

ARTICLES

IT'S JUST SECURED CREDIT! THE NATURAL LAW CASE IN DEFENSE OF SOME FORMS OF SECURED CREDIT

BRIAN M. MCCALL*

INTRODUCTION

For decades commercial scholars have attempted to answer the question “Why secured credit?”¹ This question encapsulates two lines of inquiry: (1) can we explain and normatively justify the priority given to secured lenders, or (2) if we cannot explain and justify the current system, what changes are necessary to conform the system of secured credit to a rational and normatively justified foundation? Despite the multiplicity of explanations and justifications advocated in academic literature for decades, no satisfactory conclusion has been reached. A consensus has not been formed either justifying secured credit or proposing significant alterations to the system. This Article identifies the reason for the inability to come to a conclusion and proposes a normative theory of secured credit. The remainder of this Introduction sets the parameters of the argument. Part I surveys the main arguments about secured credit advocated over the past few decades. Part II articulates a normative justification for secured credit rooted in the Aristotelian/Aquinian natural law theory of usury and business investment. Part III applies this natural law model to the current system of secured credit. This analysis demonstrates that the current system generally is explained and justified by the natural law theory of credit. The analysis further indicates a few aspects of the priority regime that need to be amended to better conform to that theory.

Before examining the main arguments advocated in the debate thus far, it is necessary to more precisely define the scope of the question: Why secured credit? This simple formulation of the inquiry is both too broad and too narrow in scope. It is too broad in that it asks for a single answer without distinguishing between consumer and commercial credit. The debate about secured credit must

* Associate Professor, University of Oklahoma College of Law. J.D., University of Pennsylvania; M.A., King's College University of London; B.A., Yale University. I would like to thank Lynn M. LoPucki and Steve Knippenberg for their review of a prior draft of this Article.

1. Professor Robert Scott dates the initiation of the debate to 1979. See Robert E. Scott, *The Truth About Secured Financing*, 82 CORNELL L. REV. 1436, 1437 (1997). For further examples of articles published on this question, see *infra* Part I.

distinguish between consumer and commercial loans. Although certain efficiency gains may be obtained by combining filing systems for consumer and commercial secured loans, the normative justification for each, as well as the priority rules that flow therefrom, are fundamentally different. Despite the generality of the claims of the articles contributed to date, these articles really address only the narrower question: “Why secured credit *for businesses?*” Some articles limit their analysis explicitly to commercial secured loans,² and others implicitly create that limitation by advancing arguments and examples in support of secured credit only applicable to a commercial context.³ Part II clarifies that the normative justification for secured credit advanced in this Article applies only to secured credit in business contexts. The justification for and scope of secured credit in consumer lending must be considered in light of different principles.

The question Why secured credit? is also too narrow in the sense that it questions secured credit without first considering the question “Why credit?” Despite some scholars’ calls to reconsider the first principles and assumptions of the law of secured transactions in anticipation of the major revisions to Article 9 of the Uniform Commercial Code in 1999,⁴ they limited the first principles to secured credit only. Secured credit, as a subset of extensions of credit to businesses in general, can only be evaluated in light of a theory of general business credit. The natural law theory of business credit articulated in Part II presents a comprehensive normative justification for and regulation of business credit—unsecured or secured—which naturally provides answers to the question Why secured credit? These answers allow us to evaluate the current system of

2. See, e.g., Elizabeth Warren, *An Article 9 Set-Aside for Unsecured Creditors*, 51 CONSUMER FIN. L.Q. REP. 323, 323 (1997) (limiting her set-aside proposal explicitly to “commercial loans”).

3. The following articles do not explicitly state that they are limiting their analysis to business loans but argue as if this were the case: Douglas G. Baird, *Security Interests Reconsidered*, 80 VA. L. REV. 2249, 2259 (1994) (“Once we view secured debt as simply one kind of investment instrument in a firm, it becomes hard to do much to alter the capital structures for which the parties bargain.”); Steven L. Harris & Charles W. Mooney, Jr., *A Property-Based Theory of Security Interests: Taking Debtors’ Choices Seriously*, 80 VA. L. REV. 2021, 2033 (1994) (“D’s acquisition of \$100 in loan proceeds that were not otherwise available could enable D to pursue new projects, buy additional inventory or more efficient equipment, employ additional workers, or otherwise behave in a way that would decrease the likelihood that D would fail and would enhance the prospects that D would become more profitable.”); Lynn M. LoPucki, *The Unsecured Creditor’s Bargain*, 80 VA. L. REV. 1887, 1913-14 (1994) (“The tort-first regime that I propose is grounded in the premise that whoever supplies the capital that enables a business to operate should be legally responsible for its torts, at least to the extent of the supplier’s investment. Whether the capitalist should control that liability by monitoring, involving itself in management, lending only to those whom it trusts, or delegating the task to an insurance company is left to the capitalist to decide.”).

4. See Baird, *supra* note 3, at 2249; Elizabeth Warren, *Further Reconsideration*, 80 VA. L. REV. 2303, 2303-04 (1994).

secured credit in light of this theory.

I. THE ONGOING DEBATE OVER SECURED CREDIT

This Part provides a summary of the main arguments advocated so far in the secured credit debate. This Part does not attempt to be complete in presenting every argument advanced thus far or in exploring all of their nuances. Rather, it argues that both the apologists for and critics of the existing secured credit system have failed to articulate a coherent normative justification for defending or reforming the institution. This conclusion sets the stage for expostulating such principles in Part II. This Part groups current scholarship into three categories: (1) the “Efficiency Scholars,” (2) the “Bad Effects Scholars” and (3) the “Property Rights Scholars.”

A. *The Efficiency Scholars*

The Efficiency Scholars have been attempting to justify or reform the secured credit system on the basis of the answer to the question: “Is secured credit efficient?” This debate dates from the 1979 Yale Law Journal article by Professors Jackson and Kronman.⁵ Although they did not explicitly use the term “efficiency,” they were effectively arguing that the institution of secured credit was efficient, and therefore, changes to the institution should be avoided, as they would decrease wealth.⁶ Since Jackson and Kronman staked their claim, scholars have debated whether or not, or to what extent, secured credit is efficient.⁷ One

5. See Thomas H. Jackson & Anthony T. Kronman, *Secured Financing and Priorities Among Creditors*, 88 YALE L.J. 1143 (1979).

6. *Id.* at 1158-64; Homer Kripke, *Law and Economics: Measuring the Economic Efficiency of Commercial Law in a Vacuum of Fact*, 133 U. PA. L. REV. 929, 930 (1985) (stating that Jackson and Kronman “conclude that taking security is economically efficient”).

7. See generally Barry E. Adler, *An Equity-Agency Solution to the Bankruptcy-Priority Puzzle*, 22 J. LEGAL STUD. 73 (1993); Richard L. Barnes, *The Efficiency Justification for Secured Transactions: Foxes and Soxes and Other Fanciful Stuff*, 42 U. KAN. L. REV. 13 (1993); Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857 (1996) [hereinafter Bebchuk & Fried, *The Uneasy Case*]; James W. Bowers, *Whither What Hits the Fan?: Murphy’s Law, Bankruptcy Theory, and the Elementary Economics of Loss Distribution*, 26 GA. L. REV. 27, 57-68 (1991); F.H. Buckley, *The Bankruptcy Priority Puzzle*, 72 VA. L. REV. 1393 (1986); David Gray Carlson, *On the Efficiency of Secured Lending*, 80 VA. L. REV. 2179 (1994); Thomas H. Jackson & Alan Schwartz, *Vacuum of Fact or Vacuous Theory: A Reply to Professor Kripke*, 133 U. PA. L. REV. 987 (1985); Hideki Kanda & Saul Levmore, *Explaining Creditor Priorities*, 80 VA. L. REV. 2103 (1994); Kripke, *supra* note 6; Saul Levmore, *Monitors and Freeriders in Commercial and Corporate Settings*, 92 YALE L.J. 49 (1982); LoPucki, *supra* note 3; Randal C. Picker, *Security Interests, Misbehavior, and Common Pools*, 59 U. CHI. L. REV. 645 (1992); Steven L. Schwarcz, *The Easy Case for the Priority of Secured Claims in Bankruptcy*, 47 DUKE L.J. 425 (1997); Alan Schwartz, *Security Interests and Bankruptcy Priorities: A Review of Current Theories*, 10 J. LEGAL STUD. 1 (1981); Alan Schwartz, *The Continuing Puzzle of Secured Debt*, 37 VAND. L. REV. 1051 (1984); Robert E. Scott, *A*

branch of the Efficiency Scholars embarking from the Modigliani-Miller Irrelevance Hypothesis⁸ contends that the presence of secured debt may represent a zero-sum game where interest rate savings for issuing secured debt are offset by corresponding interest rate increases for unsecured debt.⁹ Another line argues that security is efficient because it allows for the extension of more credit to businesses than otherwise would be available only on an unsecured basis.¹⁰ Many scholars believe that even if lower interest rates for secured credit are offset by unsecured credit, the institution of security provides other economic benefits such as: (1) cost-efficient necessary monitoring of debtors,¹¹ (2) providing a lower cost method for achieving what could otherwise be contracted by the secured party and its debtor,¹² (3) lower cost provision of additional financial planning and consulting benefits,¹³ (4) policing of inefficient asset

Relational Theory of Secured Financing, 86 COLUM. L. REV. 901 (1986); Paul M. Shupack, *Solving the Puzzle of Secured Transactions*, 41 RUTGERS L. REV. 1067, 1118 (1989); George G. Triantis, *Secured Debt Under Conditions of Imperfect Information*, 21 J. LEGAL STUD. 225 (1992); James J. White, *Efficiency Justifications for Personal Property Security*, 37 VAND. L. REV. 473 (1984).

8. Franco Modigliani & Merton H. Miller, *The Cost of Capital, Corporation Finance and the Theory of Investment*, 48 AM. ECON. REV. 261 (1958) (arguing in general that given various assumptions, the choice of capital structure (debt versus equity) is irrelevant and does not affect the value or returns of the firm).

9. See Kanda & Levmore, *supra* note 7, at 2104 ("Reductions in interest costs obtained from creditors who expect priority must be offset by increased charges from those who can see they will be in a subordinate position."); Schwarcz, *supra* note 7, at 429 (summarizing the zero-sum game argument).

10. See JAMES C. VAN HORNE, FINANCIAL MANAGEMENT AND POLICY 536 (3d ed. 1974) (noting that in regard to firms that pose a significant risk of default, lenders often "require security so as to reduce their risk of loss"); Kripke, *supra* note 6, at 941.

11. See, e.g., Jackson & Kronman, *supra* note 5, at 1149-61. Jackson and Kronman state: Consequently, the monitoring required to prevent the debtor from increasing the riskiness of a secured loan is likely to be significantly less than that required when the loan is unsecured. A secured creditor can focus his attention on the continued availability of his collateral and is largely free to disregard what the debtor does with the remainder of his estate. By restricting his attention in this way, the secured creditor can reduce the number and complexity of his monitoring tasks and thus achieve a substantial savings in monitoring costs.

Id. at 1153; see also Saul Levmore, *Monitors and Freeriders in Commercial and Corporate Settings*, 92 YALE L.J. 49, 55-57 (1982). *But see* Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy: Further Thoughts and a Reply to Critics*, 82 CORNELL L. REV. 1279, 1315-18 (1997) [hereinafter Bebchuk & Fried, *Reply to Critics*] (arguing that security interests may actually inefficiently decrease monitoring).

12. See, e.g., Jackson & Kronman, *supra* note 5, at 1157 ("These transaction costs can be avoided by allowing the debtor himself to prefer one creditor over another. The rule permitting debtors to encumber their assets by private agreement is therefore justifiable as a cost-saving device that makes it easier and cheaper for the debtor's creditors to do what they would do in any case.")

13. See, e.g., Scott, *supra* note 7, at 913 ("The external benefits of this financing arrangement

wasting in failed bankruptcy reorganizations,¹⁴ (5) protecting against asset substitution transactions and other debtor misbehavior,¹⁵ and (6) reducing of credit screening costs.¹⁶

Without entering into a detailed discussion of the merits of these arguments, one can reach the conclusion that a comprehensive justification of secured commercial credit on efficiency grounds is unproven and perhaps not provable. This question of efficiency is just as open as it was in 1979, despite some refining of positions, and that testifies to the fact that the efficiency justification stands on shaky ground. A comment by David Carlson aptly summarizes this failure of efficiency arguments to reach a comprehensive conclusion: “[S]ecured lending is not necessarily inconsistent with economic efficiency, though whether any given security interest is efficient is highly contingent and probably unknowable.”¹⁷

Assuming for the moment that it could one day be proven that the institution of security provides efficiency benefits, this conclusion would not normatively justify the existing legal regime. As Aristotle claimed millennia ago, economic efficiency is not the end of human existence or political society.¹⁸ Proof of economic efficiency merely tells us one of the effects of a given course of action;

derive from the valuable financial planning and coordination provided by the creditor. The financial inputs are a ‘public good’ that will not be provided unless the creditor can structure the relationship so as to capture a share of the returns from the venture [which necessitates the grant of security].”).

14. See, e.g., White, *supra* note 7, at 488-89 (“Without exception, one can assume that the unsuccessful reorganization attempt will have dissipated some of the assets that might otherwise have been distributed to creditors had liquidation occurred upon default.”).

15. See, e.g., Carlson, *supra* note 7, at 2213 (“Instead, we can assert very simply that security interests disable the borrower from personal misbehavior by preventing or at least inhibiting transfers by the borrower to third parties. As a result, the risk of such misbehavior is effectively destroyed in part or in whole”); Jackson & Kronman, *supra* note 5, at 1153 (“But so long as the particular items of property securing his loan remain intact, a creditor will be immunized from the effects of his debtor’s misbehavior.”); Schwarcz, *supra* note 7, at 11; Scott, *supra* note 7, at 909-11 (summarizing the argument that security deters debtor misbehavior).

16. See, e.g., Buckley, *supra* note 7, at 1469.

17. Carlson, *supra* note 7, at 2213; see also Ronald J. Mann, *Explaining the Pattern of Secured Credit*, 110 HARV. L. REV. 625, 682 (1997) (“Secured credit is an area in which broad conclusions are likely to be incorrect: suppliers do not always lend on an unsecured basis, and large companies do not always borrow unsecured. To make a serious effort to describe the richness of the real pattern, a theory must not only acknowledge, but embrace, the variety of the circumstances in which parties make lending decisions. This conclusion may frustrate those who search for a single unifying theory for credit decisions.”).

18. ST. THOMAS AQUINAS, COMMENTARY ON ARISTOTLE’S NICHOMACHEAN ETHICS 7 (C.I. Litzinger trans., Henry Regnery Co. 1964) (1993) (“Hence we see that the noblest of the operative arts, for example, strategy, domestic economy, and rhetoric fall under political science.” (quoting ARISTOTLE, NICHOMACHEAN ETHICS II, 1094a28-1094b3)).

it does not tell us normatively if such a thing should be done.¹⁹ For example, even if it could be proven that the economy would be more efficient if ninety-five percent of the population were eliminated, such a conclusion would clearly not tell us that such an act of genocide should occur. All other normative issues being equal, efficiency may be a reason for selecting one legitimate option in lieu of another, but it cannot be *the* normative reason for all decisions.

B. *The Bad Effects Scholars*

The Bad Effects Scholars have argued that even if purported net efficiency gains really exist, they may come at the expense of other people who deal with particular insolvent debtors. Several Bad Effects Scholars argue that many of these persons, (e.g., tort victims and environmental cleanup funds) involuntarily become creditors to the debtor, and their ability to recover for losses inflicted by the debtor on them is adversely impacted by the presence of security.²⁰ The argument has even been extended to parties who voluntarily deal with the debtor, but who are unable to adjust their relationship when security interests are later created.²¹ Although these arguments have an aura of normative overtones, they are often merely another variation of the efficiency debate. The language of these normatively cloaked efficiency arguments is often couched in the terminology of efficiency, using phrases such as “[s]ecurity tends to misallocate resources”²² and “whether those costs should be internalized to the operation of a business.”²³ Some of this debate merely takes a wider view of efficiency that requires more externalities to be taken into account in computing net efficiency. However, two arguments employed by the Bad Effects Scholars appear to transcend the efficiency debate: (1) consent theory and (2) distributive justice.

Lynn LoPucki critiques the current secured credit institution because it permits the rights of certain involuntary creditors to be affected without their actual or meaningful consent.²⁴ Bebchuk and Fried argue that full priority violates the principle that creditors should not be subordinated in payment without their consent, and this is exactly what happens to non-adjusting creditors.²⁵ Yet, consent is not an absolute normative value in all cases. People

19. See Elizabeth Warren, *Making Policy with Imperfect Information: The Article 9 Full Priority Debates*, 82 CORNELL L. REV. 1373, 1377 (1997) (“Economists are, however, the first to note that using economic analysis as a tool for understanding policy choices has its limits.”).

20. See, e.g., John Hudson, *The Case Against Secured Lending*, 15 INT’L REV. L. & ECON. 47 (1995); LoPucki, *supra* note 3, at 1896-1902; Warren, *supra* note 19, at 1389.

21. See Bebchuk & Fried, *Reply to Critics*, *supra* note 11, at 1295 (using the term “non adjusting creditors” to refer to this larger group of uncompensated creditors); Bebchuk & Fried, *The Uneasy Case*, *supra* note 7, at 882.

22. LoPucki, *supra* note 3, at 1891.

23. Warren, *supra* note 19, at 1388.

24. LoPucki, *supra* note 3, at 1891 (“[I]mposing on unsecured creditors a bargain to which many, if not most, of them have given no meaningful consent.”).

25. See Bebchuk & Fried, *Reply to Critics*, *supra* note 11, at 1285 (“[N]otwithstanding its

do not have the general right to consent to every action of another person that has an effect on them.²⁶ A supplier may sell inventory on credit, and the buyer may sell the inventory and use the proceeds to pay an electric bill rather than paying the supplier. Such a use of proceeds diverts resources from paying the supplier. Not even LoPucki would argue that a principle of justice has been violated simply because the supplier has not consented. The consent argument has not thus far clearly articulated why particular involuntary or non-adjusting creditors are entitled to the consent claimed for them.

Elizabeth Warren has argued that the current preference for secured creditors redistributes wealth from involuntary to voluntary creditors by allowing security interests to be granted.²⁷ The difficulty with Warren's argument is that distributive justice only requires that all individuals in a group receive distributions consistently with the principle of distribution adopted *ex ante*.²⁸ Warren does not clearly articulate what principle of distribution should be operative in commercial contexts. Even assuming a particular principle of distribution (*X*) is adopted, Warren then needs to demonstrate why treating

long history, full priority is actually inconsistent with an important general principle of commercial law: that a borrower may not subordinate one creditor's claim to that of another without the consent of the subordinated creditor.”).

26. Harris and Mooney give the example of a solvent debtor making payments to one creditor, reducing resources his available to pay the second creditor. They point out that neither fraudulent transfer law nor critics like Carlson call for the invalidation of such payments because they affect other creditors without their consent. *See Harris & Mooney, supra* note 3, at 2037-39 & n.47 (citing David G. Carlson, *Accident and Priority Under Article 9 of the Uniform Commercial Code*, 71 MINN. L. REV. 207, 245-46 (1986)).

27. Warren, *supra* note 19, at 1389-91.

28. *See AQUINAS, supra* note 18, at 293 (“Moreover, this is clear from the fact that bestowal should be made according to merit, for the just thing in distribution has to be done according to a certain merit. But all do not agree that merit consists in the same thing.” (quoting ARISTOTLE, NICHOMACHEAN ETHICS IV, 1131a24-29)); ST. THOMAS AQUINAS, SUMMA THEOLOGICA, at II-II Q.61 A.2 (Fathers of the English Dominican Province trans., Benzinger Brothers, Inc. 1947) (“[I]n distributive justice something is given to a private individual, in so far as what belongs to the whole is due to the part, and in a quantity that is proportionate to the importance of the position of that part in respect of the whole. Consequently in distributive justice a person receives all the more of the common goods, according as he holds a more prominent position in the community. This prominence in an aristocratic community is gauged according to virtue, in an oligarchy according to wealth, in a democracy according to liberty, and in various ways according to various forms of community. Hence in distributive justice the mean is observed, not according to equality between thing and thing, but according to proportion between things and persons: in such a way that even as one person surpasses another, so that which is given to one person surpasses that which is allotted to another. Hence the Philosopher says that the mean in the latter case follows *geometrical proportion*, wherein equality depends not on quantity but on proportion. For example we say that 6 is to 4 as 3 is to 2, because in either case the proportion equals 1-1/2; since the greater number is the sum of the lesser plus its half: whereas the equality of excess is not one of quantity, because 6 exceeds 4 by 2, while 3 exceeds 2 by 1.”) (citation omitted).

secured and unsecured creditors differently is inconsistent with principle *X*. If secured and unsecured creditors are different types of individuals, it is not necessarily inconsistent with distributive justice for them to receive different treatment as long as their distributions retain the same proportionality determined for their respective groups. Although Warren argues that the treatment of secured creditors in bankruptcy violates the principle of distributing burdens and losses pro rata, the preference for secured creditors violates distributive justice only if the principle of distribution adopted is that all creditors, regardless of their secured status, should receive distributions proportionate to their debt. On the other hand, if a different principle of distribution is adopted that makes a distinction between secured and unsecured creditors and requires distributions to be proportional both to debt and value of security securing that debt then distributive justice has not been violated. Again, those advancing this argument need to articulate and defend a principle of distribution and then see if the Bankruptcy Code and Article 9 effect a different proportionate distribution.

Beyond this preliminary difficulty, the actual arguments Warren advances are merely consent and efficiency arguments in a different guise. She argues that it is unjust to redistribute wealth from involuntary creditors to voluntary creditors without their consent.²⁹ Bankruptcy primarily concerns the ability of the state to redistribute resources without consent.³⁰ Although the image of an uncompensated tort victim may sympathetically appeal to our emotion of compassion, Warren has not clearly articulated a jurisprudential argument why this redistribution of resources violates a principle of justice, and if it does, which one. Her second argument is one of efficiency in another guise. Secured creditors with priority may be able to use their preferred status to block otherwise economically beneficial reorganizations.³¹ Thus, both of these arguments are really another instance of the consent and efficiency lines of reasoning.

Yet, as Harris and Mooney point out,³² most Bad Effects Scholars appear only to present criticisms of specific results of the current system, which appear

29. See Warren, *supra* note 19, at 1389 (“To the extent that the rules create any redistribution among creditors of a failing business, the system directs resources away from creditors who are involuntary, underrepresented, and least able to spread their losses. Instead, value is directed toward lenders who are entirely voluntary, best able to protect their rights, and best able to spread their risks among numerous projects.”).

30. See *e.g.*, 11 U.S.C. § 1126(f) (2006) (allowing for “cramdown” of a plan, approval of a plan without the consent of the particular creditor).

31. See Warren, *supra* note 19, at 1390 (“Notwithstanding the features of bankruptcy that curtail the power of the secured creditor, the ability of the secured creditor to demand adequate protection and to insist on a priority repayment of assets effectively gives the secured creditor the power to block a reorganization.”).

32. See Harris & Mooney, *supra* note 3, at 2046-47 (“Given that security interests will not be abolished, the [Bad Effects Scholars] should come forward with a principled basis for casting a cloud of doubt or suspicion about security interests generally. If they really wish to argue that the creation of security interests should be more difficult, time consuming, expensive, and risky, then they must explain why.”).

undesirable from their point of view. Because the Bad Effects Scholars have not suggested the complete elimination of a system of secured credit, they must accept that some form of system should exist. They need to clearly articulate a coherent justification for and understanding of a secured credit system that can be used to demonstrate why the currently enacted system varies from such a model.

C. *The Property Rights Scholars*

The Property Rights Scholars appear to articulate a normative justification for the current system of secured credit.³³ After disputing the assertions that secured credit is necessarily inefficient and harmfully redistributive, Harris and Mooney argue that the normative values of property rights and freedom of contract justify the current system of secured credit.³⁴ They offer the following definition of the nature of property rights that justify secured credit:

(i) the right to use an asset (*usus*), (ii) the right to capture benefits from that asset (*usus fructus*), (iii) the right to change its form and substance (*abusus*), and (iv) the right to transfer all or some of the rights specified under (i), (ii), and (iii) to others at a mutually agreed upon price. Implicit in these elements is an owner's right to exclude others from exercising ownership rights over the owner's property.³⁵

Harris and Mooney do not present a detailed justification for private property and freedom of contract on the assumption that most people would agree that these principles are normatively justifiable.³⁶ They list a few general values that they assume most people would agree are connected with the institution of private property and freedom of contract, such as “the promotion of economic efficiency, the enhancement of political freedom and liberty, the contribution to an owner's sense of ‘self,’ and the encouragement of innovation” and “respect for the autonomy of . . . persons.”³⁷ Yet, even Harris and Mooney concede that, notwithstanding near unanimous agreement that private property and freedom of contract are normatively justifiable, these general concepts do not represent absolute rights and norms incapable of some legal circumscription.³⁸ As every

33. *See id.* at 2047 (“Our *normative* theory of security interests is grounded upon the *normative* theories that justify the institution of private property.” (emphasis added)).

34. *Id.* at 2042-49.

35. *Id.* at 2048 (quotations and footnote omitted).

36. *See id.* at 2050-51 (“We embrace the baseline principles that underlie current law insofar as it generally respects the free and effective alienation of property rights and the ability of parties to enter into enforceable contracts. We believe that these principles reflect widely shared normative views that favor party autonomy concerning both property and contract. We need not undertake, here, a defense of these principles. Instead, we accept them as sound . . .”).

37. *Id.* at 2048-49 (footnotes omitted).

38. *See id.* at 2049-50 (“Nevertheless, some restrictions on alienability actually may promote efficiency. . . . And some restraints [on alienability] may be warranted on normative grounds

first year law student learns, each of the four elements in Harris and Mooney's definition of property is limited to some extent by jurisprudential principles other than property (contracts, torts, environmental law, constitutional law, criminal law).³⁹ Likewise, principles such as capacity, duress, misrepresentation, and unconscionability limit the enforceability of specific exercises of freedom of contract.⁴⁰ Put another way, property and contract rights are normatively justifiable in general, yet the specific implications of any particular exercise of them will vary when they intersect with other normative and jurisprudential principles applicable to that context. For example, the freedom to use one's property as one chooses is, as a general proposition, accepted. Yet, one's exercise of this right is curtailed when the use involves a crime (e.g. using a car to speed).

The recognition and enforcement of security interests are, as Harris and Mooney claim, a form of property and contract rights. Yet, these rights intersect with the extension of credit to business ventures. Thus, to apply property and contract principles in the context of secured credit requires the understanding of the normative principles underlying business credit because these principles may affect the way in which this particular form of property and contracts rights are regulated. Part II turns to the development of this theory of business credit.

II. THE NATURAL LAW THEORY OF BUSINESS CREDIT

To understand the nature of the property and contract rights created when a business loan is secured, this Article examines the scholastic theory of credit, which is rooted in economic natural law. This Part traces the theory explaining the norms of commutative justice that define and limit the extension of business credit so that these norms can be applied in Part III to the legal institution of security.

The scholastic theory of credit is rooted in a fundamental distinction between the investment of capital in a business venture or wealth-producing assets and the lending of money to fund consumption.⁴¹ This distinction leads to a different system of principles governing the relationships between investor and investee on one hand and consumer lender and borrower on the other. The natural law

unrelated to economic efficiency. . . . Yet this 'freedom of contract' abstraction that so dominated classical contract law doubtless does not and never did exist in a pure form in the real world. Although the central attribute of an enforceable contract is the right of a party to call upon the state's coercive power to provide a remedy, examples abound both of contracts that the courts will not enforce and of challenges to the theoretical bases for contract law.").

39. See John F. Hart, *Colonial Land Use Law and Its Significance for Modern Takings Doctrine*, 109 HARV. L. REV. 1252, 1281 (1996).

40. See FARNSWORTH, CONTRACTS 225-73, 307-16 (Aspen 3d ed. 1999).

41. See, e.g., Peter John Olivi, *On Usury and Credit*, in 4 READINGS IN WESTERN CIVILIZATION: MEDIEVAL EUROPE 318, 318 (1986) (distinguishing between handing over money to someone "to be spent on his own personal needs" and to an "average merchant engaged in legitimate enterprise").

usury theory concludes that someone who lends money for the purpose of consumption should be entitled to compensation for loss incurred in making the loan (interest in the original Roman law meaning of the word).⁴² The charging of a gain above the amount loaned, plus any cost of reimbursement,⁴³ constitutes usury and is unjust.⁴⁴

This conclusion is rooted in the distinction between money and capital. Natural law theorists defined money essentially in the same way as modern commercial law. Money is an “instrument artificially invented [by the State] for the easier exchange of natural riches” and a balancing “instrument for the exchange of natural riches.”⁴⁵ Money thus has two interconnected uses: It can measure the value of something and hence facilitate exchange transactions, and it can store value for future use.⁴⁶ Money is important to society because it is essential to facilitate necessary exchange transactions.⁴⁷ As simple bartering between individuals is too limited to supply all human needs, money facilitates a broader range of exchange by providing a method of measuring value in multiple exchanges occurring across time and space.⁴⁸ A farmer can exchange

42. See Brian M. McCall, *Unprofitable Lending: Modern Credit Regulation and the Lost Theory of Usury*, 30 *CARDOZO L. REV.* 549, 590-93, 601-02 (2008).

43. Historically there were many debates about what constituted costs capable of reimbursement by interest payments and the appropriate method of calculating loss. The nuances of this history and its ultimate resolution are not directly relevant to the topic of this Article as its argument assumes the presence of a business investment, not a consumer loan. See *id.* at 570-71, 590-93.

44. BENEDICT XIV, *VIX PERVENIT* (1745), reprinted in *THE PAPAL ENCYCLICALS, 1740-1878*, at 15-16 (Claudia Carlen ed., Pierian Press 1990), available at <http://www.ewtn.com/library/ENCYC/B14VIXPE.HTM> (“The nature of . . . usury has its proper place and origin in a loan contract. This financial contract between consenting parties demands, by its very nature, that one return to another only as much as he has received. . . . [A]ny gain which exceeds the amount [the lender] gave is illicit and usurious.”).

45. NICHOLAS ORESME, *THE DE MONETA OF NICHOLAS ORESME AND ENGLISH MINT DOCUMENTS 4-5* (Charles Johnson ed. and trans., 1956); see DIANA WOOD, *MEDIEVAL ECONOMIC THOUGHT* 70 (2002). Cf. U.C.C. § 1-201(b)(24) (amended 1990) (defining money in almost identical terms).

46. See GRATIAN, *DECRETUM* D.88, c.11 [hereinafter GRATIAN, *DECRETUM*] (noting that money is meant for no purpose other than to buy something (*quoniam pecunia non ad aliquem usum disposita est nisi ad emendum*) but noting that money could be stored up (*pecunia reposita*) for future use).

47. AQUINAS, *supra* note 18, at 307, 310.

48. Aristotle used the example of shoes and a home. In a direct exchange, the shoemaker would have to transfer as many shoes as equal the value of a house. Because the house builder will not have need for so many shoes, money allows the two to achieve an exchange of a house or a pair of shoes for money, which represents the equivalent value. This money can then be exchanged with others for required goods. *Id.*; WOOD, *supra* note 45, at 71-73 (“[M]oney, when authorized by the State, overcame the difficulties of barter by providing a uniform measure.” (citing the Roman jurist Paul)).

his crops for money, which can then be exchanged with a clothes maker, shoemaker, and doctor for other goods and services. Thus, the primary function of money is to be used in exchange transactions. Because exchanges are not simultaneous,⁴⁹ the secondary purpose of money is to store value for future use.⁵⁰ To use the prior example, the farmer may keep some of the money he received from his crops until he needs a pair of shoes.

Once money is seen as a mere instrumentality either to effect present exchange transactions or to store value for future ones, it can only be normatively evaluated in the context of a particular use.⁵¹ As Aquinas says:

All other things from themselves have some utility; not so, however, money. But it is the measure of utility of other things And therefore the use of money does not have the measure of its utility from this money itself, but from the things which are measured by money according to the different persons who exchange money for goods.⁵²

In other words, because money can only be used to trade for other things (now or in the future) its use cannot be evaluated normatively in isolation but only in the context of a particular exchange. Money can be exchanged either for an interest in something productive (which produces some additional wealth) or something which is non-productive (something that can be used or consumed but which use does not produce additional wealth). This Article maintains the distinction by referring to money when it is exchanged for an interest in something productive as capital and by referring to it merely as money when it is not so used.

With this definition of money established, the two main arguments supporting the scholastic limitation on profit from a loan of money can be summarized. They are rooted in both commutative and distributive justice. Charging more than the amount loaned (plus any compensation for loss) is a violation of commutative justice which requires equality in voluntary exchange transactions. Aristotle argued that commutative justice⁵³ required equality in all

49. JUSTINIAN, DIGEST 18:1:1 ("The coincidence was not always readily found, that when you had what I wanted I had what you were willing to give.").

50. See AQUINAS, *supra* note 18, at 311 ("For future exchanges money is as it were a guarantee that a man, who has no present need, will be helped when he is in want later on." (quoting ARISTOTLE, NICHOMACHEAN ETHICS IX, 1133b10-14)).

51. See GRATIAN, DECRETUM, *supra* note 46, at D.88, c.11 (articulating that from money which is not being exchanged and merely storing value, one takes no use—*ex pecunia reposita nullum usum capis*).

52. JOHN T. NOONAN, JR., THE SCHOLASTIC ANALYSIS OF USURY 52 (1957) (translating and quoting ST. THOMAS AQUINAS, IV LIB. SENT. III:37:1:6).

53. Two quotations from St. Thomas Aquinas can serve as a definition of commutative justice. "In the first place there is the order of one part to another, to which corresponds the order of one private individual to another. This order is directed by commutative justice, which is concerned about the mutual dealings between two persons." AQUINAS, *supra* note 28, at 1452.

[I]n commutations something is paid to an individual on account of something of his

exchange transactions between individuals in society.⁵⁴ The principle of equality in exchange held that particular transactions between individuals—voluntary or involuntary—were not a principled method to achieve redistribution. James Gordley explained that equality in exchange is not meant to achieve a just distribution of wealth in and of itself, the achievement of which involves principles of distributive, not commutative, justice.⁵⁵ Rather, the equality in exchange is meant to avoid “random redistributions” of wealth through the system of exchange.⁵⁶ When someone borrows money for consumption, its value equates to the value of the thing whose consumption was procured with the borrowed money. As the thing consumed does not increase in wealth by being consumed, the value of the borrowed money likewise does not increase. To charge a profit in addition to the return of the money lent, plus compensation for any actual loss occasioned thereby, is, therefore, an unjust exchange.

The injustice of charging a profit on a loan of money can also be demonstrated by the distinction between ownership and use. The lender who merely provides money, as opposed to capital, charges both for the ownership of the money itself (in requiring the return of the same amount of money) and for its use (the usury or additional gain charged).⁵⁷ To charge for the ownership and use of something which is consumed in use is to charge twice for the same thing.⁵⁸ Put another way, the usurer exchanges his money for a right to receive

that has been received, as may be seen chiefly in selling and buying, where the notion of commutation is found primarily. Hence it is necessary to equalize thing with thing, so that the one person should pay back to the other just so much as he has become richer out of that which belonged to the other.

Id. at 1453. See Jacques Melitz, *Some Further Reassessment of the Scholastic Doctrine of Usury*, 24 KYKLOS INT'L REV. FOR SOC. SERVICES 473, 476 (1971) (“[T]he usury doctrine, dating mainly from 1150-1350, appeals not to authority and charity, but to ‘natural law’, therefore to reason and commutative justice.”).

54. AQUINAS, *supra* note 18, at 300 (citing ARISTOTLE, NICHOMACHEAN ETHICS VI, 1131b32-1132a7).

55. See James Gordley, *Equality in Exchange*, 69 CAL. L. REV. 1587, 1587-88 (1981).

56. See *id.* at 1616-17. This equality in exchange does not mean that one party cannot use the thing received in exchange to make a profit, but that use is not a gain from the exchange itself.

57. GRATIAN, DECRETUM, *supra* note 46, at D.88, c.11 (“Unde super omnes mercatores plus maledictus est usurarius; ipse namque rem datam a Deo uendit, non comparatam, ut mercator, et post fenus rem suam repetit, tollens aliena cum suis, mercator autem non repetit rem uenditam.” (“Over all merchants, the most accursed is the usurer, for he sells a thing given by God, not bought as a merchant; and after the usury he reseek his own good, taking back his own good and the good of the other. A merchant, however, does not reseek the good he has sold.”) (author’s translation)).

58. AQUINAS, *supra* note 28, at 1518 (“To take usury for money lent is unjust in itself, because this is to sell what does not exist, and this evidently leads to inequality which is contrary to justice. In order to make this evident, we must observe that there are certain things the use of which consists in their consumption: thus we consume wine when we use it for drink, and we consume wheat when we use it for food. Wherefore in such like things the use of the thing must not be reckoned apart from the thing itself, and whoever is granted the use of the thing, is granted

the same amount back and to charge a profit in addition is to demand an unequal exchange.⁵⁹ This prohibition on charging for use does not apply to the lending of a durable good that can be used without consuming it. In such a case, one transfers the right to use the thing without the right to own or dispose of it, such as renting a house.⁶⁰ However, because money's only use is to exchange it for something else,⁶¹ thereby consuming it, one cannot use it (exchange it for something) without having the right to transfer it (ownership). In contrast, someone can use a house (live in it) without owning it.

In addition to violating principles of commutative justice, the charging of usury involves undesirable redistributions of wealth. Allowing the charging of usury for a consumptive loan establishes a principle of distribution based on surplus and need. Those in need (the borrowers) redistribute their future wealth to those with excess wealth (the lender).⁶² The charging of usury—gain on a loan—results in individual injustice due to an inequitable exchange and societal redistribution of wealth. The borrower at usury transfers a portion of his future wealth to the usurer for current consumption. The society suffers as usury diverts investment away from productive activities, such as farming, because the wealthy invest their money in usurious loans where the money is put to non-productive uses.⁶³

the thing itself; and for this reason, to lend things of this kind is to transfer the ownership. Accordingly if a man wanted to sell wine separately from the use of the wine, he would be selling the same thing twice, or he would be selling what does not exist, wherefore he would evidently commit a sin of injustice. In like manner he commits an injustice who lends wine or wheat, and asks for double payment, viz. one, the return of the thing in equal measure, the other, the price of the use, which is called usury.”)

59. The theory permits a lender to ask for reimbursement of actual or estimated losses caused by the transaction, but to recover these is not to charge a profit because they are limited to compensation for loss. *See supra* notes 41-44 and accompanying text.

60. *See* GRATIAN, *DECRETUM*, *supra* note 46, at D.88, c.11 (distinguishing charging for the use of a field or house from the lending of money: “[a]dhuc dicit aliquis: Qui agrum locat, ut agrariam recipiat, aut domum, ut pensiones recipiat, nonne est similis ei, qui pecuniam dat ad usuram? Absit. Primum quidem, quoniam pecunia non ad aliquem usum disposita est, nisi ad emendum; secundo, quoniam agrum habens, arando accipit ex eo fructum, habens domum, usum mansionis capit ex ea. Ideo qui locat agrum uel domum, suum usum dare uidetur, et pecuniam accipere, et quodammodo quasi commutare uidetur cum lucro lucrum . . .”) (footnotes omitted).

61. Even if money is considered as a store of value, the ultimate purpose of storing value would be to use it later. In any event, it seems illogical to borrow money to store value—not using it—only to return it later.

62. *See* NOONAN, *supra* note 52, at 73-74 (summarizing the arguments of St. Bernadine of Sienna, refuting the claim that despite such harmful redistributive effects some people need to borrow at usury, by stating that no person needs to borrow at usury because it only makes the needy worse off in that they now need to return the money lent plus the additional amount of usury, which payment only exacerbates their poverty by transferring what little future wealth they may earn to the usurer).

63. INNOCENT IV, *COMMENTARIA APPARATUS IN V LIBROS DECRETALIU* 516-17, *De Usura*,

The same objections to contracting for a profit do not apply to a transaction not involving a loan of money.⁶⁴ When someone exchanges money for the right to receive an interest in future profits generated from the productive use of it, this exchange of money is transformed from a loan of money into an investment of capital. As the invested capital is exchanged for something capable of producing additional wealth, the capital can be valued in excess of its original invested value. John Maynard Keynes, in re-evaluating the scholastic theory of usury and capital, restated this conclusion in modern economic terminology:

I was brought up to believe that the attitude of the Medieval Church to the rate of interest was inherently absurd, and that the subtle discussions aimed at distinguishing the return on money-loans from the return to active investment were merely jesuitical attempts to find a practical escape from a foolish theory. But I now read these discussions as an honest intellectual effort to keep separate what the classical theory has inextricably confused together, namely, the rate of interest and the marginal efficiency of capital.⁶⁵

Likewise, Henry Somerville explained:

Now the Canonists never quarrelled with payments for the use of capital, they raised no objection to true profit, the reward of risk, ability and enterprise, but they disputed the identification of the lending of money with the investment of capital and denied the justice of interest as a reward for saving [merely storing up value] without investment.

...

The Canonist principle was that sharing in trade risks made an investor a partner, a co-owner of capital, not simply a moneylender, and gave a title to profit.⁶⁶

The use to which the invested money is meant to be put is what transforms money into capital. For it is not money which produces gain in a business but the use to which the money, now transformed into capital, is put that creates profit.⁶⁷

ante *caput.1* (discussing some harmful effects of usury).

64. See BENEDICT XIV, *supra* note 44, at 3, III (“Nor is it denied that it is very often possible for someone, by means of contracts differing entirely from loans, to spend and invest money legitimately either to provide oneself with an annual income or to engage in legitimate trade and business. From these types of contracts honest gain may be made.”).

65. JOHN MAYNARD KEYNES, *THE GENERAL THEORY OF EMPLOYMENT, INTEREST, AND MONEY* 351-52 (Harcourt, Brace & World 1964) (1936).

66. H. Somerville, *Interest and Usury in a New Light*, 41 *ECON. J.* 646, 648 (1931).

67. NOONAN, *supra* note 52, at 111 (in discussing whether a usurer must restore not only the usury charged but any additional profit the usurer was able to make using the money received as usury, he comments on the relation of money to making profit thus: “The money . . . is not related as a root to the profit which is made from it, but only as matter. For a root has to some degree the

Because the investor of capital is merely requesting a share of the profits he assisted in creating, he is not charging for the loan of money, which is merely acting for him as a store of value. As money can only be valued in the context of its use, the natural law theory of usury evaluates the use of money as money in one way but the use of money as capital in another. The former produces no new wealth, whereas the latter does.

Much of the work of natural law scholars over the centuries was dedicated to discerning the characteristics which enabled one to distinguish the substance, as opposed to the mere form or nomenclature, of an investment of capital—payment of money in exchange for an interest in a business venture or productive asset—from a mere loan of money.⁶⁸ By examining the analysis of particular transactions under the scholastic usury theory, which were found to be licit business investments, it is possible to develop normative principles justifying the receipt of profit from a business investment. From these principles, a theory of just returns from business investments can be developed. Because security can be a characteristic of both money loans and capital investment, the way in which it is used in the transaction is a relevant factor to distinguish a usurious money loan from a capital investment. Security interests with certain characteristics and priorities could be inconsistent with a capital investment. To evaluate the effect a characteristic of a security interest has on the substance of a transaction, as either a money loan or capital investment, one must delve more deeply into the scholastic analysis of what constitutes capital investments.

The group of transactions considered by the natural law theory of usury can be categorized into two main areas, delineated by the scope of investment. The first group includes various investments in a going concern business venture, whereas the second is centered on the returns from a specific asset or pools of assets. Historically, within the first group, the pooling of assets and labor directed toward a common profit-seeking enterprise, variations with respect to the scope of the venture and its time horizon are observable.

A *commenda*, dating from at least the tenth century,⁶⁹ involved one party who would commit or entrust (*commendare*) merchandise, or capital to buy merchandise, to a merchant for a specific period of time and purpose—for example travelling to a particular fair to sell the goods in exchange for a percentage share of the profits made from the sale.⁷⁰ The amount of the

power of an active cause, inasmuch as it ministers food to the whole plant; whence, in human acts, the will and intention are compared to a root, so that if it is perverse, the work will be perverse; this, however, is not necessary in that which is matter . . ." (translating and quoting ST. THOMAS AQUINAS, *QUAESTIONES QUODLIBETALES* III, Q. 3, Art. 19)).

68. See McCall, *supra* note 42, at 569-80.

69. See W.J. ASHLEY, *AN INTRODUCTION TO ENGLISH ECONOMIC HISTORY AND THEORY: PART II. THE END OF THE MIDDLE AGES* 412 (New York, G.P. Putnam's Sons 1893).

70. *Id.* at 413-15. Ashley includes two examples of typical *commenda* contracts: "Ego bonus vasallus maraccius accepi in commendacionem a te wilielmo filardo libras 50 in pannis, has portare debeo apud messaniam laboratum et ex inde quo voluero, quartam proficui habere debeo et expensas debeo facere per libram;" and "Ego Paschalis Tresmezaillas confiteor et recognosco tibi

percentage share varied depending upon the details of the arrangement. For example, if the merchant who would conduct the trading voyage contributed none of the capital, he would typically be entitled to one quarter of the profits plus expenses.⁷¹ If the trading merchant also contributed capital assets, his percentage share would increase proportionately with the amount of his investment.⁷² The three significant characteristics of this legal form are the retention of an ownership right in the capital, or the goods purchased with such capital, by the entrusting partner exemplified by the use of the term “in *commenda*” with its connotation of entrusting. Secondly, the percentage return was subject to the risk of the specific venture being profitable; if the goods did not sell, the partner entrusting goods merely received them back. Finally, the party who took no part in the active trading was not liable for the debts of the trading partner; if the venture failed (e.g., by being lost at sea), his only exposure was the loss of the entrusted goods.⁷³

A *commenda* was generally limited in scope and time to a particular voyage or fair circuit, and it was therefore complimented by longer-term forms of business investment. The company and the *societas* involved a longer-term investment in a business rather than a specific business transaction. The company was usually an association of craftsmen or merchants, often of the same family, working and living together in the same house and shop.⁷⁴ All of the members of the company were liable for the business.⁷⁵ As this type of structure involved merely the pooling of labor, it is not particularly relevant to our analysis of capital investment.

The *societas*, or partnership, was a form-facilitating capital investment that transcended a single voyage or trading circuit. The contract form existed in

Johanno de Mandolio me habuisse et recepisse a te in comanda 40 libr. regalium coronatorum, implicatas in 1 caricha piperis, etc. . . . cum qua comanda predicta ibo . . . ad lucrandum et negotiandum in viagium Capte . . . ad tuum rese gum et ad quartam partem lucri.” *Id.* at 478 n.125 (citations omitted). This can be translated as “I, Maraccius, a good vassal, have accepted in entrustment (*commendacionem*) from you Wilielmus Filardus 50 pounds in cloth, I ought to carry these having worked near Messina and from that place I will have travelled in a circuit whither; I ought to have the fourth part of profit and I ought to make expenses by the pound;” and “I, Paschal Tresmezaill, confess and admit I held and undertook for you, John of Mandol, by you in entrustment (*commenda*) 40 pounds of the royal crowns, together with one measure of peppers . . . etc. Furnished with which aforementioned, I will go . . . to take a voyage near your kingdom to make a profit and trade and for a fourth part of the profit.” (author’s translation).

71. *Id.* at 413.

72. *See id.* at 413-14.

73. *See id.* at 416.

74. *See id.* at 415. The fact that the business partners would share the same household, sharing common bread, probably gave rise to the modern word (company) from the Latin *cum panis*. *See id.*; *see also* JOHN MICKLETHWAIT & ADRIAN WOOLDRIDGE, *THE COMPANY: A SHORT HISTORY OF A REVOLUTIONARY IDEA* 8 (2003).

75. *See* ASHLEY, *supra* note 69, at 415-416; *see* MICKLETHWAIT & WOOLDRIDGE, *supra* note 74.

Roman law, where it was a “pooling of resources (money, property, expertise or labour, or a combination of them) for a *common purpose*.”⁷⁶ Each partner’s claim to profit and return of capital were contingent upon the success of the business venture.⁷⁷ Although Roman law allowed the partners to allocate the partnership profit and loss among themselves, a partner could not shield himself from loss by allocating all of the loss but none of the gain to one partner.⁷⁸ Although the form provided no asset shielding for the partners vis-à-vis third parties,⁷⁹ if the partnership’s assets were lost, a partner could not recover his investment and hoped-for gain from the personal assets of the other partner.⁸⁰

When the Medieval lawyers, canonists, and philosophers turned their attention to examining this Roman law contract under usury theory, they distinguished a partnership from a money loan on two grounds. First, as with the *commenda*, the partner retained an ownership interest in the capital contributed because he bore the risk of its loss during its use in the venture,⁸¹ as evidenced by the restriction on recovery of invested capital from the personal assets of the other partner. The inability of the other partner to use the invested money in a way not in accordance with the common venture demonstrated an attribute of retained ownership in the invested capital. The nature of the partners’ ownership of contributed assets changed; the two partners became joint owners of the capital rather than sole owners of their contributed share.⁸² They also contractually agreed to limit the use of their joint property in accordance with their specific common purpose. Thus, although the nature of their ownership had changed, they still retained an ownership interest in the joint assets. This retained ownership distinguished the *societas* from a money loan, or *mutuum*, since in a *mutuum* the lender lost any ownership interest in the money provided as the borrower was free to consume it in use.⁸³ Further, the return of profit on the investment in a *societas* was subject to business risk whereas in a loan it was subject merely to contractual default risk. Usury was merely a function of time whereas in a *societas*, the gain of a partner was contingent on the business making a profit.⁸⁴ St. Thomas Aquinas provides a succinct summary of the distinguishing characteristics of a partnership from a loan:

76. REINHARD ZIMMERMANN, *THE LAW OF OBLIGATIONS: ROMAN FOUNDATIONS OF THE CIVILIAN TRADITION* 451 (1990); see also Henry Hansmann et al., *Law and the Rise of the Firm*, 119 HARV. L. REV. 1333, 1356 (2006).

77. See ZIMMERMAN, *supra* note 76, at 458-59.

78. See *id.* at 459 (a purported agreement where one partner bore only loss and no gain was referred to as a *societas leonina*).

79. See *id.* at 458-59.

80. See NOONAN, *supra* note 52, at 134.

81. See ASHLEY, *supra* note 69, at 419.

82. See ZIMMERMANN, *supra* note 76, at 465 (“[E]ach [partner] having ‘totius corporis pro indiviso pro parte dominium.’”).

83. See *id.* at 165 (describing a *mutuum*); ASHLEY, *supra* note 69, at 419.

84. See ASHLEY, *supra* note 69, at 419.

He who lends money transfers the ownership of the money to the borrower. Hence the borrower holds the money at his own risk and is bound to pay it all back: wherefore the lender must not exact more. On the other hand he that entrusts his money to a merchant or craftsman so as to form a kind of society, does not transfer the ownership of his money to them, for it remains his, so that at his risk the merchant speculates with it, or the craftsman uses it for his craft, and consequently he may lawfully demand as something belonging to him, part of the profits derived from his money.⁸⁵

The ability of the partners to agree among themselves the particular allocation of the profits of a *societas* led to the development of variations of the form. In the sixteenth century, the triple contract (*contractus trinitas*) involved the addition of two significant features to the accepted *societas*.⁸⁶ In the first new feature, one partner agreed to exchange the percentage share of uncertain future profits of the partnership for a fixed amount of guaranteed profit payments.⁸⁷ In the second contract, one partner insured the return of the other partner's capital in exchange for a further reduction of the agreed guaranteed profit.⁸⁸ Usury theorists of the sixteenth century had to grapple with the question of whether these two additions destroyed the substantial differences between a partnership and a money loan, a form of retained ownership and the presence of business risk. Although the debates were sometimes intense and examples of prominent thinkers on either side can be found,⁸⁹ by the end of the eighteenth century a consensus emerged, recognizing the triple contract as distinct from a usurious money loan.⁹⁰ Because each element (the simple *societas*, the exchange of the unlimited share of profits for a fixed return, the insurance of this fixed return, and the initial capital by the other partner in exchange for a reduction in return) could be distinguished from a money loan, their combination seemed to be distinguishable as well.⁹¹ Partners

85. AQUINAS, *supra* note 28, at 1521.

86. See EDWIN S. HUNT & JAMES M. MURRAY, *A HISTORY OF BUSINESS IN MEDIEVAL EUROPE* 243 (1999).

87. *See id.*

88. *See id.*; ASHLEY, *supra* note 69, at 440; NOONAN, *supra* note 52, at 209.

89. *See* NOONAN, *supra* note 52, at 227-28.

90. *See id.* at 228-29.

91. *See* ASHLEY, *supra* note 69, at 440-441 (“A man could enter into partnership with B; he could insure himself with C against the loss of his capital; and he could insure himself with D against fluctuations in the rate of profit. If all this was morally justifiable, why should not A make the three contracts with the same man, B?”) (emphasis added); NORMAN JONES, *GOD AND THE MONEYLENDERS: USURY AND LAW IN EARLY MODERN ENGLAND* 11 (1989). It appears that a rate of five percent of the original capital became a common amount agreed to in lieu of a percentage of the profit. *See* HUNT & MURRAY, *supra* note 86. The theory justifying the triple contract did not depend on this particular amount necessarily. Five percent was not a fixed legislated maximum. The requirement was that the exchange of risk for a fixed return involved a sale not a loan and was thus governed by the just price doctrine not the usury doctrine (i.e. that the exchange of the

could allocate future profits from the *societas* as they chose so long as they did not create a *societas leonine* (where one partner bore all of the loss and no gain).⁹² Even though one partner agreed to assume the risk of loss of his partner's investment and guaranteed his partner a preferred payment of future profit, this partner was not left with only loss and no possibility of gain; in fact his percentage of gain has increased by the amount accepted in exchange for the fixed return. The fact that the insured partner had to pay for the risk he shifted to his partner indicates the presence of risk for the partner. The requirement that the partnership actually engaged in business and have a prospect of success was the final characteristic distinguishing the triple contract from a money loan.⁹³ Finally, even though one partner "guaranteed" a return to the other partner, the risk of ownership still existed as *socii* were liable for the acts of the *societas* and their capital could thus be lost, leaving them to look to the guaranty by the other partner, the value of which could be affected by the failure of the *societas*. The guaranty related to there being assets left to satisfy the claim.⁹⁴

Angelus Carletus de Clavasio presents a typical example of the defense of the triple contract using such arguments. A partner who "commonly for profit of the partnership . . . would have received 6 per cent or 8 per cent and sometimes more, so he agrees with his partner that his partner give him only 3 per cent or 4 per cent as profit and insure him on the capital."⁹⁵ Because a *societas* was distinguishable from a usurious loan and because insurance (the sale of the risk of an uncertain result for a fixed price) was universally accepted as an otherwise acceptable sale subject only to the just price constraint,⁹⁶ their combination was permissible. The risk inherent in speculative business ventures was sufficient evidence, as had previously been concluded, of retention of ownership of the capital invested and retention of ownership (at least joint) distinguished the

fluctuating return of a partnership interest and risk of original investment for a fixed profit must be a just exchange). Five percent was discussed by many as an amount under the existing circumstances that appeared within the range of the just price and in many areas it thus became common. See *id.* at 18, 28. For more detailed information on the just price theory, see Brian M. McCall, *Learning from Our History: Evaluating the Modern Housing Finance Market in Light of Ancient Principles of Justice*, 60 S.C. L. REV. 707, 716-21 (2009).

92. See *supra* note 78 and accompanying text.

93. See ASHLEY, *supra* note 69, at 447 (noting that merely calling a loan a partnership did not save the transaction from the usury prohibition if the purpose was for consumption and not business).

94. See ZIMMERMANN, *supra* note 76, at 467-69; JEAN PIERRE GURY, COMPENDIUM THEOLOGIE MORALIS, pars i. n. 917 (7th ed. 1858) (teaching that the condition "ut quivis socius subeat onus damnorum et expensarum, quae intuitu societatis adveniunt" was necessary for a triple contract to be accepted as a true partnership).

95. NOONAN, *supra* note 52, at 204-05 (quoting ANGELUS CORLETAS DE CLAVASIO, SUMMA ANGELICA DE CASSIBUS CONSCIENTIAE n.7 (1485)).

96. See *id.* at 203 ("Thus, without any important opposition whatsoever, the insurance of property was accepted by the theologians.").

societas from the *mutuum*, or money loan.⁹⁷ The purchase of insurance against this risk did not defeat the indices of ownership because the desire to purchase insurance indicated rather than disproved the presence of business risk.⁹⁸ Further, the entitlement to profit from a partnership arose from the use of capital in a business with a prospect of making a profit.⁹⁹

Although some who objected to the acceptance of the triple contract criticized the argument as paying excessive attention to the form of the transaction,¹⁰⁰ the debate¹⁰¹ was not a discussion of form for form's sake. Rather the defenders were attempting to discern if the change in form of the *societas* altered the substance of the transaction enough to change it from a capital investment into a money loan. Those on the prevailing side still found evidence of ownership of capital (although the risk giving rise to this was insured against) and the fructifying of productive assets that gave rise to the right to profits. Thus, the fundamental theoretical framework of the usury theory was essentially intact and merely applied to a new, more complicated factual context.

Once the three components of the triple contract are individually and then collectively accepted, the end result, which can be summarized as the contribution of capital to a business in return for a preferred fixed agreed return and a right to recovery of the capital invested guaranteed by the other investors, is accepted even if the separate components were no longer precisely documented. Defenders of the triple contract saw its components as implicit contracts within the investment of capital with a merchant in any business venture even if not explicitly stated as a partnership and insurance contracts.¹⁰²

All of the above forms involved investing capital in a business venture, short term as in the *commenda* or longer term as in the *societas*. Another form existed for specifically investing in productive assets rather than a venture.

The *census* or *rente* contract existed through the Middle Ages and survived into modern times. John Munro provides an excellent summary of this investment contract from Carolingian times:

[T]he Carolingian *census* contract [was a form] that many monasteries had long utilized in order to acquire bequests of lands, on condition that the donor receive an annual usufruct income (*redditus*) from the land, in

97. *See id.* at 205.

98. *See id.*

99. *See id.* at 205-06; BENEDICT XIV, DE SYNODO DIOECESANA, lib. x. c. 7, 2 (1755) (noting in a description of a licit triple contract, that the investing partner must have credible hope (“*probabiliter sperat*”) of making more profit than the agreed fixed return, otherwise he would not be trading anything for the guarantee of the fixed return).

100. *See JONES, supra* note 91, at 14.

101. Although those holding the triple contract not a usurious loan in substance prevailed in establishing a consensus, there were some who argued even into the eighteenth century that the triple contract in substance so altered form of a *societas* that the triple contract was in fact a loan and any profit from it usurious. *See NOONAN, supra* note 52, at 225-28.

102. *See id.* at 269-71.

kind or money, for the rest of his life and sometimes for the lives of his heirs. The income was deemed to be part of the “fruits” of the property (for example, the harvest): originally it was paid in wheat, wine, olive oil, or similar commodities, and, from the twelfth century, more commonly in money. For that reason, the *census* or *cens* came to be known as a “rent” or *rente*, from which we derive the term *rentier*. The closest equivalent in modern English is the annuity, although this term does not imply that the annual return was necessarily based on a “fruitful good,” as stipulated in all medieval discussions of both *rente* and *census* contracts, in both canon and civil law.¹⁰³

A fundamental feature distinguishing the *census* or *rente* contract from a loan at interest was that the payments were derived from a productive asset.¹⁰⁴ Outside of agricultural resources, a *rente* could be sold on an artisan’s stall or other income-producing asset.¹⁰⁵ The *census* can be thought of in modern legal terms as a partial property right (such as mineral rights in land) or the securitization of a fixed amount of annual future income from an asset or asset pool. The connection to property law of a *census* contract can be seen in the discussion of its permissibility where it is discussed as a purchase and sale.¹⁰⁶ Although many canonists, philosophers, and theologians expressed concern that this form of contract could be used as a subterfuge to disguise what was really just a consumer loan at usury (*in intentione usurias esset*),¹⁰⁷ their concern was not a rejection of a legitimate *census* on a productive asset (*res frugifera*). Putting aside the outcome of the debates of whether a redemption feature or a set number of years was sufficient to convert a lawful sale of future income into a disguised usurious loan, the participants recognized the right of an owner of productive property to sell a portion of his rights to future fruits that the property

103. John H. Munro, *The Medieval Origins of the Modern Financial Revolution: Usury, Rentes and Negotiability*, 25 INT’L HIST. REV. 505, 518 (2003) (footnotes omitted).

104. ABBOTT PAYSON USHER, *THE EARLY HISTORY OF DEPOSIT BANKING IN MEDITERRANEAN EUROPE 140* (1943) (“[S]uch rent-charges could be created only when the annual income from the property exceeded all preëxisting burdens. . . . The tenant of agricultural land might be able to create a rent-charge if the produce of his land had risen above the level of his tenurial obligations.”).

105. See ASHLEY, *supra* note 69, at 410-11. An attempt to base a *census* on the future personal income of a person was seen as illicit as not founded on a real asset, although some authors would admit a *census* founded on the labor of one’s serf. See NOONAN, *supra* note 52, at 159.

106. See, e.g., INNOCENT IV, *supra* note 63, titulus XIX, caput 5. Innocent IV analyzes the contract as a transaction *contractis venditionis*, in contracts of sale of goods. Thus, it is generally licit as long as the future income stream is sold for a just price (understood in the context of a credit sale where there is doubt as to the future value of the thing sold (*venditio sub dubio*) which Innocent IV has just discussed in the preceding part of this chapter), or the common estimation (*communi aestimatione*). Innocent IV describes the future payments as coming forth (*emisset*) from the property the subject of the sale transaction and not personally from the *census* seller. For more information on just price theory and *venditio sub dubio*, see McCall, *supra* note 42, at 576-78.

107. See ASHLEY, *supra* note 69, at 408-11; NOONAN, *supra* note 52, at 154-64.

generates.¹⁰⁸ Fundamentally, what distinguished a *census* from a *societas* on one hand and a usurious loan on the other was that the extent of the *census* return was limited to the agreed periodic *census* payment (not a percentage of profit) and was subject to the asset base actually producing a minimum return to pay the *census*.¹⁰⁹ Unlike a loan for usury, a *census* buyer bore the risk of sterility of the *census* base that constituted indices of ownership of an interest in the asset base.¹¹⁰

Thus, the natural law theory of usury provided a wide range of options for structuring an investment in businesses. The forms varied, depending on the negotiation of the parties involved, to permit a property right in future profit which was tied to a specific asset (as in a *census*) or a particular business transaction (as in a *commenda*) or to a business generally (as in a *societas*). The forms left latitude to the parties to structure the method of sharing in the success or failure of the business or asset.

First, there could be a divided unlimited return (proportioned according to the amount invested in a basic *societas*) as in modern equity instruments. Second, some partners could choose smaller but fixed annual amounts (as in the case of the *contractus trinitas* or the *census*) as in modern fixed coupon debt securities or special purpose vehicle asset securitization.¹¹¹ Further, the investors were free to guarantee to one investor the return of capital or guaranteed profit payment and this guaranty could be general or limited to the invested capital of the guarantying partner. The common substantive characteristics that transcend these legal forms are: (1) some form of property right in business assets, (2) profit having some contingency based on business risk, and (3) legitimate gain coming from productive assets or business ventures. Natural law justified earning a return from these contracts because the investor held some property right in the assets producing them. Despite the ability to reallocate gains and losses, business failure risk of some degree fundamentally distinguished these transactions from a simple loan of money, the return of which bore no relation to its productive use. Finally, gain was licit because the amount paid was merely a share of fruits or profits made possible by the investment that was sold in advance. The use of the word “debt” to describe both a consumer loan to buy clothing and the purchase of a corporate bond is impossible according to the natural law usury theory. Investment of capital in businesses and their assets in all these forms bear no similarities to loans of money to procure consumption. A business lender is to a greater or lesser extent, depending on the terms of their

108. See NOONAN, *supra* note 52, at 154-64.

109. This is most obvious in the early form of the *census* in which payment was made in the fruit itself (a portion of the crop of a field for example). Later the transactions were simplified so that the *census* seller could substitute an equivalent in money rather than delivering the fruit itself much like the cash settlement of a modern futures contract. See *id.* at 155.

110. See *id.* at 157-58; ASHLEY, *supra* note 69, at 410.

111. As noted, *supra* note 91, other theories or bodies of law (i.e., contract formation or just price theory) did regulate the process and substance of the negotiations over these amounts.

agreed relationship, a business partner with the firm.¹¹²

Thus, the modern distinctions between equity and debt securities, general partners, and shareholders are distinctions without a difference according to the natural law usury theory.¹¹³ All are merely contractual variations of one form of transaction distinct from the mere lending of money in exchange for a promise to return it. In this sense, the natural law distinction comes close to some modern finance theory, which is beginning to see corporate debt as not fundamentally different from equity, but merely another way to allocate property rights in the firm's assets, corporate governance responsibility, profits from the business, and priority of loss bearing risk.¹¹⁴ Among this literature, Armour and Whincop argue for an understanding of corporate governance and capital structure, as does the natural law theory advocated in this Article, as a process of delineating property rights and allocating future profits.¹¹⁵ The variety of forms of structuring business finance (debt and equity) represent merely "more than one way" of "partitioning . . . property rights" and "dividing quasi-rents between contractors."¹¹⁶ Although this division is accomplished by and for the benefit of investors and managers, it can, upon the giving of proper public notice, bind outsiders who deal with the firm because it involves property rights.¹¹⁷ In this context the institution of security is a means for informing outsiders of the contractual arrangement among investors in a firm with respect to their retained ownership interests.

Two characteristics of all the forms of investment of capital discussed so far distinguish them from the mere loan of money at usury. First, all involve the transformation of money into capital invested in an income producing business or asset as opposed to money being spent for consumption. Second, the investor's hoped for gain is related at some level to profit being generated by the borrower/investee. Although the details of each type of bargain vary, this right to share in business profits is the substance for which the capitalist exchanges

112. In practice business bankers acknowledge that their relationship with their corporate borrower is much more than a lending of money to be returned and more of a business partnership. See Scott, *supra* note 7, at 948 (quoting a vice president of Chase Manhattan Bank as saying "a banker should act almost in the position of a partner") (citation omitted).

113. LEONE LEVI, *MANUAL OF THE MERCANTILE LAW OF GREAT BRITAIN AND IRELAND* 118-19 (1854) (noting that partnerships and corporations are really two forms of the same thing; and that in the history of their development they were originally seen as two forms of partnership, one private and contractual and the other public and formed by the Crown or Act of Parliament and interests divisible into shares).

114. See, e.g., John Armour & Michael J. Whincop, *An Economic Analysis of Shared Property in Partnership and Close Corporations Law*, 26 J. Corp. L. 983 (2001); Ronald J. Gilson & Charles K. Whitehead, *Deconstructing Equity: Public Ownership, Agency Costs, and Complete Capital Markets*, 108 COLUM. L. REV. 231 (2008); Milton Harris & Artur Raviv, *The Theory of Capital Structure*, 46 J. FIN. 297 (1991).

115. See Armour & Whincop, *supra* note 114, at 988-91.

116. See *id.*

117. See *id.* at 992-94.

money. Although the extent differs, all of the investments involve some form of risk of failure to generate the expected profit. The *census* buyer runs the risk of the sterility of the *census* base. The entrusting partner in a *commenda* risks that the merchant will not be able to sell goods. The *societas* may not make enough profit to pay the hoped for return to a *socius*. Even in the *contractus trinitas*, the investor faces the risk that the *societas* will not generate a profit and he will have to look to the guaranty by his fellow investor, which may be contractually limited to the value of that partner's partnership interest. Business gain and risk of failure are a hallmark of all the transactions. If these two characteristics are not preserved, the transaction is a mere loan of money;¹¹⁸ therefore, any profit is a charge for the lending of money to the business entity, which the natural law treats as unjust.¹¹⁹

III. APPLICATION TO THE INSTITUTION OF SECURITY

This Part applies the theory of business investment developed out of the natural law usury theory in Part II to the institution of security. It argues that security interests are a justified means of achieving some of these capital investment arrangements. Finally, it proposes some limited changes to the current legal regime governing security interests.

For the purposes of this analysis, the term creditor as used in secured credit law¹²⁰ needs to be broken down into two different categories. A distinction must be made between capital investors in a business or assets who may have property claims and claims to a share of profits, and those who are simply owed the repayment of money. To facilitate discussion, this Article refers to the first group as "Debt Investors" and the second as "Monetary Creditors." Debt Investors include those who provide capital to businesses in exchange for a negotiated combination of contractual and property rights relating to assets of, and future profits from, the business. Typical modern forms include secured and unsecured notes, bonds, and debentures and securitization structures.

Monetary Creditors comprise those who have not sought to invest capital in a business in exchange for a bundle of claims relating to return of capital and a share in profits of the business. To express the definition in the affirmative, they are creditors entitled to the payment of a specified sum of money, as opposed to capital, by the business, unrelated to profits of that business. Examples are parties entitled to payment of a contractual obligation (other than one documenting the relationship with a Debt Investor), payments owed to the governing authority as a result of positive law, settlement of a delayed payment transaction, and claims for monetary payment as compensation for harm caused for which the law provides a remedy. Examples of categories of Monetary Creditors are employees, trade creditors, taxing authorities, and tort victims.

118. See *supra* notes 41-44 and accompanying text.

119. See *supra* note 44.

120. Secured credit law refers to both state law (specifically Article 9 of the Uniform Commercial Code) and Federal Bankruptcy Code.

Monetary Creditors, like lenders of money for consumption (in the natural law sense of the term *mutuum*), have a legal claim for the payment of a fixed monetary sum plus any compensation for loss arising from non-payment when due. They have no just claims to profit or gain on their dealing with the business, but merely claims under commutative justice to an equitable settlement of their monetary liabilities.

Although some examples of forms of transactions representing these two categories have been listed, the definitions present fact intensive questions. Thus, the fact that an employee may document his right to payment of wages by issuing a note does not necessarily transform his status from a Monetary Creditor to a Debt Investor (unless of course in substance, the employee, and business agree that the employee may invest his salary as capital in the business).¹²¹ In summary, the economic difference between the two is that Debt Investors look to share in some profit of the business whereas Monetary Creditors look to recover a fixed payment of money (plus any damages due to non-payment).

Debt Investors equate, in the natural law language, to a *socius* in a *societas*, or an entrusting partner in a *commenda*, or a purchaser of a *census*, with each entitled to certain negotiated property rights in their invested capital and rights to future profits.¹²² Once Debt Investors are distinguished from Monetary Creditors, the varying claims of Debt Investors must be separated. These must be broken down into claims to the return of invested capital and claims to a share of profits. The natural law theory justifying the nature of these different claims will shed light on the nature of the property claim on assets represented by a security interest.

A. *First Claim—Return of Invested Capital*

The first claim is for a return of the original capital invested. The most relevant aspect is the priority of this claim in relation to all other capital investors. As such, it is reached through contractual agreements with the business and other investors, directly or indirectly. The natural law theory allowed great freedom to the investor and investee in determining the priority of this claim and the relation of the claim to the capital invested. The relationship involved the retention of varying forms of property rights over the invested capital. A broad spectrum of options is discernable from the historical forms discussed in Part II. The property right in a *commenda*, as an entrustment, was

121. Interestingly English company law still preserves a distinction between these types of creditors and it refers Debt Investors as holders of "loan stock," which is treated as part of the capital of the company. There does not appear to be a legally significant difference, however, in the way the two groups are treated for priority purposes. See, e.g., Criminal Justice Act, 1993, c. 36, § 2 (Eng.) (including "loan stock" in the definition of debt securities); Financial Services and Markets Act, 2000, c. 8, § 12, sched. 2 (Eng.) (including "loan stock" in a definition of instruments creating indebtedness).

122. See *supra* notes 69-71, 76-78, 103 and accompanying text.

the strongest form of retained ownership.¹²³ The transaction involved only an entrustment of identified assets to a merchant who traded on behalf of the entrusting partner. The assets remained under the exclusive ownership of the investor while possession passed to the trading merchant. The investor could choose, however, to transfer more of a property right than an entrustment as in a *commenda*.

In a *contractus trinitas* a partner transferred ownership of capital to a partnership but received in return a claim to the return of the value of that capital guaranteed by the other partners.¹²⁴ This involved only a property right to the amount of that capital from the partner and not a right to assets of the partnership itself.¹²⁵ A weaker form of property right was involved in a simple *societas*, where the investor transforms ownership into joint ownership with the other partners and retained no individual property right to the return of the invested assets or capital. Finally, the *census* represented merely the purchase of fruits or income from assets and no property right in the assets themselves, as distinguished from their fruits, or any claim to return of the purchase price.¹²⁶

Four categories of Debt Investors can be discerned based on the analysis of the *commenda*, *contractus trinitas*, *societas*, and *census*. Modern transaction forms will next be identified for each category and the function of the granting of a perfected security interest in that transaction explained by viewing each category in light of the historical precedents presented in Part II.

First, the investor may choose to only entrust possession of assets to a business for a constrained use (e.g., an attempt to sell them) and require return of any unused asset upon completion of the agreed period. The Debt Investor may contribute his investment and may restrict the use of the assets associated with that investment through the retention of a security interest therein, as in a consignment.¹²⁷ For example, the secured Debt Investor may restrict transfer of the specified asset. If this is the case, a third party cannot obtain an interest in the property to the extent of the reserved interest by the secured Debt Investor. The details of the reservation of a property right must be determined by reading the applicable security agreement. The secured Debt Investor's filing of a financing statement serves the functions of putting third parties on notice that transfer to them may be restricted by a conflicting property right.¹²⁸ Some

123. See *supra* note 6 and accompanying text.

124. See *supra* text accompanying notes 86-94.

125. See *supra* notes 87-88 and accompanying text.

126. See *supra* text accompanying notes 103-10.

127. Article 9 defines a consignment as "a transaction, regardless of its form, in which a person delivers goods to a merchant for the purpose of sale" and which meets certain other technical requirements. U.C.C. § 9-102(a)(20) (2001).

128. One may argue that the contents of a financing statement are insufficient public notice of the nature of the reserved rights, as does Lynn LoPucki. See LoPucki, *supra* note 3, at 1963-65 (proposing to encourage disclosure of more information in public filings by creating presumptions that certain items are not in an agreement unless disclosed). LoPucki states, "It holds voluntary unsecured creditors to the terms of security agreements to which they did not in fact agree and to

commentators have objected that even public notice of a security interest is unfair to involuntary creditors such as tort victims.¹²⁹ These involuntary creditors cannot benefit from any public disclosure of reserved property rights because they do not choose to become a creditor to the debtor.¹³⁰ Yet, one must be precise about what is unfair in this situation. The fact that an investor did not transfer unrestricted ownership of his original investment to the tortfeasor is not the source of the injustice; rather, it is that a tort has been committed against the victim (or a debt otherwise created involuntarily). Allowing the investor to limit the amount of his investment by reserving a property interest and restricting voluntary or involuntary transfer is no more unjust than a tortfeasor failing to obtain a greater investment from potential investors. Taken to its logical conclusion, this line of argument suggests that it would be unjust that the tortfeasor did not have a higher paying job that would have enabled his satisfaction of the judgment.

The second category involves retention of a weaker property right with the actual transfer of the ownership of the asset to the business but with a guaranty of return of the value of the capital committed, as in a *contractus trinitas*.¹³¹ Ownership of the asset transfers from the investor to the business subject to a commitment to return the contribution under agreed circumstances. An example of this type of transaction would be a secured Debt Investor who does not restrict transferability of the asset associated with the capital investment through a security interest. In this context the security interest is the method of achieving the guarantee of returning the capital originally invested so long as it is still owned by the business. The security agreement identifies the capital invested and the rights of the secured creditor to repossess the collateral (to the extent still owned by the business) and functions as the guaranty of the returned capital.

The analysis of this category of transaction thus far has used the term "asset" or "capital" in a general sense that must be clarified before advancing further. In the instance where an asset other than money is invested the security interest, as with a consignment, identifies the specific asset contributed and guarantees its return. When a Debt Investor provides the investment of capital in the form of liquid funds, however, the security interest serves a slightly different purpose: It identifies the productive asset into which the money is to be transformed.

As a medium of exchange, money can only be evaluated in terms of that for which it is exchanged.¹³² The grant of a security interest can be re-characterized as the purchase of assets by the investor from a third party (as in a Purchase

which they do not even have access. The terms of those agreements are binding regardless of how unreasonable they may be." *Id.* at 1963. Yet, despite the potential merit in requiring more disclosure in a financing statement of the nature of the secured party rights or, alternatively, the public filing of security agreements, the issue of fair disclosure is separate from the justification for the restriction on transfer of the asset and the corresponding reserved property right.

129. See, e.g., LoPucki, *supra* note 3, at 1901.

130. See *id.* at 1898-1912.

131. See *supra* text accompanying notes 86-94.

132. See *supra* notes 45-52 and accompanying text.

Money Security Interest¹³³) or from the business itself followed by a contribution of those specific assets (or a portion thereof) to the business with a retained guaranty of their return. The claim of the Debt Investor can be re-characterized as a claim to a return of the specific asset contributed or the assets associated with the capital such investor contributed. When the amount invested is less than the value of the assets upon their repossession, the Debt Investor must return any excess above the capital claim to the business.¹³⁴ The Debt Investor and the business can agree that this contributed asset is to remain in its current form or they can agree that the business is permitted to exchange this asset for different assets.

So far, existing Article 9 law appears consistent with this re-characterization of a secured business loan as a *contractus trinitas* with its guaranty of return of capital invested and retention of ownership in the assets directly or indirectly contributed to the partnership. Yet, there is one aspect of current law that appears inconsistent, and thus, is perhaps a candidate for reform. In two ways current Article 9 allows the value of collateral to increase above the amount of the original capital invested.¹³⁵ Article 9 authorizes a business to grant a security interest in after acquired collateral without limit to amount.¹³⁶ An after-acquired property clause does not in and of itself appear inconsistent with the proposed re-characterization of the transaction thus far. It could be used to accommodate a Purchase Money Security Interest (PMSI), for example, where the Debt Investor provides the money prior to the purchase of the assets by the business.¹³⁷ Yet, the analysis thus far implies that when assets are identified through the granting of a security interest, as those into which the capital contributed is to be transformed, then the value of the assets subject to that security interest cannot exceed the value of the capital contributed.¹³⁸ Thus, we can conclude, at least provisionally, that an after-acquired property clause should be limited in its effectiveness to a total value of collateral not exceeding the original investment.

The second aspect of Article 9 that appears inconsistent with the proposed

133. See U.C.C. § 9-103 (2001) (defining a purchase money security interest).

134. See *id.* § 9-608; see also 11 U.S.C. §§ 101(12), 502 (2006). Both the Uniform Commercial Code and bankruptcy law calculates the surplus differently as the secured party is entitled to retain more than the original capital invested. Compare U.C.C. § 9-608, with 11 U.S.C. §§ 101(12), 502. The Code uses the phrase all “obligations” secured by the security interest, which can include obligations to pay interest. See U.C.C. § 9-608. The Bankruptcy Code uses the terms “claim” and “debt” to refer to whatever the contract between the debtor and creditor says is owed. See 11 U.S.C. § 101(5), (12). Claims to costs and interest are dealt with *infra* notes 145-49 and accompanying text.

135. One justification for this policy could be that the value of the claim is increasing as interest accrues. The right to use collateral to achieve priority for interest payments is discussed *infra* notes 139-44 and accompanying text.

136. See U.C.C. § 9-204 (2001).

137. *Id.* § 9-103.

138. See discussion *supra* Part II.

analysis is the treatment of proceeds.¹³⁹ A Debt Investor may agree that the assets identified as his investment may be sold or exchanged for other assets.¹⁴⁰ Yet, Article 9's definition of proceeds goes beyond a mere tracing of the original invested value through exchanges of assets.¹⁴¹ It allows the value of the collateral to grow in several ways. First, proceeds does not require, in all cases, the sale, transfer or exchange of the collateral.¹⁴² It includes payments received as a result of the collateral such as rental payments.¹⁴³ Secondly, the combination of the definition of proceeds and the rule that security interests can continue in the collateral sold or transferred, allows the value of collateral to increase by the addition of proceeds.¹⁴⁴ Article 9 does not allow the secured party to recover more than their total claim (which includes interest) against the debtor,¹⁴⁵ yet, it reserves more assets to guarantee that claim that originally contributed by the Debt Investor.¹⁴⁶ This growth would only be justified if it were justified as guarantying another claim of the Debt Investor beyond return of the original capital contributed.

The Bankruptcy Code treats after acquired property and proceeds differently, and, under at least one reading, more in accord with natural law concepts than Article 9 does. First, the Bankruptcy Code limits the effectiveness of an after acquired property clause as of the commencement of the case.¹⁴⁷ Thus, although not completely aligned to the proposed analysis of a secured creditor's claim, at least as of the time of the assertion of jurisdiction of the bankruptcy regime over the situation, it disallows the expansion of the collateral base. Second, at least one reading of the definition of proceeds contained in section 552(b) of the Bankruptcy Code¹⁴⁸ limits the value of a security interest in post-petition proceeds to the value of the pre-petition collateral converted or transformed into such proceeds,¹⁴⁹ which does not permit an expansion of the value of the

139. See U.C.C. § 9-102(a)(64) (2001) (defining "proceeds"); *id.* § 9-203(f) (extending a security interest to proceeds of collateral).

140. See *id.* § 9-315 (permitting security parties to authorize disposition of collateral); *id.* § 9-205 (validating freedom of secured party and debtor to restrict or allow use and disposition).

141. See U.C.C. § 9-102(a)(64) (2001).

142. See *id.*

143. See *id.*

144. See *id.* § 9-315(a).

145. See *id.* § 9-201 (limiting the effectiveness of a security agreement to its terms).

146. See *id.* § 9-315.

147. 11 U.S.C. § 552 (2006).

148. Section 552(b)(1) of the Bankruptcy Code provides, in part, "if the security interest created by such security agreement extends to . . . proceeds . . . then such security interest extends to such proceeds . . . to the extent provided by such security agreement and by applicable nonbankruptcy law, except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise." *Id.*

149. See *In re Northview Corp.*, 130 B.R. 543, 548 (B.A.P. 9th Cir. 1991) ("It appears that in sub-part (b) Congress intended to preserve the viability of security interests which attached to pre-petition collateral notwithstanding that the collateral might subsequently be converted into a

collateral as under Article 9. Thus, Article 9 (but at least not one of the possible interpretations of the Bankruptcy Code) would seem to go beyond the natural law limitations on capital investments in allowing the unlimited effectiveness of an after acquired property clause and attachment of a security interest to proceeds.

In the third category, the investor relinquishes a property right in the specific asset invested and agrees to a lower priority return of capital shared with other investors pro rata. This is a simple *societas* where ownership of capital became joint and pro rata (in agreed proportions) and could be transferred by any partner to a third party, subject to the liability of a transferring partner to other partners for violating a term of their partnership.¹⁵⁰ Such an agreement is in exchange for a higher percentage return than in a *contractus trinitas*. By foregoing the retention of an individual property interest in the capital, the assets representing the capital are capable of being consumed or transferred by the business in its operation. This is the added risk these investors agree to in their bargain. The implication is that these investors' claims to the return of capital are subject to claims of Monetary Creditors who are owed money by the business. Put another way, their capital is completely subject to the risk of the operation of the business. This category encompasses unsecured Debt Investors and investors in all equity securities. Here, a security interest would not be present because there is no guaranteed claim to a return of capital and no retention of ownership to facilitate that guaranty.

Finally, in the fourth category the investor retains no property right in the invested capital but merely purchases a priority right to payment of an agreed amount of revenues generated from a set of assets, as in the purchase of a *census*.¹⁵¹ An example of this category involves the securitization of future income or the sale of accounts receivables. In these types of transactions the Debt Investor's claim is to a portion of future income (from a securitized asset pool or from the collection of accounts). The grant of a security interest, or in the case of the sale of accounts receivable, mere filing of a financing statement, is used to identify the asset base out of which the income has been sold. The secured creditor's rights in this instance enable the Debt Investor to enforce its claim to the future income when it arises.

Thus, four types of investors in businesses have been identified. Each group

different form. . . . '[P]roceeds' . . . refers to secured pre-petition personal property which is converted into some other property."); see also *In re Cafeteria Operators, L.P.*, 299 B.R. 400, 410 (Bankr. N.D. Tex. 2003) (holding that lender with a blanket lien was entitled to a security interest in post-petition revenue of a restaurant as proceeds but limited such security interest in proceeds to the value of inventory subject to a pre-petition security interest which was consumed in producing such revenue). *But see* *Great-West Life & Annuity Assurance Co. v. Parke Imperial Canton, Ltd.* 177 B.R. 843, 853 (Bankr. N.D. Ohio 1994) ("The problem with *Northview's* reasoning, of course, is that there is nothing in the ordinary interpretation of 'product' or 'profits' of the debtor's secured property that limits the scope of those terms to types of property that need a 'conversion' before they come into being. Conversion is the crucial element of proceeds.").

150. See discussion of *societas*, *supra* text accompanying notes 76-80.

151. See *supra* text accompanying note 103.

has contracted for a different status with respect to the repayment of its investment. In the first case, a security interest is used to prevent any ownership from vesting in the business. This is the most protected position, and in exchange for it, the investor trades a greater share of the business's profits. The second group grants more flexibility to the business to transfer and transform the capital invested, yet agrees with lower priority investors to a right to withdraw the amount of its original investment if those assets (or their successors in transformation) are still owned by the business (i.e. have not already been consumed or used to pay Monetary Creditors). These investors would expect a higher profit sharing relationship than the more secured investors. The third group has transformed all of its property rights in its invested capital into a joint ownership of the assets of the business. Thus, it has no specific claim to any particular capital or assets. It merely agreed to receive all distributions of any capital remaining at liquidation after all obligations of the business have been paid. The final group purchased a priority right to income produced by certain assets but did not retained any right (beyond this future income) in the assets themselves.

B. Claims to Profit Payments

A Debt Investor also has a claim to the agreed portion of future income from the business. The amount of income can take various forms ranging from a percentage of net income shared pro rata with all other investors, to a priority claim to a fixed dollar amount of profits from the business, to the revenue received from the business's use of a particular asset. As the various legal forms examined in Part II demonstrate, the natural law theory allows great flexibility in allocating the amount of profit and the timing of its payment over the life of the venture (priority of payment). It even allowed the other investors to guarantee the payment of a fixed sum of profits to one investor. If the negotiations were conducted justly, the precise amount of profit to which an investor is entitled is a function of the other terms of such agreement: priority repayment of capital, guaranty, etc.

In this light, what is labeled an interest payment on a modern loan to a business is, in the natural law analysis, the agreed amount of annual profit of the business to which the Debt Investor is entitled. If the negotiations have been justly conducted, this amount is less than the Debt Investor would expect to receive in a pro rata share of profits among all investors, because he has foregone this higher amount in exchange for a lower consistent annual payment. When the Debt Investor takes a security interest in assets of the business that secures its claim to the interest (profit) payment, the Debt Investor achieves guaranty of that return by the other investors in the *contractus trinitas*. The guaranty could be general: a guaranty from the other investors payable out of their personal wealth, what contemporary practice would call a personal guaranty, or it could be limited to the guarantor's claim to the return of capital from the same business. In other words, the security interest represents a transfer of claims of the junior investors to their share of the business's capital represented by the pledged assets to the secured Debt Investor as a guaranty for the profit payment. Thus, the secured

Debt Investor has two potential sources of payment of the agreed profit: cash profits earned by the business or the capital invested by junior investors.

There are two implications from this insight. First, the value of the secured Debt Investor's claim may increase beyond his own claim to capital repayment¹⁵² to the extent that profit payments are not made and this second claim to profit may be secured by additional assets (named in the security agreement as collateral) but not initially allocable to the capital investment of the secured Debt Investor. The definition of collateral in the security agreement may encompass assets in excess of the capital invested and even future assets to the extent that these interests represent a transfer of the junior investors' claims on capital represented by these assets to the secured Debt Investor. Further, the secured Debt Investor's second secured claim must logically be limited to the aggregate of all junior investors' claims on capital represented by the secured assets. The implication of this limitation is that this claim to profit must rank behind the claims of Monetary Creditors. As the junior creditors who have agreed to guarantee the profit claims of the secured Debt Investors have not themselves retained a security interest to secure their own capital investment, their claims are to be paid only after the Monetary Creditors' claims. This result is consistent with the logic of the natural law theory of business investment.¹⁵³ The secured Debt Investors have agreed *with the other investors* to a guaranteed share of profits. They have not struck such an agreement with the Monetary Creditors. Unlike the claim to repayment of invested capital, this claim does not involve the retention of any ownership interest in a contributed asset. It is a claim to future property (profit). The limitation of this claim to the junior investors' claims on capital is the one lynchpin distinguishing this transaction from a mere loan of money, which would be subject to the usury restrictions on profit. There is still an element of business risk retained by the secured Debt Investor with respect to his profit claim. To the extent there is insufficient capital to realize on the guaranty given by junior investors, the claim to guaranteed profit will go unsatisfied.

As discussed in Part I, this business risk is the hallmark of capital investment. It can be shifted from one investor to another contractually, but it cannot simply be eliminated without transforming the investment into a mere money loan seeking payment of usury. If the secured Debt Investor's claim to profit were to outrank the Monetary Creditors, the risk would not just be shifted to the other investors it would be eliminated, becoming a simple payment risk. In a *contractus trinitas*, the risk that insufficient profits will be generated by the business was not eliminated, only insured by the other classes of capital investors. Absent a personal guaranty by the other investors, this insurance is limited to the other investors' capital invested. As unsecured Debt Investors and equity investors, such claims to capital are subject to payment of Monetary Creditors. Under the principle of *nemo dat*,¹⁵⁴ such investors cannot give a

152. See *supra* Part III.A.

153. See discussion *supra* Part III.

154. See LYNN M. LOPUCKI & ELIZABETH WARREN, SECURED CREDIT A SYSTEMS APPROACH

greater claim than they themselves possess.

An example may usefully illustrate the implications of the preceding analysis. A business that has assets worth \$300 in which the following investors have invested:

Secured Debt Investor	\$100 Bond secured on all assets of the business and an annual interest coupon of 5%
Unsecured Debt Investor	\$100 Debenture with an annual interest coupon of 7%
Equity Investor	\$100 Common Stock

The security agreement with Secured Debt Investor prohibits any transfer of collateral without the Secured Debt Investors' consent. During the first year, the business generates \$50 of accounts receivables that is securitized with Securitization Investor, who pays \$45 for the right to receive all accounts receivable actually collected.¹⁵⁵ After conducting business for one year, the business is unprofitable and files bankruptcy for a liquidation. It has Monetary Creditors with aggregate claims of \$100. No payments were made on any Debt Investor instruments because there were no profits generated. The assets, other than accounts receivable, are sold for \$300 and the business has \$20 of unpaid accounts receivable. As of the date of distribution, the business had collected \$5 on accounts receivable (not included in the \$300 figure) that had not yet been paid to Securitization Investor. The proceeds, under the theory articulated in this Article, would be distributed as follows for the reasons stated:¹⁵⁶

<u>Recipient and Amount</u>	<u>Reason</u>
Securitization Investor: \$5 plus whatever is eventually collected on the \$20 accounts receivable	The security interest in the accounts receivable represents a right to all fruits of this asset so the \$5 and whatever can be collected from the remaining.

559-60 (Aspen 5th ed. 2006).

155. For the purposes of this argument, it is not necessary to consider how the securitization is documented (a secured loan, true sale, or special purpose vehicle structure). All that is significant is that whatever legal formalities the law requires to grant a property right to the securitization investors in the proceeds of collection of the receivables constituting the pool (e.g., filing a financing statement) have been complied with.

156. In order to illustrate more clearly the principles, various transaction costs (to make the investments and achieve the liquidation of assets, for example) are treated as zero. Their introduction would alter the dollar results but not the principles of distribution.

Secured Debt Investor: \$100	The security interest reserved a property right of the Secured Debt Investor in the asset up to the amount of its capital contribution and assets subject to this property right were sold in an amount at least equal to \$100.
Monetary Creditors: \$75	The Unsecured Debt Investor and holders of common stock did not retain an individual property interest in their capital contributed and it thus became the exclusive property of the business. They are only entitled to a share of whatever capital the business has not used in its business.
Secured Debt Investor: \$5	The security interest now represents the priority claim to the distribution of remaining capital to junior investors that was allocated to guarantee the fixed profit payment of the Secured Debt Investor. This claim of the Secured Debt Investor follows the Monetary Creditors because it is a transfer of the claims of junior investors whose claim is, as discussed above, paid following Monetary Creditors.
Unsecured Debt Investors: \$100	The Unsecured Debt Investor contracted for a priority return of its capital in advance of the common stock. Its interest payment represents a fixed payment of profits in priority to the common stock. As there were no profits, its claim is worth nothing. Because it did not obtain a guaranty from the junior investors, as did the Secured Debt Investors, it is not entitled to a portion of the capital of the junior investors, holders of the common stock, to satisfy its claim to profit payments.
Common Stock Holders: \$20	This is the balance of capital returned.

The above example is similar to the result that would be reached under current law with three exceptions:

1. The Secured Debt Investor's claim representing unpaid interest is subordinated to the claims of Monetary Creditors;
2. The claim of the Unsecured Debt Investor to the return of principle is subordinated to the claims of Monetary Creditors; and
3. Claims to unpaid interest of Unsecured Debt Investors are subordinated to the claims to a return of initial capital of the Common Stock Holders.

Changes to the Article 9 and Bankruptcy Code priority schemes would need to be adopted to accomplish the above three changes and thus conform secured business investments to the required characteristics of the natural law understanding of capital investment, as opposed to a money loan.¹⁵⁷

CONCLUSION

Despite decades of debate, academic thinking has not offered a cohesive justification for secured credit even in the commercial context. The arguments of the Efficiency Scholars appear no closer to empirical or theoretical resolution than they did in 1979. The Bad Effects Scholars have raised an intuitively appealing criticism of the current system.¹⁵⁸ Some participants (such as tort creditors) appear to receive too little from the current arrangement. Yet, these scholars have not offered a full normative justification for what constitutes "too little." The Property Rights Scholars have argued that an explanation of and justification for the secured credit system exists in the values of freedom of contract and property rights.¹⁵⁹ Although acknowledging that these values are limited by other principles, they have not considered in detail the impact of these limitations.

The natural law theory of usury and commercial investment constitutes a set of values that interacts with freedom of contract and property rights in the context of secured credit. Examination of this philosophical system illuminates the function of and limitations on the use of security in a business context.

First, the distinction between the investment of capital and claims to the payment of money creates a distinction between Investors (including Debt and Equity Investors) and Monetary Creditors (even if the form of transaction used in either category is called a loan). Debt Investors are distinguishable from Monetary Creditors by the presence of an investment decision in the business and some level of profit risk. The fully secured Debt Investor negotiates for the minimal amount of profit risk, and thus a smaller claim to profit. Although the secured Debt Investor's risk is limited by the retention of a property right in the

157. See discussion *supra* Part III.

158. See discussion *supra* Part I.B.

159. See discussion *supra* Part I.C.

capital contributed, it is still subject to the risk of the loss, destruction or depreciation of value of the assets allocated to its capital as well as some risk of future profits of the enterprise. The unsecured Debt Investor has a greater risk as it has not retained this property right but has bargained for less risk than the equity holders in that its claim to return of capital has priority. The Securitization Investor has invested capital but not in the business generally. It has invested in an asset of the business, like the accounts receivable. Its risk is limited to the risk of that specific asset actually producing a return, in our example, payment of accounts. In contrast to all of these, a Monetary Creditor is merely owed a sum of money arising on account of, e.g., payment for goods or services, settlement of another type of transaction, or damages for harm caused. As a consequence, the Monetary Creditor is only entitled to its payment plus any damages caused by a delay in payment and not profit.¹⁶⁰ It is the presence or absence of risk of expected future profit—even small future profit—that distinguishes a Debt Investor from a Monetary Creditor.

Security interests thus serve as devices for achieving some of these forms of investment. A security interest can be created for any of the following purposes:

1. A method for reserving some of the property rights in contributed capital that entitles the holder to a right to remove its capital from the business before other claimants;
2. A method for junior investors to transfer their residual claims on capital represented by specific assets to senior investors in exchange for different profit allocations; or
3. A method to facilitate the purchase of future revenue produced from assets identified as subject to the security interest.

Thus, there is no single answer to the question of “Why secured credit.” A security interest is merely a method for accomplishing a variety of forms of investment in businesses that are considered distinguishable from usurious lending, and hence just under the natural law theory of usury and capital investment. As the Property Rights Scholars assert, security interest is a property right normatively justifiable on the basis of the acceptance of property and contract rights generally.¹⁶¹ Yet, this particular form of property right is created at the intersection of property law and other normative contexts, either a loan of money or an investment of capital. As instrumentalities, security interests are neither just nor unjust. Their normative justification comes from their use in these contexts. Their priority should be subject to which of the three identified functions they are serving.

Much of existing secured credit law is consistent with the natural law. Yet, some modification to the current priority system is necessary. Primarily, it would mean subordinating that portion of a secured creditor’s claim to unpaid interest (or profit in the original language of the natural law) to Monetary Creditors. Because the claim to interest rests on a claim to a more or less secure claim to

160. See discussion *supra* Part III.

161. See discussion *supra* Part I.C.

profit, there can be no claim where there is no profit. Monetary Creditors' claims are to the payment or repayment of money, and as a result, they are entitled to be paid before profit and capital guaranteeing that profit is distributed. Because the guaranty of profit represented by a security interest should be seen as a transfer of the right to capital of junior investors, this claim cannot be paid until that junior creditor is entitled to that capital. Although such a modest adjustment of priorities may not fully satisfy the intuitive objections of the Bad Effects Scholars to the treatment of certain creditors (involuntary or non-adjusting),¹⁶² this theory does at least present a coherent normative argument for some adjustment of the results under the current priority system.

Fundamentally, secured credit in the business context is just secured credit when it remains a capital investment and is treated consistently with the natural law theory of usury and capital. When a security interest and the credit it secures ceases to be a capital investment then the transaction should be subject to usury analysis and limited to mere repayment plus damage compensation. In certain ways the current system of secured credit treats capital investments inconsistently with the distinction between capital and money and leads to unjust results in certain contexts. Yet, a few changes would conform the system more closely to the principled distinctions of the natural law theory of usury and capital.

162. See discussion *supra* Part I.B.