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Conflicts in Property

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CONFLICTS IN PROPERTY

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CONFLICTS IN PROPERTY

*Hanoch Dagan & Michael Heller**

I. INTRODUCTION

Property is conflict. More precisely, property exists to govern conflicts. Property conflicts come in two forms: conflicts of individuals and conflicts of interest. While the first form has received most scholarly attention, the second has quietly come to dominate the development of property law. This Article brings conflicts of interest to the fore.

Conflicts of individuals have long been the paradigmatic property struggle. We both want to fish; there are not enough fish. I got there first; so I argue the fish are mine. Based on a rule of “first possession” for governing such interpersonal conflicts, the state may give me a property right such that I can exclude you from the fish. “Trespass” is another such rule. I own Blackacre; you own Whiteacre. The state allows us each to exclude the other. If I want to cross your Whiteacre, I must acquire the right from you. According to this conception, the drama of property consists in furthering a productive struggle between autonomous excluders, with each individual cloaked in the Blackstonian armor of “sole and despotic dominion.”

From this perspective, conflict of interests are never good. They represent war within rather than among individuals. Individuals at war with themselves are disabled from acting forthrightly and decisively as market transactors. So, when conflicts of interest do arise, they should be eliminated. People can avoid them in two ways. They can redefine the underlying relationship so there is no longer a conflict, or they can disclose the conflict so there is no longer a betrayal of trust. Either escape or disclosure restores the parties to their autonomous status as formally-equal, unconflicted parties, all contributing in their own self-interested ways to creation of well-functioning markets. But this is an impoverished view of property.

Focusing on productive competition overlooks the equal value of productive cooperation. Large parts of property law encourage productive cooperation by helping people manage conflicts of interest rather than avoid them. I want to fish from our lake and I want us to leave fish for our children; I want to irrigate our land and I want your help in harvesting. Often, an individual or a subset of owners decide how a group’s resource will be used—consumed and invested, managed, and alienated. Disclosure

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cannot effectively address difficulties of conflicts of interests that inhere in such cases, and escape means giving up the advantages of cooperation through property.

Property law knows better than these two disappointing strategies. A thick and rather sophisticated set of property rules encourage decision-makers not only to satisfy their self-interest, but also to take into account the interests of their fellow group members. The state addresses these intra-personal conflicts through laws of co-ownership, partnership, or marital property, for example. According to this conception, the drama of property consists in creating governance institutions that manage conflicts of interest arising within those individuals who control, use, or transfer group resources.

A conflict of interest can be more sharply defined. We can say that someone has a conflict of interest if, and only if, that individual (1) is in a relationship with another requiring the exercise of judgment on the other's behalf, and (2) has some interest tending to interfere with the proper exercise of judgment in that relationship.¹ For the purposes of this definition, "the relationship required must . . . involve one person trusting (or, at least, being entitled to trust) another to do something for her—exercising judgment in her service."² Managing conflict stands for any "partial realigning of interests, not enough to eliminate the conflict of interest but enough to make it seem likely that benefits will more than repay the costs."³

This concern for "partial realigning of interests" can help bring large areas of property law into focus. While property law encourages individuals to compete productively, it also encourages them to govern group resources so as to create the economic and social gains possible from cooperation. In this conception, conflicts of interest play a subtle role, to be avoided in some circumstances, managed in others. A well-governed property system fosters both productive competition and productive cooperation, autonomy and interdependence, exclusion and governance, avoidance and management of conflicts of interest.

In this Article, we situate the management of conflicts of interests at the core of property governance. Part II demonstrates how property governance solves conflicts of interest for individuals acting in their own self-interest and as decision-makers over group resources in which they have a stake. We tease out the governance mechanisms by which property

¹ See MICHAEL DAVIS, *Introduction*, in CONFLICT OF INTEREST IN THE PROFESSIONS 8 (Michael Davis & Andrew Stark, eds. 2001).

² *Id.*

³ *Id.* at 12-14.

law helps people manage these conflicts, create interdependence, and achieve the gains possible from productive cooperation. More particularly, we show how property governance serves to (a) internalize, (b) democratize, and (c) de-escalate conflicts—three mechanisms that allow people to engage safely in productive cooperation, rather than always falling back to competition.

Part III explains the patterns that emerge from the heterogeneous solutions that property law provides to manage conflicts of interests. First, we show that the ratio of economic to social benefits in a particular group resource setting best predicts and best justifies the property form chosen for managing conflicts. Second, we show that when “economic” considerations predominate in managing a group resource, the property form typically uses formal and foreground mechanisms for “partial realigning of interests,” while property forms usually use informal and background safety net rules at the “social” end of the group resource spectrum. Third, and finally, we show that substantive rules for managing conflicts also ranges predictably along the economic to social spectrum, with contribution-based allocation of rights and responsibilities at one end, and egalitarian substantive rules at the other. The conflicts of interest prism helps make sense of an otherwise bewildering array of discrete property doctrines.

II. PROPERTY CONFLICTS

A. *Conflicts and Conflicts of Interests*

Currently, most property scholars seem to have little interest in conflicts of interest and their regulation. This is not to say that conflicts are alien to property. Quite the contrary. In the conventional view, conflicts pervade property. But these are conflicts of a very different type. The conventional narrative of property is one of conflicts between autonomous excluders.⁴

The Blackstonian tradition, which conceptualizes property as sole and despotic dominion,⁵ invites and supports this analysis. While no one seriously thinks anymore that property always and necessarily entails

⁴ See CAROL M. ROSE, *Property as Storytelling: Perspectives from Game Theory, Narrative Theory, Feminist Theory*, in PROPERTY AND PERSUASION: ESSAYS ON THE HISTORY, THEORY, AND RHETORIC OF OWNERSHIP 25 (1994).

⁵ WILLIAM BLACKSTONE, 2 COMMENTARIES ON THE LAWS OF ENGLAND *2 (University of Chicago ed., 1979) (1765-69).

unqualified dominion,⁶ the conception of “property as exclusion” is still perceived as the regulative idea of private property.⁷ If indeed property is *about* exclusion, as scholars such as Thomas Merrill and James Penner have recently argued,⁸ then the doctrinal home for property conflicts is trespass law. As the paradigmatic doctrine for regulating conflicts between strangers, trespass law seems to have very little to do with conflicts of interest and their regulation. Because conflicts of interest require a background relationship in which one is entitled to *trust* another person, this concept seems indeed to be irrelevant to the main actors in property dramas—excluders with no strong entitlement to each other’s trust.

We do not deny that property is *also* about exclusion: conflicts giving rise to trespass law are part of the landscape of property. But the traditional discourse, with its focus on exclusion, independence, and competition, overstates its case. Exclusion can exhaust the field of property only if one, somewhat arbitrarily, sets aside large parts of what is property law, at least according to the conventional understanding found in the case law, Restatements, and academic commentary. Property institutions provide structures for various types of interpersonal relationships—from strangers and market transactors through landlords and tenants, members of a local community, neighbors, co-owners and partners, to the intimate relationship among family members.⁹ Accordingly, people experience property as both a locus of competition and an arena for cooperation. In other words, governance—the ongoing management of cooperative relationships—typifies property at least as much as exclusion does. For this reason, the concept of conflict of interest and the discussion of strategies for regulating conflicts of interest can highlight important aspects of property law.

B. Avoiding and Managing Conflicts of Interests

Property law is filled with diverse mechanisms for dealing with conflicts of interest. Some of these rules allow people to avoid conflicts of interest; others—of particular interest to this Article—help them manage conflicts of interest.

⁶ Even Blackstone didn’t. See Carol M. Rose, *Canons of Property Talk, or, Blackstone’s Anxieties*, 108 YALE L.J. 601 (1998).

⁷ See Jeremy Waldron, *Property Law*, in A COMPANION TO PHILOSOPHY OF LAW AND LEGAL THEORY 6 (Dennis Patterson ed., 1999).

⁸ See Thomas W. Merrill, *Property and the Right to Exclude*, 77 NEB. L. REV. 730, 730 (1998); JAMES E. PENNER, *THE IDEA OF PROPERTY IN LAW* 103 (1997).

⁹ For an account of this realist conception of property, see Hanoch Dagan, *The Craft of Property*, 91 CALIF. L. REV 1517 (2003).

Because of our societal commitment to exit, property law does, and indeed should, allow people to avoid, rather than manage, conflicts of interest. Exit is a bedrock liberal value. It stands for the right to withdraw or refuse to engage; it is the ability to dissociate, to cut oneself out of a relationship with other persons.¹⁰ The commitment of (liberal) law to exit—to the idea of open boundaries that enable geographical, social, familial, and political mobility—“enhances the capacity for a self-directed life, including the capacity to form, revise, and pursue our ends.”¹¹ Thus, for example, in the co-ownership and marital property areas, partition and divorce are simple mechanisms for escaping conflicts of interest. We value exit so highly that mechanisms such as partition or divorce are essentially unwaivable.¹² These mechanisms recast resource struggles from conflicts of interest into conflicts of individuals, shifting people from productive cooperation to productive competition.

Avoidance has been relatively better documented over the years and proves less germane to the more theoretically-promising issues involved in managing conflicts of interest. So, instead of focusing first on partition or divorce, we look at how property law facilitates cooperation for people who do want to work together. The challenge of what we call liberal commons institutions, such as co-ownership and marriage, is to facilitate people’s ability to gain the economic and social benefits of productive cooperation in the difficult context where the possibility of exit—of escaping the conflicts of interests inherent in property governance—threatens the very possibility of trust and reciprocity.¹³

To face this challenge, each of these property institutions contains rules for managing conflicts of interests in three spheres of decision-making that may affect the collective interest in a resource: decisions about consumption and investment; about management; and about allocation. Each of these spheres can be helpfully analyzed as a means for “partial realigning of interests.” Given the multiplicity and apparent diversity of property governance rules in each of these spheres, however, even a bare catalogue of these rules would be a daunting and unproductive task. So, we do not attempt a full restatement. Instead, our task here is to highlight some

¹⁰ See ALBERT O. HIRSCHMAN, EXIT, VOICE, AND LOYALTY 19-21 (1970).

¹¹ Leslie Green, *Rights of Exit*, 4 LEGAL THEORY 165, 176 (1998); see also Michael Walzer, *The Communitarian Critique of Liberalism*, 18 POL. THEORY 6, 11-12, 15-16, 21 (1990).

¹² See respectively Hanoch Dagan & Michael A. Heller, *The Liberal Commons*, 110 YALE L.J. 549, 567-70 (2001); Carolyn J. Frantz & Hanoch Dagan, *Properties of Marriage*, 104 COLUM. L. REV. 75, 85-87 (2004).

¹³ See generally Dagan & Heller, *supra* note 12.

patterns that emerge across a wide set of these institutions and show how property law provides a general set of solutions to conflicts of interest.

C. *Internalization, Democratization, and De-escalation*

Canvassing property law as a whole, we uncover three primary tools that property law has developed to manage conflicts of interest: internalizing externalities; democratizing management; and de-escalating transactions. Internalization, democratization and de-escalation solutions roughly correspond to the conflict of interest dilemmas that arise from consumption and investment, collective governance and decision-making, and policing exit from and entry into group property resources.

(1) *Internalization*. Consider cases where individuals want to transform the group resource, either by taking something out for their individual benefit, or investing something that may benefit the others. A co-owner wants to chop down trees on co-owned land, or to invest in machinery for the common enterprise; people want to invest in businesses but are worried that their associates might impose upon them excessive liabilities. In these instances, the individual's self-interest may diverge from their interest in their co-owners' or partners' welfare. Property law offers a range of doctrines for managing these conflicts.

One common approach to conflicts of interest regarding consumption of and investment in group resources is to interpose governance rules that partially or wholly concentrate the costs or benefits of such a decision on the individual. For example, the co-owner may have to account to the community for the value of trees chopped, and may be able to keep at least some of the gains attributable to his or her individual investment in the commons resource.¹⁴ Likewise, a variety of property-holding forms—such as the limited liability company, limited liability partnership, and the limited liability limited partnership—offer mechanisms allowing members to participate in management and control but also constrain the liability of members for the actions of their co-adventurers.¹⁵ By internalizing the consequences of individual decision-

¹⁴ *Id.* at 584-86.

¹⁵ See J. WILLIAM CALLISON & MAUREEN A. SULLIVAN, LIMITED LIABILITY COMPANIES: A STATE-BY-STATE GUIDE TO LAW AND PRACTICE (2003). For two representative examples, see TEX. REV. CIV. STAT. ANN. art. 6132a-1, § 3.03 (Vernon Supp. 2004) (limited partner's liability for debts of or claims against the partnership is limited to the limited partner's capital contribution to the partnership plus any additional amounts agreed to be contributed); KY. REV. STAT. ANN. §362.220 (Michie 2002) (partner in a registered limited liability partnership personally liable only for his own negligence, malpractice, wrongful acts, and misconduct).

making, property governance rules regarding consumption and investment help people take autonomous decisions regarding the group resource while preserving productive cooperation. Internalization proves to be a powerful path to managing conflicts of interest.

(2) *Democratization*. Sometimes a community may decide to reserve certain types of management decisions to the group as a whole, rather than allowing individual autonomy, say for decisions that have larger or more enduring consequences for the resource. For example, a unit owner may want the condominium to put a new roof on the building, or a spouse may want to mortgage the family house. Again, the individual owner's self-interest and their regard for the community's interest may diverge.

To address conflicts of interest that go to fundamental management decisions, property law often limits the scope of action open to individuals and shifts decision-making to a sphere of democratic self-governance. Condo owners or spouses may be disabled from acting directly. Property law instead interposes governance institutions that empower owners to act indirectly, such as through an elected condo board or through joint agreement in a community property.¹⁶ There are many such conflict-transforming institutions that align individual and group goals by aggregating individual preferences or objectives. These range from democratic participatory institutions, like a simple majority rule, to representative or hierarchical mechanisms, such as a condo board in a common interest community or a board of directors in a close corporation.¹⁷

(3) *De-escalation*. In many cases, people just don't want to manage conflicts. They want to avoid them, leave a bad relationship, and get on with their lives (or opt for exclusion and autonomy). Property law offers a range of governance tools for de-escalating the conflicts of interests that arise as people exit from and enter into cooperative property institutions. For example, rules like rights of first refusal, cooling off periods, and exit taxes are intended to ease conflicts of interest by allowing the individual to leave, but to do so in a way that is community-enhancing.¹⁸ Similarly, rules regarding who can enter a community, and the terms of entry, help to de-escalate conflicts. By exercising some control over who enters, existing

¹⁶ See respectively, e.g., RESTATEMENT (THIRD) OF SERVITUDES Ch.6 Pt. D (2000); J. Thomas Oldham, *Management of the Community Estate During an Intact Marriage*, 56 L. & CONTEMP. PROBS. 99, 112-115 (1993) (discussing representational management of community property arising by operation of law).

¹⁷ See, e.g., Henry Hansmann, *Condominium and Cooperative Housing: Transactional Efficiency, Tax Subsidies, and Tenure Choice*, 20 J. LEGAL STUD. 25 (1991).

¹⁸ See Dagan & Heller, *supra* note 12, at 598-601.

members can find new members who are relatively more likely to take a community-enhancing approach to the conflicts of interest that may arise.¹⁹

The three approaches property law employs in managing conflicts of interest—internalizing externalities around individual use and investment decisions, democratizing a set of management decisions by shifting authority from individual to group control, and de-escalating tensions around entry and exit—are ideal types, which in turn cover vastly divergent rules. Thus, for example, internalizing consumption and investment decisions by owners can be achieved by limiting access to the joint resource or by an opposing rule that allows access but then provides some accounting mechanism for costs and benefits. Democratizing management, in turn, can be accomplished by an elected hierarchical management; but it can also be reached using a more participatory set of procedures. And de-escalating tensions can be achieved by relying on exit through sales into the market, or through procedures regulating entry and exit. A restatement of the rules dealing with consumption and investment, management, and alienation across the wide range of liberal commons institutions would need to include rules of all of these types and many more.

III. A TYPOLOGY OF CONFLICTS IN PROPERTY

In this part, we show that the multiplicity of property solutions to conflicts of interest is neither chaotic nor unprincipled. Rather, these solutions can be explained by reference to the divergent “characters” of the underlying property institutions. Property law supports a wide range of institutions that facilitate the economic and social gains possible from cooperation. Some of these institutions, such as a close corporation, are mostly about economic gains—securing efficiencies of economies of scale and risk-spreading—with social benefits being merely a (sometimes pleasant) side-effect. Other institutions, such as marriage, are more about the intrinsic good of being part of a plural subject, where the *raison d’être* of the property institution refers more to one’s identity and interpersonal relationships, while the attendant economic benefits are perceived as helpful by-products, rather than the primary basis for cooperation.²⁰ The underlying character of the divergent relationships proves to be the key to explaining property law’s devices for managing conflict of interest.²¹

¹⁹ See Margaret A. McKean, *Success on the Commons: A Comparative Examination of Institutions for Common Property Resource Management*, 4 J. THEORETICAL POL. 247, 263 (1992).

²⁰ See Dagan & Frantz, *supra* note 12, at 81-84.

²¹ Notice that a public-spirited goal does not, of itself, make a property form “social” (continued...)

A. Conflict Management and the Character of Property Institutions

We begin by stating our most general proposition regarding how property law partially realigns stakeholders' interests: management rules track the economic or social character of the underlying property institution. Our distinction between economic and social is not about whether the activity is economic or not, in some absolute sense. After all, we are dealing with property institutions that always have economic implications, especially at the "end-game" when relationships break down, and people move from managing conflicts of interest to escaping them. Thus, even in the marital property context, end-game rules concern themselves primarily with economic allocation rather than facilitating social interactions. But colorful dramas at the end-game of property institutions should not obscure the daily—but ultimately more germane—mid-game life of these property institutions.²² Hence, we focus on the role of property institutions as fora for various types of interpersonal relationships. Our reference to the "character" of the property institution seeks to capture its predominant or underlying purpose.

The differing purposes of property institutions are all-important, as they should guide the rules which are needed to support the mid-game, interpersonal relationship which the underlying property institution aims to facilitate. Even rules about the end-game (partition or divorce) can be analyzed from this perspective because they can, and should, serve as background norms to channel and shape the expectations of participants in the varying property institutions at stake.²³ In other words, mid-game purposes dealing with the daily and the mundane inform end-game rules dealing with failures and pathologies. Rather than focusing analysis on the failures of these property institutions, we instead look at the core period of success, the period that provides stakeholders their predominant motivation

²¹(...continued)

in our taxonomy if this goal is mostly *external* to the members' relationships *inter se*. For this reason, it should not be surprising that the prevalent institutional form of nonprofit organizations is business-like. See, e.g., Evelyn Brody, *Institutional Dissonance in the Nonprofit Sector*, 41 VILL. L. REV. 433 (1996); Eugene F. Fama & Michael C. Jenson, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 318-21(1983); James J. Fishman, *The Development of Nonprofit Corporation Law and an Agenda for Reform*, 34 EMORY L.J. 617 (1985).

²² For the claim that instead of focusing on law's pathologies, lawyers should turn their attention to the way it functions in people's daily lives, see H.L.A. HART, *THE CONCEPT OF LAW* 79-88 (1961).

²³ See Dagan & Heller, *supra* note 12, at 597-98; Frantz & Dagan, *supra* note 12, at 95-98.

for entering the relationship, and that structures the rules for conflicts management.

In many contexts the economic and social mid-game purposes tend to reinforce one another because interpersonal capital facilitates trust, which, in turn, gives rise to economic success, and economic success tends to strengthen trust and mutual responsibility.²⁴ But at times economic success and social cohesion push in different directions. While neither front can be wholly abandoned—because either total economic failure or the collapse of social cohesion will effectively end cooperative resource management—different property institutions (from close corporations to families) allow differing emphases for economic success and social cohesion. More precisely, for property institutions at the economic end of the spectrum, ideal-typic parties to conflicts of interests are (implicitly) conceptualized by law as “absentee investors”; by contrast, at the social end, they are “active participants.”

As property institutions approach the economic pole of the spectrum, the more likely it is that stakeholders will be treated as “absentee investors,” interested in maximizing profit while minimizing their daily involvement.²⁵ This implicit conceptualization affects the nature of the legal rules regulating potential conflicts of interest in all three decisional spheres. Concerns about potential conflicts of interests regarding the sphere of individual consumption and investment decisions—concerns about internalizing costs of over-use and under-investment—will be solved by limiting access to the resource. Potential conflicts of interests in the sphere of democratizing management decisions, in turn, are likely to be handled by setting hierarchical and formal procedures. And in the third sphere of transactions, de-escalating conflicts, there will be little internal control because market transactions provide ample policing against the external effects of stakeholders’ decisions.

By contrast, the closer a property institution is to the social pole, the more stakeholders are increasingly understood—by themselves and by others—as active participants in a joint endeavor, members in a purposive community. Thus, concerns about over-use and under-investment can no longer be solved by limiting access. The law must set what we call a sphere of “individual dominion”—a realm of decisions regarding consumption and investment that a member can take on her own. In this realm, the potential abuses of over-use and under-investment must be regulated head-on by

²⁴ See Philip Pettit, *The Cunning of Trust*, 24 PHIL. & PUB. AFF. 202, 209-10 (1995).

²⁵ See, e.g., Henry Hansmann & Rainer Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387, 423-25 (2000); MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE 4-8, *passim* (1994).

setting accounting rules that protect against such opportunism. Furthermore, when we get to the sphere of more fundamental managerial decisions, hierarchies become—at least in liberal legal environments—increasingly unacceptable. Where the economic aspect is tangential to the role of the joint resource as a focal point of a community’s self-identification, participatory procedures are called for. The closer a property institution is to the social pole, the higher the emphasis is on voice; the more likely, in other words, that we will find a republican governance regime in which joint management is not only a means to the end of maximizing yield, but also a forum and a medium of community-building. Finally, in these types of property institutions the market does not provide sufficient protection against external effects in stakeholders’ transactional decisions. The more social it is, the higher are the risks of opportunistic exit and entry. Thus, the more social it is, the more collective control we see over exit and entry. Supporting predominantly social property institutions requires legal mechanisms aimed at policing opportunistic exit and preempting opportunistic entrants.²⁶

As these sketches suggest, the economic/social spectrum informs the animating values that drive law’s solutions to conflict of interest problems. The discussion below develops the argument by showing that this spectrum helps explain, and indeed justify, many of the rules addressing problems of conflict of interest in consumption and investment, management, and alienation of group resources. In other words, situating legal rules in context transforms seeming chaos into a coherent legal landscape.

B. Addressing Consumption and Investment

Legal rules addressing conflicts of interests in the context of consumption and investment by individual stakeholders take three main forms: limiting access to the joint resource; providing for an accounting based on the relative contribution of the individual parties; and prescribing a regime which collectivizes their individual inputs and outputs. Each form is based on a specific understanding of the parties’ relationship and will be ill-suited if transplanted in an alien context.

As a corner case, beyond the direct scope of the Article, consider a shareholder in a publicly held corporation. Such a shareholder is precluded from having access to the assets of the firm: she can neither consume these resources nor make any (individual) decisions regarding investment in

²⁶ See Dagan & Heller, *supra* note 12, at 567, *passim*.

them.²⁷ Other stakeholders in property institutions do have some access to the joint resource, but the scope of their rights to consume and invest, and, even more importantly, the legal consequences following such individual acts vary significantly.²⁸ More specifically, as we shift from economic to social, we are shifting away from simple stakeholding and towards a more robust set of rights and responsibilities. In between the absentee owner and the spouse, we can find cases of active members in “Lockean communities” – communities committed to awarding rights or wages to those who contribute to the collectivity by engaging in purposeful value-creating activities.²⁹ In such cases, contribution-based accounting rules safeguard the community against abuses of the decision-making power in consumption and investment decisions. Then, at the furthest social end of the spectrum—marital property—not only is the realm of individual involvement the widest, but it is also the most egalitarian.³⁰

The law of co-ownership provides a nice example of a Lockean community. Internalization typifies the regulation of consumption and investment decisions in both common law and civil law traditions. This mechanism is firmly established in the Continental tradition with clear rules prescribing liability for the fair market value for use³¹ and an entitlement to pro rata contribution for investment in preservation of the common resource.³² The rules of the common law fall short in some respects: liability for use is contingent upon the ouster of the absentee commoner;³³ and the entitlement to contribution is in most cases deferred up until the

²⁷ See, e.g., MODEL BUS. CORP. ACT §§ 6.30, 6.40, 8.01 (1998); see also ROBERT CHARLES CLARK, CORPORATE LAW § 3.2.1 (1986) (directors have formal legal authority to manage corporation); Hansmann & Kraakman, *supra* note 24; but compare DEL. CODE ANN., TIT. 8, § 351 (allowing charter of close corporations to indicate management by owners rather than board of directors); N.Y. BUS. CORP. LAW § 620 (2004) (allowing more robust ownership voting control over directors in corporations whose shares are not traded on national securities exchanges or regularly quoted in an over-the-counter market)

²⁸ Dagan & Heller, *supra* note 12, at 582-90; see also BROMBERG & RIBSTEIN ON PARTNERSHIPS § 3.04-3.05 (2004) (discussing abiding ambiguity in model partnership acts between “aggregate” and “entity” theories of property holding).

²⁹ See STEPHEN BUCKLE, NATURAL LAW AND THE THEORY OF PROPERTY 149-52 (1991) (discussing Lockean justification for property rights as reward for productive labor); STEPHEN R. MUNZER, A THEORY OF PROPERTY 255-67, 285-87 (1990) (pointing to the centrality of desert for labor to the justification for private property.)

³⁰ See Frantz & Dagan, *supra* note 12, at 126-32.

³¹ See, e.g., ISRAEL LAND LAW § 33, 1959, 23 L.S.I. 288, (1968-1969).

³² See § 748 BGB, translated in THE GERMAN CIVIL CODE 122 (Ian S. Forrester et al., trans., 1975); ISRAEL LAND LAW § 32.

³³ See, e.g., 2 AMERICAN LAW OF PROPERTY § 6.13, at 52-54 (A. James Casner ed., 1952).

time of partition.³⁴ These differences are not insignificant.³⁵ But for our purposes the similarities are much more important. Both traditions allow individual commoners access to the common resource for the purposes of consumption and investment. Both therefore need to set internalization rules that manage the resulting conflicts of interests which come about from the divergence between the self-interest of the individual commoner and the collective interest. And—our main point here—these internalization rules assume a Lockean baseline, which is the premise of law’s accounting procedure, calculating individual inputs and outputs.

Compare this scheme with the law of marital property. As a liberal commons institution, marital property law is also concerned with possible conflicts of interests between spouses in their investment decisions in the marital estate. But while the rhetoric of individual contribution still pervades marital property law, its actual doctrine has very little to do with the Lockean desert-for-labor principle.³⁶ Instead of an accounting mechanism of individual inputs and outputs, the most basic norm of marital property law is equal division upon divorce.³⁷ This norm takes different forms in different jurisdictions—a bright line rule, a presumption, or a “starting point” which applies at the very least with regard to the family home.³⁸ What is important for our purposes here is again the common denominator of these different doctrines: their rejection of the accounting logic of Lockean baselines. A rule of equal property division on divorce discourages keeping an accounting of individual investments in and returns from the marital relationship. Contrariwise, equal division makes it easier for spouses to engage in sharing behavior that typifies marriage—investing in relationship-specific goods, specializing, and making individual sacrifices for the overall good of the marital community. Spreading the benefits and the risks of this kind of behavior equally between the parties transforms personal sacrifice into joint endeavor.³⁹

The same egalitarian premise, but with a twist, applies to potential conflicts of interest in the consumption of marital assets. The basic rule follows the fundamental premise of sharing with no accounting by allowing

³⁴ See, e.g., ROGER A. CUNNINGHAM ET AL., *THE LAW OF PROPERTY* § 5.9, at 215-16 (2d ed. 1993).

³⁵ See Dagan & Heller, *supra* note 12, at 611-13.

³⁶ See Frantz & Dagan, *supra* note 12, at 89-90.

³⁷ See, e.g., Martha Garrison, *The Economic Consequences of Divorce: Would Adoption of the ALI Principles Improve Current Outcomes?*, 8 *DUKE J. GENDER LAW & POL’Y* 119, 124 (2001).

³⁸ See Frantz & Dagan, *supra* note 12, at 101.

³⁹ *Id.* at 104.

normal consumption by a spouse even if it is not equal to the consumption of the other spouse. But in order to protect a daily routine of no accounting, marital property law also anticipates the pathological cases and protects each individual spouse from abusive consumption choices by the other. Hence, it also includes an ancillary rule which provides remedies for extremely irresponsible or overly self-interested consumption decisions, such as in cases of gambling, drinking, and drug-use, which tend both to benefit one spouse disproportionately and to threaten the integrity of the marital estate.⁴⁰

C. Regulating Collective Decision-Making

Paralleling the shift in underlying values guiding conflicts management, we also see a shift in the style of decision-making, moving from formal and hierarchical to informal and participatory. Predominantly economic property institutions are usually highly formal and hierarchical. Here, the regulation of conflicts of interests in the context of management decisions is addressed by *ex ante* rules setting governing bodies, allocating powers among them, and prescribing procedures for their routinized operation.⁴¹ These rules are typically foreground rules: rules that stakeholders and legal players alike expect to be deployed in the daily life of the property institution at stake (and not only during the end-game, which is inevitably legal).

By contrast, predominantly social property institutions are highly informal and participatory. Parties to neighborly relationships often find formalistic decision-making and resort to law to be the beginning of the end.⁴² So, if law is to facilitate such property institutions, it needs to act in softer ways by setting more participatory and looser procedures. Governance in these contexts is understood not only instrumentally, but also as a means to intensify the parties' inter-personal relations. Hence, republican participatory governance substitutes for the top-down

⁴⁰ See Oldham, *supra* note 16, at 161-64.

⁴¹ See, e.g., Zohar Goshen, *The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality*, 91 CALIF. L. REV. 393, 401-08 (2003); 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 (1999); Frank H. Easterbrook & Daniel Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271 (1986); Eugene F. Fama & Michael C. Jensen, *Agency Problems and Residual Claims*, 26 J.L. & ECON. 327 (1983).

⁴² See, e.g., ROBERT C. ELLICKSON, *ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES* 60-64, 69, 76, 274 (1991); Elizabeth S. Scott & Robert E. Scott, *Marriage as Relational Contract*, 84 VA. L. REV. 1225, 1285-87, 1294-95 (1998).

governance of purely economic property institutions.⁴³ Furthermore, instead of foreground rules, law typically employs background regimes for consensual decision-making. Thus, a majority rule can provide a safety net against the potential abuse of holdout.⁴⁴ Similarly, incentives for third-parties can help police the community's governance rules indirectly by voiding decisions regarding the common resource that were not reached by the appropriate majority or through the appropriate procedures.⁴⁵

At first sight, it may seem that the effect of the character of property institutions on law's internalization mechanisms is a matter of substance, whereas its effect on law's democratization mechanisms is a matter of form. While the form/substance dichotomy maps to a large extent to these different mechanisms, it would be incorrect to ignore the ways in which management rules (democratization) implicate substance and consumption and investment rules (internalization) implicate form. Thus, the norm of equality that typifies the social end of our spectrum informs not only substantive rights of spouses, but also their voting rights. For instance, voice is not related to contribution in marriage.⁴⁶ On the other hand, not only law's democratization mechanisms for regulating potential conflicts of interests in management decisions function as safety nets in the background of the parties' relationships. Law's accounting rules governing consumption and investment decisions also function in a similar way, affecting the parties' behavior and expectations and protecting them from abuse, rather than regulating their daily life.⁴⁷

But our focus in this section is on democratization: the differing ways in which property law addresses conflicts of interest that go to fundamental management decisions by setting procedures of collective management. The law of common interest communities provides a rich example for a formal and hierarchical management regime which typifies predominantly economic property institutions. A common interest community has the powers to manage the common property and administer the servitude regime of a real-estate development or neighborhood.⁴⁸ It can raise funds (by way of assessment of fees); manage, acquire, and improve common property; adopt rules governing use of property; and set

⁴³ See McKean, *supra* note 19, at 258, 260-61.

⁴⁴ See Dagan & Heller, *supra* note 12, at 577-79.

⁴⁵ See generally Dagan, *supra* note 9, at 1535-50.

⁴⁶ See Frantz & Dagan, *supra* note 12, at 103-06.

⁴⁷ See Dagan & Heller, *supra* note 12, at 578.

⁴⁸ See RESTATEMENT (THIRD) OF SERVITUDES §§ 6.4, 6.2(1) (2000).

procedures to encourage compliance and deter violations.⁴⁹ A common interest community is managed by an association, which is in turn governed for most purposes by a representative government: a board elected by its members. The board is entitled “to exercise all powers of the community except those reserved to the members,” and members have “the right to vote in elections for the board of directors and on other matters properly presented to [them], to attend and participate in meetings of the members, and to stand for election to the board of directors. Except when the board properly meets in executive session, [members] are [also] entitled to attend meetings of the board of directors and to a reasonable opportunity to present their views to the board.”⁵⁰

Compare this formal and hierarchical management structure to the informal and participatory regime applicable in predominantly social property. One example comes from the governance of commons property in the Continental tradition, in which the law prescribes only a basic norm of majority rule, accompanied by open-ended rules of disclosure, consultation, and fair hearing.⁵¹ Another example comes from the rules community property law prescribes for the governance of marital property.⁵² Transactions in the marital estate that involve substantial amounts of money (such as a community real estate or business) or resources that reflect the group-identity of the marital community and the personhood of its members (again, the marital residence, but also its contents) require joinder.⁵³ Joinder is desirable in these context to ensure that decisions indeed reflect the communal goods; to manage, in other words, the potential conflict between the interest of each individual spouse and the collective good. The joinder rule is a background rule. It neither prescribes any specific governance procedure, nor does it require judicial intervention within a functioning marriage. Rather, in most cases where joinder is required, banks and other third-parties are recruited to police conflicts of interest. Where such third parties realize that effective transactions require joinder, they are likely to require joinder before they enter into the pertinent transaction with a spouse, thus indirectly preventing self-serving violations of the community.⁵⁴

⁴⁹ See *id.* at §§ 6.5-6.8.

⁵⁰ *Id.* at §§ 6.2(3), 6.16, 6.18 (2000).

⁵¹ See Dagan & Heller, *supra* note 12, at 615-16.

⁵² A somewhat similar analysis applies in the majority of common law jurisdictions that recognize the tenancy by the entirety. See Dagan, *supra* note 9, at 1524, *passim*.

⁵³ See Frantz & Dagan, *supra* note 12, at 126.

⁵⁴ See, e.g., JOHN P. DWYER & PETER S. MENELL, PROPERTY LAW AND POLICY: A (continued...)

D. Policing Exit and Entry

Decisions to sell (or buy) a share in the common resource can affect the well-being of the community and thus may give rise to worries of conflicts of interest. Yet, where predominantly economic property institutions are at issue, the pricing mechanism of the market sufficiently polices against abuse, so that there is no further need for a more fine-tuned de-escalating mechanism. This is indeed the law in the limiting case of our inquiry: publicly-held corporations.⁵⁵ As we move towards the pole of predominantly social institutions, things become more complicated. With respect to these property institutions, social cohesion is an increasingly important part of the value of the common resource, both to the remaining commoners and to the potential entrants. Here, to protect the community from opportunistic exit, we find rules aimed at ameliorating such potential conflicts of interest.

With some liberal commons institutions, these mechanisms take the form of moderate alienation restraints that protect cooperation values. Thus, one way to manage conflicts of interests in property institutions is by prescribing cooling off periods. This technique applies in many co-ownership settings⁵⁶ and was recently introduced (albeit in a controversial fashion) in some states that provide for waiting periods before divorce.⁵⁷ Cooling off periods can help ameliorate the damaging domino effect of defection in consumption and investment decisions. Such “grace periods” are, at times, enough to support the parties’ continued trust and

⁵⁴(...continued)

COMPARATIVE INSTITUTIONAL PERSPECTIVE 218 (1998).

⁵⁵ In these institutions, the presumption in favor of free alienability can even extend to sales of controlling blocks of shares, which may allow large blockholders to capture arguably disproportionate premia for the sale of control. Cf. Frank E. Easterbrook & Daniel Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 715-19 (1982) (arguing in favor of “market rule”).

⁵⁶ For example, Israel law sets a time limitation of five years for agreements restraining alienation, and prescribes that the time limit on agreements restraining partition is left to the discretion of the court—after three years, the court may order partition despite the agreement if the court deems it just to do so is. See ISRAEL LAND LAW §§ 34(b), 37(b).

⁵⁷ Covenant marriage, first adopted in Louisiana, is one well-known example of waiting periods for divorce. LA. CIV. CODE ANN. 9:272-75.1, 307-09 (West 2000). To the extent that covenant marriage does not allow immediate exit from emotionally or psychologically abusive relationships, it is obviously unsupportable. See Jeanne Louise Carriere, “*It’s Deja Vu All Over Again*”: *The Covenant Marriage Act in Popular Cultural Perception and Legal Reality*, 72 TUL. L. REV. 1701 (1998).

cooperation even if fully “rational” parties would behave cooperatively only in indefinite games.⁵⁸

Similarly, exit taxes that monetize the destructive effects of exit (the costs of recruitment and socialization of a replacement commoner) and are properly attuned to deter opportunistic departure,⁵⁹ can also serve as legitimate background rules that create more safety nets for community to work. The shift in marital property law from title theory through contribution theory to the increasingly prevalent norm of equal division upon divorce can be analyzed as an important example for such a virtuous exit tax.

Finally, de-escalating the conflicts of interests generated by exit decisions and policing against opportunistic entry may require entry-control mechanisms, such as a right of first refusal. This technique—applied notably in the contexts of condominiums and cooperatives⁶⁰—allows the group some degree of control over the identity of future transferees of the current commoners by screening non-cooperative entrants. By doing so, they also prevent exploitation by exiters who may be motivated either by spite or by the possibility of side payments from remaining members to ensure cooperative replacements.

These three techniques—cooling off periods, exit taxes, and entry-control—constitute a rich repertoire of de-escalating strategies for addressing the potential conflicts of interests generated by a member’s decision to exit. But the context of exit raises another potential conflict of interest—a mirror-image of the one we thus far discussed, namely the fear that the exiter (or any individual commoner, for that matter) will be opportunistically diluted by other members of the community (the majority). Here again, insofar as predominantly economic property institutions are concerned, the pricing mechanism of the market provides a sufficient policing mechanism so that there is no need for any further de-escalating technique. But as we move to the more social property institutions, the market may not be enough. In those contexts, sale may not sufficiently protect against opportunistic dilution, because it can be expected to under-value the pro rata ownership share of the exiter. This undervaluation is increasingly likely and significant as the social benefits

⁵⁸ Cf. MARTIN J. OSBORNE & ARIEL RUBINSTEIN, *A COURSE IN GAME THEORY* 135 (1994).

⁵⁹ A complicated matter, to be sure. See Dagan & Heller, *supra* note 12, at 600-01.

⁶⁰ See Mark D. Rosen, *The Outer Limits of Community Self-Governance in Residential Associations, Municipalities, and Indian Country: A Liberal Theory*, 84 VA. L. REV. 1053, 1099-101, 1126-27 (1998); Gregory S. Alexander, *Dilemmas of Group Autonomy: Residential Associations and Community*, 75 CORNELL L. REV. 14-15, 50-53 (1989); Hansmann, *supra* note 17, at 31-32.

of cooperation, and the role of participatory management, become more central to the commons resource, such as in the contexts of co-ownership and partnership. Because allowing a departing individual to break up the property institution is, in these contexts, the only way of policing against such an opportunism and preserving people's right to exit, the doctrine governing these contexts provides an inalienable right (which can be limited only temporarily) to partition or dissolution.⁶¹

IV. CONCLUDING REMARKS

Once released from the straightjacket of exclusion theory, property law provides a fertile ground for inquiries about conflicts of interest. Because property is just as much about cooperation as it is about competition—because property law regulates governance at least as much as it addresses exclusion—property scholars need to begin thinking about management mechanisms for conflicts of interest. Managing conflicts is the inevitable price of cooperative property institutions. To be sure, avoiding and escaping conflicts of interests are, and should be, important legal responses. Nothing in what we have claimed in this Article argues against the centrality of the fee simple absolute or against the availability of exit—by sale and, where needed, even by dissolution. However, in an increasingly interdependent world, people frequently want or need to work together, but worry that others may take advantage of them. Property governance, properly understood as a set of techniques for managing conflicts of interests in liberal commons institutions, is law's response to this challenge.

Property law employs three types of techniques for the partial realignment of stakeholders' interests: internalization, democratization, and de-escalation. And the specific form of each technique is, by and large, fine-tuned to the character of the pertinent property institution. Table 1, below, reorganizes and summarizes our claims on this matter. Of course, as we mentioned throughout, economic and social aspects inhere in every property governance form, so what we present as a dichotomy exists as a spectrum. Also, there is not a necessary link between each mode of managing conflicts in property and each sphere of property governance. These associations are typical, but not inevitable.

⁶¹ See respectively JOHN E. CRIBBET & CORWIN W. JOHNSON, PRINCIPLES OF THE LAW OF PROPERTY 114 (3d ed. 1989) (only agreements by co-owners not to partition which do not amount to restraint on alienation are enforceable and only for limited time); REVISED UNIFORM PARTNERSHIP ACT § 801(a) (1996) (dissolution of partnership at will); BROMBERG & RIBSTEIN, *supra* note 28, at § 7.01(a) (discussing right of dissolution at will as expressive of root norm of *delectus personarum*, that partners choose their associates).

	Economic	Social
1. Internalization/ Consumption and Investment	limiting access	accounting (from contribution to equality)
2. Democratization/ Management	formal & hierarchical	informal & participatory
3. De-Escalation/ Entry and Exit	market transactions	some internal collective control

TABLE 1: *Managing Conflicts of Interest in Property*

We hope to have taken here the first steps towards a better understanding of the ways in which property law deals with—avoids and escapes, but also manages—conflicts of interests. As a by-product, this inquiry may have also yielded a lesson regarding the concept of conflicts of interest itself, which may have applications beyond the context of property. We therefore conclude with the following thought, which we hope to develop in our future work.

Maybe the spectrum of solutions we have identified is not just a matter of varying manifestations of conflicts of interest, but is rather explained by the very different nature of such conflicts as one moves along the economic/social spectrum. By including different relationships between the active individual and the interest which is threatened by a conflict of interest, our spectrum reveals very different understandings (or conceptions) of the problem of conflicts of interest itself.⁶²

On the one pole – the predominantly economic – conflicts are between the well-defined interest of an individual *qua* individual and the expectation that the individual will represent the collective interest the person is assigned to represent. Limiting access (or a Lockean accounting), hierarchical and formal governance, and market-based de-escalation devices are fine solutions to problems of conflicts of interests understood within the paradigm of an I/We dichotomy.

As one moves along the spectrum towards the more social contexts, this conceptualization of the problem of conflict of interest is increasingly

⁶² Cf. Ariel Porat, *The Many Faces of Negligence*, 4 THEORETICAL INQ. L. 105 (2003) (arguing that negligence law should be reconsidered to account for the variety of balancing of interest dilemmas that are regulated through tort liability).

problematic because its implicit dichotomy between I and you (or we), and mine and yours (or ours), becomes increasingly reductive. At the social pole of the spectrum (e.g., marriage) conflicts of interest are, to an extent, *internal* to the individual actor, because the group is also part of the actor's own self-understanding.⁶³ As the plural identity of the collective group becomes a more constitutive element of each individual's self-understanding, applying predominantly economic understandings of, and responses to, conflicts of interest threatens to undermine rather than advance the good that the property institution is designed to encourage. Law's tools for internalization, democratization and de-escalation in these contexts – equal sharing, informal and participatory governance, and collective mechanisms for regulating exit and entry – appropriately mirror their social character.

More generally, property law's varied solutions to conflicts of interest respond to these underlying differences in the nature of the group resource dilemma. Perfectly plausible solutions to conflicts of interests in predominantly economic property institutions are increasingly ill-suited to more social property institutions (and vice versa). The inventory of management techniques employed by property law may seem at first sight confusing, almost chaotic. The conflicts of interest lens opens a new and challenging perspective that brings focus to this doctrinal muddle.

⁶³ See, e.g., MARGARET GILBERT, *LIVING TOGETHER: RATIONALITY, SOCIALITY, AND OBLIGATION* 2, 8 (1996); ELIZABETH ANDERSON, *VALUE IN ETHICS AND ECONOMICS* 151 (1993); MILTON C. REGAN, JR., *FAMILY LAW AND THE PURSUIT OF INTIMACY* 147 (1993).