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Boston University Law Review

May, 1993

73 *B.U.L. Rev.* 389

ESSAY: THE LEGAL INFRASTRUCTURE OF MARKETS: THE ROLE OF CONTRACT AND PROPERTY LAW

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SUMMARY:

... I consider the law regulating markets to be a subset of property law. ... I argue that if we wish to create and maintain efficient markets, contract law - especially the freedom of contracting parties to customize their relationship - must yield to the mandatory rules of property law. ... For example, contract law contains rules that help the parties ascertain the existence of the contract, and property law promotes certainty through rules about the possession and transfer of property rights. ... Even though contract law today interferes in the parties' relationships more than it did in the past, property law remains the comparatively more intrusive category. ... I do suggest that, in addition to contract law, markets require an infrastructure that is grounded in property law. ... The desirability of efficient markets justifies the priority of the property law over contract law. ... This role of intermediaries is crucial in volatile markets, in which either the buyer or the seller often has incentive to renege on her promises. ... The rules that regulate the markets and provide them with an adequate infrastructure are housed in a separate common law category - property law - and in legislative categories, such as securities regulation. ... To flourish, markets require both contract law and property law.
...

TEXT:

Introduction

Markets are social institutions that facilitate exchange transactions. Therefore, they require a regime of freedom to exchange - a contract regime. Markets can be made more efficient by reducing the transaction and information costs for market actors. Such a reduction can be effected by standardizing the products exchanged, the terms of the transactions, and the nature of the rights transferred. Information costs can be reduced by publicizing the transactionsⁿ¹ and by using the services of intermediaries.ⁿ²

Some of the conditions that enhance market efficiencies can be imposed and regulated privately by market participants. However, it is not always possible for these participants, acting separately, to create and enforce all these conditions on their own.ⁿ³ Therefore, some of these conditions must be established by law. I define "law" here as rules, and customs that are deemed coercive. Some scholars emphasize the spontaneous - rather than the regulatory - quality of markets. Friedrich Hayek, for example, questions the extent to which we can control markets, but concedes

that his spontaneous order can rest "on rules which are entirely the result of deliberate design." n4 I argue that efficient markets must rest on coercive rules, not merely that they can rest on such rules.

I consider the law regulating markets to be a subset of property law. Although the laws of property and contract overlap, market regulation and its underlying values and policies are more akin to those of property law than to those of contract law. n5

In sum, the institution of markets requires a contract regime and a property regime. However, some contract rules are incompatible with property rules. n6 For example, under contract law, not all contract rights are transferable. Additionally, the parties to a contract are allowed to prohibit the transfer of their contract rights. By contrast, under property law, property rights are transferable, and a total prohibition on the transfer of property rights is unenforceable. n7 In general, contract law allows the parties far more freedom to design the terms of their agreement than property law does.

I argue that if we wish to create and maintain efficient markets, contract law - especially the freedom of contracting parties to customize their relationship - must yield to the mandatory rules of property law. n8 This argument applies to a broad ongoing movement in our society to "propertize" n9 tangibles and intangibles - such as legal relationships - and create markets in them, n10 barring public policies to the contrary. n11 To summarize my arguments: (i) efficient markets require both contract and property rules, (ii) some property rules are designed to satisfy the essential conditions for efficient markets, (iii) contract and property rules may conflict, and, (iv) when they conflict, property rules should prevail over contract rules.

I. On Contract and Property

A. The Prototypes

Contract and property prototypes differ; in some respects they are compatible, and in others they conflict. The contract prototype posits a relationship consisting of promises enforceable by law. n12 Although the parties' interests may conflict, each party expects to benefit from the contract relationship.

The property prototype differs from contract in a number of ways. The property prototype posits a relationship between a person with property rights (the owner) and others. The relationship has two aspects, depending on the context in which it arises. One is the context of the owner's rights vis-a-vis others. n13 The second is the context of the owner's trading in her ownership rights with others. In this context, the property prototype is focused on enhancing efficient markets. Because efficient markets require strong and clear property rights, the two aspects of the prototype - the owner's relationship with market traders and her relationship to others regarding her property rights - are closely related.

The prototypes also contain implicit or explicit assumptions about the character of the parties - their motivations, expectations, and anticipated behaviors. These assumptions serve as criteria for classifying new candidates to membership in a contract or property category. Implicit in the contract prototype is the assumption that parties interact freely to reach a bargain from which each hopes to benefit. Further, the contract prototype assumes that parties possess relatively equal bargaining power, are independent of other parties, and can fend for themselves. By comparison, the property prototype posits the owner both as the dominant party in her relationship with others regarding her property, and also as an "equal" contract party concerning the transfer of her property rights. n14

B. Values

The guiding value of contract law, subject to few exceptions, n15 is that society supports individuals' freedom to interact by mutually consenting to binding exchange relationships - free of coercion, and free of law's (government's) interference. The government intervenes in the contract relationship only upon the request of a party to enforce the bargain, and bargains are generally enforced if made under the conditions assumed in the contract prototype - that is, the parties consent freely to enter into the relationship, that they can fend for themselves, and that they have capacity to enter into the relationship. n16

The values underlying property law reflect the two aspects of the property prototype. First, society supports the property owner's dominion over her property - her right to exclude others from her property, and to do with the property as she wishes. Even though the owner's dominion is limited by laws that protect third parties from harm or promote social policies, n17 the owner's dominion is the starting point and "default" value; the limitations, however numerous, are perceived as exceptions.

Second, society places high value on the liquidity of property - on facilitating efficient markets in, and the movement of, property - hopefully to those who can make it most productive. n18 To this end, the owner's rights to do with her property as she wishes are subject to regulation when she engages in market activities. Her dominion and her contract freedoms are curtailed by the conditions necessary to create and maintain efficient markets.

Thus, the values underlying both contract and property law recognize the parties' freedom, n19 but differ in the extent and nature of this freedom.

Contract law represents the freedom to interact with others, free of government coercion. The freedom is limited by the power of others to withhold their consent to interact, and by the power of parties to limit their own freedom through agreements with others, for example, in exclusive brokerage contracts.

The value structure of the property prototype is more complex. With respect to the relationship between an owner and others regarding her property rights, the owner's freedom from coercion of others is both stronger and more unilateral than the comparable freedom of contract parties. The values underlying property law support the right to control the use of one's property independently of the consent of others. As compared to contract rights, property rights are also supported by stronger remedies. n20 However, the owner's freedom from government intervention, however, is weaker than that of a contract party.

With respect to the relationship between a property owner and other market traders, the high value society places on efficient markets is not always compatible with contract freedom from government intervention, and when the two values conflict, property law can override the freedom of contract. n21

C. Policies, Certainty of Boundaries, and Rules

The policies of both contract and property law aim at reducing peoples' planning costs and transaction costs. Planning is facilitated by rules that remove, as much as possible, ambiguities and legal risks in the relationships. For example, contract law contains rules that help the parties ascertain the existence of the contract, n22 and property law promotes certainty through rules about the possession and transfer of property rights. n23

Thus, the policies of both contract and property law include creating certainty and predictability to reduce the parties' planning and transaction costs. Not surprisingly, however, the rules in each category have a different focus. Contract law focuses on the contract parties. Property law focuses on the market actors. The different focuses can result in conflicting rules.

II. Where Contract and Property Conflict

Although contract and property policies share some features, as well as the goal of reducing the actors' transaction costs, in some respects they also differ and conflict. While both contract and property law interfere with peoples' freedom to interact and to act within their relationships, contract law accords more deference to the agreement that the parties establish for themselves than property law. n24 As compared to contract, property law interferes far more in the terms of the parties' agreement. Property law imposes quantitatively more, and qualitatively stricter, conditions for the enforcement of property relationships.

The guiding rules in contract law, therefore, are that the parties' agreement governs the relationship and that courts should limit their interference in contract terms and avoid designing the contract for the parties. "Hard bargains" are enforced so long as the initial bargain met the traditional conditions for contract formation. n25 There are, of course, exceptions that depend on public mores and the type of contract. n26 For example, the courts today will not enforce contracts of adhesion, and might interfere in long-term contract relationships, n27 based on the assumed intention of the parties. n28 Such expanded judicial interpretation can result in judge-made contract terms, which seems to conflict with the guiding policy of judicial non-interference. n29

Even though contract law today interferes in the parties' relationships more than it did in the past, property law remains the comparatively more intrusive category. For example, absolute dominion over property has given way to overriding laws: zoning laws, n30 housing codes, n31 and government-forced sales, n32 to name just a few. This interference has increased as the view of property rights has changed from unconditional dominion to dominion subject to responsibilities and duties. n33

Just as importantly, because an overriding policy of property law is to encourage markets, n34 the law curtails the power of owners to carve up future and present property rights for transfer and prescribes the forms of these transfers.

These limitations reflect the necessary conditions for creating and facilitating markets; yet these limitations can conflict with contract freedom. Thus, contract and property laws are often incompatible.

I do not suggest that our markets today can exist without strong contract rights. Binding contracts are essential for the creation of our markets. Indeed, markets exist to help increase the number of binding contracts. I do suggest that, in addition to contract law, markets require an infrastructure that is grounded in property law. Markets are not quintessentially in the contract domain.

The following subparts examine four areas in which property law interferes in the parties' relationships more than contract law. These areas are: the terms of the relationship, the nature of the rights, publicity and transferability of the transactions, and the existence of intermediaries. Each of these areas affects the conditions for creating and maintaining efficient markets. The desirability of efficient markets justifies the priority of the property law over contract law.

A. The Terms of the Relationship - Standardization

Contract and property law differ on the extent to which they allow the parties to determine the terms of their arrangement. Under contract policy, parties may design their relationships as they wish - subject to a few important exceptions, such as the prohibition on illegal contracts and on agreements in restraint of trade. n35

In contrast, property rules impose numerous restrictions on sellers, depending on the products and markets involved. One type of restriction is the required standardization of various aspects of transactions. n36 Standardization fosters the creation and efficiency of markets. It reduces buyers' information costs about products and transaction terms and avoids confusion among market actors. For example, official weights, quantity standards, and labeling requirements n37 facilitate the calculation and comparison of prices for products and their substitutes. Standardized forms of real estate transfers and standardized classes of substantive property rights in real estate have a similar effect. n38

To be sure, there are exceptions to standard property rights. For example, trusts can be used to customize official "packages" of rights and graft over them a second layer of custom-made groups of property rights. Further, markets can develop in unique non-standard items, such as whole loans. n39 Not all standards are, or should be, mandatory. Notwithstanding the exceptions, property law policies support standardization far more than contract law policies do. n40

B. The Nature of the Rights

Contract and property law differ on the extent to which the parties may design their rights free of law's intervention. Contract law allows the parties to design their bargain. With few exceptions, such as the prohibition on penalty damages, n41 they can modify the law of remedies for breach by drafting unique substantive contract rights and remedies. n42 Further, because rules regarding contract terms are mostly permissive, the rights under a particular contract may be expressed in vague terms, by intentional or negligent drafting. n43

In contrast, property law tends to establish strong and clear rights and remedies. Efficient markets require that transferred property rights be as strong, as clear, and as certain as possible. Markets in which too many unexpected and conflicting property claims can arise are less efficient because buyers' risks are higher, and because accurate pricing of such property becomes costly and difficult. n44

C. Publicity and Transferability

Contract and property laws impose on the parties to the relationship different duties to provide information to each other and to inform third parties. To avoid confusion among the contracting parties about the transaction, contract law imposes certain formalities requirements. These formalities provide information to the parties about the status of their relationship. Otherwise, contract policies place on each party the responsibility and cost of gathering the information needed to make the decision on whether to enter into a relationship. These policies are faithful to the prototype of contract relationship because the prototype posits independent and self-sufficient parties in face-to-face negotiations. Therefore, contract law places the cost of information gathering on each party, and does not intervene to reduce these costs. However, because the seller is an efficient and accurate source of information the law imposes on her a legal duty to answer the buyer's queries truthfully. Responsibility remains with the buyer to ask - the seller need not volunteer information. As to third parties, contract law does not require contracting parties to publicize the existence or terms of the contract; they can keep their relationship confidential and can impose such confidentiality in their contract. Third parties must gather the information at their own expense.

Property law is quite different. Many trades require publication not only of the transfers, but also of some of their terms. The reasons are not hard to find. Information costs to market actors can be prohibitively high, especially when trades are impersonal and buyers cannot seek information from sellers. Therefore, publicity reduces buyers' information costs by making property rights more predictable and prices more ascertainable. Under property law, depending on the type of property, sellers must disclose information necessary for buyers to make a decision on whether to trade, and if so, at what price. For example, the regulation of markets for consumer commodities and food requires significant disclosure through labeling. n45

Property law also requires publication of the transfer of certain types of property, such as bulk sales of businesses n46 and real estate. n47 Property law also encourages the use of standardized transfer forms for various properties to reduce confusion among traders, to lower the cost of trading, and to give third parties notice of the trade. Thus, property law allows parties far less privacy than contract law.

Contract and property laws also differ and conflict on the extent to which the parties may agree to allow or to prohibit the transfer of their rights. One long-standing policy of contract law is that interpersonal relations should be fostered, and one early contract rule was that contractual relationships may not be transferred without the consent of all the parties. n48 When new investment opportunities rendered some contracts - especially long-term ones - disadvantageous, courts pushed contract law against the limits of its prototype to accommodate transfers of contract rights, for example, by allowing assignments. n49 Assignments do not render contract rights fully liquid, however. n50 In addition, if the terms of the contract prohibit its assignment, the courts will enforce the prohibition, barring a statute or strong public policy. n51 Thus, the starting point in contract law, though subject to significant common law and statutory exceptions, is that a contract is personal and not transferable. Indeed, transferability is the exception.

In contrast to the law of contract, property law is strongly biased in favor of transferability of property rights and is hostile to limitations on transferability. n52 The starting point in property law is that property rights should be transferable. Unless imposed by statute n53 or by the unique nature of the particular property rights, n54 restrictions on alienation should be the exceptions. Total restrictions should be unenforceable. n55

D. Intermediaries

The contract law prototype is based on the assumption that parties will negotiate face-to-face. The property law prototype is based on the assumption that the parties are likely to transact through intermediaries. In fact, efficient markets require the services of intermediaries because intermediaries reduce the transaction costs of the parties.

One example of the utility of intermediaries is the securitization process, in which intermediaries facilitate the movement of funds from savers to borrowers. Pension funds and insurance companies hold much of the long-term savings in this country. Because these funds do not engage in lending but invest mainly in securities, they serve as a funding source only to borrowers that can issue securities. Pension funds do not make direct loans; they do not lend directly to mortgagors, consumers, and small and medium-sized businesses. Using the securitization process, intermediaries can help direct the flow of funds from pensions and other large pools of savings to mortgagors, consumers, and some commercial borrowers. n56 Different types of intermediaries take part in the process. Some intermediaries make loans, others convert them into securities, and some sell the securities to savings pools and create secondary markets in the securities. Intermediaries thus provide the channels through which funds flow from savers to borrowers, hopefully putting the funds to the best use for the benefit of all.

In addition, intermediaries can be used in particular markets to reduce the enforcement costs of contracts among parties. This role of intermediaries is crucial in volatile markets, in which either the buyer or the seller often has incentive to renege on her promises. n57 The regulation of intermediaries in property law and in specific legislation has no parallel in contract law, and it may conflict with contract policies by restricting the parties' freedom to interact among themselves and with their intermediaries.

III. Resolving the Conflicts: Property Trumps Contract

Many contract and property rules do not conflict. n58 However, when property imposes duties and constraints on market traders, property rules should apply, regardless of whether contract rules are silent or in conflict with property rules. Contract law is a broad and useful "default" category. It helps maintain uniformity across situations in other categories of transactions on issues that are not unique to market transactions. n59 With respect to legal interference in peoples' interactions in a broad sphere of activities, it applies when more restrictive categories do not apply. Being the more pervasive and permissive of the two categories, it ought to govern unless property law, or rules in other special categories, provides otherwise.

When contract and property rules conflict, there should be a presumption in favor of the property rules because our society places a high value on the creation and maintenance of markets. The rules that regulate the markets and provide them with an adequate infrastructure are housed in a separate common law category - property law - and in legislative categories, such as securities regulation. The rules in these categories should overrule contract law. If no additional regulation is necessary to facilitate the creation and maintenance of markets, contract law will apply. But if additional regulation is necessary, it should be housed in a property category or in a separate legislative category, and rules in these categories should prevail over conflicting contract rules. n60

Conclusion

I argue that markets require a legal infrastructure. "Free" markets will not exist without law's interference in market actors' interactions. There are certain conditions that facilitate the creation and maintenance of efficient markets in physical, financial, or intellectual products. These conditions include the reduction of information and transaction costs for market actors, and the use of intermediaries. These conditions must be supported by legal rules. I classify such rules as a subset of property law.

To flourish, markets require both contract law and property law. Contract law regulates relationships among discrete parties. Property law regulates relationships among discrete parties on the one hand and the rest of the market actors on the other hand. In addition, property law provides the markets with institutional rules that impose the conditions necessary to enhance market efficiencies.

Both contract law and property law provide the main building blocks for market infrastructures. However, rules in these two categories can conflict; property rules may impose regulations while contract rules leave the matter to the parties. Assuming we wish to maintain market efficiencies, when contract and property rules conflict, property rules should prevail.

FOOTNOTES:

n1. For an analysis of the contributions of stock exchanges to efficient markets that emphasizes similar factors, see Jonathan Macey & Hideki Kanda, *The Stock Exchange as a Firm: The Emergence of Close Substitutes for the New York and Tokyo Stock Exchanges*, 75 *Cornell L. Rev.* 1007 (1990).

n2. Intermediaries - such as brokers or dealers - not only reduce the cost of transactions, but also help increase the number of transactions. More intermediaries attract more market buyers and sellers. This definition of markets excludes, for example, fairs in which producers and buyers meet directly to exchange their goods. See 1 Tamar Frankel, *Securitization: Structured Financing, Financial Assets Pools, and Asset-Backed Securities* 3.1, at 67-68 (Ronald S. Borod ed., 1991) (discussing criteria helpful in assessing the market benefits of intermediation systems).

Efficient markets also require numerous and dispersed sellers and buyers. Antitrust legislation and the common law doctrine of restraint of trade were designed to prevent concentrations of buyers or sellers and promote market efficiency.

n3. These conditions might conflict with the short-term self-interest of some sellers. For example, buyers' information costs may increase if sellers compete by distinguishing their wares from those of other sellers in many and confusing ways. Buyers' information costs may also increase if sellers "pass off" their products as those of their competitors. In both cases, buyers might offer lower prices to compensate for their trouble. Further, an institutional framework established by sellers in a particular market may reduce competition among them because they might collude to set terms and prices.

Legal rules might be necessary to equalize the regulatory regime among various market actors and create a fair "level playing field." In addition, government intervention is sometimes needed when the private sector is unable or unwilling to bear the cost of creating new instruments or markets, or to bear the cost of collecting necessary information and marshalling required expertise. See 1 Frankel, *supra* note 2, 1.04, at 1-15 (the techniques for securitizing loans were developed with the active initiative and help of the United States

Government); Tamar Frankel, Testimony Before the Subcommittee on Economic Growth and Credit Formation of the Committee on Banking, Finance and Urban Affairs of the U.S. House of Representatives (Feb. 16, 1993) (transcript on file with the Boston University Law Review); Howell E. Jackson, What Should the Federal Government Do to Promote a Secondary Market for Business and Commercial Loans?, Testimony Before the Subcommittee on Economic Growth and Credit Formation of the Committee on Banking, Finance and Urban Affairs of the U.S. House of Representatives (Apr. 21, 1993) (transcript on file with the Boston University Law Review) (the government can interfere in the markets by offering credit enhancement).

n4. 1 Friedrich A. Hayek, *Law, Legislation, and Liberty* 46 (1973); see also *id.* at 36-37, 41.

n5. Arguably, there is no justification for grouping rules that regulate markets under property law and distinguishing this group of rules from contract law. Markets are regulated in part by property law and by rules from other legal categories, including contract or antitrust. Perhaps a new term, such as "market law," representing all rules governing markets, may be more precise.

I use the traditional names of property and contract for several reasons. First, I believe that both lawyers and non-lawyers share a general understanding of "contract" and "property." Although the use of the term "property" for market regulation may sacrifice precision, this general understanding is preserved. Besides, I doubt whether a name of a legal category can ever be precise. Ultimately, the creation of a new category for market regulation would demand a level of time and attention unnecessary for this discussion.

n6. Contract and property law are even less compatible when the property right traded in the markets is an intangible legal obligation such as a debt. Still, the clash between the two legal areas persists even if the traded property is tangible. See *infra* part II.

n7. See *infra* part II.B.

n8. See 2 Frankel, *supra* note 2, 15.4, at 129-34, 20.4.3, at 302-06; Barton Crockett, System Set Up to Ease Confusion in Managing Syndications, *Am. Banker*, Apr. 23, 1993, at 3.

n9. By "propertize," I mean creating the privilege of entry and use as well as the legal right to exclude others from this privilege. Note, for example, the recognition by state courts, of a spouse's property rights in the graduate degrees attained by the other spouse. See, e.g., *Lovett v. Lovett*, 688 S.W.2d 329, 332 (Ky. 1985) ("although a professional degree ... may not be property in the literal sense, they are assets of the marriage" for purposes of dividing marital property); *O'Brien v. O'Brien*, 489 N.E.2d 712, 715 (N.Y. 1985) ("Marital property encompasses a license to practice medicine to the extent that the license is acquired during the marriage."). But see *Archer v. Archer*, 493 A.2d 1074, 1079 (Md. 1985) ("A professional degree or license does not possess any of the basic characteristics of property within the ambit of the State Property Disposition in Divorce and Annulment Law.").

n10. For example, while contract options existed for decades, it was only during the past 20 years that markets in options developed. Options were standardized, and a legal infrastructure was designed for markets in them. See *Multiple Trading of Options, Securities Exchange Act of 1934, Exchange Act Release No. 34-24613, 38 S.E.C. Docket (CCH) 865, 867* (June 18, 1987) (citing Securities Exch. Comm'n For Use of House Comm. on Interstate and Foreign Commerce, 96th Cong., 1st Sess., Report of the Special Study of the Option Markets to the Securities Exchange Commission 1 (Comm. Print 1979)). Similarly, swaps have been standardized and traded. See William P. Rogers, Jr., Interest Rate and Currency Swaps: The Secondary Market, in *Interest Rate and Currency Swaps* 23-44 (PLI Corporate Law & Practice Course Handbook Series No. 603, 1988). Therefore,

if we wish to encourage the movement to market certain legal relationships, we should classify these legal relationships as property and apply property rules to them. Without reclassification, efficient markets do not develop. See 1 Frankel, *supra* note 2, 1.9.2, at 22.

n11. Examples of propertized relationships that are not for sale are college degrees. College degrees are not transferable because they represent the personal achievement of the holder of the degree. Transfer to others would mislead third parties. Similarly, although pension rights are property rights under the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. No. 93-406, 88 Stat. 829 (codified as amended in scattered sections of 5, 18, 26, 29, 31, and 42 U.S.C.), they are transferable only pursuant to a statutory scheme.

n12. See *Restatement (Second) of Contracts 1* (1979) (defining a contract as "a promise or set of promises for the breach of which the law gives a remedy, or the performance of which the law in some recognizes as a duty"). For the exception of the unilateral contract, see Mark Pettit, Jr., *Modern Unilateral Contracts*, 63 *B.U. L. Rev.* 551, 552 (1983).

n13. These rights range from the right to entry and use of property - an easement, for example - to an entitlement to exclude others from property. See Ray A. Brown, *The Law of Personal Property* 1.5, at 6 (Walter B. Raushenbush ed., 3d ed. 1975) ("Ownership, or the right of property, is ... a collection or bundle of rights, of legally protected interests.").

n14. See *id.* at 7 ("One of the attributes of a property owner's ownership is the power to confer upon others one or more of his various interests in it while retaining some of the others.").

n15. One exception is a contract contrary to public policy; another is an illegal contract. See 6A Arthur L. Corbin, *Corbin on Contracts* 1373-1375, at 1-20 (1963).

n16. See 1 E. Allan Farnsworth, *Farnsworth on Contracts* 4.4-.5, at 379-90, 4.19, at 443-44, 4.26, at 478-90 (1990).

n17. See Gerald Bowden, *Protecting Our Environment Through Legislation: Approaching a New Concept of Property*, 4 *Real Est. L.J.* 165, 174 (1975) ("Traditional liberal notions ... place individual interests above the collective social interest.").

n18. See 1 Farnsworth, *supra* note 16, 11.1-.2, at 58-67; 5 Herbert T. Tiffany & Basil Jones, *The Law of Real Property* 1343, at 161-62 (3d ed. 1939 & Supp. 1992).

n19. Both freedoms are constitutionally protected from government encroachment. U.S. Const. amend. V ("No person shall be ... deprived of life, liberty, or property without due process of law; nor shall private property be taken for public use, without just compensation."); *id.* art. I, 10, cl. 1 ("No State shall ... pass any ... Law impairing the obligation of contracts.").

n20. For example, a lender cannot control the borrower's use of the loan proceeds except when the loan agreement specifically so provides. However, a beneficial owner of property under the control of another is entitled to judicial protection as of the first day when control passed. The controlling fiduciary is regulated as to how to deal with the property, even though the parties did not explicitly contract to that effect. In addition, the

beneficial owner is entitled to accounting, and to the imposition of a constructive trust on his fiduciary's improper profits. See generally Tamar Frankel, *Fiduciary Law*, 71 *Cal. L. Rev.* 795 (1983).

The history of pension rights is instructive. Pensions were first considered charity, not legally enforceable. Pensions evolved into contract rights, and under the Employee Retirement Income Security Act of 1974 (ERISA) became beneficial property rights (although the transferability of the rights is limited for public policy reasons). See Russell K. Osgood, *The Law of Pensions and Profit Sharing* 11.1.7, at 271-72 (1984).

One unique case demonstrates the difference between contract and property remedies. In *Snepp v. United States*, 444 *U.S.* 507 (1979), the Supreme Court imposed a constructive trust on the proceeds from a book written by a former CIA agent. *Id.* at 515. The agent published the book in breach of his agreement with the CIA, in which he undertook not to publish material about the agency without its prior approval. *Id.* at 507-08. The government could not collect under contract law, however, because it could not show damages. *Id.* at 509-10. The Court awarded the government a property remedy. The published information (although it was public) was "propertized" as government property. Because this property was used without the owner's permission, the Court imposed a constructive trust on profits from the information and ordered the profits paid to the government. *Id.* at 515-16.

n21. For example, property law will override the freedom of contract parties to restrict the alienation of property. I recognize exceptions for unique types of property, such as intellectual property, for which the second aspect of the property prototype is less important than the first.

n22. For contract rules regarding consideration and formalities, see 1 Farnsworth, *supra* note 16, 1.6, at 23-24, 2.16, at 126-29; 2 Farnsworth, *supra* note 16, 7.1-.2, at 191-98.

n23. See *Sharon Steel Corp. v. Chase Manhattan Bank, N.A.*, 691 *F.2d* 1039, 1048 (2d Cir. 1982), cert. denied, 460 *U.S.* 1012 (1983) (distinguishing "boilerplate" trust indenture clauses from "contractual provisions which are peculiar to a particular indenture"); *infra* note 59.

n24. See *Restatement (Second) of Contracts* 178 cmt. b (1979) ("Only infrequently does legislation, on grounds of public policy, provide that a term is unenforceable.").

n25. See Howard O. Hunter, *Modern Law of Contracts* 1.02 (1986) (although the victim of a breach of contract "does not necessarily under common law get the performance that he wanted, ... he gets the value of the performance, or an approximation of it in money"); Morris R. Cohen, *The Basis of Contract*, 46 *Harv. L. Rev.* 553, 576 (1933) ("The classical view is that the law of contracts gives expression to and protects the will of the parties, for the will is something inherently worthy of respect.").

n26. Historically, courts strictly followed the policy of minimal interference in contract. For example, until the late 1920s, insurance contracts contained unconscionable provisions, such as the required forfeiture of policies' cash values on default of premium payments. Yet, consistent with contract law policies, the courts upheld and enforced these terms of the policies. See, e.g., *Illinois Bankers Life Assurance Co. v. Tennison*, 213 *P.2d* 848, 852 (Okla. 1949) ("Courts will not make a better contract for the parties than they saw fit to make, or alter their contract for the benefit of one party."); 3A John A. Appleman & Jean Appleman, *Insurance Law and Practice with Forms* 1751, at 62-63 (1967); S.S. Huebner & Kenneth Black, Jr., *Life Insurance* 402 (7th ed. 1969). Similarly, the courts viewed legislation establishing a minimum wage as interfering with the parties' freedom of contract. See, e.g., *Adkins v. Children's Hosp.*, 261 *U.S.* 525, 553 (1923) (minimum wage regulations impermissibly restricted "liberty of contract"), overruled by *West Coast Hotel Co. v. Parrish*, 300 *U.S.* 379 (1937); *Lochner v. New York*, 198 *U.S.* 45, 57-65 (1905) (invalidating a state law limiting the maximum number

of hours certain employees could work each week as an impermissible state interference with the liberty of contract), overruled by *Day-Bright Lighting, Inc. v. Missouri*, 342 U.S. 421 (1952).

n27. See 1 Farnsworth, *supra* note 16, 4.26, at 478-90. Judicial intervention in "relational contracts" may conflict with the assumption that contracts reflect the parties' expectations. See Ian R. Macneil, *Contracts: Exchange Transactions and Relations* 14-16 (2d ed. 1978) (constructing a spectrum of contractual behavior between "relational" and "transactional" behavior); Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 *Va. L. Rev.* 1089, 1091 (1981) (describing the "two doctrinal linchpins of relational contracts as the obligation of one party (the 'agent') to use its 'best efforts' to carry on an activity beneficial to the other (the 'principal'), and the concomitant right of the principal to terminate the relationship").

n28. The change might be explained as a broader interpretation of the elements of contract formation, rather than as a change in the policy of non-interference in the parties' agreement. See, e.g., *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 449 (D.C. Cir. 1965) (refusing to enforce a one-sided bargain); *Johnson v. Mobil Oil Corp.*, 415 F. Supp. 264, 269 (E.D. Mich. 1976) ("The notion of free will has little meaning as applied to one who is ignorant of the consequences of his acts."); *Henningsen v. Bloomfield Motors, Inc.*, 161 A.2d 69, 99-100 (N.J. 1960) (an automobile purchaser may recover damages for personal injuries arising because of a defect in the product, even though the purchaser lacked privity with both the dealer and the manufacturer); *Jackson v. Seymour*, 71 S.E.2d 181, 184 (Va. 1952) (granting relief based on constructive fraud); Marvin A. Chirelstein, *Concepts and Case Analysis in the Law of Contracts* 74 (1990) (according to the cases and the Uniform Commercial Code, "where circumstances indicate that one party did not, or could not fully comprehend its meaning of the contract, then the court is free to use its own judgment to determine whether the contract terms are fair"); Richard A. Epstein, *Unconscionability: A Critical Reappraisal*, 18 *J.L. & Econ.* 293 (1975) (courts should enforce all contracts unless there is proof of "some defect in the process of contract formation ... or ... some incompetence of the party against whom the agreement is to be enforced").

n29. Without alternatives, a person may have been free in theory, but bonded in fact. For example, if freedom is unrelated to limited choice, then there is no such thing as unemployment: an individual without choice may indeed "freely" opt to work a 16-hour day for a loaf of bread. Adopting similar theories of freedom, courts at one time enforced burdensome contracts entered into by parties with severely limited choice, and invalidated legislative attempts to establish minimal terms for these parties. Yet unless work is available on terms that allow workers to maintain a minimal standard of living, such contracts are coercive in a very real sense. The meaning of "minimal" is, of course, debatable.

n30. See, e.g., *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 132-33 (1978) (upholding a landmark preservation law severely restricting owners' rights to develop the airspace over their property); *Euclid v. Ambler Realty Co.*, 272 U.S. 365, 395-96 (1926) (a decrease in property value caused by a zoning ordinance made in the public interest required no compensation under the Fifth Amendment).

n31. See, e.g., *Help Hoboken Hous. v. City of Hoboken*, 650 F. Supp. 793, 799 (D.N.J. 1986) (an ordinance requiring landlords to rent vacant apartments to paying tenants was not an unconstitutional taking, nor a violation of due process or equal protection).

n32. See, e.g., *Hawaii Hous. Auth. v. Midkiff*, 467 U.S. 229, 242-43 (1984) (upholding a state scheme to take title to real property from lessors and transfer it to lessees to reduce concentration of land ownership); *Poletown Neighborhood Council v. City of Detroit*, 304 N.W.2d 455, 459-60 (Mich. 1981) (upholding a government-mandated conveyance of a large tract of land to a large private corporation for an assembly plant).

n33. "The net effect of police power regulations, environmental law, and public trust doctrines has been to make many decisions regarding land use into joint ventures between the individual and the state. Clearly, our concept of property is changing." John E. Cribbet, *Concepts in Transition: The Search for a New Definition of Property*, 1986 *U. Ill. L. Rev.* 1, 26.

n34. See, e.g., Richard A. Posner, *Economic Analysis of Law* 10-13 (1972) ("The legal protection of property rights has an important economic function: to create incentives to use resources efficiently.").

n35. See 2 Farnsworth, *supra* note 16, 5.3, at 16-27.

n36. See generally *Mass. Gen. L. ch. 183, 16-17* (1990) (standardizing "warranty" and "quitclaim" covenants); Tiffany & Jones, *supra* note 18, 756-828, at 199-400.

n37. See, e.g., 7 C.F.R. 810 (1992) (official U.S. grain standards); 9 C.F.R. 317 (1992) (federal labeling requirements for meat products). The Federal Bureau of Standards is charged with establishing measures and standards.

n38. For centuries, property rights in real estate have been standardized. The law acknowledges the transfer of about 15 distinct "packages" of property rights; only transfers of these rights can be enforced. See Lawrence C. Becker, *The Moral Basis of Property Rights*, in XXII *Nomos* 190-92 (J. Roland Pennock & John W. Chapman eds., 1980). The various interests involved can be classified into four general classes: freehold estates, non-freehold estates, concurrent estates, and future interests. See Roger A. Cunningham et al., *The Law of Property* 2.1, at 80-81 (1984). Today, some subcategories of property law, such as leases, tend toward the contract model, allowing the parties to agree on non-standard rights. See Jesse Dukeminier & James E. Krier, *Property* 386-87 (2d ed. 1988) ("Courts ... are coming more and more to emphasize the contractual nature of leases, with important consequences."). Nonetheless, today, as before, constraints on the design of rights are greater in property law than in contract.

n39. See 1 Frankel, *supra* note 2, 2.6, at 54-56 (describing the market in whole loans). See generally Crockett, *supra* note 8, at 3 (describing steps that facilitate trading in loan participations, such as voluntary standardized designations of the traded participations and a plan to emulate the recording systems used in securities tradings).

Markets can also develop in works of art. However, these markets are relatively inefficient, requiring costly expert evaluations and costly intermediaries, such as art galleries and auction houses.

n40. Arguably, a parallel trend in contract law is illustrated by the Uniform Commercial Code's general imposition of uniform meanings on transactions in certain markets, facilitating contract formation and reducing enforcement costs.

n41. See 3 Farnsworth, *supra* note 16, 12.18, at 283-87.

n42. For example, when portions of a large loan are sold as loan participations, the parties can agree that the seller retain the rights to enforce the loan, and explicitly relieve the seller of any fiduciary duties to the buyers. See 2 Frankel, *supra* note 2, 19.5.1, at 261-64. Consequently, if the borrower fails, the buyers of participations

have no direct enforcement rights against the borrower and only weak remedies against the seller for failing to collect on the loan. See *id.*

n43. See 1 Frankel, *supra* note 2, 7.22-.23, at 265-78, 10.7-.15, at 424-47. There is no law that requires a loan transfer to indicate clearly whether the transferee is a buyer of the loan or a lender to the transferor, with a security interest in the third party loan. Both parties might leave the classification of the instrument intentionally ambiguous. Should the third party borrower fail, the transferee would classify the transaction as a loan to the solvent transferor so that the transferor, rather than the transferee, will bear the loss from the borrower's failure. On the other hand, should the transferor fail, the transferee would classify the transaction as purchase of a beneficial ownership in the loan and claim the full amount of the loan from the solvent borrower against the transferor's creditors. The transferor may have similar motives for leaving the instruments unclear: e.g., to be free to argue the reverse, depending on future events. Because loan participations are deemed contracts, some loan participations can be drafted with such vague instruments. *Id.*

n44. See 1 Frankel, *supra* note 2, 2.7, at 57 ("The more standard and simple the terms of the loans are, the more predictable their cash flow and maturity are, and the more easily they can be priced and securitized."); Owen L. Anderson & Charles T. Edin, *The Growing Uncertainty of Real Estate Titles*, 65 *N.D. L. Rev.* 1, 90 (1989) (judicial decisions rendering real estate title "less certain and hence, less efficient" undermine the public policy of certainty of land titles that "encourages investment in real estate and ... maintains a healthy real estate industry").

n45. See 16 C.F.R. pt. 500 (1992); 21 C.F.R. pt. 101 (1992). Similarly, under federal securities regulations, the sale of securities involves substantial disclosure obligations to reduce the costs of evaluating the prices and risks to market actors. See Louis Loss, *Fundamentals of Securities Regulation* 25-35 (2d ed. 1988).

n46. See U.C.C. 6-105 (requiring written notice to certain creditors of the seller); Steven L. Harris, *The Interaction of Articles 6 and 9 of the Uniform Commercial Code: A Study in Conveyancing, Priorities, and Code Interpretation*, 39 *Vand. L. Rev.* 179, 183 (1986) (Articles 6 and 9 of the Uniform Commercial Code seek to avoid injury to creditors "by requiring public notice of a conveyance of personal property").

n47. See, e.g., *Mass. Gen. L. ch. 183, 4* (1990). "Customized" property rights, such as trusts, receive special treatment. The special trust arrangement does not bind third parties who have no notice of the trust arrangement, however. 4 Austin W. Scott & William F. Fratcher, *The Law of Trusts* 284, at 35-36 (4th ed. 1989).

n48. Historically, a person's contract was "a personal relation incapable of delivery." 4 Corbin, *supra* note 15, 856, at 403.

n49. As markets developed, courts developed the doctrines of assignment and delegation that allowed contract parties to liquidate their investments by selling contract obligations owed to them. See *Restatement (Second) of Contracts* 317 (1979) (upon an effective assignment, "the assignor's right to performance by the obligor is extinguished ... and the assignee acquires a right to such performance"); Corbin, *supra* note 15, 856-866, at 434-59 (discussing delegation of performance and assignment of legal duties); 3 Farnsworth, *supra* note 16, 11.1, at 58-59 (distinguishing between assignment and delegation). Courts also allow contract parties to obtain a release of their promises by compensating the other party. This escape route, however, is far less advantageous to the party than a transfer of her rights.

n50. With few exceptions (e.g., the holder in due course exception) an assignee takes the assignor's rights subject to the obligor's defenses against the assignor. See 3 Farnsworth, *supra* note 16, 11.8, at 105-06. The obligor's liability to the assignee arises only after the obligor is notified of the assignment. *Id.* 11.7, at 98. While a sale of her entire interest in property (not a lease), terminates any non-contractual relationships she may have with other persons with respect to the property, a contracting party can only assign her rights under the contract, not her obligations. *Id.* 11.3, at 67. A contract party can delegate her contractual obligations, but such delegation does not discharge her from executory promises she made. *Id.* 11.10, at 126 (to be relieved of her obligations, a delegating party must obtain the consent of the obligee or the performance of the delegate); see also Addison Mueller & Arthur Rosett, *Contract Law and Its Application* 575 (2d ed. 1977) ("The same concerns that applied seven hundred years ago to limit transfer of land rights now are embodied in statutes protecting wage earners and consumers from oppression that can flow from overly free contractual assignment.").

n51. Professor Farnsworth states that the Uniform Commercial Code has implemented significant modifications "in the direction of free assignability." 3 Farnsworth, *supra* note 16, 11.4, at 83. Note, however, that these modifications apply to financial instruments, and the legal regime for such transferable instruments is similar to that of property law.

Partnership law offers an example of a compromise between personal and property relationships. The formation of a partnership creates a highly personal relationship. A partnership, however, is also a co-ownership. In order to allow a partner to utilize her equity in the partnership, she is permitted to assign her interest in distributions from the partnership, but not her rights as a partner (e.g., to vote and to manage the partnership, to represent it as agent, or to examine its books). Uniform Partnership Act 502-503 (1992). This assignment is thus not complete and will not fetch the same price as would a full sale of the partner's interest.

n52. See Cunningham et al., *supra* note 38, 2.2, at 35, 3.24, at 155. Such limitations should only be allowed when necessary to protect investments and to encourage the efficient functioning of markets. See Ralph E. Boyer et al., *The Law of Property* 6.1, at 117 (4th ed. 1991) (as a general rule of construction, "a provision in a deed or will directing that the transferee of property cannot dispose of the property is void as a disabling restraint on alienation"); William L. Cary & Melvin A. Eisenberg, *Cases and Materials on Corporations* 421 (6th ed. 1988) ("Although some of the earlier cases held that all restrictions on the transferability of shares constituted illegal restraints on alienation the modern cases hold that 'reasonable' restrictions are valid and enforceable.").

n53. For example, ERISA limits transferability of pension rights to protect family dependents. See *supra* note 11.

n54. See *supra* notes 9, 11.

n55. See 4 Corbin, *supra* note 15, 3.17, at 492 (distinguishing between prohibiting the future conveyance of property by the buyer after transfer and prohibiting the assignment of a contract right to future transfer).

n56. See 1 Frankel, *supra* note 2, 3.2.1, at 69-72.

n57. Because "traders in commodities with volatile prices are exposed to a higher risk of breach of contract ... custom and law have shifted enforcement costs from the contract parties to more effective enforcers: the market intermediaries. Since these intermediaries have the incentive to execute transactions in order to earn their commissions, the intermediaries were given powers to ensure enforcement, similar to escrow arrangements" *Id.* 3.2.3, at 78-79 (footnotes omitted).

n58. For example, both property and contract rules prohibit fraud against other parties. Fraud on many market traders is as pernicious as fraud on one party to a contract. Yet, even on this subject, property law differs from contract. The differences reflect the adjustment of rules governing face-to-face negotiations for application to impersonal transactions through intermediaries. Compare 1 Farnsworth, *supra* note 16, 4.11-.15, at 402-30 (describing the elements of common law contract fraud) with 17 C.F.R. 240.10b-5 (1992) (Rule 10b-5 promulgated under the Securities Exchange Act of 1934, 10(b), 15 U.S.C. 78j(b) (1988)).

n59. This uniformity reduces the ability of the parties to go "category shopping" for the general principles of contract law such as consent.

n60. For an example in which property rules prevail over contract rules, see *Sharon Steel Corp. v. Chase Manhattan Bank, N.A.*, 691 F.2d 1039 (2d Cir. 1982), cert. denied, 460 U.S. 1012 (1983). Sharon Steel distinguished "boilerplate" indenture clauses from "contractual provisions which are peculiar to a particular indenture." *Id.* at 1048. Boilerplate provisions "must be given a consistent, uniform interpretation" because "uniformity in interpretation is important to the efficiency of capital markets." *Id.* "Whereas participants in the capital market can adjust their affairs according to a uniform interpretation, ... the creation of enduring uncertainties as to the meaning of boilerplate provisions would decrease the value of all debenture issues and greatly impair the efficient working of capital markets." *Id.*

The rules of setoff in the context of securitization demonstrate a case in which contract law is not trumped by property law. In my opinion, these rules contribute to inefficiencies in the markets for loan participations. See 2 Frankel, *supra* note 2, 21.7-.12.3, at 393-412.