

# **Corporate Democracy And The Frum Investor: Halakhot Of Investing In The Stock Market**

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## **I. THE NATURE OF STOCK OWNERSHIP**

The extent to which stock ownership is considered active partnership in a corporation is a critical question in numerous areas of halakha. Conceivably, by buying a single share of stock a person could find himself committing transgressions from all four sections of the Shulchan Arukh! Some examples include:

from Orach Chaim - Shabbat prohibitions such as profiting from one's business, employing Jews and working animals; possessing leaven during Passover,

from Yoreh De'ah - benefiting from a mixture of milk and meat, from avoda zara, and from orla; lending and borrowing at interest, doing business in forbidden foodstuffs;

from Even Ha-Ezer - being a partner in licentious activities;

from Choshen Mishpat - being a partner in robbery, withholding of wages, or commission of damages.

This article will not discuss all the halakhic issues relevant to the limited liability corporation, but only possible problems in the actual ownership of stock. Due to its length, the article will be presented in two installments.

### **A. WHAT IS A CORPORATION?**

In order to study the rules governing the corporation, we must have a clear idea of what a corporation is. There are three main characteristics of a modern corporation:

1. **Limited liability:** Any debts of the corporation are collectable only from the assets of the corporation itself, and not from the assets of the individual shareholders. In a normal partnership, even private assets of all partners are subject to collection by the partnership's creditors.
2. **Separation of ownership and control:** The shareholders per se do not have any control over the corporation; all they can do is appoint directors and managers who will exercise day-to-day control.
3. **Legal personality:** A corporation can sue and be sued, survives until it is dissolved without any dependence on the lives of its owners and managers, and is in every way considered to be an independent legal actor.

It is not always recognized that these properties, while related, are not technically interdependent. They are not even legally dependent, and have independent expression in the secular law. Consider the following instances: In a limited partnership, the limited partner enjoys limited liability without the firm having a legal personality; in some states, an ordinary partnership can be a legal person, but there is still unlimited liability; a trust exhibits separation of ownership and control, but is not a legal person nor is it limited in its liability.

A proper understanding of the distinctions between these properties is essential, because different properties are relevant to different areas of the law. For instance, we will see that regarding forbidden interest, day-to-day control is not a factor, whereas liability may very well be. But with respect to Shabbat, control is a critical issue, and liability may be less significant. Legal personality may not constitute a leniency in any particular prohibition, and yet may be successful in preventing "mar'it ayin" - the appearance of wrongdoing.

## **B. THE ROLE OF THE SHAREHOLDER**

There are halakhic authorities who absolve the average shareholder of any responsibility for the actions of the companies whose shares he owns. The ultimate basis of the lenient position is the perception of the investor not as an owner, but rather as a creditor. Stock purchasers lend money to the company in return for a note - the stock certificate - which promises distributions of profits which are a kind of interest payment. The assets of the company are collateral on the loan. To a large extent, this gets the investor "off the hook;" after all, there is no general prohibition of lending money to individuals who may use it for purposes which would be forbidden to the lender himself.

Of course this approach raises an obvious question: if the shareholders are not the owners - the ones who bear responsibility - then who is? Several answers are given to this question:

A few authorities take the secular-law concept of a legal person at face value: the corporation itself is the owner. The halakhic justification for this is sought in legal-person- like entities such as the "tzibbur" (community) or "hekdesb" (Temple-owned property); in the authority of the secular law in monetary matters; or in the power vested in halakhic authorities to innovate new forms of ownership just as secular legislators do. (R. Dichovsky, *Piskei Din Rabani'im* Vol. X p. 273).

Alternatively, the management of the company may be considered to be the "real" owners, who owe the shareholders a share of the profits. Or, if there is a controlling interest, then the controlling shareholders may be considered the "real" owners, leaving minority shareholders as run-of-the-mill creditors. R. Moshe Feinstein (*Igrot Moshe*, EH Vol. I, 7) inclines toward this alternative lenient view in the specific case of a small shareholder who is not interested in influencing company policy.

The major halakhic authorities have not accepted the "legal-person" view of the corporation. R. Yitzchak Weiss (*Minchat Yitzchak* Vol. III, 1) cogently points out that even the secular law does not view the corporation's legal personality as entirely independent of its owners. We can give examples of this principle: The law views the managers and directors as trustees of the

shareholders; they have a fiduciary responsibility to the shareholders as owners of the corporation. Some rights of shareholders are manifestly rights of ownership: the right to examine the books of the company; to sue the management on behalf of the shareholders; to propose resolutions to be voted on by all shareholders.

The fiduciary duty of management to act in the interest of the shareholders also weakens R. Feinstein's position that management could be considered the true owners. The same is true of controlling interests, who are likewise viewed as fiduciaries of minority shareholders. Tellingly, minority shareholders can sue management or controlling interests for acting against their best interest. And even according to R. Feinstein, there is presumably no leniency in the case where management is not firmly entrenched against a potential corporate raider who could enlist the currently-passive small shareholder on his side; this description probably characterizes most large companies traded on the stock market in today's environment.

However, R. Weiss does exempt the shareholder if he has no voting rights (e.g., preferred stock). R. Moshe Sternbuch is stringent even in this case as long as the stock represents a defined percentage of the company's assets (Mo'adim U- zemanim Vol. III, 269, note 1). However, R. Sternbuch suggests a leniency in the case of a non-Jewish company due to a technical flaw in the shareholder's kinyan (acquisition) which, though he is unwilling to rely upon fully, he is prepared to combine with other lenient considerations.

To summarize, it seems that the most common view among major authorities (R. Moshe Feinstein, R. Yitzchak Weiss, R. Moshe Sternbuch, R. Menashe Klein, R. Shlomo Zalman Auerbach) is to view the corporation as an ordinary partnership, while accepting its limited liability to its creditors - though not to injured third parties. Each authority mentions leniencies which apply to special cases, but these are not due to the special legal status of the corporation, but rather to specific aspects of the stockholding which could apply just as well to an ordinary partnership.

Of course this does not answer our question but only allows us to ask it properly. What are the halakhic responsibilities of a shareholder in the unique partnership known as a corporation? This requires us to examine the particular traits of each prohibition.

## **II. SPECIFIC PROHIBITIONS**

### **A. FORBIDDEN INTEREST**

The most often discussed issue with respect to corporations is that of "ribit" - lending or borrowing at interest from a Jew. Mutual savings plans (in which depositors are really partners in providing funds to borrowers) became popular already in the beginning of the last century; Jews were among the lending partners and also among the borrowers. The fact that the funds are in the control of non-Jewish managers is of no consequence; the Tosefta (Bava Metzia 5:8) clearly states that the prohibition of interest is dependent only on who owns the lent funds - not on who manages them. Since these funds belong jointly to all of the shareholders, both lenders and borrowers seem to be taking part in a forbidden interest transaction among Jews. This stringent position is indeed that of the Kitzur Shulchan Arukh (65:28).

However, in the case where the majority of shareholders, as well as the majority of lenders, are non-Jews, many authorities take a lenient view. A variety of reasons are given for a permissive ruling. One justification assumes that there is at most a rabbinic interdict (as opposed to a biblical one) - due to the technicalities of the loan process - and this allows us to rely on "bereira" or selection: we assume that the Jewish shareholders lend only to non-Jewish borrowers, and the Jewish borrowers borrow the funds of non-Jewish shareholders specifically (Sho'el U-meshiv I:3:31). Some authorities considered the "legal person" status of a corporation to be relevant specifically to this prohibition (Tzofnat Pa'a'ne'ach 184); others view the total control of management as tantamount to ownership of the funds (Mishneh Halakhot VI:14).

The conclusion of R. Menashe Klein (Mishneh Halakhot loc. cit.) is that even though the reasons for ruling leniently are various and even contradictory, since the consensus is to permit owning stock in a company with majority non-Jewish management and ownership which lends at interest, it is possible to rely on the permissive view.

## **B. SHABBAT**

There are numerous prohibitions which relate to running a business on Shabbat.

Two of them, working one's slave or beast, are of Torah origin and are dependent on ownership. Practically, the problem is limited to animals, since few-publicly owned corporations own slaves (though it may be that the definition of slave or servant for the purposes of Shabbat is broader than for other laws; see Rambam Shabbat 20:14). It is advisable not to hold stock of a corporation which owns animals that labor on Shabbat.

The other restrictions, relating to the ban on directing others to do one's labor on Shabbat or even having them do so without orders, are of rabbinic origin and relate primarily to direct control. According to R. Feinstein (Igrot Moshe OC Vol. IV, 54), control is in the hands of management; the management resembles a sharecropper or contractor who acts on his own initiative, and not a hired worker. Therefore, a Jew may hold even a majority interest in a corporation which does business on Shabbat, provided that the controlling management is predominantly non-Jewish. (Minchat Yitzchak Vol. III, 1 rules likewise). In the case where the Jew is the primary owner, his ownership should, for appearances' sake, not be publicly known.

If the management is primarily Jewish, severe problems arise, since it is still prohibited to have a Jew work on Shabbat even on his own initiative. Several authorities have permitted, in case of great need, a partnership with a Jew who would have worked on Shabbat regardless, if a condition is made that the business belongs to the shomer-Shabbat partner only on weekdays (Igrot Moshe OC Vol. IV, 55, Chelkat Ya'akov Vol. II, 54, Tzitz Eliezer OC Vol. II, 65); perhaps the company management, who are the representatives of the shareholders, are empowered to authorize such a condition with an individual shareholder.

If the company's business cannot be conducted without Shabbat operations, this resembles the case of having the market day on Shabbat, and it is difficult to be lenient (see Shulchan Arukh OC 307:4 and Mishna Berura 15, Sha'ar Ha-tziun 15). This presumably refers to a case where business is impracticable, and not merely unprofitable, on weekdays only.

Next week we will continue with other prohibitions that a partner needs to avoid in conclusion of this article. In the meantime, the author warmly welcomes all responses - fan mail, flame mail, or even fan-the-flame mail.

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