Capital Calls & Ribbis

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Preferred Equity: Why Don’t the Elements of Risk Take Away Potential Ribbis Issues?

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Case: Reuven and Shimon create a business partnership. One of the terms was as follows. If the business ever needs money, they will give equally. If Reuven doesn’t have money at that time, he can borrow from shimon at a high interest rate. If Reuven cannot pay it back, then shimon can take some of the shares of the company as payment.

Question: Is this Ribbis? And if yes, is there anything we can do to rectify it?

Answer: This is a very common thing, and is in many operating agreements, although many people don’t even know it is there. This is most likely a ribbis issue. Even if you write a disclaimer in the operating agreement that everything was done with a heter iska.

Heter iska allows you to make the additional money as a profit from the business. If the borrower did not make profits, since the lender is not involved in the day to day business operations, and doesn’t know if that is true or not, we can force the borrower to either make a *shvua,* or if he wants to get out of the *shvua*, he can pay this “interest” as a way out. However, since in this case shimon “the lender” knows the ins and outs of the business, as he himself is a partner, he cannot say to Reuven (borrower), make a *shvua* that you didn’t make profit, or pay, because shimon knows that the company didn’t make profit. [There would also be no reason to have to verify a loss with 2 kosher witnesses.]

It is established that part of being a partner is giving capital as it is needed. I think the solution would be if someone doesn’t respond to the capital call when he is supposed to, he will get a kenas (penalty) and it would be *ribbis derech kenas* (Interest in a way of a penalty), or he can be penalized that he needs to give up his shares. This would be a structure that would be allowed.

Ribbis derech knas is normally not permitted by a regular *halva’ah* according to many rishonim, since it is called “*haarumas ribbis*”. However, in this case where there was not an intention to lend money, rather to secure the assets of the partnership it is ok for the partners to design the partnership in a way that there will be a knas (penalty) to partners that do not contribute as required by the partnership.