Making and Unmaking Property Rights: A Window into the Genesis of Law

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Abstract

This paper examines three cases where property (or in rem) rights are currently being made from contract (in personam) rights or the reverse. The cases examined are: (i) the introduction of trust legislation into civil law jurisdictions to create a proprietary separation of loan contracts from their cash flows transferred by a bank to an issuer for securitization, (ii) the introduction of property rights with purely in personam characteristics to support modern systems for the transfer of securities on stock exchanges, and (iii) the interpretation of shareholder rights against a stock corporation as purely contractual to move shareholder interests out of its centrality for corporate activity.

In the first case, a division of property rights between bank settlor and securitization trustee achieves the “remoteness” necessary for a “true sale” of assets. In the second case, a re-characterization of the relationship between accountholder and securities custodian creates negotiability of book entries and provides increased protection for accountholder against a custodian’s creditors. In the third case, a re-characterization of shares as contracts rather than proprietary interests serves to weaken the role of shareholders, and thus socially unattractive short-term profit maximization as a corporate goal.

Our examination of these three cases of making and unmaking property rights provide a window into the genetic event of law, as interests achieve legitimacy through rational argument within the systemic coherence of a legal system as allowed by a given culture.

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* Professor, Faculty of Law, Chinese University of Hong Kong. The author would like to thank the Hong Kong Research Grants Council for the generous funding of this work under the Theme Based Research Project, “Enhancing Hong Kong’s Future as a Leading International Financial Centre” (T31–717/12–R).

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I. INTRODUCTION: MAKING PROPERTY

A. Property arises from an artifice of justice

Property is of interest to everyone, although everyone’s views on property may differ. Protection of property rights is understood as the foundation of social stability. These rights lead to and derive from social balance, yet they also lead to social inequality. In one form, they enable commerce, but in another they can also impede it. There is considerable agreement that property rights are “made” although there is disagreement about whether this making occurs through unilateral assertion or recognized law. An early view containing recently debated elements is offered by Hume, who sees spontaneous conventions formed into property rights through law:

After this convention, concerning abstinence from the possessions of others, is entered into, and every one has acquired a stability in his possessions, there immediately arise the ideas of justice and injustice…. Our property is nothing but those goods, whose constant possession is established by the laws of society; that is, by the laws of justice. Those, therefore, who make use of the words property, or right, or obligation, before they have explained the origin of justice, or even make use of them in that explication, are guilty of a very gross fallacy, and can never reason upon any solid foundation. A man's property is some object related to him. This relation is not natural, but moral, and founded on justice. It is very preposterous, therefore, to imagine, that we can have any idea of property, without fully comprehending the nature of justice, and shewing its origin in the artifice and contrivance of man. The origin of justice explains that of property. The same artifice gives rise to both.

The relationship between the “conventions” and the “rights” to which Hume refers, and how the former develops into the latter under action of “justice,” are very interesting matters that we will not address this paper. The status of such conventions vis-à-vis announced law

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1 As James Madison observed in 1787: “The diversity in the faculties of men, from which the rights of property originate, is … an insuperable obstacle to a uniformity of interests. The protection of these faculties is the first object of government.” James Madison, Federalist 10, in ALEXANDER HAMILTON, JAMES; MADISON & JOHN JAY, THE FEDERALIST PAPERS (1788).
2 ADAM SMITH, THE WEALTH OF NATIONS BY ADAM SMITH: AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS, Book V, Ch. 1, Pt. 2 (1776) (“Wherever there is a great property, there is great inequality.”), also see Madison, supra note [●] for agreement.
3 Geoff Hodgson explains how the removal of feudal restrictions on the transfer of property in England contributed to the use of such property as collateral and helped to kick start the industrial revolution. See Geoffrey M. Hodgson, “1688 and All That: Property Rights, the Glorious Revolution and the Rise of British Capitalism” 6-8 (March, 2016).
4 DAVID HUME, A TREATISE OF HUMAN NATURE, BOOK III, Sec. 2, Pt. 2 (1740).
5 Calebresi and Melamed formulated the relationship powerfully: “much of what is generally called private property can be viewed as an entitlement which is protected by a property rule.” Guido Calabresi & A.
is a matter discussed ambiguously not only by economists, but also in the traditional treatment of common law, where the law is considered to arise even prior to the judicial decision declaring it, although scholars of common law do not explicitly assert that such conventions are enforceable prior to court acceptance. The possibility of conventions being accepted as law has been strongly limited by the general acceptance of the legal positivists, where announcement by an authorized institution is the most important characteristic of law.

Instead of investigating where on the continuum between informal and formal institutions law arises (when a “convention” turns into a “right”), we will examine why and how such rights take the shape they do. That is, we will heed Hume’s warning that it “is very preposterous … to imagine, that we can have any idea of property, without fully comprehending the nature of justice,” taking the liberty of translating Hume’s concept of “justice” in this context into the term “lawmaking”. To comprehend the action of this lawmaking that makes property, we examine the “artifice” that Hume argues to give rise to both justice and property, an action which has generally been understood in terms of social utility. In the three cases we examine, property rights are either in, or under pressure to commence, transition. The “artifice” applied to these rights-in-transition is undertaken for specific reasons. North puts it very well: “Rulers devised property rights in their own interests.” In our first case study, that interest is to achieve full segregation of loans from


7 See e.g., MATTHEW HALE, THE HISTORY OF THE COMMON LAW OF ENGLAND (1971), where he explains that “Usage and Custom generally receiv’d, do Obtinere vim Legis [obtain the force of law]” (at 44) and one type of judicial decision are those which “seem to have no other Guide but the common Reason of the Thing” (at 46). For a more modern view, see MELVIN A. EISENBERG, THE NATURE OF THE COMMON LAW 154 (1988) (common law consists of “the rules that would be generated at the present moment by application of the institutional principles of adjudication”).

8 This is a tricky point, as a reason why the retroactive application of the common law by a court (rule X applied to 2005 contract breach in 2007) can be considered fair is that the parties should have already known the rule two years before the court announced it, in light of the fact that the rule was previously included in the society’s unwritten understanding of justice. See Eisenberg, supra note [●], at 10.


lender for regulatory and rating purposes. In the second, the interest is to promote and solidify a new centrality of intermediaries in the shareholdings of investors. In the third, the interest is to dislodge shareholders from their historical centrality as prime beneficiaries of the duties of corporate directors. In each of these cases, the transition in question is not between no right and a property right, but between property right and contract right.

B. Rights in things and rights against people

There are significant differences between claims arising from property rights and those arising from contract rights. As Hohfeld put it in 1917, a contract right, “(right in personam) is either a unique right residing in a person (or group of persons) and availing against a single person (or single group of persons),” while a property right “(right in rem) is always one of a large class of fundamentally similar yet separate rights, actual and potential, residing in a single person (or single group of persons) but availing respectively against persons constituting a very large and indefinite class of people.” A number of robust theories have been offered to explain why, in a given situation, either property or contract rights would better apply. These include social costs, transaction costs, and information costs. We examine a cause which is related to each of these, but finds its strategic contextualization within the legal system rather than at the intersection of social or economic efficiency and law. Merrill and Smith list a few of the contexts where such strategic arguments about property and contract rights arise:

In constitutional law, property rights have been characterized as contracts in order to take advantage of the Contracts Clause, while contracts have been characterized as property in order to seek shelter under the Takings Clause. Tenants’ rights lawyers have advocated replacing rules based on property with rules grounded in contract, while welfare rights lawyers have urged that government promises of benefits be deemed a species of property. For their part, corporate lawyers have helped create new financial markets by bundling together contract rights as “securitized” property, while extending the scope of protection for intellectual property through the creative use of “shrinkwrap” contracts. Meanwhile, legal academics carry on debates about whether institutions like

14 Calebresi & Melamed, *supra note [●].*
corporations, bankruptcy, and trusts should be conceived of as being a nexus of contracts or a specialized type of property regime.\textsuperscript{16}

In none of the cases we examine do considerations like those referred to in the above quotation align with social efficiency. Rather, in each case a nonessential aspect of a property right (in two cases, treatment in bankruptcy law and in one, the magnitude of directors’ duties) is seen as desirable or undesirable and efforts are made to change the status quo.

\textbf{C. The “logic” of the law is not always Logic}

By rephrasing Holmes’ famous characterization of the common law in the title of this Section, we mean to emphasize that we think the organic, evolutionary experience that Holmes saw as so important for the common law will have a very particular pattern of constituting elements driven by the motivations observed by North. The drive of desire will have to be translated into the reason of a discipline, and the manner in which this is done will take different shapes in different circumstances. Those circumstances will be dictated by time, place and the culture that comes with them.

When a new right arises or an old right is phased out there will be some interest behind this movement, some utility. Utility will have to be brought to law-making legitimacy of the institution declaring the right to exist or be absent. Doctrinal consistency will also be important to a certain degree, but this element does not have equal importance in every jurisdiction at all times. Some of our most important legal concepts are doctrinal nonsense. For example, the concept of “negotiability” that supports trade in securities means that a transferor may “confer on a transferee a better title than that of the transferor.”\textsuperscript{17} That is, A has a negotiable instrument, which B steals and having no title whatsoever to the instrument sells it to C without the latter’s knowledge of the theft, giving C good title. This is magic, not logic, but it serves the important interest of a working payment system, and is therefore law. A related piece of nonlogic is the elimination of the \textit{ultra vires} principle in corporate law. If a person has no capacity, it cannot enter into a binding contract. Yet because lack of capacity had been used in the past by corporations whose objects did not allow them to enter into certain contracts to deny unprofitable contracts, law now consistently makes such contracts


\textsuperscript{17} BENJAMIN GEVA, \textit{THE PAYMENT ORDER OF ANTIQUITY AND THE MIDDLE AGES: A LEGAL HISTORY} 553 (2011).
binding on the corporation even where it lacks all capacity to enter into the agreement.\textsuperscript{18} Restated, a person for which it is impossible to enter into a contract is held to be able to do so because such impossibility was understood to be a potential source of abuse. Again, this is legal nonsense, but it is nevertheless generally accepted law. As a result, one cannot always count on doctrinal consistency when evaluating a change in the law.

The institution concerned will affect the approach taken to bring about change. Two of the property rights we discuss were announced by legislative action, so that institutional legitimacy is impeccable and the need for doctrinal consistency reduced. In each of these cases, doctrinal and systematic inconsistencies exist. The Chinese trust law triggers internal consistency within the enacted property law regime, which presents a serious challenge, particularly in a civil law jurisdiction. The U.S. state laws turning claims on accounts into a property right presents serious inconsistency with the doctrinal understanding of property, but does so in a culture that has not traditionally found doctrinal coherence of major importance. The case we examine where scholars are arguing against a traditional classification of a shareholder as owner of a corporation opposes a well-recognized social and ethical argument against a relatively obscure type of property right that is declared only in case law. Under the right factual circumstances, a court could decide to eliminate the property right if the academic arguments have satisfactorily conditioned the atmosphere of ideas. This probability is, however, significantly weakened by a major problem of systemic relationships. Removing shareholders as corporate owners would likely mean that corporations constituting a major part of national private assets would become ownerless.

Each of these factors considered in evaluating an attempt to make or unmake property – utility, the institution and doctrinal consistency – benefit from further introduction. Utility is a public choice point: where support exists for a given change, the probability of that change succeeding is higher. Institutional backing links in the jurisprudential position of legal positivism: we define law primarily as that product produced by institutions legitimately entrusted to produce law. The importance of doctrinal consistency is greatly dependent on culture. Both China and the United States are for very different reasons highly pragmatic in their approach to the importance of doctrinal consistency. Europe, including the United States, is

\textsuperscript{18} See e.g., Delaware General Corporation Law, sec. 124; UK Companies Act 2006, sec. 39; German Stock Corporation Act, sec. 82.
Kingdom, shows a higher degree of respect for arguments that law should have internal, doctrinal coherence. This last point is a matter for comparative law.\textsuperscript{19}

Part II of this paper examines the introduction of trust legislation into the civil law system of mainland China to create a proprietary separation of loan contracts from their cash flows transferred by a bank to an issuer for securitization. This change has been made without amending elements of the Chinese legal system which contradict the new property right’s existence, leaving the transition from contract to property open to reasonable doubt. Part III looks at the introduction of property rights with purely \textit{in personam} characteristics to support an intermediated system for the transfer of listed securities. The creation of this intermediated system was understood to have a number of negative externalities, such as disrupting communications between company and shareholders and undermining the investor’s property right in securities purchased. The change from contract to property aims to address the latter problem, giving beneficial owners a property claim in the event of an intermediary’s bankruptcy. This legal change takes place at the convergence of three areas of law (commercial, securities and corporate law) and seldom discussed. Part IV examines a recent trend to interpret a shareholder’s rights against a stock corporation as purely contractual rather than proprietary. The interest behind this argument is to move shareholder interests out of its centrality for corporate activity. In discussions of this argument, the technical function of the share of stock is rarely discussed, nor is the consequence of leaving the corporation without owners.

\textbf{II. MAKING A TRUST IN CHINA FOR THE GOOD OF ASSET MANAGEMENT}

\textit{A. Contract versus property in delegated asset management}

China’s asset management industry is composed of various management activities, including collective fund trust plans set up by trust investment companies, specific asset management plans set up by securities firms, and real estate investment plans set up by insurance companies. Securitization is considered an activity of asset management in China, and it is one that is currently booming as a means of cleaning up a very large body of unattractive loans. Generally, securitization refers to a financial transaction in which “(1) a special purpose entity (SPE) issues securities to investors and, directly and indirectly, uses

\textsuperscript{19} See e.g., the German court’s rejection of the U.S. “fraud on the market” theory in ComROAD Securities Litigation No. IV in comparison to the U.S. Supreme Court’s formulation of this theory in Basic Inc. v. Levinson et al, in \textsc{Andreas Cahn & David C. Donald, Comparative Company Law: Text and Cases of the Laws Governing Corporations in Germany, the UK and the USA} 534-545 (2010).
the proceeds to purchase rights to, or expectations of, payment, and (2) collections on the rights or expectations so purchased constitute the primary source of repayment of those securities.” For this reason, securitization generally involves three key parties: the originator of the rights generating payment flows, the issuer of the securities whose value derives from these payment flows, and the buyers of the securities.

In China, there are two basic contractual arrangements for asset management relationships. Entrusted agency and third-party-beneficial contract (i.e., stipulatio alteri) are traditional institutions that may constitute the legal basis of asset management. Entrusted agency means that an agent performs civil juristic acts within the ambit authorized by the principal in an entrustment contract. In the entrusted agency, the principal normally does not transfer the ownership of his assets to the agent for management. Meanwhile, the agent must “handle the entrusted affairs in accordance with the instructions of the principal,” and the instructions cannot be modified without the consent of the principal. The agent’s hands are largely tied in managing the principal’s assets when their title is not vested in the agent and the agent must act in the name of the principal. Besides, in the entrusted agency, asset management is terminated automatically when the agent resigns or when the agent or the principal dies or goes bankrupt.

Third-party-beneficial contract refers to a contract established in favor of a third party who has not assented but has been provided a legal right to enforce the contract. In the third-party-beneficial contract, the creditor has rights to require the debtor to perform obligations on behalf of the third party. The debtor owes obligations to the third party, and the third party has rights but no obligations. Having said that, the third party’s right is unstable because his right under the third-party-beneficial contract is like a gratuitous gift.

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23 Article 399, Contract Law of China.
24 According to China GPCL, the agent must disclose that he acts in the name of the principal. However, the rule of agent identity disclosure is relaxed by Contract Law of China, which on exceptional basis recognizes the effectiveness of the entrusted agency where the agent acts in his own name. See Articles 402-03, Contract Law of China.
25 Article 69, China GPCL; Article 411, Contract Law of China.
26 EWAN MCKENDRICK, CONTRACT LAW 175-76 (9th ed. 2011).
from the creditor, which means the creditor may rescind his contractual “donation” to the third party without the third party’s agreement.\textsuperscript{27} Moreover, it is unclear in China whether the third party can file a claim against the debtor directly for performance of his obligations when the debtor breaches the contract.\textsuperscript{28}

Both the entrusted agency and third-party-beneficial contract have weaknesses that derive from their nature as \textit{in personam} arrangements. The former creates contractual rights for the agent, who must strictly follow the principal’s instructions in asset management. The latter bestows contractual benefits on the third party, but provides the third party with at best weak devices to preserve these benefits. As will be discussed in detail below, when such arrangements are used in securitization risk multiplies because of the freedom to structure the arrangement without regard to \textit{numerus clausus} restrictions, issuers lose freedom of action, and most importantly, claims on the payment flows underlying the securities can multiply to include all creditors of the entity originating the rights from which the payment flows derive. These drawbacks of contract-based institutions urged Chinese legislators to incorporate the common law institution of the “trust” into its civil law legal system by promulgating Trust Law of China in 2001.\textsuperscript{29}

Generally, a trust arises when a person, the settlor or trustor, transfers title over trust assets to another person, the trustee, who is obliged to deal with the trust assets as a separate fund for the benefit of a third party, the beneficiary, or for a specific purpose.\textsuperscript{30} Once the institution of the trust is available, the device of “entrusted agent” can be replaced by a self-interest trust in which the trustee (formerly the agent) manages the settlor’s assets (formerly the principal’s assets) on behalf of the settlor; the “third-party-beneficial contract” can also be replaced with non-self-beneficial trust in which the trustee (formerly the debtor) manages the

\textsuperscript{27} Article 186, Contract Law of China.
\textsuperscript{28} China’s Contract Law is silent over the third party’s right of action against the debtor when he breaches the third-party-beneficial contract. \textit{See} Article 64, Contract Law of China (“Where the parties agree that the debtor shall discharge the debts to a third party and where the debtor fails to do so …, the debtor shall bear the liability for breach of contract to the creditor.”).
\textsuperscript{29} The legislation of China’s Trust Law experienced twists and turns. The first trust bill had been completed as early as 1996. When it was killed off by the National People’s Congress (hereinafter “NPC”), the trust bill was re-proposed in 2000. However, the second trust bill failed to make it through the NPC. After two attempts, the NPC finally passed the third trust bill, which became Trust Law of China and took force on October 1, 2001. For a detailed treatment of the legislation process of China’s Trust Law, \textit{see} Kai Lyu, \textit{Re-Clarifying China’s Trust Law: Characteristics and New Conceptual Basis}, 36 LOY. L.A. INT’L & COMP. L. REV. 447, 448-54 (2015).
\textsuperscript{30} \textit{See} David Hayton et al., \textit{LAWS RELATING TO TRUSTS AND TRUSTEES} 2 (18th ed. 2010); Gary Watt, \textit{TRUSTS AND EQUITY} 18 (3d ed. 2008).
settlor’s assets (formerly the creditor’s assets) in the interest of the beneficiary (formerly the third party beneficiary).

Differently from under the entrusted agency or third-party-beneficial contract, a trustee has in rem rights in the trust assets. A number of practical consequences arise from this. First, while there is no segregation of the assets in either the entrusted agency (they remain solely owned by the principal) or third-party-beneficial contract (where the beneficiary is essentially a mere donee) in the trust, a property interest in the assets is transferred to the trustee and these assets are thus segregated from the other assets of the settlor.\(^{31}\) As a result, the trustee acts in his own name in asset management,\(^ {32}\) and has free discretion to manage trust assets subject to the trust instrument. Further, the trust and its assets continue to exist regardless of what happens to the parties to the arrangement (the trustee or the settlor).\(^ {33}\)

Property rights are very useful in the originate-to-distribute activity of securitization, which includes two very important elements. Origination is the creation of securitization input—underlying assets that constitute the asset pool. The assets on which the securitization is based are fundamentally the originator’s in personam rights created by contracts between the originator and obligors. Distribution is the delivery of securitization output—ABSs. ABSs represent the investors’ rights in rem, which enable investors to directly benefit from assets or the collateral underpinning ABSs. By using an in rem structure, investors benefit from the lower information necessary thanks to numerus clausus protection,\(^ {34}\) which restrains private parties from creating new forms or contents of their property rights and leaves this privilege to laws exclusively. This also brings with it negotiability of the securities. Generally, courts and legislators discourage transfer restrictions on financial instruments except in limited circumstances for legislative reasons.\(^ {35}\)

\(^{31}\) Articles 15-16, Trust Law of China.

\(^{32}\) Article 2, Trust Law of China.

\(^{33}\) Article 52 of the Trust Law stipulates: “A trust will not be terminated due to the facts that the settlor or trustee dies, loses his civil capacity for civil conduct, the trusteeship is dissolved or canceled according to law or he is declared bankrupt according to law, neither will it be terminated due to the fact that the trustee resigns.”

\(^{34}\) See Merrill & Smith, Optimal Standardization, supra note [●].

\(^{35}\) Maintenance and respect of ownership is certainly an important policy in property law, but in dynamic financial systems this policy is superseded by a more important policy—the liquidity of properties. As Frankel states, the importance of the liquidity of properties is based on an assumption that “parties whose obligations are commoditized as financial assets put a high value on the ability to exchange ‘partners’ in the markets rather than on the identity of the initial parties to the relations.” Therefore, the fact that properties can be transferred economically and efficiently is essential for markets to realize their functions. See Frankel, Securitization: The Conflict between Personal and Market Law (Contract and Property), 18 ANNUAL REVIEW OF BANKING LAW 197, 197 (1999).
designed with standardized forms. Not only does property law bring standardization of ABSs, it has also affected the origination stage by diminishing custom-made features of contracts. For example, most loans added into asset pools have been made under standard underwriting principles with standard loan documents to reduce the cost of evaluating the asset pool.

Securitization is coupled with a bankruptcy remoteness structure by which ABS investors are isolated from risk should the SPE or the originator go bankrupt. The bankruptcy remoteness structure as a result is constituted with two special arrangements. First, the SPE is arranged as an independent, bankruptcy-remoteness entity, having no creditors other than ABS holders. The SPE issues ABSs and is responsible for paying cash flows generated by the asset pool to ABS holders. Were the SPE to go bankrupt voluntarily or involuntarily, not only would it suspend payments of ABS proceeds, but the asset pool might also be seized as the SPE’s bankruptcy estate. Second, the transfer of the asset pool from the originator to the SPE is arranged as a true sale. The asset pool is originally owned by the originator. Without a true sale, the asset pool may be clawed back from the SPE and become part of the originator’s bankruptcy estate should it file for bankruptcy.

Bankruptcy remoteness is the paramount arrangement in securitization. It cuts down financing costs by separating ABSs from adverse impacts exerted by the originator and the SPE’s founder, such as their low credit ratings and bankruptcy risks, and it relieves the originator from holding liquidity and capital against illiquid assets that have been off balance sheet. Second, bankruptcy remoteness benefits the pricing of ABSs by saving a premium reflecting expected bankruptcy risks, improves risk indicators (e.g., risk-weighted capital adequacy ratio and leverage ratio) for the originator, saves costs of monitoring the behavior of the SPE’s founder.

36 Tamar Frankel, Securitization: Its Effects on Bank Structure, in STRUCTURAL CHANGE IN BANKING 309-10 (Michael Klausner & Lawrence White eds., Business One Irwin 1993) (observing that loans are less amenable to trading than securities because loans lack necessary attributes such as standardization). Of course, not all financial instruments are standardized. Many, such as credit derivatives, are customized. Fully standardization of credit derivatives would be problematic because investors have various pursuits. Even so, derivatives are to some extent standardized by the International Swaps and Derivatives Association Master Agreement.

37 Frankel, Securitization: The Conflict between Personal and Market Law (Contract and Property), supra note [●], at 207-08.


40 Subject to different transaction structures, the SPE’s founder may be the originator, the arranger, or a third party.
of the originator and the SPE’s founder, and mitigates the investors’ burden on collecting and analyzing relevant information.

However, this task is daunting because bankruptcy remoteness arrangements are very vulnerable. The SPE’s bankruptcy-remoteness status may be challenged by a voluntary bankruptcy petition filed by its founder, who is always the sole owner of the SPE, or by other devices leading to involuntary bankruptcy such as veil piercing and substantive consolidation. The true sale may be recharacterized as a secured loan (or even an unsecured loan if necessary perfection requirements are not satisfied) by a court. In this case, the SPE is not treated as if it had purchased the asset pool but as if it had provided a loan to the originator that is secured by the asset pool. Worse still, it is unclear and largely unpredictable when courts will repudiate the SPE’s bankruptcy-remoteness status or the true sale arrangement.41

B. The resulting instability from transplanting a trust into Chinese law

The institution of the trust arose in the English law of equity,42 an informal branch of law created to avoid the sometimes harsh formalities of the common law. The trust’s most remarkable characteristic is to divide the title to the assets it governs into legal title and equitable title, the former vested in the trustee and the latter vested in the beneficiary. Each of these titles is an in rem right. China has by statute injected the trust into a system of property that adheres to the traditional doctrines of indivisible ownership (understood as sole dominium) and numerus clausus.43 China has thus had to adapt the trust institution to this preexisting legal system as part of its legal transplantation. A result of the method used is that the Trust Law of China came into existence with a unique characteristic of indeterminate ownership. Article 2 of the Trust Law states that the settlor:

42 Trust developed from the ancient “use” in England and then was widely used in the family successions and charitable donations. For an elaboration of the gradual development of “use”, see generally N.G. Jones, Uses, Trusts, and a Path to Privity, 56(1) Cambridge L.J. 175 (1997). As a unique institution originating in England, Maitland highly appraised it as “the greatest and most distinctive achievement performed by Englishmen in the field of jurisprudence.” See Frederic Maitland, SELECTED HISTORICAL ESSAYS 129 (1957).
43 Donovan WM Waters, The Future of the Trust Part I, 13 J. Int’l Tr. & Corp. Plan. 179, 182 (2006) (stating that “The civil law whose Roman roots are long pre-feudal has no doctrine of an estate or interest interposed between the person and the thing owned by the person; and therefore, there can be no division of the rights of ownership between two or more persons.”). For more details of the principles of numerus clausus and indivisible ownership in civil law, see Avihay Dorfman, Property and Collective Undertaking: The Principle of Numerus Clausus, 61 U. TORONTO L. J. 467 (2011); Peter Birks, The Roman Law Concept of Dominium and the Idea of Absolute Ownership, ACTA JURIDICA 1 (1985).
Based on his faith in trustee, entrusts his property rights to the trustee and allows the trustee to, according to the will of the settler and in the name of the trustee, administer or dispose of such property in the interest of a beneficiary or for any intended purposes. [Emphasis added]44

According to the literal wording of the above definition, although the trustee has the right to manage and dispose of trust assets, the existence of the trustee’s property right over such property completely depends on the legal definition of the word “entrust (weituo, 委托),” which is unfortunately not clarified in the Trust Law.45

The ambiguity of the trustee’s right has led to lengthy debates in the literature. Although some scholars opine that the settlor retains full ownership of the trust assets,46 more support the view that the trustee is the owner of trust assets.47 Similar to most civilian jurisdictions transplanting the trust institution, China’s introduction of the trust did not flow from the internal, doctrinal logic of the law, that is, it arose, for utility: “to cater to [the] investment and commercial utilization of assets.”48 In commercial fields, investors transfer assets to fund managers on the belief that professional skills and sophistication of fund managers can create higher investment returns for investors. The fact that the trustee is not treated as the owner may lower efficiency and flexibility of management of trust assets, particularly when the trustee’s status as owner may be conducive to exclude improper interventions from the settlor or a third party during asset management.49 Moreover, if the trustee has no prima facie ownership of trust assets vis-à-vis the outside world, there may be tiresome burdens on him to prove his authority to manage the trust assets to the satisfaction of third parties.50 Aside from that, industry practice shows that the settlor-owned trust plan is

44 Article 2, Trust Law of China.
46 HO, TRUST LAW IN CHINA, supra note Error! Bookmark not defined., at 41; Chun Zhang, Xintuo Caichan Dulixing de Fali [The Legal Philosophy of the Independence of Trust Assets], 3 J. SOC. SCI. 102, 109 (2011) (Chinese).
48 Qu, supra note [●], at 348.
49 Lusina Ho, TRUST LAW IN CHINA 38 (2003).
almost nonexistent. Therefore, in China, the trustee usually owns trust assets, though the title to trust assets may be vested on the settlor theoretically.

When the ownership of trust assets is vested on the trustee (or the settlor in theory), what is the legal status of the beneficiary? The **numerus clausus** principle as fleshed out in Article 5 of the Property Law states: “[t]he categories and contents of the property right shall be stipulated by law.” The property rights only have three types according to the Property Law: ownership, right of usufruct, and security interest. Notably, the beneficiary’s right is not any one of them, and the Trust Law does not declare it a property right explicitly. As a result, debates arise among scholars.

On this point, commentators have basically taken one of two views. The first view regards the beneficiary’s right a right *in rem*. Li et al. assert that the beneficiary’s right has some proprietary attributes because it attaches not only to new assets the trustee gains in the course of management but also to unjust enrichment sums the trustee obtains in for self-interest. The argument of Li et al., based on the real subrogation nature of the beneficiary’s right, is backed by Xu, who further strengthens the notion by arguing that the beneficiary’s right to retrieve trust assets from a third party, empowered by Article 22 and Article 49 of the Trust Law, is a property right. Lee, from a doctrinal perspective, suggests the classical

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52 See generally Property Law of China, particularly Articles 39, 117 and 170.
53 Other than the two dominant views, several scholars hold the third view: the beneficiary’s right is an independent right, different from the right *in rem* and the right *in personam* but compounding some of their attributes together.). See TANG YIHU, XIN TUO CAI CHAN QUAN LI YAN JU [RESEARCH ON THE RIGHT OF TRUST ASSETS] 45 (Beijing Shi: Zhongguo zheng fa da xue chu ban she, Di 1 ban 2005) (Chinese). Although this view has a kind of novelty, not only does it lack strong doctrinal support, but also it blurs the cut-off line between the property and the obligation, which is the foundation of the legal architecture of civil law jurisdictions. See CHEN HUABIN, WU QUAN FA [FOREIGN PROPERTY LAW] 27 (Beijing Shi: Fa lu chu ban she, Di 1 ban 2004) (Chinese); Xu Wei, Xintuo Shouyiquan: Zhaiquan? Wuquan? Yihuo Xinquanli? [The Nature of the Beneficiary’s Right: A Property Right? An Obligatory Right? Or A New Right?], 30(5) J. ANHUI UNIV. (PHIL. & SOC. SCI. ED.) 64, 65 (2006) (Chinese).
54 Li Xiaotao, Nie Ying and Yuan Xiaodong, Xintuo Shouyiquan de Falu Xingzhi Tantuo [Exploring the Legal Nature of the Beneficial Right], 4 SEC. MARKET HERALD 30, 32 (2012) (Chinese). Article 14 of the Trust Law says: “The property obtained by the trustee through administering, using or disposing of the trust property or by other means falls within trust assets.” Article 26 of the Trust Law stipulates: “Where the trustee, in violation of the provisions of the preceding paragraph, seeks interests for himself by using the trust property, the interests gained therefrom shall be integrated into the trust property.”
55 Xu Wei, Xintuo Shouyiquan de Falu Xingzhi Xintan [A New Review of the Attribute of the Trust Beneficial Right], 8(4) J. SHANGHAI UNIV. FIN. & ECON. 47, 49-50 (2006) (Chinese); Chen Xueping, Xintuo Shouyiren Quanli de Xingzhi: Duirenqu yihuo Duivquanz [The Nature of the Beneficiary’s Right: A Right in Personam or A Right in Rem], 146 J. COM. L. STUD. 73, 76-77 (2011) (Chinese) (supporting and complementing Xu’s argument). Article 22 of the Trust Law reads “If the trustee violates the purpose of the trust and disposes of the trust property, or handle the trust affairs improperly in violation of his administration duty, … the settlor has the right to apply to the court for setting aside such disposal, and has
understanding of ownership, including a bundle of rights, to be too stringent.\textsuperscript{56} She contends that the beneficiary has the right to enjoy from the trust and at the same time to exclude third parties’ intervention into her enjoyment, which are essentially proprietary elements and sufficient to constitute an ownership under the Chinese trust.\textsuperscript{57}

The second view is that the beneficiary’s right is obligatory in nature because her right cannot be realized against the trust assets directly but has to rely on the performance of the trustee’s obligations.\textsuperscript{58} As a proponent of Li, Yuhua Zhou, who distinguishes the beneficiary’s right of retrieval in the Trust Law from the tracing process in a common law trust,\textsuperscript{59} opines that the former is an obligatory right against the trustee (i.e., right in \textit{persona m}) because it is designed by imitating the creditor’s right to rescind the debtor’s detrimental action in the Contract Law.\textsuperscript{60} Lai and Wang counter Li’s argument by pointing out that the beneficiary’s right does not contain all the attributes of a property right and so it is better to treat it as a right \textit{in persona m} under the Chinese legal system.\textsuperscript{61}

In China, the regime of bankruptcy remoteness has deficiencies. In terms of SPE, it is not a thin-capitalized special purpose conduit between the originator and investors to issue ABSs, due to regulatory obstacles. The SPE is not an independent legal entity, but only a specific scheme internal to a financial institution. All ABSs up to present are issued by financial institutions such as trust investment companies, securities firms and subsidiaries of

\textsuperscript{56} Rebecca Lee, \textit{Conceptualizing the Chinese Trust}, 58 INT’L \\ & COMP. L. Q. 655, 666 (2009) (arguing the standard incidents of ownership in civil law jurisdictions, including the right to possess, the right to use, the right to the benefits, etc., have been surpassed the necessary requirement for a common law trust).

\textsuperscript{57} \textit{Id.} at 665-66 (arguing the standard incidents of ownership in civil law jurisdictions, including the right to possesses, the right to use, the right to the benefits, etc., surpassed the necessary requirement for a common law trust).


\textsuperscript{59} Basically, in the common law trust, the tracing is a process that allows the beneficiary to trace and identify the trust assets transferred by the trustee who breaches the trust to a third party. Unless, however, the third party is a bona fide purchaser without notice of the breach and requests the court to restore the traced assets or their substitute to the trust. See \textit{PETTIT}, supra note Error! Bookmark not defined., at 551.

\textsuperscript{60} Yuhua Zhou, \textit{XIN TUO FA XUE [TRUST LAW]} 231 (2001) (Chinese); Article 74 of the Contract Law stipulates: “If a debtor disclaims its due creditor's rights or transfers gratis its property and thus causes losses to the creditor, the creditor may apply to a people's court to rescind the debtor's action. The creditor may also apply to a people's court to rescind the debtor's action if the debtor causes losses to the creditor by transferring its property at a low price evidently unreasonable and with awareness of the transferee.”

fund management companies. According to conventional wisdom, this mode puts ABS investors at notable risk. Financial institutions are not bankruptcy-proof, and they conduct other businesses aside from securitization. Should they go bankrupt, both the financial institutions and their private creditors would claim securitization assets.

Most securitization projects in China have been given legal opinions of true sale by lawyers. However, no regulatory rules contain specific provisions about how to safeguard the true sale treatment through special transactional designs. The Chinese judiciary provides no guidelines either, given that no bankruptcy cases relating to securitization transactions have been tried and reported so far. If such legal opacity concerning true sale is not clarified, it will counteract part of securitization’s benefits and mitigate financiers’ motivations to engage in securitization within the Chinese financial system.

C. Has China made new property rights through its Trust Law?

To maintain the logical consistency and doctrinal integrity of Chinese legal system, it may be dangerous to regard the beneficiary’s right as *in rem* before China makes exceptions to the doctrines of indivisible ownership and *numerus clausus*. However, the beneficiary’s right is not a typical right *in personam* due to two peculiarities. The first is the “relative nature” of the beneficiary’s right against the trustee. Fundamental principles of Chinese law are that *in rem* rights are valid against the world at large while *in personam* rights are valid merely against determinate persons assuming duties.62 That being said, the right *in personam* is still effective against the counterparty, which must perform due obligations by use of all assets, movable and immovable, present and future, unless he is incapable or goes bankrupt.63 This liability is expressly limited by Article 34 of the Trust Law: “The trustee shall have the obligation to pay the beneficiary [the] benefits from the trust with limits of the trust property,” This express limitation of the trustee’s liability introduces an *in rem* element in what might otherwise be characterized as an *in personam* relationship.

Similar provisions exist with respect to “bankruptcy remoteness.” If a debtor is bankrupt, the bankruptcy procedure first freezes the debtor’s business, including the performance of obligations.64 All the properties she owns become bankruptcy estate65 and her

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63 Using a contract for the sale of goods as an example, the seller, after goods are delivered, can require the buyer to pay money out of all the cash and bank accounts the buyer owns until the debt is fully paid off.
64 Article 20, Enterprise Bankruptcy Law of China (promulgated by the NPC on Aug. 27, 2006 and effective from Jun. 1, 2007).
65 Id. Article 30.
creditors cannot realize their interests unless they claim interests to the liquidator and wait for the distribution of liquidated assets. This asset distribution process is governed by the pari passu rule, where all debts rank equally, and all creditors are distributed in proportion to the size of their admitted claims. According to the Trust Law, however, the trustee’s bankruptcy does not affect the beneficiary’s right. Article 16 of the Trust Law provides that “[w]here the trustee dies or the trustee as a body corporate is dissolved, removed, or is declared bankrupt . . . the trust property shall not be deemed his legacy or liquidated property.” Article 15 provides a like segregation from the settlor: “The trust property shall be differentiated from the settlor’s private properties not under the trust . . . if the settlor dies or is dissolved, cancelled according to law, or declared bankrupt . . . the trust property is not deemed his legacy or liquidated property.”

To sum up, in the context of Chinese legal system, the beneficiary’s right may arguably be considered a right in personam, but it also includes the most important characteristics of rights in rem for the activity of securitization. Thus, in spite of legal opacity and systemic concerns, securitization practitioners in China do not see their transactions exposed to a material risk of recharacterization, mainly because of the function of the Trust Law. While the overall regime of bankruptcy remoteness in China is not doctrinally sound, the Trust Law provides the beneficiary with the rights in rem that are seen as needed.

Similarly to the “security entitlement” discussed in the following Part III, China has created a property right that chafes on the system of property rights in which it is set. Nevertheless, when the implementing statute specifically assigns rights that have an in rem nature, it is difficult to deny that a property right has been made, particularly if such right answers a real need in the community. The balance of utility against doctrinal consistency will ultimately be determined by legal culture, and China and the United States both share a strong pragmatic current in their approach to law. Of course the interesting aspect of a utility-based definition of rights in a pragmatic atmosphere is that such rights may well become unstable if they become unpopular in the face of a changing economy or a shift in commercial practices.

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67 Article 16, Trust Law of China.
68 Article 15, Trust Law of China.
III. BUTTRESSING INDIRECT HOLDING BY MAKING CLAIMS ON ACCOUNTS PROPERTY

A. Why corporations ceded their shareholders to intermediaries

In the securities markets of highly developed countries listed shares are generally registered in the name of a central securities depository or a broker rather than the investor who paid for the shares. This does not occur by choice, but because of the way securities markets are designed. This “indirect holding system” is a model of securities settlement that was introduced in the wake of a major market failure in the United States in 1970.69 During the 1960’s, daily volume on the New York Stock Exchange (NYSE) more than quadrupled from about three million shares per day in 1960 to approximately 13 million shares per day in 1968.70 The most burdensome aspects of transferring shares are endorsing and delivering the old certificates, registering transfers on the stockholders’ list and issuing new certificates. Manually operating back office clerks were unable to register the transfer of paper security certificates at the volumes that the brokers had reached, which led to so many failed trades and lost securities that over 100 broker dealers ceased doing business independently.71 This occurred in spite of the fact that the NYSE operated on a part-time basis with abbreviated trading hours to accommodate the needs of the back offices.72 This crisis has been appropriately called the “paper crunch” or “paper blizzard,”73 and is an appropriate extinction event for a system of records and books prior to the advent of computers. The US Congress responded not by pushing toward computerization, but by amending the Securities Exchange Act74 to order that all securities certificates traded on a registered exchange be “immobilized” in a securities depository.75


70 SEC, UNSAFE PRACTICES STUDY, supra note 23, at 28.

71 See S. REP. NO. 94-75, at 183 (1975); HURD BARUCH, WALL STREET: SECURITIY RISK 189 et seq. (1971); WELLES, supra note [●], at 134.

72 REGAN, supra note [●], at 104, and SEC, UNSAFE PRACTICES STUDY, supra note 23, at 219-20.


74 S. REP. NO. 94-75, at 183 (1975). The 1975 Amendments are primarily remembered for eliminating the system of fixed commissions that had protected brokers’ income since 1792. 15 U.S.C. § 78f(e)(1); LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION §7-D.2 (3rd ed. 2004). It also introduced the national market system program, which is designed to allow trades and information to flow freely between all national and regional exchanges. 15 U.S.C. § 78k-1; S. REP. NO. 94-75, at 180 et seq. (1975); LOSS & SELIGMAN, supra, at §7-A.1. Although the national market system was mainly designed to open up isolated,
At the time of the crisis and before Congress acted, the SEC convened a conference of market participants to discuss and evaluate the existing recommendations and possible solutions for the paperwork crisis. The topic that dominated discussion was the choice between two competing models of securities settlement. One model, often referred to as a "Transfer Agent Depository," or TAD, would have used a network of computers acting as share registers receiving data transfer from the securities exchange, a decentralized network along the lines of the then newly introduced National Association of Securities Dealers Automated Quotation (NASDAQ) system. It would have linked issuers' transfer agents in a computer network so that transfers of uncertificated securities could be electronically recorded by book entry on an "account" which would also have been the "register" in which the securities were originally created by the issuer. Exchange trades would have immediately removed the seller and added the buyer to the company’s register of shareholders, and there would have been no distinction between “registered” and “beneficial” owners. Such “book entry” transfers would require no change to commercial law and would have left shareholder registers transparent. The second model was a centralized depository in which the certificates of all – or as large a percentage of the market as possible – of the securities traded would be immobilized in a central depository's vaults, and claims against accounts held with the depository would be traded. This solution required neither uncertificated securities nor sophisticated data transfer. The depository and financial intermediaries that held accounts with it created a kind of surrogate dematerialization of securities by locking the paper certificates away in their vaults and electronically trading claims against accounts holding securities registered in their own names. The introduction of this system would remove all information on shareholder identity from issuing companies, turn investors from registered owners to beneficial holders, and create a system of securities holding that was opaque to anyone outside of the financial system.

uncompetitive pockets of trading and price information to all market participants, thereby promoting competition between the NYSE and regional exchanges and segments, it was also intended to create a national system for clearing and settlement. 15 U.S.C. § 78q-1; S. REP. NO. 94-75, at 183 et seq. (1975); LOSS & SELIGMAN, supra, at §6-C-6.


76 See Id. at 180; See SEC, FINAL REPORT OF SEC ON THE PRACTICE OF RECORDING THE OWNERSHIP OF SECURITIES IN THE RECORDS OF THE ISSUERS IN OTHER THAN THE NAME OF THE BENEFICIAL OWNER OF SUCH SECURITIES 41 et seq. (1976) (hereinafter the "STREET NAME STUDY").

77 See SEC, UNSAFE PRACTICES STUDY, supra note [●], at 191 et seq.; WELLES, supra note [●], at 320 et seq.
As one might expect, the depository model was advocated by major banks, in the form of the Banking and Securities Industry Committee (BASIC), which was chaired by Morgan Guaranty Chairman John M. Meyer (one of the creators of Euroclear, a successful depository-based settlement entity located in Brussels). BASIC argued that the depository model in which financial institutions became the legal owners of all traded securities, was the best way to ensure efficient settlement of transactions. Also as one might expect, the SEC and Congress followed the lead of the major banks. A Central Certificate Service (CCS), which was operated by the NYSE was in 1973 transformed into The Depository Trust Company (DTC), and registered as a registered clearing agency with SRO status in 1983. Deposited securities were registered in the name of "Cede & Company", DTC’s nominee. Legally, the shares deposited with DTC were not even transferred, as Cede & Co. remained their legal owner, which led to a need to change the commercial law providing for ownership of securities through claims about Cede’s accounts and the accounts of its participants. This disadvantaged not only investors and issuers, but much more importantly for the decision-making on market structure, the financial intermediaries that owned, operated and used the market. To secure their claims against DTC and Cede, a change to the existing commercial law was necessary.

B. Adapting the commercial law to trading claims on depository accounts

Once the vast majority of securities were placed in the vaults of DTC and registered in the name of Cede & Co., making the latter legal owner and registered shareholder, investors at all levels lost not only their rights as shareholders in the issuing corporations, but also their property claims on the securities they had purchased. What they received instead was a contractual claim against their custodian intermediary, which had a contractual claim against the depository or another intermediary. It is arguable that a court have construed this relationship as a constructive trust on behalf of the investor, but the possibility of a future court decision is insufficient to establish the negotiable nature of the claim and an outright ownership interest in the case of an intermediary’s insolvency. This lowered the protection of

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79 SEC, UNSAFE PRACTICES STUDY, supra note [●], at 184 et seq.
80 See Depository Trust Co., et al; Order, SEC Release No. 20221, File No. 600-1 et al. (Sept. 23, 1983). In 1999, DTC and NSCC became subsidiaries of a newly created holding company, the Depository Trust and Clearing Corporation (DTCC), which is a stock corporation staffed primarily by seconded officers of its customer-shareholders, major US banks and brokers. DEPOSITORY TRUST & CLEARING CORPORATION, ANNUAL REPORT 2008, 52 et seq.(2009)
81 See LOSS & SELIGMAN, supra note [●], at §6-C-6.
an investor in the event of an intermediary’s bankruptcy and made the claim of the investor against the security, which was no longer *in rem*, no longer negotiable.

In order to make the claim against the account of a custodial intermediary negotiable, the commercial law had to be adjusted to the indirect holding system. U.S. commercial law for the transfer of securities is found in Article 8 of the Uniform Commercial Code (UCC), which was amended to create negotiability in 1978 and again in 1994.82 In 1978, the Article 8 Drafting Committee still thought that the direct ownership of uncertificated securities was a viable option for the industry, so that "changes in ownership would continue to be reflected by changes in the records of the issuer."83 For this reasons, the 1978 amendments provided for ownership of dematerialized securities, which was not doctrinally difficult, as many forms of ownership are evidenced by register entries. This approach was reversed 15 years later. By the early 1990s, DTC was rapidly expanding the volume of securities it owned and the menu of services it offered intermediaries and “beneficial” owners. In 1994, the Article 8 Drafting Committee explained that, "[a]lthough a system of the sort contemplated by the 1978 amendments may well develop in the coming decades, this has not yet happened for most categories of securities."84 As a result the Drafting Committee took the step of creating a new form of property right existing through claims against an intermediary within the "indirect holding system," which as a pre-requisite had to establish that the booking of securities by an intermediary to the account it managed actually created those securities for all legal purposes.

The Drafting Committee conceived this new form of property right as a “security entitlement” and was keenly aware that it was dealing with a relationship which carried all the earmarks of an *in personam* claim and none of the characteristics traditionally associated with an *in rem* right:

The basic rule is very simple. A person acquires a security entitlement when the securities intermediary credits the financial asset to the person's account. . . . Thus, a security entitlement is itself a form of property interest not merely an *in personam* claim against the intermediary. The concept of a security entitlement does, however, include a package of *in personam* rights against the intermediary.85

82 See GUTTMAN, *supra* note [●], at § 1:14, 1-56 *et seq.*; UCC, Article 8 Prefatory Note, at "C. Indirect Holding System".

83 UCC, Article 8 Prefatory Note, at Sec. I.B. “The Uncertificated Securities System Envisioned by the 1978 Amendments.”

84 *Id.*

85 UCC, Article 8 Prefatory Note, at Sec. II.C. “Indirect Holding System.”
This new in rem right arises against a security issued by a listed company, but comes into existence when an intermediary “credits a financial asset to the” investor’s account. Thus intermediaries, through their book entries, create this right, and transfers through such creditors to accounts receive the same protected status as bona fide purchases have traditionally received pursuant to the law of negotiable instruments. In order to make this property right, the amendments of Article 8 devised four, custom made concepts.

The first concept is "securities intermediary," the entity that is authorized to create new property interests, which of course includes the central entity in the indirect holding system, an SEC authorized "clearing corporation," but also refers to any person that is in the business of maintaining securities accounts for others. The second concept, "securities account," is essentially a custodian account for securities, a booking to which of “financial assets” creates the new in rem right. The term "financial assets" used in this second definition is the third concept, and includes all forms of securities, and ultimately "any property" held in a securities account if the securities intermediary expressly agrees to treat it as a financial asset. The claim that an accountholder has against the securities intermediary to the financial assets is the new property created in Article 8, and is referred to as a "security entitlement." A security entitlement "is a pro rata property interest" in all interests in a specific financial asset that a securities intermediary holds in its accounts. Because these entitlements come into being only through action of the intermediary, they are not “transferred” from investor to investor when securities are sold, but are rather created and extinguished by the intermediary’s credit and debit actions. As the Drafting Committee explains, this "transaction . . . is not a 'transfer' of the same entitlement from one person to another." In order to further ensure negotiability of “security entitlements” the UCC provides that an intermediary will not be liable for making a book entry despite receiving

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86 UCC, Article 8 Prefatory Note, at Sec. I.D. “Need for Different Legal Rules for the Direct and Indirect Holding Systems”; GUTTMAN, supra note [●], § 1:13, 1-51 et seq., § 1:14, 1-58 et seq.
88 UCC § 8-501(a) (2005); GUTTMAN, supra note [●], § 1:15, § 9:7.
90 UCC § 8-503(b) and Off. Comm. (2005); UCC, Article 8 Prefatory Note, Sec. II.C. “Indirect Holding System.”
notice of an adverse claim unless the intermediary acts contrary to an injunction or restraining order, or in collusion with the wrongdoer.\(^\text{92}\)

The concept of a "security entitlement" remains the same at each level of the custodial pyramid: a clearing participant would have security entitlements for its claims against an account with DTC, a broker using the participant as a depository would have security entitlements for its own claims against that account, and a retail investor would have the same type of security entitlements on his or her account with the broker. As the "security entitlement" refers to a relationship against an account, it has exclusively \textit{in personam} characteristics from accountholder to custodian, but by express language of the UCC (and the legislation that adopts it) this \textit{in personam} claim is elevated to a property right.\(^\text{93}\) Nearly all dealing with the security entitlement will be by instruction to the securities intermediary. There is, however, a slim, \textit{in rem} tail in the event that all persons protecting the account disappear or default. An "entitlement holder" may take action against a third party who has unjustly received the holder's security entitlement only if the series of conditions listed below are met, but as the list makes clear, this ultimate claim more resembles a derivative action for breach of duty than the exercise of a property right. The conditions are:

1. Insolvency of the securities intermediary with control of the account against which the security entitlement claim is held;
2. The securities intermediary does not have sufficient interests in the relevant asset to satisfy all its outstanding security entitlements;
3. The insufficiency is caused by the intermediary’s breach of duty under § 8-504 UCC to maintain sufficient amounts of the assets;
4. The transferee of the security entitlement did not give value for or obtain control of the entitlement, or acted in collusion with the securities intermediary; and
5. The intermediary’s trustee or liquidator fails to take action to recover the asset.\(^\text{94}\)

This right, which is exercisable against a second intermediary only in the event that the first intermediary has breached its duty to hold sufficient quantities of securities, irregularly

\(^{92}\) UCC § 8-115 (2005). See also GUTTMAN, supra note \([\bullet]\), at § 6:12, p. 6-39 \textit{et seq.}, § 7:15, 7-62 \textit{et seq.} Of course when an intermediary trades on its own account, the rule on notice of an adverse claim applicable to ordinary purchasers will apply.

\(^{93}\) UCC § 8-503(b) (2005) ("An entitlement holder’s property interest with respect to a particular financial asset under subsection (a) is a pro rata property interest in all interests in that financial asset held by the securities intermediary …").

\(^{94}\) UCC § 8-503(d), (e) (2005). The requirement that intermediaries maintain sufficient interests in financial assets to cover all of their outstanding security entitlements is found in § 8-504 UCC. The requirement that a purchaser acquire a security entitlement for value and without notice of the adverse claim is found in UCC § 8-502.
“transfers” the security to another, and then entered into insolvency. Even then, it will be the duty of the receiver, liquidator or trustee to see that the claim is enforced. Only in the event that this is not done, does the claim’s *in rem* element awaken, allowing an action for recovery against the recipient of the irregular transfer. This structure evidences the new property right’s aim, which is to better protect beneficial owners in the event that the intermediary becomes insolvent.95 This property interest has far fewer *in rem* elements than the share of stock, discussed in Part IV, whose status as a property right is currently contested by some commentators. The “security entitlement” also says much about the pragmatic flexibility with which law is conceived in the United States. Other countries have not been willing to amend their law and carefully evaluated whether this type of claim may really be classified under the category "property".96 Although, as discussed in Section [●], below, a similar claim has been inserted into an international convention finalized in 2009, this convention has been adopted by only one country (Bangladesh) since being launched.

**C. Bringing the world into line with indirect holding: the UNIDROIT Convention**

Financial markets are international. Once a major jurisdiction like the United States redefines the legal relationships according to which securities are traded and held, the next natural step is to bring this change to the world. If claims on account can be shifted from contract to property in all major jurisdictions, the risk management systems of global financial institutions can be streamlined and applied uniformly across borders. In spite of the fact that by 2000 the arguments of 1975 in favor of an indirect holding system to immobilize paper certificates had ceased to exist (i.e., data transfer infrastructure was sophisticated enough to handle decentralized data flows and nearly all exchange traded securities had been dematerialized97) there was at that time a strong push for an international reinforcement of the intermediated system through major treaties and conventions. This was done partly with respect to the law applicable to securities held in custody accounts with intermediaries by drafting a Hague Convention on that topic.98 However, while the Hague Convention

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96 See e.g. DOROTHEE EINSELE, WERTPAPIERRECHT ALS SCHULDRECHT: FUNKTIONSVERLUST VON EFFEKTENRÜKUNDEN IM INTERNATIONALEN RECHTSVERKEHR (1995), a 500 page study of the nature of property rights in the custody account framework under German law.
97 See Donald, supra note [●], at 82.
98 Conférence de la Haye de Droit International Privé, Convention on the Law Applicable to Certain Rights in respect of Securities held with an Intermediary (2006). This Convention has been ratified by Switzerland and Mauritius only.
facilitates use of an indirect holding system it does not seek to change existing law. This last effort has been attempted through UNIDROIT, which created a convention with the attractive name of the “Geneva Convention” to govern substantive rights in intermediated holdings.

The drafting of the UNIDROIT Convention provided a venue for argument about the nature of a claim against an account held with a financial intermediary. The U.S. position has been explained above, and could be described as positivist (what the legislature calls property will be property). The German position followed doctrinal logic that an account entry by a financial intermediary (other than the issuer) could constitute evidence of security ownership but not the security itself, given that a transfer of property had its own rules beyond mere book entry. In France, where complete dematerialization has existed since the early 1980’s, some commercial law scholars argued that intermediation of dematerialized securities creates the danger of duplicating claims and instruments. Martin has observed that while the situs of a security certificate passing between vaults in various countries and owned by an investor through an account in another country is quite vague, the situs of a dematerialized security is certain: it is the register or account (usually held by or for the issuer) where the security originates through issue, as all rights embodied in a security can be enforced only against the issuer. By contrast, "the intermediary does nothing more than keep its own books with respect to securities that exist in the issuer's register," so that "these book-entries are not an intellectual play of bookings to displace the securities: it is advisable to restrict entries to the primary account in which the securities originate." When paper has been eliminated, not only is the point of book entries on the accounts of a depository unnecessary, it is dangerous.

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99 The Hague Convention focuses on the commercially customary rule of party’s choice in selecting applicable law, providing a series of default rules for determining that choice, but restricting choice to jurisdictions in which an account holding intermediary operates a “qualifying office.” See Hague Convention, Art. 4.

100 Institut International pour l’Unification du Droit Privé (UNIDROIT), Convention on Substantive Rules for Intermediated Securities (2009) (Geneva Convention). This Convention has been adopted by Bangladesh only.


103 "L’intermédiaire ne fait que « comptabiliser » les valeurs mobilières « inscrites chez émetteurs »" See id. S. 69 (author's translation).

104 "[L]a scripturalisation n’est pas un jeu d’écritures ouvert à toutes les fantaisies de délocalisation des valeurs mobilières: elle vaut, aussi avis de leur domiciliation dans les comptes primaires où elles écloient!” See id. S. 70. (author's translation).
This danger will be significantly amplified when each book entry of an intermediary is deemed to create securities real securities.

The position eventually taken in the definitive version of the UNIDROIT Convention finalized in 2009 was to specify the rights desired to protect investors and collateral takers, leave other rights to local law on insolvency and transfers, and avoid categorizing the claim on account under any legal concept. The result resembles that achieved by the amendments to Article 8 of the UCC, absent the express provision of in rem rights. First, negotiability is assured because every financial intermediary has the right to create securities: “intermediated securities are acquired by an account holder by the credit of securities to that account holder’s securities account …. No further step is necessary, or may be required by the non-Convention law.”

Thus, a book entry of securities will always create real securities for the account holder, and the issuer is linked to this process only by the intermediary’s duty to carry adequate securities on its books. Second, the “credit of securities … confers on the account holder … the right to receive and exercise any rights attached to the securities, including dividends, other distributions and voting rights … [and] to effect a disposition.” These rights of profit, enjoyment and disposition are fundamental rights of ownership. Third, the securities booked to an account “shall not form part of the property of the intermediary,” which provides the protection required by an account holder or collateral taker in the event of an institution’s insolvency. This assertion also allows a property right to be deduced because if no intermediary own the security, the investor is the only available option to choose from in ascribing ownership.

Despite providing the advantages or an in rem right while delicately avoiding declaration that such a right exists, the UNIDROIT Convention has found complete approval only in Bangladesh during the first six years of its existence. As technological progress in securities settlement continues, the depository, the indirect holding system at the base of the Convention and the need for property rights against such accounts will likely slip into obsolescence. It is still unclear what form a blockchain-based transaction system for securities will take, but it is very unlikely to be immobilization of physical certificates.

105 Geneva Convention, Art. 11. This is reinforced through a rule that “[u]nless an acquirer actually knows or ought to know, at the relevant time, that another person has an interest in securities or intermediated securities,” the acquirer takes free of any prior claim or defect in registration. Id, at Art. 18.


107 Geneva Convention, Art. 9.

108 Geneva Convention, Art. 25.
Moreover, the basic idea that blockchain ledgers are multiple would support Martin’s argument that only the originating account or register should be deemed the *situs* of a security. Asserting that property rights arise through intermediary bookings would then become a cause without a reason.

IV. UNMAKING SHAREHOLDER OWNERSHIP FOR THE SOCIAL GOOD

A. Pushing back against the “financialisation” of the stock corporation

Evidence abounds that the stock corporation, the people who run it and their productive activity have – like many other parts of the real economy – been pulled into a vortex of trading, speculation and market price servitude that Kay refers to as “financialisation”:

Financialisation drew the attention of corporate managers back to stock markets. Not, in general, because they needed to raise capital for their businesses, but because the times dictated fresh priorities. Companies were encouraged to pursue ‘shareholder value’. Many chief executives came to see themselves as meta-fund managers, buying and selling a portfolio of companies rather as asset traders might buy and sell portfolios of securities.109 The trader typically knows very little about the underlying characteristics of the securities he or she trades, but a great deal about other traders, and what they currently think. What ‘the market thinks’ may be little more than an accumulation of other traders’ estimates of what other traders think – the process famously satirised in Keynes’s metaphor of the beauty contest.110

In an attempt to rebalance the stock corporation as a venue of actual productive activity conducted by a team of people with complementary skills rather than a servant of market price, Blair and Stout have since the late 1990s set forth a theory of “team production” through a number of publications.111 As Cheffins has explained, the theory they promote resembles the managerialism embraced in mid-20th century U.S. scholarship, but differs from the latter by envisaging a stronger board of directors, which “serves as the final arbiter when executives, shareholders, employees and other corporate constituencies cannot resolve

110 KAY, supra note [●], at Kindle Locations 1567-1570.
disputes at lower levels.”\textsuperscript{112} Delaware Supreme Court Chief Justice Leo Strine argues that the team production model’s contention that “directors are free to promote interests other than those of stockholders ignores the many ways in which the DGCL focuses corporate managers on stockholder welfare by allocating power only to a single constituency, the stockholders.”\textsuperscript{113} Stine describes this call for directors to act as trustees for all constituencies despite the requirements of law “more an exercise in feeling good than in doing good,” and points out that “[i]f we believe that other constituencies should be given more protection within corporation law itself, then statutes should be adopted giving those constituencies enforceable rights that they can wield.”\textsuperscript{114}

The powers Delaware statutory law ascribes to shareholders and the duties that Delaware case law assigns to directors vis-à-vis such shareholders are, as Strine observes, quite clear. Another front on which Blair and Stout have focused their argument against shareholder centrality is less clear. In order to dislodge shareholders from their position of primacy in corporate law, these team production theorists have argued that the claim certificated by a share of stock is not a property right, but merely a contract right of uncertain value – “a naked claim.”\textsuperscript{115} Stout’s argument on corporate ownership is that, “shareholders do not, in fact, own the corporation. Rather, they own a type of corporate security commonly called ‘stock.’ As owners of stock, shareholders' rights are quite limited. For example, stockholders do not have the right to exercise control over the corporation's assets.”\textsuperscript{116} Shareholder rights “are quite limited” not only because of the existence of the corporate entity as body corporate (which has its own rights and liabilities, thus creating limited liability for shareholders), but also because of the joint participation of many shareholders. Such collective aggregation of shareholders “enjoy neither direct control over the firm’s assets nor direct access to them,” so that “it perhaps is excusable to loosely describe a closely held firm with a single controlling shareholder as ‘owned’ by that shareholder, it is misleading to use the language of ownership to describe the relationship between a public

\begin{thebibliography}{99}
\bibitem{Strine14} Strine, \textit{supra} note [\textbullet{}], at 768.
\bibitem{BlairStout05} Blair & Stout, \textit{Director Accountability, supra} note [\textbullet{}], at 409. Also see the discussion of this argument in David C. Donald, \textit{Shareholder Voice and Its Opponents}, 5 \textit{JOURNAL OF CORPORATE LAW STUDIES} 305 (2005).
\bibitem{Stout05} Stout, \textit{Lecture and Commentary, supra} note [\textbullet{}], at 1191.
\end{thebibliography}
firm and its shareholders.”

Indeed, the shareholders of a listed company are likely to be “a far-flung, diverse, and ever-changing group,” and such a swirling mass of alleged owners are “more akin to [the owners of] a bond than to a car or a building.”

Claimants who come and go in milliseconds as their shares are traded, who have no right whatsoever to the corporation’s assets, whose must always act on their highly limited rights only according to procedures laid out in law, and who must usually do so collectively, hardly deserve to be enshrined as the raison d’être of the corporation. Particularly when this transient constituency is contrasted with the more permanent constituencies in a company, like labor, the argument has real ethical force. Employees often lose potential they originally bring to a company as they age into their employment role. While it is assumed (or at least reasonably hoped) that a capital investment will increase in value over time, it is a fact that during the same period employees grow older, many becoming molded into a task for the company, virtually unemployable in another position. By shaking off the illusion that shareholders own corporations it will be easier for us to “liberate ourselves from the tyranny of shareholder value thinking.”

“Rejecting shareholder value thinking, and instead inviting boards to consider the needs of employees, customers, and communities, allows boards to usefully mediate not only between the interests of shareholders and stakeholders, but between the interests of ex ante and ex post shareholders as well.”

As Strine has observed, the best way to achieve this goal – which has real ethical and social merit – is to change the law. The law may be changed in the legislature or in the court (in this instance, as the statutes are currently silent). The following Section explains that the law on the property rights embodied in corporate shares is expressed sparsely, and much of it is old, so that legal scholars could with luck convince one or two courts to redefine these claims. However, such a change will create significant consistency problems within the legal system of corporate law, and is thus likely untenable.

B. The share of stock as “chose in action” property right

The property right that the law in the United Kingdom and the U.S. states has until today considered certificated by a share of stock is not simple to grasp. There are two tiers of

117 Stout, supra note 37, at 1191.
119 Stout, Shareholder Value Myth, supra note [●], at 113.
120 Stout, Shareholder Value Myth, supra note [●], at 85.
ownership involved: a person owns a stock certificate or a claim against a register and that certificate or claim refers to an intangible right in the company. The Delaware Court of Chancery has held that, "[a] certificate of stock is evidence of ownership, in the nature of a chose in action."\footnote{Equitable Trust Co. v. Gallagher, 67 A.2d 50, 54 (Del.Ch. 1949). The New Jersey Supreme Court has held that "[t]he share in the corporation constitutes a chose in action which is an intangible property right. The certificate itself, however, the document evidencing stock ownership, is considered tangible personal property." Registrar & Transfer Co. v. Director, Division of Taxation, Dept. of Treasury, 398 A.2d 1335, 1338 (N.J.Super.A.D., 1979).} The stock certificate is evidence of the share of ownership, which itself is intangible, and thus the share, quota, or portion of the corporation owned by the shareholder cannot be taken into possession the way the certificate that evidences it can be. The UK Court of Appeal has recently explained this distinction: “In the protection of rights of personal property the common law historically drew a distinction between tangible and intangible property. Tangible property, usually referred to as chattels but sometimes as choses in possession, could be the subject of physical possession and thereby physical control, whereas intangible property, consisting of rights to benefits obtainable only by action (and thus known as choses in action), could not.”\footnote{Your Response Ltd v Datateam Business Media Ltd. [2014] EWCA Civ 281; 1 CLC, para. 14. Also see J. CROSSLEY VAINES, PERSONAL PROPERTY 221 (3rd ed., 1962), citing Channel J. Torkington v. Magee, [1902] 2 K.B. 247, 430 (A "chose in action is a known legal expression used to describe all personal rights of property which can only be claimed or enforced by action and not by taking physical possession.").} Lord Hoffman, writing in 2006, summed up the property right embodied in a share: “a share is the measure of the shareholder’s interest in the company: a bundle of rights against the company and the other shareholders. As against the outside world, that bundle of rights is an item of property, a chose in action.”\footnote{Cambridge Gas Transportation Corporation v Official Committee of Unsecured Creditors of Navigator Holdings plc and others [2007] 1 AC, para. 26.}

The shared nature of the interest certificated by a share also makes it seem less like an actual property right. However, this does not appear to be a flaw in the shareholder’s right, but rather a design necessity for the collective action of group ownership. Armour and Whincop have argued that a corporation consists of "proprietary foundations" and a "contractarian superstructure."\footnote{Armour & Whincop, supra note 38, at 16.} These two mechanisms work to allow joint sharing between multiple owners, delegation of entitlements to managers, and sequential sharing (triggered by default) between owners and creditors.\footnote{Id. at 15.} That is, the nature of the share "provides mechanisms whereby the scope of the parcels of entitlements given to each participant is made …. their entitlements are protected not just against other participants to

\footnote{Id. at 15.}
the voluntary arrangement, but against persons generally. In short, the arrangements are given proprietary effect.\textsuperscript{126} The sequential endurance of the relationships among the collective (i.e., enforceability of limitations also against persons who are not currently a member of the company) is crucial in order to permit transferability of shares to third parties while maintaining consistency of relationships within the corporation.

If we look in the share of stock for the entitlements that A.M. Honoré understood to constitute the “bundle” of rights called property, a reasonable argument can be made that shares of stock represent a property interest in the company. The list assembled by Honoré includes the rights to "use" and "manage" the thing, "the right to the income of the thing, the right to the capital, the right to security . . . the rights or incidents of transmissibility and absence of term . . . and the incident of residuarity."\textsuperscript{127} Shareholders have control of a corporation though the right to elect or remove directors,\textsuperscript{128} and veto rights over a merger\textsuperscript{129} or the transmission of the corporate assets to a third party.\textsuperscript{130} Shareholders also have the right to receive income from the company in the form of dividends.\textsuperscript{131} If the company’s articles do not provide otherwise,\textsuperscript{132} shares of common stock are without term. The “residuarity” left shareholders has more than one meaning. First, shareholders have residual control over a corporation because they may take action against directors on behalf of the company for breach of duty.\textsuperscript{133} Second, in the event of the company being wound up, shareholders "are paid last, after debt investors, employees, and other investors with (relatively) 'fixed' claims.

\textsuperscript{126} Id. at 16.

\textsuperscript{127} A.M. Honoré, Ownership, in OXFORD ESSAYS IN JURISPRUDENCE 107, 113 (A.G. Guest, ed. 1961). "A.M. Honoré played a decisive role in advancing the bundle or rights metaphor by cataloguing a generally accepted list of the 'incidents' or property or ownership." Bell & Gideon, supra note 49, at 15. Bell and Parchomobsky have observed that, "[t]oday, the bundle of rights conception of property rules the academic roost." Abraham Bell & Gideon Parchomobsky, "What Property Is," Research Paper No. 04-05, University of Pennsylvania Law School Institute for Law and Economics 15 (2004). The U.S. Supreme Court routinely uses the "bundle of rights" metaphor in its decisions on the Takings Clause, U.S. Const., amend. V. For example, in Lucas v. South Carolina Coastal Council, 505 U.S. 1003 (1992), the Court explained: "the question must turn, in accord with this Court's 'takings' jurisprudence, on citizens' historic understandings regarding the content of, and the State's power over, the 'bundle of rights' that they acquire when they take title to property." Id. at 1004. Also see Thomas W. Merrill, The Landscape of Constitutional Property, 86 VA. L. REV. 885 (2000). For discussion of problems with and challenges to the "bundle" theory, see Adam Mossoff, What is Property, Putting the Pieces Back Together, 45 ARIZ. L. REV. 371 (2003).

\textsuperscript{128} Del. Code Ann. tit. 8, §§ 211(b) and 141(k); and §§ 8.03(c) and 8.08(a).

\textsuperscript{129} Del. Code Ann. tit. 8, § 251(c), and § 11.04(b).

\textsuperscript{130} See, e.g., Del. Code Ann. tit. 8, § 271(a), and § 12.02 RMBCA.

\textsuperscript{131} See, e.g., Del. Code Ann. tit. 8, §§ 170 and 154; § 6.40 RMBCA.

\textsuperscript{132} See Del. Code Ann. tit. 8, § 151, and § 6.01 RMBCA.

\textsuperscript{133} See, e.g., Del. Code Ann. tit. 8, § 327; § 7.40 RMBCA.
These equity investors have the 'residual' claim.\textsuperscript{134} Third, as Armour and Whincop point out: “'Residual' implies that the rights to control over all states of the world which are not specified by law or contract \textit{ex ante}.” Thus, if a new kind of right were to arise – such as control over data regarding decisions made by the company which become attractive to sell to big data processors – it would likely be seen as under the ultimate control of the shareholders. Generally, all these rights "run with the assets,"\textsuperscript{135} that is, they are transferred with the share of stock to any new owner.

\textit{C. Moving beyond obscurantist legal doctrines}

All of the arguments set out in the previous Section are technical and doctrinal. Moreover, it is a fact that few shareholders ever exercise any of those rights except that to receive dividends from the company. As such, to an outside observer unfamiliar (or perhaps impatient) with legal doctrine, it would be conceivable to fall back on the observation that shares are traded like bonds and receive annual payments just as bondholders do, so should be understood as contract and not property. The relationship of a shareholder to a company is so unlike that of an owner to a building or an automobile that a court may decide to free itself of rigid doctrine and embrace common sense. However, if shareholder ownership is eliminated, corporations would no longer be owned by any constituency. They would resemble public assets under the control of a small subset of the public, but would presumably remain private assets, perhaps constructively held in trust for a broad set of constituencies. This may well be socially desirable, but would create a significant problem for the orderly management of a very large portion of the world’s wealth.

Removing vast quantities of national asses from a fixed order of ownership and control would create much more significant systematic friction than that observed in the classification of the rights of a trust beneficiary in China (Part II) or the nature of a security entitlement in the United States (Part III). It is unclear whether this means that \textit{removing} a property right from a well-defined class is inherently more difficult than \textit{transferring} hitherto non-existent rights to a class. In any case, as discussed in Part I, the flexibility of legal culture in a given jurisdiction will be important. For this reason, we can probably agree with Stout\textsuperscript{136}

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\item \textsuperscript{135} "For our purposes, the attribute that distinguishes a property right from a contract right is that a property right is enforceable, not just against the original grantor of the right, but also against other persons to whom possession of the asset, or other rights in the asset, are subsequently transferred. In the parlance of property law, the burden of a property right “runs with the asset.”” Henry Hansmann & Reiner R. Kraakman, \textit{Property, Contract and Verification: The Numerus Clauses Problem and the Divisibility of Rights}, 31 J. Leg. Stud. 373, 378-379 (2002).
\item \textsuperscript{136} Stout, \textit{Shareholder Value Myth, supra} note [●], at 56, 84.
\end{enumerate}
\end{footnotesize}
that a reduction of shareholder rights in the United Kingdom, with its doctrinally focused company law, will be more difficult than in the United States, where law has been traditionally open to ceding doctrinal consistency for economic utility, however that might be understood in a given epoch.

V. CONCLUSIONS

The cases discussed in this paper provide tangible examples of how law is made. To make or unmake property, a jurisdiction requires political will, institutional legitimacy and – in many jurisdictions – systemic consistency within the legal system. While the logic of the law is not Logic, it does demand a degree of reasonableness. It can be expected that utility sets the activity in motion when some person or industry sees law as the necessary tool to achieve this end. In Parts II and III, this was the financial industry. The industry brought the desired project to one or more lawmaking institutions. This process can be direct – as in the Chinese and U.S. creation of property rights discussed in Parts II and III – or indirect, as in the seeding of the atmosphere by academic arguments of team theorists to disregard the property interest of corporate shares, discussed in Part IV – which could one day land in an important court or before a legislative body.

Consistency of the legal system and legal doctrine will matter, but will not have the same weight for all jurisdictions. The United States is famous for bringing principles of economics into its tort, corporate and securities law, making these laws far less doctrinal than their British counterparts. China has since Deng been an archetype of pragmatic law- and policy-making (“crossing the river by feeling the stones”). A good test for our theory of the components necessary to make and unmake property rights could be the attempt to unmake the property rights of corporate shares. In the United Kingdom, this effort should face opposition from both interest and a doctrinal approach to the law, which would ignore past thinking on the matter only under great social pressure. In China and the United States, if interests were to shift, the pragmatic flexibility of the law should then be ready and able to accommodate this shift.