

REAL ESTATE TRANSACTIONS AND ENTREPRENEURSHIP: TRANSFORMING VALUE THROUGH EXCHANGE

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INTRODUCTION

This Essay is offered as an invitation to a conversation about the way in which we think, or might think, about real estate transactions. Preliminary and suggestive in nature, the Essay invites readers to think about an entrepreneurial theory of real estate transactions. Many of these ideas expand on work I began in two earlier books: *Law and Market Economy: Reinterpreting the Values of Law and Economics*¹ and *Law in a Market Context: An Introduction to Market Concepts in Legal Reasoning*.² In each of these books, I develop the idea of law and market economy, or what might otherwise be identified as law and market exchange theory. This approach is based on the market as a dynamic process of exchange and involves examining the way in which exchange is initiated, the terms of trade, the subjects of exchange, and a variety of socio-legal factors that govern human interaction in a market society. It is an approach grounded in an understanding of the market as a place of meaning and value transformation rather than one of a simple utilitarian economic calculus. It assumes that the market is a means to a mission-directed end rather than an end in itself. In this Essay, I apply this approach to an initial consideration of real estate transactions to suggest that such transactions are prototypical examples of entrepreneurship because they focus on the transformation, capture, and creation of value through exchange.

At the outset, it is important to understand that the value of a transaction depends on its position and its relationship to all other elements of a given system

* E.I. White Chair and Distinguished Professor of Law at Syracuse University College of Law. The author retains full rights to use of this Essay without the need for any further permission from the *Indiana Law Review*. A shorter version of this Essay will appear in *CREATIVITY, LAW AND ENTREPRENEURSHIP* (Shubha Ghosh & Robin Paul Malloy eds., Edward Elgar Publishers) (forthcoming late 2010 or early 2011). In this Essay, as in much of my work, one can identify the influence of ideas from Austrian economics and from the philosophy of Charles Sanders Peirce. Peirce, of course, is a founding figure in modern semiotics along with Ferdinand de Saussure. Saussure developed a two-part theory of signs (the sign and the signified) and Peirce pioneered a triadic theory of signs (based on the icon, index, and symbol). Peirce was also a founding figure with William James, John Dewey, and Oliver Wendell Holmes in what became known as the philosophy of American pragmatism and realism. Although there are many books on Peirce and his theory of signs, an interesting read on Peirce and his relationship to James, Dewey, and Holmes can be found in LOUIS MENAND, *THE METAPHYSICAL CLUB: A STORY OF IDEAS IN AMERICA* (2001).

1. ROBIN PAUL MALLOY, *LAW AND MARKET ECONOMY: REINTERPRETING THE VALUES OF LAW AND ECONOMICS* (2000) [hereinafter MALLOY, *LAW AND MARKET ECONOMY*] (published in English and translated into Chinese and Spanish).

2. ROBIN PAUL MALLOY, *LAW IN A MARKET CONTEXT: AN INTRODUCTION TO MARKET CONCEPTS IN LEGAL REASONING* (2004) [hereinafter MALLOY, *LAW IN A MARKET CONTEXT*].

of exchange (a given market context). This means that exchange and the values generated are contextually informed by a variety of factors such as history, ideology, and culture. In such an environment, entrepreneurship involves the ability to successfully interpret the position and relationship of a potential transaction in order to form a plan of action that advances a particular mission-directed outcome. Mission-directed outcomes may themselves reflect a variety of human needs and motives including those related to basic food and shelter; a desire for power, control, status, security, and respect; and a sense of fairness, justice, and equity. It is important to understand that price and wealth are merely partial interpretations of value and not value itself; similarly, economics is an incomplete interpretation of market theory and not the market exchange process itself.

It should also be noted that modern real estate transactions involve the strategic coordination of networks of property-related assets including real, personal, intangible, cultural, and intellectual property. In addition, structuring a real estate transaction (especially a commercial one) requires knowledge of markets and application of other areas of law including corporate, commercial, securities, tax, finance, mortgage, environmental, and land use law. In this context, modern real estate transactions involve two primary activities: (1) the fixing of assets so that they are commodifiable (a process of assetization); and (2) the strategic use of transactional infrastructure to facilitate trade in these assets for purposes of capturing and creating value.

This Essay, therefore, undertakes to address the relationship among property, real estate transactions, and entrepreneurship. The hope is to develop an introductory typology of entrepreneurship and a sense of real estate transactions as a source of transformative change in property law. In furtherance of this goal, the Essay seeks to develop a more nuanced sense of the potential types of entrepreneurs that particular legal incentives may need to account for in promoting exchange in property-based assets. In this regard, the Essay explores several categories or patterns of entrepreneurial behavior that come into play with property transactions. Each pattern of behavior reflects different motivations for participation by people in particular types of transactions. The suggestion is that different people seek different types of returns and value rewards from property transactions and that multiple behavior patterns can nonetheless all be identified as forms of entrepreneurship. Ultimately, the Essay offers some preliminary and tentative thoughts on developing a more nuanced approach to understanding entrepreneurship in the context of the real estate transaction.

With this in mind, the Essay also seeks to define entrepreneurship in the context of real estate transactions. In accomplishing these goals, the Essay proceeds in several steps. Part I outlines key background assumptions regarding the relationship between property law as a subject area and real estate transactions as a related but distinct subject area. Part II discusses the general idea of entrepreneurship and provides a working definition for use in this Essay. Part III suggests four different patterns of entrepreneurial behavior that seem to operate in property transactions. The Essay concludes with some suggested implications for thinking about the development and teaching of real estate

transactions theory.

I. RELATIONSHIP BETWEEN PROPERTY LAW AND REAL ESTATE TRANSACTIONS

In developing an understanding of the relationship among property law, real estate transactions, and entrepreneurship, it is important to understand that this analysis is from the perspective of transactional law theory. The analysis reflects on the function of property in terms of people concerned with real estate transactions. This approach is quite different from the typical theoretical stance taken when discussing property matters. Ordinarily, work in the property area involves a property-centric view of seeing transactions from the perspective of a property lawyer (or academic) preoccupied with typical subject matter concerns of a first year property course. Such a view examines the world in terms of how everything relates to basic theories of property law. In contrast, in developing a theory of real estate transactions, one asks how everything, including property, relates to and facilitates a theory of transactions. The difference involves a shift in the interpretive frame of reference from one that is property-centric to one that decenters property and places the transactional process of human interaction at the core.³

3. I have found that the idea of decentering the property perspective does not sit well with some property scholars. The reality, however, is that there are many vantage points from which to examine property relationships. It is also important to note that the world has changed and markets have changed. We live in a world in which ideas, creativity, and entrepreneurship increasingly drive strategic gains. It is also a world in which networks and patterns of exchange become increasingly significant while property functions as a foundation on which exchange takes place. It is a world that is less concerned with property as place and more concerned with markets that transcend interjurisdictional space. People often put a great deal of value on property assets for what those assets mean in terms of exchange and access to globalized markets. For example, people do not really want to sit back and bask in the glow of owning a patent and knowing that they can exclude others from ownership; they want the value of being able to transfer and profit from ownership. The real action in property law is in developing a strategic theory of transactions while recognizing the role of the process by which assets become fixed for exchange.

So as not to be misunderstood, none of this means that we do not need property or that property is not important. Most people understand the significance of such property concepts as the rights to use, possess, and exclude, but the real strategic action in today's marketplace centers on the right to transfer and the right to profit from ownership. In terms of strategic value, the exchange has become critical while the process of assetization has become normalized. Of course, one need not accept my view of the rising importance of transactions, relative to the process of fixing assets, to acknowledge the more important point: real estate transactions involve their own scholarly and theoretical issues, and although these issues are related to property, they are distinct and of at least equal significance in understanding the use, function, and purpose of property in the world. Thus, in a course on real estate transactions, property and property theory, about which much has been written, are not at center stage. Rather, property and property theory function more as scenery and stage props for the actual drama that unfolds.

From a transactional perspective, property law is primarily about a process of fixing assets. By this, I mean that property involves the process of identifying and defining particular assets such that they can be traded and exchanged. Property is not an object or a thing; it is the process by which assets are identified, commodified, and fixed for purposes of facilitating trade and exchange. Property is simply a process of fixing assets so that the assets are identifiable and exchangeable in the marketplace. This includes fixing a writing for purposes of copyright law or fixing an invention for purposes of patent law just as much as it includes fixing a legal description and an estate interest for the identification of real property. Thus, although real property and intellectual property may have significantly different qualities, each can be properly understood as property because each involves the fixing of an asset within the basic framework of a property law regime. The idea that certain interests might also be describable in non-property terms does little to diminish the reality that such an interest can also be a legally fixed property asset. Not all property assets need to share exactly the same qualities or characteristics.

Fixing an asset involves identifying, defining, and assigning it certain qualities, characteristics, and categories.⁴ The underlying qualities include definitional matters such as fixing a legal description and the particular estate interest for real property. In terms of assigning characteristics to the asset, the typical characteristics of ownership include the right to use and possession, the right to exclude, the right to transfer, and the right to the profits attributed to the asset (including equity appreciation). Finally, property-related assets are categorized in such terms as real, personal, intangible, cultural, and intellectual property. This categorization permits a more nuanced treatment of the asset. Fixing the asset also involves ascribing certain default rules such as remedies to transactions in that asset. Thus, by simply categorizing something as “real property” one can ascribe certain qualities, characteristics, and potential causes of action to the asset. One can then deal more efficiently with the asset by reducing various transaction costs associated with learning about its potential value. Property law and property lawyers focus primarily on the fixing of assets. Consequently, property lawyers concern themselves with the questions of “what is property?” and “what ought to be property?”

In contrast to property lawyers, transactional lawyers focus on the questions of what we can do with something that is defined or treated as property (that is, what we can do with a fixed asset within a recognized property category) and what should be the incentivized priority structure of exchange within a given market context. While property lawyers identify objects of trade and exchange, transactional lawyers manage the risk, authentication, and potential enhancement of value from exchange. Put another way, property lawyers fix assets, and transactional lawyers facilitate the capture and creation of value from exchange in these assets. Thus, for example, real estate transactions involve the strategic

4. See HERNANDO DE SOTO, *THE MYSTERY OF CAPITAL: WHY CAPITALISM TRIUMPHS IN THE WEST AND FAILS EVERYWHERE ELSE* 49-51 (2000); MALLOY, *LAW IN A MARKET CONTEXT*, *supra* note 2, at 109.

use of legal infrastructure to facilitate the transfer of assets in ways that create and transform value. This practice can result in a change of ownership or an adjustment of certain characteristics of ownership with respect to an asset, or it might result in the integration of a given asset into a bigger real estate project. Similarly, transactions may generate new value opportunities by transforming the underlying asset into a new legal form. This transformation might result from something such as issuing a security supported by the underlying property asset, as in using pools of mortgages to support the issuing of mortgage backed securities.⁵ The exchange of assets creates value and transforms relationships, and much of this value is generated by the structure and strategic use of transactional infrastructure rather than the fixing of the underlying asset.

In fact, in our modern global marketplace, assets flow dynamically in fully integrated networks of finance and exchange. In this environment, local notions of place have become less significant, and the ideas of property less *strategically* important than the mechanisms for moving and transacting in various asset values.⁶ By this I mean that basic property concepts have become largely globalized, and strategically significant sources of transformative value now arise from advantages in structuring and manipulating the legal infrastructure of exchange rather than from a system for fixing assets. In other words, the scaling of exchange has changed, and as markets scale up from the localized level to regional, national, and global levels, the significance of the network infrastructure becomes strategically more important in adding and sustaining value than the underlying process of fixing assets. This is not to say that there is no longer a need for fixing assets or that property suddenly becomes irrelevant. An analogy might be to the relationship between an individual computer and a computer as a component of a large-scale network. The individual computer is of significant value and can assist its user in accomplishing many tasks. At the same time, the strategic value of the computer rapidly increases with innovations in scaling through the development of network architecture that connects the individual computer to an integrated system, likewise with a cell phone. The cell phone is a basic access tool, which is important, but it is the network that adds strategic advantage and value. Just look at television advertising, the strategic value in phone communications involves network coverage, speed, and supported applications. The phone is primarily an individual access tool, and as the network scales up, it is the network more than the phone that adds real strategic value. In the context of this Essay, property is the access tool and real estate transactions are the networks.

5. See ROBIN PAUL MALLOY & JAMES CHARLES SMITH, REAL ESTATE TRANSACTIONS: PROBLEMS, CASES, AND MATERIALS 367-406 (3d ed. 2007). This material also found in Robin Paul Malloy, *Mortgage Market Reform and the Fallacy of Self-Correcting Markets*, 30 PACE L. REV. 79, 89 (2009) [hereinafter Malloy, *Mortgage Market*].

6. See generally Robin Paul Malloy, *Place, Space, and Time in the Sign of Property*, 22 INT. J. SEMIOTICS LAW 265, 265-77 (2009) (addressing the central role of place in property and suggesting some problems with the changing nature of markets that transcend traditional notions of place).

To expand on the above, the idea behind the dynamics of this new global reality is relatively simple.⁷ For example, not so long ago (before the proliferation of personal computers), a person or business would gain a significant strategic advantage from having a computer and in-house computer software for word processing.⁸ Having such a system would give one a major advantage over a competitor without such a system. Now, however, computers dominate the workplace and everyone can have an efficient word processing system by simply buying Word or WordPerfect. There is no longer any real strategic advantage to be had in this respect. Now it is not so much about having a computer and word processing software because everyone has these basic background tools. Instead, strategy is about trying to identify unique ways to employ and network these assets for purposes of generating new exchange opportunities and values.

In a similar way, consider Buffalo, New York, once one of the wealthiest cities in the United States because of its strategic location near Niagara Falls and its ready access to a cheap and abundant source of power.⁹ That strategic geographic advantage has all but disappeared as new technology made it possible to obtain cheap power in places that were physically distant from the source. Now there is no significant advantage in locating a business in Buffalo rather than in any one of a hundred other places. The ability to generate and deliver power has been re-scaled to a higher level, and network infrastructure has strategically shifted value from the place of the source, to the delivery and exchange network. Something similar is happening in the area of property assets. The basic ideas of property, in terms of a process of fixing assets, have been globalized to a significant extent. Therefore, these background concepts and tools, although important, are no longer the primary sources of strategic advantage as they once were. In the highly integrated markets of the twenty-first century, strategic advantage in dealing with property assets more likely lies in the development of new methods of finance, the structuring of favorable tax laws, the integration of credit security systems, the emergence of new forms of risk spreading, and the development of better technologies for quickly recording, storing, and authenticating asset information across globally networked landscapes.

The strategic significance of transactional infrastructure can be seen in the economic development of China. Over the past twenty to thirty years, China has witnessed trillions of dollars of growth in real estate development even though it lacked, until recently, a legal right to property as would be understood in the United States.¹⁰ The transactional infrastructure in China developed to facilitate

7. See generally NICHOLAS G. CARR, DOES IT MATTER? INFORMATION TECHNOLOGY AND THE CORROSION OF COMPETITIVE ADVANTAGE (2004); Nicholas G. Carr, *IT Doesn't Matter*, 81 HARV. BUS. REV. 41-42 (2003); HOWARD SMITH & PETER FINGAR, IT DOESN'T MATTER: BUSINESS PROCESSES DO (2003) (analyzing Nicholas Carr's IT article in HARV. BUS. REV.).

8. Cf. CARR, DOES IT MATTER, *supra* note 7, at 63-66.

9. See *id.* at 20.

10. PRIVATE PROPERTY, COMMUNITY DEVELOPMENT, AND EMINENT DOMAIN 1-2 (Robin Paul

exchange by “plugging” local markets into a large scale financial infrastructure of investment resources from outside the country and integrating it with locally emerging networks. Network access, strategic use of leasing mechanisms, and the willingness to deal in property-like assets proved sufficient for real estate development without a need for an official legal classification of “property.” We can understand this idea of property-like assets when we think of important assets that are valued and exchanged in the United States even if they are not necessarily classified as property per se. Examples of such property-like assets include trademarks, goodwill, licenses, contract rights, and rights in lawsuits.¹¹ The important point is that assets need to be fixed, and this is a function of property law, although assets need not be fixed as property per se.

Strategically, the world has changed. As we look ahead, we need to think beyond property and traditional approaches to the economics of utilitarian cost-benefit analysis. The future is driven by an increasingly networked and global environment in which entrepreneurship is critically important. In this environment, the transformative advantage goes to the player(s) with the best-developed infrastructure of exchange and the most creative pool of transactional entrepreneurs. Perhaps this is itself the most significant transformation of value in modern property relations—the shift in primacy away from the question of *what is and ought to be property* to the question of *what can and ought to be done with property*. It is a shift away from the strategic significance of fixing assets to that of shaping and controlling the mechanisms of exchange.¹² This shift does not deny the importance of assetization as an underlying activity of property law; it merely puts property law in its proper place as an input activity in the process of transforming and creating value through exchange.

The increased focus on strategic transactional infrastructure as a source of value means that real estate transactions play a significant role in the transformative functions of property. It also means that attention must be paid not only to thinking about a theory of property, but also to developing a coherent and socially situated theory of real estate transactions. Such a theory must account for more than an economic calculus; it must address the idea of property in a market context by exploring a number of socio-legal factors. Furthermore, because the transactional process centers on capturing and creating value from exchange (a core function of entrepreneurship), it is important to develop a nuanced understanding of entrepreneurship as a core component of any theory of real estate transactions.

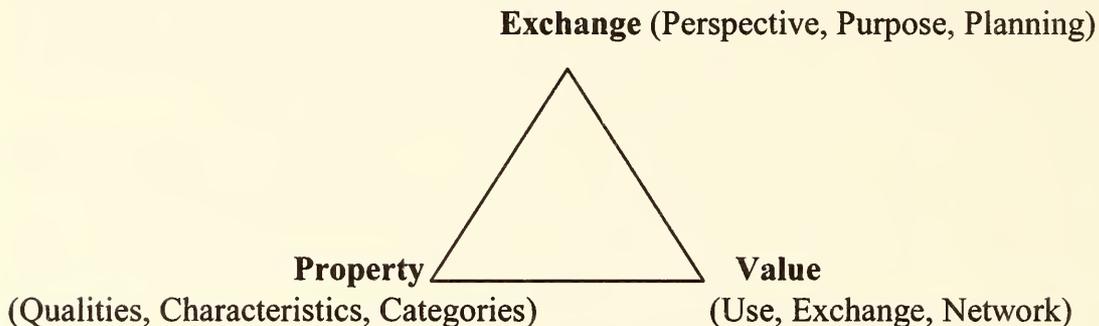
Malloy ed., 2008). The new property law in China became effective October 1, 2007. *Id.* at 1.

11. Jeremy A. Blumenthal, *Legal Claims as Private Property: Implications for Eminent Domain*, 36 HASTINGS CONST. L.Q. 373, 379 (2009) (providing some examples of assets with the ambiguous status as property) (emphasis added).

12. Today’s rapidly changing technology and integrated networks of exchange conspire to push the process of asset transformation into new territory, often creating ambiguities along the edges of established property categories (disputes over body parts, genetic information, and carbon trading rights come to mind). This ambiguity can leave property law in the position of trying to play catch-up in terms of defining emerging and evolving forms of asset value.

In an overly simplified form, the relationship between property and transactions can be illustrated triadically as shown in the diagram below.¹³ The diagram as a whole represents the way in which real estate transactions function as an entrepreneurial process directed at capturing and creating value from the strategic exchange of fixed assets.¹⁴

The Real Estate Transactions Process



In the above relationship, there are three key touch points around which to develop a theory of real estate transactions and entrepreneurship: property, exchange, and value. A brief outline of the ideas associated with each of the

13. See MALLOY, *LAW AND MARKET ECONOMY*, *supra* note 1, at 70-72; MALLOY, *LAW IN A MARKET CONTEXT*, *supra* note 2, at 69-80. In these two books, I explain the underlying theory of a triadic approach, which is informed by the work of American pragmatist Charles Sanders Peirce. Peirce's theory of meaning and understanding (termed semiotics, the study of signs) provides a rich foundation for analyzing complex and dynamic systems such as those of law and markets. My books also detail numerous sources of information about Peirce and his work. Because much of the background theory is explained in these two books, I will not go into detail in this short Essay. I will simply point out the elements in the diagram that follows, and anyone with an interest can go to my earlier books for a better understanding of the relationships. Note that *LAW AND MARKET ECONOMY* is much more focused on a theory of value and entrepreneurship than is *LAW IN A MARKET CONTEXT*. One may gain the quickest overview of my use of Peirce's semiotic approach from pages 62-85 of *LAW IN A MARKET CONTEXT*.

In a Peircean sense, the idea of a real estate transaction can be understood as a sign, and the sign stands for a certain meaning to some people. The sign consists of a first, second, and third element (the icon, index, and symbol, respectively). In the first diagram, property stands as a first, exchange as a second, and value as a third element. There is a continuous and dynamic relationship among the first, second, and third elements that Peirce identified as a process of semiosis. This process gives rise to meanings and values that form and reform over time. The point of this discussion is simply to explain that there is a lot of theoretical work behind the triadic explanations that I present. I believe that one can gain insight from thinking about the ideas being described without any deep knowledge of Peirce. At the same time, for those who have questions about the simplicity of the depictions I offer in this Essay, I acknowledge their simplicity as a starting point for a conversation and offer references to my earlier books as sources for understanding some of the background thinking that I bring to the subject.

14. The next section of the Essay will address the related concept of entrepreneurship.

three key touch points is provided to give a sense of the overall project. First, however, one must keep in mind that the above relationships are not static; they are dynamic and multi-directional relationships that reflect a continuous process of interaction, creativity, and change. Each of the three touch points is discussed below.

A. Property

Property involves a process of fixing assets. This process establishes the basic fundamental qualities of the assets that will be the subject of trade and exchange. It involves setting basic definitions and descriptions as well as the characteristics of ownership and the various subcategories of property types (as discussed above). From a transactional perspective, this is the function of basic property law and theory—to work out the technicalities of what is property and what ought to be property. Theory here consists of elements including a number of constitutional, institutional, political, and economic matters.¹⁵

B. Exchange

Exchange involves the process of strategically structuring transactions with the hope of capturing and creating value. In general, there are three types of exchanges one might encounter: contract-based exchanges, gifts, and transfers by operation of law (including takings). Real estate transactions focus predominantly on contract-based exchanges and how to strategically structure an exchange to best achieve a mission-directed outcome. Doing this means that one accounts for both the potential for gain from a successfully completed transaction and the protection against loss in the event the transaction fails (perhaps as a result of default, foreclosure, or bankruptcy).

The fixing of assets under property law implicitly, if not expressly, contemplates exchange. The exchange process intrinsically references property law for the basic raw materials of the transaction, with everything ultimately coming together in a process directed at capturing and creating value. From the exchange perspective, the real estate lawyer deals with alternative ways to structure transactions so as to transform, capture, and create value. In order to accomplish this goal, the real estate transactions lawyer must focus on three exchange factors: perspective, purpose, and planning.

1. Transactional Perspective.—In order to create value and assist others in such a process as a lawyer, one must know and appreciate the way in which the activity of exchange is interpreted and understood by the potential parties involved. One must see the transaction from the perspective of the primary parties to the contract as well as from that of the facilitating secondary parties such as attorneys, lenders, regulators, brokers, and other intermediaries.

15. Two examples of excellent work in the area of property theory (admittedly, there are more) are GREGORY S. ALEXANDER, *THE GLOBAL DEBATE OVER CONSTITUTIONAL PROPERTY: LESSONS FOR AMERICAN TAKINGS JURISPRUDENCE* (2006) and LAURA S. UNDERKUFFLER, *THE IDEA OF PROPERTY: ITS MEANING AND POWER* (2003).

Likewise, the entire transaction should account for third party perspectives. Third parties are those likely to be affected by externalities or parties who may potentially deal in the asset at some future date or in some altered form. Thus, the transactional lawyer must work on the ability to imagine and structure an exchange from multiple points of view. Even if the lawyer is engaged to represent only one particular view, it is critical to account for the motives, objectives, and constraints of the other parties so that negotiation can be successful. In directing learning and knowledge about transactions in this way, one develops alertness to a broader understanding of individualized exchange and increases the likelihood of spotting new opportunities for gain from arbitrage.

2. *Transactional Purpose*.—In order to successfully structure a transaction, one must understand the mission-directed purpose of the exchange. One must identify the immediate goal (e.g., to get financing or build a house or office building) and the implicit goal of understanding the actors' motivation and mission-based values. The idea of transacting to capture and create value is not reducible to some simple cost-benefit calculus about maximizing profit. Transactional motivations are much more complex based in part on institutional and behavioral issues to be discussed in the next two parts of this Essay. People transact to advance mission-directed objectives and do so by making value choices that account for incentivized market structures, but they are not necessarily driven by a desire to maximize a purely self-interested economic rate of return. Here the transactional lawyer needs a multifaceted theory of value and motivation that transcends the traditional economic tools of cost-benefit analysis and game theory. The transactional lawyer must do more than calculate; she must develop an understanding of the meanings that the parties bring to the exchange. This requires a richly developed "feel" for interpretation.

3. *Transactional Planning*.—In planning the strategic structure of transactions, one should think in terms of three functions: identifying and exploiting one's comparative advantage, managing risk, and confirming and authenticating the elements of the exchange. If one undertakes a transaction to capture and create value, then one should ask what comparative advantages she brings to an exchange that will allow her to get more from the asset than current or potential owners. Identifying one's comparative advantage directs attention to opportunities for creative exploitation of these advantages. Managing risk involves the need for an understanding of some theories of risk and for the strategic use of legal tools to Identify, Reduce, and Shift (IRS) risk in the contractual relationship (such as by use of conditions, warranties, title insurance, surveys, and guarantees).¹⁶

Finally, authentication involves using available tools to validate the "reality" of the transaction (as in avoiding a Ponzi scheme or other forms of fraud). This means that there is a need to authenticate the property, its ownership, and its value. For example, one does a title search and a survey to authenticate the

16. I use "IRS" as an easy way for students to remember what we do in managing risk—first, we learn to identify it, then to reduce it, and then, for risk which cannot be eliminated, we learn how and when best to shift it.

existence of the property and its current ownership, and one does credit checks and examines the documents at closing to ensure that the anticipated exchange is properly accounted for and reflected in the transfer.¹⁷ Part of the problem behind the mortgage market collapse of 2007-09 was improper authentication of the underlying transactions, resulting in billions of dollars of mortgage-backed securities supported by mortgage arrangements of little or no economic substance.¹⁸ The documents representing the underlying transactions did not reflect the authentic nature and value of the actual exchanges.

C. Value

The third key touch point in the real estate transactions process is value. Assuming that real estate transactions are primarily about the transformation, capture, and creation of value, it is important to develop a theory of how best to understand value in particular exchange environments. Value is a complex theoretical subject, but we can begin to understand some basic elements of value by thinking in terms of three transactional categories of value: use value, exchange value, and network value. Use value is about the value derived from being able to use an asset (a house provides shelter). Exchange value is the value, and potential value, that an asset represents as an access point to the market (the ability to borrow against one's home, or the home's value in resale). Network value is the value of an asset in relation to an integrated network of asset exchanges (such as the value of housing in terms of being a source of employment for construction workers and lumber companies, an engine for furniture and appliance sales, and an input item, via mortgage activity, to securitized asset markets).

Value must, of course, also account for different underlying measures of fair market, hedonic, and contingent valuation across the three above-mentioned categories. It also requires knowledge of present discounted value and the extent to which various legal rules account for different definitions of value. Additionally, value should be understood in light of the steps taken to secure a positive outcome while also protecting against failure in any given exchange.

A theory of real estate transactions must therefore account for a number of factors. It must address what can be done with property and what ought to be able to be done with property. It must address the way in which markets are structured and the way in which communities incentivize particular exchange relationships. All of these issues must also be translatable in a form that permits action in pursuit of mission-directed outcomes that are themselves focused on capturing and creating value from exchange in property related assets.

17. Many of the things that we do in a real estate transaction are about authentication: authentication of parties, assets, and value. We need to think in terms of the tools that can be used to advance authentication efforts and of the systems that lend themselves to more effective forms of authentication. Transparency is one example of an important element for such a system.

18. Malloy, *Mortgage Market*, *supra* note 5, at 100-01.

II. GENERAL IDEAS CONCERNING ENTREPRENEURSHIP

Entrepreneurship is a relatively new and growing area of interest and study.¹⁹ One can think of entrepreneurship as occurring in three different market settings identifiable as private, public, and social entrepreneurship.²⁰ In the current context, private entrepreneurship generally involves action taken by private parties to maximize profit and wealth. This action involves setting a private mission to be executed for private gain.²¹ Public entrepreneurship relates to the idea of a public entity, such as an elected or appointed body, taking action to promote a public mission as set by actors accountable to the public.²² Social entrepreneurship relates to actions taken by not-for-profit entities pursuing private missions for the promotion of the public good.²³

A broader, and I believe more useful, definition of social entrepreneurship would include all entrepreneurship pursued with the goal of adding market value while also advancing a value-based mission other than simply maximizing private wealth. In this Essay, I take the view that these categories are useful because the institutional structure and context of a transaction in property-related assets is important to have in mind when thinking about how best to advance a given mission-directed outcome. These categories help us focus on the differences in the institutional structure of the actors (public, for profit, and not-for-profit). At the same time, we must be aware of the fact that potentially different behavioral patterns related to entrepreneurship may also be operating across these three categories.²⁴

In my view, all entrepreneurship, no matter what category, involves some social aspect because entrepreneurship necessarily occurs in a social context.²⁵ Entrepreneurship arises from exchange and human interaction.²⁶ It does not occur in isolation. Invention may take place in some respects as an isolated activity, but entrepreneurship is a process and not an event. Furthermore, the entrepreneurship process is facilitated, incentivized, and protected within a given socio-legal environment. In such a setting, it is often difficult to separate the public from private aspects of a given set of activities. Separation becomes increasingly difficult as government credit and financing, as well as tax policy and regulation, work to inform private action and shape reward values related to

19. Two useful and important books on entrepreneurship are ISRAEL M. KIRZNER, *DISCOVERY AND THE CAPITALIST PROCESS* (1985) and ISRAEL M. KIRZNER, *THE MEANING OF MARKET PROCESS: ESSAYS IN THE DEVELOPMENT OF MODERN AUSTRIAN ECONOMICS* (1992).

20. MALLOY, *LAW IN A MARKET CONTEXT*, *supra* note 2, at 215-23 (providing a basic introduction to the idea of a three-sector economy consisting of the private, public, and not-for-profit sectors).

21. *Id.* at 216.

22. *Id.* at 217.

23. *Id.* at 218-19.

24. *Id.* at 222-23.

25. *See id.* at 78-94.

26. *Id.* at 94.

particular goals and missions.

In seeking to develop a framework for exploring entrepreneurship, I offer my own working definition, which can include any type of so-called private, public, or social entrepreneurship. In doing so, I discuss entrepreneurship in terms of four patterns of behavior related to what I tentatively identify as the simple transactional, speculator, innovator, and network entrepreneur. Each type of entrepreneur may be pursuing a different mission-directed outcome and brings different expectations and behavior patterns to a property exchange. For purposes of this Essay, I define an entrepreneur as (1) a person with knowledge about an activity and the alertness to spot opportunities for capturing and creating value from potential changes in the existing patterns and practices of that activity (including gaps in information); who (2) exercises judgment concerning the potential value to be gained from exploiting the observed opportunity; and (3) who acts pursuant to that judgment to advance a mission-directed outcome in the hope of transforming perceived potential value into actual value.

An entrepreneur's alertness to new opportunities and the potential for capturing value from creativity presupposes an implicit need for a theory of knowledge and interpretation. This is because creativity requires both an understanding of current boundaries and recognition of a possibility for setting new boundaries and taking new action.²⁷ Recognizing something as new requires a foundational knowledge base and a cultural-interpretive reference point. Without an understood reference point, one would not appreciate the newness of an idea or action. Thus, interpretation theory is a critical element of our background understanding of entrepreneurship.

In addressing the idea of taking action to advance a mission-directed outcome, we should think in terms of evaluating alternatives with reference to least cost strategies. Least cost strategies can assist in maximizing mission-directed value, and importantly, this is not the same concept as acting to maximize wealth, efficiency, or profit.²⁸ Value is a more complex concept than wealth or profit and includes variables that are often difficult to quantify. When we think in terms of maximizing value through least cost strategies, we acknowledge that calculating an optimal course of action is impossible in any complex system of exchange and human interaction.²⁹ The best that can be done is to identify a set of reasonable courses of action given the assumptions and constraints of our mission-directed goals. Consequently, from a least cost strategy approach, one understands that people set mission-based goals and that markets are merely a means for incentivizing particular strategies for achieving these goals.

Before addressing particular behavior-based patterns of entrepreneurship that might be identifiable in real estate transactions, I present a simplified diagram of the entrepreneurial process so that one might have a better understanding of how

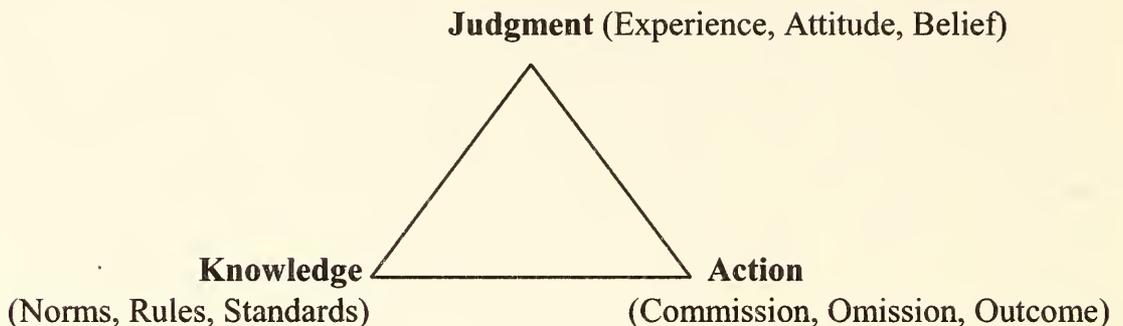
27. *Id.* at 76.

28. See generally MALLOY, LAW AND MARKET ECONOMY, *supra* note 1; MALLOY, LAW IN A MARKET CONTEXT, *supra* note 2.

29. See generally MALLOY, LAW AND MARKET ECONOMY, *supra* note 1.

the three component parts of the entrepreneurial process fit together.

The Entrepreneurial Process



One way of understanding the function of an entrepreneur is in terms of a triadic assessment based on three key criteria: knowledge, judgment, and action.³⁰ Although all of these criteria come with a need for theoretical exploration, I offer them here in simplified form as a starting point for understanding the basic process and planning further research.

A. Knowledge

In order to be an entrepreneur, one needs basic knowledge about an activity and an interpretive reference point for understanding the activity's baseline elements. Knowledge includes gaining familiarity and perhaps expertise in the norms, rules, and standards applicable to the activity. This familiarity permits one to be focused and better able to perceive opportunities for value enhancement from subtle changes and shifts in the transactional landscape.

B. Judgment

Knowledge provides a baseline set of skills and tools for understanding exchange, but value arises from the exercise of good judgment applying that knowledge. Judgment can be understood as being shaped or informed by three factors: experience (including an understanding of the feasibility of certain options with respect to market, technical, and legal feasibility), attitude (particularly regarding risk and one's sense of empowerment to make decisions and experiment), and belief (understandable at three levels starting with "asserted belief" based on speculation and hypothesis, "warranted belief" supported by authoritative reference to validation by sources outside of the actor's control, and "actualized belief" upon which action is predicated).³¹

30. See *supra* note 13.

31. See DANIEL W. BROMLEY, SUFFICIENT REASON: VOLITIONAL PRAGMATISM AND THE MEANING OF ECONOMIC INSTITUTIONS 130 (2006). This book offers an interesting and useful way of thinking about belief. Belief formation is a predicate to choice, and choice is an important part of market analysis. When we first formulate a belief, we are asserting it. Then we look at the belief in terms of trying to determine if it is warranted. Ultimately, we have to decide if it is a belief to

C. Action

Action involves making a choice and can be in the nature of commission or omission. The action is taken pursuant to a judgment about the least cost means of advancing a mission-directed outcome and in the hope of turning potential or speculative value into actualized value.

III. FOUR PATTERNS OF ENTREPRENEURSHIP

Having provided a general idea of a meaning of entrepreneurship and of the entrepreneurial process, I now suggest four patterns of behavior that seem to be identifiable in the consideration of the relationship between entrepreneurship and property-related transactions. I identify these patterns as simple transactional, speculative, innovative, and network entrepreneurship. This section outlines a basic meaning for each of the four patterns with the hope of advancing a more nuanced approach to the discussion of law and its relation to entrepreneurship. The terms I use are simply ones of convenience, and the different patterns are merely suggestions used to begin a conversation about the possibility of identifying elements that might be important in how we incentivize particular exchange relationships within the market.

A. Simple Transactional Entrepreneur

A simple transactional entrepreneur is one who takes action to participate in a routine property transaction that involves a major step for the person, even though it may be rather insignificant from a macro perspective. As an example, consider a person who decides to buy a home. For most people, this is a big personal step, even though it is routine and mundane in the context of millions of such transactions done as relatively standard exchanges. A key motivation in such a transaction is the desire to own a home, and from an economic perspective, the concern is generally to cover accounting costs.³² Simple transactional entrepreneurs are motivated by a mix of factors and making a large profit is not generally a primary motivator. Home buyers often simply ask: can I afford this home? Home ownership is driven by a set of beliefs constrained by a concern for affordability in its simplest terms.

B. Speculator Entrepreneur

A speculator entrepreneur is motivated by the prospect of big profits and generally enters a transaction based on the pursuit of economic profits rather than

act on, thus making it an actualized belief. We also go through this process of trying to turn new ideas into beliefs that others will accept and act on so as to bring about a community of belief that might give rise to a new norm, rule, or standard.

32. Accounting profits are based on covering costs in the sense that an accountant would report expenses against income. See MALLOY, LAW IN A MARKET CONTEXT, *supra* note 2, at 149-50; MALLOY & SMITH, *supra* note 5, at 3.

mere accounting profits.³³ The speculator entrepreneur takes on greater risk for the potential upside returns and is likely motivated by a desire to maximize wealth and attain high economic rents. The speculator entrepreneur may not have any original ideas but is willing to take on risk for certain types of transactions or to finance the risk to support others' ideas, assuming that an appropriate potential for return is attached to the risk of a new venture. A person that invests in and flips properties is one example of a speculator entrepreneur. A franchise operator is another example of this type of entrepreneur. Here the franchisee takes on risk but relies on the franchisor's ideas and marketing skills. The franchise business offers the franchisee potential for income and, if the franchise becomes very successful (e.g., McDonald's), a potential for big gains. The speculator entrepreneur looks for the opportunity for a potentially big payoff and the ability to capture an unusually high gain.

C. Innovator Entrepreneur

An innovator entrepreneur is driven by curiosity and has a special alertness to opportunities to capture and create value. Sometimes the activity is purposeful toward a given innovation, whereas sometimes it is directed to a particular end but results in unanticipated innovation. Many times, innovation is simply fortuitous. Generally, innovation is facilitated within certain environments of openness, diversity, and interaction.³⁴ While needing to cover accounting costs, the innovator entrepreneur also has sustaining economic motivation driven by a Ricardian concept of rents.³⁵ The innovator by definition acts to develop new ideas and not simply to take on risk.

D. Network Entrepreneur

A network entrepreneur seeks advantage by building and offering access to important networks of exchange.³⁶ This type of entrepreneur functions as a kind of market intermediary by generating value from various dynamics of the

33. In contrast to accounting profits as explained in the prior footnote, economic profits are based on the return one makes from a given undertaking relative to the return that would have been made on a comparable alternative undertaking. Thus, if the market's return on investing in a given property is five percent and I earn only a four percent return on a comparable investment, I have an accounting profit of four percent but a one percent economic loss.

34. MALLOY, *LAW AND MARKET ECONOMY*, *supra* note 1, at 78-85.

35. *See* MALLOY, *LAW IN A MARKET CONTEXT*, *supra* note 2, at 176. A Ricardian approach to rent/returns is an older view of rents/profits relative to the current economic approach based on a rent being what one gets over and above the next best offer. Ricardian rents are based on the return obtained from an undertaking that exceeds the minimal amount needed to get a person to participate. Thus, it is based not on opportunity cost, but on what it takes to get someone to pursue an undertaking. Any amount above that minimum is considered a Ricardian rent.

36. *See generally* YOCHAI BENKLER, *THE WEALTH OF NETWORKS: HOW SOCIAL PRODUCTION TRANSFORMS MARKETS AND FREEDOM* (2006); OZ SHY, *THE ECONOMICS OF NETWORK INDUSTRIES* (2001).

network itself. For example, this includes investing in and building close links to government officials in order to win government contracts, subsidies, or tax breaks. Cultivation of the network is a key element of the actual work product, or service to be delivered. Value creation is based on the network and not necessarily on the products and services delivered. We observe this behavior in developers that live off of public projects and funding for public-private partnerships. Such developers spend significant time building political networks in order to increase the odds of obtaining these potentially lucrative contracts.

E. Conclusion: Four Patterns of Entrepreneurship

When we look at these four behavioral patterns and understand that different types of entrepreneurship relate to different transactional motivations, we begin to appreciate the idea that perhaps different types of incentives, risk aversion strategies, and regulations will function best in different settings. We also gain a greater appreciation of the factors that might inform one's judgment concerning the best way to strategically structure a transaction. Therefore, when looking at property transactions, it is important to think not only in terms of the institutional structure of entrepreneurship (public, private, and social entrepreneurship), but also in terms of behavioral categories of entrepreneurship. This kind of thinking with respect to multiple forms of entrepreneurship can lead to more appropriately incentivized transactions in property-related assets.

Importantly, we must keep in mind that the above outlined behavioral patterns are offered as useful working tools and guides for analysis. In the real world, these are dynamic and interactive patterns and not discrete silos. In any given transaction, actors may exhibit multiple motivations and move in and out of various elements of a given pattern. Again, the idea is to begin developing tools for further analysis and exploration.

IMPLICATIONS AND CONCLUSIONS

In thinking about real estate transactions, and more broadly, property transactions, it is important to develop a better understanding of entrepreneurship and the relationship between property and exchange. This Essay offers some of my thoughts on how to begin a conversation about these matters. It reflects on the need for greater inquiry into the development of a new approach to understanding real estate transactions as a prototypical example of entrepreneurship. There are many rich questions to be explored.

The Essay suggests that we need to sharpen our understanding of entrepreneurship while seeing its presence in a broader socio-legal setting. We need to develop newer and richer theories of transactions, and we need to recognize that globalization has shifted strategic significance toward exchange theory and away from the already well-developed field of property theory. We also need to think not in terms of different types of transactions, but in terms of a theory of the real estate transactions process.

This Essay offers at least four central starting points for further work. First, it is important to get beyond definitions of property and look at what we can do with property. It is necessary to look at transactions in exchange (asking not just

what property is, but also, and more importantly, what can we do with property), and, from the perspective of market exchange theory, ask how we capture and create value from transactions in property.

Second, entrepreneurship requires us to develop a more complex vocabulary. We need to start thinking about a variety of types of entrepreneurship instead of dealing in an abstract sense with just one big category called “entrepreneurship.” We need to develop more nuanced categories of entrepreneurship based on different institutional settings and different observable patterns of behavior.

Third, creativity is a key to entrepreneurship, and this concept requires us to incorporate a theory of knowledge and interpretation into our basic approach. This is necessary because creativity requires both an understanding of the current boundaries of meaning (knowledge) and recognition of simultaneous opportunities for creating new boundaries and meanings. Interpretation theory enables a sense of understanding and offers a framework for imagining the potential for something new and different.

Finally, the relationship between law and entrepreneurship requires a dynamic approach to market theory. Traditional efficiency analysis is not entirely helpful because it has a substantially incomplete theory of creativity. Efficiency is directed at thinking about the alternative ways of allocating known resources. It is not about the market conditions under which creativity, innovation, and discovery are best facilitated. Therefore, there is a need to think creatively about the meaning of markets and the tools we use to understand law in a market context.

More immediately, some readers may wonder if such an approach can be successfully applied in the classroom. I think that it can. I believe that it can be one way of explaining the real estate transactions process, and I also believe that understanding a theory of why and how things fit together can improve one’s judgment as a transactional lawyer while enhancing alertness to new opportunities for gain.

In teaching my real estate transactions course, I tell my students that transactions are about creating value, looking into the future, and turning dreams into reality. The real estate transactions process is always focused on a mission-directed outcome, and the real estate lawyer needs to harness elements from almost every part of the law school curriculum, plus knowledge of markets and politics, to transform a vision into reality.³⁷ Therefore, in teaching a real estate transactions course, I believe it is important to orient students toward the future. Students need to understand that planning into the future is a creative and highly risky activity. The longer the time horizon, the more complex the exchange, and the more abstract the goal, the greater the uncertainty. Thus, it is important to understand the individual pieces of a transaction as part of a dynamic and integrative process. It is easy to state the subject matter of real estate transactions, as they simply involve “fixed assets exchanged for value.”

37. This is a different undertaking than that of a trial lawyer, for example. Trial work is about reconstructing the past and creating narratives of history. Real estate transactions, in contrast, are about imagination and the creation of new narratives that shape our future landscapes.

Translating this definition into something meaningful is the difficult part. To do this, I use materials that present the basic norms, rules, and standards applicable to the subject matter, which permit me to set up the examination of the three key touch points of the real estate transactions process. In other words, I tell students that they are going to need to learn about the process of assetization (fixing of assets) and its relationship to the strategic structuring of exchange in an effort to transform, capture, and create value.

At the outset, students need to be reoriented in at least two important ways. First, students need to understand that because transactions are about exchange, everything needs to be understood in a market context. Second, it is important for them to understand the position of property law in relation to the study of transactions. The students in real estate transactions need to appreciate that the course is not about “what is property” (even though this is important), but it is about what we do with property to successfully capture and create value for our clients and the community.

With this in mind, the entire course can be organized, synthesized, and understood in relation to the three key touch points outlined in Part I of this Essay. For example, students must first understand the asset forming the subject of an exchange. Topics related to deeds, estates, surveys, and title examination, for example, go to establishing the quantity and quality of the interest being transferred and are all about fixing and confirming the asset. Second, students must contemplate various strategies for planning and executing the transaction. Here they need to think about alternative ownership forms, competing financial structures, methods of authenticating the various elements of the exchange, and the strategic use of rules related to conditions, warranties, inspections, and risk management. In each of these examples, their focus is on the exchange function. Finally, students must evaluate the structure of the exchange relative to the mission-directed goal, and assess and protect the value expectations for the transaction. This might involve determining the most appropriate method of pricing, financing, and dealing with the asset at foreclosure or in bankruptcy. Some topic areas naturally overlap, but in general, students can understand different aspects of a real estate transactions course in terms of these three touch points: (1) fixing assets and (2) structuring exchanges in an effort to (3) transform, capture, and create value.

Moreover, each individual case throughout my course serves as a prototypical example of the overall process. Each case can be broken down in a variety of ways, and in almost all situations, one can discuss a case in terms of the nature of the fixed asset involved, the strategic structure used in the exchange, and the value-related issues expressly or implicitly present in the transaction. The process does not always need to be explicit for students, as they can learn much of it indirectly by observing and participating in the application of the process to case analysis and discussion of illustrative transactions.

As we work through the understanding of the real estate transactions process, I keep students aware of what we are doing in terms of the broader entrepreneurial process. I tell them that they will ultimately be assessed as lawyers in the same way that they will be as entrepreneurs and facilitators of entrepreneurs. The assessment will be based on their ability to add value to an

exchange as a result of their knowledge, judgment, and actions. They must learn the rules in order to have a basis for exercising good judgment, but judgment is not simply about knowing rules or understanding documents. Likewise, the ultimate indicator of their knowledge and judgment is the action they take. Students not only need to know the rules and how to use the rules in formulating judgments about alternative courses of action; they need to be able to recognize how all of this translates into the steps one needs to take in order to add value and make things happen in the real world.

All of the above takes practice and can start with simple examples such as asking students what they need to do once they know that state law requires a grantor and a grantee on a deed (basic knowledge of a foundational rule). With this simple rule easily understood, I ask them what they need to do if the grantor is a corporation. This is where knowledge and judgment confront action. What they need to do, of course, is figure out how to authenticate the corporation's ability to act as a legally recognizable grantor capable of transferring the asset in accordance with the terms of the contract of exchange and the instrument of conveyance (this involves judgment—a judgment based on knowing that a corporation may need to meet certain criteria in order to be considered a valid grantor). The question then becomes one of identifying the action one needs to take pursuant to forming this judgment. Acting on this judgment, an attorney should do such things as review the articles of incorporation, obtain the certificate of good standing, review the resolution of the board in approving the exchange, and clarify the person or persons authorized to sign the documents that materially effectuate the transfer.

Using cases and problems, each transaction can be broken down into issues of *knowledge* (basic rules, standards, and norms), *judgment* (the strategies considered and that might have been considered in structuring the transaction), and *action* (the positive and negative consequences of the actions actually taken in the exchange, and potential alternatives). By continually focusing on the acquisition of knowledge, the exercise of judgment, and the execution of action, students will learn to translate the substantive elements of the real estate transactions course into actions that add value. In so doing, the students will not just facilitate their clients' mission-directed goals; they will themselves become entrepreneurs.