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Power Without Property, Still: Unger, Berle, and the Derivatives Revolution

Cristie Ford[†] *and Carol Liao*[††]

INTRODUCTION

We are in a time when the notion of property is in flux.[1] The derivatives revolution[2] has shattered the "atom of property" well beyond what was originally imagined in 1932 by Adolf Berle and Gardiner Means.[3] This disaggregation has had fascinating, and often adverse, effects on corporate law and securities regulation. Moreover, the phenomenon has had the unexpected effect of permitting some parties that already possess considerable social, economic, and political power to accumulate even more.

Innovations in modern finance have generated a large-scale experiment, running live and on a global basis, on the impacts of disassembling classical notions of ownership and property rights. At the level of corporate law, Henry Hu and Bernard Black have examined the deleterious potential effects that arise from so-called "empty voting" and "hidden (morphable) ownership," where derivatives have allowed investors

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1. Borrowing the title "Property in Flux" from Book I of ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 3 (Harcourt, Brace & World 1968) (1932).

2. The term is not a new one. For a prescient analysis of the systemic risk associated with widespread use of over-the-counter derivatives, see Mary L. Schapiro, Remarks at the Eighth Annual Symposium for the Foundation for Research in International Banking and Finance: The Derivatives Revolution and the World Financial System (Oct. 14, 1993), *available at* http://www.sec.gov/news/speech/1993/101493schapiro.pdf.

3. BERLE & MEANS, *supra* note 1, at 8–9 (describing the "dissolution of the old atom of ownership into its component parts, control and beneficial ownership").

to readily separate economic ownership of shares from voting rights.[4] Over-the-counter (OTC) derivatives also enabled the originate-to-distribute model of lending by financial institutions, which many regard as the catalyst for the collapse of the subprime mortgage market and, subsequently, for the global financial crisis.[5] In this model, financial institutions originate consumer mortgage loans which are then tranched, repackaged, and resold in the market to investors, creating a separation in the mortgagor/mortgagee relationship and the accompanying risks. At the level of global markets, the capacity to break traditional property rights down into constituent elements has also made possible an enormous and interconnected market for synthetic financial products, characterized by unprecedented complexity and susceptibility to system effects.

The effect of the disunity of property and its relation to power is interesting to observe when juxtaposed against the theories of Roberto Unger and Adolf Berle. Both talk about the breakdown of traditional property rights, though from markedly different perspectives. Unger offers a prescription for the radical destabilization of traditional property rights within society in the service of a more egalitarian and inclusive citizenry.[6] Unger suggests that the fracturing of property rights (as he describes it, not as expressed in recent real world examples[7]) is a pro-democratic move. Berle, on the other hand, though he could not have imagined the degree to which property would break down, argued that the disaggregation of property rights results in concentrations of power and unaccountable concentrations of power are bad things. Recent events suggest that, somewhat contrary to Unger, power relationships will reassert themselves in malleable social and economic space, such as that created by a breakdown in traditional property rights. The absence of formal ownership rights will make people more, not less, vulnerable to nontransparent exercises of power. Understanding the pervasive impact

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4. Henry T. C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811 (2006).

5. The global financial crisis is broad in scope. Focusing only on the United States, the first effects of the subprime mortgage crisis began in 2006–2007, culminating with the collapse of global credit markets in fall 2008. During the 2008 collapse, major U.S. investment banks failed, bringing about an industry bailout and economic stimulus package of unprecedented size. For a timeline of the core of the crisis—from September 2008 to September 2009—see R.M. Schneiderman, *A Year of Financial Turmoil*, N.Y. TIMES, Sept. 11, 2009, *available at* http://www.nytimes.com/interactive/2009/09/11/business/economy/20090911_FINANCIALCRISIS_TIMELINE.html?ref=businessspecial4.

6. *See generally* ROBERTO MANGABEIRA UNGER, FALSE NECESSITY: ANTI-NECESSITARIAN SOCIAL THEORY IN THE SERVICE OF RADICAL DEMOCRACY (2001) [hereinafter UNGER, FALSE NECESSITY].

7. *See infra* Part II.

of power on human ordering, as Berle did, and addressing it in future lawmaking will allow us to increase the effectiveness of our regulatory frameworks.

This is not to say that we should dismiss Unger's insights. On the contrary, his work continues to be compelling and ought to be grappled with in a conversation about the contemporary breakdown of property and the effect of power. In particular, Unger's recognition that accepted social constructs, including private property, often have the effect of insulating power from challenge—and his consequent demand for what he calls "destabilization rights"—still resonates. Indeed, this aspect of Ungerian theory is having a real world policy impact through its more pragmatic and concrete (but not necessarily less provocative) descendant: new governance scholarship. The new governance movement has adopted the notion of destabilization rights, among other Unger-informed pieces, and has had increasing practical influence on regulatory design.[8]

This article begins in Part I with a broad strokes refresher on some of the theoretical concepts underlying Unger's work, particularly focusing on his notion of destabilization rights and the disaggregation of property to disentrenchment deeply rooted forms of social domination. Part II then explores real life experiments in modern finance where property rights have been decoupled, specifically highlighting the phenomenon of new vote buying as identified by Hu and Black, the originate-to-distribute model of lending in the subprime mortgage market, and the exponential growth of the OTC derivatives in global markets. These examples are reminiscent of Unger's "context-smashing" agenda and yet have resulted in markedly negative outcomes for our economic times. Part III draws upon the lessons found within these modern day experiments and identifies how the complex and nontransparent nature of disaggregated property, as well as the opportunistic pull towards excessive risk-taking behavior, has fostered an environment that allows larger manifestations of power to form within society. Finally, in Part IV we reflect upon the pervasive and persistent nature of power in relation to Unger's theories and explore the implications of this power to new governance scholarship. Drawing on Berle's insights, we recognize how understanding the ability of power to reassert itself and coalesce in liquid markets is essential to effective planning and design of institutional and regulatory frameworks. Ultimately, our argument is that power, not property, is actually at the core of both Unger's and Berle's works and

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8. *See infra* notes 126–44 and accompanying text (describing new governance).

also at the core of contemporary structural problems in corporate law and financial regulation.

This is an early stage work, a starting point that we hope will foster a dialogue on the relationship between the disaggregation of property and its problematic connection to greater concentrations of power. This article serves as an examination and critique of Ungerian theory and also a reflection on Berle's work. Recent developments in structured finance help to shed light on these authors' core concerns, just as their work sheds light on those recent developments. In addition, this is a thought experiment in the spirit of the careful work of Hu and Black, and others, which challenges the way in which increasingly complex and innovative financial instruments are becoming mechanisms for reinforcing power and exclusivity. We recognize the challenges that come with applying theory (especially radical theory) to actual practice and the imperfections that, no doubt, faithfully accompany it. Nevertheless the conversation seems to us to be an important one as we continue to chart a path for financial regulation in the wake of the recent financial crisis.

I. UNGER'S DESTABILIZATION RIGHTS AND CONCEPT OF PROPERTY—A REFRESHER

Unger's work is extensive, spanning the fields of philosophy, law, and politics, all the while offering an alternative way of explaining society and putting forward a program for changing it. One of his central insights is that no particular form of social constraint is necessary or inescapable.[9] For Unger, "[t]he great inspiring idea of the most successful efforts of modern social thought has been the idea of emancipation from false necessity."[10] He believes society can improve relative to how it currently operates, contending that "[w]e can construct not just new and different social worlds but social worlds that more fully embody and respect the creative power whose suppression or containment all societies and cultures seem to require."[11] Key to this is a recommendation that society should move towards the positive goal of creating social structures that will lessen "the distance between context-preserving routine and context-transforming conflict."[12] These new social structures are

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9. *E.g.*, UNGER, FALSE NECESSITY, s*upra* note 6, at 2. For a helpful review of Unger's central works, see Bernard Yack, *Toward a Free Marketplace of Social Institutions: Roberto Unger's 'Super-Liberal' Theory of Emancipation*, 101 HARV. L. REV. 1961 (1988).

10. ROBERTO MANGABEIRA UNGER, SOCIAL THEORY: ITS SITUATION AND ITS TASK 137 (1987) [hereinafter UNGER, SOCIAL THEORY].

11. UNGER, FALSE NECESSITY, s*upra* note 6, at 1.

12. UNGER, SOCIAL THEORY, s*upra* note 10, at 7–8.

prevented from forming into immovable constructions of hierarchy or domination since they are vulnerable to challenge and revision. By building these plastic and self-disrupting structures, we thus "cleans[e] . . . the taint of dependence and domination" from our social institutions.[13]

Underpinning Unger's approach is a stylized view of human nature as social, flexible, contentious, full of possibility, and poorly served by rigidity, routine, and hierarchy. For him, human flourishing is about permitting the greatest degree of individual self-actualization, subjected to the fewest cognitive, structural, and imaginative constraints. He says, "[t]o be fully a person . . . you must engage in a struggle against the defects or the limits of existing society or available knowledge."[14] Self-subverting social structures promote greater human happiness as well as freedom of social thought. Greater degrees of social plasticity, including more "elastic" and structure-denying structures, also allow society to obtain greater wealth and power for all its citizens.[15] In Unger's view, citizen subversion and disillusionment by ruling forces have presently subdued humanity into a "restless peace."[16] Once citizens rebel against the worlds that have been built, breaking apart the constraints on their transformative wills, humanity will be empowered. In this way, society's practical success becomes a function of its capacity for permanent innovation.

In order to achieve the plasticity that Unger speaks of, new forms of rights and institutions are required. These rights are designed to advance the emancipation of the individual. One of these rights Unger calls "destabilization rights," which operate as self-disrupting structures that permit "transformative action" and "context-smashing" in the service of a more inclusive, egalitarian, and ennobling society.[17] Large-scale organizations and ingrained forms of social practice that are unaffected by ordinary destabilizing effects "sustain insulated hierarchies of power and advantage."[18] Thus, destabilization rights protect citizens' interests by "breaking open" these entrenched institutions and areas of practice.

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13. *Id.* at 1.

14. *Id.* at 29.

15. *Id.* at 210.

16. UNGER, FALSE NECESSITY, *supra* note 6, at xvii.

17. Unger proposes four fundamentally restructured categories of rights: immunity rights, which protect the individual from the state, organizations, and other individuals; destabilization rights, which make it possible to dismantle institutions and practices that create social hierarchy and division; market rights, which constitute claims to social capital and replace conventional property rights; and solidarity rights, which are "the legal entitlements of communal life." *Id.* at 508–538.

18. *Id.* at 530.

They allow a correspondence between normative convictions about liberty, equality, and justice, and the social institutions through which citizens attempt to make those convictions a reality.[19] According to Unger, the goal is not to reach a particular version of institutional structuralism so much as to guarantee ongoing contingency. Unger points to the practice of court-ordered injunctive relief as an example of destabilization rights found in contemporary law, citing institutions such as schools and mental hospitals, as well as the social practice of electoral organization, as loci in which these rights have previously been exercised.[20] He says these examples "serve not to embody specific ideals of human association but to ensure that, whatever the . . . forms of . . . association may be, they will preserve certain minimal qualities: above all, the quality of being readily replaceable."[21]

The Relationship to Property Rights

Unger's destabilization rights are inextricably linked to his belief in the need for the disentrenchment of property rights held by ruling groups. Unger believes that the present forms of modern liberal democracies, which thrive on the passivity of their citizens, are based on the existence of absolute property rights. Berle and Means also famously recognized a level of passivity among the citizenry through the dispersion of share ownership and the constructive inability of shareholders to affect the underlying property that they own.[22] In Unger's estimation, the current political forms within society "are neither the necessary nor the best expressions of inherited ideals of liberty and equality."[23] In fact, absolute property rights "frustrate the very goals for whose sake we uphold them" in that they are used to justify and perpetuate existing unequal distribu-

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19. Unger observed that both negative and positive uses accompany destabilization rights. The negative use is seen in circumstances where institutions are insulated from conflict in a way that seems to perpetuate "stable ties of domination and dependence." Destabilization rights deny protection to these institutions, leaving them vulnerable to conflict through things such as market forces and democratic deliberation. The focus then turns to ensuring the institutions in question "remain available to *some* mode of attack." Unger places value on strengthening this "negative capability" as a level of human freedom in and of itself and also as a method of achieving other goals. When the focus "falls on the evil to be remedied rather than on its cause," there is then a positive aspect whereby the destabilization right acts as an entitlement on the citizen to prevent groups from gaining a privileged hold upon "the means for creating the social future within the social present." In this sense, the destabilization right causes attention to be drawn to the ways in which insulation from conflict perpetuates these existing patterns of control and dependence. *Id.* at 531.

20. *Id.* at 532.

21. *Id.* *See also id.* at 1–8, 530–32.

22. BERLE & MEANS, *supra* note 1, at 64.

23. UNGER, SOCIAL THEORY, *supra* note 10, at 6–7.

tions of political and economic power.[24] Absolute property rights are linked to the market institution and only support one version of the marketplace; they serve as an "indispensable prop" to justify the unequal distribution of political and economic wealth. In this sense, Unger finds that "social democracy makes the liberal project of the enlightenment—the cause of liberty, equality, and fraternity—unnecessarily hostage to a transitory and replaceable institutional order."[25]

Unger believes markets based on absolute property rights, the "private rights complex," are one of the pillars of that institutional order. They are a "formative context"—that is, an institutional and imaginative structure of social life that "circumscribe[s] our routine practical or discursive activities and conflicts . . . ."[26] Creating openness and flexibility within these formative contexts is imperative in the pursuit of a more empowering social order. Unger insists that a market economy has no necessary set of built-in legal-institutional arrangements. Rather, "institutional fetishism" has perpetuated a "mythical history" that alleges some necessary connection between private rights, the market, and ultimately democracy.[27] Moreover, Unger argues that Western liberal democracy is held hostage by ruling groups that own large proportions of property. In Ungerian terms, there has been an ascendancy of the "consolidated property right."[28] The consolidated property right stands in the way of greater degrees of economic decentralization and drastically restricts our capacity to envision possible alternatives to current market systems.

To liberate humans from this control, Unger argues for disaggregating property and abolishing consolidated property holdings to force greater societal plasticity. His prescription: a three-tiered property structure under which the conditions and terms of economic growth can be reconciled with democratic experimentalism.[29] Specifically, this structure would entail a transfer of control over major productive assets to a "rotating capital fund" which would disaggregate property rights down through tiers.[30] The capital fund would be controlled by a centralized democratic government that would then lease the capital on a competitive basis to autonomous investment funds operating in different sectors which, in turn, would auction or ration resources to various teams of pro-

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24. *Id.* at 7.

25. UNGER, FALSE NECESSITY, *supra* note 6, at 27.

26. *Id.* at 7, 304.

27. *Id.* at 196–207, 211–13.

28. *Id.* at 511–13.

29. *Id.* at 491–501.

30. *Id.* at 491–502; *see also* ROBERTO MANGABEIRA UNGER, DEMOCRACY REALIZED: THE PROGRESSIVE ALTERNATIVE (1998) [hereinafter UNGER, DEMOCRACY REALIZED].

ducers and innovators for set periods of time.[31] Citizens would have welfare rights guaranteeing minimum income, to protect them from the vagaries of markets. This would allow the capital-takers to be even more innovative and take bigger risks.[32] Unger thereby replaces absolute, consolidated property rights with a method of reallocating disassembled elements of property among various citizens. Once certain limits of "personal enrichment and enterprise investment" have reached their natural capacities or saturation points within society, the additional capital is returned to the original capital fund for further investment by the next team of innovators.[33]

Human creativity and initiative play a large role in Unger's vision. The first stage in his prescription requires the recognition of a false necessity in deeply embedded structures and institutions that limit freedom and serve to perpetuate the power of a privileged few in the current social hierarchy. Destabilization and disentrenchment of these structures is the first step to rescuing humanity from the ingrained and oppressive status quo. Unger knows, of course, that destabilization is not enough; rather, it is the "intervention provoked by the exercise of a destabilization right [that] must change the disrupted practice . . . ."[34] The next step then rests on Unger's vision of an empowered and empowering democracy. It is up to a newly liberated populace to investigate and actualize a fuller range of imaginative possibilities. At this stage, in Unger's view, oppression is not tolerated and a climate develops in which radical measures seem both practical and desirable, with new conceptions forming among a creative citizenry, free from the invisible shackles of a powerful elite.

Obviously, Unger's vision has not been realized at this stage. What is curious is that, stripped of its normative agenda, there are aspects of Unger's prescription that could be said to describe recent real world

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31. Unger claims that his theory satisfies the imperative of economies of scale by developing an alternative economic order that makes it possible to pool manpower, technology, and financial capital without distributing permanent and unqualified rights to their use. *See* UNGER, FALSE NECESSITY, *supra* note 6, at 491–502.

32. See *infra* notes 114 and 115 on how the American public and its government may currently be resistant to the idea of greater risk taking.

33. UNGER, FALSE NECESSITY, *supra* note 6, at 496. In his book, *Democracy Realized*, Unger is more concrete in his analysis and advocates in favor of shattering boundaries that allow for the consolidation of property. He suggests structural changes that would eliminate private inheritance in favor of social inheritance mechanisms, encourage private saving, implement a broad-based consumption tax, and unify all private and public pension funds (some of which would then be used in the capital fund). An additional branch of government would be created to enforce such positive rights. UNGER, DEMOCRACY REALIZED, *supra* note 30, at 133–251.

34. UNGER, FALSE NECESSITY, *supra* note 6, at 531.

events in corporate law and financial regulation. Property rights *have* been disaggregated, though this took place first at the individual share level and only subsequently and partially at the systemic level Unger describes. And, this has had the effect of spurring innovation and creativity and radically expanding the imaginative possibilities when it comes to the treatment of property in the markets. Yet, while bold, decentralized innovation and the deconstruction of traditional structures are part of Ungerian theory, recent examples suggest this destabilization is of a different nature than what Unger imagined. The following examples highlight the effects of the atomization of property rights and suggest Unger's project does not match real world capabilities; instead, the disaggregation of property seems to exacerbate inequality and allow for greater power to amass among the already powerful. Following these examples, we consider the broader ramifications of leaving such faith in human nature to manage this open, unfixed space of revisionary ideals.

II. CLASSICAL NOTIONS OF PROPERTY AND REAL LIFE EXPERIMENTS IN MODERN FINANCE

Implications for Corporate Law: The "New Vote Buying"

A classical property rights description within a corporation would expect shareholder voting rights to be assigned to common shareholders in proportion to share ownership. In this way, a shareholder's voting interests are tied to economic ownership, so there is an incentive to exercise voting rights to increase share value. Shareholder voting has been regarded by some as legitimating the concept of managers controlling property they themselves do not own.[35] Shareholders are regarded as the residual claimants to a firm's income and thus the ability to exercise proportionate voting power among holders is logically sound. This is not ignored by the courts; Delaware takeover law has traditionally favored shareholder voting decisions over market decisions. Delaware courts have also habitually given great deference to actions reflecting shareholder votes.[36]

The common debate regarding governance of public corporations typically rests on whether or not shareholder voting can effectively influence corporate management if ownership is widely dispersed. Berle and Means noted in 1932 that shareholders in public companies are subser-

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35. *See, e.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 63–67 (1991).

36. *See, e.g.*, Hu & Black, *supra* note 4, at 850 (citing Blasius Indus, Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988)).

vient to directors "who can employ the proxy machinery to become a self-perpetuating body . . . ."[37] Scholars in the years since have continued to weigh in on the subject. Some scholars agree with Berle and Means that shareholder voting power is insignificant because the obstacles in the way of achieving collective action are too difficult and expensive to surmount.[38] Others see virtue in this structure, finding board control promotes efficient and informed decision-making, deters inter-shareholder opportunism, and allows for greater investment in other corporate stakeholders.[39] Still others maintain that shareholders actually do have meaningful control over the corporation, even in cases of a diverse ownership base with no clear majority shareholder.[40]

While the debate is still relevant, it is losing some of its descriptive and normative force as the exponential growth and development of derivatives has begun to adjust common assumptions related to shareholder voting rights. The derivatives revolution has changed underlying conditions. The conversation, also, should be moving away from the issue of whether or not shareholder voting has an impact on corporate control (and whether this is good or bad), and towards the question of who actually holds the voting rights and how decisions can be manipulated by a recently exposed phenomenon in corporate law: new vote buying using equity derivatives.

For those unfamiliar, derivatives are financial instruments that are derived from some other underlying asset. Derivatives can generally be classified into three groups: futures/forwards, swaps, and options. Every derivative specifies a future price at which some item can or must be sold. The present value of a derivative is determined, in part, by value fluctuations in the underlying asset. The underlying asset may be a commodity, a financial security, or something more abstract like a price index. A simple historical example of a forward derivative would be an agreement between a farmer and a miller on the price to be paid in the future for the farmer's yet-to-be-harvested wheat crop. In this agreement, the farmer hedges against the risk that the market price of his or her wheat will be lower in the future than the current price agreed upon with the miller, and vice versa for the miller, who hedges against the risk that the future market price will be higher. Today, much derivatives ac-

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37. BERLE & MEANS, *supra* note 1, at 6.

38. *See, e.g.*, Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675 (2007).

39. *See, e.g.*, Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 93 VA. L. REV. 789 (2007).

40. *See, e.g.*, Dennis Leech, *Corporate Ownership and Control: A New Look at the Evidence of Berle and Means*, 39 OXFORD ECON. PAPERS 534 (1987).

tivity is fundamentally concerned with the process of unbundling and repackaging credit and market risk and, particularly for the investor, with whether a derivative effectively hedges an existing risk.[41]

Additionally, in the corporate law context, derivatives have been employed by sophisticated investors to separate economic ownership of shares from their corresponding voting rights. Particularly, growth in equity swaps and other OTC equity derivatives have made it easy to disassemble interests and allow for vote buying on the market. In a celebrated series of recent articles, Henry Hu and Bernard Black have written extensively on this new phenomenon of vote buying and its broader implications.[42] Hu and Black note that "decoupling" has become a worldwide phenomenon over the last several years, although it is still "largely unregulated and often unseen."[43] They describe two main varieties: "empty voting" and "hidden (morphable) ownership."

In empty voting, investors are able to separate their interests and hold more votes than their economic ownership traditionally allows. This decoupling is achieved through various equity derivatives.[44] One method is through the share lending market which allows investors to borrow shares from one another. Under this arrangement, the borrower can temporarily hold voting rights without economic ownership, while the reverse is true for the lender, who holds onto economic ownership without having the accompanying votes for a period of time.[45] Along these lines, using record date capture, the investor could borrow shares just before the record date for a shareholder vote, and then reverse the transaction afterwards—providing the investor with the right to vote even though he or she has no positive economic interest in the company's success.[46] Alternatively, through equity swaps, an investor with the "equity leg" of the swap can acquire the economic ownership of shares

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41. *See generally* MERTON H. MILLER, MERTON MILLER ON DERIVATIVES (1997).

42. *See* Henry T. C. Hu & Bernard S. Black, *Debt and Hybrid Decoupling: An Overview*, 12 M&A LAW. 1 (2008) [hereinafter Hu & Black, *An Overview*]; Henry T.C. Hu & Bernard Black, *Debt, Equity and Hybrid Decoupling: Governance and Systemic Risk Implications*, 14 EUR. FIN. MGMT. 663 (2008) [hereinafter Hu & Black, *Debt, Equity, and Hybrid Decoupling*]; Henry T. C. Hu & Bernard Black, *Empty Voting and Hidden (Morphable) Ownership: Taxonomy, Implications, and Reforms*, 61 BUS. LAW. 1011 (2006) [hereinafter Hu & Black, *Taxonomy, Implications, and Reforms*]; Henry T. C. Hu & Bernard Black, *Equity and Debt Decoupling and Empty Voting II: Importance and Extensions*, 156 U. PENN. L. REV. 625 (2008) [hereinafter Hu & Black, *Empty Voting II*]; Henry T. C. Hu & Bernard Black, *Hedge Funds, Insiders, and the Decoupling of Economic and Voting Ownership: Empty Voting and Hidden (Morphable) Ownership,* 13 J. CORP. FIN. 343 (2007) [hereinafter Hu & Black, *Hedge Funds, Insiders, and Decoupling*]; Hu & Black, *supra* note 4.

43. Hu & Black, *supra* note 4, at 818.

44. *Id.* at 828–35.

45. *Id.* at 816, 828–31.

46. *Id.* at 816, 857.

(but not the voting rights) from the "interest leg." More often than not, the interest leg (or short-side) hedges its economic risk by holding onto the shares, resulting in the short-side investor having votes without any net economic interest.[47] A third method popular among corporate insiders is the use of zero-cost collars, which involves buying a put option (to limit downside) while simultaneously selling a call option (thus reducing potential gain). The collar preserves voting rights but sharply reduces one's economic ownership.[48]

The impact of insider decoupling of share-based interests is mixed in that, on the one hand, it may "mitigate the risk-taking conflict between managers and diversified shareholders," but on the other hand, it could weaken the market for corporate control as a disciplining mechanism. In empty voting scenarios, a vote holder may have limited, no, or even negative economic interest and subsequently have an incentive to vote in ways that reduce share value. Hu and Black provide the example of Multi-Fineline Electronix, Inc. (M-Flex), a Delaware company, which in 2006, offered to purchase MFS Technology Ltd. (MFS), a Singapore company.[49] Under M-Flex's charter, affirmative votes by both a majority of all shareholders and a majority of minority shareholders were required to approve the transaction. M-Flex set up a special committee to investigate whether the deal was beneficial for its minority shareholders; the committee determined that the terms were unfavorable and recommended that minority shareholders vote against the acquisition. Stark Master Fund Ltd. (Stark), a hedge fund, held at least a 48% minority shareholder interest in M-Flex but, despite the special committee recommendation, had the incentive to vote for the deal even if it was bad for M-Flex's minority shareholders. This was because Stark had hedged all or most of its economic interest in M-Flex and also had a large coupled interest in the target company. Thus as an "empty voter" of M-Flex, Stark held a negative overall economic interest and would have benefited if the company overpaid for MFS.

The M-Flex/MFS example shows how "[t]he corporate governance risk posed by the new vote buying is clear, but the remedy is not."[50]

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47. *Id.* at 815–17, 828–35.

48. *Id.* at 817, 831–32.

49. Hu & Black, *Empty Voting II*, *supra* note 42, at 634 (detailing the M-Flex/MFS transaction).

50. Hu & Black, *supra* note 4, at 819. Hu and Black have offered an "integrated ownership disclosure" reform proposal to address the phenomenon of new vote buying. The proposal attempts to ensure adequate disclosure of most new vote buying while also simplifying current ownership disclosure. In particular, they suggest "(1) moving toward common standards for triggering disclosure and for disclosing positions . . . ; (2) providing a single set of rules for . . . ownership posi-

Clearly, empty voting can also be a factor in proxy fights for control, again attenuating the relationship between voting power and a vested interest in the company's success. In addition, as Hu and Black point out, "[c]leverness in vote buying—a characteristic not necessarily associated with the ability to run the company well—may become central to proxy fight success."[51]

In the mirror image arrangement, "hidden (morphable) ownership," investors hold more economic ownership than votes, though often with morphable voting rights, meaning investors hold the de facto ability to acquire the votes if needed.[52] Hu and Black call this hidden ownership because the economic ownership and de facto voting ownership are often not disclosed. Hidden voting is also achieved using equity derivatives—again using equity swaps but this time only holding economic interests until votes are needed, when the investor can then unwind the swaps and buy matched shares back from the derivatives dealer.

Hu and Black have identified several specific uses to hidden ownership. In particular, the de facto ability to obtain formal votes means shareholders have the ability to make voting rights disappear when they want to hide their stake and reappear when votes are needed. This allows investors to avoid disclosing their economic interests under disclosure rules that rely largely on voting rights rather than economic ownership. It is also useful in avoiding mandatory bid rules in jurisdictions where a shareholder who exceeds a certain threshold of ownership (again, based on voting rights) must offer to buy all remaining shares at a set price.[53] Decoupling can be used to circumvent the following: statutory, contractual, and other limits on voting power; income tax rules; recapture of "short-swing" trading profits; limits on short sales, or "margin borrowing" against the value of the shares; and antitrust rules.[54] Morphable rights are also useful for obtaining "quiet toeholds" in companies to be acquired, to prevent a price run-up over a potential takeover.[55] Finally, Hu and Black point out how the investor can use the same types of ma-

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tions . . . ; (3) requiring disclosure of all positions conveying voting or economic ownership, arising from shares or coupled assets; and (4) requiring symmetric disclosure of positive and negative economic ownership." *Id.* at 876. *See also id.* at 875–886. They also offer longer run responses and strategies to new vote buying, particularly addressing voting rights, voting architecture, and supply and demand forces in the markets on which new vote buying relies. *See id.* at 886–906.

51. *Id.* at 830.

52. *Id.* at 836–42.

53. *Id.* at 839–40 (specifically citing Italy and Australia as countries with mandatory bid rules).

54. Hu & Black, *Debt, Equity, and Hybrid Decoupling*, *supra* note 42.

55. Hu & Black, *supra* note 4, at 840–41 (this aspect may be considered a positive one by those in support of an active corporate control market).

neuvers to shed voting rights in order to make a target company unfavorable to potential purchasers. An investor holding shares in a target company may decouple its interests and lend its voting rights to other companies under the informal understanding (but not legal requirement) that the rights will be returned to them once a takeover threat disappears. A potential purchaser has to then contend with the possibility that those voting rights will not be returned if they purchase the target. This technique allows an investor to deny voting rights to another party while maintaining access to votes if circumstances turn in their favor.[56]

From a theoretical perspective, it is easy to see how the phenomenon of new vote buying can have significant implications for traditional understandings of corporate governance and in takeover contexts. However, Hu and Black note that this impact is difficult to gauge in practice. In their research, they have found several examples by following up on rumors and combing through public disclosure documents. Other sources, such as foreign regulatory changes, market customs, lawyer statements, and lawsuits seem to indicate that new vote buying is not an uncommon practice. Ultimately though, they suggest that a great deal of information is still unknown.[57] As of 2008, Hu and Black list over 100 cases involving decoupling activity in over 20 countries, and they note that this number is "surely an underestimate of actual activity."[58] Their research has shown that in a takeover context, "[s]ome acquirers have amassed 30–45% stakes in target firms without prior disclosure."[59] Hu and Black note a June 2008 decision from the Southern District of New York, *CSX Corp. v. The Children's Investment Fund (UK) LLP.* (CSX),[60] in which the court found that the two defendant hedge funds had violated the SEC's pertinent "anti-evasion" rule by using equity swaps to circumvent disclosure rules.[61] Hu and Black believe the CSX decision will likely inhibit the use of equity swaps (and perhaps other equity derivatives) to create significant hidden ownership positions in U.S. companies; they also believe the decision may ultimately pressure the SEC to address the problematic economic-only SEC disclosure rules. In September 2009, Hu was appointed the first director of the SEC's newly established Division of Risk, Strategy, and Financial Innovation; so, there is reason to

56. *Id.* at 841–42.

57. *Id.* at 846–847.

58. Hu & Black, *An Overview*, *supra* note 42, at 4.

59. Hu & Black, *Debt, Equity, and Hybrid Decoupling*, *supra* note 42, at 664.

60. CSX Corp. v. Children's Inv. Fund Mgmt. (UK) LLP, 562 F. Supp. 2d 511 (S.D.N.Y. 2008).

61. Hu & Black, *Debt, Equity, and Hybrid Decoupling*, *supra* note 42, at 669.

anticipate some additional regulation around this issue in the near future.[62]

Hu and Black's first article on the phenomenon of new vote buying emerged in 2006. Since that time, they have examined the implications of equity decoupling in other fields, including hedge fund practices and the practices of corporate insiders[63] and most recently have asserted that this decoupling is really just one instance of a broader global trend—generally not addressed by regulation—toward decoupling the bundles of rights and obligations we traditionally know as equity and debt.[64] In 2008, they extended their analysis to a "second generation" of articles addressing "debt decoupling" and "hybrid decoupling." These concepts are touched upon in the discussion below in the context of the originate-to-distribute model of lending in the subprime mortgage market.

Implications for Regulating Financial Institutions: The Originate-to-Distribute Model in the Subprime Mortgage Market

Hu and Black refer to debt decoupling as "the unbundling [of] the economic and governance rights normally associated with debt, often through credit derivatives or securitization."[65] Hybrid decoupling, as the name suggests, involves combined debt and equity positions. While debt decoupling has positive attributes that are well known—"it can make credit more widely available, reduce firms' cost of debt capital and contribute to financial stability in a variety of ways, partly by allowing lenders to spread risk"—it is evident that debt decoupling also has considerable downsides.[66] Hu and Black note that the growth of "[d]ebt and hybrid decoupling can potentially produce value-decreasing outcomes at particular companies."[67] They state:

> Lenders' ability to shed risk can weaken their incentives to assess and monitor debtors' repayment ability. Complex securitized products can pose model risks for both lenders and risk buyers. New forms of intermediation introduce new agency costs. M&A transactions can fail because lenders were counting on securitizing their

62. Press Release, U.S. Sec. & Exch. Comm'n, SEC Announces New Division of Risk, Strategy, and Financial Innovation (Sept. 16, 2009), *available at* http://www.sec.gov/news/press/2009/2009-199.htm.

63. *See* Hu & Black, *Hedge Funds, Insiders, and Decoupling*, *supra* note 42.

64. *See generally* Hu & Black, *Empty Voting II*, *supra* note 42.

65. Hu & Black, *An Overview*, *supra* note 42, at 4.

66. *Id.* at 5.

67. *Id.*

loans, can no longer do so, and back away from funding commitments.[68]

Some of these difficulties were playing out in real time in early 2008, around the time of Hu and Black's articles on debt and hybrid decoupling. The originate-to-distribute (OTD) lending model embodied many of the problematic features of debt decoupling. Many view the OTD model as an instigating factor in the subprime mortgage meltdown that began in 2006.[69] The OTD model allows banks to reduce their capital charges and transfer the risks associated with securitized loans to a market hungry to buy them. The OTD strategy works as follows: bankers (i) originate consumer mortgage loans (and other forms of consumer debt); (ii) bundle those loans into mortgage-backed securities (MBSs) and collateralized debt obligations (CDOs), that is, OTC derivatives, subsequently slicing them into tranches; (iii) optionally, create additional OTC derivatives such as synthetic CDOs, CDOs squared and credit default swaps (whose values are derived from those underlying loans); and (iv) distribute the repackaged securities to investors.[70]

The OTD model disaggregates the underlying mortgage interest for the purpose of converting the income stream from that illiquid asset (the mortgage) into a range of immediately sellable securities with distinct risk and return profiles. An MBS or CDO will contain multiple tranches of securities with differing risk ratings, which will generally be paid sequentially from most senior to most subordinate tranche. Other derivatives in the OTD strategy include synthetic CDOs, which developed as an outgrowth of cash CDOs. Synthetic CDOs are CDOs where underlying risks are taken using a credit default swap (where the credit protection seller (the CDO), receives premiums in exchange for agreeing to assume the risk of loss on a specific asset in the event that asset experiences a default). CDOs-squared, another form of CDO-derived financial securities, are backed by CDO tranches rather than standard bonds or loans. CDOs-squared allow the banks to resell the credit risk that they have taken in CDOs.[71]

Embedded within the OTD strategy and its accompanying tools for packaging and repackaging derivatives is a great deal of factual and ana-

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68. *Id.*

69. *See, e.g.*, Amiyatosh K. Purnanandam, *Originate-to-Distribute Model and the Sub-Prime Mortgage Crisis* (Sept. 18, 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1167786.

70. *See* Arthur E. Wilmarth Jr., *The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis,* 41 CONN. L. REV. 963, 969 (2009).

71. *See supra* note 41 and accompanying text.

lytical complexity. To begin, "each type of underlying [mortgage] requires a separate approach to modeling, including estimation of default risk, interest-rate risk and prepayment risk . . . ."[72] These risks are dynamic in that they fluctuate over time, and models attempting to plot these dynamic correlations can only be approximations. Under the OTD model, the breakdown of property by multiple asset classes underlying a given class of securities means modeling is "exponentially complicated."[73]

Under the OTD strategy, most originating banks and mortgage lenders only held onto mortgages long enough to sell them to investors. The fact that the loan originators no longer held long term credit risk promoted a higher-risk environment for loan production. In addition to creating a separation between the mortgagor/mortgagee relationship and the accompanying mortgage risks, the originating banks sold mortgages immediately to investors and were therefore able to replenish their funds and issue more loans to generate greater transaction fees. The financial incentive was so great that it motivated banks and mortgage lenders to originate risky loans without adequately screening borrowers and reduced their incentives to monitor mortgagees' behavior post-loan.[74] A potential mortgagee used to be required to provide documentation proving adequate income and assets to support the loan. With time, however, the requirements dwindled to a point where "No Income, No Asset" (NINA) mortgages were being marketed.[75] In these NINA mortgages, a potential mortgage borrower would not be required to provide any evidence of their income or asset to qualify for a loan. This, of course, also meant that no information would be verified by the mortgage lender. As put by one former executive director at the residential mortgage trading desk of Morgan Stanley: "That's a liar's loan. We are telling you to lie to us. . . . [W]e did it because everyone else was doing it."[76]

By 2006, the U.S. housing market was resting on what some called a system of "Ponzi finance" in which subprime borrowers kept taking out new loans from equity on their homes to pay off their existing mortgages on those same homes.[77] When real estate prices fell in 2007, and subprime homeowners could no longer refinance their loans, defaults on

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72. Steven L. Schwarcz, *Regulating Complexity in Financial Markets*, 87 WASH. U. L. REV. 211, 216 (2009).

73. *Id.* at 217.

74. *See generally* Wilmarth, *supra* note 70.

75. *See, e.g.*, Chicago Public Radio, This American Life, The Giant Pool of Money, at 10, transcript *available at* http://old.thislife.org/extras/radio/355_transcript.pdf.

76. *Id.*

77. Wilmarth, *supra* note 70.

these loans soared and the subprime financial crisis began. In the summer of 2008, it was revealed that many large and crucially important financial institutions had on their books large volumes of credit default swaps on those bundled mortgage securities generated from the OTD model, which had insured investors against the very defaults that were occurring. This catalyzed a worldwide freeze in the credit markets in the fall of 2008.

Back in April 2008, Hu and Black, in describing the negatives of separating economic and governance rights associated with debt, predicted what at the time seemed to be some of the more hypothetical outcomes that could result from debt decoupling. They said:

> [D]ecoupling can impede "debt governance"—interactions between creditors and firms once a loan is made, such as renegotiation of loan terms when the borrower can't meet the original terms. Decoupling will tend to make financial restructuring harder and sometimes infeasible, both in and out of formal bankruptcy. Spread across an economy, the "freezing" of debtor-creditor relationships can increase systemic financial risk.[78]

Now, in the wake of the global financial crisis, we see that Hu and Black were precisely right.

Implications for Global Markets: Growth of the OTC Derivatives Sector

The sheer volume of the derivatives market, created through debt and equity decoupling, introduced additional challenges. At the level of the market itself, as in the examples above, the act of disaggregating traditional property did not break up consolidated property holdings as Unger had envisioned. On the contrary, the OTC derivatives market became so vast, opaque, complex, and fast-moving that, in itself, it became advantageous to powerful, sophisticated parties while also curbing the very possibility of its regulation.

The United States has largely regulated derivatives through a two-pronged approach.[79] Derivatives are traded in two ways: through specia-

78. Hu & Black, *An Overview*, *supra* note 42, at 5.

79. Lynn A. Stout, *How Deregulating Derivatives Led to Disaster, and Why Re-Regulating Them Can Prevent Another*, 1 LOMBARD STREET 4, 6–7 (2009). On August 11, 2009, United States Department of the Treasury presented a bill to Congress entitled the *Over-the-Counter Derivatives Markets Act of 2009*, which would significantly augment private standardization initiatives. This Bill would allow bank regulators to establish margin and capital requirements for banks entering into derivatives contracts, require standardized OTC derivatives contracts to be cleared by a derivatives clearing organization regulated by the CFTC or the SEC and require banks to have their standardized contracts centrally cleared and traded over regulated exchanges. Dealers also would no longer be able to directly trade standardized derivatives contracts among themselves. They would be required

lized derivative stock exchanges or privately between market participants. Exchange-traded derivatives are formally overseen by the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC), which have delegated the role to organized exchanges like the New York Stock Exchange and the Chicago Mercantile Exchange. Outside the exchanges, the act of OTC derivatives trading was historically discouraged by a common law rule dating back to 1884.[80] In *Irwin v. Williar*, the court adopted a "rule against difference contracts" under which, in order for a court to enforce a contract, the demanding party would have to show to the court's satisfaction that at least one of the contracting parties had an interest in the underlying asset.[81] Therefore, speculative trading using OTC derivatives left parties with little legal protection if a deal were to go sour. The courts' ability to disregard speculative OTC derivatives as merely off-exchange futures contracts undeserving of legal enforceability meant that an incalculable amount of outstanding swaps were at risk of being legally invalidated. "This might have caused chaos in financial markets, as swaps users would suddenly be exposed to the risks they had used derivatives to avoid."[82]

The U.S. Congress changed this in 2000 with the adoption of the *Commodity Futures Modernization Act*[83] (CFMA), which confirmed the legal recognition and enforceability of purely speculative OTC derivatives. The CFMA also confirmed that OTC derivatives were off banks' balance sheets and not subject to CFTC or SEC oversight.[84] According

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to use an exchange or equivalent trading platform. *See* Press Release, U.S. Dep't of Treasury, Administration's Regulatory Reform Agenda Reaches New Milestone: Final Piece of Legislative Language Delivered to Capitol Hill (Aug. 11, 2009), *available at* http://www.ustreas.gov/press/releases/tg261.htm. Congress is still considering the bill.

80. Stout, *supra* note 79, at 5 (citing Irwin v. Williar, 110 U.S. 499 (1884)).

81. *Id.* at 6. In the U.K., the "rule against difference contracts" was overturned when the Financial Services Act of 1986, c. 60 (FSA) was implemented. This was confirmed in s. 412 of the Financial Services and Markets Act of 2000 (Consequential Amendments and Repeals) Order 200 and the Financial Services and Markets Act (Gaming Contracts) Order 2001 SI 2001/2510.

82. MARK JICKLING, REGULATION OF ENERGY DERIVATIVES, RS 21401, 3 (Jul. 7, 2008), *available at* http://ncseonline.org/NLE/CRSreports/08Jun/RS21401.pdf.

83. Commodity Futures Modernization Act of 2000, Pub. L. No. 106-554, 114 Stat. 2763.

84. This is not to say the CFTC and SEC did not make some efforts to oversee the OTC derivative market; their efforts were, however, severely limited. *See Testimony Before the S. Comm. on Banking, Housing, and Urban Affairs Concerning Turmoil in U.S. Credit Markets: Recent Actions Regarding Government Sponsored Entities, Investment Banks and Other Financial Institutions*, 110th Cong. (2008) (statement of Christopher Cox, Chairman, U.S. Sec. & Exch. Comm'n), *available at* http://www.sec.gov/news/testimony/2008/ts092308cc.htm (recognizing a lack of regulatory oversight in the market for CDSs and other derivative products); U.S. Commodity Futures Trading Commission, *OTC Derivatives Oversight: Statement of the Securities and Exchange Commission, the Commodity Futures Trading Commission and the Securities and Investments Board*, *available at*

to Lynn Stout, the motivation behind the Act's promulgation was largely to help the U.S. maintain its competitive position in global OTC derivative markets vis-à-vis its European counterparts.[85]

The lack of regulatory oversight in the OTC derivatives market significantly contributed to its exponential growth as banks began developing progressively more complex ways to leverage risk. Other past contributing factors included increased computerization, the breakdown of the Bretton-Woods system of fixed exchange rates, and other legal changes in foreign exchange, credit, and capital markets.[86] Today, investment bankers have turned hedging into a profitable business in its own right. The pace of innovation has been extraordinary, and spurred by competitive pressure between global banks. Global financial firms produced an ever greater volume of ever more complex synthetic securities in the run-up to the financial crisis, and they all sold.[87] Futures, options, and swaps came to be traded in huge quantities both on regulated exchanges and over-the-counter by banks and investment firms.

Even in the wake of the global financial crisis, OTC derivative contracts are a significant percentage of the total notional credit exposure in U.S. and world financial markets. The OTC derivatives market continuously expanded until the beginning of the crisis in 2008 caused it to shrink for the first time in its history. The total notional value of OTC derivatives at its peak in June 2008 stood at around $684 trillion.[88] By the end of 2008, the number was closer to $592 trillion.[89] As of June

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http://www.cftc.gov/International/InternationalInitiatives/oia_otcderovst.html (using soft language to describe how the regulatory bodies will "work together" and with appropriate industry groups and participants to "promote" the development of sound internal management controls, etc.). On efforts at industry self-regulation, see Stephen Labaton & Timothy L. O'Brien, *Financiers Plan to Put Controls on Derivatives*, N.Y. TIMES, Jan. 7, 1999, *available at* http://www.nytimes.com /1999/01/07/business/financiers-plan-to-put-controls-onderivatives.html?n=Top/Reference/Times%2 0Topics/People/R/Rubin,%20Robert%20E.&emc= eta1&pagewanted=1 (discussing the move towards self-regulation in derivative markets, prior to the global financial crisis).

85. Stout, *supra* note 79, at 7.

86. MILLER, *supra* note 41, at 6.

87. Michael Lewis, *The End*, CONDE NAST PORTFOLIO, Nov. 11, 2008, *available at* http://www.portfolio.com/news-markets/national-news/portfolio/2008/11/11/The-End-of-Wall-Streets-Boom/; Ben S. Bernanke, Governor, U.S. Fed. Reserve, Remarks to the Virginia Association of Economics: The Global Saving Glut and the U.S. Current Account Deficit (Mar. 10, 2005), *available at* http://www.federalreserve.gov/boarddocs/speeches/2005/200503102/.

88. Bank for International Settlements, *Amounts outstanding of over-the-counter (OTC) derivatives*, *available at* www.bis.org/statistics/otcder/dt1920a.pdf.

89. Bank for International Settlements, BIS Quarterly Review: International Banking and Financial Market Developments 46 (Sept. 2009), *available at* http://www.bis.org/publ/qtrpdf/r_qt0 909.pdf.

2009, the Bank for International Settlements calculated the notional value of all types of OTC derivatives worldwide at nearly $605 trillion.[90]

III. THE PITFALLS OF DISAGGREGATED PROPERTY

As seen in the above examples, the innovative practice of disaggregating property through modern finance has not been without its pitfalls. The problems of disaggregation surround three common and related themes: complexity, lack of transparency, and excessive risk-taking, which together foster an environment that leads to greater concentrations of power.

Complexity as Impairment

A level of complexity inevitably accompanies financial products that are highly advanced and specific to addressing sophisticated risk management. There is concern, however, when complexity reaches the point that it can impair the proper functioning of the market system. This impairment, as evidenced by the global financial crisis, negatively influenced the actions of consumers and industry actors, while disabling governing bodies from providing effective regulatory supervision.

At the consumer level, there was minimal understanding that the booming housing market was resting precariously upon a synthetic product market. The seemingly ever-increasing value of real estate spawned unscrupulous lending and borrowing. A staff report by the Federal Reserve Bank of New York identifies one of the frictions behind the sub-prime mortgage crisis as the inability of many sub-prime borrowers to understand the financial products that were being offered, since such products were "very complex and subject to mis-understanding and/or mis-representation."[91]

Complexity and asymmetrical information meant borrowers placed more reliance on lenders to interpret financial products.[92] This allowed for more opportunities of abuse by mortgage originators, including pre-

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90. Bank for International Settlements, BIS Quarterly Review: International Banking and Financial Market Developments (Dec. 2009), *available at* http://www.bis.org/publ/qtrpdf/r_qt0912.pdf.

91. ADAM B. ASHCRAFT & TIL SCHUERMANN, FED. RESERVE BANK OF N.Y., STAFF REPORT NO. 318: UNDERSTANDING THE SECURITIZATION OF SUBPRIME MORTGAGE CREDIT (2008), *available at* http://www.newyorkfed.org/research/staff_reports/sr318.pdf. *See, e.g.*, This American Life, *supra* note 75.

92. *See, e.g.*, George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism,* 84 Q. J. ECON. 488 (1970).

datory lending in the subprime mortgage market.[93] Adjustable-rate mortgages (ARMs) in particular were offered to borrowers as an attractive way to enter the housing market with initially low, fixed interest rates. Some lenders reportedly misrepresented the terms of mortgage loans to financially unsophisticated borrowers, who were unaware of just how much their mortgage payments would increase as a result of interest rate changes.[94]

This is not to say mortgage borrowers were entirely blameless in the subprime mortgage meltdown. Mortgage fraud was common among borrowers. Many borrowers falsified information within loan documents in order to game the housing system and make quick profits from the low interest rates proffered by eager lenders.[95]

Steven Schwarcz has pointed out the complexity in the assets that underlie modern structured financial products (for example, variability in property values, interest rates, mortgage terms, and the creditworthiness of individual mortgagees),[96] over-layered with complexity in the design of the securities themselves (for example, in the design of synthetic CDOs so complex that adequate disclosure to investors was virtually impossible),[97] and exacerbated by complexity in modern financial markets (including indirect holding systems and the widespread use of complex mathematical risk modeling).[98] For CDOs in particular, it has been suggested that "[w]hat may be gained in diversification is lost in incomprehensibility."[99] The manner in which the CDO "jumbles together various loans, notes, receivables, mortgages, etc." causes it to act as "a fixed-income mutual fund with adverse selection in its construction."[100]

Complexity surrounding derivatives has also resulted in market participants being overly dependent on credit rating agencies (CRAs) to determine the risk level of CDOs and other financial products when making investment decisions. Understanding the credit and default risk behind a particular tranche of a CDO would require an extraordinary amount of time and expertise. This meant companies heavily relied upon the credit

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93. *See* ASHCRAFT & SCHUERMANN, *supra* note 91 (accounting for a high level of predatory lending).

94. *Id.* at 70–71 (describing predatory lending situations in which borrowers did not know what they were getting into with ARM mortgages and are now on the brink of foreclosure).

95. *Id.* at 72–74 (describing predatory borrowing situations).

96. Schwarcz, *supra* note 72, at 216–20.

97. *Id.* at 220–31.

98. *Id.* at 231–36.

99. Martin Mayer, *Glass-Steagall in Our Future: How Straight, How Narrow* 12 (Networks Fin. Inst. at Ind. St. U. Policy Brief, 2009-PB-07), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1505488.

100. *Id.*

rating assigned by CRAs to represent an accurate overall assessment of a debt obligor's creditworthiness. The CRA interference in market pricing mechanics, with regards to CDOs, would not necessarily have been as problematic but for the fact that the calculations behind the CRA risk models were wrong. First, their models assumed housing prices would generally continue increasing in value and that the correlation between mortgage defaults would be small.[101] Second, CRAs had limited to no information on the creditworthiness of the (multitude of) individual subprime borrowers behind the MBSs and CDOs and, therefore, erroneously relied on historical data to compensate.[102] Third and finally, the level of complexity behind the MBSs and CDOs became too much to handle for some CRAs. In a July 2008 report on CRAs by the SEC, it noted that "there was a substantial increase in the number and in the complexity of . . . MBS and CDO deals since 2002, and some [CRAs] appeared to have struggled with the growth."[103]

The reliance on CRA credit ratings turned out to be very problematic with regards to firms' risk management levels. Sophisticated investors often purchased (or were permitted to purchase) a CDO note only if it obtained a certain credit rating, such as investment grade, from a CRA.[104] In order to generate a high return for perceived risk, these investors would tend to buy notes issued by CDOs that were inexpensive (i.e. had high yields) relative to the CRA credit rating. However, the CDO notes were inexpensive because, notwithstanding the CRA credit rating, the market as a whole viewed them as riskier than more expensive CDO notes. Thus, in a classic case of adverse selection, investors such as pension funds (of all things) would tend to purchase the riskiest CDO

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101. Christian C. Opp, Marcus M. Opp & Milton Harris, *Rating Agencies in the Face of Regulation: Rating Inflation and Regulatory Arbitrage* 2–4 (January 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1540099.

102. Christopher Cox, Chairman, U.S. Sec. & Exch. Comm'n, Statement at Open Meeting on Credit Rating Agency Reforms (Dec. 3, 2008), *available at* http://www.sec.gov/news/speech/2008/spch120308cc.htm ("One of the significant weaknesses in the credit rating process has been that while the credit rating agencies often relied on others to verify the quality of assets underlying structured products—and thus their ratings were vulnerable to reliance on incorrect information—there was frequently inadequate explanation of the limitations on the ratings of these products.").

103. DIV. OF TRADING & MKTS. & OFFICE OF ECON. ANALYSIS, U.S. SEC. & EXCH. COMM'N, SUMMARY REPORT OF ISSUES IDENTIFIED IN THE COMMISSION STAFF'S EXAMINATIONS OF SELECT CREDIT RATING AGENCIES 1 (July 2008), *available at* http://www.sec.gov/news/studies/2008/craexamination070808.pdf.

104. *See, e.g.*, Frank Partnoy, *The Siskel and Ebert of Financial Markets?: Two Thumbs Down for the Credit Rating Agencies*, 77 WASH. U. L.Q. 619 (1999); Roger Lowenstein, *Triple-A Failure,* N.Y. TIMES MAG. Apr. 27, 2008, *available at* http://www.nytimes.com/2008/04/27/magazine/27Credit-t.html.

notes within a certain CRA credit rating.[105] When the CRAs' risk models turned out to be based on incorrect assumptions about housing prices and mortgage default rates, these investors were left with particularly risky CDO notes.

One of the striking lessons from the global financial crisis has been the impact of complexity on the financial markets, and the degree to which existing regulatory structures failed to manage its effects. Schwarcz has suggested, plausibly, that complexity is the "greatest financial-market challenge of the future."[106] He examines how these multiple complexities can lead to inappropriate lending standards, failures of disclosure, and a lack of transparency and even comprehensibility. Perhaps most difficult to manage, they also create a complex system characterized by intricate causal relationships and a "tight coupling" within credit markets, in which events tend to amplify each other and move rapidly into crisis mode.[107] Prior to the global financial crisis, there was a general failure by all concerned to appreciate the myriad of interrelated ways in which complexity can impair markets and financial regulation.

Lack of Transparency Amounts to a Lack of Accountability

The speed of innovation, frequency of change, and unpredictability of newness inherent in the derivatives revolution has contributed to the development of nontransparent, "dark" markets within modern finance. The lack of transparency has resulted in dysfunction at a corporate governance level, in the financial markets, and within a broader context of financial regulation and also the capacity of governing bodies to provide meaningful oversight and accountability to sophisticated market actors.

As Hu and Black point out, proper corporate governance has long been premised on a proportional relationship between economic interest and shareholder votes: one share, one vote. This relationship gives shareholders the incentive to exercise their voting power responsibly, makes possible the market for corporate control, and legitimizes the power of management. The ability to make one's voting rights disappear when one wants to hide a stake has had obvious implications on corporate law and governance in general. The legitimacy of managerial authority following director elections may be diminished. It can also mean investors (even corporate insiders) have motivations in opposition to those in the best interests of the company and are now able to act accor-

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105. Wilmarth, *supra* note 70, at 1028–29.
106. Schwarcz, *supra* note 72, at 213.
107. *Id*. at 231–36.

dingly. Moreover, sophisticated parties are the ones most able to take advantage of the power of this flexibility, which is beyond the capacity of small or retail investors.

In terms of the impact on financial markets, it is clear in the wake of the global financial crisis that the disaggregation of property in the OTD model upset the normal market conditions for the exchange of goods and services. Thus, market prices did not reflect the economy but rather a bubble, rising high in part because of the encouragement of sales forces. The inability for market participants to accurately assess the value of CDOs and the ultimate deficiency of effective quality assurance on the part of CRAs meant the market was functioning like a market for lemons.[108] In reaction to the sub-prime mortgage crisis, the SEC implemented reform measures in 2008 to bring increased transparency to the credit rating process of derivatives. Then-SEC Chairman Christopher Cox stated the new rules would promote the goals of the *Credit Rating Agency Reform Act of 2006* by "foster[ing] increased transparency, accountability, and competition in the credit rating agency industry . . . ."[109]

The SEC reforms seek to introduce more transparency to the CRA rating process. This is an important step, but there are limits to what this can accomplish in the context of the OTC derivatives market, which is characterized by highly complex products and a lack of exchange-based price discovery. Where there is underlying uncertainty anyway—for example, around a new or extraordinarily complex product or line of business—or where there is no metric for evaluating something (a compliance program, a product, a risk) across institutions, the problem of self-interested action can be exacerbated.[110] Furthermore, the inability to adequately observe what is transpiring in a nontransparent market means there is no foreseeability; thus, there is no opportunity to preemptively deter potential power abuses.

Excessive Risk-Taking at the Expense of Others

The derivatives revolution has fostered an environment of excessive risk-taking in financial markets. The ability to leverage without explicit borrowing, through the use of derivatives, may mean greater degrees of

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108. *See* Akerlof, *supra* note 92. Others have observed this as well; see, for example, W.P. Carey School of Business, *The Market for Lemons: How Information Contributes to Efficiency*, Jan. 5, 2010, *available at* http://knowledge.wpcarey.asu.edu/article.cfm?articleid=1846.

109. Press Release, U.S. Sec. & Exch. Comm'n, SEC Proposes Comprehensive Reforms to Bring Increased Transparency to Credit Rating Process (Jun. 11, 2008), *available at* http://www.sec.gov/news/press/2008/2008-110.htm; *see also supra* text accompanying notes 102.

110. *See generally* William S. Laufer, *Corporate Liability, Risk Shifting, and the Paradox of Compliance*, 52 VAND. L. REV. 1343 (1999).

return, but also greater potential for loss. Firms routinely engaged in regulatory arbitrage and short-sighted gaming behavior, without sufficient attention to systemic risk. Powerful market actors also used derivatives to move their own risk downstream, provoking even greater risk-taking behavior while leaving them with larger portions of the upside. The perceived capacity to fully hedge any risk fostered an environment that allowed many to turn a blind eye to the excessive housing market risk that was accumulating.

Securitization can bring real benefits in terms of hedging and risk management. After a certain point, however, those benefits are extracted and additional innovation exists primarily to serve speculators, to move risk onto others, and to generate book-level financial value that exists at a metaphysical remove from the "real" economy. This poses great risk to systemic stability. Even taken on their own terms—in terms of the benefits that structured products confer for fine-tuning risk profiles and improving investor choice—by design or in effect, at some point the costs of innovative new products outweigh their benefits to overall social welfare. As the March 2009 Turner Review from the United Kingdom suggested, the global financial crisis has challenged the "underlying assumption of financial regulation in the US, the UK and across the world . . . that financial innovation is by definition beneficial, since market discipline will winnow out any unnecessary or value-destructive innovations."[111] On the contrary, in retrospect, some recent forms of financial innovation delivered few benefits, but permitted rent-seeking and contributed to significantly increased levels of systemic risk.[112] As the Turner Review noted:

> [I]t seems likely that some and perhaps much of the structuring and trading activity involved in the complex version of securitised credit [over the last ten to 15 years], was not required to deliver credit intermediation efficiently. Instead, it achieved an economic rent extraction made possible by the opacity of margins, the asymmetry of information and knowledge between end users of financial services and producers, and the structure of principal/agent relationships between investors and companies and between companies and individual employees.[113]

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111. U.K. FIN. SERVS. AUTH., THE TURNER REVIEW: A REGULATORY RESPONSE TO THE GLOBAL BANKING CRISIS 49 (2009), *available at* http://www.fsa.gov.uk/pubs/other/turner_review.pdf.

112. *Id.* at 109.

113. *Id.* at 49.

It is not surprising that the fallout from the global financial crisis has led to a severe backlash in American public sentiment towards risk-taking by financial firms. Since last year, U.S. Treasury Secretary Tim Geithner has championed a relatively circumscribed regulatory response to the crisis, based primarily on requiring banks to hold more capital in reserve to cover losses.[114] Geithner's view seems to have been that broad-based prohibitions on specific risky activities would be less effective, in part because such bans would unnecessarily eliminate some legitimate activity. Instead, on January 21, 2010, President Barack Obama chose a more aggressive (and some would say populist) option. He announced his support of the position held by Paul Volcker, former chairman of the U.S. Federal Reserve and head of Obama's Economic Recovery Advisory Board, by calling for limits on the size and trading activities of financial institutions in order to reduce excessive risk-taking activity.[115]

Volcker has argued that banks should be prevented from taking advantage of governmental safety nets to make speculative investments. He stated:

> We ought to have some very large institutions whose primary purpose is a kind of fiduciary responsibility to service consumers, individuals, businesses and governments by providing outlets for their money and by providing credit. . . . They ought to be the core of the credit and financial system. Those institutions should not engage in highly risky entrepreneurial activity.[116]

Volcker's proposals for structural reform in the banking industry are important in curtailing conflicts of interest and, purely in terms of outcomes for consumers and taxpayers, in protecting them from the risks associated with speculative trading. Interestingly, this is something of an external, or ex post, solution. If one starts, as we do, from the proposition that excessive concentration of power is the real problem, then addressing the risk to which normal investors are exposed only tangentially responds to that problem. Some firms will obviously be smaller if they must choose between consumer depository banking and investment

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114. *See* Jackie Calmes, *With Populist Stance, Obama Takes on Banks*, N.Y. TIMES, Jan. 21, 2010, *available at* http://www.nytimes.com/2010/01/22/business/economy/22policy.html; David Cho & Binyamin Appelbaum, *Obama's 'Volcker Rule' shifts power away from Geithner*, WASH. POST, Jan. 22, 2010, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2010/01/21/AR2010012104935.html?nav=emailpage.

115. Nicholas Johnston & Julianna Goldman, *Obama Calls for Limiting Size, Risk-Taking of Financial Firms*, BLOOMBERG, Jan. 22, 2010, *available at* http://www.bloomberg.com/apps/news?pid=20601087&sid=an1RUYC9UqAY.

116. Cho & Appelbaum, *supra* note 114.

banking. Yet reducing the clout of the banks is not Volcker's primary goal. If Volcker were bent on destabilizing entrenched accumulations of power, he would be directly advocating the breakup of "too big to fail" banks. If he were focused specifically on reducing the opportunities for sophisticated parties to aggregate power in nontransparent ways, he would be focused on shoring up mechanisms to ensure transparency and accountability—perhaps through comprehensive reform of CRA regulation, greater involvement of the exchanges, or the addition of some new oversight body.

That said, there are reasons to be optimistic about the Volcker plan. To begin with, as noted above, placing limits on proprietary trading by banks that also take consumer deposits will affect the size and relative power of a subset of the global firms. Also, from a purely practical perspective, a bright-line prescription against a clearly-defined and fairly easily monitored activity makes regulation easier—a meaningful consideration in an environment as profoundly complex as the global financial markets. Perhaps, Volcker is simply being realistic about the prospects of trying to control the enormous OTC derivatives market, or the sophisticated and influential parties that trade in it. Rather than seek to produce significant change there, Volcker, in these circumstances, has perhaps decided simply to distance the real economy and depository banking from the forward trajectory of the OTC derivatives market. In an indirect but real way, this may promote more responsible behavior by returning the large global banks to the ranks of businesses that, like any other business, can be allowed to fail.

IV. THE CONCENTRATION OF POWER

The final section of this paper sketches out the fundamental distinction between Unger and Berle in terms of their understandings of power and its relationship to property. For Unger, it is the public's role (even destiny) to smash consolidated power and property ownership within society. The trouble is that while the practice of destabilization may potentially uproot forces of domination and dependence, without additional elements it also creates a vacuum that will be filled through the actors' self-interested behavior. Unger does not consider how power can creep back into new structures and models, and how reorganization only shakes up power momentarily unless some architecture exists to consolidate social welfare gains, prevent backsliding, and prevent powerful players from using nontransparent means to further their own ends.

Like Unger, Berle's work considers the possibility that property can be disaggregated (in his case, particularly in terms of the separation of ownership from control within the corporation) and evaluates the impact

on relative power. Many continue to regard his book with Gardiner Means, *The Modern Corporation*, as the single most influential book in corporate legal history.[117] Unlike Unger, however, Berle's account sees dispersed and disaggregated ownership as actually permitting unaccountable concentrations of power—not as being the means for its destruction. Berle's work is still remarkably relevant today in the wake of the derivatives revolution.

Unger and the Persistence of Power

A common theme—in retrospect, an inevitable one—runs through the above narratives, concerning the ways in which sophisticated parties seized the opportunities presented by the disaggregation of property rights. Consistent with their own self-interest, the parties doing the decoupling effectively kept what they wanted to keep (votes, upside risk, liquidity) and discarded what they did not (risk, reporting and disclosure obligations, assets in illiquid states). It was sophisticated parties that had the capacity to work with the new tools. Moreover, their actions in their own interests did not advance the general good. Through empty voting and hidden ownership, sophisticated investors have ratcheted up the level of expertise required to compete effectively in contests for corporate control, for example, but without advancing the best interests of investors as a whole—indeed, while potentially undermining them—and without improving corporate governance standards. Similarly, while financial institutions' balance sheets could be improved through hedging using derivatives, selling structured finance instruments, and speculative trading, downside risks associated with those activities did not disappear; they were shifted initially to counterparties, but ultimately to be borne by the global economy and to a large extent, by taxpayers.

The version of property rights disaggregation that arose as a result of financial innovation is not, of course, the same thing as the essentially state-based redistribution of wealth that Unger envisions taking place through property rights disaggregation. That said, the examples above point to something fundamental, not contemplated by Unger, about the relationship between existing legal structures and priorities, such as accountability and transparency. Specifically, disaggregating property also disaggregates legal accountability mechanisms, premised on property ownership, that have developed over time in the service of advancing the

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117. BERLE & MEANS, *supra* note 1. *See, e.g.*, Columbia Law School, *Berle and Means'* The Modern Corporation *Still Relevant 75 Years Later*, *available at* http://www.law.columbia.edu/media_inquiries/news_events/2007/December07/berle.

rule of law, protecting investors from the worst abuses, and promoting confidence in the markets. New vote buying thus undermines statutory protections for shareholder voting rights and minority shareholders, and allows sophisticated parties to achieve their goals via non-transparent means. This may be perceived as an even worse outcome than an already existing, but static, consolidated property right.

Unger's response to the derivatives problem might be that we have not gone far enough. The use of structured financial products has atomized equity and debt but a broadly available destabilization right (for example, a power to disrupt the status quo in profound ways, available not only to shareholders but all stakeholders including creditors, employees, local communities, citizens writ large, and representatives of the global environment) did not follow.[118] The result is the persistence of features like a hollowed-out legacy mechanism for ensuring a voice through shareholder voting, which is no longer connected to the central interests to be protected and which is available to be used strategically by sophisticated parties. The implication may be that society cannot meet Unger's theory partway, or allow it to evolve organically—there must be a full throttle ideological and practical embrace of Ungerian theory in order to attain his conception of an empowered democracy.[119]

It is far from likely that we will experience a state with a desire to smash consolidated property holdings—and directly threaten powerful interests—on a large scale.[120] This is not to say that it cannot happen, as the trust-busting era of Theodore Roosevelt demonstrated. So far though, the challenges of modern finance and the regulatory responses to it suggest that the establishment of broadly available destabilization rights is unlikely to follow the disintegration of formal property rights. Moreover, we cannot assume that this form of destabilization will consistently happen on its own. While it is theoretically possible that "ungoverned" mechanisms can create rich accountability in the absence of

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118. *See* UNGER, FALSE NECESSITY, *supra* notes 6 and 17. *See also* ROBERTO MANGABEIRA UNGER, POLITICS: THE CENTRAL TEXTS 367–95 (Zhiyuan Cui ed., 1997).

119. *See* Cristie L. Ford, *New Governance in the Teeth of Human Frailty: Lessons from Financial Regulation*, WISC. L. REV. (forthcoming summer 2010), *available at* http://ssrn.com/abstract=1525645 (considering whether new governance theory is "modular"—that is, able to still confer benefits when applied partially or imperfectly).

120. One of the more pessimistic accounts of the sway that economic power exerts over politics in the wake of the global financial crisis is Simon Johnson, *The Quiet Coup*, ATLANTIC, May 2009, *available at* http://www.theatlantic.com/doc/200905/imf-advice (arguing that one of the causes of the financial crisis in the United States was the domination of the financial industry by oligarchs with ties to government and predicting that the power of the oligarchs would also impede economic recovery because the necessary bold steps toward industry regulation would not be taken).

formal mechanisms in at least some contexts,[121] this is not an inevitable outcome. All three narratives above demonstrate that in a world characterized by considerable information asymmetries and power imbalances, less happy results that reflect existing power relationships may also result. Even where acute problems associated with securitization are resolved, it is not clear from where the impetus will come to generate a fundamental revision of existing structures along Ungerian lines.

Unger sees the promise of structural reform in context-smashing and self-disrupting structures. But he does not concern himself enough with the insidious but determinative ways in which power hangs onto power while adapting to new structural environments. Unger does not consider that those given control, such as the governmental representatives expected to control the rotating capital fund in his model, will become the new power holders that those with resources will begin to solicit.[122]

Similarly, even where ambitious reformative steps are taken to force structural reform, as Volcker proposes, the examples above suggest that power will try to reinsert itself at every decision-making juncture. In fact, the examples above should be seen as useful case studies of how, in practice, an aspirational theory premised on flexibility and destabilization is likely to be interpreted and put in operation in specific situations. With respect to corporate governance, financial institutions' lending practices, and global markets generally, property has been disaggregated for the purpose of permitting its component pieces to be employed as tools by powerful interests, in their own interests. The consequence has not been the de-insulation of power from contestation; what we have seen, rather, is less transparency, less accountability, and greater concentration of power.[123]

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121. *See, e.g.*, Charles F. Sabel, *Ungoverned Production*, *in* CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 310 (Jeffrey N. Gordon & Mark J. Roe eds., 2004); Matthew C. Jennejohn, *Collaboration, Innovation, and Contract Design*, 14 STAN. J.L. BUS. & FIN. 83, 86–87 nn.12–14 (2008).

122. Consider, e.g., Kellye Y. Testy, *Linking Progressive Corporate Law with Progressive Social Movements*, 76 TUL. L. REV. 1227, 1234 (2002) (critiquing the "team production theory" of corporate law, and suggesting that "[i]n a corporate governance model that allocates rents according to who can strike the best bargain with the board, it is clear who will end up with the largest slice: the best bargainer. And what makes one the best bargainer? Power.").

123. An example from the legislative realm, which also highlights our concerns regarding the persistent way in which power coalesces, involves the repeal of the *Banking Act of 1933*, popularly known as the *Glass-Steagall Act* (GSA). The GSA had restricted commercial banks from involvement in the securities industry, thus creating a firewall between commercial banking and investment banking. Its formal repeal via the *Financial Services Modernization Act of 1999*, otherwise known as the *Gramm-Leach-Bliley Act* (GLBA), represents a breaking down of a rigid and admittedly imperfect but also public-protective structure in favor of more fluid possibilities, thereby producing a

Implications for New Governance

While Unger's work is not generally at the center of practical conversations about regulation, new governance theory, which owes a substantial debt to Unger, increasingly is. Over the last decade, some new governance theorists have picked up and elaborated on Unger's destabilization rights concept and its relationship to structural reform.[124]

"New governance" is an umbrella term that captures within it several discrete but related scholarly approaches, applied across a range of specific subject areas.[125] Relative to the Ungerian approach, new gover-

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further concentration of power. At the time of the GLBA, then-U.S. Treasury Secretary Lawrence Summers called the repeal of the GSA "updat[ing] the rules that have governed financial services since the Great Depression and replac[ing] them with a system for the 21st century" thereby allowing American banks to grow larger and "better compete" on the world stage. *See* Cyrus Sanati, *10 Years Later, Looking at Repeal of Glass-Steagall*, N.Y. TIMES, Nov. 12, 2009, *available at* http://dealbook.blogs.nytimes.com/2009/11/12/10-years-later-looking-at-repeal-of-glass-steagall/.

Senator Phil Gramm, the chief sponsor of the GLBA, described the GSA as a "punitive" law that was brought on by fear and popular "demagoguery" following the Great Depression, which imposed an "artificial separation of the financial sector of our economy." 145 CONG. REC. S13913 (daily ed. Nov. 4, 1999). Other senators also argued the GSA was "unnecessary" and created "inefficiencies" in the economy, thus applauding its demise. 145 CONG. REC. S13907 (daily ed. Nov. 4, 1999); 145 CONG. REC. S13876 (daily ed. Nov. 4, 1999).

According to Arthur Wilmarth, between 1990 and 2005, more than 5,400 mergers occurred in the U.S. banking industry, involving more than $5.0 trillion in banking assets. Wilmarth, *supra* note 70, at 975. The bank merger wave meant that the proportion of banking assets held by the ten largest U.S. banks more than doubled, from 25% in 1990 to 55% in 2005.

Wall Street firms also secured bank-like powers by acquiring depository institutions insured by the Federal Deposit Insurance Corporation (FDIC), enabling them to offer FDIC-insured deposits, and make commercial and consumer loans. Along with permitting the creation of financial institutions so crucial that they could not be allowed to fail, the repeal of regulatory firewalls also invited "massive contagion" between banking industry sectors. *See, e.g.*, ANDREW SHENG, FROM ASIAN TO GLOBAL FINANCIAL CRISIS: AN ASIAN REGULATOR'S VIEW OF UNFETTERED FINANCE IN THE 1990S AND 2000S at 326 (2009).

124. *See, e.g.*, Michael C. Dorf & Charles F. Sabel, *A Constitution of Democratic Experimentalism*, 98 COLUM. L. REV. 267 (1998); Charles F. Sabel & William H. Simon, *Destabilization Rights: How Public Law Litigation Succeeds*, 117 HARV. L. REV. 1015 n.13 (2004).

125. This description is inevitably subjective and incomplete. *But see, e.g.*, GRÁINNE DE BÚRCA & JOANNE SCOTT, EDS., LAW AND NEW GOVERNANCE IN THE EU AND THE US: ESSAYS IN EUROPEAN LAW (2006); Orly Lobel, *The Renew Deal: The Fall of Regulation and the Rise of Governance in Contemporary Legal Thought*, 89 MINN. L. REV. 342 (2004). We might identify a subgroup of "experimentalist" scholars comprising especially Charles Sabel of Columbia Law School and his colleagues. *See, e.g.*, Dorf & Sabel, *supra* note 124; Sabel & Simon, *supra* note 124; James S. Liebman & Charles F. Sabel, *A Public Laboratory Dewey Barely Imagined: The Emerging Model of School Governance and Legal Reform*, 28 N.Y.U. REV. L. & SOC. CHANGE 183 (2003); Ronald J. Gilson, Charles F. Sabel, & Robert E. Scott, *Contracting for Innovation: Vertical Disintegration and Interfirm Collaboration*, 109 COLUM. L. REV. 431 (2009). Susan Sturm's important work on new governance-style institutional change and public law remedies also informs and is informed by experimentalism. *See, e.g.*, Susan Sturm, *Second Generation Employment Discrimination: A Structural Approach*, 101 COLUM. L. REV. 458 (2001) [hereafter Sturm, *Second Generation*], Susan Sturm, *The Architecture of Inclusion: Advancing Workplace Equity in Higher Education,* 29 HARV. J. L. &

nance moves away from the theoretical plane to focus more on improving the responsiveness, representativeness, and effectiveness of existing institutions.[126] It draws insight from contemporary regulatory theory[127] and from theoretical antecedents beyond Unger, including Teubnerian reflexive law,[128] Deweyan pragmatism,[129] and neo-Madisonian republicanism.[130]

For purposes of this paper, the essential components of a new governance approach are, above all, a commitment to permitting flexibility and context-sensitivity in regulatory design, generally for the same purposes that Unger describes: to advance human flourishing and what, in one formulation, are described as the Enlightenment ideals of liberty, equality, and fraternity.[131] At this level, a critique of Ungerian theory should also provoke reflection with respect to its more practically-minded cousin, new governance. New governance scholarship proceeds

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GENDER 247 (2006); Joanne Scott & Susan Sturm, *Courts as Catalysts: Re-Thinking the Judicial Role in New Governance*, 13 COLUM. J. EUR. L. 565 (2007).

126. However, consensus is lacking on whether new governance can and should work from empirical analysis to theory (to identify the real life constraints that affect outcomes) or from theory to empirical analysis (to identify the nascent possibilities in admittedly imperfect real life examples). *See* Sturm, *Second Generation*, *supra* note 125. Recent scholarship has also suggested that new governance continues to be overly abstract (as we argue here that Unger is as well) in its depiction of the actual human beings that populate its discursive models. *See* Amy J. Cohen, *Negotiation, Meet New Governance: Interests, Skills, and Selves*, 33 LAW & SOC. INQUIRY 503 (2008).

127. A careful parsing of the genealogy of new governance is beyond this project's scope. However, the roots of new governance thought represent, in part, a reaction to bureaucracies and hierarchies that had become ineffective because of over-reliance on rigid rule-making processes and centralized decision making structures and/or because of co-optation by interest group politics. Operationally, new governance methods share substantial ground with "responsive regulation" and "management based regulation." *See, e.g.*, respectively, IAN AYRES & JOHN BRAITHWAITE, RESPONSIVE REGULATION: TRANSCENDING THE DEREGULATION DEBATE (1992); Cary Coglianese & David Lazer, *Management-Based Regulation: Prescribing Private Management to Achieve Public Goals*, 37 LAW & SOC'Y REV. 691 (2003). *See also, e.g.*, Joanne Scott & David M. Trubek, *Mind the Gap: Law and New Approaches to Governance in the European Union*, 8 EUR. L. J. 1 (2002); DONALD F. KETTL, THE GLOBAL PUBLIC MANAGEMENT REVOLUTION: A REPORT ON THE TRANSFERENCE OF GOVERNANCE (2000); MALCOLM K. SPARROW, THE REGULATORY CRAFT: CONTROLLING RISKS, SOLVING PROBLEMS, AND MANAGING COMPLIANCE (2000).

128. Gunther Teubner, *Substantive and Reflexive Elements in Modern Law*, 17 LAW & SOC'Y REV. 239 (1983); Eric W. Orts, *Reflexive Environmental Law*, 89 NW. U. L. REV. 1227 (1995); Lobel, *supra* note 125.

129. *See, e.g.*, Bradley C. Karkkainen, *"New Governance" in Legal Thought and in the World: Some Splitting as Antidote to Overzealous Lumping*, 89 MINN. L. REV. 471, 481–86 (2004) (arguing that many new governance scholars rely more on Deweyan pragmatism than on Teubnerian social theory); William H. Simon, *Solving Problems vs. Claiming Rights: the Pragmatist Challenge to Legal Liberalism*, 46 WM. & MARY L. REV. 127 (2004).

130. *See, e.g.*, Brandon L. Garrett & James S. Liebman, *Experimentalist Equal Protection*, 22 YALE L. & POL'Y REV. 261 (2004).

131. *Id.* at 295–99; Dorf & Sabel, *supra* note 124, at 446–52; James S. Liebman & Brandon L. Garrett, *Madisonian Equal Protection*, 104 COLUM. L. REV. 837, 852–57, 971–73.

from the conviction that the best way to address public questions—better than so-called "command-and-control" regulation[132] or the perpetuation of "immovable [legal] boundary stones"[133]—is through decentralized decision-making by those possessing the best contextual information. The new governance regulator prioritizes mechanisms that share information from localized experiments[134] and that push localities to improve by comparison to the experience of others, rather than trying to regulate via detailed, process-based regulatory requirements. As a matter of institutional design, it relies on information-based and information-forcing techniques; specifically, reason-giving, transparent processes, benchmarking and outcome analysis, and participatory and carefully structured dialogue.

The notion of contingency, or revisability, is as essential to new governance as it is to Unger. At the level of social theory, the revisability of starting positions gives participants the freedom to work through differences in unexpected ways, and to identify new possibilities around even seemingly intractable problems. In the words of Chuck Sabel and Bill Simon, speaking about public law litigation, "destabilization through new public law creates opportunities for collaborative learning and democratic accountability that the more certain world of pluralist bargaining under the aegis of courts or legislatures often precludes."[135] In terms of practical problem-solving, open-ended and flexible processes permit a pragmatic learning-by-doing method that is promising from an outcome-oriented perspective. For the regulator as well, embedded within the new governance approach is the recognition that regulators (especially in fast-moving and complex sectors, such as global finance) are knowledge-poor relative to the industries they regulate. New governance-style methods support industry-level innovation, seeking to then fold situational learning up into regulatory expectations through industry best practices and outcome analysis.[136]

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132. Kathleen G. Noonan, Charles F. Sabel, & William H. Simon, *Legal Accountability in the Service-Based Welfare State: Lessons from Child Welfare Reform*, 34 LAW & SOC. INQUIRY 523 (2009); Susan P. Sturm, *A Normative Theory of Public Law Remedies*, 79 GEO. L.J. 1355 (1991).

133. Dorf & Sabel, *supra* note 124, at 420.

134. In the context of financial and securities regulation (as elsewhere), this favors hybrid public/private models. This is not to say that new governance is the same thing as self-regulation. *See* Cristie L. Ford, *Principles-Based Securities Regulation in the Wake of the Global Financial Crisis*, 55 MCGILL L. J. (forthcoming 2010).

135. Simon & Sabel, *supra* note 124, at 1101.

136. On the relationship between new governance theory and the recent financial crisis, see Ford, *supra* note 119.

New governance values incrementalism and learning-by-doing, as it should, because new governance starts from the premise that in an increasingly complex and decentered (or at least polycentric and networked) world, the path to human flourishing is through permitting innovation and parallel experimentation, and creating flexible and revisable structures that open the door to new possibilities.[137] Yet, the stories above are cautionary tales about some potential effects of innovation, flexibility, and complexity on transparency, accountability, and power. While a full response to these challenges is beyond the scope of this paper, it seems evident that new governance scholars need to take seriously the risk that the phenomena described above will replicate themselves in the interstices of many new governance processes, including those in fields other than financial regulation. A clear view of human nature needs to be at the core of the new governance model because within fluid space, it will drive process and outcomes. Understanding how people and their institutions operate, individually and in groups, requires us to build in compensatory responses in regulatory design in the same way that we would design for other predictable flaws.

We may also need to consider whether and to what degree background factual or legal uncertainty will generate new ideas that increase general social welfare. Conditions of deep instability are sometimes proposed as the moment when new governance approaches stand the best chance of being realized—times when no one knows what the solution to a problem might be, or how to get there, but everyone knows that the status quo cannot persist.[138] Ronald Gilson, Charles Sabel, and Robert Scott similarly describe a promising "contracting for innovation" phenomenon arising around interfirm collaboration, as a response to what they understand as a problem of "Knightian" uncertainty.[139] The trouble is that power relationships assert themselves in fluid space, such as the space between ownership and voting rights created through mechanisms like empty voting and hidden ownership.[140] In other words, instability

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137. *See generally* Dorf & Sabel, *supra* note 124.

138. *See, e.g.*, Edward Rubin, *The Myth of Accountability and the Anti-Administrative Impulse*, 103 MICH. L. REV. 2073, 2131–34 (2005) (arguing for open-ended formulations where the regulator "knows the result it is trying to achieve but does not know the means for achieving it, when circumstances are likely to change in ways that the [regulator] cannot predict, or when the [regulator] does not even know the precise result that she desires").

139. Gilson, et al., *supra* note 125.

140. Consider the insights of critical race scholars with respect to the value of formal equality provisions for minority groups. *See, e.g.*, PATRICIA J. WILLIAMS, THE ALCHEMY OF RACE AND RIGHTS (1991). A debate exists within new governance scholarship about the degree of "hard law" background measures needed (or assumed to exist) to safeguard participatory rights or address power disparities. *See, e.g.*, Cohen, *supra* note 126, at 543 n.47. Some scholars have argued for shoring

and fluidity may well generate new structures but on their own may not generate new structures that are actually better for the common welfare than the old ones were. The resulting lack of transparency not only *can* be, but in practice is *designed* to be, beneficial to the powerful actors that are employing these devices. Those that benefit from it will resist efforts to force transparency and accountability both overtly, and in hard-to-measure ways.[141]

This leads us to Berle, whose instincts on human nature, power, and property are essential here. Like Unger, Berle talks about the disaggregation of the traditional bundle of rights we know as property. Also like Unger, it seems clear that what Berle was actually talking about was power. Unger uses the language of property, particularly his "consolidated property right," as a tool to convey his underlying concerns over the abuse of power at the hands of entrenched ruling groups. Berle, as well, was very aware of property's close link to power, stating "[t]here is no unit of power measurement comparable to the inexact but revealing dollar-unit used in respect of property."[142] Berle understood, as Unger did, the risks and implications of a small minority carrying a large proportion of the population's wealth.

Berle and Modern Finance

The derivatives revolution is reminiscent of Berle and Means' identification of the divergence of interest between ownership and control in the corporation, but metastacized, fractalized, and multiplied. Berle and Means saw the connection between disaggregated property and the concentration of power and later, Berle himself recognized the need for checks and balances to ensure large bodies of power would be held accountable.

Is Berle's perspective more sensible, or more predictive, than Unger's pro-destabilization agenda? Berle and Means recognized some of the concerns associated with exchanging physical property for fungible,

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up non-negotiable substantive rights in response to perceived equality problems under new governance-style approaches. *See, e.g.*, Lisa T. Alexander, *Stakeholder Participation in New Governance: Lessons from Chicago's Public Housing Reform Experiment*, 16 GEO. J. ON POVERTY L. & POL'Y 117, 127–28, 180–84 (2009); Douglas Neaime, *When New Governance Fails*, 70 OHIO ST. L.J. 323 (2009).

141. Sturm, *Second Generation*, *supra* note 125, identifies subtle resistance problems and offers a solution, a solution based on building in responsive architecture rather than perpetuating plasticity. New governance scholars also emphasize that broadly participatory and information-based stakeholder participation can do some of this work.

142. ADOLF A. BERLE, JR., POWER WITHOUT PROPERTY: A NEW DEVELOPMENT IN AMERICAN POLITICAL ECONOMY 78 (1959).

notional instruments that operate in an ever-changing, liquid environment. They observed that in liquid markets, the owner is "practically powerless through his own efforts to affect the underlying property."[143] Thus, while Unger believed a disaggregation of property meant a more engaged citizenry and the elimination of opportunities for discrete groups to hoard power, Berle and Means claimed the opposite: that dispersed or decentralized ownership may very well mean greater passivity on the part of shareholders, and reduced accountability by managers to their shareholders. The concentration of power arising from the separation of ownership and control was starkly apparent to Berle and Means:

> Within [the corporate system] there exists a centripetal attraction which draws wealth together into aggregations of constantly increasing size, at the same time throwing control into the hands of fewer and fewer men. The trend is apparent; and no limit is as yet in sight. . . . So far as can be seen, every element which favored concentration still exists, and the only apparent factor which may end the tendency is the limit in the ability of a few human beings effectively to handle the aggregates of property brought under their control.[144]

Berle was also apparently one of the first to characterize the separation between registered share owners and beneficial owners in terms of a separation of voting from economic interests. In his 1959 book, *Power Without Property*,[145] Berle stated that the corporate share in carrying rights to both distributions and votes, had begun to split. This was due to the increasing role of "fiduciary institutions" (such as institutional holders, pension trusts, mutual funds, and insurance companies) purchasing shares on behalf of beneficiaries and thus becoming the holders with voting rights.[146] By virtue of contract, these institutions would be required to provide the dividends or other benefits for distribution among its beneficiaries the separate holders of economic ownership. In this context, when warning of the perils of disaggregated ownership, Berle empha-

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143. BERLE & MEANS, *supra* note 1, at 64.

144. *Id.* at 18. Interestingly, in *Power Without Property*, Berle reflected upon how he felt *The Modern Corporation* "in no way broke new ground." BERLE, POWER WITHOUT PROPERTY, *supra* note 142, at 19. For Berle, pointing out that corporations increasingly held large concentrations of power was not a new realization and he queried as to why the book had been received in the academic community as novel. He felt that he had been "describing a phenomenon with which everyone was familiar" and still thought this to be the case. *Id.* at 19–20.

145. BERLE, POWER WITHOUT PROPERTY, *supra* note 142, at 59.

146. *Id.* at 59–69; *see also* Tamar Frankel, *The New Financial Assets: Separating Ownership from Control*, 33 SEATTLE U. L. REV. 931 (2010).

sized the need to appropriately govern the changing relationship between power and property, stating:

> The breakdown of the economic unit we regarded as "property" into its component elements may be matter of economic analysis. But one outstanding result of it – the erection of organizations largely resting on and certainly developing power – plainly raises problems whose nature is essentially political.[147]

It is Berle's recognition of the human desire to have power that puts him at some remove from Unger. Unger seems to assume that through careful and continually improving social design, one can structure (or destructure) power relationships and build in ongoing contestability; but he does not seriously consider the torque that human nature will impose on that design. Berle, by contrast, puts human nature at the foundation of his analysis.

Of course, Berle could not have imagined the degree to which property would break down through the derivatives revolution and the phenomenon of new vote buying.[148] Arguably, he also underestimated the risk (or perhaps it was smaller then) that economic power would come to influence broader social policy and political decisions. He felt that "[a]bsent combination with other forms, economic power is indeed impressive but not uncontrollable."[149] He was not as concerned as Unger continued to be about significant concentrations of economic power, so long as there was a responsible government and an active public consensus to monitor it. Berle also asserted that the "public consensus" could act as an efficient check and balance on concentrated economic power. Berle noted, candidly, that "[a]t all events, the outline of a democratic economy does emerge as that of concentrated economic power," and he was clear in noting that there are dangers related to such power. However, he argued that concentrated economic power was checked by, and responsible to, an uncommitted citizenry that had the ability to direct such power through the choices they made in the markets. He contended that "[i]n economic as in political government, a people gets (more or less) the government it deserves. Certainly that is true in as sensitive and free a democracy as ours."[150] Thus, while Unger believed that those

147. BERLE, POWER WITHOUT PROPERTY, *supra* note 142, at 17.

148. This is particularly true given that the original 1932 RESTATEMENT OF CONTRACTS, § 568 (1932) made the sale of voting rights devoid of economic interest illegal (and New York corporate law still prohibits shareholders from selling or exchanging their votes for money or "anything of value"). *See* Hu & Black, *supra* note 4, at 861.

149. BERLE, POWER WITHOUT PROPERTY, *supra* note 142, at 87.

150. *Id.* at 26.

holding the property would ultimately exercise control (overt or covert) over the citizenry, Berle saw economic and political power as meaningfully distinct.[151]

This perspective may be less tenable today. There is evidence to suggest that today economic and political power elites overlap to a substantial degree, and that the agendas of powerful financial interests hold considerable weight with elected representatives.[152] In financial history, the repeal of the *Glass-Steagall Act* demonstrates that legislators sometimes have little choice but to react to events already happening on the ground among private parties.[153] (That story is also among the many that

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151. Berle said, in language reflecting his political era, "It is conceivable that sufficiently concentrated economic power could cause the overthrow of a political governing system; but even Lenin asserted that this could not occur if the government maintained control over effective military power." *Id.* at 87–88. Berle extended his theories on power in ADOLF A. BERLE, POWER (1969), in which he describes the sources and limits of four manifestations of power: economic, political, judicial, and international.

152. *See, e.g.*, *supra* note 120.

153. *See supra* note 123 and accompanying text for background. By the 1990s, the GSA had already been considerably weakened by incremental bank incursions over the line through the 1990s, but the merger between Citicorp, Inc. (Citicorp) and Travelers Group Inc. (Travelers) greatly influenced the government's repeal of the GSA. Indeed, according to Kenneth Thomas, a consultant and Lecturer in Finance at the Wharton School, "Citigroup [was] not the result of [the GLBA] but the cause of it." Kenneth H. Thomas, Letter to the Editor, *Don't Underestimate the Power of Sandy Weill*, BUSINESSWEEK, Sept. 30, 2002, *available at* http://www.businessweek.com/magazine/content/02_39/c3801026.htm. The $70 billion merger (totaling over $698 billion in assets) to form Citigroup Inc. (Citigroup) was in violation of certain provisions of the GSA, as well as the *Bank Holding Company Act of 1956*, 12 U.S.C. § 1841, et seq., because as a combined entity it would be a financial services company offering commercial banking and investment operations. *See* Mitchell Martin, *Citicorp and Travelers Plan to Merge in Record $70 Billion Deal: A New No. 1: Financial Giants Unite*, N.Y. TIMES, Apr. 7, 1998, *available at* http://www.nytimes.com/1998/04/07/news/07iht-citi.t.html?pagewanted=1.

The timing of the Citicorp/Travelers merger is sometimes described as occurring following the repeal of the GSA and as a consequence of that legislation. Citigroup even says this itself. *See* Citigroup, http://www.citi.com/citi/corporate/history/citigroup.htm (March 2000: "Citigroup Inc. qualifies as a financial holding company, among the first to take advantage of the new *Gramm-Leach-Bliley Act,* the *Financial Services Modernization Act* signed by President Clinton in November 1999." (emphasis added)). While it is true that the Citicorp/Travelers merger became legal following the implementation of the GLBA, in fact the parties had announced the signing of the merger to the media on April 6, 1998, some 11 months before the Senate Banking Committee approved the initial draft of the GLBA. *See* News from the Senate Banking Committee, *Time Line of* Gramm-Leach-Bliley Act, http://banking.senate.gov/prel99/1105tme.htm (last visited Apr. 4, 2010); *see also* Citigroup, http://www.citigroup.com/citi/homepage/ (last visited Apr. 4, 2010). At that time, Sandy Weill of Travelers, in responding to questions regarding the legal hurdles before them, stated, "We are hopeful that over that time the legislation will change. . . . We have had enough discussions [with the Federal Reserve Board] to believe this will not be a problem." Martin, *supra*.

In his induction into the Academy of Achievement, Weill's biography outlines the strategic maneuvers that led to changing the law, stating:

> In the 1980s, banks and insurance companies had won limited regulatory waivers from the *Glass-Steagall* restrictions, and many in the financial services industry called for their

highlight the cross-pollination between the financial industry and its regulators.[154]) The recent Supreme Court decision in *Citizens United v. Federal Election Commission*, which eliminated the ban on corporate political spending, could magnify this point in the future.[155]

If anything, our divergence with Berle on the connection between economic and political power only causes us to take more seriously his argument that the human will to acquire power is an inescapable reality that must be grappled with, not only at the level of institutional structure, but also at the mundane but crucial level of implementation. Berle recognized that "a power vacuum is always filled by a power holder . . . ."[156] Thus, for Berle, the issue was not about removing sources of power—or in Unger's case, having those in power being subject to ongoing destabilization—but about ensuring that those in power are properly and effectively regulated, taking into account both the blatant and the subtle ways in which power operates.

> complete repeal. Weill and Citicorp Chairman John S. Reed decided to force the issue. They went ahead with their plan and secured a waiver whereby the temporary merger of the companies would be permitted, pending congressional action. Weill recruited former President Gerald Ford, a Republican, and former Treasury Secretary Robert Rubin, a Democrat, to serve on the board of the merged companies and assist them in making their case to Congress.

Academy of Achievement, Sanford Weill Biography, *available at* http://www.achievement.org/autodoc/page/wei0bio-1 (last visited Apr. 4, 2010) (emphasis added). For a helpful summary see PBS, The Long Demise of Glass-Steagall, *available at* http://www.pbs.org/wgbh/pages/frontline/shows/wallstreet/weill/demise.html (last visited Apr. 4, 2010) (subtitled "A chronology tracing the life of the *Glass-Steagall Act*, from its passage in 1933 to its death throes in the 1990s, and how Citigroup's Sandy Weill dealt the coup de grâce").

154. Consider Robert Rubin's role. Rubin was still Secretary of the Treasury at the signing of the Citigroup merger, serving in that capacity from 1995 to 1999. U.S. Department of the Treasury, *History of the Treasury: Secretaries of the Treasury*, Robert E. Rubin (1995–1999) *available at* http://www.ustreas.gov/education/history/secretaries/rerubin.shtml (last visited Apr. 4, 2010). Previously, he had been a Co-Senior Partner and Co-Chairman at Goldman, Sachs & Co. *See* Citigroup Schedule 14A, at 24, Mar. 13, 2008, *available at* http://www.sec.gov/Archives/edgar/data/831001/000119312508055394/ddef14a.htm. Rubin played a large role as Treasury Secretary in brokering the passage of the final draft of the GLBA, which allowed Citicorp and Travelers to merge legally. Following Senate approval of the bill on May 6, 1999, Rubin resigned as Treasury Secretary. In October 1999, he became Chairman of the Board at the newly formed Citigroup. We are not suggesting any impropriety here, and we recognize that it was Rubin's expertise and intelligence that made him one of a very small group of people under serious consideration to take on these government and private sector roles. At the same time, the example demonstrates how governmental responsibility and economic power can come to be intertwined. The Obama Administration has, of course, not been immune to the charge of having an overly cozy relationship with Wall Street. Heidi Przybyla, *Obama Embrace of Wall Street Insiders Points to Politic Reforms*, BLOOMBERG, Nov. 19, 2008, *available at* http://www.bloomberg.com/apps/news?pid=20601070&sid=aWSz2kUxdTiU.

155. Citizens United v. Fed. Election Comm'n, 558 U.S. __ (2010), *see also* Adam Liptak, *Justices, 5-4, Reject Corporate Spending Limit*, N.Y. TIMES, Jan. 21, 2010, *available at* http://www.nytimes.com/2010/01/22/us/politics/22scotus.html.

156. BERLE, POWER, *supra* note 151, at 39.

The regulatory solutions to current dilemmas, then, must be alive to the problems created by concentrated power. Additionally, as lessons in modern finance have shown, the response to problems of power should not be toward institutional design alone, unless that institutional design contains as a core element accurate instincts about human nature. Unger's prescription for destabilization rights is an important one. Destabilization rights continue to play an essential, and instinctively attractive, role in responding to the anti-democratic entrenchment of powerful interests. At the same time, destabilization brings with it uncertainty and as it turns out, there is more to ensuring social welfare than ensuring a high degree of social and institutional plasticity. There may be situations in which the disadvantages of fluid processes (in terms of increased complexity, decreased transparency, reduced regulatory capacity to provide meaningful oversight, and greater opportunities to concentrate power) are very significant. In order to succeed, regulatory reform in the financial sector will have to anticipate the ways in which all available tools will be used by the most adept actors to advance their own ends and expand their own power. In this regard, Berle's insights about human nature and how power can become concentrated in fluid environments cannot be ignored.