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ADVERSE POSSESSION - TITLE SYSTEMS

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Abstract

This chapter studies the various efficiency arguments of the doctrine of adverse possession, a distinctive legal method found in civil and common law systems. We question whether there are valid arguments for the distinction between good and bad faith possession as made in most civil law systems. No study of adverse possession can be complete without a review of title systems. In a world of imperfect information on the sequence of title transfers, where competing ownership claims may arise, the finer points of the land title systems will affect efficiency.

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A. Adverse Possession

1. The Concept of Adverse Possession

Under the doctrine of adverse possession the occupier of a land who is not the true owner acquires title to the land without consent from or compensation to the 'true' owner. This legal rule, found in both civil and common law legal systems, specifies that after a certain period of time, often termed the *limitation* or *statutory period*, not even the true owner of the property can bring action to eject an unauthorized possessor. Adverse possession places a statute of limitation on the owner's right to bring action against a possessor.

Adverse possession was formalized in English common law in 1632 in the Statute of Limitations. It fits within the framework of the general doctrine of limitations, which fixes the time within which parties must

follow suit to bring an action. After a certain period of time a person, whether he had acquired the possession of property rightfully or wrongfully is to be protected from actions to recover possession of the property (Callahan, 1961).

Although the doctrine of adverse possession was adopted as a rule in all states of the US, its legal implementation and interpretation by the courts varies (on some of these differences, see Netter, Hersch and Manson, 1986).

For the rules of adverse possession to apply, a few interrelated conditions have to be met. The possessor must hold the property actually, exclusively, continuously, openly and notoriously, adverse to the owners, for the statutorily defined time period. The interpretation of these conditions have been the subject of debate and the interpretation differs between states (see Netter, Hersch and Manson, 1986). Generally it is required that the possessor holds the possession exclusive from others for a period at least as long as the statutory period, without being dispossessed (continuously), in an open and visual manner that is inconsistent with the title of the owner (adverse) and without the owner's permission.

With the exception of variations in time periods and other minor differences the doctrine of adverse possession under common law does not differ much from that found in most civil law systems. Under the common law system, adverse possession similarly provides an individual with a means to acquire title through possession according to the law.

The major difference between the rule of adverse possession within civil law countries and that found under common law is the significance of the distinction between good and bad faith possessors. In Anglo-American law there is a debate whether the intention of the possessor matters for the applicability of the adverse possession doctrine. In the US the so-called Maine rule holds that intent is required, as mistaken possession is not found to be sufficiently hostile to the owner's right. The newer Connecticut rule emphasizes that the possessor's state of mind is irrelevant. Under both rules a bad faith possessor would be able to acquire ownership through adverse possession (Mascolo, 1992). A survey by Helmholz (1983) indicates that courts tend to rule against awarding title when encroachments were made intentionally, whereas the opposite is true in case of good-faith errors. Further on in this article we will consider whether the different treatment for bona fide and mala fide possessors is economically justified (see Section 4.a, 4.b).

Under the Statutes of Limitation which were in force in England prior to 1833 the effect of remaining in possession for the prescribed period was to bar only the remedy of the person dispossessed, not his rights. His title remained intact. If he were to obtain possession of the land in a lawful manner his title would prevail against the possessor. Under the statutes that have been in force since 1833 the right as well as the remedy of the

dispossessed owner is extinguished. The *usucapio* of Roman law, as adopted in civil law systems, represents what is often called *acquisitive prescription* in the sense that adverse possession conferred a positive title upon the occupier, who had remained in possession for a certain time. English law never adopted this, especially not with regard to chattels, although it has done so with profits.

2. Adverse Possession and Efficiency

Over the years various economic justifications for adverse possession statutes have been forwarded in the literature.

Adverse possession involves an important reduction of evidence costs. Evidence decays over time, which makes it difficult to try cases after some amount of time has passed. Therefore, not to require all parties to maintain all records necessary for litigation allows for cost saving.

This argument is not entirely convincing. Today, one would assume that modern technology allows for efficient, less costly, record keeping. Another justification would be that owners should bear a penalty for sitting on their rights. They should be provided with incentives to make use of their property efficiently. The objection to this argument can be that it assumes that the original owner was not maximizing the value of the property by not using it. In most cases it will, however, be hard to assess the most valuable use of the property as it might well be in the future. Then, the value maximizing use is to wait for the optimal time to act.

Adverse possession reduces the risks associated with title transfer (Baird and Jackson, 1984; Netter, Hersch and Manson, 1986; Bouckaert and De Geest, 1998). It contains an element of transaction cost savings. Search costs and verification costs are reduced as the potential purchaser is assured of the validity of the title presented. A potential purchaser who knows that the current possessor has occupied the property for the requisite statutory period is assured that the title he acquires is good. Take the example of a young professor who wants to build a home to start a family with his wife. He has his mind set on a certain piece of land near the university campus. As negotiations start it is important for him to take into account the nature of the rights to the land held by the seller. The seller/land holder could either be the true owner of the piece of land, in the sense that he has the best legal title to the land or he could merely be the possessor of the land, where he is only a person occupying the land. The higher the uncertainty of the true ownership to the land, the lower will be the transaction price (Netter, Hersch and Manson, 1986). In this sense adverse possession is a device that reduces uncertainty as to the person who holds the valid title to the property concerned. This example also illustrates the importance of a good definition

and protection of property rights. This rests on the assumption that by eliminating old claims to property transaction costs will be cut.

Moreover, adverse possession can increase certainty by reducing the effects of mistakes and errors. Miceli views the doctrine of adverse possession as a solution to the problems associated with boundary errors in real property. According to his theory adverse possession has a dual function in the sense that not only does it create incentives for the possessor to avoid boundary errors prior to investing in development (the first-best solution), but at the same time it also maintains incentives for the owner to mitigate errors in a timely fashion after the possessor has commenced developments (the second best solution) as it reduces the ability of a true owner to extract rents from a possessor who has relied on an error to improve the property (Miceli, 1997).

The typical adverse possession case, according to Miceli, involves a boundary dispute between adjacent landowners. Take our example from above. Imagine that the professor has bought a piece of land and built a home. Having just received tenure at the university, he wants to build a tennis court on a portion of his land near the boundary with his neighbor. Suppose the exact location of the boundary is uncertain. The value that the professor attaches to the piece of land might well be higher than the subjective valuation by the neighbor. If it were discovered that the piece of land is owned by the professors' neighbor there would be room for an exchange. However, if construction of the tennis court had started, the maximum amount the professor would be willing to pay will increase. If constructions are halted the specific investments in the tennis court are lost. The difference between the value he attached to the land prior to the construction and the value afterwards would represent an 'appropriable quasi-rent' (see Crawford, Klein and Alchian, 1978). To avoid wasteful rent-seeking expenditures after the fact, it is recommended that parties determine ownership of the disputed piece of land before any investments are made.

However, it is inevitable that errors will occur. The possessor may be convinced that the land is his. Or even worse, the possessor may encroach intentionally. In the case of an error, the next best outcome is for the owner to correct the error in a timely fashion. But as the valuation of the land by the possessor will grow as he increases investment, the owner will lack an incentive to correct the error, because by waiting he will be able to extract a higher payment (Miceli, 1997).

Thus a time-limited property rule, where the owner retains a right to eject a possessor from his land if a bargain is not reached, which resembles the doctrine of adverse possession, offers a solution to both problems. It provides the possessor with incentives to correct errors in a timely manner and limits bargaining costs between both parties.

The possibility for the appropriation of quasi-rents by the owner is due to the fact that the owner can eject the possessor from the land if a bargain is not reached. An alternative would be the implementation of a liability rule in cases of boundary encroachments. Miceli (1997) correctly notes that this would create problems with regard to the incentives of the possessor. It eliminates his incentives to discover errors before developing and, moreover, it actually creates incentives for him to encroach intentionally as this will allow him to obtain the land more cheaply than by bargaining with the owner. In fact, the introduction of a liability rule would shift the incentive problem from the owner to the possessor.

Finally, the conditions whereupon the application of adverse possession are based seem to be designed to reduce the costs of mistakes in boundaries. The requirements of possession during the statutory period to be actual, open, notorious and exclusive give the true owner the opportunity to discover boundary errors prior to investment by the encroacher (Miceli and Sirmans, 1995b).

On the other hand, there are costs to the application of the adverse possession doctrine. With the risk of losing title, owners must monitor their land. When they are not using the property they need to be careful not to lose ownership to a possessor. By reducing the costs of mistakes of encroachments, adverse possession introduces a moral hazard problem, in the sense that there is less incentive to make sure mistakes are not made in the first place (Netter, 1998).

Although there are costs associated with adverse possession (monitoring) and although the arguments regarding the reduction of evidence costs and of the element of punishment are not entirely convincing, sufficient economic arguments can be forwarded to uphold the assumption that the concept of adverse possession is called-for and economically justified within a property order. The remainder of the article will focus on the length of the prescription period and other possible modifications to the concept of adverse possession, namely the distinction between good and bad faith possessors and the optimal choice of title system.

3. The Optimal Statutory Period - Determination of the Limitation Period

Adverse possession essentially involves the following efficiency trade-off: a shorter statutory period reduces uncertainty as to the title in subsequent transfers, while longer statutory period reduce the costs to property owners to protect their land from potential adverse possessors.

Figure 1

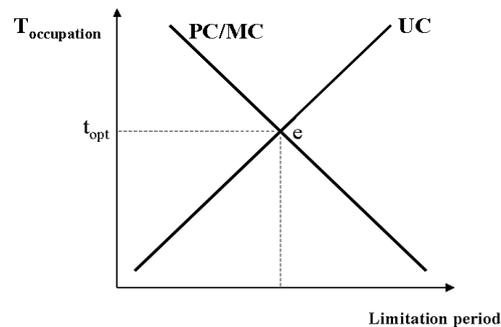


Figure 1 illustrates this trade-off. At point e , where the time of occupation (on the vertical X-axis) required to obtain title is set optimally, a balance is found between prevention and uncertainty costs. As the limitation period is set beyond point e , the uncertainty costs, represented by the UC curve, increase further. The longer the statutory period is set, the lower the monitoring costs of owners. If the limitation period is set below e , prevention and monitoring costs, represented by the PC/MC curve, increase while uncertainty costs go down.

Economic theory holds that the greater the benefit from reducing uncertainty with regard to the ownership of a good, the shorter should be the time period required of adverse possession.

A fairly recent study of prescription statutes in the different North American states (Netter, Hersch and Manson, 1986) provides empirical evidence on the various differences and examines the determinants of the length of the occupation period in the statutes of limitations of states' adverse possession at the time of statehood.

First, a negative relationship between property value in a state and statute length was observed. When the property has great value, there is simply a higher return to be obtained from ending potential disputes about ownership that arise from mistakes. Also, the costs of mistakes are higher when property value is high. In such circumstances it is recommendable that adverse possession requirements (length, type of possession) are less demanding. However, it should be acknowledged that if property values are high, owners have more to lose from adverse possession.

Secondly, a positive relationship between population density and statute length was found. As population density increases more property transfers take place, which raises the probability that errors (in determination of boundaries, identification of the title holder, registration, and so on) will occur. The length of the prescription period will affect incentives in various ways.

Protection costs will be lower when protection periods are relatively long. The shorter the prescription time period, the more theft or deceit is encouraged (Merill, 1986). Stolen, lost and fraudulently acquired goods will have a higher market price when potential buyers know that the possibility of claims and other repossession actions are restricted to only a limited period of time. Thus, the introduction of a prescription period will affect criminality and tortuous acquisition rates. The possibility of becoming a true owner through mere adverse possession increases the value of an adversely possessed good. A thief who wants to resell the stolen good will be able to charge a higher price to the buyer under a system where the latter can become the legally unchallenged owner after the elapse of a short period of time. As theft, fraudulent and deceptive acquisition will become more profitable, property owners will need to invest more into protection of the property.

Also, short prescription periods force owners of lost, stolen or fraudulently divested goods to concentrate their search and repossession acts within a short period of time, which leads to higher opportunity costs of search (Bouckaert and De Geest, 1998). On the other hand, short prescription periods provide the possessor with efficient incentives with regard to investment.

The length of the statutory period may also be dependent on the type of the property, and more precisely the possibility/desirability of registration. This might provide an explanation for the long prescription periods for real property as found in most legal systems (See Table 1 for data on the Franco/Belgian, German, English and Quebec provisions). The possibility to survey land registers and verify whether the seller has a valid title reduces the uncertainty of the acquirer substantially, provided that these registers are reliable.

4. Good and Bad Faith Reconsidered

(a) The Distinction between Good and Bad Faith Possession

One remarkable feature of adverse possession in most civil law systems is the distinction made between good and bad faith possession. Generally, prescription periods are longer for the bad faith possessor (*mala fide* possessor) than for the *bona fide* possessor.

Table 1

Country	Good faith		Bad faith
	Chattel	Estate	
France-Belgium	0	10	30
Germany	0	30	30
England	6	12	NO
Quebec	3	10	10

This distinction between good and bad faith possession, as illustrated in Table 1 with comparative data on the French/Belgian German, English and Quebec provisions on limitation periods raises certain questions. First of all, there is the matter of evidence. Good faith errors are difficult, often impossible, to distinguish from intentional errors, for instance with regard to real property issues such as boundary encroachments. Trying to prove bad faith will impose high evidence costs, notably where the plaintiff has to reverse the presumption of good faith against the defendant possessor. This raises the question whether the distinction between good and bad faith possessors, mainly grounded in notice of justice, is justified from an economic perspective.

Bona fide possessors may be regarded as neutral actors within a given property order (Bouckaert and De Geest, 1998). The notion of good faith possession implies neutrality with respect to the incentive to affect the property order. Good faith possessors do not disrupt or undermine the property order intentionally the way, for instance, thieves do - they just happen to be the possessor of property without any influence on its adverse character.

This would imply that bona fide possessors should be submitted to the normal, optimal rules of prescription, that is, short- or even zero-prescription time periods when registration is too costly; long- or even infinite-prescription time periods when registration is justified.

On the other hand, there seem to be solid economic arguments in favor of extending the prescription period for mala fide possessors. As explained above, by extending the prescription period the value of goods obtained with wrongful intent will be lower. A thief will only not be able to obtain such a high price for a good for which there is a prescription period of thirty years as he would have been able to if, say, the prescription period was only three

years. Note, however that this impact of the length of the prescription period on prices will be limited due to the difficulty to prove bad faith.

The advantages of a different, for example longer, prescription period for bad faith possessors need to be balanced against the transaction and uncertainty costs caused by long prescription periods.

An alternative would be to rely on criminal sanctions for thieves, deceivers and their recipients when they are in complicity (Bouckaert and De Geest, 1998).

The prospect of damages combined with criminal sanctions may deter theft and deception in a more effective way than long prescription periods do, without impairing investment incentives (Bouckaert and De Geest, 1998).

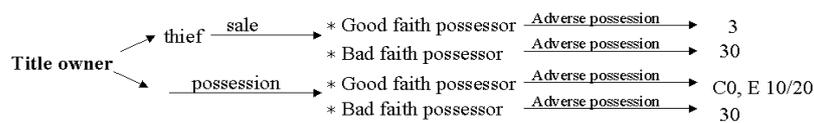
(b) Difference between the Bona Fide Acquirer in General and Bona Fide Possessor of Stolen and Lost Goods

Sometimes an additional distinction is made between the good faith acquirer of goods in general and of lost or stolen goods. Some countries make an exception with regard to lost or stolen goods.

Table 2

Country	Good faith		Bad faith
	Chattel	Estate	
France-Belgium	0	10, 20	30
Germany	0/10	30	30
England	6	12	NO
Quebec	3	10	10

In the German code lost or stolen goods can be reclaimed from bona fide possessors by the owner during a period of ten years (937 B.G.B.), while the Code in France and Belgium explicitly provides that dispossessed owners of lost or stolen real property (estate) can reclaim it for three years from the date of the theft (art 2279 C.C., see Figure 2). In England and Quebec no such distinction is made. What could be the arguments to treat the bona fide acquirer a non domino of such goods differently from acquirers in general?

Figure 2 Adverse Possession in Belgium and France

The assumption goes that there is a more than average probability that the acquirer of stolen or lost goods is mala fide. As stolen or lost goods are mostly sold through black markets, the buyer of such goods may well suspect that the purchased goods were illegally obtained by the seller. However, due to the difficulties and the costs of providing evidence of bad faith, such buyers would in most cases escape the treatment of bad faith possessors. The reasoning above might provide a justification for the legal distinction in most European continental law systems which treats them as 'semi-mala fide' possessors by imposing a regime which is closer to that of bad faith possession.

As a result, prices for stolen or lost goods will be somewhat lower than for normal goods because the bad faith possessor is offering a somewhat weaker title to third parties, and the risk-averse buyer faces the possibility of being dispossessed. The distinction would thus provide the function of discouraging theft.

One should take into account the costs caused by the complexity of such a system and compare them with the significance of the deterrent effects on theft and fraudulent behavior. Will the increase in price outweigh the costs associated with a complex system as found, for example, in the French code? One alternative would be to simplify the system dramatically by treating all bona fide third party acquirers in a homogeneous way, perhaps by applying to all bona fide acquirers the rule of 'possession is title' combined with rendering the rebuttal of the presumption of good faith less difficult (Bouckaert and De Geest, 1998).

B. Personal and Real Property: Title Systems

We have seen above that uncertainty plays an important role as one of the dominant cost factors in title transfer. This is certainly the case with real

property where boundary and survey errors are common and often very costly. In a world of perfect information about all previous transfers of property the law should simply enforce the rights of the current possessor. If, however, there is uncertainty whether a fraudulent transfer occurred, the law faces a trade-off between protecting the rights of the current possessor or those of the last possessor prior to divestment. A comparison between a system where title is established by mere possession (possession is title), to a filing system built upon public records of property exchanges that can be used to trace the history of a title, leads us to conclude that the latter is more costly to administer but reduces the likelihood of non-consensual transfer while the former facilitates transactions but not without raising the possibility of fraud and theft (Baird and Jackson, 1984).

The choice between a property-based system and a filing system will depend on the magnitude of the different cost categories (Miceli, 1997), which in turn will be determined by the characteristics of the property. In the literature the following determinants for the choice between a filing system or a property-based system have been advanced: the durability of the good in question, homogeneity, frequency of transfer, the value of the good (Bouckaert and De Geest, 1998) and the desirability of shared ownership (Miceli, 1997). If a good is durable, it will be relatively more worthwhile (that is, cheap) to register. Non-homogeneous goods will be easier to register. If goods are frequently transferred, registration becomes very costly. If the value of the good tends to be high the costs of registration will be relatively low, so that it is efficient to reduce the costs of uncertainty of title by registration. When a certain good regularly requires shared ownership it will be costly to rely solely on possession as evidence of ownership. As Miceli notes (1997), land is considered as the standard type of property for which a filing system is preferred. Land is not transferred often, it can easily be distinguished and, moreover, shared ownership is often required to cultivate or use the land.

Within a property order that incorporates a regime of adverse possession, what is then the optimal type of filing system? We can distinguish two types of title systems: the registration and the recording system.

5. Registration System

Under a registration system the owner registers his or her land with the government. When a legitimate claimant arrives at a later date, the current owner retains title while the claimant must seek compensation from a public fund, financed by registration fees. The current owner retains the land in event of a claim and the claimant receives monetary compensation. The

government provides insurance for wrongfully displaced owners, subsidized by the registration fees.

6. Recording System

Under a recording system the written record provides only evidence of title, it does not guarantee title. Errors in records or in the interpretation by the searcher remain possible.

As a result private title insurance has developed under the recording system to protect holders against financial losses (for a survey of the possibilities of title insurance under both title systems, see Miceli and Sirmans, 1995a)

7. Normative Goals under Economic Analysis

Miceli and Sirmans argue that an efficient title system should create proper incentives for landowners to invest in capital improvements prior to the appearance of adverse claims and provide compensation for wrongfully injured parties. A title system that satisfies the demand of the former motive has the following characteristics:

- a) It promotes ex-post efficiency as it allocates land to the highest valuing user. We may assume there is a positive relationship between increase of subjective valuation of the land, above market value and land tenure. Therefore, a system that awards the land to the current holder and compensates legitimate claims by the original owner at market value will maximize the value of the land with regard to the enhancements that have been made previously by the owner.
- b) It provides incentives for efficient investment in land ex-ante by the landowner.

8. Evaluation of Both Systems

Under the registration system the current holder who has successfully registered the property will be able to retain the property rights to the land that he has occupied during the statutory period. The true owner, on the other hand, may seek compensation through an insurance system provided by the registration fees. It can easily be observed that a registration system of such nature promotes ex-post efficiency, as it allows the most valuing

owner, most likely to be the occupying party, to benefit from his benefits/his reliance interest. Regarding incentives for capital improvements to the land Miceli and Turnbull conclude (1997) that the registration system is also efficient ex-ante as it induces owners to maximize the return from land.

A recording system, on the other hand, seems more likely to meet the requirements of ex-ante efficiency, as the possibility of future expropriation will provide landowners with an incentive to investigate title prior to investment decisions.

In their model Miceli and Turnbull postulate that under the registration system current owners retain title and have no incentive to insure against potential claimants, which precludes private insurance provision. While the registration system creates publicly mandated insurance, that of levying transfer fees or property taxes, under the recording system owners have an incentive to insure themselves against risks. Owners, faced with the risk of expropriation, will desire protection of their reliance interests through insurance. Under the assumption that the profit incentives of private insurance firms enforces efficiency in the title examination process to an extent beyond the reach of a governmentally administered registration indemnity fund, where this profit incentive is lacking, they conclude that the recording system may have an advantage over the registration system.

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