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USE OF THE ECONOMIC ANALYSIS OF LAW METHOD IN UNDERSTANDING THE ESSENCE OF A LEGAL ENTITY

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Abstract. This article explores how the economic analysis of law method can improve the understanding of the structure of legal entities. While economic analysis cannot address all legal issues, it can serve as a supplementary tool for evaluating the effectiveness and necessity of legal norms and their implementation. As a methodological foundation, economic analysis can be useful in examining societal phenomena. The study emphasises that the tools of modern economic theory are employed in both economic and legal studies of legal entities to provide economic substantiation and explanation of their nature. It is therefore evident that the fundamental nature of a legal entity is economically substantiated not solely by cost-effectiveness (where revenues equal or exceed expenditures) but also by productive appropriation or the sphere of dominance by legally capable organisations. The conclusion drawn from the economic analysis of law is that a legal entity can be understood as follows: firstly, a system of contracts based on relationships between founders (participants), managers, and the legal entity itself, which has advantages and disadvantages in various economic contexts; secondly, a tool for separating property to limit risks for the real (physical) persons behind it. Consequently, the concept of a legal entity as an extension of its founders' individualism (egoism) remains pertinent, as recent events have vividly demonstrated. The present analysis explores the question of whether a legal entity is solely a means of property separation to limit the risks of property loss by real individuals. From an economic perspective, this assertion is valid, as the risk undertaken by the founders is confined to the assets transferred to the entity. The economic risk is realised indirectly through potential inefficiencies (losses) in the organisation's operations. The *subject of the research* is the application of economic analysis of law to the understanding and conceptualisation of legal entities. The *purpose of the research* is to examine how economic analysis of law contributes to the interpretation of legal entities, particularly in justifying their structure, function, and essence in terms of economic rationality and risk limitation. The *research methodology* is based on a combination of analytical approaches tailored to examine the economic and legal dimensions of the subject. The economic analysis of law serves as the principal methodological framework, allowing for the evaluation of economic efficiency, clarification of the nature and function of legal entities, and informed managerial decision-making. The logical method is applied through analysis and synthesis of global academic theories, contributing to an understanding of the limitations and supplementary role of economic analysis within legal research. The systemic-structural method ensures a holistic and consistent examination of legal categories, enabling the identification of defining characteristics of legal entities from an economic standpoint. Quantitative and qualitative analysis techniques are employed to track changes in economic activity, evaluate the influence of various factors, and observe development trends across economic structures, thereby supporting the investigation of both internal and external drivers of business and legal processes. Finally, comparative analysis is used to contrast national and international perspectives in the field of legal and economic thought, through integration of diverse scholarly approaches.

Keywords: legal entity, corporation, economic analysis of law, ownership, property, civil turnover, rights and obligations, responsibility.

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1. Introduction

The establishment of an artificial participant in civil turnover, in the form of a legal entity, has been demonstrated to both expand spatial opportunities for commercial operations and establish an effective form of capital concentration for economic investments and intensification of turnover. It furnished entrepreneurs at all levels with increasing opportunities to independently determine the degree of acceptable commercial risk, which, in turn, led to a rapid acceleration of economic development.

The relevance of studying the mutual influence of legal and economic processes in modern conditions is due to the fact that these spheres remain interdependent and significantly impact every aspect of societal life. Legal norms have been shown to play a crucial role in shaping a stable economic system, and economic transformations have been demonstrated to directly influence the development of legal institutions. A considerable corpus of scientific discourse has established the foundation for the examination of the legal system through economic methodologies. This has exposed the reciprocal influence and interdependence between law and economics, and economics and law. Nevertheless, the economic approach to law has often been the subject of criticism from jurists, despite the fact that one of the law's primary objectives is the regulation of economic legal relations.

The advent of structural changes in economics, politics, society, and consequently in consciousness (or rather, in the awareness of these changes), as well as the pace of these processes, is reflected in legal constructs. Some of these constructs fade over time, others are revitalized, and still others consolidate their positions. The replacement of legal categories and widely recognised legal structures with economic, technical, or organisational ones that have not found adequate embodiment in law has resulted in numerous contradictions.

It is widely acknowledged that the legal entity is among the most complex legal phenomena. In order to comprehend this phenomenon, it is imperative to ascertain the period during which it emerged and the social factors that engendered it. Many authors have drawn parallels between modern legal entities and ancient corporations. It is evident that one cannot simply place an equal sign between them, a notion that is cautiously supported by the majority of civil law scholars, who regard ancient corporations as prototypes of modern legal entities. A common characteristic of ancient corporations known to us was their aspiration to regulate social relations associated with implementing increasingly complex large-scale economic projects. The advent of corporations within the legal domain, typified by the formalisation of compulsory relationships, was chiefly propelled by the imperative to regulate market-type relations. These relations emanated from the pursuit of personal gain, which could only be realised through joint activity, thereby also embodying solidarity relations.

One of the primary state measures within the normative regulation of economic relations is the delineation of the relevant participants. In the contemporary context, a multitude of obstacles pertaining to this matter are attributable to economic, social, and legal factors. Firstly, the composition of normative acts encompasses a diverse array of participants within their respective relationships, predicated on disparate economic foundations that underpin each specific normative act (e.g., legal entity or enterprise). Secondly, participants of legal entities – business entities – frequently self-identify as owners of enterprises, an economically-oriented perspective that, however, does not align with the legal aspect. Thirdly, the construct of a legal entity through property separation is frequently employed as an economic method of avoiding participant liability. However, these questions, for which there is as yet no definitive resolution within either economics or law, require resolution.One of the primary state measures within the normative regulation of economic relations is defining the circle of their participants.

2. Methodology

The situation, with its theoretical and methodological foundation within the field of law, particularly in civil science, raises justified concern among many researchers. The prevailing approach in national legal science is characterised by its insularity within the domain of formal legal issues, its dissociation from pragmatic concerns, and its inability to align with economic imperatives. Consequently, since the 20th century, global legal thought has undergone a marked evolution, with a focus on identifying methodologies for integrating research outcomes into economic requirements.

The evaluation of the legal system's status should not be confined to the assessment of economic efficiency indicators. However, when analysing legislation and judicial practices with economic content, this indicator is prioritised, necessitating the expansion of the methodological toolkit of economic-legal research methods with the instruments of economic analysis of law.

The analysis of any economic entity necessitates the consideration of the effects of economic laws and conditions, the identification of general developmental trends, the nature of interconnections between indicators, internal deviations and their causes, objective and subjective factors, as well as the quantitative and qualitative impacts of each factor. The resolution of

such intricate analytical tasks is contingent on the deployment of an array of research techniques and methodologies, which are selected in accordance with the objectives and nature of the analysis in question.

The present article is founded upon specific scientific cognition methods, with primary emphasis on the economic analysis of law as a foundation for legal doctrines concerning the legal entity. The research is structured around the hypothesis that this method represents a scientific approach to the study of business activities. It comprises research techniques and methods used to determine quantitative and qualitative changes in such activities, as well as the impacts of internal and external factors. The purpose of this is to facilitate effective managerial decision-making. As a civil institution, a legal entity must demonstrate economic efficiency, providing an optimal balance between benefits and costs and rational distribution of societal resources. These aspects directly pertain to the consequences of employing the "legal entity" construct and identifying its ultimate beneficiaries – individuals who might use it as a shield against potential negative economic outcomes of business activities.

Applying the logical method, through the analysis and synthesis of global scientific doctrines, leads to the conclusion that the economic approach to law cannot comprehensively cover all legal issues. Instead, it functions as an ancillary instrument for the examination of the efficacy and necessity of a legal act or its practical implementation.

The systemic-structural method employed in this study facilitates an integrated approach to examining general categories used by doctrine and legal practice, systematically structuring qualifying features from the perspective of economic analysis of law. The present study integrates contemporary economic theory tools to economically justify legal entities, thereby attempting to explain their essence. It is therefore evident that the fundamental nature of a legal entity is defined economically as non-cost revenue generation (where revenues are at least equal to expenditures) and productive appropriation (or the domain of legally capable organisations). This provides an economic justification for the existence of legal entities.

3. Recent Research and Findings

The recent history of foreign legal science demonstrates the emergence of a novel scientific paradigm within the discipline, manifesting through two primary avenues: ethical-political and economic analyses of law. The ethical-political approach primarily serves legislators and, to a lesser extent, the judiciary, which frequently requires moral and legal guidance when making decisions. Conversely, the economic analysis of law is oriented towards addressing business needs and fulfilling economic state obligations. The economic approach to law is predicated on the assumption that individuals involved in law-making pursue rational maximization of their benefits (Posner, 1975, p. 759). Posner noted that until the 1960s, economic analysis of law was synonymous with antitrust law analysis, despite the existence of economic studies in tax law, corporate law, patent law, and contract law (Posner, 1975, p. 759). In developing this approach, Miceli emphasised that the application of economic analysis to the field of law is predicated on the notion that economic efficiency is conducive to the study of legal norms and institutions (Miceli, 1997, p. 3).

The growth of production, goods and services turnover, centralized manufacturing, and co-operative distribution, along with capital concentration to establish these productions, necessitated relevant organisational-legal forms. The legal entity category was the most suitable for these demands, requiring legislators to establish organisational-legal forms that accommodated economic turnover requirements, and taking into account managerial and property-specific characteristics (e.g., forming associations). Significant theoretical research and legislative consolidation occurred primarily in the 19th century, laying the foundational concepts of legal entities. During the mid-to-late 19th century, rapid economic growth significantly advanced studies on legal entities. Innovative concepts emerged from scholars such as Bierling, von Jhering, von Savigny, von Gierke, and others, predominantly German and French civilists, forming the contemporary understanding of this institute. Economic aspects of legal entities have been studied by Landers, Easterbrook, Jensen, Meckling, Spasybo-Fateeva, and others. A pertinent and contemporary paper that delves into the economic analysis of corporate law is the scholarly article by David Gindis and Martin Petrin titled "Economic Analysis of Corporate Law" (Gindis & Petrin, 2020). The present work delineates the foundational aspects of economic analysis applied to corporate law, and it contrasts traditional approaches with more recent functional scholarship. The text goes on to discuss specific issues such as limited liability, managerial liability, and takeovers. However, despite extensive research by many scholars, there remains no comprehensive approach addressing the role of economic analysis of law in understanding the legal nature of entities, termed enterprises in economic literature and certain normative acts.

4. Research Results

The establishment of formal behavioural rules by the state is instrumental in ensuring the realisation of the interests of so-called special interest groups.

A special interest group can be defined as a collective of individuals who share aligned economic interests, particularly benefiting from the actions or inactions of executive authorities or from legislators adopting ineffective legal acts. The benefits derived from the fulfilment of special interests are concentrated within the group, while the costs are distributed across society. The expression of such benefits may be in the form of either monetary income or material privileges that serve to enhance utility functions. It is evident that special interest groups exert significant influence over the enactment of legal acts, primarily to serve their own interests rather than to promote public goods. Instead, these groups tend to act in a manner that advances narrow interests, consequently impacting societal redistribution through the transfer of costs to other segments of the population.

The contemporary economic system is influenced by a number of factors, including market dynamics and the efficiency of legal institutions, which impact various spheres of civil turnover. In this context, the role of normative regulation governing the corporate sector, property rights, and contractual relations is of particular significance.

According to R. A. Posner, effective corporate regulation is crucial for ensuring transparency, trust, and efficiency within the business environment (Posner, 2003, p. 82). The prevailing legal norms delineate the structural framework for legal entities, the governance procedures for corporations, the liabilities of participants (shareholders), and the regulations pertaining to the disclosure of information. These legal norms are instrumental in defining the organisational and legal forms of business management. However, the nature of legal entities and their economic foundations necessitates detailed examination through the lens of economic analysis of law. The field of economic analysis of law (also known as law and economics) involves the application of economic theory to the investigation of the state and structure of law and legal institutions. The aim is to assess their direct and indirect impact on the economy. Consequently, the formation of a legal entity serves to fulfil collective economic interests (economic development, technical co-operation, patent relations, goodwill), resolve conflicts of interest, and efficiently group resources (Immenga, 1998, pp. 7–14).

Investment interests by various market actors manifest in ownership structures within legal entities, characterised by the division of authorised capital into shares (stocks, units). It is evident that the shares in question are attributable to a variety of participant categories, including but not limited to majority and minority shares. Consequently, the capital of a legal entity and its participants are congruent, with a focus on values that are appealing to each group. For legal entities, these are funds obtained, for instance, from issuing shares; for participants, these are the shares providing specific rights (Zhornokui, Zhornokui, Syadrysta, 2018, p. 396).

The legal entity institute in civil law emerges from a number of factors, including commodity-money relations in the market economy, social labour division, and the necessity to involve other organisations' property in civil turnover to satisfy personal and property interests of individuals. The formulation of changes in ownership relations and entrepreneurship is required within existing private law institutions, reflecting a shift from personal relations to those based on abstract capital. From a legal perspective, this is encapsulated within the domain of corporate legal relations, which can be defined as a system of norms and internal behavioural rules that govern the legal entity (Spasybo-Fateeva, 1998, p. 13).

Property relations within legal entities characteristically possess a factual nature, not conforming strictly to general ownership regulations (primarily the Civil Code of Ukraine). The nature of such relations deviates from that of conventional property rights, thus giving rise to concerns regarding the differentiation of property between legal entities and their participants. This is particularly salient in the context of participant liability for entity debts.

The economic analysis of law is predicated on new institutional economic theory, which serves to refine its assumptions. In contradistinction to conventional institutionalism, new institutional economics proffers a cogent conceptual framework that facilitates verifiable research outcomes (Volovyk, 2012, p. 57). Its primary function is to evaluate legal norms based on economic efficiency, social welfare, and optimal resource allocation.

Dialectics, in its capacity as a general approach, constitutes the foundation of economic analysis methodology. The study of legal entities is predicated on dialectical principles, which facilitate the examination of economic phenomena in dynamic contexts, with consideration given to the interconnectedness and interdependence of indicators.

The state's commitment to economic stability is evidenced by its proactive approach to decision-making, which aims to facilitate vital economic expansion, thereby benefiting both individual entities and society as a whole. The economic analysis of law is comprised of three interconnected elements. Firstly, economic theory is applied to evaluate the effects of legal norms. Secondly, the economic efficiency of legal norms is assessed in order to recommend improvements to their usage. Thirdly, optimal legal norms are identified. It is evident that these aspects are associated with pricing theory, welfare economics, and public choice theory (Friedman, 2000, pp. 8–17).

The foundational theoretical framework of economic analysis of law is predicated on human economic

behaviour, which varies within different legal contexts, rather than the inverse (Volovyk, 2012, p. 58). The analysis of property rights protection led to the development of a distinct economic analysis, with a particular emphasis on the rights of corporations. In contradistinction to classical ownership, corporate property relations create a separation between participants and assets, thus offering corporate rather than direct property rights.

The social acceptance of economic policies is significantly influenced by prevailing conditions, necessitating the consideration of societal interests in decision-making. Capital concentration for economic expansion is an inherently risky endeavour, and as such, there is a need for strategies to minimise risk. This development subsequently led to the emergence of artificial subjects – defined as legal entities or corporations – which serve to mitigate the risk exposure of participants.

Doctrinal analyses indicate common economic foundations for legal entities, including capital accumulation, transactional cost resolution, and risk externalisation through limited liability. These underpin property-control separation in large entities, minimal statutory capital requirements, and minority shareholder protections (squeeze-out procedures).

The apparent invisibility of the creation of legal entities gave rise to perceptions of their fictitious nature. Nevertheless, it is important to note that the global recognition of the concept was not the result of any legislative decree; rather, it was the consequence of universal economic reasons. The economic distinction between non-expense revenue generation (legal entities) and expense-based appropriation (individuals) necessitates different legal forms, underpinning the economic basis for corporate existence.

In the contemporary context of legal practice, there is a pronounced emphasis on the consideration of economic fundamentals in corporate activities. This emphasis highlights the significance of property separation, capital concentration, and unified management decision-making as critical mechanisms. Property independence is considered a fundamental aspect of legal entities' active civil participation, though there remains ongoing debate surrounding its explicit doctrinal recognition.

The legal entity institute has been shown to objectively relate to capital movement, requiring property separation, management structure creation, and participant interactions. The selection of a rational organisational-legal form remains of crucial importance, with formalised analyses being employed to optimise efficiency (Zhornokui, Zhornokui, Syadrysta, 2018, p. 399).

Therefore, in order to comprehend legal entities, it is necessary to integrate economic theory, thereby emphasising the intricacy and economic pertinence that are intrinsic to legal entity structures and corporate law practices.

The legal entity institute is objectively linked to capital movements, as it necessitates the separation of property, the establishment of management structures for this property, and the resolution of interaction issues among legal entity participants. These aspects are reflected in legislation concerning specific types of legal entities and corporate investment forms. Legislation is subject to constant evolution, giving rise to novel regulatory aspects due to increased cross-border capital flows and the emergence of legal forms of international co-operation.

A thorough investigation into the selection of a rational organisational and legal form for new legal entities remains a critical task in contemporary economic science. Recent economic studies have focused on legal entities as economic formations and examined tools for selecting the organisational and legal form for entrepreneurial entities. The rational choice of organisational and legal form is emphasised as a strategy for enhancing production efficiency, which is closely tied to economic efficiency indicators. However, mathematical modelling methods and factor analyses for management decision-making regarding organisational and legal forms remain underdeveloped. It is imperative to emphasise that only a meticulous analysis, underpinned by formalised methodologies and calculations, can ensure the selection of genuinely rational solutions from among the numerous proposed options. This approach enables the prioritisation of optimal outcomes relative to incurred costs, rather than subjective interests.

The essence of a legal entity is that it: 1) has the capacity to know and exercise its rights as a legal agent and 2) is subject to the same legal sanctions typically applied to individuals (Solaiman, 2017, pp. 167–174). Discussions of legal entities' legal capacity are underpinned by two main theories: the artificial subject theory (fiction theory) and the real subject theory (realist theory or independent personality theory). The contractual theory (symbolic theory) posits that corporations are constituted by the aggregation of their participants and delineates relationships on a principal-agent basis. This theoretical framework accentuates the fictional nature of legal entities (Chesterman, 2020, p. 823). Conversely, the real subject theory considers corporations to be genuinely independent entities, distinct from their participants, possessing their own interests, intentions, moral sentiments, rights, and obligations – making them as real as individuals (Machen, 1911, p. 348).

In light of contemporary Ukrainian realities, it can be argued that a legal entity functions primarily as a property separation instrument, with the aim of mitigating the risk of property loss resulting from

activities undertaken by real (physical) individuals behind the entity (founders). Consequently, the concept that a legal entity is an extension of its founders' individualism (egoism) remains pertinent, as recent developments have vividly demonstrated. Consequently, the principle of "unlimited liability without the possibility of managerial control" is regarded as "economically unsound" (Easterbrook & Fischel, 1991, p. 42).

Limited liability does not eliminate the risk of business failure; rather, it transfers this risk from individual investors to voluntary and involuntary creditors of the corporation, who bear insolvency risks. It is important to note that arguments supporting limited liability are not conclusively persuasive. The reduction in assets available for creditor compensation has a direct impact on the increased costs of corporate borrowing. Nevertheless, participants (shareholders) may relinquish such liability. Limited liability can be defined as a rule of insolvency; it is reasonable if most shareholders prefer limited liability to higher returns from reduced corporate borrowing costs. Limited liability thus externalises failure risks (Landers, 1975, pp. 589, 619–620).

In accordance with the prevailing perspective within the field of economic analysis, which considers a corporation to be a nexus of contracts (Jensen & Meckling, 1976, p. 305), experts within this methodology advocate the principle of shareholder freedom in the structuring of internal corporate relationships. However, the extent of autonomy is contingent upon the specific nature of the corporate entity. Non-public corporations, which typically involve a smaller number of entrepreneurs, uphold a significant degree of contractual freedom. Such contracts facilitate a variety of relationships and investor interactions. Virtually all economic activities rely on contracts, determining who finances what, who sells what to whom, and where to invest. Without them, economic activity would cease, rendering legal entities unnecessary.

It is evident that the terms "organisation" and "bundle of contracts" offer distinct yet non-exclusive descriptions of a unified phenomenon. However, some authors advocating the "bundle of contracts" definition argue against the use of "firm" and "organisation" categories (Fama, 1980, pp. 288–307; Cheung, 1983, pp. 1–21). Nevertheless, such perspectives overlook the firm as an independently existing entity. It is imperative to conceptualise a firm as a contract collection that is meticulously managed and designed by a central manager.

Nevertheless, it is imperative to contemplate the disadvantages inherent in this methodology. Securing capital for legal entities through the implementation of substantial contracts gives rise to a number of issues pertaining to the separation of ownership and control. Consequently, the economic component of contractual theory carries negative connotations, as economists often overlook legal entities as independent subjects with their own rights, duties, and interests. From an economic and practical standpoint, investors continue to regard themselves as proprietors of legal entities, a misconception that is both erroneous and fallacious. Participants (shareholders) do not possess the company itself, but rather possess shares, which are independent objects that grant new rights. This critical distinction is often ignored by economic experts.

5. Conclusions

The present study demonstrates that the legal entity, as a foundational institution of civil law, should not be perceived solely as a formal legal construct, but rather as an economically functional mechanism deeply embedded in the structural logic of the market economy. The article employs economic analysis of law to substantiate the proposition that legal entities serve multifaceted economic purposes, including but not limited to the efficient allocation of resources, reduction of transactional costs, facilitation of capital accumulation, and the mitigation of investment-related risks through the principle of limited liability.

The legal entity serves as a conduit for the separation of assets, enabling actual persons, such as founders, shareholders, and other stakeholders, to engage in economically substantial activities while minimising their personal liability for potential financial losses. While this mechanism is rooted in legal doctrine, it also reflects broader economic principles, including the optimisation of risk distribution and the enhancement of managerial efficiency. The study affirms that the economic justification for the existence of legal entities is closely linked to the capacity of such entities to internalise collective interests, resolve conflicts of interest among participants, and provide a stable framework for contractual coordination in complex commercial environments.

Moreover, the article critically engages with the prevailing doctrinal debates surrounding the nature of legal entities, particularly contrasting the "fiction theory," the "real entity theory," and the "contractual theory." From an economic standpoint, corporations are increasingly conceptualised as "nexuses of contracts," in which the legal structure merely reflects the underlying economic arrangements between various stakeholders. However, this contractual perspective, while providing significant explanatory power, may overlook the legal entity's status as a subject of law, endowed with its own rights, obligations, and institutional interests.

It is important to note that the research highlights the limitations of limited liability, which is frequently

justified as an economically efficient default rule, emphasising its potential drawbacks. This phenomenon can result in the externalisation of risks to creditors and other third parties, particularly in instances where corporate governance structures fail to align managerial decision-making with the interests of a broader stakeholder base. The concept that shareholders possess ownership of the corporation is subjected to rigorous scrutiny and ultimately refuted, leading to the adoption of a more nuanced perspective. It is posited that shareholders hold ownership of shares, which are recognised as distinct legal entities bestowing specific rights. However, this does not extend to ownership of the legal entity itself.

In light of these findings, the study concludes that the modern legal entity is best understood as a dynamic hybrid of legal and economic principles. Its legitimacy is not only rooted in statutory recognition but also in its demonstrated capacity to contribute to economic stability, organisational efficiency, and social welfare. This contribution is achieved through its role in the structuring of capital flows, the management of risk, and the enablement of complex business operations. It is recommended that future research continue to explore the interplay between legal doctrine and economic functionality, particularly in the context of global capital markets and evolving forms of corporate organisation.

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