



BANKRUPTCY IN HALACHAH

Credit is the lifeblood of modern economies. Home loans, car loans and business loans allow the consumer, individual businessman and corporation to finance purchases and investment, which spurs demand, creates jobs and allows economies to grow.

However, a careful balance is required. Too little credit will slow an economy down and cause a recession, while too much credit can lead to inflation, housing bubbles and borrowers taking on more debt than they can afford. This was evidenced by the implosion of the real estate market and the surge in the foreclosure rate at the end of the last decade. When companies or individuals find themselves unable to service their debt, they commonly have no choice but to resort to bankruptcy.

Chapters 7 and 11

In previous times, a debtor incapable of repaying a loan was thrown into debtors' prison. Nowadays, most countries have some form of court-supervised bankruptcy proceedings. In the United States, the most common forms of bankruptcy are Chapter 7 and Chapter 11. Chapter 7 allows for a corporation or individual to submit all his assets to the court, which liquidates the assets and distributes the proceeds to the creditors. Chapter 11 allows for the debtor to remain an ongoing concern by reducing the amount of the debt to be repaid and/or extending the maturities of the debt. In either case, the process absolves the debtor from any additional liability, even if he subsequently recovers financially and has the wherewithal to pay the debt in full.

The underlying theory of bankruptcy is that while individual creditors stand to lose when bankruptcy is declared, the net result of these laws is beneficial to society. If a debtor would remain liable for his overwhelming debts, he might be unable to recover and become reliant on government help, rather than starting anew and (hopefully) becoming a productive member of society. Chapter 11 bankruptcy enables a company to remain a going concern, which tends to preserve jobs and allows it to recover or be sold, which benefits the economy.

Repaying Loans in Halachah

Repaying a loan is a Torah imperative,¹ and refusing to repay may involve a violation of a negative precept as well.²

While the Torah is sensitive to a borrower who does not have the means to repay a loan, *Halachah* has no bankruptcy mechanism that would discharge one's debts. As such, it would seem that although civil law may allow a debtor to discharge his debt, this would not absolve a Jew of his halachic obligation to repay his loan.

Dina d'Malchusa Dina

Dina d'malchusa dina is an oft-quoted but poorly understood term. To complicate matters, the varying opinions and the parameters of the law are hard to clarify. Simply put, it loosely translates as "the law of the land is the law." This means that a king or any sovereign entity has the right to enact laws or collect taxes that are necessary. Therefore, a Jewish citizen who violates these laws is in violation of *Halachah* as well. The question, of course, is, how expansive is *dina d'malchusa*? In regard to this matter, there are essentially three principal views as to how broadly *dina d'malchusa* can be applied:

1. It is limited strictly to areas critical for a government to function, such as taxes, currency regulation, import and export regulations, etc. Therefore, any evasion of taxes by a Jewish citizen is not only a violation of federal law, but is also a violation of *Halachah*. This more limited view is adopted by the *Mechaber*.³
2. It applies to any legislation that aids in the smooth functioning of society. This more expansive view is codified as *Halachah* by the Rema.⁴
3. The Shach⁵ limits *dina d'malchusa* to areas where it does not directly contradict an existing *halachah*.

Dina d'Malchusa and Bankruptcy

Bankruptcy laws are not a critical requirement of government. Therefore it would seem that *dina d'malchusa* would not be applicable according to the view of the *Mechaber*. Similarly, permanent discharge of loans is in direct contradiction to Torah law; therefore relief under bankruptcy laws would not be permissible according to the opinion of the Shach. However, since these laws were enacted for the benefit of society, it would seem that bankruptcy could be valid halachically according to the Rema.



Of course, it needs to be analyzed whether bankruptcy laws in fact have a net positive benefit for society. If it were found that on the whole these laws were being abused and in actuality did little more than provide safe haven for reckless debtors, it would seem that even according to the Rema, they would not have halachic validity.

Minhag Hasochrim

Another area relevant to our discussion is that of *minhag hasochrim* (customary business practice). The Gemara explains that “*minhag mevatal halachah*” — local custom supersedes the *halachah*.⁶ The underlying rationale is that when two people consummate an agreement, the assumption is that they are doing so according to customary practice. Consequently, if either of the parties had in mind terms that were at variance with the local custom, they must stipulate so. Accordingly, it can be argued that when two parties transact in a country that has legal bankruptcy protection, each is accepting that risk unless they stipulate otherwise.

Application of Minhag

As with *dina d'malchusa*, the question is, how broadly do we apply the concept of *minhag mevatal halachah*?

The Maharshach dealt with a group of creditors of whom the majority were willing to extend the payment terms to their debtor. One creditor was unwilling to do so and wanted relief as granted to him by *Halachah*. The Maharshach ruled that since the custom among the merchants was that the majority could force the minority to a compromise, local custom would govern, and the lone creditor would have to acquiesce to the will of the others.

If *minhag* can force a creditor to accept an extended time frame, there does not seem to be any rationale to prevent *minhag* from allowing a complete discharge of the debt, as is the case in bankruptcy. Indeed, both Rabbis Blau and Basri apply the ruling of the Maharshach to modern bankruptcy discharge.⁷ However, a counter argument can be made that personal bankruptcy is not common enough today to qualify as a *minhag*.

Corporations

The discussion above is regarding personal bankruptcy. In

contrast, corporate bankruptcy is accepted by all *poskim* with little debate, since the entire concept of the corporation was created in order to limit the liability of the shareholders; thus, anyone transacting with a corporation is implicitly accepting that he has no recourse beyond the corporate assets.

Poskim and Modern-Day Bankruptcy

Harav Moshe Feinstein, *zt”l*, validates bankruptcy based on *dina d'malchusa*, as per the opinion of the Rema.⁸ Although the *teshuvah* deals with asset allocation and not permanent discharge, he seems to suggest that all areas where the government has a vested interest in consistency would be covered by *dina d'malchusa*. Other *poskim*, as mentioned above, allow for bankruptcy based on customary business practice, as expressed by the Maharshach.

While these *Poskim* rule that bankruptcy release is halachically valid, there is basis to argue that there is an ethical “*latzeis yedei Shamayim*” to repay the debt regardless. This is based on the *halachah* of *Shemittah*. Although *Shemittah* wipes out all loans (in the absence of a *pruzbul*), nevertheless the *Mishnah*⁹ praises one who insists on repaying his debts in spite of the release. Logically, this should apply to bankruptcy as well. While bankruptcy may wipe out the financial obligation, one who repays his creditors regardless would be praiseworthy.

Other *Poskim* however, argue that *halachah* does not accept bankruptcy. Harav Yaakov Breish has a dissenting opinion and argues that the *Mechaber* that limits *dina d'malchusa* to areas critical to the government would certainly reject modern bankruptcy discharge. Additionally, even the Rema would reject bankruptcy since it is not beneficial to society to allow people to default on their debts. (Rav Breish gave little credence to the argument that bankruptcy was a net positive to the economy.) Furthermore, because it runs counter to a clear *Halachah*, *dina d'malchusa* cannot apply, as per the Shach.¹⁰

It should be noted that the entire discussion applies only to a legitimate bankruptcy. But if a debtor denuded the corporation of its assets and then declared bankruptcy to avoid his creditors, all agree that *Halachah* would not recognize the subterfuge, and the debtor's liability would remain. ■

This article is for informational purposes only and should not be relied upon for paskening she'eilos. For practical halachah one should consult a Rav.

1. There is considerable discussion in the Rishonim as to exactly which mitzvah applies. See Rashi, Kesubos 86a, priyas; Shita Mekubetzes, *ibid.*, quoting Talmidei Rabbeinu Yonah; and Teshuvos Haradbaz (610) for three varying opinions.

2. See Ahavas Chessed, ch. 24.

3. C.M. 369:6.

4. C.M. 369:11.

5. C.M. 73:39; see also C.M. 356:10.

6. Yerushalmi, Bava Metzia 6:1. It is important to note that this principle exclusively applies to monetary matters and does not spill over to the other areas of Halachah.

7. Pischei Choshen, Hilchos Halvaah, ch. 2, note 63; Dinei Mamonos vol. 1, p. 71 note 17.

8. Igros Moshe, C.M., vol. 2, no. 62.

9. Sheviis 10:8.

10. Chelkas Yaakov, vol.2, no. 32.