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The Multi-Faceted Halakhic Identity of a Jewish Investment Broker

Nearly all investors in the securities markets must avail themselves of the services of brokerage firms. Even sophisticated investors who choose their own investment portfolio usually rely on brokerage services to execute their transactions. Other investors rely on brokers for their professional and (hopefully) informed and competent advice. Given the irrational exuberance that affected many investors in the trading markets in the years prior to the 2008 market meltdown, it behooves us to address, from a halakhic perspective, some of the issues which emerge in a broker-client relationship.[1]

The purpose of this essay is to address whether a Jewish investment broker or a manager who owns partnership interests in a fund is liable for failing to comply with his Jewish client's instructions to execute a buy or sell of an investment product.[2] For example, if the broker fails to sell a security and the investment declines in value, is the broker liable for the

[1] The issue of a broker providing incomplete or false information such as a misrepresentation of investment earnings, failure to warn a customer of the dangers of the lack of diversification such as over-concentration in volatile securities or over-leveraging through margin borrowing have been addressed in this writer's, "The Investment Advisor: Liabilities & Halachic Identity," *Journal of Halacha and Contemporary Society* 58 (Fall 2009), p. 107 (hereafter, "*The Investment Advisor*"), and will be further focused upon in the forthcoming, "The Scope of the Tort of Negligent Misrepresentation in Investment Planning," *Jewish Law Annual* 19 (2011), and therefore will not be discussed in this forum.

Additionally, there are other realms of halakha which impact upon a broker's identity, namely, *hilkhot hit'hayyevut,* i.e., laws of obligations including but not limited to labor relations, and surety [i.e., *arevut*] relations, and laws of theft, all of which are beyond the scope of this presentation.

[2] An investment broker must be distinguished from an investment advisor. An investment advisor furnishes to clients personal, competent, unbiased, ongoing advice regarding the management of their investment portfolio. The Investment Advisors Act of 1940 obligates an advisor to act solely in the best interests of his clients.

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loss? If the broker fails to buy a product he's been instructed to buy, and the security increases in value, is the broker liable for the loss of anticipated profits? A reply to these questions and others requires us to examine the multi-faceted identity of a broker and an investment manager of a fund as a *shaliah*, i.e. an agent, and as a *shomer*, i.e. a bailee.[3]

A broker may service his clientele with two types of accounts. One type of a brokerage account is non-discretionary, which requires a customer's authorization prior to the execution of any investment transactions. The duties of a broker handling such an account are more than simply being an "order taker" who competently executes a securities transaction for a client who manages his own investment portfolio. In the absence of any written agreement between the broker and the client, the duties required in handling a non-discretionary account include due diligence in evaluating an investment, the duty to execute an order promptly in accordance with the client's instructions and best interests, the obligation

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On the other hand, a broker is engaged in effecting transactions in securities for the accounts of others. A broker is regulated by the National Association of Securities Dealers which mandates "a suitability standard" whereby a broker must always put the client's interest before the broker's own and the investment must be suitable for the client, but, for example, not necessarily the least expensive. Based upon New York Stock Exchange Rule 405, brokerage houses must perform due diligence in determining a client's net worth, income and investment expectations prior to accepting to service an account. Given that the definition of financial risk is a function of the above factors, in the words of Prof. Aaron Levine, "rule 405 should be viewed as society's judgment that risk is an inherent *defect* of a financial product." See Aaron Levine, *Case Studies in Jewish Business Ethics*, (Ktav: New York, 2000), p. 124.

Clearly, discount brokers and online discounters owe no suitability duty when merely serving as "order clerks" executing an unsolicited purchase order to purchase an unrecommended security. However, a discount brokerage would owe a suitability obligation to a customer if it engaged in a pattern of conduct that would constitute a "recommendation." See Laura Unger, Commissioner, SEC, "On-Line Brokerage: Keeping Apace of Cyberspace" (November 1999).

This essay is limited to addressing a broker's responsibility vis-à-vis his clients.

[3] For contemporary *teshuvot* which view a broker through the prism of *hilkhot shelihut* and *shomerim*, see Shear Yashuv Cohen, "The Responsibility of Economic Advisors" (in Hebrew), *Torah She-be-al Peh*, vol. 26 (5745), p. 33; *Piskei Din shel Battei ha-Din ha-Rabbaniyim* (hereafter: *PDR)* 9:16 (Rabbis Tenna, Nesher and Horowitz); *Iggerot Moshe, Hoshen Mishpat,* vol. 2, no.16; *Piskei Din mi-Bet Din le-Dinnei Mammonot u-le-Birur Yahadut*, 4: 265; *Mishpatekha le-Ya'akov*, v.ol. 2, no. 34.

Our analysis is not limited to a broker who may sell partnership interests in a financial product but equally applies to an investment manager who sells partnership interests in his fund. In other words, the manager and clients are partners in a fund. See *Bava Batra* 42b; *Tur, Hoshen Mishpat* 176:11; *Shulhan Arukh, Hoshen Mishpat* 176:8 and infra text accompanying notes 69-81.

to refrain from any self-dealing, and the obligation not to misrepresent any fact relating to the trade.[4] As such, brokers are not mere "order clerks" mechanically executing buy and sell orders. Nevertheless, the broker's services are transaction-specific and are limited to a faithful execution of the client's instructions; rather than offering risk assessments such as the dangers of the lack of diversification or over-concentration in volatile securities.[5] In many instances, account agreements make it explicitly clear that the customer is responsible for his own investments.[6]

[4] *Leib v. Merrill Lynch, Pierce Fenner & Smith, Inc.*, 461 F. Supp. 951, 952-953 (E.D. Mich. 1978), *affirmed*, 647 F.2d 165 (6th Cir. 1981); *Merrill Lynch Pierce Fenner & Smith, Inc. v. Cheng,* 901 F. 2d. 1124, 1128 (D.C. Cir. 1990).

Clearly, the *halakhot* of *shelihut* and *shemira* furnish guidelines in defining the broker-client relationship. Nevertheless, given that we are dealing with monetary matters, halakha allows the parties to determine their own business relationship, provided that the arrangement complies with a proper form, e.g. *kinyan* and, is not violative of any prohibitions such as theft or the interdict against taking *ribbit*. See *Kiddushin* 19b; *Bet Yosef*, *Hoshen Mishpat* 305:4; Rema, *Hoshen Mishpat* 344:1. Consequently, if the prospectus or written agreement between the broker and customer varies from the norms of *hilkhot shelihut* and *shemira*, the agreement will be valid and binding upon the parties.

Pursuant to most decisors, such an arrangement will exempt the broker from responsibility for any negligent behavior. See *Meiri, Bava Metsia* 94a; *Teshuvot Maharit*, Vol. 2, *Hoshen Mishpat*, no. 116; *Arukh ha-Shulhan*, *Hoshen Mishpat* 344:1. Cf. R. Baruch of Regensburg, *Or Zarua, Bava Metsia*, no. 297.

Finally, once the client signs off on the agreement, generally speaking he cannot subsequently claim that he did not understand what he signed or failed to read all the provisions of the agreement. See *Shulhan Arukh, Even ha-Ezer* 61:13, *Shulhan Arukh and Rema*, *Hoshen Mishpat*, 45:3. For a contemporary application of this ruling to brokers, see *PDR*, supra n. 3, at 25.

[5] Possibly a broker would breach his duty to his client if the broker front-runs an order authorized by the customer by trading in advance of executing the order, perhaps in awaiting its impact on the market.

[6] Should a customer be unsophisticated with regard to financial matters or exhibit diminished capabilities such as being a victim of a stroke, the broker is additionally obligated to inform his customer regarding any attendant risks in choosing a particular security. In such circumstances, the broker effectively assumes control of the account, negating its nondiscretionary status. See *Hecht v. Harris, Upham & Co.*, 430 F. 2d 1202 (9th Cir. 1970); *Leib v. Merrill Lynch, Pierce Fenner & Smith, Inc.*, 461 F. Supp. 951, 954-955 (E.D. Mich. 1978), *affirmed*, 647 F.2d 165 (6th Cir. 1981); **);** *Duffy v. Cavalier, 264 Cal. Rptr.* 740, 750 (Ct. App. 1989); *Beckstrom v. Parnell*, 730 So. 2d 942 (La. Ct. App. 1998).

Cf. case law which mandates a broker's duty to warn a sophisticated client regarding the dangers of certain risky investment choices. See *Gochnauer v. A.G. Edwards & Co.*, 810 F.2d 1042, 1044 (11th Cir. 1987; *Quick & Reilly, Inc. v. Walker*, 930 F. 2d 29 (9th Cir. 1991).

I.

What happens, however, if the broker abstains from following his client's instructions to purchase an investment and the product subsequently declines in value? Is the broker liable to reimburse his client for the ensuing loss of anticipated profits?

Halakha provides that a broker, similar to an agent, should execute an agreement with his client either through oral communication or in writing. As *Shulhan Arukh* rules,[7] "If one instructs his agent 'proceed and sell land or chattel for me', or 'acquire for me,' the agent sells and buys and executes his mission…and one who appoints an agent does not require a *kinyan* or witnesses."

Or as R. Samuel de Medina observes, "Authorizing an agency via writing is more effective than orally creating one."[8] An agency agreement in writing provides the terms of the agent's mandate (and by extension a broker's performance) as well as the consequences of his failure to perform. In short, the broker has actual authority to engage in trading on behalf of his customer. This agreement serves as the broker's mandate to serve the best interests of his client and defines the parameters of his mandate.[9]

Nevertheless, should a broker abstain from executing a transaction, is he liable for any ensuing loss of anticipated profits? The halakhic stance regarding this matter has been recently summarized by Dr. Michael Wygoda, Senior Director of Jewish Law at the Ministry of Justice in Israel,[10]

> The principal… has no legal claim, but merely a grievance, against an agent who fails to carry out his mandate… however, if the principal sustains a loss because of the agent's action, he is, in some cases, entitled to claim damages from the agent, and need not make do with expressing a grievance…
>
> Some early authorities hold that, in principle, the preclusion of profits is indeed not grounds for indemnification… Other early authorities, however, maintain that… in principle, prevention of profit does provide grounds for a claim, provided the anticipated profit was certain…

[7] *Shulhan Arukh*, *Hoshen Mishpat* 182:1

[8] *Teshuvot Maharashdam, Hoshen Mishpat*, no. 146.

[9] For a summary overview of agency law in English sources, see Issac Herzog, *The Main Institutions of Jewish Law,* (Soncino: London, 1967), vol. 2, pp. 141-153; Emanuel Quint, *A Restatement of Rabbinic Civil Law* (J. Aronson: New Jersey, 1995), vol. 6, pp. 49-80.

[10] Michael Wygoda, "The Agent who Breaches his Principal's Trust," vol. 18 *The Jewish Law Annual* (2009), pp. 265, 273, 285-286.

Numerous authorities ascribed to the latter approach and argue that in cases where the profit is speculative or dependent upon the actions of a third party, there is no recovery for lost profits.[11] Consequently, given our situation, the value of securities is subject to market fluctuation; hence, a broker who fails to execute his mandate to buy or sell a product is exempt from liability for any lost profits.

The above conclusion is corroborated by the dominant interpretation of the following Talmudic passage:[12]

> If someone gives money to his friend to go and purchase wine for him during the season while the price was low, but he was negligent and failed to buy it, the law is that he has to pay him with wine according to the low price.

Here, a promise was made, the promisee relied upon the promisor to purchase wine, and the promisee suffered monetary loss. The Talmud concludes that the promisor is liable to compensate for the harm incurred. Many opine that the compensation resulting from the promisee's reliance is due to the fact that the promisor explicitly agreed at the time the agreement was made to reimburse the promisee for the loss resulting from failure to finalize the wine purchase.[13] Analogously, a written agreement between a broker and his client mandating liability for failure to execute a transaction would be valid. On the other hand, in the absence of such

[11] *Sefer Ra'avya* , no. 957 (Deblitsky edition); *Netivot ha-Mishpat, Hoshen Mishpat* 183:1; *Teshuvot Radvaz* ,vol. 1, no. 399; *Teshuvot Havot Yair*, no. 151; *Maharash ha-Levi, Even ha-Ezer,* no. 5; *Teshuvot Maharits,* vol. 1, no. 167; *Teshuvot Hatam Sofer, Hoshen Mishpat*, no. 178.

[12] *Bava Metsia* 73b.

[13] *Piskei ha-Rosh*, *Bava Metsia* 73b; *Mordekhai*, *Bava Kamma*, nos. 114-115; *Teshuvot Maharam*, Cremona edition, no.103. Furthermore, such an agreement must not run afoul of the strictures of *asmachta*, i.e. the lack of firm resolve of the obligator such as the absence of the execution of a *kinyan*. See *Siftei Kohen, Hoshen Mishpat* 40:4; 61:10. Whether commercial practice may validate an agreement which runs afoul of *asmachta* is subject to debate. See *Shulhan Arukh, Hoshen Mishpat* 207:16*; PDR* 3:131, 139-149; 14: 334,344

Cf. others who contend that preclusion of profit is illustrative of a case of *gerama*, i.e. indirect causation, and one is exempt from acts of *gerama*, or that it is a case of *asmakhta*, i.e. that the individual who undertook the obligation did not firmly resolve that he would receive the profits and therefore no obligation was ever undertaken. See *Talmud Yerushalmi, Bava Metsi'a* 5:3; *Shakh, Hoshen Mishpat* 207:16.

Whether a recovery of lost profits known in legal parlance as an example of consequential damages is a violation of the prohibition of *ribbis* is beyond the scope of this presentation.

an agreement, any harm suffered from relying upon the promise would be unrecoverable.[14]

What happens, however, in a situation where the broker receives instructions to sell an investment product such as a stock or bond and the broker fails to carry out his client's instructions and the customer sustains losses due to the broker's inaction? At first glance, absent any agreement that states otherwise, given that the damage was only indirect (*gerama*), and the ruling that "one who causes indirect damage is exempt from liability" (*gerama be-nezikin patur*),[15] the broker cannot be considered legally liable for his client's losses.[16]

As we will demonstrate, however, the broker as an agent may nevertheless be deemed legally liable by virtue of his status as a *shomer sakhar*, i.e., paid bailee, who is liable for negligence including *gerama*, loss, and theft, and is entrusted with managing the purchase/sale of stocks, bonds, annuities, or mutual funds which are objects of *shemirah*, i.e., bailment, and therefore subject to *hilkhot shemirah*.[17] Given that the client instructed

[14] However, there exists the minority opinion of the *Ra'ah* who argues that one does not require an agreement that provides for recovery for anticipated profits. In lieu of an agreement, by giving money to the agent to execute a wine purchase at an attractive price and hearing the promisor's words, the promisee relied upon the promisor's compliance. For further discussion of how to understand this position, see *Novellae of Ritva, Bava Metsia* 73b, 75b and this writer's forthcoming "A Theory of Efficient Breach: A Jewish Law Perspective," in Aaron Levine,(ed.) *The Oxford Handbook on Judaism and Economics*, (Oxford University Press: N.Y., 2010), pp. 340, 347-348. Invoking such a position requires that it is certain that there will be an accrual of profit. See *Teshuvot Hatam Sofer, Hoshen Mishpat,* no. 178; *Hazon Ish, Bava Kamma* 22:20. Consequently, in situations where profit would have clearly accrued and the broker abstained from executing the transaction, he would be liable. See *PDR* supra at n. 3, at p. 50. Cf. *Ginat Egoz*, no. 51 and *Piskei Din me-Bet Din le-Dinei Mamonot u-le-Berur Yahadut*, 4: 265, 269 who seem to understand the *Ra'ah*'s position as obligating a broker to pay even in a case where the yielding of profit is uncertain.

[15] *Bava Kamma* 60a; *Bava Batra* 22b. Alternatively, given that a broker is viewed as a *shomer* and *shaliah*, he would be liable for acts of *gerama*. See *Teshuvot Yaavets*, vol. 1, no. 85; *Teshuvot Teshurat Shai*, vol. 1, no. 593; *Teshuvot Hatam Sofer, Hoshen Mishpat* no. 140..

[16] However, morally he would be obligated to furnish compensation. See *Mishna Bava Kamma* 6:4, 16. Moreover, according to the Ra'ah's view (see supra n. 14), he would be liable. And possibly, as suggested by Dr. Wygoda and Haym Zafri, this is the basis of R. Feinstein's ruling that a broker who refrains from selling a stock, which subsequently depreciates, is liable for losses incurred. See *Iggerot Moshe*, supra n. 3, Haym Zafri and Michael Wygoda, Agency, Section 9, Ministry of Justice, Jerusalem: Israel [manuscript on file with author].

[17] Shear Yashuv Cohen, supra n. 3; *Teshuvot Iggerot Moshe,* supra n. 3*; PDR*, supra n. 14*; Hoshen Mishpat* 2:16; *Piskei Din me-Bet Din le-Dinei Mammonot u-le-Berur Yahadut*, 4: 265; *Sefer Meshiv be-Halakha,* pp. 138-140, 170.

the broker to execute certain transactions, in exchange for which the broker would receive compensation, the broker is considered a *shomer sakhar*.[18]

Implicit in our presentation is that halakha recognizes commercial relationships which primarily entail the accumulation of wealth and are accompanied by the entrustment of assets, i.e., bailment, to the broker. Is this the case? For example, the Talmud discusses a partnership arrangement which is called an "*iska*." This arrangement is defined as "*palga milveh u-palga pikkadon*", i.e., half loan and half bailment. The investing partner invests the funds which are required for the business enterprise and plays no role in managing the business, while the managing partner uses the investor's capital to operate the business. Unless stipulated otherwise, all profits and losses are to be divided equally between the two partners. The investing partner receives the profits from the half which is designated as a loan and the managing partner receives his profits from the half labeled as a bailment. In effect, the managing partner receives remuneration for his time and effort in managing the bailment.[19] The *iska* arrangement is an example where an individual is managing somebody else's money while being entrusted as a bailee to protect those assets.

In viewing an agent as a bailee who is entrusted with assets within a commercial setting, it is unsurprising to find the following responsum penned by R. Joseph Trani which addresses our issue of liability for damages incurred by indirect causation. R. Trani deals with an agent who was remunerated and authorized to sell merchandise given to him by the principal, but failed to finalize the sale. Is he liable for its depreciated value? Though in terms of *hilkhot nezikin* we are dealing with a case of *gramma*, we would expect the agent to be exempt from liability. Nevertheless, R. Trani concludes that the agent is liable for indirectly caused damages.[20] In effect, the *halakhot* of *shelihut* and *shomerim* trump the *halakhot* of *nezikin*. R. Trani's posture is endorsed by others.[21]

Given a broker's receipt of compensation for his willingness to serve as an agent for his client, he has the status of a *shomer sakhar*. See *Teshuvot Shevut Ya'akov*, vol. 3, No. 142; *Teshuvot Maharik*, Shoresh no. 131.

Regarding securities as an object of *shemira*, see *The Investment Advisor*, supra n. 1, at p.12

[18] *Tur, Hoshen Mishpat* 185:7; *Shulhan Arukh, Hoshen Mishpat* 185:7.

[19] As such, according to most decisors, the laws of a paid bailee, i.e., *shomer sakhar*, govern his relationship to the *iska*. See *Shulhan Arukh, Yoreh De'ah* 177:5; *Teshuvot Torat Hayyim*, vol. 1, no.75.

[20] *Teshuvot Maharit*, *Hoshen Mishpat*, no. 110.

[21] *Divrei Geonim* 15:17, 95:32. See supra n. 15.

Seemingly, we may analogize to our case of the broker who fails to fulfill his customer's mandate. Just as in R. Trani's case, where the businessman is liable for failure to sell the merchandise, a broker who fails to act should be liable for any subsequent damages. Implicit in both cases, is that an agent who serves equally as a bailee is responsible for the depreciation of the value of the bailment entrusted to him.

Does a *shomer*'s duty of care [and by extension a *shaliah's* duty] extend to protecting the market value of an asset in his safekeeping or is it limited to ensuring the physical state of the bailment? The resolution of this issue emerges from a question regarding the prohibition to benefit from *hamets* that was in the possession of a Jew over Pesah (*hamets she'avar alav ha-Pesah*). If a Jew deposits *hamets* with a fellow Jew on the eve of Pesah and the Jewish bailee neglects to sell the *hamets* to a gentile before the onset of Pesah, will the owner of the *hamets* be forbidden to derive benefit from it after Pesah?[22] Is a *shomer* obligated to prevent the loss of the *hamets*'s value? Most decisors argue that a *shomer*'s responsibility is limited to ensuring the preservation of the physical state of the bailment, namely the actual *hamets*, no different than the Talmudic conclusion regarding the *shomer*'s duty to prevent the spoilage of fruit.[23]

Nevertheless, in situations of potential devaluation of currency or depreciation of documentation such as a lottery ticket, most authorities argue that a *shomer* is obligated to redeem this currency lest the owner of the assets incur financial loss.[24] For example, in case of an agent's neglect to extend the expiration date of a lottery ticket, R. Yaakov Emden ruled that he should indemnify the principal for the market value of the ticket prior to its expiration date.[25] Without having to render an independent authoritative opinion of our own regarding this issue, pursuant to majority rule, we may conclude that in cases of imminent document or currency depreciation, a *shomer* must engage in safekeeping and save the value of his client's assets.[26]

[22] *Pesahim* 13a. See *The Investment Advisor*, supra n. 1 at pp.15-16.

[23] *Bava Metsia* 38a; *Tosafot Bava Metsia* 30a, *s.v. letsorkho*; *Teshuvot Meshiv Davar,* vol. 3, no.18; *Taz, Orah Hayyim* 443:4; *Mishnah Berurah, Orah Hayyim* 443:16; *Teshuvot Iggerot Moshe, Hoshen Mishpat,* vol. 2, no. 16. Cf. *Magen Avraham, Orah Hayyim* 443:5; *Teshuvot Bet Ephraim*, *Orah Hayyim*, no. 37; *Teshuvot Hatam Sofer, Orah Hayyim*, no. 105; Baruch Kahane, *Shomerim*, pp. 351-354.

[24] *Teshuvot Zekan Aharon*, vol. 1, no. 112; *Teshuvot Teshurat Shai*, no. 593; *Teshuvot Tarshish Shoham,* no.105; *Teshuvot Sha'arei Rahamim, Hoshen Mishpat,* no. 13. Cf. *Teshuvot Mishpatekha le-Yaakov, Orah Hayyim*, no. 24; *Teshuvot Imrei Yosher*, vol. 2, no. 185.

[25] *Teshuvot She'elat Ya'avets*, supra n. 15

[26] *Mishnah Berurah* 443:16.

Similarly, one may argue that a *shomer* who is aware of a potential loss in the market value of an investment and fails to sell the investment is liable for the loss.[27] On the other hand, given that a nondiscretionary account is transaction-specific, once the transaction is executed, absent any agreement to the contrary, the broker has discharged his mandate and therefore the *halakhot* of agency and bailment no longer govern his relationship with the client. Should the investment depreciate, the broker is no longer under any *halakhic-legal* obligation to avert any of the client's losses. In other words, such a claim for losses incurred generates no monetary redress and therefore will not be addressed by a bet din.

However, should the broker become aware at some juncture that his former client's investments are depreciating he is obligated to sell his former client's assets. There is a duty based upon the Biblical exhortation relating to the restoration of lost property, "And you shall return it to your brother,"[28] which directs one to save a fellow Jew's assets in the case that there is an impending clear loss.[29] After the transaction is executed and the broker has discharged his duties as memorialized in the agreement, should the broker become aware that his former client's investment has declined in value, he may sell it with the former client's consent and it is understood that he can charge the client for professional services rendered.[30] Though generally one should restore property gratuitously,[31] nevertheless the finder should not incur a financial loss, even a preclusion of profit, and therefore he should justifiably be reimbursed for his

[27] Given this diversity of halakhic opinion, one contemporary authority concluded that one cannot extract money from a money changer (an agent who equally serves as a bailee) if he fails to exchange the currency prior to an impending devaluation. See *Berurei Halakha*, vol. 4, p. 12. In effect, pursuant to this position, one would be unable to file a claim in a *bet din* against a broker who manages a nondiscretionary account, fails to sell an investment, and generates a loss for his client. It is worth noting that this authority failed to factor into his decision the discussion of currency devaluation discussed in the text accompanying notes 24-25 and endorsed the majority opinion regarding *hamets she'avar alav ha-Pesah*. A discussion of this matter may have motivated him to reconsider his ruling.

Regarding the issue of whether the declining value of an investment is to be labeled a "*hezek she-eino nikkar*", i.e., imperceptible damage, see *The Investment Advisor*, supra n. 1, at p. 122, n. 53; and Wygoda, supra, n. 10, at p. 274, n. 25.

[28] Deut. 22:1.

[29] Rema, *Hoshen Mishpat* 294:6; *Teshuvot Sho'el u-Meshiv*, vol. 3, part 3, no. 160; *Teshuvot Mishnat Ya'avets* (Zolti), *Hoshen Mishpat*, 40:2.

[30] See *PDR* , supra n. 3, at 44; *Teshuvot Radvaz* , vol. 1, no. 313; *Hazon Yehezkel, Tosefta Bava Metsia* 2:9.

[31] *Shulhan Arukh, Hoshen Mishpat* 265:1

services rendered.[32] As noted by Rema, the *Ketsot ha-Hoshen*, and *Netivot ha-Mishpat*, recovery of a lost object is grounded in the concept that "a benefit may be conferred upon a person in his absence, but a burden may not be imposed on anyone unless he is present." In other words, should the conduct be construed in the eyes of the owner as a *hov*, i.e., a detriment, an individual must abstain from saving the asset.[33] Consequently, in the absence of an agreement otherwise, the client may feel that his former broker's involvement would be detrimental to his interests, and therefore the broker should abstain from saving his assets.

To avoid any potential problems such as the client's reluctance to have his broker execute another transaction, or the possibility that another broker will be hired to manage the customer's account, which would construed as a "*hov*" to the customer, the provisions of the first broker's agreement ought to address the parameters of their business relationship both prior to the broker's finalization of the transaction as well as his responsibilities after its consummation[34] (including his professional fees for services rendered[35]). In the absence of a written agreement, the broker should notify his former client regarding the depreciation and ask him whether he should sell the financial product.[36]

Our conclusion regarding a broker's ongoing responsibility after a customer's order has been executed stands in bold contrast to the position of American law which limits a broker's duty to the narrow task of warning his client of the risks of certain investments and then consummating the transaction requested rather than continuing to monitor his account and informing his client should his assets begin to depreciate.[37] However, we need to point out that the broker's duty to inform his client of asset depreciaion is a halakhic-moral obligation and therefore it cannot be enforced in a *bet din*. Absent a written agreement to the contrary, and

[32] *Shulhan Arukh, Hoshen Mishpat* 264:1; *Shulhan Arukh ha-Rav, Hilkhot Metsia u-Pikkadon*, 33.

[33] Rema, *Hoshen Mishpat* 262:1; *Netivot ha-Mishpat* ad. locum. *Ketsot ha-Hoshen, Hoshen Mishpat* 262:3.

[34] *PDR*, supra n. 3, at p. 36. In other words, though a broker may become aware of losses for his former client, nevertheless, unless there is an agreement between the parties regarding the broker's involvement in the customer's holdings after the finalization of the transaction, the broker should refrain from taking any action. See *Teshuvot Sho'el u-Meshiv*, supra n. 29.

[35] Rema, *Hoshen Mishpat* 265:1; *PDR*, supra n.3, at p. 36. Cf. *Shulhan Arukh, Hoshen Mishpat* 265:1; *Shakh*, ad. locum.

[36] *Pit'hei Hoshen, Aveidah* 7:1, n. 2.

[37] See supra notes 4 and 6; *De Kwiatkowski v. Bear, Stearns & Co.*, 306 F. 3d 1293 (2d Cir. 2002); *Press v. Chem. Inv. Servs. Corp.* 166 F. 3d 529, 536 (2d Cir. 1999).

given the pragmatic considerations of the broker's unawareness of the client's wishes and present management of the portfolio, should the broker refrain from "saving" the value of his client's assets, he is not liable for any ensuing loss.[38] In the words of R. Ephraim Navon, "we have not found that he is obligated to pay for recovery of a lost object."[39]

In short, on the one hand, pursuant to halakha, similar to American judicial opinion, a broker must warn an owner of a nondiscretionary account about the dangers of risky investment choices. On the other hand, unlike American law, with its tradition of rugged individualism, which inexorably serves as the ideological backdrop for a broker's circumscribed duties via-a-vis his client,[40] halakha instructs us that it is incumbent upon a broker to intervene on behalf of his former client by warning him of an impending loss from a recent trade.

In sum, if a broker is servicing a nondiscretionary account in a case of anticipated profits, there are no grounds for indemnification. On the other hand, should he fail to execute a client's instructions to sell an investment and the client suffers losses, he is liable. However, once a broker's duties have been discharged and the mandated transaction has been executed, unless the agreement provides otherwise, any subsequent losses due to market fluctuations are beyond the broker's halakhic responsibility.

What happens, however, if a client directs a broker to execute a transaction, but a few minutes prior to finalizing the buy or sell, circumstances have changed and the broker realizes that executing such a transaction

[38] *Shulhan Arukh, Hoshen Mishpat* 259:1; *Be'ur ha-Gra, Hoshen Mishpat* 348:22; *Ketsot ha-Hoshen, Hoshen Mishpat* 66:21; *Teshuvot Hakham Tsevi*, no. 132; *Mishnah Berurah*, 443:12. However, should the agreement indicate that, upon becoming aware of the decline of the investment, the broker is obligated to initiate steps to avert a loss, then the halakhic-moral duty of the restoration of lost property is transformed into a halakhic-legal duty which may be addressed in a *bet din* setting.

[39] *Mahaneh Ephraim, Hilkhot Shomrim*, no. 35.

[40] *Powers v. Francis I. DuPont & Co.,* 344 F. Supp. 429 (E.D. Pa. 1972; *Chee v. Marine Midland Bank*, No. 88 CIV. 0557, 1881 WL 15301 (E.D. N.Y. 1991); *T-Bill Option Club v. Brown & Co.,* No. 92-2737, 1994 U.S. App. LEXIS 11976 (7th Cir. May 23, 1994); Barbara Black and Jill Gross, "Economic Suicide: The Collision of Ethics and Risk in Securities Law," 64 *U. Pittsburgh L. Rev.*, pp. 483, 484-485 (2002-2003).

However, as noted by Prof. Aaron Levine (in a written communication to this author), in the case of a full service broker who receives a higher fee for his services, there is a requirement that ongoing advice regarding his investment continue to be offered even after the execution of a trade and the nondiscretionary account has been closed. See Black and Gross, op. cit., 499-503. In fact, industry practice suggests that a broker has a duty to monitor a client's portfolio after a transaction has been completed. See Black and Gross, op. cit., 504-505.

would result in losses to the client? Unable to contact his client regarding the impending loss, does the broker comply with his mandate and finalize the transaction, causing losses to his customer, or does he refrain from fulfilling his mandate in order to protect his client's interests?

Not only are the parties bound by the express terms of the agreement, an agreement which memorializes the broker's actual express authority, but certain duties are implied. Actual implied authority emerges within two contexts. Firstly, the broker must perform the client's mandate. Nevertheless, the broker must also do what is necessary to achieve the principal's objectives even if it is not memorialized in their agreement. Additionally, the agent may not have been explicitly mandated to take a particular action, but if he can infer that he is authorized to do so based upon the principal's goals, then he is authorized to execute such conduct.

The Talmud argues that an agency relationship is premised upon the fact that an agent "shall act for the benefit of the principal rather than his detriment."[41] As such, the *Shulhan Arukh* concludes, "Every principal who appoints an agent implicitly articulates that any detriment resulting from the agent's performance negates his agency."[42] Consequently, if the principal can demonstrate that the agent's actions undermine his mandate, the agency relationship is null and void.

The above *halakhot* of implied agency will apply equally to a broker's discretionary account as well as a non-discretionary account. Should circumstances arise that were not contemplated when the agreement was negotiated, would the agent be responsible? R. Samuel Kalai addressed a question regarding a principal who authorized an agent to deliver goods to a particular individual. Upon investigation, the agent discovered that the third party was impoverished and would therefore be unable to pay for the goods. Despite this clear warning signal, the agent delivered the goods to the third party. As anticipated, payment was not forthcoming. R. Kalai ruled that the agent had deviated from his mandate by undermining his implied authority to serve the principal's best interests, and he was therefore liable.[43]

Addressing a similar scenario, R. Samuel de Medina argues that by dint of the agent being a *shomer*, the significance of this warning sign should have propelled the agent to refrain from executing the

[41] *Kiddushin* 42b; *Ketubbot* 99b.
[42] *Hoshen Mishpat* 182:3
[43] *Teshuvot Mishpetei Shemuel*, no.52

transaction.[44] As a *shomer*, he was obligated to safeguard these goods rather than cause damage to his principal.[45]

In our scenario, if changed circumstances were not contemplated when the agreement was negotiated, and the execution of a transaction would incur losses for the client, it is incumbent upon the broker to refrain from finalizing the transaction.[46] For example, if Moody downgrades a firm's debt to "junk bond" status and this rating is announced prior to the opening of the futures market, it would be incumbent upon a broker to contact his customer to decide how to proceed.

II.

In the absence of any written agreement between the broker and the client, how does halakha address discretionary accounts where the broker fails to execute a transaction he was instructed to make and the value of the product subsequently declines? Is the broker liable to reimburse his client for the ensuing loss of anticipated profits?

In contrast to the management of a nondiscretionary account, a broker handling a discretionary account determines whether to buy or sell without any instructions from the client. To execute transactions wisely, the broker must be duly informed of market fluctuations which affect his client's interests, protect his client's objectives, and provide ongoing advice regarding the risks entailed in purchasing or selling an investment. In effect, the broker manages the account and is granted power of attorney to engage in securities transactions for the client without his prior approval. Whereas in a nondiscretionary account a broker's duties are circumscribed on a transaction-by-transaction basis, in a discretionary account, there is an ongoing relationship between the broker and his client, wherein the broker is authorized to execute numerous transactions without prior approval. Ongoing due diligence requires that the broker be cognizant of whether a precipitous decline in a security is due to the financial integrity of the company, or, in Prof. Aaron Levine's words, "the halo effect" of the financial markets. The broker's understanding of the situation will determine whether to sell or refrain from selling the

[44] *Teshuvot Maharashdam, Hoshen Mishpat,* no. 50.

[45] *Teshuvot Maharashdam, Hoshen Mishpat*, no. 127. For the differing rationales for the respective positions of the *Maharashdam* and *Mishpetei Shemuel*, see Wygoda, supra n. 10 at pp.272-273, n. 19.

[46] *Mahaneh Ephraim, Hilkhot Sheluhin ve-Shuttafin* , no.1.

product. Furthermore, the broker must keep in mind the investor's goals, i.e., whether his needs are long term or short term.[47] For example, if his client is relatively young and everything else is equal, a broker may decide that his client's retirement portfolio should consist of volatile securities. On the other hand, once this client reaches old age, the broker's responsibility may be to transfer his portfolio to more conservative securities.

In short, similar to our conclusions regarding a nondiscretionary account, in a case of anticipated profits relating to an investment executed by a broker managing a discretionary account, there are no grounds for indemnification. However, should the broker fail to execute a client's instructions to sell an investment and the client suffers losses, he would be liable. Finally, in a discretionary account, the execution of a transaction is not a sign of the discharge of the broker's mandate. After the execution of a transaction, the broker has an ongoing duty to provide clients with investment advice and provide risk assessment of their securities. Consequently, should there be red flags that indicate a potential depreciation of an investment, the broker as is obligated to prevent any potential losses.

III.

Absent any agreement which provides otherwise, what happens if the investment manager (hereafter: manager) of a nondiscretionary account or discretionary account chooses to appoint another manager to manage the account? Does halakha recognize the institution of an agent appointing a sub-agent and what are the managers' responsibilities in this case?

In the absence of a written authorization from the principal, can an agent appoint a sub-agent? Articulating the position of normative halakha regarding this matter, a contemporary writer states,[48]

> The agent may appoint a second agent [a subagent] to do the assigned task for the principal and the second agent may appoint another subagent, and so forth…All this may be done without authority of the principal unless he expressly forbids such further appointments, or unless the acts to be done by the agent are so sophisticated or entail a high degree of trust.

[47] See supra n. 1.

[48] Quint, supra n. 9, at p. 60. Whether the sub-agent becomes the agent of the original principal or the agent of the first agent is subject to debate. See *Ketsot ha-Hoshen* 188:2 and 244: 2; *Taz , Even ha-Ezer* 42:25; *Bet Shemuel, Even ha-Ezer* 42: 58; *Yad ha-Melekh, Hilkhot Ishut* 6:16; *Teshuvot Bet Ephraim, Even ha-Ezer* 111.

In short, the sub-agent's authority flows from the authority of the agent, rather than that of the principal. In effect, the agent is appointing an agent for the principal.

Rivash rules that, "Throughout the entire Torah, an agent may appoint another agent in cases where there is no insistence on personally appointing one."[49] However, should the agent unilaterally appoint a sub-agent, according to some authorities such an appointment would be valid ex post facto. As Rambam rules,[50]

> If a husband gave a bill of divorce to his agent and said to him, "only you should deliver it to her," he should not send it with another, but if he gave it to another agent… then she is divorced.

Clearly, our broker-client relationship provides another illustrative example of a principal's potential insistence on being selective regarding his agent of choice. Professionals, such as investment managers and brokers, regardless of whether they are managing a discretionary account or nondiscretionary account, by virtue of their training and expertise, have a special relationship of confidence and trust with their clients. Elsewhere[51] we discussed how various indicia, such as a broker's expertise, his words of persuasion, and receipt of a professional fee, serve to engender a relationship of trust and reliance between the parties which give rise to a broker's duty of care. As such, given the vulnerability, dependency, and substantial disparity in knowledge which might exist between the broker and client, we may assume that the client may insist on personal service and would be reluctant to have his account managed by another broker. Consequently, should an unauthorized transfer be made to another broker or manager, the client may justifiably exclaim, "I do not want my bailment to be in the possession of another!"[52]

[49] *Teshuvot Rivash*, no. 228. See Michael Wygoda, Israel's Law of Agency: Section 16, Ministry of Justice, Jerusalem: Israel [manuscript on file with author].

[50] Rambam, *Hilkhot Gerushin* 9:35. See also, *Shulhan Arukh, Even ha-Ezer* 141:38. For other opinions which invalidate the sub-agency *ex post facto,* see *Pit'hei Teshuva, Even ha-Ezer* 141:41.

[51] See supra, note 1. Cf. Shimshon Ettinger, *Agency in Jewish Law* (Hebrew), (Magnes: Jerusalem: 5769), pp. 215-216, who argues that the requirement of demanding a particular agent rather than allowing the agent to appoint a sub-agent is inapplicable to commercial affairs is baseless. Clearly, the significance of induced-reliance in the broker-client relationship as a factor in a client's readiness to authorize a sub-agent's appointment belies the paramount importance of receiving the principal's consent in a sub-agent's appointment in monetary matters. See Herzog, supra n. 9, at p. 150.

[52] *Gittin* 29a. As we have shown, an agent has certain responsibilities as a *shomer* and therefore a *mafkid*'s insistence to appoint a particular agent may be extrapolated from the laws of bailment. See *Shulhan Arukh, Hoshen Mishpat* 123:4. However,

Nonetheless, the Talmud instructs us:[53]

> What does [the mishna] mean when it states "he gave it over to a shepherd"? It means he transferred it to an apprentice because it is customary of a shepherd to give over his charges to his apprentice to watch.

In other words, the animal owner knew that the shepherd would not guard his animal personally and would entrust it to the safekeeping of another; therefore, the first *shomer* is exempt from any liability resulting from negligent conduct of the second bailee.[54] In other words, everything depends upon the customary practice of the shepherd and the animal owner's awareness of that practice.

The authorities extend this Talmudic rule to encompass situations where it is customary for a salesman who holds merchandise to entrust it to another for safekeeping, or where a craftsman who is authorized to repair an item gives it to his worker to perform the work – there is a presumption that the customer is well aware that his asset will be in the hands of another and therefore we may assume that the client consents to the appointment of the new *shomer*.[55] Analogously, in our case, though the client developed a sense of trust and confidence with his manager, and one would expect that the client would insist in benefiting from the broker's personal service, nevertheless, if the client is aware that the manager usually delegates his responsibilities to others, absent any explicit protest from the customer, we assume that the client implicitly agreed to the appointment of the second broker.

Given that we can infer from the circumstances that the client consents to the appointment of a sub-manager, what are the respective responsibilities of the first manager and the sub-manager? As we explained, the responsibility of a broker or investment manager who sells partnership interests in his own fund is defined both by *hilkhot shemirah* and *hilkhot shelihut*.[56] As such, we are dealing with a situation of *shomer*

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should such an appointment be executed, it would be valid *ex post facto*. See supra text accompanying n. 49.

[53] *Bava Kamma* 56b.

[54] Generally speaking, when one *shomer* transfers an object to another *shomer*, the first *shomer* is liable for theft and loss. See *Pit'hei Hoshen, Hilkhot Pikkadon ve-She'elah* 4:1, 6. However, if said transfer transpires with the consent of the *mafkid*, the second *shomer* is solely responsible. See Rema, *Hoshen Mishpat* 291:26; *Teshuvot Mabit*, Vol. 1, no. 304; *Teshuvot Maharashdam, Hoshen Mishpat,* no. 40.

[55] *Teshuvot Rashbash*, no. 338; *Teshuvot Maharitats,* no. 21; *Teshuvot Imrei Noam*, *Hoshen Mishpat,* no. 1.

[56] See supra n. 3. Moreover, though according to the *Shakh*, a partnership such as the relationship between a manager and his client is not governed by *hilkhot shelihut* and consequently, preempts the client from arguing that "I appointed you for my benefit

she-masar le-shomer, i.e., one bailor who transfers the bailment to another bailor. In our particular case, we are dealing with a *shomer sakhar* who asks a second person to become a *shomer sakhar*. Consequently, in the absence of any agreement regarding this transfer, each *shomer* is liable for negligence, loss and theft.[57] In such a situation, the principal has the option to seek redress from either agent. Therefore, should the sub-manager be incapable of paying, the original manager remains liable[58]

However, in our scenario, where there exists tacit agreement regarding the transfer of the account management to a second manager, should negligence, loss, or theft of assets transpire under the watch of the second manager, who may the customer proceed against for redress? Numerous *Aharonim* have understood Rambam's posture as arguing that the sub-agent is in actuality the agent of the principal. Therefore, the first agent disappears from the picture and assumes no responsibility via-a-vis the entrusted asset.[59] Others have interpreted Rambam's view (hereafter: the second approach) as claiming that the first agent is exempt from any responsibility provided that he could not foresee that the entrusted asset would have been lost, stolen, or negligently handled. However, if the agent knew of the negligent conduct of the sub-agent and still decided to refrain from intervening, the first agent is still responsible.[60] For example, if a *shomer* asks another person who customarily serves as a *shomer for the first shomer*, and the second *shomer* misappropriates the object of the

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rather than my detriment," numerous authorities claim that principal-agent ties do exist. See *Shakh, Hoshen Mishpat* 77:19. Cf. *Tumim, Hoshen Mishpat* 77: 9; *Netivot ha-Mishpat*, ad. locum; *Sha'ar ha-Mishpat* 77:4;*Beth Shmuel, Even ha-Ezer* 86:19; *Bet Meir, Even ha-Ezer* 86 (end); *Teshuvot Bet Shlomo, Hoshen Mishpat* 47; *Teshuvot Maharsham* 5:28. As such, a partner who deviates from his partnership agreement will be responsible to his partner(s). Such deviation is measured by an assessment of how partners operate in the marketplace, i.e., *umdana*. See *Sha'ar ha-Mishpat*, ibid., and *Maharsham*, ibid.

However, when the deviation entails negligent conduct, even *Shakh* would agree with Rema that the partner would be liable. See Rema, *Hoshen Mishpat* 176:10.

[57] *Pit'hei Hoshen, Hilkhot Pikkadon ve-she'elah* 4:1, 6.

[58] *Shakh, Hoshen Mishpat* 291: 41; *Mahaneh Ephraim, Hilkhot Shomerim*, no. 33.

[59] Rambam, *Hilkhot She'ela* 4:9; *Shulhan Arukh, Hoshen Mishpat* 291:24; *Teshuvot Maharaits,* no. 21. For this rationale of Rambam's view see *Sema, Hoshen Mishpat* 291:41. For differing reasons for his posture, see *Teshuvot Nivhar Kesef, Hoshen Mishpat*, no. 83; *Teshuvot Lehem Rav*, no. 181; *Teshuvot Maharshdam, Hoshen Mishpat*, no. 134; *Teshuvot Divrei Rivot*, no. 217. Kahane, supra n. 23, at p. 1195.

[60] *Netivot ha-Mishpat* 291:24 as understood by *PDR* 1:186; *Dibberot Moshe, Bava Metsia,* No. 35. The implicit assumption is that Rambam's ruling which deals with a father transferring his bailment to members of his household equally applies to situations where it is the customary practice to entrust an asset for bailment to a particular party. See infra, text accompanying note 61.

shemirah in the first agent's presence, i.e., *shelihut yad*, the first agent is to be held responsible.[61]

A similar ruling endorsing the second approach was handed down in another case. Isaac, the salesman of Abraham, was entrusted to sell one of Abraham's assets, and Isaac sold it to Ya'akov. Prior to purchasing the merchandise, Ya'akov invited Isaac and his assistant to dine at his home. While Ya'akov was hosting Issac, the assistant was guarding the merchandise in another room. After some time elapsed, the assistant left the room and dined with the others. Exploiting the absence of the assistant from the other room, Ya'akov took the merchandise and fled without paying for it. Clearly, the theft of the merchandise was due to the combined acts of negligence of Isaac and his assistant. On one hand, the assistant's departure from the room in which the merchandise was being stored was an act of negligence. On the other hand, Isaac was negligent by failing to protest when his assistant walked into the dining room without the goods. As such, the bailor, the owner of the asset, may opt to seek redress from either Isaac or the assistant,[62] and, should the assistant be impoverished, Isaac is solely responsible.[63]

A third approach, subscribed to by Rabbeinu Tam and Rosh, and endorsed by various *Aharonim*, is that, in the event of negligent behavior perpetrated by the sub-agent, the principal may proceed directly against the sub-agent.[64] The rationale is that the principal never wanted the sub-agent to be the sole individual responsible for the assets. Had this been the case, the principal would have hired the sub-agent.[65] Or one may argue that in actuality the sub-agent was holding the assets for safekeeping for the benefit of the agent rather than the owner of the assets and therefore the agent continued to remain in the picture and therefore if negligence ensued he could be liable.[66] Regardless of which rationale serves to explain the aforementioned position, given that the sub-agent acted negligently, he will be liable. Should he be impoverished, then the principal may seek redress from the agent.

[61] *Teshuvot Oholei Ya'akov*, no. 64.

[62] *Teshuvot Maharam Alsheikh,* no. 20. For a discussion of *Oholei Ya'akov's* responsum, see supra n. 61 and *Alsheich*'s responsum, see Kahane, supra n. 23, at p. 443.

[63] *Shakh, Hoshen Mishpat* 291: 41.

[64] *Tosafot, Bava Metsia* 42b *s.v. kol ha-mafkid*; Rosh, *Bava Metsia* 3:23; *Be'ur ha-Gra, Hoshen Mishpat* 291:42-43; *Levush, Hoshen Mishpat* 72:31; *Arukh ha-Shulhan, Hoshen Mishpat* 291:55..

[65] *Teshuvot Sho'el u-Meishiv, Mahadura* 4, *Helek* 3, no. 143

[66] *Novellae of Rashba, Bava Metsi'a* 36a; *Ketsot ha-Hoshen* 291:8; Kahane, supra n. 23, at pp. 427-428.

All of the above three approaches are predicated upon the fact that the responsibility of the agent was defined by *hilkhot shelihut* and *shemira*. Moreover, should we be dealing with an agent who is equally a partner with the third party by dint of having the status of a *shomer*, the parameters of his responsibility will be the same as that of any agent.[67]

Similarly, in our situation, assuming that the appointment of a second broker was approved by the client, if subsequent evidence indicates that the first broker failed to avert the loss or dissipation of assets due to the negligent behavior of the second broker, the assignment of liability would be subject to debate. According to the first approach, the second broker alone would still be liable. However, pursuant to the two other views, the initial broker would be responsible. Should the second broker be incapable of paying for the loss, the first broker would indemnify the client. However, should an agreement between the parties provide that the initial broker must monitor the results of the second broker's servicing of the account, if the second broker is incapable of paying for any incurred losses due to his negligence, the first broker would remain liable.

However, how does halakha address the case of an investment manager who owns partnership interests in a fund, sells some partnership interests to investors, and, pursuant to his agreement with the investors, directs a second manager to invest these assets in other financial securities? Clearly, the investment manager assumes the responsibilities of a *shomer*;[68] therefore, the investment manager, similar to the initial broker in the aforementioned case, will be liable for any negligence committed by the second manager should he be unable to pay.

What is the definition of negligence in the above case? Regarding entrusted assets, the *Rema* states,[69] "the assets are to be placed in a guarded place, which is a function of the locale and the times." In other words, the duty of care required of the *shomer* is dependent upon the prevailing standards of the community for safekeeping such assets. The assumption of the *mafkid* is that the *shomer* will treat the asset according to communal standards.[70] Moreover, the *shomer* may treat the object entrusted to him in the same fashion as he treats the same object in his own possession.[71] However, should the *shomer*'s standard fail to measure up to the communal standard, he will be liable for any negligence.[72]

[67] *Pit'hei Hoshen, Hilkhot Shuttafut*, 2:3. See infra n. 69.
[68] *Tur, Hoshen Mishpat* 176:11; *Shulhan Arukh, Hoshen Mishpat* 176:8
[69] *Rema, Hoshen Mishpat* 291:18. See also, *Bet Yosef, Hoshen Mishpat* 291:20.
[70] *Teshuvot Maharshdam, Hoshen Mishpat*, no. 134.
[71] *Tosefta Bava Metsi'a* 8:6; *Shulhan Arukh, Hoshen Mishpat* 291:14.
[72] See supra n. 68.

Similarly, in our scenario, a manager or broker is obligated to comply with the standards adopted by the capital markets in servicing investment portfolios.[73] Moreover, should industry standards dictate that a manager who earns a higher fee than a discount broker monitor his client's portfolio while being managed by a second manager, failure to exercise such due diligence in the wake of a customer's investment depreciation will result in the first manager being held liable.

A broker or manager may opt to protect his client's assets in the same fashion as he treats his own portfolio. However, should his performance be significantly below the prevailing standard, he will be liable for any loss.[74] Moreover, if a second manager is managing assets under the assumption that the client acquiesces to his appointment then according to the second and third approaches we outlined above,[75] the initial manager's scope of responsibility to avert the negligence of the second manager would be equally defined by industry standards. For example, if the investment community adopted certain standards relating to the overseeing of a second manager's accounts, then should the first manager turn a blind eye to red flags indicating a depreciation or dissipation of the client's assets by the second manager, he would be liable if the second broker is unable to repay the client. Adopting the first approach, on the other hand, would exempt the first manager from liability based on *hilkhot shelihut*. However, should the initial manager have a partnership interest with his former clients, he would remain liable for failing to respond to warning signs of a depreciation or dissipation of their assets.[76]

[73] The scope of responsibility for *peshi'a* which is defined by accepted norms of behavior, *i.e. nohag mekubbal,* of the marketplace is not limited to a *shomer* and equally applies to a broker qua *shaliah* or manager who is viewed as a both a *shaliah* and a partner. See *Mahaneh Ephraim, Hilkhot Sheluhin ve-Shuttafin*, no. 3; *PDR*, supra n. 3, at 46; *Pit'hei Hoshen*, supra n. 67, at p. 46, n. 9; *Mishpatacha le-Ya'akov*, v.ol. 2, p. 429.

Due to the ongoing right of a principal to invoke that his mandate "should be for his benefit rather than his detriment", Rabbi Tenna demurs and argues that a broker or manager is obligated to consider even infrequent instances of potential problems which are not contemplated by most people. See *PDR*, supra n. 3, at pp. 31-32.

[74] Should his treatment be only marginally below the accepted standard, he would be exempt from liability. See *Teshuvot Maharshdam, Hoshen Mishpat* , no. 117.

Moreover, the manager is obligated to operate according to the agreement with his clients. See supra n. 56. *A fortiori,* the manager will be liable for any acts of *peshi'a*. See *Bet Meir*, supra n. 56; *Pit'hei Hoshen*, supra n. 67.

[75] See text accompanying notes 60-63 and 64-66.

[76] See supra, notes 57, 74 and 75. Despite the absence of a principal-agent relationship, given that the manager has a financial interest in these assets, he remains liable

Should the agreement explicitly provide for someone to serve as a sub-manager, the first manager would disappear from the picture and the second manager alone would be liable for any negligence.[77] The client's consent to the appointment of the second manager indicates that he considers him trustworthy.[78] However, should the agreement between the parties provide that the initial manager continue to monitor the second one's asset management, here, again, the scope of the oversight will be determined by market standards.[79]

In the last ten years, the financial markets have undergone a boom and bust cycle that has generated a record number of clients' claims filed at securities arbitration forums, such as the National Association of Securities Dealers, Inc. The securities industry has continued to market new financial investment products and customers have increasingly become susceptible to deceptive promises which offer freedom from financial woes. As members of the Jewish covenant-faith community, it behooves us to address our disputes regarding such matters in a *bet din*, a binding arbitration panel which may resolve such issues according to halakha and/or civil law [80]

as a partner. See *Teshuvot Bet Yitshak, Orah Hayyim* 32:12; Hayyim Zafri, Agency, Section 1, Ministry of Justice, Jerusalem: Israel. [manuscript on file with author].

[77] Rema, *Hoshen Mishpat* 291:26; *Teshuvot Mishpatim Yesharim* (Birdugo), vol. 1, no. 65; *Mahaneh Ephraim*, *Hilkhot Shomerim*, no. 20; *Netivot ha-Mishpat, Hoshen Mishpat* 291:24.

[78] *Hazon Ish, Hoshen Mishpat* 5:11.

[79] Given that the first manager is only a *shomer*, it might be cogently argued that even R. Tenna would concur that the first manager's responsibility would be limited to being aware of prevailing trade standards. See supra n. 73.

Regarding the responsibilities of the second manager, see *Mishpatekha le-Ya'akov*, supra n. 75, at 425-430.

[80] For the ability to resolve these matters pursuant to civil law, see *The Investment Advisor*, supra n. 1 at n. 30.