

## Why Might Preferred Equity Be Considered Ribbis?

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We mentioned in the first session on this subject that various types of investments exist in today's business world that sometimes raise halachic questions related to the prohibition of *ribbis*. One of these, preferred equity, refers to where an investor is guaranteed his money back as well as receiving an additional return even before the owner receives his profit. Thus, the investor essentially has no risk to his funds when investing them in this case.

Here is one *shaila* received by the Bais HaVaad concerning preferred equity.

**Case:** Shimon's friend Reuven owns real estate. Reuven offers to give Shimon preferred equity in one of his buildings, such that Shimon is guaranteed his money back plus a 12% extra return even before Reuven receives his profit.

**Question:** Is this investment considered to violate the prohibition of *ribbis* in any form? If it does, why should that be if the investor is simply a partial owner in the building who happens to have precedence in receiving his return?

**Answer:** Before explaining the details of the halacha in this case, we must remember that the prohibition of forbidden interest (where a lender lends money and then receives his loan back plus an additional sum) involves six *lavin* (negative prohibitions) on the lender and at least two *lavin* on the borrower, and is considered very similar to *gezeila* (theft), such that the Gemara even asks why *pesukim* forbidding both are necessary. Thus, one must be especially cautious in determining which cases are classified as *ribbis* to ensure that one does not violate this serious prohibition.

In our case, it is true that the investor may merely intend to become a part-owner in the building through the money he invests. On the other hand, the fact that he receives a guarantee that his money will be returned demonstrates that it is more comparable to a loan, which must be returned exactly as it was given. This is different from a real purchaser, who when buying a portion of the building would be exposed to some risk of a financial loss.

The Maharshdam (Y.D. 61) discusses a similar case of two partners where one invests \$100 and the other invests \$50. The latter then says he wishes to receive extra security for the additional \$50, such that when the partnership is dissolved, he will receive all of that money back before they divide the rest of the money. In addition, he also requests a 12% return. The Maharshdam rules that this case is defined as *ribbis ketzutza*, fixed interest, which is *assur de'oraisa*. There is a discussion among later *Acharonim* whether this ruling is agreed upon by all, but it seems that no authorities explicitly disagree with him either (as explained by the Maharsham). The reason for that is because in the event of a loss, the first partner who invested \$100 will still receive his principal and a return, which means that the second partner (who invested \$50) loses. This would

seem to be classified as *ribbis ketzutza* and is *assur de'oraisa*.

Our case of the investment in the building is very similar to the case of the Maharsham and would also seem to be one of *ribbis ketzutza*. It is true that many may argue that according to Rav Moshe Feinstein, lending to a corporation (in this case an LLC) is not considered *ribbis*, and perhaps he would argue that this case does not violate any prohibitions of *ribbis*. Nevertheless, we generally only rely upon Rav Moshe's leniency when there are other considerations for leniency as well, since there are many questions and difficulties with his position.

Therefore, in our case, where the investor purchases a portion of the building, and receives his principal and profit regardless of whether there is a loss or not, we would be *machmir* in accordance with the *Maharshdam*.