view, most courts, including the United States Supreme Court, continue to acknowledge the right to exclude as one of the most important rights in the bundle.²⁷

Recently, there has been renewed interest in the nature of property and the right to exclude. James Penner has argued that “the right to property is a right to exclude others from things which is grounded by the interest we have in the use of things.”²⁸ Likewise, Merrill and Smith have attempted to revitalize the idea that “property at its core entails the right to exclude others from some discrete thing.”²⁹ These property theorists have attempted to emphasize that exclusion is “not an end in itself”³⁰ but rather the “practical means” by which an interest in the “use of property” is protected.³¹ However, their work has provoked a number of debates about the nature and purpose of property rights.³²

Historically, many prominent intellectuals have had a more pessimistic view about the effects of private property on social interaction. For Karl Marx, property entails each person attempting “to find satisfaction of his own selfish need” and thus “every new product represents a new potentiality of mutual swindling and mutual plundering.”³³ Marx’s objective was to transcend private property in order to return to a “social” existence: “The positive transcendence of *private property* as the appropriation of *human* life, is therefore the positive transcendence of all estrangement—that is to say, the return of man . . . to his *human*, i.e., *social*, existence.”³⁴ For this reason, in the *Communist Manifesto*,

²⁷ See, e.g., *Lingle v. Chevron U.S.A. Inc.*, 544 U.S. 528, 539 (2005) (declaring that the “right to exclude others from entering and using her property” is “perhaps the most fundamental of all property interests”); *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 435 (1982) (“The power to exclude has traditionally been considered one of the most treasured strands in an owner’s bundle of property rights.”); *Kaiser Aetna v. United States*, 444 U.S. 164, 179–80 (1979) (characterizing the “right to exclude” as being “universally held to be a fundamental element of the property right” (internal quotation marks omitted)).

²⁸ PENNER, *supra* note 4, at 71 (italics removed).

²⁹ MERRILL & SMITH, *supra* note 4, at vii; see also *id.* at 449; accord Thomas W. Merrill, *Property and the Right to Exclude*, 77 NEB. L. REV. 730, 742–43 (1998).

³⁰ Henry E. Smith, *Mind the Gap: The Indirect Relation Between Ends and Means in American Property Law*, 94 CORNELL L. REV. 959, 964 (2009).

³¹ PENNER, *supra* note 4, at 68–74 (discussing the connection between exclusion and use).

³² See, e.g., Daniel B. Klein & John Robinson, *Property: A Bundle of Rights? Prologue to the Property Symposium*, 8 ECON. J. WATCH 193, 194–96 (2011); see also *infra* notes 37–38.

³³ KARL MARX, *Human Requirements and Division of Labour Under the Rule of Private Property*, in ECONOMIC AND PHILOSOPHIC MANUSCRIPTS OF 1844, at 101, 101–02 (Progress Publishers trans., 5th ed. 1977) (italics removed).

³⁴ KARL MARX, *Private Property and Labour. Political Economy as a Product of the Movement of Private Property*, in ECONOMIC AND PHILOSOPHIC MANUSCRIPTS OF 1844, *supra* note 33, at 83, 91.

Marx and Friedrich Engels call for the abolition of private property.³⁵ Today, few scholars advocate abolishing private property entirely. But there remains a certain degree of skepticism about the role of property in a market economy, especially as economic inequality, commercial exploitation, and environmental degradation have not ceased (and, in some ways, accelerated) since Marx.³⁶

Thus, there is currently a robust debate over the significance of exclusion. Descriptively, many scholars disagree over whether the right to exclude is the organizing principle of property law, one right within the bundle of rights, or something else.³⁷ Normatively, scholars continue to disagree about the extent to which robust private property rights can be consistent with authentic social interaction and human flourishing.³⁸ Despite such disagreements, the unifying feature of this literature is its focus on the relative importance of *exclusion* as

³⁵ KARL MARX & FRIEDRICH ENGELS, *THE COMMUNIST MANIFESTO* 67 (Penguin Books 1998) (1848) (“[P]rivate property is the final and most complete expression of the system of producing and appropriating products, that is based on class antagonisms, on the exploitation of the many by the few. In this sense, the theory of the Communists may be summed up in the single sentence: Abolition of private property.”).

³⁶ See, e.g., Thomas Piketty & Emmanuel Saez, *The Evolution of Top Incomes: A Historical and International Perspective*, 96 AM. ECON. REV. (PAPERS & PROC.) 200 (2006) (discussing economic inequality); Samson Imasogie Omofonmwan & Lucky Osaretin Odi, *Oil Exploitation and Conflict in the Niger-Delta Region of Nigeria*, 26 J. HUM. ECOLOGY 25 (2009) (discussing commercial exploitation and environmental degradation).

³⁷ See generally Symposium, *Property: A Bundle of Rights?*, 8 ECON. J. WATCH 193 (2011) (compiling essays both defending and critiquing the bundle-of-rights view); Shyamkrishna Balganes, *Demystifying the Right to Exclude: Of Property, Inviolability, and Automatic Injunctions*, 31 HARV. J.L. & PUB. POL’Y 593, 593 (2008) (describing the right to exclude as the correlative of a duty of nonowners to stay away from property, which “derives from the norm of inviolability, a defining feature of social existence”); Abraham Bell & Gideon Parchomovsky, *A Theory of Property*, 90 CORNELL L. REV. 531, 531 (2005) (“propos[ing] a unified theory of property predicated on the insight that property law is organized around creating and defending the value inherent in stable ownership”); Larissa Katz, *Exclusion and Exclusivity in Property Law*, 58 U. TORONTO L.J. 275, 275 (2008) (arguing the central concern of property law is not the exclusion of nonowners, but rather maintaining the owner “as the exclusive agenda setter for the owned thing”); Adam Mossoff, *What Is Property? Putting the Pieces Back Together*, 45 ARIZ. L. REV. 371, 439 (2003) (offering an “integrated theory” in which property “comprises the exclusive rights to acquire, use and dispose of one’s possessions”); Eric R. Claeys, Response, *Exclusion and Private Law Theory: A Comment on Property as the Law of Things*, 125 HARV. L. REV. F. 133, 143 (2012), http://www.harvardlawreview.org/media/pdf/forvol125_claey.pdf (advancing a philosophical, rather than economic, view of property in which “property’s exclusivity is always calibrated to property’s legitimate use or use-determination”).

³⁸ Compare Alexander, *supra* note 8, at 747–48 (“The core image of property rights . . . is that the owner has a right to exclude others and owes no further obligation to them. . . . The law has relegated the social obligations of owners to the margins, while individual rights, such as the right to exclude, have occupied the center stage.”), with Smith, *supra* note 30, at 963 (“[Alexander] laments that social obligation appears only implicitly in property law and that there is a ‘gap’ between property law and human flourishing. I will argue . . . that far from being problems, this implicitness and gappiness is the strength of a property law that promotes flourishing.”).

the basis of property rights, with little discussion of an owner's right to include others.

B. Including Others in Property

Property not only involves exclusion but also entails inclusion. Inclusion may be *involuntary*, i.e., a nonowner's right to be included, or *voluntary*, i.e., an owner's right to include.³⁹

1. Involuntary Inclusion

Several criticisms of the right to exclude focus on competing claims by others to use, possess, or enjoy an owner's property. For example, in *Property: Values and Institutions*, Hanoch Dagan argues against the "trend of exclusion-centrism in property."⁴⁰ In a chapter entitled "Exclusion and Inclusion in Property," Dagan contends that "property neither is nor should be solely about exclusion or exclusivity and that, at times, inclusion is part of what property is rather than external to its core."⁴¹ Dagan is correct in saying that exclusion is not the end of the story. But what Dagan means by "inclusion" is different than what this Article means by the right to include.

Dagan is investigating a nonowner's right of access, i.e., the right to be included.⁴² He illustrates his argument with examples drawn from public accommodations law, fair use in copyright law, and the Fair Housing Act.⁴³ Each of these examples, like access in general, is a vital topic within property. Accordingly, there is a fairly well-developed literature examining situations in which a legal rule of exclusion conflicts with a public policy favoring inclusion,⁴⁴ and many examples in which a nonowner's right to be included trumps an owner's right to exclude.

³⁹ Cf. Robert C. Ellickson, *Two Cheers for the Bundle of Sticks Metaphor, Three Cheers for Merrill and Smith*, 8 ECON J. WATCH 215, 218 (2011) ("A well-designed private property system . . . must enable many forms of consensual, and sometimes even nonconsensual, decomposition.").

⁴⁰ HANOCH DAGAN, *PROPERTY: VALUES AND INSTITUTIONS* 38 (2011).

⁴¹ *Id.* at 48.

⁴² *Id.* at 44–45 (discussing "The Right to be Included" and "categories of cases where property law vindicates the right of nonowners to be included").

⁴³ *See id.* at 48–54.

⁴⁴ *See, e.g.*, EDUARDO MOISÉS PEÑALVER & SONIA K. KATYAL, *PROPERTY OUTLAWS: HOW SQUATTERS, PIRATES, AND PROTESTERS IMPROVE THE LAW OF OWNERSHIP* (2010); JOSEPH WILLIAM SINGER, *ENTITLEMENT: THE PARADOXES OF PROPERTY* (2000); Alexander, *supra* note 8; Dagan, *supra* note 8; Singer, *supra* note 8.

As Blackstone himself acknowledges, an owner's right to exclude is not absolute.⁴⁵ For example, a person may enter upon another's land based on necessity to preserve human life.⁴⁶ Likewise, hunters have long held a right to enter unenclosed lands;⁴⁷ indeed, a few American states, as well as many European nations, recognize a right of access for hunters, and about half the states require owners to post signs on the border of their property to exclude hunters.⁴⁸ Commercial airlines fly their planes over millions of parcels,⁴⁹ even though doing so would be a trespass under the *ad coelum* rule.⁵⁰ Moreover, in two well-known cases on the right to exclude, *State v. Shack* and *PruneYard v. Robins*, courts privileged the nonowners' interest in access over the owners' interest in exclusion.⁵¹ Plus, public accommodations and antidiscrimination law are widely recognized as important limitations on the right to exclude.⁵²

Similarly, in intellectual property (IP) law, nonowners often assert a right to be included. In copyright law, the fair use exception is a limitation on an author's right to exclude others from copying an original work.⁵³ In patent law, compulsory licensing is premised on a claim that a potential licensee has the

⁴⁵ See J. Harvie Wilkinson III, *The Dual Lives of Rights: The Rhetoric and Practice of Rights in America*, 98 CALIF. L. REV. 277, 290 (2010) (noting that, "[a]fter describing property rights as exclusive," Blackstone utilizes "five hundred pages describing various situations in which property rights properly yielded to community interests").

⁴⁶ See, e.g., *Ploof v. Putnam*, 71 A. 188, 189 (Vt. 1908); see also *Vincent v. Lake Erie Transp. Co.*, 124 N.W. 221, 222 (Minn. 1910).

⁴⁷ See, e.g., *McConico v. Singleton*, 9 S.C.L. (2 Mill) 244 (1818).

⁴⁸ See Mark R. Sigmon, Note, *Hunting and Posting on Private Land in America*, 54 DUKE L.J. 549, 558–64 (2004) (describing current laws regarding hunting on private land); see also Richard M. Hynes, *Posted: Notice and the Right to Exclude*, 45 ARIZ. ST. L.J. 949, 952 n.10, 955–56 (2013).

⁴⁹ See *Hinman v. Pac. Air Transp.*, 84 F.2d 755, 756 (9th Cir. 1936).

⁵⁰ See MERRILL & SMITH, *supra* note 4, at 13–15.

⁵¹ *PruneYard Shopping Ctr. v. Robins*, 447 U.S. 74, 82–84 (1980) (holding that a state limitation on a shopping mall owner's right to exclude individuals engaged in political speech did not constitute an unconstitutional taking of the owner's property); *State v. Shack*, 277 A.2d 369, 371–72, 374 (N.J. 1971) (holding that a health worker and staff attorney, who had entered a farm to speak with migrant workers living and working on the farm, did not commit a "trespass" because "ownership of real property does not include the right to bar access to governmental services available to migrant workers").

⁵² See 42 U.S.C. § 2000a (2006) (prohibiting "discrimination or segregation in places of public accommodation"); *id.* § 3604 (prohibiting "discrimination in the sale or rental of housing" on the basis of race, color, religion, sex, family status, national origin, as well as disability). On public accommodations, see generally A.K. Sandoval-Strausz, *Travelers, Strangers, and Jim Crow: Law, Public Accommodations, and Civil Rights in America*, 23 LAW & HIST. REV. 53 (2005); and Joseph William Singer, *No Right to Exclude: Public Accommodations and Private Property*, 90 NW. U. L. REV. 1283 (1996).

⁵³ See Ben Depoorter & Francesco Parisi, *Fair Use and Copyright Protection: A Price Theory Explanation*, 21 INT'L REV. L. & ECON. 453, 454–55 (2002); Henry E. Smith, *Intellectual Property as Property: Delineating Entitlements in Information*, 116 YALE L.J. 1742, 1812 (2007) ("[T]he doctrine of fair use is another limitation on copyright.").

right to be included in using a drug or invention.⁵⁴ More broadly, in advocating for an expansion of the public domain, many IP scholars emphasize the rights of users to be included.⁵⁵

Overall, the right of access is central in many areas of property and IP law. Furthermore, several leading property scholars, including Gregory Alexander, Hanoch Dagan, and Joseph Singer, outline theories that explain, justify, and promote inclusion in this sense.⁵⁶ However, there are clear differences between a nonowner's right to be included and the owner's right to include, and these differences deserve independent consideration.

2. *Voluntary Inclusion*

Owners often include others in their property. Yet, unlike the right to exclude or the right to be included, neither courts nor commentators have focused much on the right to include. In delineating the bundle of rights that characterizes property, courts have not identified the right to include as a distinct attribute of ownership.⁵⁷ Moreover, in defining property, many casebooks do not mention, or only briefly mention, the right to include.⁵⁸ Overall, the focus of most courts and commentators is on other attributes of property, such as the right to exclude, transfer, possess, or use.⁵⁹ To date, there is no systematic effort to investigate the right to include and its implications.

⁵⁴ See, e.g., Donald Harris, *TRIPS After Fifteen Years: Success or Failure, as Measured by Compulsory Licensing*, 18 J. INTEL. PROP. L. 367, 383 & n.72 (2011); Subhasis Saha, *Patent Law and TRIPS: Compulsory Licensing of Patents and Pharmaceuticals*, 91 J. PAT. & TRADEMARK OFF. SOC'Y 364, 366–67 (2009).

⁵⁵ See, e.g., L. RAY PATTERSON & STANLEY W. LINDBERG, *THE NATURE OF COPYRIGHT: A LAW OF USERS' RIGHTS* 14–15 (1991); Yochai Benkler, *Free as the Air to Common Use: First Amendment Constraints on Enclosure of the Public Domain*, 74 N.Y.U. L. REV. 354, 354, 359 (1999).

⁵⁶ See generally DAGAN, *supra* note 40, at 44 (“[P]roperty values . . . necessitate the incorporation of some dimension of social responsibility into the concept of property . . .”); SINGER, *supra* note 44, at 18 (“[T]here is no core of property we can define that leaves owners free to ignore entirely the interests of others.”); Alexander, *supra* note 8 (proposing a social-obligation theory of property, in which people have an obligation to promote human flourishing in their communities, which could extend to an obligation to share).

⁵⁷ See, e.g., *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 435 (1982) (“Property rights in a physical thing have been described as the rights ‘to possess, use and dispose of it.’” (quoting *United States v. Gen. Motors Corp.*, 323 U.S. 373, 378 (1945))); *Kafka v. Montana Dept. of Fish, Wildlife & Parks*, 2008 MT 460, ¶ 33, 348 Mont. 80, 201 P.3d 8 (defining property as “rights to exclude, use, transfer, or dispose of the property” (quoting *Members of the Peanut Quota Holders Ass’n v. United States*, 421 F.3d 1323, 1330 (Fed. Cir. 2005))) (internal quotation mark omitted).

⁵⁸ See, e.g., JOHN G. SPRANKLING, *UNDERSTANDING PROPERTY LAW* 4–5 (2d ed. 2007) (“[T]he most important sticks in the bundle are: (1) the right to exclude; (2) the right to transfer; and (3) the right to possess and use.” (footnote omitted)); see also *infra* notes 61, 63 (citing casebooks by Thomas Merrill & Henry Smith and by Jesse Dukeminier et al., both of which mention an owner's right to include).

⁵⁹ See *supra* notes 57–58.

Recently, several scholars, while emphasizing the right to exclude as the unifying or essential feature of property, have hinted that there may be another, related concept just beneath the surface. Specifically, a handful of scholars, including Penner, Merrill and Smith, and Merges, emphasize the fact that owners have the ability to *include* others. Penner uses the analogy of the gatekeeper to suggest that owners can include as well as exclude: “The right to property is like a gate, not a wall.”⁶⁰ Likewise, Merrill and Smith compare owners to gatekeepers in noting that “it is important not only to be able to exclude other persons from the thing, but also to be able to include other persons in the use and enjoyment of the thing.”⁶¹

Neither Penner nor Merrill and Smith adopt the realist perspective of property as a bundle of rights.⁶² But some realists, including Felix Cohen, also hypothesize that property entails not just the ability to exclude but also the power to “grant permission” to use something.⁶³ Moreover, several scholars, including Robert Ellickson, have argued that one of the virtues of the “bundle of rights” or “bundle of sticks” metaphor is that it highlights “an owner’s powers to transfer particular sticks in a bundle” and thereby include others.⁶⁴

This idea of inclusion arises in intellectual, as well as real, property. Merges contends that analyzing “a typical property right (including especially most IP rights) reveals all sorts of ways that the supposedly exclusive right of property is actually bound up with various forms of *inclusion*.”⁶⁵ Merges describes inclusion as not enforcing or waiving IP rights.⁶⁶ For example, if a firm owns a patent that is being infringed, the firm can decide not to enforce its patent. Similarly, if a firm wants to provide life-saving drugs to individuals in a developing nation, the firm can waive its IP rights. Merges advocates a “robust ‘right to include,’” which he says is “coextensive with the traditional right to

⁶⁰ PENNER, *supra* note 4, at 74.

⁶¹ MERRILL & SMITH, *supra* note 4, at 449; *see also* Merrill, *supra* note 29, at 742–44; Henry E. Smith, *Property as the Law of Things*, 125 HARV. L. REV. 1691, 1710 (2012).

⁶² *See* Merrill & Smith, *supra* note 19, at 360; Penner, *supra* note 24, at 714–15; *see also* Ellickson, *supra* note 39, at 216 (describing Merrill and Smith as “the leading critics of the bundle metaphor”).

⁶³ *See* Felix S. Cohen, *Dialogue on Private Property*, 9 RUTGERS L. REV. 357, 372 (1954) (“Without freedom to bar one man from a certain activity and to allow another man to engage in that activity we would have no property.”); *see also* JESSE DUKEMINIER ET AL., PROPERTY 88 (7th ed. 2010) (describing Cohen’s idea of property as “a relationship among people that entitles so-called owners to *include* (that is, permit) or *exclude* (that is, deny) use or possession of the owned property by other people”).

⁶⁴ Ellickson, *supra* note 39, at 218 & n.4; *see also* Richard A. Epstein, *The Disintegration of Intellectual Property? A Classical Liberal Response to a Premature Obituary*, 62 STAN. L. REV. 455, 464 (2010).

⁶⁵ MERGES, *supra* note 2, at 295.

⁶⁶ *See id.* at 286, 295.

exclude at the heart of IP and property generally.”⁶⁷ He concludes that this “ability to easily *include* is an important flip side to the grant of property rights.”⁶⁸

However, except for brief treatments by Penner, Merrill and Smith, and Merges, the property theory literature has not focused much on an owner’s right to include others. Moreover, the literature on the economic analysis of property has not investigated the social advantages and disadvantages of dividing property rights, with a few notable exceptions.⁶⁹ Instead, most scholars have focused almost exclusively on the costs, rather than the benefits, of fragmentation.⁷⁰ Yet, as Part II suggests, the benefits of inclusion are an important, albeit underexplored, dimension of property.

II. ON THE SOCIAL DESIRABILITY OF INCLUSION

To illustrate why inclusion is socially beneficial, consider a thought experiment. Imagine a world in which (a) you cannot include others in the use, possession, or enjoyment of your property and (b) others cannot include you in their property. Such a world—atomistic, isolated, and exclusive—differs dramatically from the interrelated and inclusive world in which we live, work,

⁶⁷ *Id.* at 290–91.

⁶⁸ *Id.* at 296.

⁶⁹ See generally SHAVELL, *supra* note 10, at 27–32 (discussing the advantages and disadvantages of property division); Ian Ayres & Eric Talley, *Solomonic Bargaining: Dividing a Legal Entitlement to Facilitate Coasean Trade*, 104 YALE L.J. 1027, 1029 (1995) (arguing that “[d]ividing a legal entitlement between rivalrous users can facilitate efficient trade”); Jeffrey Evans Stake, *Decomposition of Property Rights*, in 2 ENCYCLOPEDIA OF LAW AND ECONOMICS 32 (Boudewijn Bouckaert & Gerrit De Geest eds., 2000) (summarizing literature on the division of property into less than full ownership interests). In a forthcoming work, I discuss under what circumstances an owner’s private incentive to divide property diverges from the socially optimal division. See Daniel B. Kelly, *Dividing Possessory Rights*, in THE LAW AND ECONOMICS OF POSSESSION (Yun-Chien Chang ed., forthcoming 2014).

⁷⁰ See MICHAEL HELLER, THE GRIDLOCK ECONOMY: HOW TOO MUCH OWNERSHIP WRECKS MARKETS, STOPS INNOVATION AND COSTS LIVES, at xvi (2008); Michael A. Heller, *The Tragedy of the Anticommons: Property in the Transition from Marx to Markets*, 111 HARV. L. REV. 621, 623–26 (1998); Michael A. Heller & Rebecca S. Eisenberg, *Can Patents Deter Innovation? The Anticommons in Biomedical Research*, 280 SCIENCE 698, 698 (1998); see also Francesco Parisi, *Entropy in Property*, 50 AM. J. COMP. L. 595, 595–96 (2002); Francesco Parisi, *Freedom of Contract and the Laws of Entropy*, 10 SUP. CT. ECON. REV. 65, 65 (2003). Excessive fragmentation is a particularly salient issue in the wake of the mortgage crisis. See, e.g., David A. Dana, *The Foreclosure Crisis and the Antifragmentation Principle in State Property Law*, 77 U. CHI. L. REV. 97, 97 (2010); Note, *The Perils of Fragmentation and Reckless Innovation*, 125 HARV. L. REV. 1799, 1800 (2012).

and play. Inclusion is critical because human beings depend upon each other, not only to survive but also to flourish.⁷¹

Yet an owner's decision about whether to include another party entails a dilemma. Although inclusion can be highly beneficial, it creates a danger of strategic behavior and conflicts over use. How to maximize the benefits of inclusion, while minimizing its potential costs, is the key to unlocking the dilemma. To this end, Part II.A examines the benefits of inclusion, including sharing, exchange, financing, risk-spreading, and specialization. Part II.B analyzes some of the primary costs of inclusion: coordination disputes, strategic behavior, and conflicts over use.

A. *Social Benefits of Inclusion*

1. *Sharing*

Most individuals or families, in ancient as well as modern times, own relatively little property. Inclusion can therefore emerge out of necessity, e.g., obtaining permission to hunt on another's land,⁷² renting a field to grow crops,⁷³ or sharing subsistence harvests.⁷⁴ Inclusion through sharing is ubiquitous across cultures. Anthropologists and ethnographers have documented the role that "hosting" (i.e., inviting others into one's home) plays all over the world and throughout history.⁷⁵

Similarly, a recent article entitled "Is Civilization the Result of Humans' Need to Share?," reports on how a study in *Science* "shows that young human children perform as well as apes on intelligence tests, but that kids beat apes in

⁷¹ See GREGORY S. ALEXANDER, *COMMODITY AND PROPRIETY: COMPETING VISIONS OF PROPERTY IN AMERICAN LEGAL THOUGHT 1776–1970*, at 1–2 (1997) (characterizing human persons as "inevitably dependent on others not only to thrive but even just to survive"); Penner, *supra* note 5, at 185 ("Humans, *qua* humans, depend upon co-operative activity to survive as a matter of their very nature . . .").

⁷² See Sigmon, *supra* note 48, at 552–58.

⁷³ See MERRILL & SMITH, *supra* note 4, at 649.

⁷⁴ See, e.g., Hannah B. Loon, *Sharing: You Are Never Alone in a Village*, *ALASKA FISH & GAME*, Nov.–Dec. 1989, at 34, 36 (discussing various kinds of equitable, charitable, and ceremonial sharing of subsistence harvests in Inupiaq Eskimo villages).

⁷⁵ See, e.g., Harumi Befu, *An Ethnography of Dinner Entertainment in Japan*, 11 *ARCTIC ANTHROPOLOGY (SUPPLEMENT)* 196 (1974) (discussing the rituals that accompany hosting dinner guests); Russell Zanca, "Take! Take! Take!" *Host–Guest Relations and All That Food: Uzbek Hospitality Past and Present*, *ANTHROPOLOGY E. EUR. REV.*, Spring 2003, at 8; see also ADAM YUET CHAU, *MIRACULOUS RESPONSE: DOING POPULAR RELIGION IN CONTEMPORARY CHINA* 126 (2006) ("Hosting is arguably the most important social activity for Shaanbei people.").

social skills.”⁷⁶ The article speculates that “this human need to voluntarily *share* is why we have language” and also may “explain blogs, YouTube, and social networking.”⁷⁷ Indeed, in recent years, many people have participated in the “sharing economy,” in which renters use the Internet to connect with owners who are renting their spare rooms (on Airbnb), cars (on RelayRides), or other assets that are being less than fully utilized.⁷⁸ Finally, as economists have pointed out, sharing can be the result of either self-interest or altruism.⁷⁹ For example, even a profit-maximizing firm may share its resources with developing countries by waiving IP rights to life-saving drugs.⁸⁰

Sharing is socially beneficial if the benefits to a donor and donee outweigh the social costs. However, the private incentive to share may diverge from the socially optimal level of sharing because, even if donors are altruistic and benefit from an increase in the happiness of donees, donors may not take into account that this benefit to donees is itself relevant to social welfare.⁸¹ As a result, unless a donor’s motivation is to maximize social welfare, rather than the donor’s own self-interest, the private incentive to include others for purposes of sharing may diverge from what is socially optimal.⁸²

⁷⁶ Christie Nicholson, *Is Civilization the Result of Humans’ Need to Share?*, SCI. AM. (May 27, 2008), <http://www.scientificamerican.com/podcast/episode.cfm?id=2BA90A6B-C679-1D75-05835D9B22FE24FC> (discussing Esther Hermann et al., *Humans Have Evolved Specialized Skills of Social Cognition: The Cultural Intelligence Hypothesis*, 317 SCIENCE 1360 (2007)).

⁷⁷ *Id.*

⁷⁸ *The Rise of the Sharing Economy: On the Internet, Everything Is for Hire*, ECONOMIST, Mar. 9, 2013, at 53. See generally RACHEL BOSTMAN & ROO ROGERS, *WHAT’S MINE IS YOURS: THE RISE OF COLLABORATIVE CONSUMPTION* (2010).

⁷⁹ On self-interested or “warm-glow” giving, see generally SHAVELL, *supra* note 10, at 58 (“[T]he act of giving itself may supply utility to the donor, independently of the degree of satisfaction it renders the donee.”). James Andreoni, *Impure Altruism and Donations to Public Goods: A Theory of Warm-Glow Giving*, 100 ECON. J. 464 (1990) (describing utility from giving itself as a “warm glow”). On altruistic giving, see generally Joseph G. Altonji et al., *Parental Altruism and Inter Vivos Transfers: Theory and Evidence*, 105 J. POL. ECON. 1121, 1122 (1997) (“Two motives compete to explain family exchange: altruism and self-interest.”); Steven Shavell, *An Economic Analysis of Altruism and Deferred Gifts*, 20 J. LEGAL STUD. 401 (1991) (discussing economic rationale motivating donors and deferred giving).

⁸⁰ See, e.g., Sarah Boseley, *Glaxo Offers Free Access to Potential Malaria Cures*, GUARDIAN (U.K.), Jan. 20, 2010, <http://www.theguardian.com/science/2010/jan/20/glaxo-malaria-drugs-public-domain>; Russell Williams, Editorial, *Drug Firms Proud of Their Work Globally*, TORONTO STAR, July 29, 2009, at A18. See generally M. Todd Henderson & Anup Malani, *Corporate Philanthropy and the Market for Altruism*, 109 COLUM. L. REV. 571 (2009) (discussing corporate philanthropy and examining the role that corporations should play in satisfying the demand for altruism).

⁸¹ See Louis Kaplow, *A Note on Subsidizing Gifts*, 58 J. PUB. ECON. 469, 469–70 (1995) (discussing positive externality in giving).

⁸² See *id.*

2. *Exchange*

Unlike sharing, which entails a gratuitous transfer, exchange entails a transfer with consideration. Exchange is fundamental to a market economy because, through voluntary agreements, resources move from low-value to high-value users.⁸³ The future exchange of goods and services requires contracts. Thus, *A* agrees to a contract with *B*, and *B* agrees to a contract with *A*, only if *A* and *B* believe they will benefit from their agreement.⁸⁴

Consider several types of exchange, each of which entails inclusion. In a residential lease, a landlord remains the owner of an apartment but transfers possession of the apartment to a tenant. The landlord benefits from receiving the rent; the tenant benefits from having a place to live.⁸⁵ By selling tickets, i.e., revocable licenses, the owner of a stadium permits spectators to enter the arena. The owner benefits from selling the tickets; fans pay for a chance to watch the concert or game.⁸⁶ Finally, in an IP licensing agreement, a firm maintains ownership of its IP rights but allows consumers or other firms to use the information or idea.⁸⁷ The firm obtains a licensing fee; the licensees benefit from having access to the intellectual property rights.⁸⁸

In short, the exchange function of inclusion allows parties to enter into various kinds of mutually beneficial agreements regarding property without requiring complete alienation. Of course, if the law did not enforce such agreements, parties might engage in fewer exchanges. Moreover, exchange is a

⁸³ See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 39 (8th ed. 2011); see also Benjamin E. Hermalin, Avery E. Katz & Richard Craswell, *Contract Law*, in 1 *HANDBOOK OF LAW AND ECONOMICS*, *supra* note 14, at 3, 7 (“The essence of a free-market economy is the ability of private parties to enter into voluntary agreements that govern the economic exchange between them.”).

⁸⁴ See ANTHONY T. KRONMAN & RICHARD A. POSNER, *THE ECONOMICS OF CONTRACT LAW* 2 (1979); see also SHAVELL, *supra* note 10, at 296 (discussing “the mutual desirability of a contract”).

⁸⁵ See Ellickson, *supra* note 16, at 1372; cf. Louis De Alessi, *Gains from Private Property: The Empirical Evidence*, in *PROPERTY RIGHTS: COOPERATION, CONFLICT, AND LAW* 90, 102 (Terry L. Anderson & Fred S. McChesney eds., 2003) (“Voluntary renting and leasing are prevalent usufruct arrangements that facilitate the bundling of resource rights and their flow to higher-valued users.”).

⁸⁶ A study estimates that over 277 million tickets were sold in the United States in 2005 for professional sports events and NCAA football and men’s basketball games. See Brad R. Humphreys & Jane E. Ruseski, *Estimates of the Dimensions of the Sports Market in the US*, 4 *INT’L J. OF SPORT FIN.* 94, 100–01 (2009).

⁸⁷ See WILLIAM E. O’BRIEN ET AL., *INTELLECTUAL PROPERTY LICENSING AGREEMENTS* § 2, at 2 (2d ed. 2012) (“A license is defined as a grant of rights by an owner of intellectual property to use, make, have made, or sell the owner’s intellectual property.”).

⁸⁸ See *id.* (“A license agreement enables the owner and licensor to share technology or intellectual property with a licensee in exchange for compensation while retaining and controlling ownership of the licensed materials.”).

broad term that includes several types of mutually beneficial activities, including financing, risk-sharing, and specialization.

3. *Financing*

Financing is also instrumental in a market economy. One method of financing is a loan from a lender to a borrower. The borrower obtains the loan and, in return, promises to repay the lender (usually, with interest). The borrower may pledge collateral as security against the debt. A security interest, including a mortgage, is itself a type of inclusion.⁸⁹ But other forms of inclusion also serve this financing function.

Historically, leases served as a financing device. In discussing ancient land law, Robert Ellickson and Charles Thorland point out that “[a]nthropological evidence indicates that members of preindustrial societies tend to engage in land-leasing at an earlier stage than land-selling.”⁹⁰ Ellickson and Thorland maintain that “[r]ental arrangements respond to land-occupancy demands of relatively transitory or capital-poor persons.”⁹¹ Likewise, as Edward Glaeser and others have documented, the lease was a way of circumventing the prohibition on usury.⁹² Indeed, before the emergence of capital markets, leases served as a financing device for farmers⁹³ as well as early entrepreneurs.⁹⁴

Similarly, today’s consumers, especially consumers with few assets or poor credit, may prefer to lease, rather than buy, property for the sake of financing.⁹⁵

⁸⁹ See MERRILL & SMITH, *supra* note 4, at 808 (“Security interests can be seen as another form of divided ownership.”). On security interests in property law, see generally Barry E. Adler, *Bankruptcy as Property Law*, in RESEARCH HANDBOOK ON THE ECONOMICS OF PROPERTY LAW 206 (Kenneth Ayotte & Henry E. Smith eds., 2011), discussing how claims against assets in bankruptcy implicate property law.

⁹⁰ Robert C. Ellickson & Charles DiA. Thorland, *Ancient Land Law: Mesopotamia, Egypt, Israel*, 71 CHI.-KENT L. REV. 321, 369 (1995) (citing FREDERIC L. PRYOR, *THE ORIGINS OF THE ECONOMY: A COMPARATIVE STUDY OF DISTRIBUTION IN PRIMITIVE AND PEASANT ECONOMIES* 143 (1977)).

⁹¹ *Id.*; see also Arthur R. Gaudio, *Wyoming’s Residential Rental Property Act—A Critical Review*, 35 LAND & WATER L. REV. 455, 458 (2000) (“One of the initial uses of the leasehold estate was as a financing device for persons in need of funds.”).

⁹² See Edward L. Glaeser & José Scheinkman, *Neither a Borrower nor a Lender Be: An Economic Analysis of Interest Restrictions and Usury Laws*, 41 J.L. & ECON. 1, 25 (1998); see also MERRILL & SMITH, *supra* note 4, at 648; Mary B. Spector, *Tenants’ Rights, Procedural Wrongs: The Summary Eviction and the Need for Reform*, 46 WAYNE L. REV. 135, 142 (2000).

⁹³ See MERRILL & SMITH, *supra* note 4, at 649.

⁹⁴ See THEODORE F.T. PLUCKNETT, *A CONCISE HISTORY OF THE COMMON LAW* 572–73 (5th ed. 1956); Gaudio, *supra* note 91, at 458.

⁹⁵ See MERRILL & SMITH, *supra* note 4, at 649; see also Spector, *supra* note 92, at 144 n.21 (“[P]arties negotiate leases as a means of obtaining financing . . .”).

Several types of leases, including ground leases and sale-leasebacks, are well-established financing devices.⁹⁶ Likewise, if a person needs a new car, the person can buy the car (and finance the purchase with a loan) or, alternatively, lease the car.⁹⁷ The lease is also a common device for financing the purchase of aircraft.⁹⁸

Other forms of inclusion also serve as financing devices. Licenses are instrumental in financing various types of intellectual property rights, including rights in motion pictures.⁹⁹ Mortgage trusts are “a useful mechanism for real estate financing,” and, “[w]ithout [such] trusts, it would be impossible to explain the expansion of the U.S. housing market after World War II.”¹⁰⁰ Partnerships also facilitate financing and can sometimes serve as an alternative to a secured loan.¹⁰¹

4. *Risk-Spreading*

Inclusion also enables both owners and nonowners to reduce certain types of risk. Spreading risk is socially beneficial if parties are risk averse. Parties may attempt to mitigate their exposure to risk in various ways, including diversification and insurance.¹⁰² Yet another mechanism for mitigating risk is inclusion.

⁹⁶ See Gregory M. Stein, *Mortgage Law in China: Comparing Theory and Practice*, 72 MO. L. REV. 1315, 1332 (2007) (describing how the ground lease “functions as a financing device”); see generally Marvin Milich, *The Real Estate Sale-Leaseback Transaction: A View Toward the 90s*, 21 REAL EST. L.J. 66 (1992) (exploring the advantages and disadvantages of the sale-leaseback as a financing device).

⁹⁷ See MERRILL & SMITH, *supra* note 4, at 650 (“Auto leasing . . . is clearly a financing device, and functions as a substitute for purchasing an auto with a loan secured by a lien on the auto.”).

⁹⁸ See Michael Downey Rice, *Current Issues in Aircraft Finance*, 56 J. AIR L. & COM. 1027, 1032 (1991) (“Lease financing of aircraft is often viewed as the alternative to ‘straight’ debt financing.”).

⁹⁹ See, e.g., Lorin Brennan, *Financing Intellectual Property Under Revised Article 9: National and International Conflicts*, 23 HASTINGS COMM. & ENT. L.J. 313, 444 (2001) (explaining that the financing of motion pictures “illustrates prototypical intellectual property financing, with tiers of exclusive and non-exclusive licenses”).

¹⁰⁰ Dante Figueroa, *Civil Law Trusts in Latin America: Is the Lack of Trusts an Impediment for Expanding Business Opportunities in Latin America?*, 24 ARIZ. J. INT’L & COMP. L. 701, 750 (2007) (describing mortgage trusts).

¹⁰¹ See generally Robert H. Scarborough, *Partnerships as an Alternative to Secured Loans*, 58 TAX LAW. 509, 512 (2005) (“analyz[ing] current law treatment of partnership structures resembling secured financings”); see also Glaeser & Scheinkman, *supra* note 92, at 25 (discussing a “number of subtle mechanisms used . . . to avoid the usury ban” including limited partnerships).

¹⁰² On the role of diversification, see HARRY M. MARKOWITZ, *PORTFOLIO SELECTION: EFFICIENT DIVERSIFICATION OF INVESTMENTS* 5 (2d ed. 1991). On the role of insurance, see GEORGE E. REJDA, *PRINCIPLES OF RISK MANAGEMENT AND INSURANCE* 20 (11th ed. 2011).

The risk-sharing function of inclusion is not a modern phenomenon. Ellickson and Thorland posit that another reason that members of preindustrial societies may have engaged in land leases, even prior to land sales, is that leases serve to spread risks.¹⁰³ They point out that one of the “two principal theories for the widespread use of sharecropping throughout human history” is that “its risk-splitting feature appeals to cultivators, who are assumed to be more risk-averse than landlords.”¹⁰⁴ Indeed, in a seminal contribution to the economic analysis of law, *The Theory of Share Tenancy*, Steven Cheung describes sharecropping as a risk-sharing device.¹⁰⁵

Today, many forms of property mitigate risk. Several types of leases serve as risk-spreading devices, including residential leases,¹⁰⁶ oil and gas leases,¹⁰⁷ and leases on state trust lands.¹⁰⁸ Likewise, as Henry Hansmann contends, condominiums may have surpassed cooperatives in part because condos are a superior device for sharing risk.¹⁰⁹ Overall, inclusion allows certain risk-averse parties to use, possess, and enjoy property while bearing less risk.

5. *Specialization*

Inclusion is also ubiquitous because of the advantages of specialization.¹¹⁰ A landlord manages an apartment complex on behalf of tenants; a trustee manages funds for beneficiaries; and a CEO manages corporate assets on behalf of shareholders. An owner’s inclusion of a nonowner may benefit both parties because each party is able to utilize her own strengths and capabilities.

Many property forms, including leases, condos, trusts, and corporations, entail specialization. In leasing an apartment or office, tenants “specialize in possession and operation of discrete units within the larger complex,” while

¹⁰³ See Ellickson & Thorland, *supra* note 90, at 369 (citing J.V. Henderson & Y.M. Ioannides, *A Model of Housing Tenure Choice*, 73 AM. ECON. REV. 98 (1983)).

¹⁰⁴ *Id.* at 371.

¹⁰⁵ STEVEN N.S. CHEUNG, *THE THEORY OF SHARE TENANCY* 68 (1969). *But cf.* DOUGLAS W. ALLEN & DEAN LUECK, *THE NATURE OF THE FARM: CONTRACTS, RISK, AND ORGANIZATION IN AGRICULTURE* 10 (2002) (finding little support for risk-spreading theory).

¹⁰⁶ See MERRILL & SMITH, *supra* note 4, at 649 (describing how leasing reduces risk for both tenants and landlords).

¹⁰⁷ See, e.g., *Comm’r v. Engle*, 464 U.S. 206, 219 n.17 (1984) (noting that “lessees can spread their risks over many leased properties”).

¹⁰⁸ See, e.g., JON A. SOUDER & SALLY K. FAIRFAX, *STATE TRUST LANDS: HISTORY, MANAGEMENT, AND SUSTAINABLE USE* 71–77 (1996) (discussing “leasing as a mechanism for managing and apportioning risk”).

¹⁰⁹ See Henry Hansmann, *Condominium and Cooperative Housing: Transactional Efficiency, Tax Subsidies, and Tenure Choice*, 20 J. LEGAL STUD. 25, 60 (1991).

¹¹⁰ See YORAM BARZEL, *ECONOMIC ANALYSIS OF PROPERTY RIGHTS* 51 (2d ed. 1997).

the landlord is responsible for “constructing, maintaining, insuring, and coordinating assets common to the entire complex.”¹¹¹ Likewise, condos are popular in part because residents own their individual units and hire managers to supervise the complex and maintain common areas.¹¹² Trusts, by providing managerial intermediation, exemplify the benefits of specialization: beneficiaries enjoy distributions of income and principal, while the trustee is responsible for managing and investing the trust corpus.¹¹³ Finally, in a corporation, shareholders bear the benefits and burdens of ownership, while the directors and managers operate the firm on a daily basis.¹¹⁴

Overall, many property forms promote specialization through inclusion.¹¹⁵ In discussing the benefits of divided ownership, Yoram Barzel notes how “sole ownership may result in yet a greater loss due to reduced specialization.”¹¹⁶ And specialization is often advantageous for owners and nonowners alike.

* * *

Including others is often beneficial because different parties derive benefits from different aspects of the property. *Sharing* enables donative transfers without requiring the transfer of ownership (e.g., waiving IP rights over a life-saving drug or creating a trust to support a surviving spouse). *Exchange* facilitates mutually beneficial agreements regarding the use or possession of property without complete alienation (e.g., licensing software). *Financing*

¹¹¹ MERRILL & SMITH, *supra* note 4, at 650; *see also* Victor P. Goldberg et al., *Bargaining in the Shadow of Eminent Domain: Valuing and Apportioning Condemnation Awards Between Landlord and Tenant*, 34 UCLA L. REV. 1083, 1095 (1987) (“Leasing is economically beneficial because it permits specialization of functions.”); Lueck & Miceli, *supra* note 14, at 217 (“A lease . . . can enhance efficiency by allowing gains from specialization.”).

¹¹² *See* Jonathan D. Ross-Harrington, Note, *Property Forms in Tension: Preference Inefficiency, Rent-Seeking, and the Problem of Notice in the Modern Condominium*, 28 YALE L. & POL’Y REV. 187, 196 (2009) (“[C]ondominiums create efficiencies by allowing for specialization in management . . .”).

¹¹³ *See* JESSE DUKEMINIER & ROBERT H. SITKOFF, WILLS, TRUSTS AND ESTATES 579 (9th ed. 2013); MERRILL & SMITH, *supra* note 4, at 779.

¹¹⁴ *See* ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 4–6 (Transaction Publishers 1991) (1932); *see also* Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 261–65 (1967) (discussing efficiency of specialization in the corporate form).

¹¹⁵ *See* MERRILL & SMITH, *supra* note 4, at 646, 649–50, 778–79, 805–06 (explaining that leases, trusts, corporations, and partnerships “permit the management of resources to be separated from their use and enjoyment” and promote the “specialization of functions”).

¹¹⁶ BARZEL, *supra* note 110, at 55; *see also* Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 301–02 (1983) (presenting a model in which division of ownership and control is an efficient specialization of functions); Henry E. Smith, *The Language of Property: Form, Context, and Audience*, 55 STAN. L. REV. 1105, 1173 (2003) (“Divided property rights in assets can be used to facilitate specialization in production or consumption.”).

allows a party to obtain access to property without purchasing it (e.g., leasing rather than buying a car). *Risk-spreading* allows nonowners, as well as owners, to share risks (e.g., renting an apartment for what could be a short-term move). Finally, *specialization* allows parties to maximize their joint gains by performing distinct roles or functions (e.g., having one party manage a trust for a fee while another party enjoys the income from the trust).

B. Social Costs of Inclusion

If contracts were complete or property rights could be perfectly specified and enforced, inclusion would be straightforward. But *ex ante* specification is difficult for several reasons.¹¹⁷ Because contracts are incomplete and property rights are imperfect,¹¹⁸ inclusion entails a number of potential issues, including (1) coordination difficulties, (2) strategic behavior, and (3) conflicts over use.

¹¹⁷ First, it is difficult to foresee all potential contingencies. See Hermalin et al., *supra* note 83, at 75 (discussing the idea that, because of bounded rationality, individuals “fail to foresee all possible contingencies and, thus, their contracts suffer from unforeseen contingencies”). Second, even if foreseeable, it is costly for the parties to specify additional terms. See *id.* at 76–77; see also SHAVELL, *supra* note 10, at 299 (“[P]arties will tend not to specify terms of low probability events . . .”). Third, in defining the scope of inclusion, parties may be unable to observe whether they share a common understanding of certain terms or conditions. See Hermalin et al., *supra* note 83, at 78–79 (discussing asymmetric information and the problem of observability). Fourth, even if the parties have the same understanding, either party may act opportunistically, and it is costly for the parties to rely on courts or other enforcement mechanisms to verify compliance. See *id.* at 79 (discussing the problem of verifiability); see also Henry Hansmann & Reinier Kraakman, *Property, Contract, and Verification: The Numerus Clausus Problem and the Divisibility of Rights*, 31 J. LEGAL STUD. S373, S382 (2002) (“[I]f the parties solve the coordination problem, each needs assurance that the other will not opportunistically assert rights that properly belong to the other.”).

¹¹⁸ On incomplete contracts, see SHAVELL, *supra* note 10, at 299–301; and Hermalin et al., *supra* note 83, at 75–80. See generally OLIVER HART, FIRMS, CONTRACTS, AND FINANCIAL STRUCTURE (1995) (arguing that the existence of incomplete contracts and *ex post* opportunism help to explain many economic institutions and arrangements); Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 J. POL. ECON. 691, 691 (1986) (“When it is costly to list all specific rights over assets in the contract, it may be optimal to let one party purchase all residual rights. . . . [T]his inevitably creates distortions.”); Oliver Hart & John Moore, *Foundations of Incomplete Contracts*, 66 REV. ECON. STUD. 115 (1999) (attempting to provide a foundation for the idea of “incomplete contracting”). On imperfect specification and enforcement of property rights, see Sebastian Galiani & Ernesto Schargrodsky, *Land Property Rights and Resource Allocation*, 54 J.L. & ECON. S329, S330 (2011) (citing BARZEL, *supra* note 110), noting that “creating, specifying, and enforcing property rights is costly and, hence, these rights will never be perfect.” Cf. Henry E. Smith, *An Economic Analysis of Law Versus Equity* 9 (Oct. 22, 2010) (unpublished manuscript), http://www.law.yale.edu/documents/pdf/LEO/HSmith_LawVersusEquity7.pdf (suggesting that “opportunism is behavior that is undesirable but that cannot be cost-effectively captured—defined, detected, and deterred—by explicit *ex ante* rulemaking”).

1. *Coordination Difficulties*

If a single party, *A*, owns property, in fee simple absolute, there is little or no difficulty in coordinating how to use the property. *A* can use her property in whatever way, and to whatever extent, she believes to be best (assuming the use does not constitute a nuisance or violate a covenant or zoning ordinance). If *A* wants to go for a swim in her pool, then *A* can do so. As long as she does not schedule two events on her property at the same time, there is no possibility of conflict.

However, suppose that *A* decides to divide her property by including another party, *B*. Now *A* and *B* must coordinate how to use the property. For example, *B* may have a limited right to use the property for a certain purpose (as in a license or easement), with *A* retaining the right to use it for all other purposes. Or *B* may have the right to possess the property for a limited period of time (as in a lease or bailment), with *A* reserving the right to retake possession when *B*'s interest ends. A division of rights also could entail *A* and *B* using the property at the same time or in close proximity. In each situation involving more than one party, there is a higher likelihood that disputes will arise because of coordination difficulties. Put another way, multiple parties may want to use the swimming pool at the same time.¹¹⁹

2. *Strategic Behavior*

Coordination problems can be exacerbated by the possibility of strategic behavior. Including others creates a risk for many types of opportunism.¹²⁰ An owner may want to include another for one purpose, but it may be difficult for the owner to limit access for this particular purpose. For instance, a party who is being included may seek to expand the scope of the inclusion. Or, other parties may attempt to expand the inclusion by using the property for the authorized purpose. If the expected costs of inclusion become too high, owners may decide not to include others at the outset.

¹¹⁹ See SHAVELL, *supra* note 10, at 29 (“If many individuals have the right to use a person’s backyard swimming pool at different times, the odds of different people wishing to use the pool simultaneously will increase.”).

¹²⁰ Oliver Williamson defines opportunism as “self-interest seeking with guile.” OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING* 47 (1985). Williamson describes “guile” broadly to include “calculated efforts to mislead, distort, disguise, obfuscate, or otherwise confuse,” as well as incomplete disclosure of information. *Id.*; see also Oliver E. Williamson, *Opportunistic Behaviour in Contracts*, in 2 *THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW* 703, 703 (Peter Newman ed., 1998). I use “strategic behavior” and “opportunism” interchangeably.

Consider two examples that illustrate the problem of opportunism in the context of inclusion. A homeowner, *H*, may be willing to grant a neighbor, *N*, an easement over *H*'s land to provide *N* with access to a beach for swimming and boating.¹²¹ But, once included, *N* may increase the intensity of use, number of authorized uses, or scope of the easement.¹²² For example, *N* may use the easement not only for swimming and boating but also for having a picnic.¹²³ Similarly, a patent owner, *P*, may seek to license a patent to a firm, *F*, for a new smartphone.¹²⁴ Yet, once included, *F* may attempt to increase the scope of the license.¹²⁵ Anticipating strategic behavior, owners, such as *H* and *P*, may be less willing to include nonowners, such as *N* and *F*, at the outset.

Of course, opportunism is a two-way street: owners, like nonowners, may act strategically. For example, a patent troll owns a property interest solely for the purpose of inclusion because the troll is only able to monetize its interest through strategic licensing agreements. In this case, nonowners may choose to forgo an otherwise beneficial inclusion.

Overall, opportunism is problematic for several reasons. First, fearing strategic behavior, there is less incentive for owners to include others or for nonowners to seek to be included and, thus, a lower likelihood of sharing or exchange. Second, even if including others is feasible, parties often will incur additional costs in specifying the terms of inclusion. Third, opportunism may result in monitoring costs, especially if a nonowner is acting as an agent (e.g., a trustee or manager) on behalf of the owner, the principal (e.g., the settlor or shareholders).¹²⁶ The possibility of strategic behavior is thus a significant cost of inclusion and may impede certain transfers that involve including others.¹²⁷

¹²¹ See, e.g., *Mountainview Landowners Coop. Ass'n v. Cool*, 86 P.3d 484, 486 (Idaho 2004) (describing an easement for "use of the beach area . . . for swimming and boating only" (internal quotation mark omitted)).

¹²² See Lee J. Strang, *Damages as the Appropriate Remedy for "Abuse" of an Easement: Moving Toward Consistency, Efficiency, and Fairness in Property Law*, 15 GEO. MASON L. REV. 933, 935–36 (2008).

¹²³ See *Mountainview Landowners*, 86 P.3d at 488 ("Picnics and gatherings for relaxation and social interaction would not under any stretch be swimming.").

¹²⁴ See, e.g., Dan Levine & Edwin Chan, *Apple Expert Shines Light on Samsung Sales in U.S.*, REUTERS (Aug. 13, 2012, 2:34 AM), <http://www.reuters.com/article/2012/08/14/us-apple-samsung-idUSBRE87C0SC20120814> (reporting that "an Apple executive testified that the company had licensed prized design patents to Microsoft").

¹²⁵ See Dan Levine & Poornima Gupta, *Apple, Samsung Launch Salvos as Smartphone Trial Heats Up*, REUTERS (July 31, 2012, 7:47 PM), <http://www.reuters.com/article/2012/07/31/us-apple-samsung-trial-idUSBRE86Q16X20120731> ("Apple sued Samsung in . . . federal court, accusing the South Korean company of slavishly copying the iPhone and iPad.").

¹²⁶ A corporate manager may not have the same interests as the shareholders. See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J.

3. *Conflicts over Use*

A related difficulty with inclusion is the potential for conflicts over use. Because a nonowner may have a shorter time horizon than an owner with respect to the property, the nonowner may discount the future utility of the property.¹²⁸ As a result, the nonowner may engage in actions—such as imposing excessive wear-and-tear—that do not maximize the property’s value in the long run.¹²⁹ For the same reason, a nonowner’s private incentive to maintain or improve the property may diverge from what is socially optimal.¹³⁰ As a result, a nonowner may engage in actions—such as not maintaining the property—that result in a decline in the asset’s value.

Consider the classic example of a landlord and tenant. A tenant will take actions that affect the property’s future value.¹³¹ But the tenant does not bear the full costs or benefits of using or maintaining the property. Consequently, the tenant may use the property excessively or maintain the property inadequately.¹³² For instance, in an agricultural lease, the owner of the land may worry that a tenant farmer will ignore the long-term sustainability of the field.¹³³ In a residential lease, the landlord may fear that a tenant will ignore a minor problem (e.g., a leaky faucet), resulting in a more serious problem in the future (e.g., flooding).¹³⁴ Likewise, a rental car company may limit the number of miles but is usually unable to prevent excessive wear-and-tear on the brakes

FIN. ECON. 305, 308–09 (1976). A trustee may not have the same interests as the settlor. See Robert H. Sitkoff, *An Agency Costs Theory of Trust Law*, 89 CORNELL L. REV. 621, 621 (2004).

¹²⁷ Cf. Hansmann & Kraakman, *supra* note 117, at S382–83 (stating that the potential for opportunism may decrease the value of rights as “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”).

¹²⁸ See POSNER, *supra* note 83, at 90.

¹²⁹ See *id.* at 90–92 (discussing divided ownership in estates in land); SHAVELL, *supra* note 10, at 79 (discussing externalities in the treatment of rental property).

¹³⁰ See Lueck & Miceli, *supra* note 14, at 217 (“The division of ownership and use . . . creates potential incentive problems for both landlords and tenants regarding the optimal maintenance and use of the property.”).

¹³¹ See POSNER, *supra* note 83, at 90–91; SHAVELL, *supra* note 10, at 79.

¹³² See Lueck & Miceli, *supra* note 14, at 217.

¹³³ See SHAVELL, *supra* note 10, at 79 (“When a person rents farmland, he may reduce its usefulness by abusing it, letting it erode, and so forth . . .”); Lueck & Miceli, *supra* note 14, at 218 (developing a model in which, given a fixed rent, landlord and tenant “under invest in maintenance”).

¹³⁴ Cf. *Javins v. First Nat’l Realty Corp.*, 428 F.2d 1071, 1078 (D.C. Cir. 1970) (“A tenant’s tenure in a specific apartment will often not be sufficient to justify efforts at repairs.”); *Davidow v. Inwood N. Prof’l Grp.—Phase I*, 747 S.W.2d 373, 376 (Tex. 1988) (“[B]ecause commercial tenants often enter into short-term leases, the tenants have limited economic incentive to make any extensive repairs to their premises.”).

or upholstery.¹³⁵ In a similar way, the interests of licensors and licensees, settlors and trustees, and shareholders and directors may diverge as well.

Thus, although the actions of nonowners may affect the future value of the property, nonowners may not have an incentive to internalize the full costs of their actions. Owners can take measures to mitigate the problem.¹³⁶ However, such measures are usually imperfect and costly. As a result, owners will have an incentive to include others less often than if the interests of the parties were aligned. And, once again, the problem is reciprocal: there is a risk that owners, as well as nonowners, may engage in this type of behavior.¹³⁷

III. COMPETING MODES OF INCLUSION

To maximize the net benefits of inclusion, the law authorizes multiple ways of including others, including informal, contractual, and proprietary inclusion. Part III.A discusses informal inclusion through nonenforcement and waiver. Part III.B analyzes inclusion via contract, compares informal and contractual inclusion, and identifies certain limitations of contract in deterring opportunism. Part III.C considers inclusion through well-recognized forms of property. After examining the functional justifications for distinguishing between these property forms and contracts, I compare several forms of property that facilitate inclusion.

A. *Informal Inclusion*

Informal inclusion involves situations in which an owner includes another in property, but the inclusion imposes no legal obligations on the parties. Unlike formal inclusion, which relies on contract or property law, informal inclusion relies on an owner's discretion and social norms to govern the scope, terms, and termination of the inclusion. This Article discusses two types of informal inclusion: nonenforcement and waiver.

¹³⁵ See POSNER, *supra* note 83, at 94; SHAVELL, *supra* note 10, at 79. The impediments to monitoring driver behavior are sometimes legal, not economic or technological. See, e.g., Elizabeth C. Yen, *Rent a Car, Rent a Spy*, BUS. L. TODAY, July/Aug. 2005, at 59, 59. On rental car agreements, see generally Irma S. Russell, *Got Wheels? Article 2A, Standardized Rental Car Terms, Rational Inaction, and Unilateral Private Ordering*, 40 LOY. L.A. L. REV. 137 (2006), studying the form contracts of ten rental car companies.

¹³⁶ See SHAVELL, *supra* note 10, at 17.

¹³⁷ See DUKEMINIER ET AL., *supra* note 63, at 482 (discussing how tenants have an incentive to "neglect maintenance" and landlords have an incentive to "neglect everyday repairs").

As noted above, Robert Merges discusses how owners can include others by not enforcing property rights.¹³⁸ Merges highlights the “crucial *postgrant* stage in the life of a typical property right.”¹³⁹ He argues that attending to this stage “reveals all sorts of ways that the supposedly exclusive right of property is actually bound up with various forms of *inclusion*.”¹⁴⁰ “The most obvious example,” according to Merges, is “nonenforcement” because “rights that are theoretically exclusive can be voluntarily left idle for all sorts of reasons—rendering them not very exclusive at all.”¹⁴¹

Nonenforcement (e.g., not ejecting a trespasser or not filing a claim against a patent or copyright infringer) is distinct from other types of inclusion. First, nonenforcement is passive. Unlike a gratuitous license or a lease, an owner who includes through nonenforcement does not have to take any affirmative steps.¹⁴² Second, nonenforcement is *ex post*. Unlike a waiver that is given in advance, the decision not to exclude a nonowner usually occurs, or is made evident, after the nonowner begins to use the owner’s property.¹⁴³ Third, unlike contracts or property forms, nonenforcement does not create new rights or duties. In other words, nonenforcement functions as an implicit waiver of the right to exclude after the fact.

The problem with nonenforcement is that it provides little certainty. The nonowner is able to use the property only under a continual risk of losing access. At any time, the owner may decide to exclude.¹⁴⁴ With a few exceptions like estoppel, laches, and adverse possession, the law does not provide a nonowner with any legal rights or remedies. Of course, social norms and other factors may affect the circumstances in which the owner decides to terminate the inclusion.¹⁴⁵ But, ultimately, the decision not to enforce is within the owner’s discretion. An owner may decide to exclude at any time or for any

¹³⁸ See *supra* notes 65–68 and accompanying text.

¹³⁹ MERGES, *supra* note 2, at 295.

¹⁴⁰ *Id.*

¹⁴¹ *Id.*; see also Robert P. Merges, *Autonomy and Independence: The Normative Face of Transaction Costs*, 53 ARIZ. L. REV. 145, 161 n.22 (2011) (collecting sources regarding “empirical evidence on extensive underenforcement of patents in biotechnology” and “extensive nonenforcement of copyrights in the online context”).

¹⁴² See MERGES, *supra* note 2, at 295.

¹⁴³ See *id.*

¹⁴⁴ See *id.*

¹⁴⁵ See, e.g., Rebecca S. Eisenberg, *Noncompliance, Nonenforcement, Nonproblem? Rethinking the Anticommons in Biomedical Research*, 45 Hous. L. REV. 1059, 1095 (2008) (discussing the social norms governing the “nonenforcement of patents”).

reason, even if opportunistic.¹⁴⁶ Moreover, a nonowner may have an incentive to expand the scope of the inclusion and to use property excessively, especially knowing that the owner can revoke at any time. Thus, nonenforcement may provide little protection against strategic behavior.

Another type of informal inclusion is waiver. An owner can include a nonowner in her property by gratuitously waiving the right to exclude.¹⁴⁷ A waiver of the right to exclude is a “permission slip” from the owner to a nonowner.¹⁴⁸ The waiver may be explicit (e.g., an invitation) or implicit (e.g., a store opening its doors).¹⁴⁹ Yet, unlike nonenforcement, which entails an owner’s decision not to enforce after the fact, a waiver entails a decision to include before the fact—essentially, a promise in advance not to exclude.

Including others through waiver is pervasive.¹⁵⁰ A common type of waiver is a gratuitous license.¹⁵¹ A gratuitous license involves a waiver of the right to exclude, converting what would otherwise be a trespass into a lawful entry upon or use of the owner’s property.¹⁵² Another example is the waiver of IP rights in life-saving drugs.¹⁵³ Because waiver is consistent with several of the

¹⁴⁶ See, e.g., Robert P. Merges, Response, *Individual Creators in the Cultural Commons*, 95 CORNELL L. REV. 793, 804 (2010) (describing companies that withhold patent information from standard-setting organizations of which they are a part, and stating that “the strategic use of patents here has the potential to do real economic harm”).

¹⁴⁷ See MERGES, *supra* note 2, at 295.

¹⁴⁸ Thomas W. Merrill, *The Landscape of Constitutional Property*, 86 VA. L. REV. 885, 976 (2000) (“A license is a ‘permission slip’ from someone with the right to exclude that allows another to gain access to a resource.”).

¹⁴⁹ See, e.g., *St. Petersburg Coca-Cola Bottling Co. v. Cuccinello*, 44 So. 2d 670, 676 (Fla. 1950); see also JOSEPH WILLIAM SINGER, PROPERTY LAW: RULES, POLICIES, AND PRACTICES 362 (3d ed. 2002) (“Entering a store during business hours would not be deemed a trespass because entry onto the property is based on implied consent.”). There is also the possibility of an implied IP license. See Mark D. Janis, *A Tale of the Apocryphal Axe: Repair, Reconstruction, and the Implied License in Intellectual Property Law*, 58 MD. L. REV. 423, 514 (1999).

¹⁵⁰ See MERGES, *supra* note 2, at 286–87 (“The choice to waive property rights is part and parcel of the property system, and owners often exercise this choice so as to reduce the worst potential effects of property rights.”); SINGER, *supra* note 149, at 362 (“Possessors of real property constantly grant non-owners permission to enter their property.”).

¹⁵¹ See THOMAS W. MERRILL & HENRY E. SMITH, THE OXFORD INTRODUCTIONS TO U.S. LAW: PROPERTY 85 (2010) (noting that “licenses are ubiquitous in everyday life”).

¹⁵² See JON W. BRUCE & JAMES W. ELY, JR., THE LAW OF EASEMENTS AND LICENSES IN LAND § 11:1 (2013) (defining a license as “the permission to do something on the land of another that, without such authority, would be unlawful”).

¹⁵³ See MERGES, *supra* note 2, at 286 (citing *Pharmaceuticals: Quagmire to Goldmine?*, ECONOMIST, May 17, 2008, at 102) (“Most major pharmaceutical companies have undertaken voluntary free drug distribution programs.”).

advantages of inclusion, Merges contends that “the ability to waive property rights is a crucial benefit.”¹⁵⁴

The problem with waiver, even if inclusion is socially beneficial, is that it provides little certainty to nonowners. Compared to nonenforcement, waiver lowers the risk to a nonowner; without revoking a waiver, the owner cannot claim a nonowner is trespassing or infringing. However, like nonenforcement, a waiver or gratuitous license is freely revocable.¹⁵⁵ If an owner withdraws a waiver or license, the nonowner may have no legal remedy, unless the license is coupled with a grant or constitutes an easement by estoppel.¹⁵⁶ The ambulatory nature of the interest means that, in the absence of social norms or repeat play, a nonowner may have little incentive to rely on a waiver.

Thus, except in limited circumstances, waiver does little to reduce the possibility of opportunism. Nonowners may attempt to increase the scope of their rights, to utilize the property excessively, or to maintain the property inadequately. These problems may discourage owners from granting a waiver or license. Similarly, nonowners may hesitate to participate in informal inclusion, given that a waiver or license is freely revocable and an owner can revoke, or threaten to revoke, the waiver at any time. To deter opportunism, it may be necessary to rely on more formal mechanisms of inclusion like contracts.

B. Contractual Inclusion

While informal inclusion typically relies on the discretion of owners and social norms, formal inclusion relies on legal rules. Specifically, two or more parties may enter into a contract in which an owner includes another in the use, possession, or enjoyment of property in exchange for some consideration. For example, an owner may include a nonowner by contractually agreeing not to enforce an exclusion right, from distressed loan workouts and foreclosure defenses,¹⁵⁷ to the settlement of patent and copyright disputes.¹⁵⁸ Similarly,

¹⁵⁴ *Id.*

¹⁵⁵ See 25 AM. JUR. 2D *Easements and Licenses* § 122 (2004) (“A license ordinarily may be revoked without notice and without cause” (footnote omitted)).

¹⁵⁶ Generally, a gratuitous license is irrevocable only in two circumstances: (i) if a licensor combines the license with a grant or (ii) if the license constitutes an easement by estoppel because the licensee reasonably and substantially relies on the license and revoking the license would be unjust. *See id.*

¹⁵⁷ See Richard S. Fries, Bingham McCutchen LLP, Distressed Loan Workouts and Remedies, Presentation at the Practising Law Institute Seminar: Negotiating Real Estate Deals 2012 (June 5, 2012) (discussing agreements to waive or not to enforce rights).

there are many types of contracts, including IP licenses, in which an owner includes another by waiving the right to exclude in advance.¹⁵⁹

Unlike gratuitous licenses, which entail sharing, contractual licenses involve exchange. A ticket that permits a spectator to enter a sports stadium or movie theater is, by most accounts, a license.¹⁶⁰ In exchange for entry into the stadium or theater, a licensee pays the admission price—i.e., the cost of the ticket. Similarly, an owner may license a patent in exchange for royalty payments or an equity stake in a firm.¹⁶¹ Licensing IP rights also serves as a mechanism for financing, risk-spreading, and specialization.¹⁶²

However, unlike gratuitous licenses, which are freely revocable, the meaning of “revocability” in contractual licenses is ambiguous.¹⁶³ There is uncertainty about whether such agreements entail a contract, a license, or a contract and a license.¹⁶⁴ The modern view is that nongratuitous licenses have most, perhaps all, of the attributes of contracts.¹⁶⁵ Yet, arguably, even modern licenses, including IP licenses, are not identical to contracts. In analyzing copyright, Christopher Newman contends “the concept of license . . . belongs fundamentally to property, not contract.”¹⁶⁶ Likewise, Merrill and Smith suggest that it may be worthwhile to distinguish between a “license” and a “contract for a license” because “it probably leads to confusion to start treating licenses as if they were themselves contracts.”¹⁶⁷ Finally, IP licenses may

¹⁵⁸ See Carl Shapiro, *Antitrust Limits to Patent Settlements*, 34 RAND J. ECON. 391, 392 (2003) (“The lion’s share of patent disputes are settled rather than litigated to a resolution in court.”).

¹⁵⁹ See Glen O. Robinson, *Personal Property Servitudes*, 71 U. CHI. L. REV. 1449, 1452 (2004) (noting the “ubiquitous use of restrictive licensing agreements” in IP).

¹⁶⁰ See BRUCE & ELY, JR., *supra* note 152, § 11:1 n.55 (collecting cases).

¹⁶¹ See, e.g., Herbert Hovenkamp, *Response: Markets in IP and Antitrust*, 100 GEO. L.J. 2133, 2154 (2012) (“[M]ost IP licensing agreements . . . measure royalties by the number of times an IP-protected good or process is used or the number of units that are created.”); Ash Nagdev et al., *IP as Venture Capital: A Case Study of Microsoft IP Ventures*, 8 WAKE FOREST INTELL. PROP. L.J. 197, 208–09 (2008) (“Microsoft IP Ventures seeks to capitalize on this opportunity by licensing its IP in exchange for an equity stake in a potentially high growth start-up company.”).

¹⁶² See Nagdev et al., *supra* note 161, at 209.

¹⁶³ While a contractual license is “revocable” in one sense, revocation may constitute a breach of contract, resulting in a claim for damages. See BRUCE & ELY, JR., *supra* note 152, § 11:6.

¹⁶⁴ See MERRILL & SMITH, *supra* note 151, at 86.

¹⁶⁵ See, e.g., *McCoy v. Mitsuboshi Cutlery, Inc.*, 67 F.3d 917, 920 (Fed. Cir. 1995) (“Whether express or implied, a license is a contract ‘governed by ordinary principles of state contract law.’” (quoting *Power Lift, Inc. v. Weatherford Nipple-Up Sys., Inc.*, 871 F.2d 1082, 1085 (Fed. Cir. 1989))).

¹⁶⁶ Christopher M. Newman, *A License Is Not a “Contract Not to Sue”*: *Disentangling Property and Contract in the Law of Copyright Licenses*, 98 IOWA L. REV. 1101, 1109 (2013).

¹⁶⁷ THOMAS W. MERRILL & HENRY E. SMITH, *TEACHER’S MANUAL TO PROPERTY: PRINCIPLES AND POLICIES* 157 (2d ed. 2012).

entail anti-opportunism devices that contracts do not, including the use of mandatory rules and the application of doctrines like misuse.¹⁶⁸

Compared to informal inclusion, contracts provide several benefits. Contracts allow parties to include others with more certainty. Because both parties know they can rely on legally enforceable remedies to vindicate their rights, they have less concern about opportunism and conflicts over use. Moreover, unlike informal inclusion, which is freely revocable, contractual inclusion provides more certainty to nonowners. Thus, an owner's promise not to enforce the right to exclude may encourage socially beneficial reliance.¹⁶⁹ In addition, because an owner will have less incentive to exclude, contracts may deter various types of strategic behavior—one of the primary objectives of contract law.¹⁷⁰

However, contracts are not without limitations. As an initial matter, contracts are costly to negotiate, draft, and enforce.¹⁷¹ Given such costs, informal inclusion can be superior to contractual inclusion in a number of circumstances.

First, if the benefits of inclusion are relatively small, a contract may not be worth the costs.¹⁷² For example, if a child needs to enter a neighbor's yard to retrieve a ball, the costs of a contract would exceed the benefits. Likewise, an invitation, rather than a formal contract, usually suffices for a dinner party. In both situations, there is little or no risk of opportunism.

Second, even if opportunism is possible, relying on nonlegal sanctions such as social norms may be superior to drafting and enforcing a contract if the only risk is "low-value opportunism." In analyzing the choice between law and norms in property disputes, Ellickson explains why the "the size of the stakes matters."¹⁷³ If the stakes are high, channeling parties into contracts and formal remedies may be preferable because "the exercise of informal remedies [may]

¹⁶⁸ See Christina Bohannon, *IP Misuse as Foreclosure*, 96 IOWA L. REV. 475, 511 (2011).

¹⁶⁹ See Charles J. Goetz & Robert E. Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 YALE L. J. 1261, 1276–83 (1980); Shavell, *supra* note 79, at 419; cf. Richard A. Posner, *Gratuitous Promises in Economics and Law*, 6 J. LEGAL STUD. 411, 416 & n.11 (1977).

¹⁷⁰ See POSNER, *supra* note 83, at 117.

¹⁷¹ See ROBERT C. ELICKSON, *ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES* 246–48 (1991) (discussing contracts as social controls and indicating that one "major drawback" of contracts is "the transaction costs of arranging and enforcing them").

¹⁷² See *id.*

¹⁷³ *Id.* at 257.

trigger a violent feud.”¹⁷⁴ By contrast, if the stakes are low, “a grievant is less likely to regard the relatively high administrative costs of the legal system to be worthwhile.”¹⁷⁵ Similarly, in analyzing the role of the law in facilitating cooperation, Eric Posner points out that “nonlegal sanctions deter low-value opportunism” whereas “contract law serves to deter certain kinds of high-value opportunism.”¹⁷⁶

Third, even with high-value opportunism, informal division can be superior to contractual division if reputation is sufficiently important or social norms are sufficiently robust.¹⁷⁷ For example, the diamond trade in New York City involves valuable merchandise and a high risk of misappropriation.¹⁷⁸ Nevertheless, as Lisa Bernstein explains, “the industry is able to use reputation/social bonds at a cost low enough to create a system of private law enabling most transactions to be consummated and most contracts enforced completely outside the legal system.”¹⁷⁹

Overall, owners will have an incentive to include others by contract, rather than via nonenforcement or waiver, if the net benefits of contractual inclusion are positive and exceed the net benefits of informal inclusion. If the benefits of inclusion are relatively small, then drafting a contract is often not worth the costs. Even if the benefits of inclusion are significant, parties may not enter a contract if transaction costs are substantial (the attorneys’ fees may quickly exceed the gains from trade). Parties are likely to include others through contract if transaction costs are not prohibitive, if there is a danger of high-value opportunism, and if reputation or social norms are inadequate to deter strategic behavior.

However, even if owners have the ability to include both informally and contractually, their private incentive to include others may diverge from the socially optimal level of inclusion. There may be too little inclusion because contracts deter opportunism and prevent conflicts only imperfectly. For example, because contracts rely primarily on compensatory damages (while

¹⁷⁴ *Id.*

¹⁷⁵ *Id.*

¹⁷⁶ Posner, *supra* note 1, at 762; cf. Claire A. Hill, *Bargaining in the Shadow of the Lawsuit: A Social Norms Theory of Incomplete Contracts*, 34 DEL. J. CORP. L. 191, 210, 212–13 (2009) (arguing that litigation in complex contracts is limited to extreme cases of opportunism).

¹⁷⁷ See, e.g., Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115, 134 (1992).

¹⁷⁸ See *id.* at 120.

¹⁷⁹ *Id.* at 138.

disfavoring specific performance and disallowing punitive damages), contracts may be inadequate to deter certain types of strategic behavior.¹⁸⁰ Thus, the usual remedies for breach may be insufficient to deter opportunism, resulting in too little cooperation.¹⁸¹

C. *Proprietary Inclusion*

In addition to informal and contractual inclusion, the law authorizes parties to include others through various forms of property. Proprietary inclusion, like contractual inclusion, is typically more costly than informal inclusion. Although more expensive than informal inclusion, contractual inclusion and proprietary inclusion both provide more certainty and greater protection against the possibility of opportunism. However, if owners could achieve an optimal level of inclusion using contracts, then the forms of property would seem to be superfluous.

As this Article explains below, these property forms continue to perform a useful function—they are instrumental in deterring opportunism and promoting cooperation—because parties cannot achieve the optimal level of inclusion through contract alone. Essentially, property forms complement contracts by providing owners with a set of standardized forms from which to choose in deciding how to include others. Moreover, these forms not only serve as viable alternatives to contract. In many situations, property forms also can provide more certainty and a greater degree of protection against opportunism.

Accordingly, this Article analyzes four features of property that help to distinguish contractual and proprietary inclusion: (a) third-party effects, (b) mandatory rules, (c) fiduciary duties, and (d) supracompensatory remedies. There is, of course, a substantial literature on each of these features. This Article attempts to extend the existing analysis by focusing on how each attribute functions as an anti-opportunism device and how these attributes can serve as substitutes as well as complements. Ultimately, each feature serves as a justification for maintaining both contractual and proprietary inclusion.

¹⁸⁰ See, e.g., Richard A. Posner, *Common-Law Economic Torts: An Economic and Legal Analysis*, 48 ARIZ. L. REV. 735, 746 (2006); see also Richard Squire, *Shareholder Opportunism in a World of Risky Debt*, 123 HARV. L. REV. 1151, 1205 (2010) (discussing shareholder opportunism and arguing that fraudulent transfer law “provides a powerful equitable remedy in a setting where contractual remedies often are inadequate to deter opportunism”).

¹⁸¹ Cf. Posner, *supra* note 1, at 762 (arguing that the “traditional model of contract law is inadequate” because rational individuals would act differently “if they could rely on the courts to deter opportunism in contractual relationships”).

1. *Justifications*

a. *Third-Party Effects*

Authorizing owners to include others through contracts or property forms is defensible only if there are meaningful differences between these two types of inclusion. Several scholars, including Thomas Merrill and Henry Smith, Henry Hansmann and Reinier Kraakman, and Robert Merges, have pointed out important differences between contracts and property with respect to third parties. One difference between contracts and property is that contracts are in personam—binding the parties to the contract—whereas property rights are in rem—binding “the world.”¹⁸² Merrill and Smith argue that the reason these two modalities of rights exist is third-party information costs.¹⁸³ Thus, allowing inclusion by both contract and property forms might be advantageous because, in different circumstances, each type of inclusion may reduce information costs with respect to third parties.¹⁸⁴

Like Merrill and Smith, Hansmann and Kraakman believe that there is a functional difference between contracts and property.¹⁸⁵ However, they assert the difference is that “a property right in an asset, unlike a contract right, can be enforced against subsequent transferees of other rights in the asset.”¹⁸⁶ In other words, “a property right ‘runs with the asset.’”¹⁸⁷ Under this view, in which limitations on property types “facilitate verification of ownership of the rights offered for conveyance,” the law reduces verification costs “by presuming that all property rights in a given asset are held by a single

¹⁸² See Thomas W. Merrill & Henry E. Smith, *The Property/Contract Interface*, 101 COLUM. L. REV. 773, 780–89 (2001) (discussing the nature of in rem rights).

¹⁸³ See *id.* at 790–99.

¹⁸⁴ The argument for distinguishing contract and property based on third-party information costs rests on assuming that adequate notice does not solve the problem, an assumption that has been the subject of debate. Compare SHAVELL, *supra* note 10, at 32 n.7 (arguing that the information-cost problem can be resolved through adequate notice and registries), and Hansmann & Kraakman, *supra* note 117, at S374 (arguing that limitations on property are not a matter of standardization but of notice), with Thomas W. Merrill & Henry E. Smith, *Optimal Standardization in the Law of Property: The Numerus Clausus Principle*, 110 YALE L.J. 1, 43–45 (2000) (rejecting the idea that “notice cures all” because of “third-party information costs” on other market participants), and Henry E. Smith, *Standardization in Property Law*, in RESEARCH HANDBOOK ON THE ECONOMICS OF PROPERTY LAW, *supra* note 89, at 148, 170 n.4 (contending that Hansmann and Kraakman “overlook the more pervasive role played by information costs that arise from nonstandard formats of information and that face more impersonal audiences such as potential violators of property rights”).

¹⁸⁵ Hansmann & Kraakman, *supra* note 117, at S374.

¹⁸⁶ *Id.*

¹⁸⁷ *Id.*

owner.”¹⁸⁸ This presumption of undivided ownership, according to Hansmann and Kraakman, is “subject to [an] exception that a partitioning of property rights across more than one owner is enforceable if there has been adequate notice of that partitioning to persons whom it might affect.”¹⁸⁹

To illustrate why property and contract might differ in terms of their effects on third parties, compare the functional implications of two types of property (easements and leases) with a type of contract (Creative Commons licenses).¹⁹⁰ Easements and leases both run with the land and thus bind future transferees.¹⁹¹ By contrast, in Creative Commons licenses, license terms are not necessarily binding on downstream users because, as Merges points out, those users are not in privity of contract.¹⁹² As a result, the original contract between licensor and licensee does not capture the interests of all the users. For this reason, Merges advocates a statutory, rather than contractual, solution to this problem: Congress should legislate a “right to include” by incorporating a robust waiver mechanism into IP law.¹⁹³ In doing so, Merges helpfully illustrates one limitation of contract in deterring opportunism and facilitating inclusion.

b. Mandatory Rules

While contracts rely primarily on default rules that the parties may modify, property forms often entail nonwaivable rules that restrict customizability, from disclosure requirements to the implied warranty of habitability. One function of these mandatory rules is to deter strategic bargaining, especially in situations in which parties may have asymmetric information.¹⁹⁴

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

¹⁹⁰ See Robert P. Merges, *A New Dynamism in the Public Domain*, 71 U. CHI. L. REV. 183, 198 (2004) (“From a legal perspective, the Creative Commons is a copyright license. Thus the entire scheme operates by virtue of contract.”).

¹⁹¹ See MERRILL & SMITH, *supra* note 4, at 983. In most easements, “the benefit of the easement is attached to a particular parcel of land, and runs with the ownership of the benefitted land.” MERRILL & SMITH, *supra* note 151, at 200–01. Similarly, if a landlord transfers an apartment, the general rule is that the new landlord is “subject to the ongoing leasehold interest” and is bound by those provisions of the original lease that “run with the land.” MERRILL & SMITH, *supra* note 4, at 712.

¹⁹² See Merges, *supra* note 190, at 198.

¹⁹³ MERGES, *supra* note 2, at 229 (“The problem is that these [Creative Commons] licenses are only contracts. A better mechanism would be to build the waiver mechanism directly into copyright (and patent) law . . .”); see also *id.* at 290 (advocating “a simple and binding mechanism for *waiver*—allowing a rightholder to make a binding dedication of his works to the public, and thus implementing a *right to include* that is coextensive with the traditional right to exclude at the heart of IP and property generally”).

¹⁹⁴ See Merrill & Smith, *supra* note 182, at 826–27.

Many scholars note the role of mandatory rules in deterring opportunism. In discussing joint custody, Saul Levmore emphasizes that “mandatory rules reduce strategic behavior and attendant costs.”¹⁹⁵ In analyzing the implied warranty of habitability, Merrill and Smith suggest that the implied warranty may be immutable because it “can plausibly be viewed as a form of protection strategy adopted in a context where tenants remain rationally ignorant and are vulnerable to strategic behavior by landlords.”¹⁹⁶ In examining the corporation, Melvin Eisenberg asserts that the “law should also provide mandatory rules that empower the courts to override bargains concerning structural and distributional terms when necessary to prevent opportunism.”¹⁹⁷

Of course, mandatory rules also may prevent two parties from achieving a mutually beneficial exchange. Plus, there is a possibility that mandatory rules sometimes may increase opportunism.¹⁹⁸ Thus, in any context, there is room to debate whether a nonwaivable rule is beneficial. But, theoretically, a rule that is mandatory may deter opportunism by preventing certain types of strategic bargaining.

c. *Fiduciary Duties*

As is well recognized, fiduciary duties are useful in reducing agency costs.¹⁹⁹ Fiduciary law applies in many situations that entail a principal–agent relationship, including settlors and trustees and shareholders and managers.²⁰⁰ If an agent’s incentives diverge from the principal’s objectives, the relationship entails agency costs.²⁰¹ Agency costs include the costs associated with shirking as well as any costs that a principal may incur in attempting to monitor the agent to prevent shirking.²⁰²

¹⁹⁵ Saul Levmore, *Joint Custody and Strategic Behavior*, 73 *IND. L.J.* 429, 433 (1998).

¹⁹⁶ Merrill & Smith, *supra* note 182, at 833.

¹⁹⁷ Melvin Aron Eisenberg, *The Structure of Corporation Law*, 89 *COLUM. L. REV.* 1461, 1466 (1989).

¹⁹⁸ See, e.g., Jonathan R. Macey, *Corporate Law and Corporate Governance: A Contractual Perspective*, 18 *J. CORP. L.* 185, 197 (1993); cf. Larry E. Ribstein, *Law v. Trust*, 81 *B.U. L. REV.* 553, 554–55 (2001) (“[U]sing mandatory rules to increase trust, in any form, may have precisely the opposite effect.”).

¹⁹⁹ See Robert H. Sitkoff, *The Economic Structure of Fiduciary Law*, 91 *B.U. L. REV.* 1039, 1042 (2011).

²⁰⁰ See Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 *N.Y.U. L. REV.* 1045, 1046 (1991).

²⁰¹ See Sitkoff, *supra* note 199, at 1040, 1042; see also *supra* note 126 and accompanying text.

²⁰² See Jensen & Meckling, *supra* note 126, at 309; see also JEAN-JACQUES LAFFONT & DAVID MARTIMORT, *THE THEORY OF INCENTIVES: THE PRINCIPAL–AGENT MODEL* 215 (2002).

The purpose of fiduciary duties, including the duties of loyalty and care, is to reduce agency costs by providing an *ex post* check on opportunism.²⁰³ Because the agent has fiduciary obligations to the principal, the agent may be liable if the agent violates one of the duties.²⁰⁴ Aware of this potential liability, the agent may have less incentive to act opportunistically.²⁰⁵ In discussing the role of fiduciary duties in corporate law, Frank Easterbrook and Daniel Fischel point out that the fiduciary principle “replaces prior supervision with deterrence” and that the “contours of the fiduciary principle reflect *the difficulty that contracting parties have in anticipating when and how their interests may diverge.*”²⁰⁶ Similarly, in exploring agency costs in trust law, Robert Sitkoff explains how “the fiduciary obligation has eclipsed limited powers as the chief device for controlling managerial agency costs.”²⁰⁷

Moreover, the substance of fiduciary duties varies by context: fiduciary duties in corporate law are different from such duties in trust law.²⁰⁸ Therefore, in various contexts, fiduciary duties can play an important role in reducing agency costs and encouraging inclusion.²⁰⁹ Economists have long emphasized the role of different organizational forms in controlling agency costs.²¹⁰

d. *Supracompensatory Remedies*

Property forms also differ from contracts in terms of their remedies. Unlike contracts, which typically rely on compensatory damages, many property forms entail supracompensatory remedies, including specific performance and

²⁰³ See Sitkoff, *supra* note 199, at 1049 (“Agency theory, and in particular its emphasis on the problem of opportunism in circumstances of asymmetric information, explains these basic contours of fiduciary doctrine.”).

²⁰⁴ See *id.* at 1043.

²⁰⁵ See D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1404 (2002) (“[F]iduciary law can be justified on the grounds that it deters opportunistic behavior.”).

²⁰⁶ Frank H. Easterbrook & Daniel R. Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 702 (1982) (emphasis added).

²⁰⁷ Sitkoff, *supra* note 126, at 683.

²⁰⁸ See A. Joseph Warburton, *Trusts Versus Corporations: An Empirical Analysis of Competing Organizational Forms*, 36 J. CORP. L. 183, 186–87 (2010); see also Sitkoff, *supra* note 199, at 1045 (“[T]he precise contours of the fiduciary obligation vary across the fiduciary fields.”).

²⁰⁹ Fiduciary duties are sometimes characterized as default rules, as the parties may customize the scope of the duties—e.g., exempting certain conflicted transactions from a duty of loyalty. See generally Tamar Frankel, *Fiduciary Duties as Default Rules*, 74 OR. L. REV. 1209, 1211–12 (1995) (“In my opinion, most fiduciary rules constitute default rules.”). Typically, however, parties cannot eliminate the fiduciary obligations entirely. See Sitkoff, *supra* note 199, at 1046 (discussing the “mandatory core” of fiduciary duties).

²¹⁰ See, e.g., Fama & Jensen, *supra* note 116, at 323.

injunctions, punitive damages, and restitution.²¹¹ Often, these remedies can play a role in deterring opportunism as well.²¹²

First, consider specific performance and other forms of injunctive relief. For several reasons, including a concern about deterring efficient breach,²¹³ contract law generally disfavors the remedy of specific performance.²¹⁴ By contrast, many property forms rely on specific performance more often.²¹⁵ There is some empirical evidence that requiring performance *ex post* may deter opportunism *ex ante*.²¹⁶ More generally, one function of equity and equitable remedies, including injunctive relief, is to deter strategic behavior.²¹⁷

Second, consider punitive damages. In the American legal system, “[p]unitive damages are not recoverable for a breach of contract.”²¹⁸ However, there is a possibility of punitive damages or treble damages for many forms of property, including easements,²¹⁹ leases,²²⁰ and trusts.²²¹ In many situations,

²¹¹ See PEÑALVER & KATYAL, *supra* note 44, at 16; Merrill & Smith, *supra* note 19, at 381.

²¹² Cf. Walter Kamiat, *Labor and Lemons: Efficient Norms in the Internal Labor Market and the Possible Failures of Individual Contracting*, 144 U. PA. L. REV. 1953, 1970 n.27 (1996) (“[H]ard-to-detect opportunism must be subject to quite severe sanctions if it is to be effectively deterred.”).

²¹³ See Steven Shavell, *The Design of Contracts and Remedies for Breach*, 99 Q.J. ECON. 121, 146–47 (1984) (arguing that specific performance “may be an undesirable remedy from the point of view of the creation of incentives to perform”); see also Steven Shavell, *Damage Measures for Breach of Contract*, 11 BELL J. ECON. 466, 466, 468 (1980) (emphasizing the desirability of moderate damages and the role of damages as substitute for complete contracts).

²¹⁴ See Melvin Aron Eisenberg, *The Emergence of Dynamic Contract Law*, 2 THEORETICAL INQUIRIES L. 1, 20 (2001).

²¹⁵ See Merrill & Smith, *supra* note 19, at 381.

²¹⁶ See, e.g., Yair Listokin, *The Empirical Case for Specific Performance: Evidence from the IBP–Tyson Litigation*, 2 J. EMPIRICAL LEG. STUD. 469, 470 (2005); see also Subha Narasimhan, *Modification: The Self-Help Specific Performance Remedy*, 97 YALE L.J. 61, 84 (1987) (“In contracts involving non-fungible goods or services, the only way to deter promisor opportunism is to strictly enforce the specific performance remedy.”).

²¹⁷ See Smith, *supra* note 118 (manuscript at 3) (arguing that “equity in private law . . . is a coherent package of features motivated largely by one overriding goal: preventing opportunism”).

²¹⁸ See RESTATEMENT (SECOND) OF CONTRACTS § 355 (1981).

²¹⁹ See, e.g., *Apel v. Katz*, 697 N.E.2d 600, 601, 608–09 (Ohio 1998).

²²⁰ See, e.g., MASS. GEN. LAWS ch. 186, § 15F (2013) (providing for treble damages “[i]f a tenant is removed from the premises or excluded therefrom by the landlord or his agent except pursuant to a valid court order”); *Polk v. Sexton*, 613 So. 2d 841, 845 (Miss. 1993) (upholding a punitive damages award for the breach of a commercial lease).

²²¹ See, e.g., *Miner v. Int’l Typographical Union Negotiated Pension Plan*, 601 F. Supp. 1390, 1393 (D. Colo. 1985) (citing *Rivero v. Thomas*, 194 P.2d 533 (Cal. Dist. Ct. App. 1948)) (“Exemplary damages are available in the common law of trusts not to secure performance but to deter conduct harmful to the trusts.”).

the rationale for these types of supracompensatory damages is a concern about opportunism or bad faith,²²² including an ability to avoid detection.²²³

Third, consider the remedy of restitution.²²⁴ In contract law, a court usually calculates damages based on a party's expectation interests, with reliance and restitution being described as "alternative" measures.²²⁵ Yet, as Andrew Kull explains, restitution can protect against certain types of opportunistic behavior in contractual enforcement.²²⁶ Recently, the *Restatement (Third) of Restitution & Unjust Enrichment*, for which Kull served as the reporter, extended the remedy of disgorgement of profits to opportunistic breaches.²²⁷ By contrast, unlike its relatively limited role in contract (at least historically), restitution has played, and continues to play, a significant role in several property forms, including trust and fiduciary law.²²⁸

2. Applications

As noted above, proprietary inclusion entails a number of forms. Each of these forms relies on a unique mixture of anti-opportunism devices, including mandatory rules, fiduciary duties, and supracompensatory remedies. In this section, I examine several well-recognized property forms, including (a) easements, (b) leases, (c) bailments, (d) condos and co-ops, and (e) trusts;

²²² See David D. Haddock et al., *An Ordinary Economic Rationale for Extraordinary Legal Sanctions*, 78 CALIF. L. REV. 1, 1 (1990).

²²³ See A. Mitchell Polinsky & Steven Shavell, *Punitive Damages: An Economic Analysis*, 111 HARV. L. REV. 869, 874 (1998) ("[P]unitive damages ordinarily should be awarded if . . . an injurer has a chance of escaping liability . . ." (italics removed)).

²²⁴ On restitution, see generally HANOCH DAGAN, *THE LAW AND ETHICS OF RESTITUTION* (2004); Mark P. Gergen, *What Renders Enrichment Unjust?*, 79 TEX. L. REV. 1927 (2001); Andrew Kull, *Rationalizing Restitution*, 83 CALIF. L. REV. 1191 (1995); and Saul Levmore, *Explaining Restitution*, 71 VA. L. REV. 65 (1985).

²²⁵ See, e.g., E. Allan Farnsworth, *Legal Remedies for Breach of Contract*, 70 COLUM. L. REV. 1145, 1148–49 (1970); see also Samuel Williston, *Repudiation of Contracts*, 14 HARV. L. REV. 317, 318 (1901) (discussing the "right to restitution as an alternative remedy instead of compensation in damages").

²²⁶ See Andrew Kull, *Restitution As a Remedy for Breach of Contract*, 67 S. CAL. L. REV. 1465, 1517 (1994) (noting that rescission affords "protection against those forms of opportunism that exploit undercompensatory enforcement").

²²⁷ RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 39 (2011); see also Caprice L. Roberts, *The Restitution Revival and the Ghosts of Equity*, 68 WASH. & LEE L. REV. 1027, 1046 (2011) (describing "the disgorgement of profits remedy for opportunistic breach of contract").

²²⁸ See Sitkoff, *supra* note 199, at 1049 (noting that the "availability of a disgorgement remedy . . . reflects the additional deterrent and disclosure purposes of fiduciary law"); Smith, *supra* note 205, at 1496 (noting that the "deterrent effect of restitution mitigates the temptation for a fiduciary to act opportunistically").

compare these forms both to each other and to other types of inclusion; and explore how each form deters opportunism.

a. Easements

In the United States, “[v]ast numbers of easements encumber land title records.”²²⁹ An easement is a “nonpossessory right to enter and use land in the possession of another and obligates the possessor not to interfere with the uses authorized by the easement.”²³⁰ Because owners may grant easements “gratuitously or as part of a more general exchange of property rights,”²³¹ easements can facilitate sharing or exchange.

Easements differ from other types of inclusion that enable sharing. Compared to nonenforcement or waiver, easements offer greater certainty and permanence.²³² An owner that includes others via nonenforcement or waiver can still decide to exclude at any time.²³³ By contrast, the owner of land that is subject to an easement cannot exclude the owner of an estate that has an easement to use the land.²³⁴

Distinguishing easements and licenses is difficult.²³⁵ The difficulty is that both forms divide property according to a particular use, not possession. The “fundamental difference” between easements and *revocable* licenses is that, with revocable licenses, owners may “revoke consent at any time and thereby terminate the license[s],” while “easements are irrevocable interests in land of potentially perpetual duration.”²³⁶ Thus, compared to revocable licenses, easements provide more certainty. But the challenge is in distinguishing easements from *irrevocable* licenses.²³⁷ Courts usually characterize easements

²²⁹ Long Beach Unified Sch. Dist. v. Godwin Cal. Living Trust, 32 F.3d 1364, 1369 (9th Cir. 1994).

²³⁰ RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 1.2(1) (2000).

²³¹ MERRILL & SMITH, *supra* note 151, at 202.

²³² Compare RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 7.1 (2000) (stating that easements are terminable by agreement between the landowner and the benefited party), with RESTATEMENT OF PROP. § 519(1) & cmt. a (1944) (stating that licenses are terminable by the landowner’s will).

²³³ See RESTATEMENT OF PROP. § 519(1) & cmt. a (1944).

²³⁴ See RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 1.2(1) (2000) (“An easement . . . obligates the possessor not to interfere with the uses authorized by the easement.”).

²³⁵ See, e.g., Closson Lumber Co. v. Wiseman, 507 N.E.2d 974, 976 (Ind. 1987); see also Wesley Newcomb Hohfeld, *Faulty Analysis in Easement and License Cases*, 27 YALE L.J. 66, 66 (1917) (noting “[t]he unusual chaos of conceptions and inadequacy of reasoning in easement and license cases”).

²³⁶ BRUCE & ELY, JR., *supra* note 152, § 1.4.

²³⁷ See 3 MILTON R. FRIEDMAN & PATRICK A. RANDOLPH, JR., FRIEDMAN ON LEASES § 37.1.2 (Patrick A. Randolph ed., 5th rev. ed. 2013) (“[T]he distinction between a license, particularly an irrevocable license, and an easement, is endlessly elusive . . .”).

as “real property” as opposed to “mere licenses.”²³⁸ Yet the authority for the in rem nature of easements is “relatively thin.”²³⁹ Moreover, contractual licenses are arguably more like property than many courts have assumed.²⁴⁰

Easements also differ from several types of inclusion that enable exchange. Unlike leases, easements are “nonpossessory” because they authorize only “limited uses” on the burdened property.²⁴¹ Because they involve limited uses, the financing and risk-sharing functions that are pertinent for leases are not relevant for easements. Instead, easements serve a role similar to agreements between parties (often, neighbors) regarding the use of property. The modern trend is to view most easements as contracts,²⁴² but easements retain several noncontractarian features. For example, unlike contracts, easements allow the original parties to bind future owners; that is, both the benefit and burden of an easement typically run with the land.²⁴³

Easement law also has developed doctrines to combat opportunism, from disfavoring the variation of easements to issuing injunctions for abuse. Courts are reluctant to vary a party’s obligations under an easement.²⁴⁴ Antony Dnes and Dean Lueck suggest that the rationale for this reluctance is that “variation could be claimed opportunistically as a means of altering the easement, possibly resulting in costly adjudication.”²⁴⁵ In addition, an easement holder may “abuse” an easement by exceeding the scope of the easement.²⁴⁶ While Lee Strang advocates damages, rather than injunctions, as the proper remedy

²³⁸ See, e.g., *Borek Cranberry Marsh, Inc. v. Jackson Co.*, 2010 WI 95, ¶ 15, 328 Wis. 2d 613, 785 N.W.2d 615; *Simmons v. Abbondandolo*, 585 N.Y.S.2d 535, 536 (App. Div. 1992).

²³⁹ MERRILL & SMITH, *supra* note 151, at 202.

²⁴⁰ See Newman, *supra* note 166, at 1103, 1109; see also *supra* notes 164–68 and accompanying text.

²⁴¹ See RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 1.2 cmt. d (2000); cf. *Wagner v. Doebring*, 553 A.2d 684, 687 (Md. 1989) (“The nonpossessory character of an easement distinguishes the interest from possessory interests . . .”).

²⁴² See *Abington Ltd. P’ship v. Heublein*, 717 A.2d 1232, 1240 (Conn. 1998) (“[T]he recently approved provisions of the Restatement (Third) of the Law of Property (Servitudes) . . . adopt a contracts oriented view of the law of easements and servitudes.”); cf. Susan F. French, *Toward a Modern Law of Servitudes: Reweaving the Ancient Strands*, 55 S. CAL. L. REV. 1261, 1305 (1982) (stating that “[c]urrent easement law needs little modification” to recognize a servitude as an interest in land that can be created by contract).

²⁴³ See Carol M. Rose, *Servitudes, Security, and Assent: Some Comments on Professors French and Reichman*, 55 S. CAL. L. REV. 1403, 1403 (1982); see also *supra* note 191 and accompanying text.

²⁴⁴ See Antony Dnes & Dean Lueck, *Asymmetric Information and the Law of Servitudes Governing Land*, 38 J. LEGAL STUD. 89, 109–10 (2009).

²⁴⁵ *Id.* at 105 tbl.1.

²⁴⁶ See BRUCE & ELY, JR., *supra* note 152, § 8:17; see also *supra* notes 121–23 and accompanying text.

for this type of abuse,²⁴⁷ the traditional remedy of injunctive relief²⁴⁸ may help to reduce the likelihood of strategic behavior.

b. Leases

Leasing is one of the most common ways by which owners include others in their property.²⁴⁹ In 2010, out of nearly 112 million occupied housing units in the United States, over 37 million units were rentals.²⁵⁰ Many businesses, including most law firms, lease commercial real estate.²⁵¹ And almost half of the nearly 3 million owners of farms rent their farmland to others.²⁵² Leasing is also a common way of acquiring personal property such as airplanes and automobiles,²⁵³ as well as commercial and industrial equipment.²⁵⁴

Leases facilitate exchange without requiring the outright transfer of property.²⁵⁵ A lessor transfers possession of the apartment, office space, farm, or car to a lessee. In return, the lessee makes a (rental) payment to the lessor. As discussed above, leases also have served as a financing device from preindustrial times to the present.²⁵⁶ They help to spread risk by providing tenants with more flexibility than ownership would provide.²⁵⁷ And leases entail specialization: a landlord and tenant both benefit by performing different functions in managing and using a complex asset.²⁵⁸

However, leases differ from other forms of inclusion, including licenses and easements. While a license concerns *use*, a lease concerns *possession*,

²⁴⁷ See Strang, *supra* note 122, at 937.

²⁴⁸ See *id.* (“[C]ourts will, under the American rule, enjoin misuse of an easement.”).

²⁴⁹ See Ellickson, *supra* note 16, at 1372 (“The scores of millions of leaseholds in the United States demonstrate the ubiquity of these opportunities for mutual gain.”); Thomas J. Miceli et al., *The Property–Contract Boundary: An Economic Analysis of Leases*, 3 AM. L. & ECON. REV. 165, 165 (2001) (“[L]easing . . . is a common economic arrangement.”).

²⁵⁰ U.S. CENSUS BUREAU, STATISTICAL ABSTRACT OF THE UNITED STATES: 2012, at 615 tbl.982 (2011), available at <http://www.census.gov/compendia/statab/2012/tables/12s0982.pdf>.

²⁵¹ See Ed Poll, *Farewell, Firm Overhead*, LEGAL MGMT., Apr./May 2012, at 58, 60.

²⁵² See BUREAU OF THE CENSUS, U.S. DEP’T OF COMMERCE, SB/93-10, WHO OWNS AMERICA’S FARMLAND? (1993), available at http://www.census.gov/prod/1/statbrief/sb93_10.pdf.

²⁵³ MERRILL & SMITH, *supra* note 4, at 650.

²⁵⁴ See U.S. CENSUS BUREAU, *supra* note 250, at 756 tbl.1227.

²⁵⁵ See Miceli et al., *supra* note 249, at 183 (“In many economic settings, leasing an asset is preferred to owning it.”).

²⁵⁶ See *supra* Part II.A.3.

²⁵⁷ See *supra* Part II.A.4.

²⁵⁸ See *supra* Part II.A.5.

which allows a nonowner to engage in multiple uses of the property.²⁵⁹ In addition, compared to the rules governing licenses, lease law entails more mandatory rules, including the implied warranty of habitability in residential leases.²⁶⁰

Distinguishing leases and easements is straightforward, in theory.²⁶¹ The distinction turns on whether an interest is for “exclusive possession,” in which case it is a lease, or a “nonpossessory right to use,” in which case it is an easement.²⁶² But, if the terms of a lease narrow a possessory interest and the terms of an easement involve relatively broad use rights, the distinction begins to disappear.²⁶³

Finally, since the landlord–tenant revolution,²⁶⁴ many courts assume leases are contracts.²⁶⁵ However, although residential leases are similar to contracts, including in their remedies for breach, leases differ in several ways. First, once in possession, a tenant, unlike a party to a contract, has an in rem right against the world.²⁶⁶ Second, at least for residential leases, lease law relies on mandatory rules, such as the implied warranty of habitability, more often than contract law.²⁶⁷ Third, like the benefit and burden of an easement, the terms of a lease often run with the land.²⁶⁸ This feature of property can produce outcomes, like the inability of a new landlord to evict an existing tenant, that differ from the result if leases were simply contracts.²⁶⁹

Many of the rules governing leases target opportunism. Historically, agricultural leases provided a way to minimize the risk of a landlord’s expropriating the land and inputs.²⁷⁰ By contrast, modern residential leases

²⁵⁹ See FRIEDMAN & RANDOLPH, *supra* note 237, § 37.1.1.

²⁶⁰ See 1 *id.* § 10:1.2 (noting that the “implied warranty of habitability . . . confronts all residential landlords”).

²⁶¹ BRUCE & ELY, JR., *supra* note 152, § 1:20.

²⁶² *Id.*

²⁶³ See FRIEDMAN & RANDOLPH, *supra* note 237, § 37.1.2.

²⁶⁴ See Mary Ann Glendon, *The Transformation of American Landlord–Tenant Law*, 23 B.C. L. REV. 503, 503 (1982) (“It is generally acknowledged that the 1960’s and 1970’s saw a revolution of sorts in American landlord–tenant law.”); Edward H. Rabin, *The Revolution in Residential Landlord–Tenant Law: Causes and Consequences*, 69 CORNELL L. REV. 517, 517 (1984).

²⁶⁵ See, e.g., *Javins v. First Nat’l Realty Corp.*, 428 F.2d 1071, 1075 (D.C. Cir. 1970).

²⁶⁶ See *Merrill & Smith*, *supra* note 182, at 822.

²⁶⁷ See *id.* at 826–28.

²⁶⁸ *Id.* at 827–28.

²⁶⁹ See *id.*

²⁷⁰ See *Miceli et al.*, *supra* note 249, at 177 (“[T]he conveyance gives the tenant a greater incentive to invest by protecting him from the risk of appropriation . . .”).

involve active management, maintenance, and governance problems in which landlords can exploit asymmetric information.²⁷¹ As a result, the law attempts to deter landlord opportunism by providing each tenant with an implied warranty of habitability.²⁷² There is a considerable literature on whether this warranty should be a mandatory or default rule.²⁷³ However, if the purpose of the rule is to deter landlord opportunism, there is a case for the rule being nonwaivable. A mandatory rule may protect tenants who lack the financial resources to hire an attorney to review the lease or a professional to inspect the property.²⁷⁴ Because of asymmetric information, such tenants may be particularly “vulnerable to strategic behavior.”²⁷⁵

Understanding the lease as an anti-opportunism device helps to explain divergences among the different types of leases. Unlike residential leases, most commercial leases are not subject to a warranty of fitness for intended purpose.²⁷⁶ Moreover, while most states impose a duty to mitigate damages on a landlord if a tenant vacates a dwelling,²⁷⁷ there is in most states no analogous duty to mitigate if a tenant vacates a commercial property.²⁷⁸ These differences may be justifiable if the risk of opportunism is lower in the context of commercial leases. In general, commercial tenants may have more sophistication, greater legal representation, and higher financial stakes than residential tenants.²⁷⁹ Courts recognize an implied covenant of good faith and fair dealing in commercial leases, and this covenant may serve as a check on

²⁷¹ MERRILL & SMITH, *supra* note 4, at 651; Merrill & Smith, *supra* note 182, at 827.

²⁷² See Lueck & Miceli, *supra* note 14, at 218–19 (describing how the law “provide[s] tenants with an enforcement mechanism by transforming the lease into a contract with an implied warranty of habitability”).

²⁷³ See, e.g., David A. Super, *The Rise and Fall of the Implied Warranty of Habitability*, 99 CALIF. L. REV. 389, 424–25 (2011) (examining the negative effects of a default rule on tenants and collecting citations).

²⁷⁴ See Merrill & Smith, *supra* note 182, at 827.

²⁷⁵ *Id.* at 833; see also *supra* Part III.C.1.b (discussing mandatory rules).

²⁷⁶ See MERRILL & SMITH, *supra* note 4, at 695 (citing *Barton Enters. v. Tsern*, 928 P.2d 368 (Utah 1996)) (“To date, only a small minority of states have adopted an implied warranty of fitness in commercial cases.”). For a survey, see Anthony J. Vlatas, Note, *An Economic Analysis of Implied Warranties of Fitness in Commercial Leases*, 94 COLUM. L. REV. 658, 659 n.5 (1994).

²⁷⁷ See, e.g., *Austin Hill Country Realty, Inc., v. Palisades Plaza, Inc.*, 948 S.W.2d 293, 296–97 (Tex. 1997) (adopting a duty to mitigate and noting that forty-two states and D.C. have adopted this duty in residential leases); see also *Sommer v. Kridel*, 378 A.2d 767, 770–71 (N.J. 1977).

²⁷⁸ See Lueck & Miceli, *supra* note 14, at 220 n.95 (“[T]he duty to mitigate has not been universally applied to commercial leases.”).

²⁷⁹ See Daniel B. Bogart, *Good Faith and Fair Dealing in Commercial Leasing: The Right Doctrine in the Wrong Transaction*, 41 J. MARSHALL L. REV. 275, 277–78, 300–01 (2008) (discussing ways in which commercial leases differ from residential leases).

opportunism.²⁸⁰ But, overall, the risk of opportunism based on informational asymmetries is arguably lower in the commercial context.

Conversely, tenants may impose costs on landlords by excessively utilizing or inadequately maintaining rental property.²⁸¹ The common law addressed this concern through the doctrine of waste,²⁸² which still applies, although now landlords usually specify what tenants may or may not do in the terms of a lease.²⁸³ As Lueck and Miceli suggest, the implied warranty of habitability and the doctrine of waste may “work in combination to create efficient bilateral incentives for maintenance in the presence of the rental externality.”²⁸⁴

c. *Bailments*

The bailment “continues to be a pervasive transaction in modern life.”²⁸⁵ A bailment is a legal form in which an owner transfers *possession* of personal property to a nonowner who maintains temporary custody of the property for a limited purpose.²⁸⁶ A bailment can serve many functions, including sharing, exchange, and specialization. A gratuitous bailment entails the sharing of property by a bailor or the free provision of custodial services by the bailee.²⁸⁷ By contrast, a bailment for hire, in which the bailor and bailee both benefit,²⁸⁸ facilitates exchange. Bailments also involve specialization. For example, dry cleaners and jewelers perform specialized services, and valet parking and coat checks are specialized ways of parking cars and hanging coats.

²⁸⁰ See *id.* at 280.

²⁸¹ See John A. Lovett, *Doctrines of Waste in a Landscape of Waste*, 72 MO. L. REV. 1209, 1211 (2007); Vlatas, *supra* note 276, at 690–91.

²⁸² See Jedediah Purdy, *The American Transformation of Waste Doctrine: A Pluralist Interpretation*, 91 CORNELL L. REV. 653, 675–77 (2006); Stake, *supra* note 69, at 38.

²⁸³ See Lovett, *supra* note 281, at 1219–20 (“[P]arties frequently negate common law or statutory default rules on waste by adopting their own contractual terms.”).

²⁸⁴ Lueck & Miceli, *supra* note 14, at 219.

²⁸⁵ R.H. Helmholtz, *Bailment Theories and the Liability of Bailees: The Elusive Uniform Standard of Reasonable Care*, 41 U. KAN. L. REV. 97, 100 (1992).

²⁸⁶ See MERRILL & SMITH, *supra* note 4, at 464 (“[E]xamples of bailments include the transfer of clothing to a dry cleaning shop for cleaning, the transfer of securities to a broker for safekeeping, or the transfer of an automobile to a valet for parking.”).

²⁸⁷ See Merrill & Smith, *supra* note 182, at 812 n.118 (“Gratuitous bailments are those voluntary bailments in which the bailee receives no explicit or implicit consideration, current or prospective.”).

²⁸⁸ See JOSEPH STORY, COMMENTARIES ON THE LAW OF BAILMENTS § 23, at 27 (James Schouler ed., 9th ed. 1878) (setting out a tripartite framework for a bailee’s duty of care based on whether the bailment is for the sole benefit of bailee, the sole benefit of bailor, or beneficial for both).

Bailments differ from both licenses and leases. While bailees typically enjoy the right to exclude third parties, licensees generally do not.²⁸⁹ In addition, while bailees usually obtain possession of bailed property for a specific purpose,²⁹⁰ tenants may use leased property for any lawful purpose not prohibited in the lease.²⁹¹ Moreover, unlike leases, bailments only apply to personal property, and often (but not always) involve smaller stakes.²⁹²

While bailment law has a “strong contractual element,”²⁹³ bailments and contracts are distinct.²⁹⁴ First, once a bailor transfers possession to the bailee, the bailee steps into the bailor’s shoes and has a right to exclude third parties from the property.²⁹⁵ Second, after transferring property to a bailee, the bailor retains most of the rights associated with ownership, including the right to exclude, transfer, or devise.²⁹⁶ Third, unlike contracts, bailments entail several mandatory rules that impose strict liability.²⁹⁷ A bailee might convert goods for personal use, deviate from the bailment’s terms and use the property for other purposes, or misdeliver goods by returning them to a wrong party.²⁹⁸ Yet, in each situation—conversion, contractual deviation, and misdelivery of goods—the law imposes an immutable rule of strict liability.²⁹⁹

Imposing strict liability via these mandatory rules may deter opportunism. For example, mandatory strict liability for conversion may be desirable because the bailee is violating a bailor’s rights by using the property for the bailee’s own purposes.³⁰⁰ Permitting the parties to opt out of this rule might open the door for opportunism, and the benefits of allowing a nonnegligent use

²⁸⁹ See BRUCE & ELY, JR., *supra* note 152, § 11:5; MERRILL & SMITH, *supra* note 4, at 464.

²⁹⁰ Merrill & Smith, *supra* note 182, at 812.

²⁹¹ *See id.* at 822.

²⁹² *See id.* at 811.

²⁹³ *See* MERRILL & SMITH, *supra* note 4, at 464.

²⁹⁴ *See* Merrill & Smith, *supra* note 182, at 811–20 (investigating in personam, intermediate, and in rem relations in bailment law); *see also* William V. Vetter, *The Parking Lot Cases Revisited: Confusion at or About the Gate*, 40 SANTA CLARA L. REV. 27, 31 (1999) (“Bailment rules, as applied, seem more consistent with property, agency, or trust law than with contract law.”). For an earlier statement suggesting that, in practice, bailments and contracts diverge, *see* William King Laidlaw, *Principles of Bailment*, 16 CORNELL L.Q. 286, 287 (1931) (“Although it is frequently said that bailment is founded upon contract, the actual decisions show that it is not so founded.”).

²⁹⁵ *See* MERRILL & SMITH, *supra* note 4, at 464.

²⁹⁶ *See* Merrill & Smith, *supra* note 182, at 812.

²⁹⁷ *See id.* at 816–19.

²⁹⁸ *See id.*

²⁹⁹ *See id.*

³⁰⁰ *Id.* at 817–18.

of the bailor's property are negligible.³⁰¹ Moreover, strict liability for contractual deviation may deter bailees from presenting themselves as the ostensible owners of the property.³⁰² Again, there seems to be little cost in discouraging this type of strategic behavior. Finally, opportunism may help to explain a puzzle about misdelivery: namely, why the law employs a negligence standard for bailed property that is lost, stolen, or destroyed but strict liability for goods that a bailee misdelivers.³⁰³ Strict liability for misdelivery may deter certain types of opportunism in which the bailee could collude with a third party.³⁰⁴ By contrast, deterring opportunism may be less of a concern for goods that are lost, stolen, or destroyed if the bailee cannot benefit.³⁰⁵ Thus, strict liability for misdelivery, as well as conversion and contractual deviation, may serve an anti-opportunism function.

d. Condos and Co-ops

The use of common-interest communities (CICs), including condominiums (condos) and cooperatives (co-ops), has grown exponentially.³⁰⁶ With condos and co-ops, residents purchase individual units and pay an association fee to maintain common areas and amenities.³⁰⁷ By purchasing individual units, residents obtain some of the benefits of homeownership, e.g., residents may prefer living in CICs to leasing apartments if they value having control over decisions like remodeling the kitchen.³⁰⁸ At the same time, CICs also achieve

³⁰¹ See *id.* at 819.

³⁰² *Id.* at 818.

³⁰³ See, e.g., Helmholz, *supra* note 285, at 99 (concluding that “[i]t is hard to see any good reason” for this distinction).

³⁰⁴ Merrill and Smith hint at this type of collusion by noting that “misdelivery confers a benefit on a third party” and, as a result, “the bailee may be tempted to connive with a third party to ‘misdeliver’ the property, and it will be difficult for the bailor to prove that this has happened.” MERRILL & SMITH, *supra* note 151, at 480 (quoting Merrill & Smith, *supra* note 182, at 815) (internal quotation mark omitted).

³⁰⁵ A bailee's conniving with a third party to “steal” goods is less likely because, unlike a bona fide purchaser who can acquire title if he receives misdelivered goods from a bailee in the ordinary course of business, a third party could not acquire title for goods that are “stolen” because the third party would not be a buyer in the ordinary course of business. See U.C.C. § 2-403(2) (2012).

³⁰⁶ See Michael H. Schill et al., *The Condominium Versus Cooperative Puzzle: An Empirical Analysis of Housing in New York City*, 36 J. LEGAL STUD. 275, 278–80 (2007); see also Hansmann, *supra* note 109, at 25 (discussing how condos and co-ops “have spread rapidly through the real estate market”).

³⁰⁷ See Hansmann, *supra* note 109, at 26.

³⁰⁸ MERRILL & SMITH, *supra* note 4, at 750.

economies of scale regarding maintenance and certain amenities, like a pool or tennis courts, that residents may not otherwise have been able to afford.³⁰⁹

Compared to leases, CICs mitigate the costs of inclusion. Because residents own their units, condos avoid excessive utilization or inadequate maintenance, except in common areas of the building.³¹⁰ But, unlike leases, CICs introduce the risk of opportunism by an association or governing board.³¹¹ Moreover, as Lior Strahilevitz notes, some amenities can function as exclusionary devices, suggesting that CICs also may involve a danger of discrimination.³¹²

The main differences between condos and co-ops involve financing and approving residents. With respect to financing, condos may have a financing advantage because the collective mortgage in a co-op means that each owner “bears a portion of the risk that one of his or her fellow share owners will default.”³¹³ However, the collective mortgage in a co-op does make it easier for co-ops to utilize tax-deductible debt for improvements, impose liens on defaulting owners, and evict owners for transgressing rules.³¹⁴ In approving residents, co-ops may reduce demand by requiring the disclosure of financial records, imposing limitations on shareholder debt, and prohibiting subletting.³¹⁵ On the other hand, these strict financing and approval requirements may reduce the risk for other shareholders.³¹⁶ Plus, some owners may desire the type of exclusivity that certain co-ops provide, though attempts by co-ops “to maintain a community with certain desired characteristics” can increase the risk of discrimination.³¹⁷

³⁰⁹ See Lee Anne Fennell, *Contracting Communities*, 2004 U. ILL. L. REV. 829, 841–42; Mark D. West & Emily M. Morris, *The Tragedy of the Condominiums: Legal Responses to Collective Action Problems After the Kobe Earthquake*, 51 AM. J. COMP. L. 903, 927 (2003).

³¹⁰ See Hannah J. Wiseman, *Rethinking the Renter/Owner Divide in Private Governance*, 2012 UTAH L. REV. 2067, 2075 (arguing that, for both condo owners and apartment tenants, “a third party typically provides most building maintenance—thus creating different incentives for upkeep by unit tenants”).

³¹¹ See Yoram Barzel & Tim R. Sass, *The Allocation of Resources by Voting*, 105 Q.J. ECON. 745, 770 (1990); see also West & Morris, *supra* note 309, at 927 (discussing how strategic behavior is a “source of collective-action costs” for condo owners).

³¹² See Lior Jacob Strahilevitz, *Exclusionary Amenities in Residential Communities*, 92 VA. L. REV. 437, 449 (2006) (exploring whether “residential golf communities have functioned as exclusionary club goods”).

³¹³ Schill et al., *supra* note 306, at 283; see also Allen C. Goodman & John L. Goodman, Jr., *The Co-op Discount*, 14 J. REAL ESTATE FIN. & ECON. 223, 225 (1997).

³¹⁴ See Schill et al., *supra* note 306, at 283.

³¹⁵ *Id.* at 283–84.

³¹⁶ See *id.* at 284.

³¹⁷ *Id.*; cf. Strahilevitz, *supra* note 312, at 452 (discussing how residents in Manhattan cooperatives may want to exclude certain applicants).

The laws governing CICs entail rules aimed at mitigating opportunism. A key feature distinguishing condos from co-ownership is that the owners of condos generally do not possess the right of partition.³¹⁸ This eliminates the risk of strategic exit.³¹⁹ Jurisdictions differ on whether condo developers are subject to fiduciary duties,³²⁰ but condo directors are normally subject to such duties.³²¹ In addition, in many jurisdictions, the covenants in the master deed, as well as subsequent actions by the association or board, are subject to a “reasonableness” requirement.³²² Finally, other anti-opportunism doctrines, including the implied warranty of habitability, apply to co-ops (technically, co-op shareholders are “lessees”),³²³ but generally do not apply to condos.³²⁴

Should an anti-opportunism device like the implied warranty of habitability extend to CICs? Existing law appears to turn on a formalistic distinction: co-op shareholders, as lessees, enjoy an implied warranty; condo owners, who are not lessees, do not.³²⁵ But, functionally, the owners of co-ops and condos are similarly situated. Unlike residential tenants, the owners of co-ops and condos tend to have a significant financial stake in the property.³²⁶ Plus, a purchaser of a co-op or condo may be more likely than a residential tenant to obtain an inspection of the unit,³²⁷ especially if a lender requires it.³²⁸ Thus, there may be

³¹⁸ See Hanoch Dagan & Michael A. Heller, *The Liberal Commons*, 110 YALE L.J. 549, 616 n.258 (2001).

³¹⁹ See *id.*

³²⁰ See 31 C.J.S. *Estates* § 261 (2008 & Supp. 2013).

³²¹ See, e.g., VINCENT DI LORENZO, NEW YORK CONDOMINIUM AND COOPERATIVE LAW § 12:2 (rev. 2d ed. Supp. 2013).

³²² See, e.g., *Nahrstedt v. Lakeside Vill. Condo. Ass'n*, 878 P.2d 1275, 1278 (Cal. 1994) (citing CAL. CIV. CODE § 1354 (current version at CAL. CIV. CODE § 5975 (2014))).

³²³ See Christopher S. Brennan, Note, *The Next Step in the Evolution of the Implied Warranty of Habitability: Applying the Warranty to Condominiums*, 67 FORDHAM L. REV. 3041, 3042 (1999).

³²⁴ See *id.* at 3041.

³²⁵ See *id.* at 3041–42.

³²⁶ See Hansmann, *supra* note 109, at 26.

³²⁷ See, e.g., Alisa M. Levin, *Condo Developers and Fiduciary Duties: An Unlikely Pairing?*, 24 LOY. CONSUMER L. REV. 197, 204–05 (2011) (discussing how condominium form contracts typically provide an inspection period at or near the time of contracting, at or near the time of closing, or both).

³²⁸ Cf. Craig R. Thorstenson, Note, *Mortgage Lender Liability to the Purchasers of New or Existing Homes*, 1988 U. ILL. L. REV. 191, 202 (“Construction loans usually contain a provision allowing the mortgage lender to inspect the house as its construction progresses.”). *But cf.* Hansmann, *supra* note 109, at 38 (“No individual purchaser [of a condo or co-op] has an incentive to bear on his own the full cost of inspecting the common features of the building In contrast . . . the purchaser of a single-family house, receives the full benefit of an inspection and, therefore, has an appropriate incentive to undertake it.”); Debra Pogrud Stark & Andrew Cook, *Pay It Forward: A Proactive Model to Resolving Construction Defects and Market Failure*, 38 VAL. U. L. REV. 1, 4 n.7 (2003) (“With a condominium purchase, the purchaser rarely inspects the common elements of the building, especially if there are a large number of units for the building. But, pursuant to state

less need for an implied warranty of habitability to prevent opportunism, and no reason for treating co-ops and condos differently in this regard.

e. Trusts

The three main types of trusts—donative, charitable, and business—each facilitate inclusion. Donative and charitable trusts promote sharing, as owners gratuitously transfer property to trustees for the benefit of ascertainable beneficiaries³²⁹ or charitable purposes.³³⁰ These trusts facilitate specialization as well because they rely on “managerial intermediation”: the beneficiaries receive distributions of income and principal from the trust, while a trustee specializes in managing, investing, and distributing trust property.³³¹

Business trusts facilitate exchange, rather than sharing, in pensions, investments (asset securitization, mutual funds, and real estate investment), and corporate and municipal bond transactions.³³² Business trusts also serve the functions of financing, risk-spreading, and specialization. For example, the use of trusts as “special purpose vehicles” in asset securitization plays a key role in structured finance.³³³ Financial institutions utilize business trusts “to diversify lending risk,”³³⁴ and mutual funds rely on trusts to allow small investors to diversify their portfolios.³³⁵ Corporate and municipal bond transactions that embrace the trust form also benefit by having a trustee act as a “sophisticated financial intermediary.”³³⁶

Trusts differ from other forms of inclusion in important ways. Inclusion by waiver, rather than through a donative or charitable trust, would eliminate the benefits of managerial intermediation.³³⁷ Moreover, while charitable trusts are

condominium laws, there is typically a lengthy Property Report that is provided to the purchaser that should disclose the condition of the common elements.”).

³²⁹ See UNIF. TRUST CODE § 402 (2010).

³³⁰ See *id.* § 405(a).

³³¹ See Robert H. Sitkoff, *Trust Law as Fiduciary Governance Plus Asset Partitioning*, in *THE WORLDS OF THE TRUST* 428, 429–30 (Lionel Smith ed., 2013); Robert H. Sitkoff, *Trusts and Estates: Implementing Freedom of Disposition*, 58 ST. LOUIS U. L.J. (forthcoming 2014) (manuscript at 9), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2327153; see also DUKEMINIER & SITKOFF, *supra* note 113, at 543.

³³² See John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 YALE L.J. 165, 167–74 (1997); Steven L. Schwarcz, *Commercial Trusts as Business Organizations: Unraveling the Mystery*, 58 BUS. LAW. 559, 562 (2003).

³³³ Schwarcz, *supra* note 332, at 564–65.

³³⁴ *Id.* at 565.

³³⁵ See DUKEMINIER & SITKOFF, *supra* note 113, at 556.

³³⁶ See Langbein, *supra* note 332, at 174.

³³⁷ See *supra* Part III.A.

a “close cousin” to nonprofit organizations,³³⁸ a trust is more focused in purpose and has more stringent fiduciary duties.³³⁹ Partnerships and corporations compete with business trusts but, as discussed below, these organizational forms differ in several respects, including their fiduciary duties.

Finally, John Langbein and others have noted the close connection between trusts and contracts.³⁴⁰ Insofar as these forms differ, the differences seem explainable by alternative approaches to opportunism. For example, trust law entails a greater reliance on both asset partitioning³⁴¹ and mandatory rules.³⁴²

Because a trustee acts as an agent of both the settlor and the beneficiaries, a trust entails a high risk of opportunism. Robert Sitkoff emphasizes that the “problems of shirking and monitoring, the driving concerns of agency cost analysis, abound in trust administration.”³⁴³ The primary legal constraints on this type of “agency misbehavior,” which Jonathan Macey describes as “trustee opportunism,”³⁴⁴ are fiduciary duties.³⁴⁵ The duty of loyalty and duty of care can deter trustees from misappropriating or mismanaging trust property.³⁴⁶ A key feature of fiduciary duties is that they vary by context. For example, fiduciary duties are more stringent in trust law than corporate law.³⁴⁷ This tailoring of fiduciary obligations provides parties with multiple forms from which to choose when deciding whether to include others.

The risk of opportunism is especially significant in charitable trusts. Unlike donative trusts, whose beneficiaries often are in a position to enforce the

³³⁸ Henry Hansmann & Ugo Mattei, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 N.Y.U. L. REV. 434, 437 (1998). On nonprofits, see generally Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835 (1980).

³³⁹ See *Stern v. Lucy Webb Hayes Nat’l Training Sch. for Deaconesses & Missionaries*, 381 F. Supp. 1003, 1013 (D.D.C. 1974).

³⁴⁰ See John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 650–59, 671 (1995); see also Sitkoff, *supra* note 126, at 629–31 (discussing the contractarian challenge).

³⁴¹ See Hansmann & Mattei, *supra* note 338, at 472 (discussing how trusts play an asset partitioning function that is impracticable to replicate via contract); Sitkoff, *supra* note 126, at 631–33.

³⁴² See M.W. LAU, *THE ECONOMIC STRUCTURE OF TRUSTS* 30 (2011) (arguing that, because of the role of mandatory rules, “[t]rust law is not merely a specialized branch of contract law”).

³⁴³ Sitkoff, *supra* note 126, at 623.

³⁴⁴ Jonathan R. Macey, *Private Trusts for the Provision of Private Goods*, 37 EMORY L.J. 295, 316 (1988).

³⁴⁵ *Id.*; see also Sitkoff, *supra* note 199, at 1049 (“[T]he problem of opportunism in circumstances of asymmetric information explains [the] basic contours of fiduciary doctrine.”).

³⁴⁶ See Macey, *supra* note 344, at 316; Sitkoff, *supra* note 199, at 1049; see also *supra* notes 203–05 and accompanying text.

³⁴⁷ See Sitkoff, *supra* note 199, at 1045 (discussing how the agency problem in family trusts differs from agency problem in publicly traded corporations); see also *supra* note 208 and accompanying text.

trustee's fiduciary duties, charitable trusts rely on state attorneys general, who usually have limited resources, and little political will, to expend on enforcement.³⁴⁸ As a result, some law reform efforts have attempted to incorporate new enforcement mechanisms, including the expansion of standing for the settlor, in order to monitor the duties of a charitable trustee.³⁴⁹

Business trusts also rely on fiduciary duties to prevent opportunism. Historically, fiduciary duties were a key element in adopting the trust form in ERISA and pension law.³⁵⁰ Even after ERISA, opportunism by an employer or employees is still possible.³⁵¹ However, in comparing business trusts and corporations, Joseph Warburton finds that "trust law is effective in curtailing opportunistic behavior, as trust managers charge significantly lower fees than their observationally equivalent corporate counterparts."³⁵² Warburton's study suggests that "trusts are more effective than corporations in curtailing opportunistic behavior by managers," and that the fiduciary duties in trust law are "a superior mechanism for mitigating managerial opportunism and agency conflict within business organizations."³⁵³ As discussed below, fiduciary duties in corporate law may have certain offsetting advantages.

3. Extensions

a. Partnerships and Corporations

Rather than relying on business trusts, today's business enterprises organize primarily as partnerships and corporations.³⁵⁴ Including others via a partnership (general, limited, limited liability, or limited liability limited) or corporation (publicly traded, closely held, or privately held) serves several functions, including financing, risk-spreading, and specialization.

³⁴⁸ See Susan N. Gary, *Regulating the Management of Charities: Trust Law, Corporate Law, and Tax Law*, 21 U. HAW. L. REV. 593, 622–24 (1999); Joshua C. Tate, *Should Charitable Trust Enforcement Rights Be Assignable?*, 85 CHI.-KENT L. REV. 1045, 1047 (2010); see also Sitkoff, *supra* note 331 (manuscript at 20).

³⁴⁹ UNIF. TRUST CODE § 405(c) (2010); see also Tate, *supra* note 348, at 1051–56.

³⁵⁰ See Langbein, *supra* note 332, at 182.

³⁵¹ See, e.g., Daniel Fischel & John H. Langbein, *ERISA's Fundamental Contradiction: The Exclusive Benefit Rule*, 55 U. CHI. L. REV. 1105, 1158 (1988) ("Once the initial agreement is concluded, either party may have an incentive to behave opportunistically.").

³⁵² Warburton, *supra* note 208, at 183.

³⁵³ *Id.* at 187.

³⁵⁴ See Schwarcz, *supra* note 332, at 559–60.

Partnerships are an alternative to debt financing,³⁵⁵ and corporations serve as financing devices as well.³⁵⁶ In addition, partnerships and corporations both help to spread risk. Indeed, one explanation for the partnership form is the “insurance theory” of partnership.³⁵⁷ Likewise, in corporations, maintaining limited liability and different classes of stock can reduce the risk borne by shareholders.³⁵⁸ Finally, both forms entail specialization. In their seminal work on the corporation, Adolf Berle and Gardiner Means discuss the advantages of separating ownership (by shareholders) from control (by managers).³⁵⁹ This type of separation allows the officers to serve as “specialized managers of a complex of assets,” while the shareholders, or partners, receive the “benefits of this asset management” through dividends or earnings.³⁶⁰

Overall, partnerships and corporations provide more certainty than informal inclusion, greater protection than contracts, and more flexibility than business trusts. Specifically, informal inclusion is insufficient to provide the permanence necessary for a business of potentially infinite duration. Contracts may not be capable of replicating the functions of a corporation, including partitioning assets³⁶¹ and preventing opportunistic holdup.³⁶² Partnerships and corporations do serve as substitutes for business trusts.³⁶³ But these forms differ from trusts, in terms of their insolvency regimes and residual claimants.³⁶⁴ Plus, the flexibility of the corporate form may explain why most owners incorporate rather than create a trust for their business enterprises.³⁶⁵

Partnerships and corporations both entail anti-opportunism devices. The risk of opportunism is pervasive in partnerships, close corporations, and public

³⁵⁵ See WILLIAM KLEIN & JOHN C. COFFEE, JR., *BUSINESS ORGANIZATION AND FINANCE: LEGAL AND ECONOMIC PRINCIPLES* 53–54 (3d ed. 1988).

³⁵⁶ See FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 10–11 (1991) (“The corporation is a financing device and is not otherwise distinctive.”).

³⁵⁷ See Kevin Lang & Peter-John Gordon, *Partnerships as Insurance Devices: Theory and Evidence*, 26 *RAND J. ECON.* 614, 614 (1995).

³⁵⁸ See POSNER, *supra* note 83, at 536–37; Schwarcz, *supra* note 332, at 574.

³⁵⁹ See BERLE & MEANS, *supra* note 114, at 5–7.

³⁶⁰ MERRILL & SMITH, *supra* note 4, at 805–06.

³⁶¹ See Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 *YALE L.J.* 387, 390 (2000).

³⁶² See WILLIAMSON, *supra* note 120, at 47; Grossman & Hart, *supra* note 118, at 716–17.

³⁶³ See Henry Hansmann et al., *The New Business Entities in Evolutionary Perspective*, 2005 *U. ILL. L. REV.* 5, 14.

³⁶⁴ See Langbein, *supra* note 332, at 189 (discussing insolvency regimes); Schwarcz, *supra* note 332, at 585 (discussing residual claimants).

³⁶⁵ See Warburton, *supra* note 208, at 184 (“[T]he business flexibility that corporations grant leads to greater agency conflict and risk taking, but also to potentially superior risk-adjusted performance.”).

corporations.³⁶⁶ In partnerships and close corporations, “reputation and interpersonal trust can play a larger role in protecting against opportunism.”³⁶⁷ Partners may apportion income to reduce strategic behavior.³⁶⁸ If shareholders of a close corporation threaten to exit strategically, the corporate form itself “provides a robust solution to the problem caused by threats of opportunistic exit.”³⁶⁹ In addition, in publicly traded firms, the potential for investors to “exit” by selling their shares may deter opportunism by managers as well as shareholders.³⁷⁰ Corporate law also entails mandatory rules, such as disclosure requirements and insider trading prohibitions,³⁷¹ that may assist in deterring strategic behavior.³⁷²

The ultimate safeguards against strategic behavior in partnership and corporate law, as in trust law, are fiduciary duties.³⁷³ Although trust law, with its more stringent fiduciary duties, may be superior to corporate law in deterring opportunism, Warburton finds there is a trade-off: corporations retain greater flexibility and achieve a higher rate of return for their investors.³⁷⁴ In any event, the risk of opportunism, as well as the range of anti-opportunism devices, is an important factor in selecting among such organizational forms.³⁷⁵

³⁶⁶ See, e.g., Paul G. Mahoney, *Trust and Opportunism in Close Corporations*, in CONCENTRATED CORPORATE OWNERSHIP 177, 177 (Randall K. Morck ed., 2000); Charles R. O’Kelley, Jr., *Filling Gaps in the Close Corporation Contract: A Transaction Cost Analysis*, 87 NW. U. L. REV. 216, 238 (1992); Richard Squire, *Strategic Liability in the Corporate Group*, 78 U. CHI. L. REV. 605, 605 (2011).

³⁶⁷ Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 93 VA. L. REV. 789, 796 n.18 (2007); see also Edward B. Rock & Michael L. Wachter, *Waiting for the Omelet to Set: Match-Specific Assets and Minority Oppression in Close Corporations*, 24 J. CORP. L. 913, 927–29 (1999) (discussing nonlegal constraints on opportunism in close corporations).

³⁶⁸ See Bradley T. Borden, *Partnership Tax Allocations and the Internalization of Tax-Item Transactions*, 59 S.C.L. REV. 297, 303–17 (2008).

³⁶⁹ Rock & Wachter, *supra* note 367, at 921.

³⁷⁰ See Darian M. Ibrahim, *The New Exit in Venture Capital*, 65 VAND. L. REV. 1, 26 (2012).

³⁷¹ See Dennis W. Carlton & Daniel R. Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857, 882–86 (1983). *But cf.* Henry G. Manne, *Insider Trading: Hayek, Virtual Markets, and the Dog That Did Not Bark*, 31 J. CORP. L. 167, 174–78 (2005) (noting the relative silence by “officers, directors, and controlling shareholders” toward the issue of insider trading).

³⁷² On the use of mandatory rules in corporate law, see generally Lucian Arye Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820 (1989); Lucian Arye Bebchuk, *The Debate on Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1395 (1989); and Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542 (1990).

³⁷³ Robert C. Clark, *Agency Costs Versus Fiduciary Duties*, in PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS 55, 77 (John W. Pratt & Richard J. Zeckhauser eds., 1991).

³⁷⁴ Warburton, *supra* note 208, at 184.

³⁷⁵ See O’Kelley, Jr., *supra* note 366, at 218–19 (explicating a “theory of form choice” in which parties “choose a governance structure for their firm that provides the optimal mix of adaptability and protection from opportunism”); cf. Clayton P. Gillette, *Regionalization and Interlocal Bargains*, 76 N.Y.U. L. REV. 190, 215

b. Franchises

The franchise is a popular legal device for including others.³⁷⁶ The owner of a franchise (the franchisor) may franchise an outlet by including another (the franchisee), rather than expanding the firm, if doing so reduces agency costs.³⁷⁷ Specifically, a firm will create a franchise if the agency costs of franchising (inefficient risk-bearing, free riding, and appropriating quasi-rents) are lower than the agency costs of owning and operating a new outlet (managerial shirking).³⁷⁸

While franchises are an alternative form of inclusion for attempting to reduce agency costs, there is a risk of opportunism by both franchisors and franchisees.³⁷⁹ For example, franchisees may fail to maintain a brand.³⁸⁰ They may “manipulate information” or shirk their obligations to provide customer service and to “maintain the cleanliness of [their] unit[s].”³⁸¹ Such actions increase monitoring costs for owners and reduce the agency-cost advantage of franchises.³⁸² Conversely, franchisors may act strategically by threatening to terminate an agreement to extract quasi-rents,³⁸³ although *ex post* rents may discourage *ex ante* opportunism.³⁸⁴ Franchisors also may encroach upon

(2001) (“[F]irms select from among the menu of possible organizational forms for the very purpose of surmounting the difficulties otherwise imposed by contracting costs.”).

³⁷⁶ See G. Frank Mathewson & Ralph A. Winter, *The Economics of Franchise Contracts*, 28 J.L. & ECON. 503, 503 n.1 (1985) (“Franchising accounts for approximately one-third of total retail sales in the United States and Canada.”).

³⁷⁷ See *id.* at 503; Paul H. Rubin, *The Theory of the Firm and the Structure of the Franchise Contract*, 21 J.L. & ECON. 223, 226 (1978); see also James A. Brickley & Frederick H. Dark, *The Choice of Organizational Form: The Case of Franchising*, 18 J. FIN. ECON. 401, 402 (1987) (“[T]he trade-off between agency problems associated with each form of organization is an important variable in explaining how firms choose between the two organizational forms.”).

³⁷⁸ See Brickley & Dark, *supra* note 377, at 403–07.

³⁷⁹ See Benjamin Klein, *Transactions Cost Determinants of “Unfair” Contractual Arrangements*, 70 AM. ECON. REV. 356, 358–60 (1980) (discussing opportunism by franchisors and franchisees).

³⁸⁰ See *id.* at 358 (“Given the difficulty of explicitly specifying and enforcing contractually every element of quality to be supplied by a franchisee, there is an incentive for an individual opportunistic franchisee to cheat the franchisor by supplying a lower quality of product than contracted for.”).

³⁸¹ Uri Benoliel, *The Behavioral Law and Economics of Franchise Tying Contracts*, 41 RUTGERS L.J. 527, 529 (2010).

³⁸² See *id.* at 530 (“[O]ppportunistic actions are likely to significantly increase the franchisor’s monitoring costs and thereby off-set the reduction of the franchisor’s product-quality monitoring costs arguably generated by a franchise tying contract.”).

³⁸³ See Klein, *supra* note 379, at 359 (“[T]he franchisor may engage in opportunistic behavior by terminating a franchisee without cause, claiming the franchise fee and purchasing the initial franchisee investment at a distress price.”).

³⁸⁴ See Patrick J. Kaufmann & Francine Lafontaine, *Costs of Control: The Source of Economic Rents for McDonald’s Franchisees*, 37 J.L. & ECON. 417, 419 (1994).

existing franchisees by authorizing new franchisees or establishing new outlets to compete in the same geographic area.³⁸⁵

Franchises are an important organizational form because they are distinct from other types of inclusion like contracts and leases. Although similar to contracts, franchises differ because franchise law entails certain mandatory rules (e.g., limitations on termination) and attempts to deter renegotiation in ways that contract law generally does not.³⁸⁶ Franchises are also similar to leases because a franchisor is leasing the use of its trademark to a franchisee for a period of time.³⁸⁷ But, unlike leases, franchises do not entail any implied warranties; instead, franchisees bear almost all the risk of a new franchise.³⁸⁸

Franchises also differ from corporations because they have different residual claimants and control agency costs in different ways.³⁸⁹ In a franchise, the franchisees are the residual claimants and thus have an incentive to monitor their employees in ways that shareholders generally do not.³⁹⁰ Moreover, unlike corporations as well as trusts, franchises generally do not impose any fiduciary obligations on the franchisor.³⁹¹

Finally, the Federal Trade Commission requires a franchisor to provide a disclosure document to a franchisee fourteen days before finalizing a franchise agreement.³⁹² This mandatory disclosure is an attempt to reduce asymmetric information.³⁹³ In addition to regulating entry, the law attempts to regulate exit

³⁸⁵ See Robert W. Emerson, *Franchise Encroachment*, 47 AM. BUS. L.J. 191, 193 (2010). See generally Uri Benoliel, *Criticizing the Economic Analysis of Franchise Encroachment Law*, 75 ALB. L. REV. 205 (2012) (discussing the short- and long-term effects of current franchise encroachment law).

³⁸⁶ See R. Preston McAfee & Marius Schwartz, *Opportunism in Multilateral Vertical Contracting: Nondiscrimination, Exclusivity, and Uniformity*, 84 AM. ECON. REV. 210, 210 (1994).

³⁸⁷ See Rubin, *supra* note 377, at 224.

³⁸⁸ Franchise agreements usually do not include guarantees or warranties for franchisees. See Robert W. Emerson, *Franchise Contract Clauses and the Franchisor's Duty of Care Toward Its Franchisees*, 72 N.C. L. REV. 905, 959 (1994).

³⁸⁹ See Steven C. Michael, *To Franchise or Not To Franchise: An Analysis of Decision Rights and Organizational Form Shares*, 11 J. BUS. VENTURING 57, 61 (1996).

³⁹⁰ See Rubin, *supra* note 377, at 226.

³⁹¹ See, e.g., *Amoco Oil Co. v. Cardinal Oil Co.*, 535 F. Supp. 661, 666 (E.D. Wis. 1982) (holding that an obligation of good faith under Wisconsin contract law does not make the franchisor–franchisee relationship a fiduciary one); *Crim Truck & Tractor Co. v. Navistar Int'l Transp. Corp.* 823 S.W.2d 591, 594–96 (Tex. 1992) (rejecting the imposition of general fiduciary duties on the franchise relationship); see also Emerson, *supra* note 388, at 922–26 (arguing that only “some clauses in a franchise contract merit the imposition of fiduciary duties” but a general fiduciary duty for the relationship is not appropriate).

³⁹² 16 C.F.R. § 436.2(a) (2013).

³⁹³ Disclosure Requirements and Prohibitions Concerning Franchising, 72 Fed. Reg. 15,444, 15,534 (Mar. 30, 2007) (to be codified at 16 C.F.R. pts. 436–37).

via franchise termination laws that prevent strategic termination.³⁹⁴ Franchisors structure agreements to minimize franchisee opportunism and choose this form if it will reduce their own agency costs, so the law generally seeks to reduce the possibility of franchisor opportunism.³⁹⁵

c. Co-ownership

Finally, co-ownership itself entails a type of inclusion if an existing owner includes a nonowner in her property.³⁹⁶ Including a nonowner as a co-owner may facilitate sharing (if gratuitous) or exchange (if for some consideration).³⁹⁷ Co-ownership also can provide a financing function if one (or more) of the co-owners provides capital or assists in paying a mortgage.³⁹⁸ Co-ownership may play a risk-spreading function, especially in the absence of insurance or other support systems.³⁹⁹ Co-ownership also can facilitate various types of functional specialization, from organizing a household⁴⁰⁰ to operating a taxicab.⁴⁰¹ Indeed, co-ownership can be an alternative to other forms of inclusion, such as forming a trust, partnership, or corporation.⁴⁰²

³⁹⁴ See Jonathan Klick et al., *Federalism, Variation, and State Regulation of Franchise Termination*, 3 ENTREPRENEURIAL BUS. L.J. 355, 364 (2009) (noting trade-off in termination laws between “reducing ‘cream skimming’” by franchisors and “preventing franchisors from disciplining shirking franchisees”).

³⁹⁵ See Antony W. Dnes, *Franchise Contracts, Opportunism and the Quality of Law*, 3 ENTREPRENEURIAL BUS. L.J. 257, 270–73 (2009).

³⁹⁶ If an owner includes a nonowner as a co-owner, the new co-owner has a separate but undivided interest in the property. See MERRILL & SMITH, *supra* note 4, at 596 (“[E]ach interest is *undivided*, in the sense that each tenant in common has the right to possess the whole of the property . . .”).

³⁹⁷ See *id.* at 594 (“There are many reasons for multiple people to wish to be co-owners, involving various types of multiple use and relationships based on sharing.”).

³⁹⁸ See ROBERT C. ELLICKSON, *THE HOUSEHOLD: INFORMAL ORDER AROUND THE HEARTH* 85 (2008) (citing Sandra Fleishman, *The Buddy System; A New Theory of Buying Power: With Double the Income, Even Singles Can Afford Double the House*, WASH. POST, Mar. 17, 2001, at H.1; Jim Rendon, *Splitting the Cost of Buying a House*, N.Y. TIMES, July 11, 2004, § 11 at 1). Legal barriers may prevent certain types of lending among co-owners. See Bradley T. Borden, *Open Tenancies-in-Common*, 39 SETON HALL L. REV. 387, 428 (2009) (“The IRS’s prohibition against inter-co-owner lending finds little support in economic theory.”). Co-ownership also may impose additional monitoring costs on lenders. See Alex R. Pederson, *The Rejuvenation of the Tenancy-in-Common Form for Like-Kind Exchanges and Its Impact on Lenders*, 24 ANN. REV. BANKING & FIN. L. 467, 480 (2005).

³⁹⁹ See Ellickson, *supra* note 16, at 1341.

⁴⁰⁰ See GARY S. BECKER, *A TREATISE ON THE FAMILY* 30–53 (1991) (discussing the division of labor in households and families); ELLICKSON, *supra* note 398, at 77 (“An increase in numbers may make it easier for housemates . . . to specialize in their work both within and beyond the home.”).

⁴⁰¹ See BARZEL, *supra* note 110, at 57–58.

⁴⁰² See MERRILL & SMITH, *supra* note 4, at 595 (“For example, if A, B, and C want to share ownership of a summer cottage, they could either hold title to the cottage as concurrent owners, or they could form a partnership or corporation which would then hold title to the cottage.”).

But co-ownership involves a risk of opportunism. In real property, co-owners may fail to share rental income or pay their portion of the expenses.⁴⁰³ In intellectual property, Arti Rai et al. point out that “[p]atent law encourages strategic behavior on the part of co-owners by allowing each one to ‘make, use, offer to sell, or sell the patented invention . . . without the consent of and without accounting to the other owners.’”⁴⁰⁴ Likewise, Robert Merges and Lawrence Locke note that this “common ownership problem highlights the fact that co-owners have incentives to behave ‘opportunistically’ with respect to one another—i.e., to cheat on each other.”⁴⁰⁵

Co-ownership may entail excessive utilization or inadequate maintenance because “[t]he effects of the use by each co-owner are only partially internalized to that owner.”⁴⁰⁶ Yoram Barzel provides a particularly vivid example of this problem, a cab that is owned and operated by two people.⁴⁰⁷ Given shared ownership of the cab, there is a danger that either owner may engage in excessive use.⁴⁰⁸ While the co-owners may delineate time slots or “shifts” for using the cab and pay for their own fuel, certain items like tires, upholstery, and the engine are more likely to become common property.⁴⁰⁹

Like the law governing other forms, co-ownership law has developed mechanisms to mitigate strategic behavior and conflicts over use. For example, the right of partition “gives each cotenant an automatic right to terminate the cotenancy at any time.”⁴¹⁰ By giving a co-owner the ability to exit *ex post*,

⁴⁰³ See Evelyn Alicia Lewis, *Struggling with Quicksand: The Ins and Outs of Cotenant Possession Value Liability and a Call for Default Rule Reform*, 1994 WIS. L. REV. 331, 349.

⁴⁰⁴ Arti K. Rai et al., *Pathways Across the Valley of Death: Novel Intellectual Property Strategies for Accelerated Drug Discovery*, 8 YALE J. HEALTH POL’Y L. & ETHICS 1, 23 (2008) (quoting 35 U.S.C. § 262 (2006)).

⁴⁰⁵ Robert P. Merges & Lawrence A. Locke, *Co-ownership of Patents: A Comparative and Economics View*, 72 J. PAT. & TRADEMARK OFF. SOC’Y 586, 592 (1990).

⁴⁰⁶ MERRILL & SMITH, *supra* note 4, at 594–95; see also *supra* Part II.B.3 (discussing similar conflicts between owners and nonowners). On the potential problems of common ownership, see generally ELINOR OSTROM, *GOVERNING THE COMMONS: THE EVOLUTION OF INSTITUTIONS FOR COLLECTIVE ACTION 2* (1990) (discussing a “pasture ‘open to all’” and noting that “[e]ach herder is motivated to add more and more animals because he receives the direct benefit of his own animals and bears only a share of the costs resulting from overgrazing”); Demsetz, *supra* note 9, at 357 (“[A]n increase in the number of owners is an increase in the communality of property and leads, generally, to an increase in the cost of internalizing.”); Ellickson, *supra* note 16, at 1327 (noting that group, unlike individual, ownership entails the “transaction costs of monitoring potential shirkers and grabbers within the group’s membership”).

⁴⁰⁷ See BARZEL, *supra* note 110, at 57.

⁴⁰⁸ *Id.* at 57–58.

⁴⁰⁹ See *id.*

⁴¹⁰ MERRILL & SMITH, *supra* note 4, at 598.

partition may reduce the incentive to act opportunistically *ex ante*.⁴¹¹ However, because any co-owner may utilize partition to force a sale of the entire property, a co-owner also may employ partition strategically.⁴¹²

Another co-ownership arrangement, one that may arise if there is a high risk of opportunism, is a semicommons. A semicommons is a mixed form of ownership containing both private and common property, which interact with each other.⁴¹³ As a result, a semicommons usually entails a risk of opportunism by owners as well as nonowners.⁴¹⁴ For example, if a private landowner is also the common herdsman in a common field, the landowner “would have an incentive not only to shirk but also to favor his own land,” by preventing trampling or hoarding manure.⁴¹⁵ As Henry Smith hypothesizes, the scattering and intermixing of plots of land in the medieval open fields system made it “difficult to direct animals in the common herd grazing on the commons away from anyone’s plots and toward any other plots.”⁴¹⁶ Ultimately, as Smith points out, a semicommons is likely to arise only “if the benefits of multiple use are worth incurring the costs of abating strategic behavior.”⁴¹⁷

⁴¹¹ See *id.* at 604 (“Partition affords each co-owner an avenue for *exit*, and the threat of exit can help a co-owner protect her interests.”).

⁴¹² See Thomas W. Mitchell, *From Reconstruction to Deconstruction: Undermining Black Landownership, Political Independence, and Community Through Partition Sales of Tenancies in Common*, 95 NW. U. L. REV. 505, 508 (2001); John G. Casagrande Jr., Note, *Acquiring Property Through Forced Partitioning Sales: Abuses and Remedies*, 27 B.C. L. REV. 755, 756–57 (1986); see also *supra* notes 318–19 and accompanying text.

⁴¹³ See Henry E. Smith, *Semicommon Property Rights and Scattering in the Open Fields*, 29 J. LEGAL STUD. 131, 131–33 (2000) (identifying the open fields system as a semicommons).

⁴¹⁴ Unlike prior explanations for scattering strips in open fields that emphasize diversifying risk, Smith emphasizes the role of strategic behavior. See *id.* at 146–54; see also Robert A. Heverly, *The Information Semicommons*, 18 BERKELEY TECH. L.J. 1127, 1172–83 (2003) (discussing strategic behavior in “the information semicommons”).

⁴¹⁵ Smith, *supra* note 413, at 146–47, 149 (footnote omitted).

⁴¹⁶ *Id.* at 147.

⁴¹⁷ Henry E. Smith, *Governing the Tele-Semicommons*, 22 YALE J. ON REG. 289, 299 (2005). In addition to open fields, scholars have identified semicommons in the Internet, information and creative works, telecommunications, water rights, and software standards. See Lee Anne Fennell, *Commons, Anticommons, and Semicommons*, in RESEARCH HANDBOOK ON THE ECONOMICS OF PROPERTY LAW, *supra* note 89, at 35, 46–49 (discussing semicommons); James Grimmelmann, *The Internet Is a Semicommons*, 78 FORDHAM L. REV. 2799, 2799 (2010) (“[T]he Internet [is] a particularly striking example of . . . a *semicommons*.”); Heverly, *supra* note 414, at 1127 (“Information . . . is a *semicommons*.”); Smith, *supra*, at 289 (describing the regime created by the Telecommunications Act of 1996 as a semicommons); Henry E. Smith, *Governing Water: The Semicommons of Fluid Property Rights*, 50 ARIZ. L. REV. 445, 445 (2008) (“The challenges of exclusion that water and other fugitive resources present often lead to a *semicommons*”); Greg R. Vetter, *Open Source Licensing and Scattering Opportunism in Software Standards*, 48 B.C. L. REV. 225, 226 (2007) (“Software Standards are a type of technology *semicommons*.”).

**TABLE 1:
FORMS OF INCLUSION & ANTI-OPPORTUNISM DEVICES**

Form of Inclusion	Mandatory Rules	Fiduciary Duties
1. Contracts	good faith and fair dealing; duty not to defraud; UCC = quantity term	No
2. Licenses	implicated more often in certain licenses (e.g., software licenses) than contracts	No
3. Easements	benefit and burden “run with the land”	No
4. Residential Leases	Tenant (T): implied warranty of habitability (IWH); Landlord (L): constructive eviction	No
5. Commercial Leases	T: no IWH or suitability, but good faith and fair dealing; L: constructive eviction	No
6. Agricultural Leases	T: no IWH; implied covenant of good husbandry	No
7. Bailments	strict liability for misdelivery; non-disclaimable rules to standardize	No
8. Cooperatives	IWH (residents = lessees)	board = loyalty (BJR = business judgment rule)
9. Condominiums	no IWH; restrictions = “reasonable”	board = loyalty + care; developers (split)
10. Donative Trusts	Unif. Trust Code (UTC) § 105(b): benefit of beneficiaries, modify, inform, good faith	loyalty (sole benefit); care (no BJR)
11. Charitable Trusts	UTC § 105(b); “charitable purpose”	loyalty (sole benefit); care (no BJR)
12. Nonprofits	“any lawful purpose” but no distribution of net earnings	loyalty + care (similar to corporation)
13. Business Trusts	fiduciary duties (in ERISA); information disclosure (in mutual funds); no exculpation	loyalty + care (no BJR)
14. Partnerships	Rev. Unif. Partnership Act (RUPA) § 103: duty of loyalty/care (unless reasonable or approved); good faith; disassociate; expel	RUPA § 404: loyalty; care (gross negligence); good faith/fair dealing
15. Corporations	duty of loyalty; meetings of directors and shareholders; disclosure; no insider trading	loyalty (best interest); care (BJR) + exculpation
16. Franchises	good faith; franchise termination laws	No
17. Co-ownership	each co-owner has an undivided interest = right to possess the whole of the property	No

**TABLE 1 (CONT.):
FORMS OF INCLUSION & ANTI-OPPORTUNISM DEVICES**

Form of Inclusion	Remedies	Other Doctrines
1. Contracts	compensatory damages (\$); at times, specific performance (SP); no punitive \$	duress; unconscionability; limitations on stipulated \$
2. Licenses	compensatory \$; at times, SP; injunctive relief under Copyright Act	irrevocable only if grant or easement by estoppel; misuse
3. Easements	If abuse of the easement, injunction = majority rule; \$ = minority rule	irrevocable but can abandon; presumption against variation
4. Residential Leases	T: \$, reformation, or rescission; L: terminate = \$ or maintain = back rent	T: can assign; no waste; L: duty to mitigate
5. Commercial Leases	T: \$ (disfavor SP); L: T liable as rent is due, re-let for T, or accept surrender	T: can assign; no waste; L: no duty to mitigate
6. Agricultural Leases	L breaches → T must perform, sue for \$; T breaches → L must perform, sue for \$	T: no waste; L: no duty to mitigate
7. Bailments	tort: \$ for destruction, conversion, harm; contract: \$ (including foreseeable \$)	bailee's duty of care = default; often, small stakes
8. Cooperatives	liens; ejection (some states); breach of IWH → \$ = maintenance – rental value	financial disclosure; board approval; often no subleasing
9. Condominiums	\$ and injunctions (vs. board, neighbors, or developer); board brings some claims	no partition right; restrictions on leasing/subleasing
10. Donative Trusts	against trustee (UTC § 1001) = \$; removal (UTC § 706)	asset partitioning; spendthrift clause; ascertainable Bs
11. Charitable Trusts	injunctions; \$; cy pres (reform as near as possible to intent); removal (UTC § 706)	asset partitioning
12. Nonprofits	injunctions; \$; cy pres; lose exemption; personal liability; \$ (= taxes owed)	certain disclosures to IRS
13. Business Trusts	against trustee = \$; removal of trustee (less rigorous)	asset partitioning; conduit taxation; voting rights
14. Partnerships	\$, all partners jointly and severally liable, unless limited liability; dissociation (RUPA § 602)	limited liability (LLP, LLLP)
15. Corporations	\$, injunctions; also, derivative actions	asset partitioning; limited liability; voting rights
16. Franchises	\$, injunctions, future royalties (newer)	disclosure document (FTC)
17. Co-ownership	partition (for any reason or no reason); accounting if partition or ouster	less customizable than trusts, partnerships, or corporations

* * *

Overall, each type of inclusion—informal, contractual, and proprietary—has distinct advantages and disadvantages. Informal inclusion usually entails little cost but may provide little certainty and few protections against opportunism. Contractual inclusion is more costly to create and enforce but may provide greater certainty and deter certain types of strategic behavior. Contracts typically entail default rules, arms-length negotiations or standard forms, and compensatory remedies. They also bind only the parties to the agreement. By contrast, property forms not only bind third parties in ways that contracts cannot but also entail a number of additional anti-opportunism devices, including mandatory rules, fiduciary duties, and supracompensatory remedies. These anti-opportunism devices help to deter certain types of opportunism that contracts, by themselves, address only imperfectly. Moreover, as the discussion above highlights and diagram above illustrates, each property form entails a unique combination of anti-opportunism devices and thus serves a distinct functional purpose. Overall, this proliferation of forms helps to ensure that an owner's private incentive to include others converges with the level of inclusion that is socially optimal.

IV. THE IMPLICATIONS OF INCLUSION

A. *The Property/Contract Interface*

Understanding how owners include others has implications not only for law reform but also for property theory. Recently, there has been significant interest in the distinction between property and contract.⁴¹⁸ Because inclusion is highly customizable,⁴¹⁹ many forms of property appear to converge with contract.⁴²⁰ As a result, there is a tendency among some courts, law reformers, and legal scholars to adopt a contractarian approach for many forms, including licenses, leases, easements, trusts, and corporations.⁴²¹

⁴¹⁸ See, e.g., Hansmann & Kraakman, *supra* note 117, at S378; see also Merrill & Smith, *supra* note 182, at 774.

⁴¹⁹ See *supra* Table 1.

⁴²⁰ See Merrill & Smith, *supra* note 182, at 774.

⁴²¹ See, e.g., McCoy v. Mitsubishi Cutlery, Inc., 67 F.3d 917, 920 (Fed. Cir. 1995) (“Whether express or implied, a license is a contract governed by ordinary principles of state contract law.” (internal quotation marks omitted)); Javins v. First Nat’l Realty Corp., 428 F.2d 1071, 1072–73 (D.C. Cir. 1970) (“[A] warranty of habitability . . . is implied by operation of law into leases of urban dwelling units . . . and th[e] breach of this warranty gives rise to the usual remedies for breach of contract.”); EASTERBROOK & FISCHER, *supra* note 356, at 15 (utilizing an “analogy to contract” to analyze the structure of corporations); French, *supra* note 242, at

Yet, while many property forms involve contractual elements, most of these forms differ from contracts in several ways.⁴²² Because property rights are in rem and run with the land, these forms often provide more certainty over time, especially for future owners and users. Moreover, as discussed above, many of the property forms provide additional protection against certain types of opportunism because they rely to a greater extent on mandatory rules (to prevent strategic bargaining), fiduciary duties (to reduce agency costs), and supracompensatory remedies (to deter opportunistic breach). Thus, rather than converging with contracts, these property forms perform distinct functions.

The reason that the law authorizes “multiple doctrines with differing rules by which rights are subdivided”⁴²³ is to promote and facilitate cooperative activities. Owners are more likely to include others if they are able to select from among multiple forms, each of which entails a unique combination of anti-opportunism devices. In certain situations, nonowners also may prefer proprietary inclusion over informal or contractual inclusion because of the certainty and protection against opportunism that particular forms of property may provide. By reducing the risk of opportunism and other costs of inclusion, a proliferation of property forms helps to ensure that the private incentive to include converges with the socially optimal level of inclusion.

One lesson for courts and law reformers is that attempting to eliminate the forms as functionally obsolete, or to rely exclusively on contracts to promote the inclusion of others, may be misguided. Instead, by authorizing multiple forms of inclusion, including informal, contractual, and proprietary inclusion, the law promotes the social use of property.

B. *The Numerus Clausus Principle*

There is a related debate about why property provides pre-packaged or “off-the-rack” forms. That is, why does contract allow free customizability, whereas property entails a *numerus clausus* principle, in which the number of forms is limited or closed?⁴²⁴ One theory is that off-the-rack forms reduce

1310 (“[C]ontract law . . . can be applied to servitudes.”); Langbein, *supra* note 340, at 671 (arguing for the “contractarian vision of the trust”).

⁴²² See *supra* Part III.C.1 (discussing justifications for distinguishing between contractual inclusion and proprietary inclusion).

⁴²³ Stake, *supra* note 69, at 42.

⁴²⁴ For a seminal analysis framing the issue, see generally Bernard Rudden, *Economic Theory v. Property Law: The Numerus Clausus Problem*, in *OXFORD ESSAYS IN JURISPRUDENCE: THIRD SERIES* 239 (John Eckelaar & John Bell eds., 1987).

bargaining costs.⁴²⁵ A second theory, developed by Merrill and Smith, is that some degree of standardization based on a menu of forms reduces *information costs*.⁴²⁶ A third theory, formulated by Hansmann and Kraakman, is that the law regulates the type and degree of notice for creating different kinds of property to minimize *verification costs*.⁴²⁷

This Article does not contradict any of these theories. It also emphasizes transaction costs (broadly understood). Like Hansmann and Kraakman, this Article emphasizes the role of opportunism.⁴²⁸ However, unlike Hansmann and Kraakman, who focus mainly on third-party opportunism,⁴²⁹ the primary focus of this Article is on the risk of opportunism between the owner and nonowner. The law authorizes, and attempts to maintain, the contours of a (limited) number of forms in order to provide mechanisms for reducing opportunism and facilitating inclusion. The law provides these various forms as “focal points” around which parties can organize their activities by including others through different combinations of anti-opportunism devices.⁴³⁰ Hence, property forms not only can facilitate communication among market participants by reducing information costs, and facilitate verification of ownership of rights offered for conveyance by reducing verification costs, but these forms also create more opportunities for cooperation between the original parties themselves.

The point does not contradict Merrill and Smith’s observation that the costs of complex property interests are usually incorporated into the price of an asset.⁴³¹ Most of the costs discussed above, including disputes about coordination, the costs of opportunism, and conflicts over use, like excessive utilization and inadequate maintenance, are not third-party externalities. Instead, such costs affect only the owner seeking to include or the nonowner seeking to benefit from being included. However, if the incentive to include is too low and diverges from the optimal level of inclusion, there is a social loss

⁴²⁵ See, e.g., Carol M. Rose, *What Government Can Do for Property (and Vice Versa)*, in *THE FUNDAMENTAL INTERRELATIONSHIPS BETWEEN GOVERNMENT AND PROPERTY* 209, 213 (Nicholas Mercuro & Warren J. Samuels eds., 1999) (“[O]ff-the-rack property devices can reduce transactions costs . . .”).

⁴²⁶ See Merrill & Smith, *supra* note 184, at 40; see also *supra* notes 182–84.

⁴²⁷ See Hansmann & Kraakman, *supra* note 117, at S399–400; see also *supra* notes 185–89.

⁴²⁸ See Hansmann & Kraakman, *supra* note 117, at S382–84.

⁴²⁹ See *id.*

⁴³⁰ See THOMAS C. SCHELLING, *THE STRATEGY OF CONFLICT* 57–59, 71–74 (1980) (discussing the value of focal points in tacit coordination, tacit bargaining, and explicit bargaining); cf. John H. Langbein, *Substantial Compliance with the Wills Act*, 88 HARV. L. REV. 489, 493–94 (1975) (discussing the “channeling” function of legal formalities for wills).

⁴³¹ See Merrill & Smith, *supra* note 184, at 28–29.

because certain types of inclusion that otherwise would occur may not. A legal system that supports inclusion through the optimal set of forms expands the production-possibility frontier by increasing the number of opportunities for parties to cooperate in socially beneficial ways.⁴³²

A related, but relatively unexplored, question is how many forms are optimal.⁴³³ The question is especially salient in the context of the property forms that enable inclusion. Some courts have questioned the significance of such forms, suggesting that the forms are antiquated or unnecessary.⁴³⁴ If so, then it may be socially beneficial to reduce the number of forms, or eliminate them altogether. Conversely, sometimes a single form (e.g., a lease) applies in multiple contexts (agricultural, commercial, and residential) in which owners may have different objectives and the form itself may serve different purposes (e.g., financing, risk-spreading, and specialization).⁴³⁵ If so, then it could be useful to divide the forms further so they correspond more closely with their functions.

This Article suggests that restricting the menu of forms too much, or eliminating them altogether, would be undesirable. There are advantages to having multiple forms of property by which parties may include others. Each form serves a unique function. At the same time, if the property forms were freely customizable, the forms might be less effective as focal points in facilitating coordination and cooperation. Because too much customizability would result in confusion among the basic categories of forms, maintaining clear distinctions among forms allows parties to select the form that minimizes

⁴³² See JAMES D. GWARTNEY ET AL., *ECONOMICS: PRIVATE AND PUBLIC CHOICE* 42 (12th ed. 2009) (“Changes in legal institutions that promote social cooperation . . . will also push the production possibilities curve outward.”).

⁴³³ See Merrill & Smith, *supra* note 184, at 40 (“We do not argue that any particular number of property forms is in fact optimal.”).

⁴³⁴ See, e.g., *Golden W. Baseball Co. v. City of Anaheim*, 31 Cal. Rptr. 2d 378, 395 (Ct. App. 1994) (noting that “[l]ittle practical purpose is served by attempting to build on this system of classification” because “it is increasingly difficult and correspondingly irrelevant to attempt to pigeonhole these relationships as ‘leases,’ ‘easements,’ ‘licenses,’ ‘profits,’ or some other obscure interest in land devised by the common law in far simpler times”).

⁴³⁵ See, e.g., MERRILL & SMITH, *supra* note 4, at 650 (“One problem that has long vexed lease law in the real property context is that it does not differentiate between leases in terms of the underlying functional reasons the parties have for entering into a lease.”); Carol M. Rose, *Property in All the Wrong Places?*, 114 *YALE L.J.* 991, 1006 (2005) (reviewing MICHAEL F. BROWN, *WHO OWNS NATIVE CULTURE?* (2003); and KAREN R. MERRILL, *PUBLIC LANDS AND POLITICAL MEANING: RANCHERS, THE GOVERNMENT, AND THE PROPERTY BETWEEN THEM* (2002)) (“The modern residential lease is worlds away from the agricultural lease of the sixteenth century or from the modern commercial lease in a shopping center, but property makes room for all of them.”).

the risk of opportunism. Of course, as the benefits and costs of inclusion change over time, the law can add or subtract new forms of inclusion and rely on new devices and doctrines to deter opportunism.

C. *The Right to Exclude Revisited*

In analyzing the “social” dimensions of property, the prior literature focuses on how using property may generate social costs and how owning it may entail social obligations.⁴³⁶ By contrast, in analyzing the right to include, this Article highlights another social dimension of property: property forms can facilitate cooperation and, in doing so, promote the social use of scarce resources.⁴³⁷

As noted above, one conventional view of private property is that property rights are individualistic. Marx believed that human beings could return to their true “social” existence only by transcending property.⁴³⁸ More recently, a number of theorists have commented on the connection between property and exclusive rights, on one hand, and individualism, on the other. For example, Eduardo Peñalver notes that “the individualistic school of property thought is certainly the dominant one within Anglo-American property law.”⁴³⁹ Likewise, James Penner observes: “Our paradigm or standard ‘picture’ of property comprises the single owner, along with their goods, occupying their land, to the exclusion of others.”⁴⁴⁰ To a certain extent, this conventional picture of property is descriptively accurate: individual rights in private property are a central feature of any market economy. But many commentators often assume that, because of this right to exclude, ownership is fundamentally inconsistent, incompatible, or in tension with the “social function” of property.⁴⁴¹

Recognizing that owners have a right to include, as well as exclude, helps to clarify the social nature of property. Some owners may misuse their property by imposing social costs on others, isolating themselves from others, or

⁴³⁶ See *supra* notes 7–8.

⁴³⁷ See PENNER, *supra* note 4, at 74–75; Penner, *supra* note 5, at 167.

⁴³⁸ See *supra* notes 33–35 and accompanying text.

⁴³⁹ Eduardo Moisés Peñalver, *Redistributing Property: Natural Law, International Norms, and the Property Reforms of the Cuban Revolution*, 52 FLA. L. REV. 107, 195 (2000).

⁴⁴⁰ Penner, *supra* note 5, at 166 (footnote omitted).

⁴⁴¹ Sheila R. Foster & Daniel Bonilla, *Introduction to Symposium, The Social Function of Property: A Comparative Perspective*, 80 FORDHAM L. REV. 1003, 1003–04 (2011); cf. Penner, *supra* note 5, at 188 (noting “the individualistic taint which has attached itself to ownership, at least amongst legal and political philosophers”).

discriminating against others. But many owners decide to use their property not only as a “wall” to exclude others but also as a “gate” to include their neighbors, friends and family, colleagues and customers, and even strangers who need help.⁴⁴² If so, property is capable of promoting human sociability, not merely atomistic individualism. In this way, understanding the right to include may assist in properly contextualizing the right to exclude and perhaps reconciling competing perspectives about the function of property.⁴⁴³

CONCLUSION

This Article has investigated how owners may include, as well as exclude, others from their property. Until now, this “right to include” has received little attention. But inclusion plays a valuable role in coordinating economic activities and social relationships. By promoting sharing and exchange, facilitating financing and risk-spreading, and enabling specialization, inclusion can be highly beneficial. But inclusion also entails costs, such as coordination difficulties, conflicts over use, and other types of strategic behavior.

There is thus a danger that the risk of opportunism may result in owners including others too little. If law did not provide a range of options to reduce strategic behavior, owners may decide not to include others in their property. But the law provides multiple forms of inclusion: informal, contractual, and proprietary. Informal inclusion entails the nonenforcement or waiver of an owner’s right to exclude. Contractual inclusion involves a formal waiver of exclusion. However, in addition to informal or contractual inclusion, owners may include others through various forms of property, including easements, leases, bailments, condos and co-ops, trusts, partnerships, and corporations. Each of these forms entails a unique mix of mandatory rules, fiduciary duties, and supracompensatory remedies. By providing more certainty and protection against opportunism, these forms help ensure that an owner’s private incentive to include converges with the level of inclusion that is socially optimal.

Analyzing the forms of inclusion suggests that the law should continue to provide a range of options by which owners may include others. Because each of the forms plays a unique role in deterring opportunism, these forms are distinct from one another as well as from contracts. Authorizing a menu of

⁴⁴² Cf. Penner, *supra* note 24, at 745 (arguing that “the ability to share one’s things, or let others use them, is fundamental in the idea of property” (italics removed)).

⁴⁴³ Cf. Dagan & Heller, *supra* note 318, at 622 (“Sympathizers of privatization and communitarian approaches have seen conflict where there can be—and from a global perspective, often is—harmony.”).

forms not only reduces information and verification costs but also facilitates cooperation by providing parties with focal points to coordinate their activities. Ultimately, analyzing the many ways in which owners can include others in the use, possession, and enjoyment of their property suggests that ownership is not necessarily exclusive or individualistic. Rather, ownership is often inclusive and thereby promotes the social use of property.