A COMMERCIAL CONUNDRUM: DOES PRUDENCE PERMIT THE JEWISH "PERMISSIBLE VENTURE"?

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I. INTRODUCTION

Many religious systems purport to regulate the commercial, as well as the ritual, conduct of their adherents. To the extent that religious law is autonomous, parties can predict its consequences and fashion their business negotiations and investments accordingly. Where, as in the United States, religious rules coexist with a separate, secular legal system which may have fundamentally dissimilar conceptualizations of legal entities and norms, there are inherent dangers of misunderstanding and miscalculation leading to unanticipated and undesirable commercial consequences.

This article addresses one example of this phenomenon. A Jewish "permissible venture"[1] is a unique contractual arrangement devised under Jewish law[2] to circumvent the religious prohibition on the collection or payment of interest.[3] A permissible

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[1] A literal translation of the term used for the contract is "permission for a venture." The Hebrew is transliterated in many ways including *hetter iska*, *hetter isske*, *hetter iske* and *heter iskoh*. The phrase "permissible venture" is employed to refer to the agreement and to the venture itself.

[2] The term "Jewish law" is used merely for convenience to refer to the body of Jewish religious precepts known as *halakhah* which is a transliteration from Hebrew, generally translated as "law." In this article I neither describe this body of precepts nor evaluate whether it should properly be called "law," as that term is technically employed in legal literature.

[3] The ban on the payment and collection of interest in transactions between Jews is of biblical origin. *See Exodus* 22:25 ("If you lend money to any of my people with you who is poor, you shall not be to him as a creditor, and you shall not exact interest from him."); *Leviticus* 25:35-37 ("And if your brother becomes poor, and

venture substitutes an investment scheme in lieu of a loan without meaningfully altering the parties' respective rights. Within the realm of Jewish law, this device has been employed for centuries to facilitate consumer as well as commercial financing.

Under Jewish law, the implications of a permissible venture are quite different from those of a partnership under American law. Nevertheless, there is a risk that the permissible venture, especially as it is commonly composed, would be perceived through the prism of secular law as a partnership, yielding unintended adverse ramifications for one or both of the parties. This possibility exists where the permissible venture is employed, perhaps with even greater frequency in recent years,[4] by institutional and individual lenders, in major United States financial centers and throughout the world.[5]

In Part II, I will describe how the permissible venture works. In Part III, I will explain why American law might treat the permissible venture as a partnership, and I will identify the attendant negative repercussions. In Part IV, I will explore whether the Jewish and secular legal systems are sufficiently flexible to eliminate, or at least substantially reduce, the risk of such an unfortunate outcome by allowing the religious objective to be obtained without the attendant adverse commercial ramifications. I will also evaluate a variety of analytical approaches, some of which would warrant, from a technical, legal, and policy perspective, characterization of the permissive venture as a loan. In Part V, I will survey alternatives to the permissible venture which have been suggested to avoid the Jewish ban on interest.

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cannot maintain himself with you, you shall maintain him. . . . Take no interest from him or increase, but fear your God. . . . You shall not lend him your money at interest . . . ."); *Deuteronomy* 23:20-21 ("To a foreigner you may lend upon interest, but to your brother you shall not lend upon interest.").

[4] Increased awareness of the need for permissible ventures is evidenced by the recent publication of related English articles and Hebrew treatises. In addition, various religious organizations have recently taken steps to further educate Jews about permissible ventures through informative mailings and seminars. A number of lending institutions have recently adopted general permissible ventures. A discussion of general permissible ventures can be found in Part II, *infra*.

[5] Israeli financial institutions ordinarily utilize the general permissible venture described in Part II, *infra*. Additionally, both institutional and individual investors may employ permissible ventures in international transactions.

The interplay between religious and secular law regarding the charging of interest might also be studied in the context of a different religious law system, such as Moslem law, which also bans interest, or a secular law system other than that of the United States. Although each instance will present its own peculiar facts and tensions, this article may provide a useful initial analytical framework.

II. THE BAN ON INTEREST UNDER JEWISH LAW AND THE USE OF THE PERMISSIBLE VENTURE

A. Scope of the Jewish Law Ban on Interest

The prohibition on the payment and collection of interest in transactions between Jews applies equally to all loans, whether for consumer or commercial purposes.[6] Similarly, the prohibition applies not only to third party loans, but also to purchase money mortgage financing provided by sellers of businesses or properties. Moreover, it does not matter if the parties are related or strangers.[7] The interdiction may apply even if the entities involved are not individuals. Although there are differing views on transactions involving partnerships or corporations, the predominant position is that if a majority of the partnership is owned by or the corporate stock is held by Jews, the proscription applies.[8]

B. The Individualized Permissible Venture

Although there is no single form of a permissible venture,[9]

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[6] *See supra* note 4. A religiously observant Jew would be required to avoid this prohibition even if the other party is a non-observant Jew. I use the term "religiously observant" to refer to those Jews who seek to be characterized as comporting themselves within the parameters prescribed in traditional Jewish legal-religious texts, such as the SHULKHAN ARUKH.

[7] ARBA'AH TURIM, *Yoreh De'ah* 160; SHULKHAN ARUKH, *Yoreh De'ah* 160.

[8] There are many differing opinions. At one extreme there are views that the ban on interest applies only to a lender who is an individual. *See* Y. RISHA, SHEVUS YAAKOV 166 (citing but not agreeing with S. BEE'ER, BEE'ER OSHOK). At the other extreme is the view that the charging of interest is impermissible even where a single partner or shareholder is Jewish, because the loan is treated as having been made on a pro rata basis by each of the partners or shareholders. *See* Y. BLAU, BRIS YEHUDA 508 (1979).

The predominant opinion, however, states that the prohibition only applies if the majority of the business is owned by Jews. One explanation is that the partnership or corporation is an entity possessing a discrete identity and this identity is either Jewish or non-Jewish based on who owns a majority of the ownership interests. *See* M. SILBERBERG, V'CHAI AKHIKAH I'MAHK, 33 (1986). Another explanation for the majority rule involves the application of Jewish law principles known as *brera* or *battel b'rov* which permit the transaction to be treated under Jewish law as if the loans were made by the non-Jewish partners or shareholders to the Jewish borrower. *Id. See also* Z. SHAPIRO, DARKAY TSHUVAH, 150 (1976); Y. NATHANSON, SHO'EL U'MAYSHIV I, § 3.31 (1973).

A parallel debate exists in secular law to determine whether a partnership or corporation is an entity separate and apart from the identity of its owners. *See* Crane, *The Uniform Partnership Act and Legal Persons* 29 HARV. L. REV. 838 (1916); Jensen, *Is a Partnership Under the Uniform Partnership Act an Aggregate or an Entity?*, 16 VAND. L. REV. 377 (1963); Note, *The Partnership as a Legal Entity*, 41 COLUM. L. REV. 698 (1941).

[9] *See generally* J. BLEICH, CONTEMPORARY HALAKHIC PROBLEMS II (1983) (a discussion of the historical development of various types of permissible ventures).

the most common permissible venture contemplates that the party seeking funding (Recipient) will receive fifty percent of the money as a non-interest bearing loan. The remaining fifty percent is invested by the party furnishing the funds (Financier). The Recipient obligates himself to use all of the monies in conjunction with a business venture[10] and to share the profits and losses with the Financier on a specified basis.[11] The permissible venture may provide that, irrespective of the business' actual losses, the Financier's potential loss is limited to the amount of his investment.[12] The Financier pays some nominal sum, usually one dollar, to the Recipient in consideration for the Recipient's agreement to dedicate himself to the commercial venture.

The permissible venture ordinarily contains a clause requiring the Recipient to repay the amount loaned to him (i.e., fifty percent of the total funds advanced) on or before a specific date. The obligation to repay the loan is unconditional.

In order to assure the Financier of a virtually risk-free fixed percentage return on all the money advanced, additional provisions are commonly included in the permissible venture. First, the permissible venture establishes a presumption[13] that the business is sufficiently profitable to provide the required return placing the burden on the Recipient to prove otherwise. To meet the burden, the Recipient must take a solemn oath in accordance with Jewish law.[14] Another provision recites that the

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The earliest permissible venture agreement of which there is a written record dated back to the sixteenth century. *Id.* at 376. Professor Bleich reviewed the rabbinic debate as to the efficacy of a permissible venture in avoiding the religious ban against interest, a debate which has now largely been resolved in the affirmative. *Id.* The focus of the instant article does not address when a permissible venture should be utilized but, rather, the possible secular ramifications when it is used.

10 As discussed later in section IV, *infra*, the notion of a business venture may be extraordinarily elastic.

11 There is flexibility regarding the proportional sharing of profits and losses. Many permissible venture agreements, however, injudiciously call for profits and losses to be shared equally, even if the parties have disproportionate investments in the venture.

12 The Financier's investment equals one-half of the total money advanced to the Recipient. As discussed in Part II, *infra*, this clause might permit the filing of a limited partnership agreement, even after the fact, which would shield the Financier from the claims of third parties. Even if the clause proves ineffective as to third parties, it should be enforceable between the Financier and the Recipient so as to permit the Financier to receive indemnification from the Recipient. Nevertheless, a review of various permissible venture documents revealed that none contained restrictions on liability.

13 Individual permissible ventures may employ different terminology but the effect is to create a presumption.

14 Many Jewish law authorities contend that, if the Financier personally believes

Financier agrees to relieve the Recipient from the obligation to take an oath and to give up his share of the profits in exchange for periodic payments equal to the amount of interest the Financier would have received if he had loaned all of the monies to a non-Jewish borrower. Thus, in light of religiously observant Jews' strong aversion to oath-taking, the Recipient ordinarily would make the periodic, interest-like payments.[15]

Even if the Recipient is willing to take an oath, he can only establish that the business earned no profit. The duty to repay the sum invested applies unless it is properly established that the venture sustained losses. To prove that there were net losses, which relieve the Recipient of the obligation to repay, the Recipient must adduce the testimony of two reliable and trustworthy witnesses, determined according to Jewish law. Because Jewish law requirements regarding witnesses are quite exacting, this standard is exceedingly difficult to satisfy.[16] Moreover, the per-

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that there were no profits, he cannot force the Recipient to take an oath, even though the permissible venture agreement is silent on this point. *See, e.g.*, M. FEINSTEIN, IGGEROT MOSHE, *Yoreh De'ah*, II, 62-63; S. TABAK, TESHUROT SHAI, I, 3; PANIM ME'IROT, II, 3. *But see* S. GREENFELD, TESHUVOT MANARSHAG, *Yoreh De'ah*, 4. The position that a Recipient cannot be forced to take an oath is based on Jewish law precepts regarding the taking of an oath which are independent of the particular clauses of the permissible venture agreement. Accordingly, the Recipient would be discharged from his obligation of making the fixed payment scheduled in the permissible venture document without having to take an oath. In commercial transactions, however, the likelihood that the Financier would have direct knowledge as to the operation's profitability is rare. Moreover, where, as in most instances, the permissible venture agreement does not prescribe the nature of the venture and the Recipient is engaged in various business activities, including, for example, stock market investments, it would be virtually impossible for the Financier to know whether there were profits or losses and the oath may be required according to all authorities. *See* M. STERNBUCH, MO'ADIM U-ZEMANIM, VI, 41.

15 *See* BLEICH, *supra* note 9, at 378. Because this aversion may have become attenuated in recent years, some rabbinic authorities have suggested alternative conditions including allowing the Financier to examine the Recipient's financial records and to participate in all decisions regarding expenditure of the sums advanced until and unless the fixed amounts are paid. *Id.* at 381. To the degree that the Financier possesses the power to control the operations of the business, there is a greater likelihood that the permissible venture will be characterized as a partnership. Indeed, even where there is no initial intent to establish a partnership, courts have increasingly found lenders liable as principals when they exercised control in their borrowers' businesses. *See* Flick & Replansky, *Liability of Banks to Their Borrowers: Pitfalls and Protections*, 103 BANKING L.J. 220 (1987); Lundgren, *Liability of a Creditor in a Control Relationship with its Debtor*, 67 MARQ. L. REV. 523 (1984); Sanchez, *Symposium: Lender Liability*, 15 W. ST. L. REV. 577 (1988).

16 *See, e.g.*, I. ENGLARD, RELIGIOUS LAW IN THE ISRAEL LEGAL SYSTEM 185 (1975) ("Jewish law relating to testimony is noted for its many restrictions with respect to the competence of witnesses. Among others, close relatives, wives, interested parties, persons guilty of religious transgression are disqualified.").

missible venture agreement may demand that any such testimony come from particular persons, even though it is highly improbable that the named individuals will be in a position to offer testimony.[17]

A permissible venture agreement may also establish an irrebuttable presumption that the money invested by the Financier was utilized in those business activities of the Recipient which were in fact the most profitable during the term of the agreement.

The permissible venture may also be limited as to scope. The Recipient may have an ongoing business in which he invested a great deal of money. The permissible venture may be used for the purpose of raising additional funds for specific equipment or projects in connection with that business. Therefore, the permissible venture may not be intended to create an investment in the Recipient's entire business, but only in the particular area for which the funds were advanced by the Financier.[18]

C. The General Permissible Venture

A number of institutional lenders have adopted a "general permissible venture" document, either as a substitute for or supplement to an individualized document for each particular deal.[19] This document is executed only by representatives of the lender and declares that all of the lender's transactions shall be permissible ventures under Jewish law. It further states that its terms govern even if the other party or parties to such transactions are

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[17] *See* I. ISSERLIN, TERUMAT HA-DESHEN, 302 (the Financier may require that only the testimony of the community's rabbi and cantor will be acceptable, despite the fact that their testimony, as a practical matter, is essentially impossible to secure).

[18] A Recipient may arrange separate permissible ventures with different lenders for discrete investments in connection with a single ongoing business. The Recipient will have a direct relationship with each of the Financiers, but the Financiers will not bear any direct relationship with each other.

A Recipient might also enter into two permissible ventures and pool the funds for a single investment, such as the purchase of one piece of equipment for use in his business. If a permissible venture is viewed as a partnership, the Recipient would be a partner with the first Financier and also with the second Financier. The two partnerships, by putting their assets together for one investment, may be partners as well. If the permissible venture does not create a partnership, the scenario would presumably be identical to the one in the preceding paragraph where the Recipient is directly related to each of the Financiers, but the Financiers are independent of each other.

[19] In this way, even if the lender fails to prepare a personalized permissible venture in a given case, it will have complied with Jewish law according to some authorities.

unaware of Jewish law. Although the general permissible venture is a unilateral contract, its enforceability from a Jewish law standpoint is based on the assumption that persons dealing with a lending institution will accept its standard terms, even if they are not familiar with its details.[20]

The general permissible venture is of little independent significance to the themes in this article. To the extent the borrower or depositor is aware of and agrees to the general permissible venture terms, the implications are the same as if an individualized permissible venture agreement had been executed. By contrast, if the borrower or depositor is unaware of the general permissible venture or if its terms contradict the specific documentation for the transaction in question, the general permissible venture should be null and void.[21]

D. Differences Between the Jewish Shutfus *and the Secular Partnership*

The permissible venture is recognized by Jewish law as a form of *shutfus*. The term *shutfus* is often translated into English as partnership. Yet the Jewish law regarding a *shutfus* differs significantly from secular partnership law. Under Jewish law, for instance, a person can invest in and share the profits of a *shutfus* without being personally liable for any loss. Moreover, one member of a *shutfus* is not necessarily authorized to bind another personally. Nor is one member of a *shutfus* vicariously liable for the acts of another.

The parties entering into a permissible venture agreement customarily intend that their agreement contain the restrictions customary in a *shutfus*. Although the terms, as I will explain in Part IV, might prevent the permissible venture from being characterized by a secular court as a partnership, they in no way interfere with the parties' religious objectives. Jewish law does not care how secular law labels the permissive venture relationship. It is sufficient that the terms of the permissible venture agreement are enforceable.[22]

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20 Y. BLAU, *supra* note 8, at 631.

21 Even if the specific documentation contains boilerplate language purporting to incorporate the lender's general "official terms and conditions," the language should not incorporate contradictory terms.

22 Some Jewish law authorities may believe that for religious purposes it is irrelevant whether a secular court would enforce the terms of the agreement. The better, and apparently predominant view, however, is that secular enforceability of the agreement's provisions is essential, particularly where institutional lenders are in-

III. TREATMENT OF THE PERMISSIBLE VENTURE AS A SECULAR PARTNERSHIP

A. The Risk of Treatment as a Partnership

1. Partnership Features

A number of the features of a permissible venture may lead to its characterization as a partnership rather than as a loan. For example, in a permissible venture the Financier invests in the Recipient's business and the Financier shares in the profits of the business. Further, the Financier, at least to the extent of his investment, shares in the losses of the business and there is no unconditional obligation on the Recipient to repay the investment. Additionally, in a permissible venture, the Financier may possess certain implicit or explicit powers of control over the business.

Several legal commentators have described the permissible venture as a partnership without any qualification which would suggest that it was a partnership only under Jewish law.[23] Rather, the implication is that a permissible venture constitutes a partnership under secular law as well. One professor has concluded, apparently approvingly, that "the . . . [permissible venture] has . . . been recognized by the civil courts as an instrument creating a bona fide partnership. . . ."[24]

2. Circumstances Enhancing the Risk

Several factors increase the practical risk that a permissible venture will be treated as a secular partnership. First, permissible venture agreements are often improperly drafted. Not only do the agreements needlessly omit terms which would evidence the parties' intent not to create a partnership, but the agreements frequently contain affirmatively misleading language.

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volved. *See* M. SILBERBERG, *supra* note 8, at 631. Secular enforceability is also important where one of the parties is likely to submit disputes to a secular court.

An issue arises under Jewish law as to how it should be determined whether a permissible venture agreement is enforceable under secular law. A Jewish law tribunal could choose to interpret applicable secular law itself, relying in part on testimony from secular scholars, attorneys, judges or other authorities. *See* M. FEINSTEIN, IGGEROT MOSHE, *Khoshen Mishpat* II, 62. Alternatively, the parties may seek an actual secular determination of this issue, for example, through an action for declaratory judgment. An interesting question is whether, for Jewish law purposes, the Jewish law tribunal's interpretation of secular law could overrule a ruling of a secular trial or appellate court.

[23] J. BLEICH, *supra* note 9, at 381; M. ELON, THE PRINCIPLES OF JEWISH LAW cols. 187, 504 (1975); G. HOROWITZ, THE SPIRIT OF JEWISH LAW 562 (1953). The latter source sometimes refer to it as a limited partnership. G. HOROWITZ at 562.

[24] J. BLEICH, *supra* note 9, at 381.

One of the crucial issues that a court considers in determining whether a partnership was formed is the intent of the parties. Where the parties agree to provisions uncharacteristic of a partnership, a court will be more inclined to find that the parties did not intend to create a partnership. Thus, for example, by including in the permissible venture agreement the *shutfus* restrictions referred to in Part II, D, a draftsman could improve the probability that the venture will be treated as a loan.

Unfortunately, the permissible venture agreement is ordinarily prepared by rabbinic scholars whose knowledge of applicable commercial law concepts or rules, and, sometimes even of English, is limited. Attorneys are in most cases excluded from document preparation because the parties believe that the agreement is, at least as a practical matter, of religious significance only, and they advise their attorneys accordingly. In fact, the parties may not even inform their attorneys that a permissible venture agreement will be executed.

Drafting problems often result in the permissible venture agreement. For example, the agreement may neglect to limit the extent of the Financier's liability in the event that the venture sustains net losses. Although under Jewish law a Financier need not be personally liable for such losses, a typical permissible venture form contains the following provision:

> I (we) the undersigned do hereby state that I (we) have received from _____ the sum of _____ to be returned _____ which shall be used in the form of a joint business venture. All of the profit that I (we) may earn as a result of the said _____ which is to be used in the business venture shall be divided equally, i.e. 50% shall inure to the benefit of myself (ourselves) with the other 50% going to the [Financier]. *The same shall apply to any losses in the above business venture.*

The final clause seems to render the Financier personally liable for fifty percent of all partnership losses rather than limiting his liability to the extent of his investment. Yet, this departure from the *shutfus* approach is usually inadvertent.[25]

Another example is the use of terms such as partnership or, as in the excerpt above, joint business venture, to characterize the Financier-Recipient relationship. Such phraseology is innocently in-

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[25] For instance, the rabbi who authored the provision excerpted above told me that he had intended that the Financier's exposure would be limited to the amount of his investment and that he had, in fact, explained the agreement to those who used his forms as if there were such a restriction.

tended as an approximate translation for the word *shutfus*, but its inclusion is not intended as a secular law term of art. Yet, the use of such terms could be construed as incorporating into the agreement all of the legal baggage attendant to a secular partnership. Triers of fact are likely to be unfamiliar with the intricacies or nuances of Jewish law and may be predisposed to rely on the rules of secular partnership law unless the agreement undeniably evidences a contrary intention.

3. The "Wild-card" of Judicial Review

The vagaries of judicial review are clear from the only two reported United States cases,[26] which arguably reached opposite conclusions. The decisions make unreliable precedents and underscore the risks inherent in case by case adjudication. Consequently, parties must fear that their permissible venture will be construed as a partnership, even if agreements in arguably similar situations have been treated as loans.

In a 1968 decision, *Leibovicki v. Rawicki*,[27] the Recipient refused to repay the Financier the agreed rate of interest, claiming that the interest was usurious.[28] The Financier gave the Recipient $5,000 "for the purpose of investing the same in the Real Estate field, Apartment Houses, Office Buildings, Mortgages, Real Estate Improvements, etc."[29] The written agreement between the parties provided that the Recipient guaranteed return of the Financier's principal[30] and that the Financier would receive profits, if any, up to a maximum of ten percent per annum of the monies advanced.[31] The contract recited that it would be subject to a permissible venture agreement, but there was no explanation of the terms of the agreement other than to state that it forbade

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26 Leibovicki v. Rawicki, 57 Misc. 2d 141, 290 N.Y.S.2d 997 (N.Y. Civ. Ct. 1968); Bollag v. Dresdner, 130 Misc. 2d 221, 495 N.Y.S.2d 560 (N.Y. Civ. Ct. 1985). One would expect to find a number of Israeli cases dealing with permissible venture agreements. Nonetheless, I know of only one published opinion, *Bank HaMizrachi HaMiyuchad v. Zvi Tessler* (Beis Mishpat Ha-Mekhuzi, Tel Aviv, Sept. 28, 1987). Although that case treated the permissible venture agreement as an enforceable contract, none of the partnership implications were raised.

27 57 Misc. 2d 141, 290 N.Y.S.2d 997 (N.Y. Civ. Ct. 1968).

28 *Id.* at 142-43, 290 N.Y.S.2d at 999-1000.

29 *Id.* at 142, 290 N.Y.S.2d at 998-99.

30 It should be noted that a formal, explicit guarantee by the Recipient to return all of the Financier's capital violates Jewish law. In this case, it is unclear whether, under Jewish law, the reference subordinating the undertaking to the unspecified terms of a permissible venture agreement would save the transaction.

31 *Leibovicki*, 57 Misc. 2d at 143-44, 290 N.Y.S.2d at 999-1000.

the receipt or payment of interest.[32] Moreover, no executed permissible venture document was ever submitted to the court.[33]

At the time of the transaction the charging of ten percent annual interest on a loan would, under applicable New York law, have been usurious.[34] The court stated that an "[i]ntent to overcharge is an essential and necessary element of usury."[35] Although the permissible venture agreement was not part of the record, the court found that references to the permissible venture in the parties' agreement and in a subsequent letter were "helpful in arriving at the intention of the parties."[36] In concluding that the transaction was not usurious, the court held "that an investment . . . in the nature of a joint venture is not converted into a loan of money, and therefore usurious, by the fact that one party guarantees the other against loss . . . and that his profits shall amount to a certain sum."[37] Thus, the court, at least arguably, treated the relationship between the parties as a joint venture.[38]

Although a version of a permissible venture agreement which had been proposed by one of the parties was presented to the court, the court noted that the document had not been signed by the other party and treated it as non-binding. The court neither identified, nor addressed the significance of the terms typical of permissible ventures such as the presumption of profits, the elevated substantive and procedural burden of proof

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[32] *Id.* at 144-45, 290 N.Y.S.2d at 1001. The agreement provided that "[t]his agreement is drawn according to, and with the full understanding of the *hetter isske*, which forbids the acceptance or the payment of interest." *Id.* at 142, 290 N.Y.S.2d at 999. The agreement also characterized the venture as a profit sharing arrangement. *Id.*

[33] *Id.* at 144, 290 N.Y.S.2d at 1001. There was testimony, however, that subsequent to the advancement of funds, the Recipient wrote to the Financier mentioning that no permissible venture document had been executed and enclosing one for his signature. *Id.* No proof was offered to establish that the agreement was signed. *Id.*

[34] *Id.* at 144, 290 N.Y.S.2d at 1001-02.

[35] *Id.*, 290 N.Y.S.2d at 1001 (citations omitted).

[36] *Id.*

[37] *Id.* at 145, 290 N.Y.S.2d at 1001 (citing Orvis v. Curtiss, 157 N.Y. 657, 661-62, 52 N.E. 690, 691-92 (1899)).

[38] J. BLEICH, *supra* note 9, at 381, relies on this case for the conclusion that civil courts have recognized permissible ventures as bona fide partnerships. In fact, *Leibovicki* may not support that conclusion. At one point in its opinion, the court simply stated that it was not usury for a *lender* to receive a share of profits in lieu of interest. *Leibovicki*, 57 Misc. 2d at 144-45, 290 N.Y.S.2d at 1001 (emphasis added) (citations omitted). Consequently, the court's ruling arguably did not depend upon whether the permissible venture in question was a partnership or a loan.

required to rebut this presumption and to prove losses, and the Recipient's requirement to repay all monies advanced by the Financier on a specified date, net of any pro rata losses. Yet these are precisely the terms which manifest the parties' intention that the permissible venture be the functional equivalent of a loan. Consequently, the *Leibovicki* result appears to be a poor basis for predictions regarding future cases.

Recently in *Bollag v. Dresdner*,[39] the court considered a case where the Financier gave the Recipient $15,000 to be used for business purposes.[40] Soon thereafter, the parties signed a permissible venture agreement which stipulated the amount, the terms and the conditions of the arrangement.[41] The agreement stated that the Recipient received $15,000 for a business investment from which the Recipient would share his profit with the Financier.[42] The court concluded that substance, not form, controlled the characterization of the venture, noting that "[a] transaction must be considered in its totality and judged by its real character, rather than by the name, color, or form which the parties assign to it."[43]

In reaching its conclusion, the *Bollag* court weighed various complicating factors.[44] For example, the Financier testified at trial that, despite the express terms of the permissible venture to the contrary, he did not agree to share in the Recipient's losses.[45] He also maintained that the Recipient was unconditionally obligated to repay the principal amount.[46] In addition, a rabbi who was called as an expert witness on Jewish law testified for the Fin-

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39 130 Misc. 2d 221, 495 N.Y.S.2d 560 (N.Y. Civ. Ct. 1985).

40 *Id.* at 222, 495 N.Y.S.2d at 561. The Recipient claimed that he borrowed the funds on behalf of a third party, his employer, Elco Elevator Co., with the Financier's knowledge and consent. *Id.* The Financier denied any knowledge that the money was being borrowed for a particular company, but knew that the Recipient was in the elevator business and admitted knowing that the Recipient would build elevators with the money. *Id.* at 225, 495 N.Y.S.2d at 563.

41 *Id.* at 222, 495 N.Y.S.2d at 561. The permissible venture stated that the loan was to be for six months with the Financier receiving a profit of 24% per month. *Id.* At the time of the transaction, the maximum lawful annual interest rate was 10.5%. *Id.* at 224, 495 N.Y.S.2d at 562 (citations omitted). When the Financier sought to have the agreement enforced the Recipient attempted to have the transaction voided as usurious. *Id.* at 221, 495 N.Y.S.2d at 561.

42 *Id.* at 223, 495 N.Y.S.2d at 562. The permissible venture agreement which was signed by the parties was written in Hebrew and translated for the court by an official court interpreter. *Id.* at 221, 495 N.Y.S.2d at 561.

43 *Id.* at 224, 495 N.Y.S.2d at 562-63.

44 *Id.* at 223, 495 N.Y.S.2d at 562.

45 *Id.*

46 *Id.*

ancier that the permissible venture did not create a partnership.[47] The court concluded, based on an analysis of the substantive terms of the permissible venture "as interpreted by the parties and their witnesses," that the transaction was a loan, not an investment.[48] The court may have ruled differently had the testimony supported the explicit content of the permissible venture agreement.

It is apparent that parties cannot reasonably proceed on the assumption that, irrespective of the precise terms contained within the applicable documentation and the substance of any discussions between the parties, a court will treat a permissible venture as a loan.

B. Pitfalls from Treatment as a Partnership

A permissible venture's treatment as a partnership, rather than a loan, has a number of adverse ramifications for the Financier and the Recipient.[49]

1. Joint and Several Liability

Partners are jointly and severally liable for partnership obligations.[50] This liability attaches even to persons not known by the creditor to have been a partner[51] and to silent partners who exercise no control over the partnership business.[52] If secular

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[47] *Id.* At trial, "Rabbi Singer testified emphatically . . . that the agreement did not create a joint venture or partnership." *Id.* The court did not elaborate on the specific statements made by Rabbi Singer. It may well be that Rabbi Singer meant no more than that, as a matter of substance, the permissible venture agreement was not intended to create what he believed was a secular partnership. From the court's opinion it is not clear whether the expert agreed with the Financier's contention that the Recipient was unconditionally responsible for the return of the principal.

[48] *Id.* at 224, 495 N.Y.S.2d at 563.

[49] Some technical aspects of the permissible venture may cause additional problems not separately discussed in the text. Because Jewish law does not recognize a partnership as a discrete entity, fractional title to partnership property is vested in each of the partners according to their respective interest. Many permissible ventures expressly provide for this vesting of title. At the end of the term specified in the permissible venture, the Recipient returns the Financier's investment (minus a pro rata share of any losses) and acquires title to all of the venture's property. Consummation of this purchase might require recorded documentation and might trigger transfer taxes, depending on applicable state law.

[50] Meehan v. Valentine, 145 U.S. 611 (1892); Lyon v. Barrett, 89 N.J. 294, 445 A.2d 453 (1982); Houston General Ins. Co. v. Maples, 375 So.2d 1012 (Miss. 1979).

[51] *See* Schwaegler Co. v. Marchesotti, 88 Cal. App. 2d 738, 199 P.2d 331 (3d Dist. Ct. App. 1948).

[52] Dinkelspeel v. Lewis, 50 Wyo. 380, 62 P.2d 294 (1936), *reh'g denied*, 50 Wyo. 408, 65 P.2d 246 (1937); *Schwaegler*, 88 Cal. App. 2d at 335, 199 P.2d at 334-35.

law finds that the permissible venture is a partnership, the Financier will be held jointly and severally liable for the liabilities of the business conducted by the Recipient.[53]

In addition, the Financier could not necessarily protect himself from joint and several liability as a partner by simply adding to the permissible venture a clause stating that his liability would be limited to the amount of the Financier's investment.[54] It seems well-established in secular law that "if such an intent exists [to do those things which constitute a partnership] the parties will be [considered] partners notwithstanding that they proposed to avoid the liability attaching to partners, or have even expressly stipulated in their agreement that they were not to become partners."[55]

The Financier could not avoid potential classification as a partner by obtaining an indemnification and hold harmless

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Conversely, both the Uniform Limited Partnership Act and the Revised Uniform Limited Partnership Act contain provisions which shield a person from liability as a general partner when he erroneously believed that he became a limited partner in a limited partnership. UNIFORM LIMITED PARTNERSHIP ACT § 11, 6 U.L.A. 594 (1969); REVISED UNIFORM LIMITED PARTNERSHIP ACT § 304(a), 6 U.L.A. 297 (1989).

53 Consequently, if the Recipient's business fails and the Recipient files a petition for bankruptcy the Financier may be held personally liable to the Recipient's creditors. Another problem arising in the bankruptcy setting involves claims which the Financier might have against the Recipient. The Financier would have an unsecured creditor's claim to recover the money loaned to the Recipient. In addition, the funds invested by the Financier would have an equity interest, subordinate to the claims of all creditors of equivalent rank.

Moreover, if the Recipient's trucks cause an accident and inflict injury, the Financier may be held liable. If the Recipient's products are defective and cause damage, the Financier may have to pay. If the Recipient invests in real estate which turns out to be a toxic waste dump-site, the Financier may be obligated to expend millions of dollars in clean-up costs. If the Recipient's facilities expose employees to dangerous substances, like asbestos, the Financier may face an insurmountable liability thirty years later. Because there is no end to the examples of the Financier's exposure, this problem is clearly the most serious which might result from a finding that a permissible venture created a partnership.

54 The existence of a clause which attempts to limit the Financier's liability, however, may convince a court that a permissible venture arrangement did not create a partnership.

55 Vohland v. Sweet, 433 N.E.2d 860, 864 (Ind. App. 1982) (citing Bacon v. Christian, 184 Ind. 517, 111 N.E. 628 (1916)). *See also* Murphy v. Stevens, 645 P.2d 82 (Wyo. 1982) (partnership conduct is determinative); Randall Co. v. Briggs, 189 Minn. 175, 248 N.W. 752 (1933) (court examines specific partnership conduct); Wyatt v. Brown, 39 Tenn. App. 28, 281 S.W.2d 64 (Tenn. Ct. App. 1955) (intent to do partnership acts establishes partnership); Claude v. Claude, 191 Or. 308, 228 P.2d 776, *reh'g denied*, 191 Or. 308, 230 P.2d 211 (1951) (partnership intent determined in light of total contract). There is an exception to liability arising out of partnership contracts where the third party claimant had prior knowledge of the restrictions agreed to by the partners. 59A AM. JUR. 2D *Partnership* § 640 (1987).

agreement from the Recipient for liability for any losses in excess of the Financier's original investment in the partnership.[56] The Recipient simply may not have enough money to pay the entire liability and no such agreement could bar third party claimants from directly pursuing the Financier.[57]

2. Federal Tax Consequences

A finding that a permissible venture has created a partnership may lead to unexpectedly large tax liabilities, denials of tax deductions and tax reporting violations.

In 1984, an imputed interest provision was incorporated into the federal tax code.[58] Subject to exceptions not here pertinent, this law applies to loans which are nominally interest-free treating the loans as if interest had been charged and collected by the lender. The lender is therefore considered to have received taxable interest income. In the permissible venture agreement, half of the funds advanced by the Financier are designated as an interest-free loan. If the imputed interest provision of the Internal Revenue Code applies, the Financier may be treated as having received imputed payments of taxable interest on that loan.

The periodic payments provided in the permissible venture agreement are characterized as a return on the Financier's investment. Therefore, any excess over the amount invested may be taxable either as investment profits or as payments in lieu of profits. If a court treated the entire permissible venture as a disguised loan, the Financier's taxable income would probably be limited to the excess of the investment imputing no additional interest.[59]

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[56] For Jewish law purposes, the amount of the original investment must be at risk. In the example used in Part II, *supra*, the amount at risk would equal one-half of the total investment.

[57] *See, e.g.*, Meehan v. Valentine, 145 U.S. 611, 619 (1892) (a partner cannot insulate himself from creditors' claims through an agreement with his other partners); Mosely v. Commercial State Bank, 457 So.2d 967 (Ala. 1984) (newly admitted partner liable for debt existing prior to admission); Demas v. Convention Motor Inns, 268 S.C. 186, 232 S.E.2d 724 (1977) (debt incurred in pursuit of partnership is joint debt).

[58] I.R.C. § 7872 (West Supp. 1988).

[59] It is possible that a court could distinguish the interest-free loan portion of the permissible venture from the investment element. As to the former, a court could apply section 7872 and find imputed interest. As to the latter, the court might find that in substance, if not form, it constituted an interest-bearing loan and the Recipient's payments could be treated as taxable interest income. If a court adopted this approach, the Financier could still be taxed on more money than he received. This result, however, is logically unappealing. If a court were to apply a

If a permissible venture were treated for tax purposes as a valid partnership, the monies paid by the Recipient to the Financier would represent profits or a payment in lieu of profits, not interest. Thus, if a Recipient obtains money from a bank pursuant to a permissible venture agreement, the money paid by the Recipient might not be deductible as payment of interest.[60] Because the ability to deduct interest payments is a critical factor in financial planning, the impact of this possible pitfall would be significant.

Moreover, lending institutions are customarily required to record and report to federal and state taxing authorities the amount of interest paid to their customers. A holding that permissible ventures constitute partnerships may imply that some institutions have improperly reported partnership profits as interest.

3. Proscribed Activities

If permissible ventures are deemed partnerships, lending institutions which participate in them may also be found to have violated various laws or contractual obligations. For example, many banks and savings and loan associations are prohibited under state law,[61] federal law,[62] and/or agreements with the Fed-

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substance rather than form analysis, it should do so to the entire permissible venture transaction and reach the conclusion that the money received from the Recipient represented interest on all of the monies advanced by the Financier.

60 If the payments are made pursuant to the presumptions in the permissible venture agreement, the payments might be perceived as a further investment by the Recipient to purchase the Financier's share of profits.

61 State lending institutions are ordinarily the creatures of statutes and they are often deemed to be excluded from any activities not authorized by such statutes. *See* State Bank of Blue Island v. Benzing, 383 Ill. 40, 48 N.E.2d 333 (1943); Nassau Bank v. Jones, 95 N.Y. 115 (1884); 9 CAL. JUR. III *Banks* § 37 (1974). These restrictions would forbid institutional lenders from participating as a partner in particular types of businesses.

In other states, lenders may be precluded from entering into any type of partnership arrangement. Marine Bank of Chicago v. Ogden, 29 Ill. 248 (1862); Home State Bank v. Vandolals, 188 Ill. App. 123 (1914); Interstate Trust & Banking Co. v. Reynolds, 127 La. 193, 53 So. 520 (1910).

Where lenders are precluded from entering into a partnership arrangement, joint ventures are distinguished from partnerships. Although it is difficult to delineate between the two types of entities, a joint venture is often found to exist when two or more parties join for an extremely limited purpose. States generally allow a lender to participate in joint ventures. Annotation, *Corporation's Power to Enter Into Partnership or Joint Venture*, 60 A.L.R.2d 917 (1958).

62 National banking associations, for example, are restricted to the purposes for which they may acquire, hold or lease real property. 12 U.S.C. § 29 (1989). National banks are also generally prohibited from participating in partnerships.

eral Deposit Insurance Corporation[63] from entering into partnerships or engaging in the types of businesses which are commonly pursued by the Recipients.

4. Deposit Insurance

Another potential pitfall arises when a lending institution is the Recipient and the Financier opens a savings account with a bank. It is unclear whether the entire amount deposited will be entitled to Federal Deposit Insurance or Federal Savings and Loan Deposit Insurance. When a depositor makes an ordinary deposit, he loans the entire amount to the depositee.[64] Under a permissible venture, half of the money deposited is an investment by the depositor and not a loan. It is possible that the aforesaid insurance policies would not protect depositor investments.

5. Securities Laws

Various federal and state securities laws and regulations require reporting and disclosure regarding an entity's financial status. A Financier to whom these requirements apply will be obligated to determine how to characterize the monies advanced to the Recipient. In addition, the Financier must decide whether to disclose its potential liability as a partner or to refer to any of the other possible problems discussed in the preceding sub-sections of this Part III.

IV. Analytical Models for Treating the Permissible Venture as a Loan

A. Possibility of an Allowable Religious Accommodation

An initial question is whether the religious motivation for the permissible venture warrants special treatment. In other words, should secular law offer a permissible accommodation[65]

Merchants' Nat. Bank v. Wehrmann, 202 U.S. 295 (1906); First Nat. Bank v. Stokes, 134 Ark. 368, 203 S.W. 1026 (1918).

63 FDIC, Manual of Examination Policies, § U (1979).

64 *See* Bank of Marin v. England, 385 U.S. 99, 101 (1966) ("relationship of bank and depositor is that of debtor and creditor, founded upon contract").

65 This concept is distinguishable from the principles of mandatory accommodation which state that when government has infringed a free exercise right, government must accommodate the right unless it is outweighed by a compelling and narrowly tailored state interest. *See* Lynch v. Donnelly, 465 U.S. 668, *reh'g denied*, 466 U.S. 994 (1984).

to Jewish religious interests and treat the permissible venture as a loan rather than as a partnership?

The permissible venture developed within Jewish law as a substitute for express loans. Historically, Jewish communities were relatively insular, separated from their Gentile neighbors. They were governed by rabbinic courts which applied Jewish law. Jewish law permitted a person to form a partnership while restricting his liability for the acts undertaken by his partnership. Similarly, Jewish law did not recognize the doctrine of vicarious liability. Nor were there regulations restricting the business operations of individual or group money-lenders or special tax treatment for interest income or expenses. In short, the pitfalls of partnership status described above do not exist within the Jewish law system.

Potential problems arise in transferring this religious law mechanism from its original historical and legal context into the current secular legal framework. The risks which inure from characterization as a partnership would tend to discourage or heavily burden the use of permissible ventures. A judicial or legislative response, reducing the probability of partnership characterization, would encourage investment and accommodate Jewish religious concerns. The courts have long recognized that government may take certain acts to accommodate religious interests.[66] The parameters of an allowable accommodation are broader than the scope of noninterference mandated by the free exercise clause.[67] Nonetheless, because the adoption of accommodating measures is peculiarly a matter of public policy, it is the proper subject, in the first instance,[68] for the legislature, not the

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66 For discussions regarding the accommodation of religious rights & Adams & Gordon, *The Doctrine of Accommodation in the Jurisprudence of the Religion Clauses*, 37 DE PAUL L. REV. 317, 319 (1988); Choper, *The Religion Clauses of the First Amendment: Reconciling the Conflict*, 41 U. PITT. L. REV. 673 (1980); Giannella, *Religious Liberty, Nonestablishment, and Doctrinal Development: Part I The Religious Liberty Guarantee*, 80 HARV. L. REV. 1381 (1967); Kurland, *Of Church and State and the Supreme Court*, 29 U. CHI. L. REV. 1 (1961); McConnell, *Accommodation of Religion*, 1985 SUP. CT. REV. 1; Oaks, *Separation, Accommodation and the Future of Church and State*, 35 DEPAUL L. REV. 1 (1985); Schwarz, *No Imposition of Religion: The Establishment Clause Value*, 77 YALE L. J. 692 (1968); Note, *Permissible Accommodations of Religion: Reconsidering the New York Get Statute*, 96 YALE L.J. 1147 (1987).

67 Corporation of the Presiding Bishop v. Amos, 483 U.S. 327, 334-35 (1987); Waltz v. Tax Comm'n of New York, 397 U.S. 664, 673 (1970).

68 The judiciary may be called upon to evaluate whether a specific accommodation made by a particular branch of government is constitutional or whether an additional accommodation, in a particular case, is mandated. Nevertheless, it seems inappropriate for the judiciary to fashion a substantive law accommodation.

judiciary. Assuming for the moment that there were no legal grounds for characterizing the permissible venture as a loan, there would be no authority for the judiciary to label it so.

Indeed, even the legislature may not transform a permissible venture which is really a partnership into a loan merely by declaring it to be one. Nonetheless, appropriately drafted legislation could protect Financiers from particular pitfalls. State law problems might dissipate, for example, if the legislature would (1) recognize the permissible venture as establishing a limited partnership,[69] (2) authorize lenders to participate in permissible venture limited partnerships, (3) provide that such limited partnerships are valid immediately upon the execution of a permissible venture agreement, either without a recording requirement or contingent upon subsequent recordation, and (4) specify the tax treatment applicable to the various aspects of permissible venture transactions. Of course, these measures could be challenged for going beyond the pale of allowable accommodation and representing an unconstitutional fostering of religion.[70] The permissible venture, however, is neither a religious document, nor a religious ritual. Moreover, any legislation would arguably have the secular purpose of affording Jewish borrowers the same type[71] of access to financing as non-Jews enjoy. These measures might also be structured to permit similar relief to transactions between non-Jews which were established in a permissible venture format.

Even if the regulations pass constitutional muster, legislative efforts by a single authority may be frustrated by permissible ventures which involve the laws, rules or regulations of various au-

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Of course, courts do sometimes accommodate religious litigants or counsel with respect to procedural matters such as scheduling.

69 To avoid having decisions depend upon judicial construction of the terms of particular permissible venture agreements, the legislature might adopt a *per se* rule treating all documents as a loan which are labelled "permissible venture" or which declare themselves to be a permissible venture according to the particular statute. Alternatively, the legislature could recognize a particular form of permissible venture agreement as constituting a secular loan. For Jewish law purposes, however, the legislature must also enforce the particular provisions of the agreement regarding the Recipient's ability to rebut the presumptions of profitability.

70 If, for instance, banks were otherwise precluded from participating in partnerships, a law enabling them to enter into permissible venture limited partnerships might be challenged as promoting religion.

71 Opponents would presumably contend that the same type of financing is presently available from non-Jews. Alternatively, opponents might argue that permissible venture agreements, because of the possibility of participation in profits and losses, would not in fact be the same type of financing.

thorities. Therefore, it is important to decide whether, without new rules or laws, a permissible venture establishes a secular partnership.

B. Permissible Ventures Lack Essential Partnership Criteria

The permissible venture was designed as a legal fiction. Although it resembles a partnership, it is in effect a disguised loan. The sticking point is that there is a possibility, albeit attenuated and remote, that the venture's form will have substantive significance whereby the Financier will actually participate in the profits and losses of the permissible venture business, rather than to merely receive scheduled payments. Ultimately, I contend, that for reasons set forth below this possibility is *de minimis* and should not affect the conclusion that the permissible venture is essentially a loan, not a partnership. Case law generally supports the proposition that whether parties are partners depends on the substance of their relationship rather than on the label they give to it.[72] The elements that truly mark a partnership are not formally or substantially present in permissive ventures. Consequently, courts reviewing a permissible venture should conclude that it is a loan, not a partnership.

1. Partnership Criteria

Five features are commonly regarded as highly probative of the existence of a partnership:

(1) The parties must intend to create a partnership. It is, however, unnecessary for the parties to have understood that the legal impact of their contract was to establish a partnership.[73] Nor is it essential that they foresaw all of the legal consequences attendant on the formation of a partnership. It is enough that the parties intended to agree to the terms of their contract and

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[72] *See supra* note 55 and accompanying text. Pennsylvania may be the exception that proves the rule. The Pennsylvania Supreme Court has accorded weight to a declaration by contracting parties that their arrangement was not a partnership. Kingsley Clothing Mfg. Co. v. Jacobs, 344 Pa. 551, 555, 26 A.2d 315, 317 (1942). A subsequent Pennsylvania Superior Court additionally enforced the declaration against a third-party creditor even where the contracting parties were sharing both profits and losses from the business activity. Rosenberger v. Herbst, 210 Pa. Super. 127, 130-32, 232 A.2d 634, 636-37 (Super. Ct. 1967). Interestingly, in commenting on these two cases, the United States Court of Appeals for the Second Circuit not only remarked that it would be inequitable for the parties' declaration to affect the rights of third parties, but also concluded that there had been no such effect. *In re* PCH Assoc., 804 F.2d 193, 198 (2d Cir. 1986).

[73] *See supra* note 55 and accompanying text.

that, as a matter of law, those terms were sufficient to establish a partnership.[74]

(2) To establish a partnership, the parties must engage in a profit-seeking commercial enterprise.

(3) Each of the parties must own a proprietary interest in the partnership business itself.

(4) The partners must share in the profits of the business. This component is a necessary condition, albeit not sufficient to constitute a partnership. The sharing must be based on the parties' co-ownership of the partnership business.[75] Thus, although the Uniform Partnership Act (UPA) provides that the sharing of profits is generally *prima facie* evidence of a partnership, an exception exists if the profits are received "[a]s interest on a loan, though the amount of payment var[ies] with the profits of the business."[76]

(5) Another requisite element of a partnership is that the parties must be at risk in the event that the partnership sustains losses.[77]

2. Formal or Substantive Lack of Criteria

The substance of a permissible venture, not merely its formal elements, must be explored to determine if it constitutes a partnership. A few introductory remarks regarding the substance versus form approach are in order.

i. *General Approach*

Courts frequently search beneath the superficial forms of legal entities or transactions to ascertain the form's true, or substantive nature. In some instances, this approach may be legislatively prescribed.[78] In the alternative, courts have justified this

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[74] *See, e.g.*, Randall Co. v. Briggs, 189 Minn. 175, 248 N.W. 752 (1933) (an agreement among partners may establish the partnership); Claude v. Claude, 191 Or. 308, 228 P.2d 776, 783, *reh'g denied*, 191 Or. 308, 20 P.2d 211 (1951) (although an agreement was designated as a property settlement agreement by the parties, it was deemed a partnership agreement by the court).

[75] Oshatz v. Goltz, 55 Or. App. 173, 637 P.2d 628, 629 (Or. Ct. App. 1981) ("A mere community of interest, such as the right to share in profits . . . does not make one a partner; the right to share in profits must result from part ownership of the business.").

[76] UNIFORM PARTNERSHIP ACT § 7(4)(d), 6 U.L.A. 38 (1969).

[77] Fenwick v. Unemployment Compensation Comm'n, 133 N.J.L. 295, 44 A.2d 172, 174 (E. & A. 1945).

[78] *See, e.g., In re* Opelika Mfg. Corp., 67 B.R. 169, 171 (Bankr. N.D. Ill. 1986) (citations omitted) (Georgia Commercial Code required case by case determination

approach on equitable or policy grounds.[79]

The inquiry into the substance of a transaction is often phrased as an effort to discern the parties' true intent. There is a probing evaluation of the parties subjective understanding of the transaction. If the formal partnership is only a smokescreen and the parties intended an altogether different relationship, such as a debtor-creditor relationship, the partnership form may be disregarded.[80]

Even if a permissible venture stated that the Financier and the Recipient will pursue a partnership or joint venture, this language should not be dispositive as to the parties' intent. As mentioned above, these terms may only reflect a rabbi's inelegant efforts to translate into English the Hebrew term *shutfus*.

Furthermore, certain permissible ventures, such as those used for consumer financing, are surely not partnerships. Because a permissible venture agreement accommodates at least some non-partnership arrangements, it cannot be said that execution of a permissible venture, universally reflects an intention to create a secular partnership.[81]

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of whether a lease was intended as security); *In re* PCH Assoc., 804 F.2d 193 (2d Cir. 1986) (legislative history indicates that Section 365(d)(3) of the Bankruptcy Code was intended to apply only to true leases).

79 For example, although mortgages frequently proport to convey to creditors legal title, courts have historically treated them as establishing mere liens.

80 *See, e.g., In re* Washington Communications Group, Inc., 18 B.R. 437 (Bankr. D.C. 1982) (use of a partnership agreement to establish a tax shelter will not create a partnership if the prerequisites of a partnership are not present); Skaar v. Wisconsin Dept. of Rev., 61 Wis. 2d 93, 211 N.W.2d 642 (1973) (examining elements of a partnership), *cert. denied*, 416 U.S. 906 (1974); Fenwick v. Unemployment Compensation Comm'n, 133 N.J.L. 295, 44 A.2d 172 (E. & A. 1945) (profit-sharing agreement not conclusive of partnership); Preston v. State Indus. Accident Comm'n, 174 Or. 553, 149 P.2d 957 (1944) (the parties' conduct toward a business venture determines whether they established a partnership or a partnership contract); Chaiken v. Employment Security Comm'n, 274 A.2d 707 (Del. Super. Ct. 1971) (intent to distribute profits is an indispensable requirement of partnership). *See also supra* note 55 (where a partnership relationship exists the court will disregard agreements to the contrary).

81 In attempting to fathom the true intent of the parties, courts will consider factors including the parties' subjective goals, the parties expectations, the negotiations between the parties, the parties' statements concerning their relationship, the parties' conduct and the economic effect of the transaction. *See, e.g., In re* Washington Communications Group, Inc., 18 B.R. 437 (Bankr. D.C. 1982) (creditor does not become partner by receiving percentage of profits); *In re* Opelika Mfg. Corp., 67 B.R. 169 (Bankr. N.D. Ill. 1986) (disguised security agreement between debtor and creditor renders bankruptcy code inapplicable); *In re* Nite Lite Inns, 13 B.R. 900 (Bankr. S.D. Cal. 1981) (implicitly held that the same criteria may be applied in determining if a sale-leaseback is bona fide irrespective of whether the context of the inquiry is state usury law or federal tax law).

ii. *Consumer Financing Ventures Lack Partnership Criteria*

Many Jewish law authorities allow the use of permissible venture agreements even where the Recipient is not engaged in a commercial activity but seeks only the equivalent of a consumer loan.[82] There are several reasons, in addition to those set forth below regarding commercial ventures, why these arrangements fail to constitute secular partnerships. Consumer financing ventures do not involve the carrying-on of a business for profit, the parties are not co-owners of a partnership business and they do not truly share in the profits and losses of such a business.

A majority of Jewish law authorities allow the use of a permissible venture for a consumer purpose provided that the Recipient is also involved in some business enterprise.[83] The permissible venture financing theoretically permits the Recipient to continue his business activity without liquidating the capital previously dedicated to it. Secular law does not seem to contain any mechanism by which to classify the arrangement and thereby find that the permissible venture established a partnership business.

iii. *Commercial Ventures Lack Partnership Criteria*

Commercial permissible ventures involve, at most, a conditional sharing of profits and losses. Even when used to directly fund a business activity, permissible venture agreements may not

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[82] One proposed justification is that in order to avoid paying the profit presumed by the permissible venture document, the Recipient must in any event take an oath. By making the scheduled payments to avoid taking the oath, he is not regarded as paying interest. *See* S. SCHWADRON, TESHUVOT MAHARSHAM, II, 216. The carrying-on of a partnership business, however, would not be for profit.

[83] It is argued that the Recipient's employment was a profit-making activity and the advancement of funds which permitted the activity to continue constituted a business venture. Another explanation was advanced where, but for the loan, the Recipient would have been forced to abandon his employment and seek a higher paying position. *See* J. NATHANSON, TESHUVOT SHO'EL U-MESHIV, I, 3-160. It is difficult to believe that a secular court would characterize the continued employment of the Recipient by a third party as the carrying-on of a partnership business. Indeed, many, perhaps most, Jewish law authorities do not view an arrangement as a business venture. *See, e.g.*, M. FEINSTEIN, IGGEROT MOSHE, *Yoreh De'ah*, II, 62; M. ARAK, TESHUVOT IMREI YOSHER, I, 108; A. HALEVI, GINAT VERADIM, *Yoreh De'ah, klal* 6, 4; S. ZALMAN, SHULKHAN ARUKH HA-RAV, *Hilkhot Ribbit*, § 42; S. GANZFRIED, KITSUR SHULKHAN ARUKH, 66:10.

If such an arrangement would be treated by secular law as a partnership, new problems might arise where the money was provided to a professional, like an associate in a law firm, by someone who is not licensed to practice in that profession. Often there are rules which forbid a licensed professional from entering into a partnership with a non-licensed individual.

in substance require the sharing of profits and losses. Given the presumptions set forth in the agreement, the permissible venture requires, in effect, the Recipient to make the scheduled payments unrelated to the actual profits and losses of the business. This obligation remains in effect until and unless the Recipient satisfies certain conditions regarding the proof of profits.[84] Thus, even if the Financier's mere participation in profits proves the existence of a partnership, the permissible venture agreement represents no more than an agreement permitting the Recipient the right to establish such a partnership in the future.

For example, consider a case in which A advances money to B for use in a business operated by B. A and B agree that if A rolls snake-eyes twelve times in a row, A and B will share equally in the profits from the business. If A's dice do not cooperate, however, A will simply get a twelve percent annual return on the investment. Because A will not participate in the profits until and unless the dice roll a certain way, it appears that there is no partnership until and unless the dice so fall. In the meantime, the arrangement could be characterized as a partnership subject to a condition precedent.[85] Provided that the Recipient does not actually prove profits or losses, no partnership would ever be established.[86] The same principle applies to a permissible venture. Until and unless the Recipient proves actual profits or losses by the evidentiary standards of the permissible venture agreement, the Financier will merely receive a fixed return on the investment and no partnership will be formed.

Neither of the two apparent objections to this analysis is persuasive. Contrary to the condition precedent argument, one might contend that the permissible venture agreement created a partnership subject to a condition subsequent. Yet, this characterization seems artificial and inapt. Given the presumptions of the permissible venture agreement, there is no initial sharing of profits and losses. Only the Recipient's affirmative act could create this sharing. The more natural view is that there is no part-

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84 *See supra* note 14 and accompanying text (the Recipient must prove the amount of profits, or the absence of profits, through a solemn oath).

85 *Cf.* Moore v. Walton, 17 F. Cas. 708 (N.D. Miss. 1874) (No. 9,779) (where agreement merely conferred upon a lender the option to receive a share of the borrower's net profits in lieu of interest, only an executory contract for a partnership was formed).

86 Of course, according to this particular part of my analysis, taken independently, if a Recipient proved profits and losses, a partnership relationship could exist.

nership until and unless such an affirmative act is performed. Moreover, whereas the condition precedent argument refers to the Recipient's act as the operative condition, the condition subsequent alternative awkwardly refers to a passive development, the Recipient's failure to act, as the condition. In any event, this objection is of limited significance. It is highly likely that the Recipient will fail to provide the requisite proof of the venture's profits. Consequently, the Financier would never share in the profits and losses and at no time would a partnership exist.

Another objection might be that the bringing of proof is not a condition at all but, rather, an inherent and integral element of any legal relationship. Here, the contention might continue, the parties simply agreed that only a particular level of proof would be acceptable. This is an easy argument to state, but there seems to be no authority which has declared that the need to satisfy a consensual requirement, even one pertaining to the level of proof, cannot also be deemed a condition, particularly where the standards of proof are so significantly in excess of those generally applicable under secular law.

As a matter of substance, the permissible venture does not involve the sharing of profits and losses. In many contexts it is practically, and in some cases perhaps even theoretically,[87] impossible to establish profits and losses. In no case is there more than a remote probability that a Recipient will agree to take the requisite oath or be able to adduce the necessary witnesses.

Where the Recipient is engaged in many business activities, he must be prepared to offer competent testimony on the profitability of each.[88] Moreover, permissible ventures may be of very brief duration in situations where, for example, the Recipient has the need for short-range, immediate financing, or financing on a particular piece of equipment. These limitations may make it exceedingly difficult, if not impossible, to determine the amount of profits or losses directly attributable to the permissible venture.[89]

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87 A theoretical impossibility of calculation, however, could pose a problem from a Jewish law perspective because Jewish law requires that there be a possibility that the permissible venture would have an enforceable substantive effect unlike that of a loan.

88 In a permissible venture, if the investment was made in the activity which was in fact most profitable, the investment activity will not be identified until after the venture terminates. At that time, it will be too late to arrange for witnesses.

89 Factors including increased good will, for instance, are not easily ascertainable, particularly where the temporal scope of the inquiry may be severely circumscribed.

Permissible ventures for the purchase of particular pieces of equipment also

Permissible ventures involving short-term financing during the start-up period of a business where a negative cash-flow is anticipated, would involve equally complex questions regarding the determination of profits.

Several commentators have stated that the relevant restrictions render the loss-sharing provisions of the permissible venture nugatory.[90] What remains is the Financier's right to receive and the Recipient's virtually unconditional obligation to pay the amount set forth in the permissible venture agreement.

Even if the permissible venture involved the sharing of losses, the type of loss-sharing would not be typical to a partnership.[91] Ordinarily, partners agree to unlimited exposure for partnership losses. By contrast, a Financier in a permissible venture agrees to risk only the amount of his investment,[92] and he accepts no personal liability.[93]

Nevertheless, case law suggests that the limited liability of a Financier will not preclude him from partner status. A party providing funds to a business and sharing in its profits will be treated as a partner if the obligation to repay the funds advanced depends upon the success or failure of the business.[94] Once the repayment obligation is conditioned on obtaining profits, any

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pose conceptual problems in defining the permissible venture business. One might argue that the venture is to rent the purchased property to the Recipient for use in his preexisting business. Alternatively, one could contend that it is an enterprise to participate, as a partner, in the Recipient's preexisting business. The fact that the permissible venture agreement does not specify the nature of the business may make it impossible to determine profits and losses. It is not clear that a rabbinic or secular court would supply the missing material term.

90 M. ELON, *supra* note 23, at 504; G. HOROWITZ, *supra* note 23.

91 *See* Feder, *"Either a Partner or a Lender Be": Emerging Tax Issues in Real Estate Finance*, 36 TAX LAWYER 191, 204 (1983).

92 This is the case if the permissible venture agreement is properly prepared. *See supra* note 13 and accompanying text (restrictions on liability are seldom included in the permissible venture agreement).

93 Of course, if a court finds that the other features of a permissible venture are sufficient to constitute a partnership, the court could rule that, as a matter of law, the Financier was unlimitedly liable as a partner. Nonetheless, the fact that the parties expressly restrict the Financier's liability is relevant to the parties' intent.

94 *See, e.g.*, Buford v. Lewis, 87 Ark. 412, 112 S.W. 963 (1908) (sharing of business profits is an element in establishing a partnership relationship when assessing third party rights); Dubos v. Jones, 34 Fla. 539, 16 So. 392 (1894) (a lender who shares in the profits of the debtor's business in exchange of interest will be liable to third parties if the third party is misled into believing that a partnership existed); Southern Fertilizer Co. v. Reams, 105 N.C. 283, 11 S.E. 467 (1890) (the fact that a partner is paid interest by the partnership in consideration of capital contribution will not change the parties relationship to that of debtor/creditor); Dinkelspeel v. Lewis, 50 Wyo. 380, 62 P.2d 294 (1936), *reh'g denied*, 50 Wyo. 408, 65 P.2d 246

agreement between the parties to limit the liability of the Financier is ineffective as to third parties as a matter of law.[95]

Additionally, most permissible ventures do not involve any meaningful co-ownership of the venture's business. The Financier generally possesses no control over the business. The lack of control, although permitted by the UPA, has been considered evidence of the absence of a partnership.[96] In some instances, the Financier may be entirely unaware of the use to which his money is put. Some permissible venture agreements provide that the investment is deemed to have been made in the commercial activity of the Recipient which was most profitable during the term of the venture. Thus, the use first becomes identifiable after the venture terminates and when it is possible to ascertain the profitability of the Recipient's various activities. Surely it strains logic to state that, during the term of such a permissible venture, the Financier meaningfully co-owned the venture's unidentifiable business.

Nor is the Financier automatically entitled to participate in the profitable operations of the business. During the venture, the Recipient can avoid the Financier's participation by merely making the scheduled payments set forth in the permissible venture agreement. When the venture terminates, the Recipient is entitled to buy out the Financier's purported ownership interest for an amount equal to the Financier's original investment, less the Financier's pro rata share of any loss. The Recipient can repurchase the Financier's interest even if the fair market value of

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(1937) (a creditor who is compensated through business profits in a manner which establishes a community of profits will be treated as a partner).

The language of these decisions generally suggested that there might be special circumstances which could result in a finding that there was no partnership. *See supra* text at III, B (identifying special circumstances).

There is no valid policy justification for these precedents even where, in substance as well as form, the obligation to repay is conditional. The rule of these cases surely should not be extended and applied to a permissible venture, which is clearly a partial loan, that the Recipient is unconditionally obligated to repay. Viewing the two parts of the venture arrangement together, a court should conclude that a permissible venture is distinguishable from a partnership which attempts to limit liability.

95 *But see* Kingsley Clothing Mfg. Co. v. Jacobs, 344 Pa. 551, 26 A.2d 315 (1942) discussed *supra* note 72.

96 *See, e.g.*, Chocknok v. State Commercial Fisheries Entry Comm'n, 696 P.2d 669 (Alaska 1985) (extent of spouse's participation in family business is an element in considering the existence of a co-ownership relationship); Commonwealth v. Southeastern Iron Corp., 142 Va. 107, 128 S.E. 528 (Va. Ct. App. 1925) (lack of community interest in and over business and property may prevent existence of partnership).

the Financier's ownership interest is far greater than the Financier's original investment. Upon paying the Financier, the Recipient may retain all of the hard assets of the venture and may continue the business for his own benefit. In effect, the Recipient merely repays the principal loaned by the Financier.[97]

The entire circumstantial framework of a permissible venture tends to establish that the parties sought and established the equivalent of a secular loan arrangement. The fixed schedule of payments set forth in the permissible venture embodies a definite rate of return on the aggregate funds that the Financier advanced. Therefore, the Financier cannot be motivated by the possibility of earning a higher return on the investment because the Recipient, by refusing to take an oath or bring witnesses, can force the Financier to accept the fixed payments. Moreover, the Recipient cannot be motivated by the hope that the Financier will receive less than the fixed payout. The likelihood of successfully proving profits and losses would not even warrant the expense of the necessary preparatory steps, such as maintaining adequate bookkeeping[98] and ensuring the presence of qualified Jewish witnesses.

The negotiations between the parties typically reflect their expectation of a fixed rate of return. The parties often do not focus on the details or the profitability of the Recipient's business, but on the Recipient's ability to make the fixed schedule of payments set forth in the permissible venture. Because the nature of the venture business, assuming that the transaction actually involves a business, is not customarily specified, the parties do not reach a firm understanding of the way in which the Recipient might actually prove the venture's profits or losses. Indeed, the parties may not even discuss the use of a permissible venture until all of the economic parameters are agreed. These negotiations often refer to the interest rate which will be charged, causing one of the parties to mention that, for religious purposes, a permissible venture agreement will be utilized. Moreover, Financiers often provide money for the start-up period of a business, in which there is an expectation of cash-flow losses. The parties,

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97 In conjunction with other restrictions placed on the Financier's rights during the term of the agreement, the buy-out option ensures that the Financier does not share in the venture's growth potential, further evidencing an intent not to form a partnership.

98 Where, for example, the permissible venture is for a limited purpose within the framework of an ongoing business, separate records would have to be kept on the permissible venture business.

therefore, anticipate receiving the fixed payments. In addition, there may be no meaningful relationship between the actual profit expected from the permissible venture business and the rate of return contemplated in the payment schedule.[99] For example, where a Financier provided $100, $50 of which was a no-interest loan and $50 of which was an investment, the permissible venture might contain a payment schedule representing a 20% annual return, or $10, on the $50 invested. The permissible venture may declare that a profit of 20% or greater is expected but, in fact, the Recipient will want to proceed with the permissible venture transaction even if his expected profit is only between 10% and 20%. By utilizing a permissible venture agreement the Recipient really received $100. The required payment of $10 actually reflects only a 10%, not a 20%, annual return on the total amount provided by the Financier.

Furthermore, the purportedly interest-free loan component of the transaction defies credibility. It is not the custom of average Financiers, especially institutional lenders, to make interest-free loans. Similarly, the fact that the Recipient receives only nominal consideration for managing the permissible venture business, ordinarily as little as one dollar, is hardly indicative of meaningful negotiation between the parties.

In the permissible venture agreement, the presence of terms which are uncharacteristic of a partnership,[100] but which are permitted in a *shutfus*, further indicate the parties' intent not to form a partnership. Of course, if a court finds for other reasons that a partnership was formed, some of these restrictions might not be enforceable.[101] Nevertheless, the fact that the parties intended to include these terms may impact on the threshold question of whether a partnership was established.

The economic impact of the permissible venture is almost exactly the same as if the Financier had made an interest-bearing loan to the Recipient. There is, however, the possibility of a different result if (1) the profitability of the business is less than the interest rate implied by the payment schedule, (2) the profitability is susceptible to proof in the manner set forth in the permissible venture, and (3) it is practicable for the Recipient to provide

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99 From the perspective of Jewish law, it is certainly better that there be a reasonable connection between the expected profits and the rate of return on the funds invested by the Financier. Nevertheless, it is not clear what extent of an interrelationship is actually required.

100 *See supra* text at II, D (restrictions indicative of permissible ventures).

101 *See supra* notes 54-57 and accompanying text.

the necessary proof. The confluence of these three factors is extraordinarily unlikely because in reality the Recipient's obligation to repay the monies furnished is essentially unconditional.

Courts have often disregarded the purported form of an entity or a transaction, even where the economic consequences of the purported form would differ from the substantive form which was recognized and enforced by the court.[102] A minority of courts, however, have found that there was no partnership even where the parties actually shared profits and losses.[103] Consequently, the fact that a permissible venture provides for the remote possibility of participation in the profits and the losses should not prevent secular recognition of the transaction as a loan.

iv. *Objections to Disregarding the Alleged Partnership Form*

It is perhaps unusual to disregard the form which the parties have elected, especially where the parties themselves ask for the form to be disregarded. When courts follow substance rather than form, they generally act in the interest of public policy and over the protests of the parties involved. In the permissible venture context, however, the parties seek to provide financing for a fee, while avoiding a religious prohibition against interest. This motive, without more,[104] would not offend legitimate public policies. In addition, it seems that even if a court disregards the partnership form in order to safeguard public policy, it should not disregard the form for purposes unrelated to the policies.

An arguably better view, however, would establish the legal relationship between the parties by their true intent which would be evidenced by their conduct. Identification of an improper mo-

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102 *See* Rochester Capital Leasing Corp. v. K & L Litho Corp., 13 Cal. App. 3d. 697, 91 Cal. Rptr. 827 (1970). The court stated that "[i]n determining whether a transaction constitutes a loan, the significant consideration is the substance of the transaction rather than its form or the terminology used by the parties." *Id.* at 702, 91 Cal. Rptr. at 830 (quoting Burr v. Capital Reserve Corp., 71 Cal.2d 983, 989, 80 Cal. Rptr. 345, 349 458 P.2d 185, 189 (1969)).

103 *See, e.g.*, Freese v. United States, 455 F.2d 1146 (10th Cir. 1972) (employee who received percentage of profits is not a partner); Sutton v. Schaff, 104 Kan. 282, 178 P. 418 (1919) (the sharing of profits and losses is a principal, but not conclusive test of partnership's existence); Rosenberger v. Herbst, 210 Pa. Super. 127, 232 A.2d 634 (Super. Ct. 1967) (although agreement provided for the sharing of profits and losses, one party's full control of the business prevented the establishment of a partnership).

104 If a particular permissible venture agreement would result in an effective interest rate, based on the entire sum advanced, in excess of that permitted under applicable usury law, an improper motive might be found.

tive should not be a *sine qua non* for piercing the parties' elected form. Instead, a motive inconsistent with the purported transaction should be regarded simply as evidence that the substance of the transaction in fact differs from the form adopted. There are occasions where parties are entitled to benefit themselves through the selection of a particular form. If they do not utilize that form in its ordinary manner, or observe the practices customarily associated with it, then they should not be found to have employed the form. The parties, however, might remain liable to third parties on equitable grounds.[105]

Irrespective of the merits of this argument in general, courts have held that substance rather than form should control when determining whether a partnership exists.[106] Even if a permissible venture were perceived as imbued with the form of a partnership, in substance it should be recognized as a loan.

v. *Promotion of Public Policy*

The characterization of a permissible venture as a secular loan, rather than as a partnership would promote, not offend, public policy. There is no significant public policy which would require a permissible venture to expose the Financier to the joint and several liability of a general partner. Secular law permits investors to accomplish the financial objectives of the Financier without incurring personal liability. For example, these objectives may be achieved by a person who invests in a corporation's common stock.[107] If there are business profits, he receives a proportion of the gain.[108] If the business collapses, his loss is limited to the amount of the investment. This is true even where the investor, through use of voting rights, exercised actual control

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105 Equitable estoppel may be employed to hold a party to a permissible venture liable to a third party. In the context of a permissible venture, however, there is little likelihood of third-party reliance on the existence of a partnership between the Financier and Recipient. Further, the parties to the permissible venture agreement themselves do not perceive themselves as partners.

106 *See supra* notes 54-55 and accompanying text.

107 The exact objectives may not be obtained by every investor in a corporation's common stock. For example, pursuant to the permissible venture, the Financier may still want the accrued profits to be treated as interest. In a subchapter "S" corporation, the distributed income may be treated as ordinary income, whereas in non-subchapter "S" corporations, the income may be treated as a dividend. Notwithstanding possible securities law complications, an investor could accomplish the financial objectives of a Financier in a permissible venture by purchasing stock in a subchapter "S" corporation where there is only one other shareholder.

108 The gain may be realized actually, through a dividend distribution, or equitably through stock appreciation.

over the corporation. The possibility that third parties dealing with the corporation may mistakenly rely on the shareholders' financial status does not prevent this result.

The Uniform Limited Partnership Act (ULPA) and the Revised Uniform Limited Partnership Act (RULPA)[109] provide vehicles for accomplishing, in the partnership context, what the parties to a permissible venture desire.[110] In exchange for infusing capital into a business, a limited partner, with no right to manage the venture, participates in the partnership's profits without being personally liable for its obligations. The ULPA and the RULPA protect innocent third parties by requiring a public filing to provide notice of the limited partnership. The ULPA and the RULPA even provide a safety valve for persons who mistakenly believed that they became limited partners in a limited partnership. The ULPA provides that a person who contributed capital to a partnership and mistakenly believed that he became a limited partner did not necessarily, by exercising the rights of a limited partner, become a general partner or become bound by the debts of the partnership.[111] Therefore, the investor can avoid becoming a general partner by promptly renouncing his interest in the partnership profits and in any other compensation from the partnership. A similar provision of the RULPA addresses a person who made a contribution to a partnership but who, in good faith, erroneously believed that he became a limited partner in a limited partnership.[112] The RULPA provides that the person, upon

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109 UNIFORM LIMITED PARTNERSHIP ACT, 6 U.L.A. 594 (1969); REVISED UNIFORM LIMITED PARTNERSHIP ACT, 6 U.L.A. 297 (1989).

110 This form may not be exactly what the parties to a permissible venture desire because the limited partnership income is treated for tax purposes as partnership profits, not as interest.

111 UNIFORM LIMITED PARTNERSHIP ACT § 11, 6 U.L.A. 594 (1969). ULPA Section 11 states in its entirety:

> A person who has contributed to the capital of a business conducted by a person or partnership erroneously believing that he has become a limited partner in a limited partnership, is not, by reason of his exercise of the rights of a limited partner, a general partner with the person or in the partnership carrying on the business, or bound by the obligations of such person or partnership; provided that on ascertaining the mistake he promptly renounces his interest in the profits of the business, or other compensation by way of income.

Id.

112 REVISED UNIFORM LIMITED PARTNERSHIP ACT § 304(a), 6 U.L.A. 297 (1989). RULPA section 304(a) states in its entirety that:

> Except as provided in subsection (b), a person who makes a contribution to a business enterprise and erroneously but in good faith believes that he [or she] has become a limited partner in the enterprise is not a general partner in the enterprise and is not bound by its obligations by rea-

learning his mistake, may avoid classification as a general partner if he either promptly causes an appropriate certificate of limited partnership or certificate of amendment to be filed or withdraws from future equity participation in the business. The RULPA,[113] however, does not apply to claims by third parties who transacted business with the partnership believing in good faith, at the time of the transaction, that the investor was a general partner.

The financial terms of a carefully drawn permissible venture agreement closely resemble a limited partnership. Neither the Financier, nor the Recipient perceive that the permissible venture is a general partnership under secular law and, as a result, third parties rarely, if ever, learn about or rely upon the existence of the permissible venture. It is, therefore, improbable that third parties would detrimentally rely on the existence of a partnership between the Financier and the Recipient.[114] Absent proof of reliance in a particular case, there is no policy justification for contravening the parties' intent and treating them as if they were general partners.

Restrictions on the activities of institutional lenders, whether imposed by statute or by agreement are often the result of a concern to ensure the financial stability of banks. Participation in a partnership, or in particular types of business activities, might be barred as a matter of public policy where they involve undesirable risks.

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son of making the contribution, receiving distributions from the enterprise, or exercising any rights of a limited partner, if, on ascertaining the mistake, he [or she]:

(1) causes an appropriate certificate of limited partnership or a certificate of amendment to be executed and filed; or

(2) withdraws from future equity participation in the enterprise by executing and filing in the office of the Secretary of State a certificate declaring withdrawal under this section.

Id.

113 *Id.* at 304(b). Subsection (b) of RULPA section 304 provides for liability as a general partner where:

A person who makes a contribution of the kind described in subsection (a) is liable as a general partner to any third party who transacts business with the enterprise (i) before the person withdraws and an appropriate certificate is filed to show withdrawal, or (ii) before an appropriate certificate is filed to show that he [or she] is not a general partner, but in either case only if the third party actually believed in good faith that the person was a general partner at the time of the transaction.

Id.

114 Of course, if in a particular instance there is reasonable and detrimental reliance by a third party on the existence of a partnership arrangement, the general rules of apparent liability might apply to protect them.

If a permissible venture agreement does not create a secular partnership, however, only the principal and the opportunity cost of the loan is risked. Neither the amount at risk, nor the probability of the risk is significantly different from the risk involved in ordinary loans. Every time a lender makes a loan, the principal and the opportunity cost of the money is at risk. If a borrower files in bankruptcy, for instance, a lender may recover little or nothing at all.

The literal terms of the permissible venture agreement operate to increase the degree of risk as to the amount deemed to have been invested or one-half of the total monies advanced. Pursuant to a permissible venture agreement, the Financier is not allowed to recover such monies if the Recipient proves that there are net business losses or insufficient profits, even where the Recipient is financially solvent. Nevertheless, given the likelihood that the Recipient could satisfactorily establish these facts is exceedingly small, the net increase in risk is negligible.

Additionally, public policy would be served by characterization of a permissible venture as a secular loan. With respect to tax law, for instance, the Supreme Court of the United States has declared that state law characterizations of a particular business entity or form are not controlling.[115] Even where a taxpayer has complied with the letter of the tax law in structuring a particular type of transaction, the courts can disregard the technical form and tax what it perceives to be the substance of the transaction.[116] This is true even where there are possible, although unlikely, scenarios in which the form of the transaction will have substantive significance. Although there is no reported federal tax case involving a permissible venture, courts following substance rather than form under tax law have often treated payments as interest, even though the payments used very different

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115 *See* Morrisey v. Commissioner, 296 U.S. 344 (1935). In addition, the Internal Revenue Service Treasury Regulations do not find state law classifications controlling. Treas. Reg. § 301.7701-1-4.

116 The seminal case in this area is Gregory v. Helvering, 293 U.S. 465 (1935). In *Helvering*, the taxpayer was a shareholder in corporation X; Corporation X owned 1,000 shares of corporation Y. The taxpayer desired to have corporation X convey to her the 1,000 shares of corporation Y in order for the taxpayer to sell the shares for profit. If accomplished directly, the conveyance would have been treated as a dividend to the taxpayer which would be taxed as ordinary income. In order to be taxed at the then lower capital gain rate, the taxpayer caused a reorganization under section 112(g) of the Revenue Act of 1928. The court disregarded the reorganization, which was declared to have been a sham because the underlying tax avoidance motive was outside the plain intent of the reorganization statute.

labels.[117] The commercial function of payments made pursuant to a permissible venture agreement is to permit a substitution for religiously prohibited interest. Consequently, payments pursuant to a permissible venture should be treated as interest.

Similarly, in examining usury implications, substance generally controls form. The courts examine all of the circumstances surrounding the transaction in an effort to ascertain the parties' intent.[118] If the fixed rate of return, based on the total funds advanced by the Financier, exceeds allowable interest rates, a court should find that the transaction was a usurious loan.

vi. *Proposed Permissible Venture Provisions*

It is obviously essential that the document be prepared carefully by a trained professional. The following provisions should be included in a permissible venture document to minimize the probability that a court would find that a partnership was created. First, the agreement should state that it is merely for Jewish law purposes and that, although its specific terms are intended to be enforceable under secular law,[119] the agreement is not intended to establish any sort of partnership or joint venture under secular law.[120] The agreement should indicate that, under Jewish law,

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117 *See, e.g.*, Dorzbach v. Collison, 195 F.2d 69 (3d Cir. 1952) (25% share of profits paid in lieu of interest held deductible as interest); Arthur R. Jones Syndicate v. Commissioner, 23 F.2d 833 (7th Cir. 1927) ("Sums paid as interest, regardless of the name by which it is called, may be deducted by the taxpayer from its income."); Kena, Inc. v. Commissioner, 44 B.T.A. 217, 219-21 (1941) (80% share of profits paid in lieu of interest held deductible as interest); Wynnefield Heights, Inc. v. Commissioner, 25 T.C.M. (CCH) 953, 960, ¶ 66,185 T.C.M. (P-H) 66-1071, 66-1079 (1966) (payment of a fixed amount per constructed house in lieu of interest held deductible as interest); Rev. Rul. 69-188, 969-1, C.B. 54 (interest is "the amount one has contracted to pay for the use of borrowed money, and as compensation paid for the use or forbearance of money" not dependent on the parties' characterization of the transaction).

118 *See* Call v. Palmer, 116 U.S. 98 (1885); Curtis v. LeMoyne, 248 Ill. App. 99, *cert. denied*, 278 U.S. 645 (1928).

119 If the rabbinic authorities upon whom the parties to the permissible venture rely believe that the permissible venture need not be enforceable under secular law in order to be valid under Jewish law, then the permissible venture document should clearly recite that it is only to be effective under Jewish law and not under secular law. This might indeed insulate the parties from the implications discussed in the text.

120 The label which parties give to their relationship is of some limited weight when courts determine whether a partnership was formed. *See, e.g.*, Chariton Feed and Grain, Inc. v. Harder, 369 N.W.2d 777 (Iowa 1985) (written agreement between tenant and landlord not conclusive of partnership); Fenwick v. Unemployment Compensation Comm'n, 133 N.J.L. 295, 44 A.2d 172 (E. & A. 1945) (written partnership agreement is evidence, but not conclusive of existence of partnership).

the permissible venture arrangement does not authorize the Recipient to obligate the Financier personally in any way. Furthermore, the document should state that the Recipient is not intended to have, under secular law, any actual or apparent authority to bind the Financier.

Second, the agreement should specify that the Recipient is barred from releasing the Financier's name, disclosing that a permissible venture was executed and representing that a religious or secular partnership was established. These restrictions should reduce the Financier's exposure to third party claims based on estoppel. The permissible venture agreement should also indicate that the liability of the Financier is limited to the amount of money invested.[121] The agreement should also specify that the Financier is not personally liable for the debts of the venture or for the claims of the Recipient or of third parties.[122]

Third, the agreement should contain an indemnification and "hold harmless" clause, shielding the Financier from any liability in excess of his investment. A clause should also be inserted specifically stating that the Recipient has no control whatsoever over the Recipient's business,[123] and that any losses in the permissible venture business must be proved through competent testimony under Jewish law.[124] In addition, the agreement should indicate that there is an irrebuttable presumption that the Financier's funds were invested in those business activities of the Recipient which were in fact most profitable during the term of the permissible venture agreement.

Finally, to the extent that the Financier is willing, the agreement should indicate that it is the parties' intention that, under secular law, the Financier's investment should be treated as a conditional, non-recourse loan.

Even if a court determines that no partnership was formed, it may still enforce the express terms of the permissible venture

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121 In a permissible venture the Financier's investment equals one-half of the total sum advanced.

122 If the permissible venture is treated as a secular partnership, a statement purporting to limit a partner's liability to third parties will be ineffective. Nevertheless, this type of declaration may be relevant when the court considers the threshold question of whether the permissible venture created a partnership.

123 This provision is not necessary if, of course, there is some special reason why the Financier wants control. In deciding whether the Financier desires control, the Financier should evaluate the prospects for the imposition of lender liability. *See supra* note 15.

124 The purpose of this provision is to minimize the likelihood that the Recipient can prove losses.

agreement under contract law. By taking the prescribed oath or producing the specified witnesses, the Recipient could frustrate the Financier's practical expectations. To reduce the likelihood of this result, the permissible venture should contain a clause providing that the Recipient must invest the funds diligently and with scrupulous care and that the Recipient bears various responsibilities for the safeguarding of the funds. The agreement should provide that the Recipient must satisfy specified conditions regarding the type of venture which may be pursued and that the Recipient must make ongoing financial disclosures.

If the Recipient chooses to take an oath to establish that the actual profits of the venture were less than the presumed amount, the agreement should state that the oath must also include a statement that the Recipient has faithfully fulfilled all of his obligations and responsibilities under the permissible venture agreement. Furthermore, if the Recipient chooses to bring witnesses to testify that the venture sustained losses, the Recipient must take an oath that he has faithfully fulfilled all of his obligations and responsibilities under the permissible venture agreement.

Finally, if the Financier contends that the Recipient has not faithfully performed one or more of the Recipient's obligations or responsibilities, the Recipient must prove through two qualified witnesses that he has faithfully performed his responsibilities.

If he has confidence in the truthfulness of his statement, a Jewish Recipient might overcome his general aversion to oath-taking, particularly if the stakes are high. Consequently, where there is a clear and unexpectedly large liability, a Recipient might be inclined to take an oath. Requiring that the oath also recite that the Recipient's many other duties were performed, particularly those responsibilities which are difficult to precisely define, makes it less probable that a Recipient will take the oath. Moreover, requiring an oath in addition to the production of witnesses decreases the already remote likelihood that losses will be established.

The references to Jewish law in the permissible venture agreement might raise enforceability problems under secular law which would endanger the Financier's ability to recover his money.[125] To avoid this risk, the permissible venture agreement

[125] Suppose, for example, that the Recipient called two witnesses to establish that there were net losses and the Financier contended that the witnesses were not qual-

should also include a clause requiring compulsory submission of any dispute to a particular rabbinic court for binding arbitration based on Jewish law. The provision should be crafted to ensure that, under applicable state law, any arbitration award could be entered as a judgment in state court.

A sample permissible venture containing or referring to these provisions is printed below in the Appendix.

C. *An Alternative Form for the Permissible Venture: The Non-recourse Loan*

Despite the foregoing arguments, a substantial risk remains that the form of a permissible venture which incorporates elements analogous to a secular partnership will compel a reviewing court to treat it as a partnership with all the attendant adverse consequences. Accordingly, the following section suggests that in some cases a permissible venture could be restructured as a non-recourse loan, a familiar non-partnership form.

In a typical non-recourse loan, a lender provides funds to a borrower, obtains collateral to secure repayment of the funds and agrees that, in the event of default, the borrower will not be

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ified under Jewish law or that their testimony was not competent or sufficient under Jewish law standards. A secular court might decide that it could not properly evaluate or determine such religious questions, even with the assistance of expert witnesses. Consequently, a secular court could refrain from ruling on the dispute. *See* Serbia Eastern Orthodox Diocese v. Milivojevich, 426 U.S. 696, *reh'g denied*, 429 U.S. 873 (1976). Although secular courts have determined or taken judicial notice of certain precepts of Jewish law, it is unclear whether those cases involved a genuine dispute as to the relevant rules. *See, e.g.*, Burns v. Burns, 223 N.J. Super. 219, 538 A.2d 438 (Ch. Div. 1987) (Jewish husband required to secure Jewish bill of divorcement); Rubin v. Rubin, 75 Misc. 2d 776, 348 N.Y.S.2d 61 (N.Y. Fam.Ct. 1973) (support provisions of divorce conditional on wife's obtaining Jewish divorce).

Some have suggested that there is a distinction between matters involving religious dogma and those relating to religious civil law. *See* Minkin v. Minkin, 180 N.J. Super. 260, 437 A.2d 665 (Ch. Div. 1981). The general qualification of the Jewish law witnesses and evidentiary standards could be characterized as civil, and therefore, a court could arguably apply them just as the court might proceed if the parties had agreed to be bound by the law of a foreign country. But this distinction would collapse when applied to the eligibility of Jewish law witnesses. Improper religious observance can disqualify a witness and a secular court is unlikely to rule on the conduct which constitutes proper ritual performance.

Alternatively, a court could find that there was an implicit agreement between the parties to submit disputes to a rabbinical court. In the family law context, the parties to a Jewish marriage who agreed to wed in accordance with Jewish law also implicitly agreed to comply with a rabbinical court's decision regarding divorce. *See id.* The Financier in the permissible venture context could argue that, in agreeing to provide witnesses who were reliable and trustworthy under Jewish law, the parties agreed to submit any disputes concerning the qualification of witnesses.

personally liable to the lender. The lender will collect only from the collateral. A permissible venture is similar in that a Recipient is not personally liable to the extent that he satisfactorily proves that the venture sustained net losses.

In non-recourse loans, however, lenders usually limit the amount advanced to a fraction of the value of the collateral obtained. In this way, even if the value of the property depreciates, the lenders can recover all of their money. A permissible venture is different because, if the borrower suffers losses in the venture business which he can prove, Jewish law forbids the Financier from collecting the full amount of the principal, even from collateral. The Financier must deduct from his claim an amount equal to one-half of the losses.

This formal procedure explicitly requiring that the Financier share in the losses may lead a court to rule that the permissible venture is a partnership. If the transaction can be restructured as a non-recourse loan, the court might reach a different conclusion. The problem is finding collateral which would automatically decrease in value if the venture incurs net losses, thereby satisfying the requirements of Jewish law.

One choice is to establish a fractional interest in the assets of the venture. The numerator of the fraction would be the number of dollars advanced and the denominator would be the sum of the numbers invested by both the Financier and the Recipient.[126] Consider, for example, a permissible venture in which a Financier advances $100, $50 as an interest-free loan and $50 as an investment. The Recipient invests the $50 which was provided as a loan. On the $50 of investment funds,[127] the Financier might receive an undivided 50% security interest in the assets of the permissible venture business. To ensure that the Financier does not collect more than the amount permitted by the permissible venture, the security interest must be expressly subordinated to the claims of the Recipient's creditors. The security interest should, however, be perfected to establish its priority over other potential personal creditors of the Recipient who were not involved in the permissible venture business.[128]

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[126] The Recipient's investment would include the present value of any pre-existing assets that the Recipient has dedicated to the business.

[127] Regarding the monies provided as an interest-free loan, the Recipient could be personally liable and could grant whatever security interest is agreed upon. Any security interest could be set forth in a separate document or could be incorporated in the security document dealing with the Financier's investment.

[128] Another reason to perfect the security interest is to maintain its priority over

A Financier desires that, whenever possible, the Recipient is personally liable for full repayment of the monies advanced as an investment. Under Jewish law, personal liability is not permitted if the existence and extent of losses is properly established. The permissible venture agreement, under the non-recourse loan model, could provide that, even if there are losses, the Recipient would be personally responsible for losses if he violated particular terms or conditions, including restrictions on allowable permissible venture businesses or the requirements of diligence and best efforts in the pursuit of the business.[129] The subordination of the Financier's rights to the collateral could be similarly conditioned.

In specific circumstances, technical problems may arise in connection with using the non-recourse loan alternative. For example, where the funds are used in a cash-loss period to build up intangible assets such as good will, the security interest may not be meaningful collateral. Alternatively, if the assets of the venture are subject to a pre-existing security interest, then the Financier would not be assured of repayment of his principal even if the venture suffers no losses. Moreover, in order for a financing statement to be effective, it must describe the collateral which is covered. The parties will either have to list the pertinent assets or describe them as the assets used in the venture. To make the description meaningful and effective, the parties may have to agree upon and identify the parameters of the venture's business. Specifying the business at the outset, however, may detrimentally affect the Financier. Under Jewish law, specificity is not required and the Financier's investment is deemed to have been made in the Recipient's most profitable business activity during the term of the venture.

Assuming that a permissible venture could be structured as a non-recourse loan in a particular case, the first question is whether the combination of a non-recourse debt and profit-sharing, evidences a partnership. It seems that the combination does

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the rights of other claimants and to prevent avoidance of the obligation in a subsequent bankruptcy proceeding.

[129] A modified non-recourse loan model might provide for the Recipient's personal liability, collateralized by a security interest in all of the venture's assets unless the Recipient properly proves losses, in which case the liability would be transformed into the non-recourse debt discussed in the text and collateralized by a security interest in only a fraction of the venture's assets. If feasible, this alternative would grant the Financier greater protection. Unfortunately, because conditional loan schemes are not in general use, a court might be less inclined to treat the arrangement as a loan.

not establish a partnership. Non-recourse loans are often made,[130] without causing the lender to be considered a partner of the borrower.[131] Authorities, including the UPA, have determined that receipt of a percentage of profits in lieu of interest on a loan does not establish a partnership.[132] A number of cases have determined that an investor is a partner where the obligation to repay depends on the profitability of the business. The use of a non-recourse loan appears functionally tantamount to conditioning the repayment obligation on the profitability of the partnership. If there are no losses, then the value of the collateral will permit full repayment of the funds. If there are losses which are properly established, the collateral will be worth less than the full amount of the funds advanced and the loan will not be repaid in full. Nonetheless, if form alone is followed, use of a non-recourse debt should avoid the conclusion that the permissible venture constitutes a partnership. Alternatively, if substance rather than form is applied, it should be used to evaluate the entire transaction. For the reasons set forth above,[133] the transaction, considered as a whole, should be classified as a substantively unconditional repayment obligation.

V. Possible Alternative Solutions to the Ban on Interest

A formal limited partnership might be used by religious Jews instead of the permissible venture format. This alternative offers the Financier limited liability, safeguarding him from many of the more serious risks associated with treatment as a partnership.[134] There are, however, a few drawbacks to the limited partnership format. First, some institutional lenders may be precluded from entering limited partnerships. Second, formalization of a limited partnership structure might militate against treating the Recipient's payments as interest for tax purposes. Third, the need to comply with the statutory requirements of a limited partnership may be costly and inconvenient, consuming precious time before a closing. Fourth, even where there is a limited partnership, it is possible for the limited partner to unwittingly become liable as a general partner by participation in the partnership business.[135]

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130 *See supra* note 77.

131 *See* Dunlap v. Commissioner, 74 T.C. 1377, 1435 (1980) (non-recourse nature of mortgage does not preclude taxpayer from claiming depreciation).

132 *But see supra* note 94 and accompanying text.

133 *See supra* text at IV, B.

134 *See supra* text at III, B.

135 Even in a traditional debtor-creditor relationship, there is an inherent risk

If a third party sues a Financier, alleging that the Financier is a general partner, the Financier may ignore some of the above problems and attempt to escape liability through applicable ULPA or RULPA provisions.[136] The Financier must assert that, in good faith, he erroneously believed that through the permissible venture agreement he had become a limited partner. The Financier would be required either to renounce his interest in the partnership or to cause a certificate of limited partnership to be filed. A practical problem might arise because of the statutory requirement that the general partner, the Recipient, execute the certificate of limited partnership.[137] The Recipient might refuse to execute a certificate of limited partnership, preferring to have the Financier share in the liability.[138] If the Financier can establish that the permissible venture is in fact a limited partnership, he may be able to obtain a court order requiring the Recipient to execute and file the certificate.[139] If the Financier is either sophisticated or represented by counsel, it may be difficult to establish that he believed in good faith that he was a limited partner because he was presumably aware that no certificate of limited partnership was filed.

Some rabbis have informally suggested that, as an alternative, an institutional lender earmark a certain portion of its deposits originating from non-Jewish sources for use in making loans to Jews. In this manner, they contend the loan is made directly from the non-Jewish depositors to the Jewish borrowers and no prohibition on exacting interest is involved. This argument, however, misstates the nature of the depository relationship. A deposit in a bank is a loan to the bank. When the institution lends money to others, it is lending its own money and, if the institution and the borrower are both Jewish, the prohibition against lending with interest applies.[140]

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that the creditor will exercise control exposing the creditor to direct liability. *See supra* note 15.

136 *See supra* notes 111-13 and accompanying text.

137 REVISED UNIFORM LIMITED PARTNERSHIP ACT § 204, 6 U.L.A. 297 (1989).

138 The probability of the occurrence of this problem would be substantially diminished if the permissible venture agreement were properly drafted and required the Recipient to indemnify and hold the Financier harmless from any liability in excess of the monies invested.

139 REVISED UNIFORM LIMITED PARTNERSHIP ACT § 207, 6 U.L.A. 281 (1989); UNIFORM LIMITED PARTNERSHIP ACT § 25, 6 U.L.A. 610 (1969).

140 The proposal also assumes that the funds deposited by non-Jewish sources can be maintained and dealt with as a distinct asset, despite the fact that any funds physically deposited may be commingled and that any funds wired or carried on the books of the Federal Reserve do not physically exist to be separately maintained.

These rabbis have alternatively proposed that a corporate lender segregate the equitable rights of its non-Jewish and Jewish shareholders so that there would be a fund of non-Jewish money which would be used exclusively for loans to Jews. A similar amount of money which is equitably owned by Jewish shareholders would be used for loans to other borrowers. In this way, a partnership would not be established between the lender corporation and Jewish borrowers. Instead, the parties would participate in a straight loan of money, from the non-Jewish shareholders to Jewish borrowers. The interests of Jewish and non-Jewish shareholders would be linked, at least to a certain extent, to the performance of different groups of loans. As a result, the rights of the shareholders in dissolution and in declaration and issuance of dividends would theoretically differ. To avoid any actual difference, there would be a presumption that the two groups of loans performed equally well. This presumption should be rebuttable only if a shareholder, prior to issuance of a dividend or liquidation right, could conclusively prove, by a specified and almost impossibly demanding standard of proof, that the respective groups of loans performed differently.

The primary problem with this proposal is that, given the theoretical difference in the rights of Jewish and non-Jewish shareholders, two classes of common stock must be established: one class owned by Jewish shareholders and the other owned by non-Jews.[141] Assuming the initial creation of such classes, if non-Jewish stockholders sold their shares to Jews, the Jewish law prohibition on interest would be violated in ongoing and future loans. Yet, it is inconceivable that a corporation could legally restrict ownership of its stock on religious grounds. Even if restrictions could be imposed, the attendant practical problems, including the enforcement of the restriction itself, would be significant. Moreover, this process would involve the possibility of undesired publicity for a corporation which does not want to be perceived as making religiously based distinctions.

As a final alternative, the lender could avoid permissible ventures altogether and attempt to accommodate its religious Jewish customers in other ways. There is, for example, a rabbinic view that allows lending with interest if the borrower is not personally

[141] The rights of shareholders emanates from the ownership of stock. The only conceptual manner in which to restrict the shareholders' respective rights is to affect the type of stock they own.

liable for the debt.[142] Therefore, a religiously observant Jew might deposit money into an account with a Jewish bank without a permissible venture agreement, because the shareholders of the corporation are not personally liable to the depositor.[143] Similarly, a lender might elect to make traditional non-recourse loans to religiously observant Jews.[144] Any additional risk incident to a non-recourse debt might motivate the lender to marginally increase the financing fee or to require additional collateral.

VI. CONCLUSION

It seems that there is sufficient flexibility within the Jewish and American legal systems to permit Jews to avoid their religious ban on the collection and payment of interest without incurring the significant responsibilities imposed on a partner under secular law.

Certainly, a permissible venture for a non-business purpose should not give rise to a partnership. The relationship simply lacks critical partnership criteria. Moreover, other permissible ventures, if they are properly drafted, should not be treated as partnerships. There is no significant public policy which would require Financiers to be treated as partners. Virtually identical financial goals are satisfied, either through investments in corpo-

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142 There is a possible problem, however, if during the term of the loan to or from the Jewish customer, the majority stock ownership shifts from non-Jews to Jews. In that case, the Jewish customer would have to liquidate its account by withdrawing his deposits and paying off his loans. Therefore, it would be preferable for a lender to continuously keep track of the relevant percentages and to notify religious Jews of any significant changes. The disadvantage of this approach is that the influx of Jewish customers may be chilled by the risk that they would have to liquidate accounts in the future.

143 It is interesting to note that a religiously observant Jew desiring to deposit money in a Jewish bank will not necessarily be able to accomplish his religious objective by merely convincing the bank to enter into a permissible venture with him. Through the permissible venture, the depositor would become a partner with the bank as to the bank's other business activities. Consequently, the depositor might become a partner of the bank as to interest-bearing loans made by the bank to other Jews. Presumably this problem could be solved if the permissible venture between the depositor and the bank is restricted to the bank's commercial activities with non-Jews.

144 Under Jewish law it would probably be best if the language of the non-recourse loan stated that there would be no personal obligation on the borrower, either as a matter of secular law or as a matter of religious law, to repay the loan. The agreement should also specify that if the loan were not repaid in accordance with its terms, the lender would be entitled to any and all rights against the collateral set forth in the respective collateral documentation.

rate stock or in limited partnerships, without the imposition of personal liability. Indeed, treating permissible ventures as loans will promote tax and usury law policies.

In addition, courts have historically evaluated the substance of a transaction to determine whether a partnership relationship was established. The substance of a permissible venture is the same as a loan because the rights and responsibilities of the Financier are much more like those of a lender than those of a general partner. The Financier has no control in the business of the partnership; nor does he fully enjoy the business' appreciation. As a practical matter, the Recipient will not share in the profits and losses of the business. Instead, the Recipient will almost undoubtedly receive a fixed schedule of payments, either because it is practically or theoretically impossible to calculate the profits or losses. A fixed return is likely because the Recipient will rarely take steps to keep track of the profits or losses, or, alternatively, because the Recipient will be unable or unwilling to take the required oath and/or adduce the prescribed witnesses. Even if there is some sharing of profits and losses,[145] this factor alone should be insufficient to cause the relationship to be declared a partnership. The fact that the parties' expressed motive is to avoid a religious ban, not to form a secular partnership should mitigate against treatment as a partnership. Therefore, the better rule would treat a permissible venture as a loan, not a secular partnership.

Casting the secular aspects of the transaction as a non-recourse loan may make it easier for a secular court to avoid characterizing the parties' relationship as a partnership. Nevertheless, practical problems, including a Financier's possible unwillingness to abandon the broader protection afforded by a permissible venture agreement, may preclude this alternative.

Of course, the substance versus form approach is applied on a case by case basis, exposing a lender to the vagaries of possible litigation. A lender who seeks greater protection against personal liability as a partner might choose formal limited partnerships for its permissible venture arrangements. This choice, however, would not resolve issues concerning applicable regulatory restrictions. Finally, the availability of other alternatives would depend on the Jewish law views of the persons involved.

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[145] The permissible venture agreement should provide for only a limited sharing of losses, not for the unlimited sharing which is incidental to a partnership.

APPENDIX
SAMPLE PERMISSIBLE VENTURE AGREEMENT
(*HETTER ISKA*)[146]

THIS AGREEMENT is entered into between _____ (the "Financier") and _____ (the "Recipient"), this _____ day of _____.

WHEREAS, the Recipient is desirous of engaging in one or more legal business enterprises (referred to hereinbelow as the "Business"); and

WHEREAS, the Recipient has insufficient funds for the Business; and

WHEREAS, Jewish law prohibits the payment or collection of interest on loans between Jews; and

WHEREAS, but for the Jewish law prohibition on the payment or collection of interest on loans between Jews, the Financier would have been willing to lend the sum of $_____ (amount in writing) referred to hereinbelow on an interest-bearing basis; and

WHEREAS, Jewish law permits the Financier to provide the $_____ (amount in writing) referred to hereinbelow in a way set forth hereinbelow; and

WHEREAS, the Financier and the Recipient enter into this Agreement in order that the Financier provide, and the Recipient receive, the $_____ (amount in writing) referred to hereinbelow while avoiding the Jewish law prohibition on the payment and collection of interest on loans between Jews; and

WHEREAS, under Jewish law, the terms set forth hereinbelow do not authorize the Recipient to obligate the Financier personally in any way; and

WHEREAS, the terms set forth hereinbelow are not intended, under the laws of the State of _____, or under any other secular law, to authorize the Recipient to obligate the Financier in any way; and

WHEREAS, the fact that, as set forth hereinbelow, the Fin-

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146 The provisions set forth below in brackets are optional. Refer to section IV of this article for a discussion of the function and usefulness of the proposed provisions.

As indicated in the text, there are disparate rabbinic opinions on Jewish law. Consequently, a person concerned with Jewish law requirements should consult a rabbinic authority of his choice to determine the propriety of this form.

Additionally, some states require consumer contracts to be drafted in language which may be plainly understood by the general population. *See, e.g.*, N.J. STAT. ANN. 56:12-1 et seq. (West 1989).

ancier is providing the Recipient with the Deposit or Investment terms which are defined hereinbelow, may enable the Financier to pursue various different business enterprises without having to liquidate assets from one enterprise in order to invest in another; and

WHEREAS, the terms set forth hereinbelow establish what would be designated under Jewish law as a *shutfus*; and

WHEREAS, the Jewish law of *shutfus* differs significantly from the law of joint ventures, partnerships and agencies of the State of _____ and under other secular law; and

WHEREAS, the parties specifically intend that the terms set forth hereinbelow not form a partnership, joint venture, agency relationship or any other similar relationship between them under the laws of the State of _____ or under any other secular law; [and

WHEREAS, the parties believe that under the laws of the State of _____ or under other secular law, although not under Jewish law, the provisions set forth hereinbelow regarding the $_____ (amount in writing), delivered to the Recipient, which is hereinbelow defined as the "Deposit" or "Investment" should be characterized as a non-recourse loan from the Financier to the Recipient (Note, if this clause is used, the lender should be especially insistent on receiving a perfectible security interest in collateral for the loan); and

WHEREAS, the fact that laws of the State of _____ or other secular law may label the said provisions regarding the Deposit or Investment a loan does not cause the provisions to be proscribed under Jewish law;]

NOW, THEREFORE, the parties hereto, in mutual consideration of the representations and promises set forth hereinbelow, and for other good and valid legal consideration, hereby agree, represent and promise as follows:

1. RECITALS. The foregoing recitals are incorporated herein and made a part hereof.

2. RECEIPT OF FUNDS. The Recipient hereby acknowledges receipt, contemporaneous herewith, of the aggregate sum of $_____ (amount in writing) (the "Funds") from the Financier.

3. NON-INTEREST BEARING LOAN. The Financier and Recipient hereby acknowledge that fifty percent of the Funds, or $_____ (amount in writing), was received by the Recipient as a non-interest bearing loan (the "Loan") from the Financier, subject to the terms and conditions of this Agreement.

4. DEPOSIT OR INVESTMENT. The Financier and Recipient acknowledge that fifty percent of the Funds, or $_____ (amount in writing), was received by the Recipient as a deposit or investment (the "Deposit") from the Financier.

5. SPECIFIC AGREEMENTS, REPRESENTATIONS AND PROMISES OF THE RECIPIENT. The Recipient agrees, represents and promises, without limitation, as follows:

a. The Recipient shall not disclose or confirm to any party the fact that this Agreement was entered into, nor shall the Recipient enter into, make or confirm any representation that a religious or secular partnership, joint venture or agency relationship was established between it and the Financier; provided, however, that this provision in no way restricts the Recipient: (1) from making any oral or written statements to the Rabbinic Court referred to in paragraph "12" hereinbelow; (2) from raising the existence of this permissible venture agreement as a defense to any action instituted by the Financier in a secular court; or (3) from making a statement required of the Recipient by secular law;

b. The Recipient shall not in any way use the Financier's name in connection with the business conducted by the Recipient pursuant to this Agreement;

c. The Recipient shall invest the Loan in the Business and at no time during the term of this Agreement shall the Recipient withdraw any part of the Loan from the Business;

d. The Recipient shall invest the Deposit and all undistributed profits therefrom or proceeds thereof with diligence and with scrupulous care, which the parties hereto recognize as requiring more than the mere exercise by the Recipient of its business judgment, on behalf of the Financier in the Business;

e. There shall be an irrebuttable presumption that the Deposit was invested by the Recipient in the most profitable business activity or activities that the Recipient pursued during the term of this permissible venture agreement. If no activity was profitable, there shall be an irrebuttable presumption that the Deposit was invested by the Recipient in the business activity or activities which under the terms of this permissible venture agreement would be the least unprofitable to the Financier. In order to establish that there were no profits pursuant to paragraph "7" hereinbelow, the Recipient must take the oath described therein as to each business activity that he so pursued. In order to establish that there were net losses pursuant to para-

graph "5h" hereinbelow, the Recipient must adduce proper witnesses as to each such business activity that he so pursued;

f. The Recipient shall immediately notify the Financier of the extent of any net losses from the Business during any monthly period; (Other restrictive conditions may be added regarding the manner or type of business which can be pursued, the manner in which the deposit, the profit therefrom or the proceeds thereof are maintained or protected, or the manner or the type of ongoing financial disclosures required from the Recipient.)

g. The Recipient shall defend the Financier against, hold the Financier harmless from, and indemnify the Financier as to, any loss, debt, obligation or liability which might arise under or as a result of this Agreement, other than for the loss of part or all of the Deposit pursuant to paragraph "5h" hereinbelow;

h. The Recipient shall repay to the Financier the amount of the Deposit on or before _____, along with the Financier's share of any undistributed profits therefrom; provided, however, that if the Business has net losses, the amount the Financier shall be obligated to repay shall be reduced by an amount obtained by multiplying the total net losses by a fraction whose numerator is the Deposit and whose denominator is the total amount of money, including the Deposit, which is invested in the Business. In the event that the Recipient fails to make such payment on time, he shall be in breach of this Agreement. Nonetheless, until the payment is made, the Recipient shall continue to be responsible for the Deposit on the terms and conditions set forth in this Agreement.

In the event of any dispute as to the existence or amount of net losses, the Recipient shall have the burden of proving that there were net losses and, the extent thereof. He may prove the existence and extent of net losses, as well as the extent of other money invested in the Business, only by offering the competent testimony of [either specify two particular persons and require that they are qualified to offer testimony at the time of the dispute or simply refer to "two persons qualified to offer testimony"]. Competence and qualification are to be determined in accordance with Jewish law. In addition, to be effective, the testimony must establish that there were net losses the extent of the losses, and the amount of the total investment in each and every one of the business activities which the Recipient pursued during the term of this permissible venture agreement.

In the event that the Recipient adduces such testimony, he

must also take a solemn oath administered by (name of particular rabbi(s) or rabbinic organization) in (name of place) in front of (names of particular people or congregation) while holding a Torah scroll in which oath the Recipient states that the Recipient has faithfully fulfilled all of his obligations and responsibilities under this permissible venture agreement, including, without limitation, that he has invested the Deposit diligently and with scrupulous care.

[The Recipient hereby grants to the Financier a _____% [this percentage should be determined by a fraction whose numerator is the amount of the Deposit and whose denominator is the sum of the amount of the Deposit and the amount which the Recipient is to invest in the Business] security interest in the assets used in the Business, said security interest being expressly subordinate to the claims of creditors of the Business.]

Upon such repayment, title to any property vesting under Jewish law in the Financier pursuant to paragraph "6" hereof, shall automatically vest in the Financier.

i. The Recipient shall account for and pay to Financier, on the _____ day of each month of the civil calendar, beginning _____, any rights of the Financier to profits from the Business, as set forth in paragraph "7" hereof.

j. Notwithstanding the provisions of subparagraphs "h" and "i" above, in the event that there are net Business losses in any monthly period or in the event that the Recipient breaches this Agreement, the Financier may immediately require the repayment of the Loan and the Deposit, plus the Financier's share of profits to date, pursuant to paragraph "7" hereinbelow, or minus the Financier's share of net losses to date, pursuant to paragraph "5h" hereinabove.

6. TITLE TO OBJECTS ACQUIRED. Under Jewish law, title to any objects acquired through use of the Deposit, the profits therefrom or proceeds thereof shall be vested in the Financier. The Recipient may commingle the proceeds with the Loan or with other monies invested by the Recipient. In the event of such commingling, the title, under Jewish law, of any objects acquired through the use of the deposit, the profits therefrom or the proceeds thereof, shall vest in the Financier and Recipient with the proportionate undivided share of each being equal to his respective share of the total monies so invested in the Business.

Nevertheless, under the laws of the State of _____ _____, and under other secular law, including

the Internal Revenue Code, such title shall not vest in the Financier, but in the Recipient, provided that this provision does not cause this Agreement, or any part hereof, to be violative of Jewish law.

7. FINANCIER'S RIGHTS TO PROFITS. The Financier and the Recipient shall share all net profits from the Business on an equal basis. Thus, the Financier shall receive an amount obtained by multiplying the net profits by a fraction whose numerator is the Deposit and whose denominator is the total amount invested in the said Business. Nonetheless, the Recipient anticipates net profits of at least _____% per annum of the Deposit. It shall be presumed that the Business was profitable to this extent until and unless the Recipient takes a solemn oath administered by (name of particular rabbi(s) or rabbinic organization) in (name of place) in front of (names of particular people or congregation) while holding a Torah scroll in which oath the Recipient: (1) states that there was no business activity which the Recipient pursued during the term of this permissible venture agreement in which there was a profit equal to or more than _____% per annum of the Deposit; (2) identifies which of the business activities were most profitable and, as to each, specifies the profits which were made; and (3) states that the Recipient has faithfully fulfilled all of his obligations and responsibilities under this permissible venture agreement, including, without limitation, that he has invested the Deposit diligently and with scrupulous care. The Financier agrees to forgive its claims as to any excess profits if, for such applicable period, the Recipient pays to the Financier an amount equal to _____% (this should be one-half of the percentage figure filled in on the first blank in this subparagraph) per annum on the aggregate sum of the Funds.

8. PAYMENT TO THE RECIPIENT. The Recipient acknowledges receipt, contemporaneous herewith, of $1.00 as compensation under Jewish law for his services in connection with the Deposit.

9. PROOF OF RECIPIENT'S PERFORMANCE. In the event that the Financier contends that the Recipient has failed to faithfully discharge one or more of the Recipient's obligations or responsibilities hereunder, the Recipient shall have the burden of proving that he has faithfully fulfilled all said obligations and responsibilities. He may prove compliance and fulfillment only by offering the competent testimony of two persons qualified to of-

fer testimony. Such competence and qualification are to be determined in accordance with Jewish law.

10. RECIPIENT'S CONTROL OF BUSINESS. The Financier shall have no control over or responsibility for the management or operation of the Business. Control shall belong exclusively to the Recipient.

11. REFERENCES TO JEWISH LAW. Any references herein to "Jewish law" are intended to refer to religious rules pertaining to Jews which are set forth in *Shulkhan Arukh.*

12. MANDATORY, BINDING ARBITRATION. (Insert a clause requiring mandatory, binding arbitration before a specific rabbinic panel empowered to authorize an arbitration award based on Jewish law. Ensure that the clause meets all of the conditions required in the particular jurisdiction to permit an award resulting from arbitration to be docketed as a civil judgment.)

IN WITNESS WHEREOF, the parties hereto place their hands and seals hereon, this _____ day of _____, 19_____.

WITNESS:

_____ _____

_____ _____