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Shari’a Commercial Law: “Old Wine in New Bottles?”

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Abstract

Following the 2008 global financial meltdown and the various reasons that lead to it, it seemed inconceivable that no ethical and justice-driven alternative for highly lucrative and stable financing existed, or at the very least forgotten about. Deciding to contribute to the already centuries old and continuously developing domain of Shari’a Commercial law, we were first caught by surprise when we discovered one particular problem that sparked the start of this thesis. In France, we encountered interesting debates and doctrinal findings resembling a general and common western perception of the legal nature of Islamic Finance, being Shari’a Commercial law based financing, and the requirements for its full introduction into the French legal system at the time. This initial interest in Islamic Finance then evoked an interest in the ethical and justice driven gems of Shari’a Commercial law as a whole, and as the subject of this thesis.

In today’s modern and global commercial and financial world, transactions are shrouded by excessive risk-taking and speculation akin to gambling, rendering at times colossal damages. To make matters worse, those damages are dislodged onto the public. Therefore, are there any ethical and legal precepts, principles and rules that may provide some form of a safety and social net in today’s financial markets? Is this achievable? This thesis argues that the richness of Islamic jurisprudence and its rules that have not had their benefits fully reaped and regenerated in response to new challenges till today, may still continuously provide solutions, as well as provide reforms to financial products, which exemplify justice and fairness. Within the process, new light will be shed on certain already known topics as part of the intended contribution of this thesis, but will not be the main objective of the thesis.
Thesis Question and Objective

Shari’a Commercial laws being “proprement dite” normative in nature, can they be seen as such from any new and different perspectives for the purposes of achieving social and economic justice? Can we inductively revisit its normative precepts to deductively reformulate modern day commerce against meltdowns?
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Dedication

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Introduction

The decision to embark on this project is a result of a passionate drive to make a contribution - hopefully successful - to, firstly, an ancient but recent exponentially grown area of law, and secondly to the field of law in general. To be more specific, the intended contribution of this thesis aims to directly add to previously made doctrinal findings of both individuals 1 as well as institutions 2 from France. If successful, a contribution to Shari’a law, French law and general western legal literature will have been made.

Three characteristics of the thesis topic sparked the motivation to engage in in-depth research, and to further develop the thesis question. Firstly, the topic is responsible for many active and ongoing academic debates. Secondly, it plays a considerable role in adding value to a nation’s economy. Thirdly, and on a social and human relations level, the content of the topic focuses on and is inspired by divine values. Elaborating on these values in a logical and objective manner, would potentially contribute to improving human interaction from an intellectual, practical and not less importantly, from a commercial and financial perspective. Overall, the topic was of both significant academic and practical value.

Shari’a law has been described as simply religious law as opposed to proper normative law. At one point in time, this false perception had a practical and negative effect on the pace of the introduction and growth of Islamic Finance in some countries

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such as France, as well as the growth of Shari’
a commercial and financial industry in
general. Whilst it is true that the question of "what is law?" and what are normative
laws have no one, unanimously agreed to answer, there is therefore an opportunity to
provide a different viewpoint on how Shari’a law is normative law. Although the
answer to this question has already been decisively answered in the opinion of some,
to others the question is still far from being resolved. Simply being a point of
departure, and solely a representative example and not the sole topic of this thesis,
Islamic Finance is still seen as a self contained system with no statutory or legal basis
in France, and therefore its own autonomous form would be rejected; it would have
to assume the form of a contract(s) already approved within the French legal system.
Although the findings cover Islamic Finance, they would naturally apply to Shari’a
Commercial law ("SCL"), of which Islamic Finance is only a branch thereof.

In Chapter 1 of Part 1, and to pave the way for a complicated subject often shrouded
with vagueness and misunderstandings, a brief introduction to Shari’a law generally,
as well as SCL will be made. Starting with an explanation of the term “Shari’a law”,
the chapter will then further indulge into details regarding the legal nature of Shari’a
law, the characteristics that make it a legal science - both as an immutable, main legal
framework with constantly changing laws, a dual special nature different to western
law, all stemming from its divine character. Subsequently, the chapter will indulge in
an explanation of Shari’a Commercial law; its special and wholesome history oriented
nature, history, growth, rise, stagnation and revival through Islamic Finance,
including all economical and cultural reasons for growth. This will also include facts
and figures reflecting the extent of its exponential growth, expansion and outcome of
this growth.

In demonstrating its recent growth through the Islamic Finance industry, and
exponentially to the point of significantly developing on an international level, some
reforms were much needed; specifically, the creation of uniform laws to facilitate international transactions. The reasons for the long delay behind those reforms are provided; in particular, the role of the Shari’a Advisory Boards to Islamic Financial Institutions, while certainly very valuable, it has resulted in unpredictable, inconsistent and arbitrary Islamic jurisprudence, and has been highly unreliable on both domestic and international levels; furthermore, the availability of several Islamic schools of thought representing diverse degrees of interpretation certainly did not help in standardizing Islamic jurisprudence. As a response to this particular problem, the Accounting and Auditing Organization for Islamic Financial Institutions (the “AAOIFI”) was established, and its international legal Standards (the "Standards") have and are still progressively developing. Some other institutions such as the International Swaps and Derivatives Association produced their Tahawwut Master Agreement (the “Agreement”) to further develop the Islamic Swaps market.

A detailed presentation of the AAOIFI and its Standards will be made for three reasons. Firstly, the Standards play a significant role, and are almost responsible for serving as the most reliable uniform legal standards regulating international Islamic financial and commercial transactions today. Being relatively recent as compared to conventional uniform laws, the thesis then takes the opportunity to establish their credibility, and by engaging in a comparative analysis with conventional uniform laws regulating international financial and commercial transactions; those conventional laws will be the UNIDROIT Principles and INCOTERMS, and as expressions of Lex Mercatoria (Law Merchant). The comparison will be made with a focus on the nature, objectives and roles played by each. To further strengthen the process, further reasons as to why the Standards are considered the most reliable and credible uniform laws for the international Islamic financial and commercial industry will be provided. Specifically, enjoying a universal character, being flexible with the ability to grow, its informality, its reliance on commercial custom and practice, being
autonomous, possessing the quality of being sufficient to decide a dispute, as well as being a system of law. Secondly, it will be seen in Chapter 2 of Part 2 that certain conventional, modern and complex financial products will be restructured, and according to the Standards; their justification beforehand as the most credible legal Standards eligible to govern such proposals is therefore imperative. By thoroughly presenting the Standards, the thesis also intends to increase confidence in them and in the fact that Islamic commercial and financial legal jurisprudence is no longer unreliable and unpredictable in their presence. Finally, the Agreement will be presented in equally thorough detail, and for the same reasons and objectives the Standards are presented.

In Chapter 2, the first part of the thesis question is addressed, and whether Shari’a laws are normative laws, or simply ancient religious rules. As Islamic Finance representing SCL already introduced in France in the form of lucrative financial instruments and financial products, and with increasing total assets held, to ensure that the question is not obsolete, a brief demonstration of the current status quo in France will be discussed; this will be done by providing the doctrinal findings from France, which triggered the first part of the thesis question. The findings reflect that law is only considered law via the expression of a codified norm - a classical positivist approach. The examination in the rest of the chapter therefore does not address the question of “what is law?” in general, however it adds different ways for viewing Shari’a law as normative laws other than positivism. The purpose of seeing the normativeness of Shari’a law is that once seen as proper normative laws, their derivative substance can then be articulated and incorporated into western legal systems, and without the need for further adaptation; by adaptation, reference is made to the assumption of its derivative substance in the form of western contracts and / or positive law to justify its normativeness, and which risk achieving the intended social and economic justice.
Shari’a law will be seen as normative law from 4 different perspectives. Firstly, it will be presented as being the *highest ultimate source* and substance of state positive laws themselves, and seen from its role in state constitutions from a cultural law dimension; Shari’a law dictates the culture of its Muslim followers, which are in return reflected and secured in the constitution, and subsequently into all constitutional law derived positive laws. Secondly, Shari’a law’s normativeness will be seen from its role in state constitutions as a source of state legislation in a general manner, and being either the exclusive or partial source of positive laws. Thirdly, being the ultimate source of laws, a deeper view of positivism from Shari’a law’s perspective will be presented, and which stems from the Constitution of Mecca itself; this view will demonstrate that although Shari’a laws are enforced by the state, and depending on the extent of legislative role that it plays, the state and positive laws themselves serve no more than a coercive and executive role, and are only a means to an end. Finally, Shari’a law’s normativeness will be seen in cases of international conventions where Muslim states are signatory states, by having the ability to override foreign laws in cases of conflict with national Shari’a laws. To sum up all the above points of normativeness, a comparative analysis with the role of Jewish law as normative religious law in the State of Israel will be presented. It will that appear that similar to Shari’a law, Jewish law also governs certain areas of law in Israel, as well as possessing similar overriding powers in cases of conflict between laws of foreign conventions with national Jewish laws.

Following an extensive introduction to Shari’a law and SCL and the question of its normativeness in the first part of the thesis, the second part of the thesis addresses the second part of the thesis question, being the extent of competence of Shari’a law and therefore SCL. Chapter 1 discusses general competence, and Chapter 2 discusses specific competence.
Commencing in Chapter 1 of Part 2, the quality of general competence becomes the focus of examination, and in the sense that SCL possesses the quality of competence by encompassing human nature and the well-being of the human spirit into its principles, precepts and laws. The intended contribution of this chapter is to demonstrate that Shari’a law and SCL’s intended reform of mind and spirit, aims first and foremost at having a positive, responsible and ethical effect on the professional conduct of the trader following its rules; when all traders within the same commercial and financial domain share the same divine values, and put them in practice, this would form an ideal society driven and by exemplary equality and justice.

To understand the true spirit and fundamentals of Shari’a law and SCL, and to comprehend any restrictions it imposes, the chapter defines and details the *Maqasid* (intentions and objectives) and *Masalih* (interest) of Shari’a law; this will show the good and noble ends of Shari’a law and SCL, and how they aim at preserving both private and public interest levels. Following the Maqasid and Masalih of Shari’a law, a comparison between them and the ideas of justice of Amrtya Sen, being one the world’s greatest thinkers will follow. The demonstration will hopefully show how both Shari’a law and universal notions of justice share similar objectives of “Common Good”, “General Welfare” or “Common Safety”. As part of demonstrating Maqasid al Shari’a, the essential rules governing Islamic jurisprudence on which all transactions, both commercial and non-commercial are based, will be detailed. Introducing the latter rules simply reflects the true spirit of Shari’a law, and may explain at a later stage why certain transactions are prohibited, or prohibited when conducted using certain structures.

Furthermore, the basics of Islamic commercial etiquette (*Aadaab al Mu’amalaat*) are briefly discussed; this will be done by referring to some of the most reliable Islamic sources available today, with the intention to rectify any misunderstandings or
misconceptions surrounding any of its unique terms, and which is not uncommonly found in today’s modern western literature. Following an introduction to commercial etiquette, the 3 distinctive precepts of Shari’a law, being the prohibition of Riba, Gharar, and Maysir are then discussed in great length; those serve as the precepts that ensure commercial etiquette, fairness and justice to parties to commercial transactions. All precepts will be explained in terms of linguistic and legal definition, their characteristics, their underlying reasoning to their substance, as well as the social and commercial evils they aim at preventing.

In the final part of the chapter, where Shari’a law and SCL principles, precepts and laws impose some commercial restrictions, and which potentially may seem alien to the western academic and / or practitioner, the question of whether SCL precepts are truly alien to non-Muslim state laws will be explored. The objectives and values of the 3 precepts are compared to the objectives and values of French law, and during the era when Canonical laws were normative and backed by state coercion. French law is taken as a case study, being partially the initiatory impetus for this thesis, as well pertaining to a country with enormous potential for becoming the biggest Shari’a financial centre in Europe in the opinion of this thesis. The comparative analysis aims to establish that despite changes to the current articles of the French Civil Code today, those changes are only in terms of form, however not in substance; those standards have changed in form on a gradual basis, and due to external political and economical factors over many years. It will appear that the 3 precepts in Shari’a law have their equivalents in French law, are identical in essence and origin, and are therefore not alien to non-Muslim state legal systems. Conducting commerce and finance according to the precepts is therefore realistic, as only private and public interest are their ultimate objectives.
In Chapter 2, the final chapter, the quality of specific competence of SCL is examined, and from a proficiency perspective; specifically, an examination of SCL’s ability to restructure and convert current conventional modern complex financial products to SCL based alternative products will take place. The primary reason for carrying out this examination is to assess whether conventional hedging financial products are compatible with and do not conflict with the principles, precepts and laws of SCL. The focus on hedging products in particular comes following the fact that the total global assets and international transactions of the Islamic financial industry, has reached a level nowadays, where their positions cannot go unhedged anymore; examining compatibility is therefore imperative.

The secondary reason for the examination is that many of the modern complex commercial and financial hedging products themselves are high in risk and potentially result in grave financial losses. Since the ultimate objectives of SCL are the public and private interest, finding ethical and just alternatives to those conventional hedging products using SCL jurisprudence is therefore another major objective of the examination. To carry out the examination, the proficiency of SCL will be measured against a selection of financial derivatives, namely Forwards, Futures, Options and Swaps as modern complex financial products themselves. Following a general introduction to derivatives, each one individually will be explained in terms of their characteristics, advantages, disadvantages, principle functions and mechanisms. Failing compatibility, all reasons for incompatibility with SCL will be explained, and subsequently followed by offering a SCL contract(s) based alternative product(s), as well as the value added and offered by each alternative. All alternatives will be restructured using the rules detailed in the Standards as well as the Agreement.

Following a demonstration that modern day complex derivatives can be restructured with more secure alternatives based on SCL, including the ability to restructure based
on one and / or a series of contracts in a SCL regulated manner, the issue of contract combinations will then come to light; the objective of this particular issue will be to demonstrate the capacity of SCL to unlimited financial engineering.

Finally, and as a continuation to exploring the ability of Shari’a law and SCL whether to continuously update its laws, and accommodate ever changing social and economic needs, the chapter will then discuss Ijtihad. It is this tool that allows those updates and reforms, and which in itself is one of the most essential pillars of Shari’a law; it will become clear how those reforms are done using a Purposive / Contextual Interpretation, and to ensure that all reforms are “fit for purpose”, embracing the Maqasid and Masalih of Shari’a law. Being a tool and source of law responsible for endless debates as to whether it is still a current and valid source of law, both sides of the debate will be demonstrated, followed by a contributive opinion as to why Ijtihad is still an ongoing valid source. It will appear that the reason Shari’a law and SCL were deprived of any progress or reform for centuries was due to pure political and sociological reasons, representing a classical example of a traditional clash between conservative and progressive law jurists.

Finally, the question of why Ijtihad was not exercised to reform Shari’a law and SCL for centuries is posed, and a few possible scenarios are presented. The thesis will attribute the delay in reforms to what will be labeled as “Irresponsible Conservatism”, and refering to medieval and literalist-oriented thinking conservative political Islamist forces, lacking the ability for objective “creative legal thinking”. Secondly, another reason why reformist Ijtihad has not been openly implemented will be discussed, and due to the exaggeration of what is known as Sadd al Dhari’a; a term literally meaning blocking evil or “closing off the means that can lead to evil”. Finally, an unobjective struggle for preserving identity, where much of the Muslim states have
had their laws changed through western imperialism as a reason for putting Ijtihad to a halt will be explained.
Part 1

An Introduction and Shari’a law’s Normativeness

Chapter 1

Introduction to Shari’a law and Commerce: The Basics

To pave the way for the subject of Shari’a Commercial law, being the main subject of the thesis, the very nature of Shari’a law itself must be firstly introduced, and since it contains often-unfamiliar religious and legal terms, principles and precepts very specific to it, which may have several meanings. A similar brief introduction to the character of Shari’a Commercial law will then follow.

1.1 What is “Shari’a law”? A definition

A well known but potentially puzzling term to those unfamiliar with it, what does it refer to and what does it mean? 3 First and foremost, and in the most literal sense, the term ‘Shari’a’ is an Arabic term referring to “pathway”, “path to be followed” or even the “clear way to be followed”; it has come to mean “the path upon which the believer has to tread”. In its original context, it referred to “the road to the watering place or path leading to the water” 4. The command to follow to this clear path comes directly from the Quranic verse “Then We set you upon a clear course of the Law; so follow it, and do not follow the desires of those who do not know” 5.

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3 The term has had several methods of spelling including but not limited to “Shariah”, “Sharia”, “Shari’a” and “Syariah” as will be seen in the many different quotes throughout this thesis.
4 See Hisham M. Ramadan. Understanding Islamic Law: From Classical to Contemporary. Lanham, MD: AltaMira Press. 2006. P.4. This term has been defined in a similar manner by many other authors. See also Baamir, Abdulrahman Y. Shari’a Law in Commercial and Banking Arbitration: Law and Practice in Saudi Arabia. Farnham, Surrey, England: Ashgate, 2010. P.6
When referring to the term in a legal context, and known as *Islamic Law*, one simple and well set definition chosen from many is “*the corpus of rules and principles that are derived from the Qur’an and Sunnah and aimed at regulating the spiritual as well as temporal conduct of Muslims in their relationship with God, with each other and with non-Muslims. Amongst the main characteristics of Islamic law are its divine source, comprehensive nature and flexibility*” ⁶. Being a “divine” and “revealed” source of justice, and as opposed to human decided and positivist justice, Aristotle has referred to this type of revealed justice as “natural justice”, being a product of natural and not social forces. Thomas Aquinas has referred to the divine revealed law of Christianity as “Eternal Law”, while Muslim scholars labeled Shari’a law “Eternal Law” ⁷.

The term “law” in the Arabic language can be said in several different ways including *Al Haq*, and which is studied in *Kuliyat al Haqooq* (Faculty of law); it refers to “righteousness” and “truth”. Shari’a law is the law that relays righteousness and truth via its 2 primary sources, including its other sources responsible for interpreting and developing Shari’a law.

The birth of Shari’a law is closely associated with the birth of the Quran, and according to a traditional view ⁸. The term Shari’a law refers to the direct revelation of the will, wisdom and human guidance of God; revelation was realized via the ‘legal’ verses of the Quran, as well as the Traditions of his Prophet Muhammad. The Quran is an authenticated source in itself, and the legal verses contained therein are legal judgments called “*Ayat Al Ahkam*”. 1% of those verses are absolutely clear and are 100% unequivocal and decisive, and 99% project several meanings, being

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continuously open to analysis and interpretation through consensus and analogical methods; it is this reanalysis and reinterpretation that lead to the establishment of Islamic Fiqh. It is imperative that it is remembered at all times, that there is a difference between Shari’a law as generally known today, and all its Fiqh inclusive of all norms, precepts and principles (hereinafter “Jurisprudence”); the former is the divine revealed law in the form of the Quran, while the latter is the result of the man made laws stemming from the Prophet’s Sunna, as well all derivative laws made through the exhaustive efforts of Muslim Mujtahids ⁹.

Distinguishing between Shari’a and Fiqh is crucial for understanding the relationship between its religious and legal aspects ¹⁰. The term Fiqh refers to Islamic Jurisprudence, being “the body of rules and principles that are developed by each and every Muslim jurist’s reasoning aiming at approaching as close as possible to the highest ideals of Islamic doctrinal aspiration” ¹¹. Although a science, Fiqh refers to more than just knowledge, it rather demands “intelligence” and independent judgment, as well as deciding on a point of law in the absence of clear laws from the Quran and Sunna ¹².

The study of Shari’a Law and its Fiqh is divided into two parts. Firstly, Fiqh al Ibadat (worship), which handles matters, related to ritual purification, prayers, Zakat (alms-tax), fasting and pilgrimage. Secondly, Fiqh Al Mu’amalaat (other than formal worship) governs matters related to collective affairs, including but not limited to legislation, commerce, marriage, and inheritance ¹³.

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⁹ Ibid.
1.1.1 *A unique legal nature*

Shari’a law is a rational law, and its methods of interpretation and development are rational and logical as any western man-made law is; the fact that it has come to existence via divine revelation does not mean that it is an irrational law as some suggest. Divine law in a general manner is any law revealed by the Lord to his finite humans by way of direct revelation. In terms of Shari’a law, the divine revelation that took place directly to the prophet Muhammad in Hijaz over a period of 23 years was in response to many of the problems society faced. This has been detailed in the *asbab al-nuzul* (occasion of the revelation) literature.

The divine and religious nature of Shari’a law has been a source of inquisition over issues of both generic and specific nature. An example of inquiry into issues of generic nature as a result of the divine nature of Shari’a law is the difference between *law* and *religion*, and whether religious laws can be considered normative laws. Since there is no one response to the question of “what is law?” Shari’a law, and on the one hand, is not considered to some schools of thought as law in the Roman law or Canon law sense; to them a law would not be labeled as law if no penalties were sanctioned by the state. They see it as of purely religious nature, but do not see the fact that it creates both duties and obligations, regulating people’s behavior and conduct similar to their understanding of modern day law. On the other hand, other schools of thought are of the view that Shari’a law is certainly a body of normative laws, but

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different to Canon law and Roman law, and which are not similarly concerned with the above-mentioned blend.\(^{17}\)

There are also inquiries into issues of more specific nature that take place as a result of being divine and immutable in nature. In more detailed terms, law and rules of law as understood today are subject to change overtime. Can this divine nature of once revealed divine Shari’ा law similarly allow its laws to change overtime? This latter confusion emanates from the non-distinction between its unchanged divine sources on the one hand, and its human methods of interpreting and concluding its laws, allowing them to continuously change and update over time on the other hand.

1.1.2 *Shari’ा law within the context of legal science*

The nature and structure of Shari’ा law makes it a unique blend of positive laws, legal doctrines and legal concepts, altogether making it a legal science. On a general note, it is a harmonious blend of the temporal with the spiritual, which basically aims at the approval of God; human actions are therefore categorized into what should be conducted and what should be avoided, and solely for the purposes of winning the approval of God.\(^{18}\) The relationship between the divine nature of Shari’ा law, its historical aspect as well as its evolution making it different to western jurisprudence, makes many writers of the latter unable to accept it a set of laws.

Many Western writers do not consider Shari’ा law as “Law proper” in today’s understanding of law;\(^{19}\) this idea will be strongly criticized in this thesis. Shari’ा law

\(^{17}\) It will be seen in Part 2 of this thesis that we do not agree with the view that Canon law does not possess such blend of duties and obligations; we will be discussing similarities between Shari’ा Commercial law precepts, being identical to those stemming from Canon law. See Badr, Gamal M. "Islamic Law: Its Relation to Other Legal Systems". *The American Journal of Comparative Law*. 26.2 (1978). P.188.


is certainly “Law proper”, has its own different and unique nature, and in the sense that it “has its own distinctive processes of identifying and formulating legal norms” 20. Five essential points are then to be made about its unique nature and process. First, divine sources are the highest primary sources, and therefore possess supreme character and authority. Second, other sources based on human reason are considered secondary, and if any of their content conflicts with the content of the primary sources, the latter prevails. Third, divine sources are presumed to be free of errors, whereas human sources are not, except otherwise those that are of highly credible nature. Fourth, the divine sources form the main legal framework, which outlines the general doctrines and principles of which Shari’a rules are formed, and in some instances are identical to today’s positive laws. Finally, divine sources specify that changeability is part and parcel of human nature and an indispensable norm; this is acknowledged and accepted by Shari’a law jurists 21.

Divine in nature, it is essential to note that although dictated by God and the Prophet’s Sunna, and based on the notion that the general and main framework of rules, principles and precepts are themselves unchanged, they are not rigid in their character; all derivative rules are subject to interpretation and reinterpretation in accordance to the needs of the time in question. Contrary to the belief of those who have no proper understanding of its nature, Shari’a law through its methodology is designed to allow itself to evolve and readapt, however without departing from the general framework of the original expressions of God. The key element is that its evolution takes place in line with the dictated framework set by the Lord, and not by the people themselves. The concept of the law evolving with time remains the same


as western law evolves with time. In practice however, its development had been under arrest centuries ago for different political reasons.

Shari’a law is not originally meant to be a fully comprehensive body of codified and systemic laws, but rather substance reflected in precepts and principles of which all other laws produced by Islamic jurists are based on, reflecting certain values and objectives. Accordingly, Muslim jurists throughout Islamic history have never been concerned with establishing a particular field, science or even theory; to them Shari’a law was comprehensive enough to cover any human action, transaction or conduct 22. Being a divine law, it was not a fully comprehensive and systematic set of codified doctrines and rules from its first day of formation, but was rather introduced and completed on a number of stages as previously mentioned. Principally composed of norms, and due to this gradual revelation of those norms, all norms were also gradually interpreted, reinterpreted and then codified by Muslim expert jurists at later stages. Having a religious nature, it has set out all its rules regulating the relationship between God and human beings, as well as human beings with each other from an idealistic point of view. It would be incorrect to suggest that Shari’a law from this perspective would lack the element of practicality; it suggests to the Muslim court what it ought to do, and not in a factual sense 23. Reformation based on social needs does not require the laws of Shari’a themselves to be changed, but introducing new laws, and by finding the juristic basis within the divine express or implied commands 24.

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22 See Ibid. P.171 citing “Nothing have we omitted from the book, and they (all) shall be gathered to their lord in the end”. Quran, 6:36. See also same verse “only those who will listen will respond (to you). As for the dead, Allah will resurrect them, then they will be brought back to Him”. See Qara‘i, ‘Ali Q. The Qur’an: With a Phrase-by-Phrase English Translation. Tahrike Taesile Qur’an, Inc. New York. P.177.
Shari’a law has a strong casuistic nature in its reasoning methods, used for resolving matters; this reasoning method is also an essential feature in Common law. Reaching conclusions and legal decisions by way of measuring the legal effect of a certain case over a principle legal case is called Qiyas. Although Shari’a law is a divine law, Muslim jurists say that their assessment of the divine laws was largely a constructing of the human intellect, and via the methodology of legal reasoning.

To “the Muslim there is indeed an ethical quality in every human action, characterized by Qubh (ugliness, unsuitability) on the one hand or Husn (beauty, suitability) on the other. But this ethical quality is not such as can be perceived by human reason; instead, man is completely dependent in this matter on divine revelation. Thus all human actions are subsumed, according to a widely accepted classification, under five categories: as commanded, recommended, left legally indifferent, reprehended, or else prohibited by Almighty God. And it is only in regard to the middle category (i.e. those things which are left legally indifferent) that there is in theory any scope for human legislation.” To regulate every human action, Shari’a law therefore introduces us to a number of legal concepts that are very special in their nature, and very different to today’s modern and western understanding of law. The former is more generic inclusive of some positive law content, but mainly concerned with covering the majority of situations, and with general and abstract content.

The generic and abstract legal concepts of Shari’a law that prevail over positive laws, result in the “consequence that differences between two genera are often not greater or more


essential than those between several species within the same genus; instead of an antithesis between two concepts, there are graded transitions from the central core of one concept to that of another with corresponding gradations of the legal effects. This way of thinking is typical Islamic law”. In effect, Shari’a law can link two very different series belonging to two different concepts, while providing a different legal effect for each; such is found under the furuk (differences) doctrine 28.

As is the case with any legal system, the fact that several categories exist within Shari’a law presents its legal nature with a very sharp and highly regulating meticulous character, and which allows it to regulate all types of human relationships, including those of legal nature. As previously mentioned, the norms and rules imposed by God and his prophet reflected in Shari’a law’s Mu’amalaat, do not officially segregate between legal and non-legal relationships. Not dissimilar to any western legal system, its laws are set in 3 categories, being compulsory, indifferent and simply forbidden; equally similar, there is always a difference between theory and practice. Being a system of ideals and a reflection of a certain ideology, it is content with the theoretical acknowledgment of its rules, and regardless of its practical application; consequently, the “recommended” and “reprehensible” categories are also included, just as a matter of ideological guidance. Furthermore, no punishments are provided for unless a compulsory character accompanies those rules, as well as prohibited acts becoming allowed in cases of duress 29.

1.2 Sources of Shari’a law

The jurisprudence of Shari’a law is similar to Roman law, and was the product of classical jurists who codified it after the establishment of the Islamic state. Despite the

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29 See Ibid.
differences between the various schools of thought in terms of which sources are either acknowledged or not, Shari’a law Jurisprudence stems from the Quran, Sunna, Qiyas, Ijma and Ijtihad.

a) Quran

This is the primary source, and which contains the final words of God. It is the basic source for locating the foundations of both legal norms and non-legal aspects of Islam in general 30.

b) Sunna

Being the second source of law after the Quran, it is what can be called the normative legal custom 31. Sunna needs to be distinguished from Hadith, as the latter is the sayings of the Prophet, whereas the former is the rule of law derived from it by way of his practice, or by the practice of one of his companions. For a Sunna to qualify as one, it must have been a Hadith with an Isnaad (reported by a trusted and verified source) 32. As opposed to the Quran, the Sunna provides the details and detailed practice of those laws, while the Quran provides the general framework.

Although not directly revealed by the words of God, the Sunna is also of divine nature, being first hand practical implementation of the direct words of the God; it therefore forms part of the divine Shari’a, and not the human generated Fiqh. For the

32 The most trusted sources are Sahih AlBukhari and Sahih Al Muslim. The former source is the more preferable source, since matters were arranged under legal titles, aiming to provide a firm basis for Shari’a Fiqh. See Qaradawi, Youssef. Al Qawa’id al Fiqh al Mu’amalaat (Governing Rules of Fiqh al Mu’amalaat). Dar el Shorouk. 2010. Most Sunni Muslims see Al-Bukhari as the most trusted book after the Quran. See Elsanousi, Mohamed A. “A Growing Economic Power: Muslims in North America and Integration and Contribution to Social Justice”. The Journal of Law in Society. 9.100 (2008). P.117.
followers of the Islamic religion, obeying God’s divine commands revealed in his Shari’a as well as the Prophet’s Sunna, is the exact manner of which Muslims salvage God’s approval as mentioned above 33.

c) Qiyas

Literally meaning measurement 34, and legally meaning analogy. This method is used when a jurist is incapable of finding a legal rule in all other sources, and then he must resort to the analogical method, and to rules already determined 35. Analogy usually takes place on a micro level when the jurist must examine reasoning on a single provision, or on the totality of a whole body of Shari’a laws 36.

d) Ijma

Meaning “consensus”, the basis of this source of law is the prophet’s saying “My community will never agree on an error”37. It is only the consent of the jurists of the highest authority and knowledge that counts. The consent and knowledge of any other legal practitioner or jurist who has knowledge of the Quran is insufficient 38.

e) Ijtihad

Ijtihad is referred to as a source of Shari’a law, but in reality is not a source of law in the same manner as the above 4 sources, but it is rather an intellectual tool used to reinvigorate the sources; this has been a source of major misunderstandings. Ijtihad means “endeavor” or “exertion of mental energy in the search of legal opinion, to the extent

34 Free translation.
37 Free translation.
that the faculties of jurists become incapable of further effort” 39. In a legal context, it refers to a jurist who formulates a legal rule on the basis of Dalil (evidence) found in an official source; this comes as the opposite of taqlid or “imitation”. This refers to the unquestionable acceptance of a rule, not on the basis of evidence drawn directly from a source(s), but by virtue of authority of previous jurists. Although they cannot be considered similar due to different lexical meanings, for the most part, the activities of Ijtihad resemble western “interpretation” 40.

1.3 What is Shari’a Commercial law?

Since this thesis in Part 2 will aim to argue that Shari’a Commercial law (hereinafter “SCL”) can offer substantial positive contributions to the commercial and financial industry, and following human’s ability to reap its benefits, a brief introduction to SCL must be provided. Shari’a law’s jurisprudence focuses on establishing and reforming the human ethical conduct as its priority, followed by structuring and restructuring transactions and financial instruments, both simple and complex, into safer and fairer products.

As the term implies, SCL in its modern codified form can be seen as a body of laws that governs commercial transactions, in compliance with and according to Shari’a law’s jurisprudence. It is absolutely imperative to remember at all times that SCL is a creation of Muslim jurists for reasons related to practical reference. SCL does not create a fresh new system of commercial law principles and rules, but basically to re-evaluate or even ratify the pre-Shari’a law institutions of contractual obligations and commercial law; those obligations had existed during the time of the Prophet

Muhammad, fully or partially before further development following his death, and in accordance with Islamic legal principles 41.

Shari’a Commercial law is Shari’a law’s Jurisprudence applicable to commercial and financial transactions; once again Shari’a law’s Jurisprudence is equally applicable to both legal and non-legal matters. It is a set of legal norms 42, and as opposed to its current modern day codification, it was not originally revealed in an orderly code. Commercial transactions in particular are governed and regulated by Islamic financial Jurisprudence, and which forms part of “Fiqh al - Mu’amalaat”. The term “Fiqh” has previously been defined, and the term Mu’amalaat literally refers to “dealings” 43.

Since Shari’a law provides its followers with what it considers an overall strong sense of equality, justice, a general sense of fair play and the highest set of moral values through its norms, to guide and regulate their behaviour, commercial transactions are therefore expected to be conducted no differently and according to the same norms. To be more specific, exploitation of any kind as a matter of principle is forbidden, and regardless of the form of transaction – legal or non-legal - it takes. Accordingly, when looking at Shari’a law as a body of laws, this all-encompassing nature must be taken into consideration when comparing with Western laws.

As previously mentioned, although Shari’a law itself does not set the categorization between commercial and non-commercial laws, differentiations have been made yet unlike anything in the Western division. Such differentiations have only been made by human beings centuries after its full revelation, and for ease of reference.

According to the Hanafi Fiqh, jurists do not make reference to any specific forms of

43 Free translation.
contracts uniquely pertaining to commercial exchange, and no bab al-tijara (Chapter of Commerce) exists to them 44.

1.3.1 A history related character

One of the historically related reasons as to why no distinction between commercial and non-commercial law exists in particular, is due to the fact that the Prophet Muhammad was a trader before he embarked on his prophetic mission. His equal behavior at both stages of his life is the main reason why the principles of morality apply in almost all situations, and the difference in context between business and non-business Mu’amalaat is not drawn 45. Commercial law regulations stemming from the Ayat (Quranic verses) 46, as well as the Prophet Muhammad’s Sunna in relation thereto, came into being as a response to the lack of justice and moral decay in commercial practices that had been taking place in Pre-Islamic Arabia at the time 47, and in the Meccan society 48. During that era, the social settings of Mecca witnessed rising mercantilist aristocracy, which had a tendency of monopolizing the means of production in the form of capital and land, leading to rising injustice towards the Bedouins and small businessmen. Profiteering and stinginess of the wealthy was clearly visible and prevalent through their commercial unethical practices, such as Al Ghish fil Mizan (cheating in weight balance) 49; the latter practice has been mentioned

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45 See Ibid.
46 The list of Quranic specifications regarding the manner of how commerce should be conducted is extensive; it includes but is not limited to contracts, the essential requirement of their certainty, strong focus on ethics, honoring of obligations, commercial records and contract drafting and the importance of trade. See Mallat, Chibli. “Commercial law in the Middle East: Between classical transactions and modern business.” The American Journal of Comparative Law (2000). P.91.
on numerous occasions in the verses of the Quran, as well as His Prophet’s Sunna “Al Ghish fil miyzan”. For those reasons, and as will be seen in a later stage in this thesis, God banned all forms of Riba, Gharar, Maysir, cheating, and trickery in products and pricing 50.

The commercial principles of the Quran that were revealed and further applied via the Prophet’s Sunna, were mainly concerned with banning the practices of Riba (Usury), Gharar (Speculation) and Maysir (Gambling) that were sweeping the Meccan markets at the time; they were the most repressive weapons, and which had wiped out social equality and mutual co-operation. The Quranic verses and the Prophet’s Sunna therefore showed equal concern, and banned all 3 practices for the purposes of maintaining social welfare and equality 51.

1.4 The growth of the Shari’a Commercial industry in the modern world

1.4.1 A rise

“Islam is perhaps the one great religion which affords the merchant a highly honoured place in society, and even the theological terminology of the Qur’an contains a number of words borrowed from the commercial usage of the time” 52.

Although currently experiencing a boom, SCL’s gradual development into its sophisticated and codified form today was not only realized by jurists of the modern era, however its sophistication in general stems back to the era of the Muslim empire. The Islamic merchant by nature had already been born into active trading communities 53, and where the prophet himself had been an active merchant 54, and

until the birth of Islam as a religion. Mecca and Medina were not only holy places of Islam, but also the cradle of its culture, business and government. Many writers argue that the Islamic religion is against capital, capitalism and trading, yet capitalism had developed under the Islamic religion and reached a high degree of sophistication much earlier in the Islamic regions than it had in the West, and to the extent that it made substantial contributions to the European scholastics. Scholastics had “derived their intellectual armory from the works of Arab (and other Muslims) philosophers.” Since trading and capital generation are encouraged by way of direct revelation in the Quran, this was therefore embraced and practiced by the Islamic trading communities, and through its highly enhanced and sophisticated commercial practices over a vast geographical area at the time. During the medieval ages, the Middle Eastern merchants had already been long engaging in SCL compliant transactions, including Islamic Finance - structured transactions. The finance methods and instruments used were interest free, and were conducted on a profit-and-loss sharing basis; they proved very effective in financing commerce as well as enterprises. As a result of its growing sophistication in technical and geographical contexts, SCL had been formed, developed and codified in a sophisticated manner by the jurists, and to

54 The fact that the Prophet Muhammad started his career as a caravan merchant is unique to Islamic Prophecy; the tradition relating to the other great monotheistic epigones in the figures of Abraham and Jesus does not acknowledge the centrality of trade and commerce in any similar way”. See Mallat, Chibli. “Commercial law in the Middle East: Between classical transactions and modern business.” The American Journal of Comparative Law (2000). P.92.


regulate the huge spread of those sophisticated commercial activities conducted during the Muslim empire.

Arab Muslim traders spread their commercial activities over a vast region with the expansion of their Muslim empire. The empire spread from Turkestan to the Atlantic ocean, three quarters of the coastlands of the Mediterranean Sea, and pushing as far as India, Malaya and Indonesia. “From the seventh century A.D onwards, the Arabs not only extended their military conquests but also succeeded in developing long-distance trade and international commerce on a scale which surpassed anything known before”.

For many different reasons, it is only in the Middle Ages that international conventional commercial development in the Islamic lands of Asia managed to outgrow Islamic based commerce and finance, and especially during the Mongolian invasions. As a result, Shari’a based commerce and finance business scope and growth potential gradually diminished.

1.4.2 A stagnation of use

Following the era of the Muslim empire, and with the passage of time, the Middle Eastern and Asian regions had become dominated by colonial powers; those powers had substantially changed the region from a political perspective. As a consequence of their unwelcome and prolonged dominance, nationalist and independence movements then emerged, leading to the full autonomy and independence of the region by 1962; Muslim states could now afford to cut their influence from western nations and maintain their independence. Following this revolutionary period and the movements that had taken place, and a new period of adapting to a new life, trends and legal systems, it became clear that not only did SCL almost perish, but

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Shari’a law as a legal system in general had become almost completely abandoned; although not SCL related, in some countries such as Tunisia, family law had been almost abolished from the legal system. Part of such abandonment of Shari’a law was its replacement by Western civil law and commercial law. The expansion of the European colonial empires in the 19th century spread the civil law system, which is based on Roman law, to many countries in the Middle East and North Africa.

1.4.3 A revival of the Shari’a Commercial industry via Islamic Finance

After many years of burial, Shari’a law in Muslim State legal systems began a significant revival, and consequently SCL constituted part of that process; reasons varied and were many, including those of economical and cultural nature.

1.4.3.1 Economical reasons for revival

As for some of the economic reasons for the revival of SCL, a primary one is the growth of Islamic Finance and Islamic Insurance in huge Islamic financial districts, including Dubai and Oman; following the events of the 2008 financial crisis, Islamic banks that followed SCL Fiqh Al-Mu’amalaat rules showed their resilience to the crisis, and received huge public attention as a result. Even some proponents of SCL, attributed the 2008 financial crisis to ignorance of what could have been offered by SCL, which leads to stability and resilience against any financial crisis and economic recessions. Other economic related reasons attributing to the growth of Islamic Finance and Shari’a Commercial law based industry included the unprecedented

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63 See Ibid. P.350.
boost in oil-related income of many Muslim Gulf States 66, as well as the sudden boom of foreign investment in those countries 67. Both factors allowed the Arab Muslim States the drive to experiment with Islamic Finance. Once again, it is the growth and publicizing of Islamic Finance that ultimately lead to the growth and publicizing of SCL as its regulatory law.

1.4.3.2 Cultural reasons for revival

Cultural and religious laws were arguably the most important but unacknowledged reason for revival, and when Islamic scholars stressed on the promotion of Islamic Finance. Dissatisfied and discontented with Western style capitalist models, scholars had decided that those models of operation were not Shari’a law compatible 68, and therefore not ethically based. Although awareness of Islamic Finance and SCL did not actually come into public presence before earlier in the two decades of the 1950’s and 1960’s, there were already huge debates regarding Riba, and over the question of charging of interest; the majority of the official 'maftoon' and 'ulamas' expressed strong disapproval of those banks charging those excess fees, which were Shari’a prohibited and unethical banking activities 69.

Islamic scholars in the 1960’s by then had all agreed that Riba had been largely practiced by conventional financial institutions, and that charging interest on top of a loan was usurious, and constituted excessive and exploitative interest when charged on financial transactions. They had then called for more flexible and ethical treatment

69 See Ibid P.17.
of debtors, and unanimously called for alternative ethical financing methods. The Muslim economists, bankers, Shari’a scholars and political Islamists therefore focused on the possibility of running financial institutions that do not charge interest rates, and finding Shari’a compliant alternatives to “illegal” Western style banking activities from a Shari’a law perspective.

1.4.3.3 An exponential growth

The growth of awareness of SCL through the growth of Islamic Finance had started in the Asian regions, where several pilot projects had taken place in the 1940’s, and before the formal launching of Islamic Finance had taken place in the Indian subcontinent. Similar to the medieval Middle Eastern institutions, loan co-operatives modeled on the European mutual loan experiments driven by religious and ethical standards had been launched. An interest free credit network had been created in Pakistan in the 1950s, as well as Muslim Pilgrims Savings Corporation launched in 1963 in Malaysia. The SCL based industry of Islamic Finance had then first started experiencing actual public presence, as well as actual contribution to fund capital. The first major trade company the Islamic Transaction Company was established in Cairo, Egypt, and increased its capital from 4,000 to 30,000 Egyptian pounds. This success then led to the establishment of the first industrial company, the Arabic Company for Mining and Quarries and with an initial capital of 60,000 Egyptian pounds.

As for the exponential growth of Islamic Finance as seen today, it had not actually started till the mid 1980’s; the first financial company to appear in recent history was

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71 See Ibid. P.17.
the Egyptian Mit Ghamr savings project in 1963, and in 1971 became part of the Egyptian Nasser Bank. The project worked on a co-operative basis, and depositors had the right to apply and take out loans for productive purposes. The project was for the purposes of increasing access to financial services and increasing wealth. The Mit Ghamr project was generally concerned with the Islamic socio-economic ideologies of its founder Ahmed Al Najjar, who was in fact inspired by the German savings bank models; overall, the project aimed at being more than just an interest free banking institution, but rather promoted social justice, poverty alleviation, economic development, equal access to credit and low income and middle class entrepreneurship. The institution was finally forced into liquidation in 1967, and as a result of the Egyptian government’s hostility towards the potential rise of Islamist movements.

In today’s modern age, it can be safely said that the Islamic financial industry has developed to a point where it is a major global industry, where Islamic financial institutions as well as their conventional counterparts offer a very broad range of Shari’a based financial products. Products ranging from savings and current accounts, personal financing, vehicle financing, home financing, credit cards and Takaful insurance are being offered. Additionally, more sophisticated and complicated products including but not limited to Asset-Liability Management and Treasury, Fixed Income, Equity, Project Finance and Export Finance, Structured Finance and Asset Management are also on offer nowadays.

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77 Visit www.bnpparibas.bh to see examples.
Although the term “Islamic” may potentially sound very much against sophisticated high-risk investment institutions such as mutual funds and hedge funds, Islamic hedge funds have in fact also been created. Islamic investment funds perform the same functions of any conventional hedge fund, however managing funds and managing risks are done according to Shari’a restrictions. Investment rules are defined in a very tight manner; leverages and derivatives are restructured, and investments are made strictly on real assets. Many non-Muslim investors have also recently started investing in Shari’a compliant investments, as well as Islamic mutual funds, Islamic real estate and Islamic bonds (Sukuk). The result is that some hedge funds claimed that they have outperformed their conventional counterparts. In 2014 “Islamic funds were the best performing investment vehicle for the year, driven by strong gains in Arabian markets. Equities in the GCC countries have witnessed a strong rally”, where some hedge funds gained 10.18 per cent as of May 2014 year-to-date. Overall, the current global Islamic Finance assets total may surpass US$ 2 trillion by the early end of the third quarter for the financial year 2014, and are expected to double to almost US$ 2.6 trillion by 2017. Furthermore, the number of Islamic mutual funds has reached 786 in 2013, from 687 in 2012 being double the number in 2007. In total, Islamic mutual funds hold about US$ 46 billion of assets under management, from US$ 41 billion in 2012. Islamic money markets are now the largest in this segment, and overtaking equity funds for the time, holding US$ 20.1 billion in

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assets compared to US$ 3.2 billion in 2013. Equity funds now hold US$ 19.7 billion
compared to US$ 1.5 billion in 2013 80.

1.4.3.4 Global industry expansion and outcomes

As a result of the exponential growth of Shari’a Commercial law as seen through the
growth of Islamic Finance, and in terms of global assets and product development, its
global outreach has reached a level similar to conventional financing. The availability
of an international legal framework allowing for international transactions to be
governed by uniform laws therefore became essential. This need for uniform laws
became even more crucial due to the problems posed by what are called Shari’a
Boards, which form part of Islamic Financial institutions.

Shari’a boards composed of specialists in Fiqh Al Mu’amalaat were formed with a
view to giving advice to banks regarding banking transactions, and thereby ensuring
Shari’a compliance. Shari’a board members are well known and respected, and
possess a high degree of knowledge and experience in Shari’a teachings 81. The main
responsibilities of Shari’a boards are on the one hand, to ensure that banking
facilities, services, investments and activities offered are all Shari’a compliant, and
called supervisory roles. On the other hand, the Shari’a boards also offer a
consultancy role, where Shari’a scholars may give advice on how to structure and
restructure conventional banking products to their Islamic alternative, on research
and development, as well as providing training and education for those Islamic
banks; the consultancy role is rather creative and constructive 82.

Visit Reuters website http://uk.reuters.com/article/2013/11/19/islamic-finance-funds-
idUKL5N0IE02820131119 Last visited 6 December 2013.
81 See Peter Hrubi and Adnan Siddiqi. Islamic Investments Funds Versus Hedge Funds. Munchen: GRIN
of the mission of the AAOIFI is “Achieving harmonization and convergence in the concepts and application
Whilst the emergence of Shari’a Boards has certainly contributed to a large degree the development of Islamic Finance, this is not without its problems. Due to the lack of unified rules, decisions made by the scholars up till recently were arbitrary, highly unpredictable, inconsistent, and inevitably had an enormous negative impact on the potential growth of the market. This inconsistency stems from the fact that under Shari’a law, scholars from the four Sunni schools of thought (Hanafi, Shafie, Malike, Hanbali) as well as the Shiite schools differ in their interpretations, and according to the region or jurisdiction in question. This triggered many conflicting opinions. 83

1.5 Out with the old and in with the new: AAOIFI and ISDA uniform law developments

This coming section will focus on the most up to date developments in regards to uniform non-State legal standards and frameworks for the Islamic financial and commercial industry, and for several reasons. Firstly, since this chapter has given an introduction to SCL including the current levels of its global expansion, as well as some of the challenges faced, it is part and parcel of this introduction to include the remedying measures taken to address those challenges. Secondly, since this thesis argues that a financial meltdown could have been prevented had Shari’a law’s Jurisprudence been used or even consulted, the modern systemic codification of Shari’a law’s Jurisprudence for today’s modern usage must therefore be demonstrated as a justification for such argument. Thirdly, due to the fact that those remedying measures are still relatively new as compared to their conventional counterparts,

they may be potentially be criticized as lacking credibility, sufficient weight, still in their embryonic stages and not yet sophisticated enough for regulating cross border transactions; addressing those potential criticisms preemptively, by engaging in an analogical comparative analysis with their older conventional counterparts, is imperative to establish their credibility. Although included in a first and introductory chapter, the result of this comparative process aims to serve as one of the contributions intended by this thesis. Finally, since some Shari’a Jurisprudence based alternatives to some of the conventional financial derivatives will be offered in Part 2, and using those new uniform Islamic non-state legal standards, their credibility must be justified beforehand in this introductory chapter of the thesis. It will appear that their importance, added value and reliability will perfectly equate their conventional counterparts.

In order to conduct this comparative analysis, firstly a brief introduction to the basic reasons for the development of conventional uniform non-State legal standards in general will be provided; this will include a profound explanation to Lex Mercatoria (Law Merchant), UNIDROIT Principles and ICC INCOTERMs as the classical outcome of those developments. This same logical sequence will also be used for the Islamic uniform non-State legal standards; specifically, the reasons that lead to developing uniform non-State legal standards, followed by the AAOIFI Standards and the ISDA Tahawwut Master Agreement 2010 as the outcome of those reasons will be provided. In this process, and to establish credibility for the latter two outcomes, they will be compared to the UNIDROIT Principles and ICC INCOTERMs. Finally, other characteristics that establish further credibility and reliability to non-state legal standards will be addressed, and compared to the Standards by analogy.

1.6 Law Merchant (“Lex Mercatoria”) as conventional uniform trade laws

Below is an introduction to the uniform Lex Mercatoria, as well as two selected and specific expressions of it in modern codified form, known as the New Lex Mercatoria. Thereafter, a
comparison with uniform Islamic legal standards will be made, and for the purposes of providing a justification of their credibility by analogy.

1.6.1 The term Lex Mercatoria

Lex Mercatoria is a “multi faceted term which serves both to draw boundaries around a community and its practices, and to denote a legal system. It describes the totality of actors, usages, organizational techniques, and guiding principles that animate private, transnational trading relations, and it refers to the body of substantive law and dispute resolution procedures that govern these relations”. Being “Transnational commercial law”, it “is conceived as law which is not particular to or the product of any one legal system but represents a convergence of rules drawn from several legal systems or even, in the view of its more expansive exponents, a collection of rules which are entirely anational and have their force by virtue of international usage and its observance by the merchant community. In other words, it is the rules, not merely the actions or events, that cross national boundaries”.

Since its birth, and although “unsystematic, complex and multiform, but of bewildering

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84 The Law Merchant at its earliest stages, and which originally started differently to what is known today as the New Law Merchant, went through four distinct phases; the ancient maritime customs, Middle Age merchants guilds, nationalization and to what is known today as the New Law Merchant. It is however the body of laws governing overland trade in the Middle Ages that is the true antecedent of the present doctrine. See Richard J Howarth. “Lex Mercatoria: Can general principles of law govern international commercial contracts?” Canterbury Law Review. 10 (2004): P. 40 and Dasser, Felix J. “Incoterms and Lex Mercatoria: Applicability of Incoterms in the Absence of Express Party Consent? “Diss. Harvard Law School, 1990 P.7 citing F.M Burdick. “What is the Law Merchant?” Columbia Law Review. 2.7 (1902). 470-482. P. 15. The question of whether the New Lex Mercatoria is a continuation of the original Medieval Lex Mercatoria is a question of continuous debates, with arguments for the fact that was a cut off period between the both, and other arguments for the fact that the current codified forms of New Lex Mercatoria are a continuation of the old Lex Mercatoria. The argument in short depends on the jurisdiction in question, whether looked on from a positivist and autonomist view, scope of the lex Mercatoria to have, and a question of degree. See Dasser, Felix J. “Incoterms and Lex Mercatoria: Applicability of Incoterms in the Absence of Express Party Consent?“ Diss. Harvard Law School, 1990.


vigour, realism and originality “ 87, it reflected the ultimate move away from local law towards a universal system of law, based on mercantile interests.

There is no one unified definition of Lex Mercatoria 88, however it can be simply described as the law governing international trade stemming from an autonomous mercantile community. With its transnational character being its essence, it can be described as the “rediscovery of the international character of commercial law…(a) move away from the restrictions of national law to a universal, international conception of international trade” 89. The term Lex Mercatoria is one of several terms that have been used to describe the “third legal system”; other terms used include “transnational law”, “transnational commercial law” and “international law of contracts”. It should be noted that the terms Lex Mercatoria and transnational law are at times used interchangeably 90, and depending on how Lex Mercatoria is defined 91. Lex Mercatoria refers to a concept of a-national and autonomous legal rules and principles, developed by the international business community. It is based on a


collection of trade custom, usage, industry practice, and general principles of law applied to international commercial arbitrations, and to govern commercial and financial transactions between private parties, as well private parties and States. They are rules and principles that the business community may elect to regulate their international commercial transactions, and away from national State rules which may be outdated and lacking the flexibility needed for accommodating international transactions. Furthermore, parties to international commercial transactions who cannot decide on a specific national law to be applied, or who prefer an international law containing principles common to multiple legal systems and not only one system belonging to one party without the other, would find Lex Mercatoria being a concept of a-national and autonomous legal rules and principles to be a perfect choice 92.

1.6.2 The beginnings and development of international trade and finance uniform non-State legal standards in general

Lex Mercatoria sought to provide a standard of equity, aiming at merchant courts globally accepting it as the primary source of law, and to regulate the different trade practices, cultures and languages of the different traders; this was especially important for the European merchants who’s trade practices were well expanded geographically, and due to the geographic nature of the European continent 93.


The history of Lex Mercatoria goes back as far as the Roman era, and at least from the time of the roman *ius gentium*; it was a body of commercial, financial and personal laws administered by the *praetor peregrinus*, and in relation to disputes held in Rome between two non-Roman aliens, or between a citizen and an alien. Generally, the notion of standardizing legal norms governing and facilitating dispute resolution in international commerce, is probably as old as the idea of commerce and exchange itself; the standardization process came as a response to the lack of unified laws, and to bring a degree of predictability to existence. At its earliest stages, trade was regulated mostly by merchant custom; by way of example, maritime trade over the Mediterranean area was based on general merchant traditions. The Greeks and Romans adopted the Sea Laws of Rhodes as early as 300 B.C, as well as the Consololato del Mare, being a collection of maritime customs laid down in the Consular Courts of Barcelona in the 14th Century; they were all engineered to standardize and regulate cross-border commerce.

Starting from the 17th century and onwards, this transnational customary law slowly but increasingly became embedded and incorporated into national state laws. In

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England Lex, Mercatoria amalgamated its rules with Common Law. In some civil law countries, it was equally incorporated into broad codifications, marking the beginning of official state recognition. The law was taken from the hands of merchants and their merchant courts, and placed in the hands of national legislators and national courts. Throughout the twentieth century, and still shifting in the same direction towards the “common language”, legal reforms and developments then started shifting more towards the creation of international instruments, as well as international uniform laws and frameworks - as opposed to relying on certain State laws - all designed to regulate and handle disputes for international trade. This shift towards the internationalization of laws proves its essentiality even more so in today’s globalized world, and given the rapid acceleration of trade and investment flows, the expansion of capital markets, the integration and internationalization of financial markets as well as global business operations.

As a matter of concept, it is certainly understood today that for the purposes of developing trade, whether local or international, there is a general requirement that the “legal language is by and large uniform”; “Trade usages and more specifically trade terms are examples of such common legal language”, commonly understood by all those active in the industry. Up till the twentieth century, commerce, trade, sales and financial laws can be said to have been predominantly based on English law, being that

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“common language” of international commerce. At the same time, there were also many other legal systems of domestic nature, which also regulated commerce; Roman law, American Common law, French law, Germanic law, Ibero-American legal systems, African legal systems, Middle Eastern, Asian, Eastern European and Central Asian legal systems all played a role in regulating commerce. Each neither being superior nor inferior to another, they simply were all different “languages”.

1.6.3 *Lex Mercatoria in State courts and Arbitration Tribunals*

Being a concept reflecting the need to harmonize and unify international trade laws, stemming from a diversity of global sources, Lex Mercatoria was neither a complete body of rules, nor a legal order of any kind as previously stated. Being only a concept at its early stages, it was viewed by critics and skeptics as ambiguous and indefinite, and can only be clarified once supplemented by national or international solid legislation. Even after further developments had taken place, critics continued and still continue to claim certain shortfalls of uniform laws such as lacking substance, depth, methodical foundations, procedural legitimacy, transparency,

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unanimous State and court acknowledgment, circumventing State public order 108 and needing supplementary uniform interpretations for filling the available gaps 109. Albeit old points of view, and well before later developments of some sophisticated uniform law instruments had taken place, many criticisms of this nature are traditional, and stem from critics unable to accept new ideas and a shift away from what is safely known 110. It is this kind of opposition that lead to calls for, and actual realization of more specific and systemic codifications of Lex Mercatoria, such as the UNIDROIT Principles, the Convention on Contracts for the International Sale of Goods (CISG) 111 and the ICC INCOTERMs; the latter codifications are examples and expressions of what is known today as the New Lex Mercatoria. Starting in the 1960’s, the New Lex Mercatoria, being a transnational commercial law, is also a result of the evolution of the global market place 112.

As mentioned above, Lex Mercatoria “comprises rules the object of which is mainly, if not exclusively, transnational, and the origin is customary and thus spontaneous, notwithstanding the possible intervention of inter-State or state authorities in their elaboration and/or implementation” 113; they are now however recognized by State courts

110 See Ibid.
as laws very capable of regulating international transactions, in concept. In practice though, State courts only refer to / enforce them when certain conditions relating to their credibility and consistency are met; furthermore, no State law(s) itself must contain any express rules prohibiting the application of non-State laws by a State court.

Lex Mercatoria may also be a choice of law in private arbitrations, and where the rules of some arbitration tribunals or centers do give their judges the right to refer to them; judges also do refer to them when they deem appropriate, and not necessarily conditional express party choice.

To provide an example of State legislation implying the acceptance of Lex Mercatoria, Art. 1511 of the French Decree of 13 January 2011 reforming the law governing arbitration stipulates:

“The arbitral tribunal shall decide the dispute in accordance with the rules of law chosen by the parties or, where no such choice has been made, in accordance with the rules of law it considers appropriate. In either case, the arbitral tribunal shall take trade usages into account” ¹¹₄.

Furthermore, in the field of private arbitration, and according to the International Chamber of Commerce Arbitration Rules in force as of 1 January 2012, Article 21-Applicable Rules of Law states:

“1 The parties shall be free to agree upon the rules of law to be applied by the arbitral tribunal to the merits of the dispute. In the absence of any such agreement, the arbitral tribunal shall apply the rules of law which it determines to be appropriate.

2 The arbitral tribunal shall take account of the

provisions of the contract, if any, between the parties and of any relevant trade usages” 115.

In the above two examples, by granting powers to refer to rules deemed appropriate, it is usually understood to be reference to Lex Mercatoria 116.

In this next coming section, a detailed look is taken at both the International Institute for the Unification of Private Law’s (the “UNIDROIT”) Principles (the “Principles”) and the International Chamber of Commerce (the “ICC”) International Commercial Terms (the “INCOTERMS”), both as systemic codified expressions of Lex Mercatoria. The purpose of this demonstration is to highlight their specific nature, purposes and role played for cross-border conventional commerce. Following that, a comparison will be made between them and the Accounting and Auditing Organization for Islamic Financial Institution’s (the “AAOIFI”) legal Standards (the “Standards”), for the purposes of establishing that the latter has similar roles and objectives. It is this comparative analysis that seeks to establish the credibility of the AAOIFI Standards by analogy.

1.7 The UNIDROIT Principles as an expression of Lex Mercatoria

“The Principles represent a codification of high quality homogeneity in contents, which in many respects even surpasses the quality of traditional national legal orders…..they represent a clear and stable codification created by an approved international organization” 117.

The UNIDROIT Principles represent a system of principles and rules of contract law, which are common to multi-national legal systems, and which adapts to the special requirements of international commercial transactions. It serves as a model for national and international legislators as governing rules of contract, and apart from some exceptions, are non-binding till expressly chosen by parties. When first prepared and introduced by UNIDROIT, the objectives were inspired by the U.S project of the Restatements of the Law. The latter was a project aimed at remedying the uncertainties stemming from the fact that every state had its own and separate laws, as well as the uncertainties stemming from the laws of the federal government, which is an independent source of law. The ultimate objective of the “Restatement of the Law” was to in a systematic manner “not only help make certain much that is now uncertain and to simplify unnecessary complexities, but also to promote those changes which will better adapt the laws to the needs of life.”

The Principles when preparing its first 1994 edition by a working group of leading experts in the field of international contract law and international trade law, being mostly academics, high-ranking judges and civil servants, it aimed at providing the ‘best’ solutions. Coming from different common and civil law backgrounds, they combined their efforts to “break out of their respective conceptual straitjackets to reach common ground. This only could have happened by a process of mutual education and the

120 See Ibid. P.9-11.
As law ought to be updated to meet modern needs as a matter in concept, it was drafted “with a view to a possible reconsideration of them at some point in the future” 122. Several sources of inspiration influenced the direction taken by the working group in realizing the Principles. Firstly, in deciding what was best, it intended on placing rules that are common to most legal systems. The working group had produced a set of principles that were “internally coherent”, acceptable to people engaged in international trade coming from different legal systems, as well as responding to the real needs of the “protagonists of international commerce” 123.

Secondly, in restating the law and not reinventing it, several legislative sources inspired the realization of the Principles. Apart from the obligatory point of reference to the 1980 United Nations Convention on Contracts for the International Sale of Goods, other sources including but not limited to the 1974 U.N Convention on the Limitation Period in the International Sale of Goods (as amended by the 1980 Protocol), the 1993 UNCITRAL Model Law on International Commercial Arbitration and the 2002 UNCITRAL Model Law on International Commercial Conciliation were all legislative sources of inspiration. Furthermore, other non-legislative instruments such as the INCOTERMS, the UNCITRAL Legal Guides on Drawing Up International Contracts for the Construction of Industrial Works as well as FIDIC model contracts were referred to 124.

The Principles operate on several underlying concepts and ideas, however since their analysis would be extensive, the three most concepts and ideas relevant and common with SCL and the subject of thesis are the following:

121 See Ibid. P.27-33.
122 After the success of the 1994 edition, a further ‘expansion’ to a 2004 and 2010 versions took place, and by adding further topics, and taking new commercial developments into consideration.
123 See Ibid. P.46-47.
1.7.1 Concepts of the Principles

a) Freedom of Contract

In its 2010 edition, Article 1.1 includes the concept of “Freedom of Contract as a basic principle in the context of international trade”. Specifically, it mentions that this principle is of “paramount importance” in recognizing, affirming and granting business parties the right to conduct transactions according to their terms, with a view to promote an open international market. Although the Principles have a non-mandatory nature, and within the limits of Art. 1.5, under no circumstances may they override any mandatory rules, whether national, international or supra national. Furthermore, to ensure fairness, Freedom of Contract may under no circumstances violate Good Faith and Fair Dealing, by either excluding or limiting it; all acts to the contrary are known as Abuse of Rights.

b) Trade Usage

In its Article 1.9, it states that the parties to commercial transactions are bound by any usage that they have agreed to, or even when no mention to specific usage is made; this may take place provided that the application of the usage is regular and therefore well known and established, except when usages amount to unreasonable practice. The idea behind this article is to provide the flexibility needed for enhancing international trade and commerce, and without the constant need for incorporating

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126 See 2010 UNIDROIT Principles of International Commercial Contracts. Art. 1.5
127 See Ibid. Art.1.4.
128 Art. 1.7.
130 See Ibid. Art. 1.9.
new express articles of current and constantly developing usages in the body of the Principles itself.

c) Good faith and fair dealing

Being “one of the fundamental ideas underlying the Principles”\textsuperscript{131}, the Principles state that conducting international commercial transactions is to be done in good faith and fair dealing, which is of “mandatory nature”\textsuperscript{132}. This must be guaranteed at all times even in the absence of special provisions.

1.7.2 Purposes of the Principles

The principles are not only prepared as reference for best practices, they play an essential practical role in the internationalization of commercial transactions – and this is since their realization. The Principles, and only in relation to this thesis, are set for several purposes:

a) As rules of law governing a contract

Following the latest private international law rules permitting non-State rules as a choice of contract law rules, and by express choice, parties to a commercial contract of an international nature may choose the Principles as governing contract rules to be applied by domestic courts. The Principles serve as a neutral applicable law, providing equal bargaining power to contract parties. Private arbitration tribunals may also apply the Principles\textsuperscript{133}.

\textsuperscript{131}See Ibid. Art. 1.7 Comment (1).
\textsuperscript{132}See Ibid. Art. 1.7. Comment (3).
The non-State laws must enjoy the quality of consistency to be an applicable choice of law. In a Swiss court decision *Handelgericht St. Gallen* 134 handed down on 12 November 2004, and followed by the Swiss Supreme Court on 20 December 2005, admitting as obiter dictum that in disputes held before domestic courts, parties are entitled to choose a-national or supranational rules of law such as the Principles 135. Although the dispute involved the FIFA Rules, the decision was that those non-State rules were a valid choice of law, and were comparable to the UNIDROIT Principles. There was “both sufficient internal consistency and a substantive content”, and therefore could be chosen as the law governing the contract subject of dispute 136.

The non-State laws also must not contradict compulsory State laws in order to be a valid choice of law. In the *Bundesgericht* case 137 before state courts, a decision similar in nature to the above case was taken, adding that the rules would only be applicable to the extent that they are not contrary to the mandatory provisions of the applicable domestic law 138.

b) *As a means of interpreting and supplementing international uniform law instruments*

The Principles “*may be used to interpret or supplement international uniform law instruments*” 139. The Principles may therefore be used to play an interpretative and gap-filling role in the event of the presence of ambiguities in other uniform law instruments, such as the CISG or the 1956 Convention or any other Uniform law instrument. This may occur when some contract issues arise such as contract formation, performance, interpretation, remedies etc.

134 Visit http://www.unilex.info/case.cfm?id=1123
138 See Ibid.
139 See UNIDROIT Principles 2010. Preamble. 5.
A case serving as a good example to this role may be the one involving a decision rendered by the Economic Court of the Commonwealth of Independent States (CIS). Responding to a request by the Supreme Court of the Republic of Kazakhstan, and regarding the interpretation of an agreement entered into by members States of the CIS. The enquiry was whether National Banks of member States may have the right to ask for payment of the costs of converting the national currency to the currency of payment, as well as the rate of conversion to be applied. Referring to Art. 6.1.9 (4) of the 1994 Principles “in the absence of the relevant provisions of domestic law on this issue”, National Banks are obligated to convert the currency according to domestic law conversion rates, in accordance to “rules of international law”, and regardless of whether the same rules are provided for by domestic law.

c) As a means of interpreting and supplementing domestic law

Similar to the above purpose and usage, the Principles “may be used to interpret or supplement domestic law” 141. This comes especially useful in some countries with legal systems that do not provide clear cut solutions to many legal problems, particularly in countries in transition from a planned economy to market economy; it may also be simply a developed country either lacking the necessary expertise in regulating international commercial transactions, or with sharply divided opinions. As a member of the Supreme Court of Argentina stated “the UNIDROIT Principles may be of assistance interpreting, supplementing and applying the national chosen by the parties all applicable by virtue of conflict of law rules: A applicable national rules may prove to be too rigid ill-suited to international contracts” 142.

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From over 180 cases globally where the Principles were referred to for interpretative purposes, one example of the Principles being used for interpreting domestic law was by the Supreme Court of Poland in 2003. The Supreme Court was requested to provide an interpretative decision following conflicting decisions by different Chambers of the Supreme Court. The question was whether under Polish law, a contractually stipulated penalty is to be paid even though a creditor had suffered no loss. In rendering its decision, by expressly referring to Art. 7.4.13 of the 1994 Principles, the court decided, “if a contract provides for the payment of penalty in case of default, then the other party shall have the right to claim the agreed amount, regardless of the scope of the incurred damage” 143.

On another good case serving as an example of reference to the Principles for interpretative purposes, was actually a case referred to by the Superior Court of Quebec, Montreal in 2005. In this case referred to, a Canadian shipping company sued several of its ex senior officers, for breach of their duty of loyalty towards the company; they had utilized a business opportunity that they had developed during their active term for the company, and for their own personal benefit. The defendants argued back that the non-competition clause contained in the shareholder agreement, only expressly excluded its application to shareholders exercising a put/call option for their shares. Referring to the Principles, which provide that “expressis verbis, that the parties may neither exclude nor limit the scope of the requirement for good faith”, the court rendered a decision in favor of the plaintiffs 144.

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d) *A model for national and international legislators and as a guide for drafting international contracts*

The Principles can be used in creating a whole new legislative code, or even in reviewing certain existing legislations, providing legislators with already thoroughly tested model laws and clauses, reflecting international contract rules based on common ground between multi legal systems. Furthermore, it may also be used in the same manner, for the purposes of drafting uniform contract laws 145.

Given the importance and the major role-played by the Principles as a reference by national courts, supreme state courts and arbitral tribunals, and in complementing a number of international trade law instruments, it has received official international recognition. The United Nations Commission on International Trade Law (UNCITRAL) adopted its 2004 Principles at its 40th session in 2007, and further endorsed in 2010 version in 2012 146.

1.8 *The ICC’s INCOTERMS as an expression of Lex Mercatoria*

The introduction of the Terms, and along the same reasons and objectives as the Principles, “represented a radically new concept in the industry regulated by the local rules of law….. International trade becomes more and more complex. Therefore, universally used rules are essential to avoid misunderstandings and costly disputes” 147. According to a study conducted by the ICC in the 1920, trade terms were understood and interpreted differently on a global level; this lead to inevitable disputes in international trade, since international merchants had neither a common commercial background nor a “common language”. In cases where disputes arose, their outcomes depended on the

laws where those disputes were resolved. Even standard contracts of different trade organizations themselves did not treat trade terms in a unanimous manner.

Not only was the lack of unanimity leading to costly disputes in terms of time and expenses, the uncertainty over trade terms had potentially negative implications on the future growth of the trade between the parties in dispute 148. Based on the same idea of the Principles, and although older in existence, the Terms are equally recognized uniform legal standards. They define themselves as “International regulations for the interpretation of the most commonly used trade terms in foreign trade terms”. Following a first meeting of the International Chamber of Commerce in Paris, France in 1920, and a strong comprehensive report leading to the first publication of complete “commercial terms”, publishing uncertain terms and usages of more than 30 States, and providing definitions for them, it is only in 1936 that the ICC made a complete uniform code available to practitioners of international commerce 149. Ever since its realization, and to this date, the ICC expert lawyers and trade practitioners have updated them 6 times to keep pace with the international trade 150. Being an expression of Lex Mercatoria, and reflecting its objectives of promoting the typical dynamic nature of trade and commerce 151, its incorporation as trade terms in international trade agreements reflects firstly a “harmonization” and “unification” of merchant practices internationally, and secondly recognizes the freedom of


merchants to set their own terms in the manner they deem suitable for their business ventures. Blending different laws from global legal systems, it brings concepts and principles from both common and civil law systems for enhancing international trade 152. To sum up the objectives of the Terms, they are “to ascertain the greatest common measure of practice current in international trade in the interpretation of these trade terms……The object of INCOTERMs is not to improve current practice by laying down what de lege ferenda would be desirable” 153. The Terms are more specific to harmonizing rules and usages in specific areas, and only handle certain aspects of international sale contracts 154, and can be grouped into 4 categories: merchandise delivery, transfer of risks, distribution costs and documentary formalities relating to border crossing 155. Similar to the Principles, they do not constitute laws and regulations, are not regulatory regimes, and do not provide for penalties in cases of violations; they exist to reduce discrepancies between buyers and sellers, and clarify the responsibilities and rights of each. They do not dictate practices, but rather clarify them 156.

153 See Clive M. Schmithoff. The Unification or Harmonisation of Law. International and Comparative Law Quarterly. 17 (1968): P.558. By harmonizing and unifying international merchant laws UNCITRAL notes that “Harmonization” and “unification” of the law of international trade refers to the process through which the law facilitating international commerce is created and adopted. International commerce may be hindered by factors such as the lack of predictable governing law or out-of-date laws unsuited to commercial practice….“Harmonisation” may conceptually be thought of as the process through which domestic laws may be modified to enhance predictability in cross-border commercial transactions. “Unification” may be seen as the adoption by States of a common legal standard governing particular aspects of international business transactions. See Gabriel, H.D. "The Advantages of Soft Law in International Commercial Law: the Role of Unidroit, Uncitral, and the Hague Conference." Brooklyn Journal of International Law. 34.3 (2009). P. 655.
Similar to the Principles, the Terms can become contract-binding rules of law, and once expressly chosen and indicated by parties to a contract; they can be chosen as applicable laws for international as well as domestic contracts, and specifically for the sale of goods.

As for the practical implementation of the Terms, they may be employed for the same purposes of the Principles, namely: 1- As rules of law governing a contract, 2- interpreting and supplementing international uniform law instruments, 3- as a means of interpreting and supplementing domestic law, 4- as a model for national and international legislators and 5- as a guide for drafting international contracts. Given that both the Principles and the Terms are of the same uniform nature and promote similar uniform objectives, it suffices at this stage to state that the above analysis applicable to the Principles for this specific matter is equally applicable to the Terms. No further analysis is therefore needed.

The success of the INCOTERMs was first noted in the Report of the United Nations “the Progressive Development of the Law of International Trade”, when it stated that more than 100,000 copies had been issued, and that 15 translations to different languages in addition to the English and French languages had been issued 157. The Terms have at this stage become the standard and dominant source of definitions for the commercial delivery terms used by parties to international sales contracts, and are even incorporated into the CISG through article 9(2) 158.

Finally, and similar to the Principles, the Terms are equally internationally adopted. The UNCITRAL also adopted the INCOTERMs 1990, in its 25th session in 1992, the

INCOTERMS 2000 in its 33rd session in 2000\textsuperscript{159}, and finally in its Forty-fifth session (25 June-6 July 2012), requested to endorse the INCOTERMS 2010, which had entered into force on 1 January 2011\textsuperscript{160}.

1.9 The development of the Islamic uniform non-State legal standards in general and before major reforms

As much as the growth of the Islamic Commercial and Financial industry has grown exponentially and on a global scale, it had previously experienced many challenges similar in nature to international conventional commerce and trade. Until recently, and for a long and extended period of time, no international uniform, consistent, objective or predictable Shari’a laws and court judgments could be said to have been available, codified and reliable for use; this naturally lead to scattered and disperse Islamic jurisprudence, leading to arbitrary decisions in cases of dispute resolution.

1.9.1 Arbitrariness as practiced

The view of Shari’a law as unreliable as a result of being made and used on an arbitrary basis is not only recent, but from traceable modern history, stemming back to mid 20th century. In \textit{Saudi Arabia v Aramco} (1958), where a dispute over Onassis shipping contract with Saudi Arabia led the judge to reject Shari’a law as the applicable law to the dispute, and on grounds of being “embryonic” and “leading to \textit{ad hoc law created by the ruler}”\textsuperscript{161}. This had mirrored a previously made “biased view” by


Justice Feliz Frankfurter, who decided that Islamic law was merely a law that was “unpredictable and consisted of nothing more than “qadi law” enacted by a tribal chief sitting under a tree” 162.

As the Shari’a Commercial industry continued and still continues to experience substantial growth and increased sophistication, however till very recently, the problem of lack of available unified systemically coded Jurisprudence was still evident; this particular problem was further complicated by the presence of Shari’a advisory boards of Islamic financial institutions, where their decisions were largely arbitrary, unpredictable, and had not gone through enough reform and development.

1.9.2 Dispersible: Islamic schools of thought

As previously mentioned, the problem of disunity in Shari’a Jurisprudence was largely a result of the presence of Shari’a boards, adhering to a wide diversity of Shari’a law teachings. This was confirmed in the famous Shamil Bank of Bahrain E.C. v Beximco Pharmaceuticals Ltd. and others (2003), and known as the Beximco case 163. Being a dispute over a Murabaha financing agreement (capital cost plus profit), its governing law clause stated:

“Subject to the principles of Glorious Shari’a, this agreement shall be governed by and construed in accordance with the laws of England”.

The lower court examining the dispute claim, and over a question of choice of law, discarded Shari’a law as the governing law and chose English law instead.


163 See Shamil Bank of Bahrain EC v Beximco Pharmaceuticals Ltd and others [2003] 2 All ER (Comm) 849.
Confirming the lower court decision, the Court of Appeal held that “it was the evidence of both experts that as far as the principles of Shari’a law were concerned, that there are indeed areas of considerable controversy and difficulty arising not only from the need to translate into propositions of modern law texts which centuries ago were set out as religious and moral codes, but because of the existence of a variety of schools of thought with which the court may have to concern itself in any given case before reaching a conclusion upon the principle or rule in dispute” 164.

All judges in the above cases had dismissed Shari’a law as the applicable law in above disputes, and over its lack of reliable codification and therefore lack of predicatability. As a result of this lack of codification and predictability, all judges expressly stated that Shari’a law was unreliable, being “discretionary”, lacking “any settled body of legal principles”, was “embryonic”, “leading to ad hoc law”, “unpredictable”, “of considerable controversy and difficulty” and which “need to translate into propositions of modern law texts”. Admittedly, this was historically a classic problem, and due to the existence of a variety of schools of thought, as well as the lack of globally settled uniform Shari’a law Jurisprudence at the time. Today’s uniform global Islamic legal standards have remedied the problem. This will be dealt with in the next coming section of this chapter, and in an extensive manner.

Historically more than 10 different Sunni schools of thought existed, with only four official ones that are still active today 165; those are the Hanafi, Maliki, Shafi’e and Hanbali schools. Sunni Islam constitutes 85-90% of the total global Muslim

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population. There are also Shi‘te schools of thought. Each one named after their founders, yet they neither differ nor alter the essence, spirit or basic principles of Shari‘a law, but rather only differ over interpretation and application of individual elements of the law. Each school of thought reflected the social traditions particular to their localities, and demonstrating at times a wide gap in legal theory. With different Muslims following different schools of thought in their daily practices, it naturally extends to their financial practices; accordingly, they would only invest in financial products deemed compliant, and according to their schools of thought that they personally follow.

a) *The Hanafi School*

Founded by Imam Abu Hanifa, he was a known non-Arab scholar famous for his intelligence. His teachings were well known by the use of a new approach called “ra‘y”, or subjective thinking. It depended on the Quran and Sunnah, and in line with traditions and reason; issues were also explored and analyzed using Qiyas and Ijma. He did not produce a systematic and codified set of laws, but his works were rather transmitted by his pupils. This school of thought became the most influential of schools, and reflected the complex society of Baghdad, Iraq, and mixed agricultural and commercial economy with its ethnically diverse culture. Its dominance today reflects itself in family and religious laws in the Balkans, Pakistan, Afghanistan, India and Central Asian Republics, China, Turkey, Palestine, Syria, Cyprus and Jordan.

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This school of thought along with the Maliki School was the first to develop on a wide geographic presence 171.

b) Maliki School

Established by the Imam Malik Bin Anas, it is the second school of thought that stems from Mecca, the city of the Prophet Muhammad. Known to be a scholar of Hadith, his most important work and contribution is *Al-Muwata*, which was a code of law based on the legal practices covering everything from rituals to business conduct, all supported by the Prophet’s Hadith. Some scholars go as far as saying it is the most authentic collection of Hadiths. This school is dominant mostly in Morocco, Tunisia, Libya and regions of West Africa 172. Both the Maliki and Hanafi schools tolerated difference and diversity of opinions within their doctrines. The difference in this school of thought from the others is that while it shares reference to the four sources as all other schools do, it did however refer to people’s transactions as a source of law, targeting public interest 173.

c) *Al Shafiʿe School*

Founded by the Imam Muhammad Bin Idris al Shafiʿe, he was a student of the Maliki school; he was highly influenced by its teachings. His most important contribution is *al-Risala fi usul al-Fiqh* 174; his impact on Islamic jurisprudence was very substantial and leads him to be known as the father of Islamic jurisprudence. The school is

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174 Being the plural of Asl, it is a term that literally refers to the origins or roots of a matter or an object. In legal terms, it refers to the rules governing a specific matter(s). See Müül Yüsuf Izz al-Din. *Islamic Law: From Historical Foundations to Contemporary Practice*. Edinburgh: Edinburgh Univ. Press, 2004. P. 95.
followed in mostly Egypt, Yemen, Syria, Malaysia, Indonesia, East Africa and parts of Pakistan, India 175, Indonesia, Malaysia, Sri Lanka and the Maldives 176.

d) *The Hanbali School*

Having a reputation for being the most ultra Orthodox of all schools, its founder Ahmad Ibn Hanbal 177, although a student of Al Shafi‘e and Hanafi School, relied far more on the Quran and Sunnah, with exceptional reliance on the other sources; as a matter of fact, he produced a work containing about 30,000 traditions, and was therefore considered by a variety of scholars a “traditionalist” more than a “lawyer proper” 178. This school of thought was the least popular, having its influence mainly in Saudi Arabia and Qatar.

e) *Shi‘a schools*

Shi‘a Islam follows the thought that the Prophet Muhammad’s religious leadership, both spiritual and authoritative divine guidance were passed on to his descendants, beginning with his son in law and cousin Ali ibn Abi Talib and his family 179. Shi‘a Islam has significant numbers in Iran, Iraq, Bahrain and Lebanon. Shi‘a Islam developed three main divisions, majorly disagreeing over the number of imams who succeeded the prophet Muhammad; the Zaydis who recognize only 5

imams (called the Fivers), the Ismailis who recognize seven imams (called the Seveners), and the Athna Asharis recognizing twelve imams (called the Twelvers) 180.

Apart from some differences in regards to inheritance laws, the positive doctrines of Shi’a Islam do not differ from the doctrines of Sunni Islam. Certain doctrines that were not necessarily either Sunni or Shi’a became adventitiously distinctive for Shi’a Islam against Sunni Islam (examples are those such as the acceptance of temporary marriages). Shi’a Islam represents a certain community of Muslims, originating in Iraq has been long active there. If their doctrines on technical points differ from the Sunnis, and this is due to the fact that they were based on ancient opinions once widespread in Iraq, and which were later abandoned by Sunnis 181.

Although the above differences may all seem to be theoretical, the differences between them may be seen in a practical manner; in terms of commercial and financial laws, “different jurisdictions have adopted different practices in relation to various Islamic capital market products and services” 182, and according to their respective schools of thought; differences would appear in whether different commercial or financial transactions would be deemed compliant or prohibited according to Jurisprudence. The terms Riba and Gharar for example are given diverse meanings and interpretations in different jurisdictions, and depending on whether the school of thought adopted has a flexibile or literal scope of application to Shari’a law’s Jurisprudence. Some transactions may therefore be found permissible in some

jurisdictions adhering to one school of thought, but found prohibited in another. This will be profoundly covered in Part 2 in this thesis 183.

After establishing the foundational reasons, objectives and contributions of the above Principles and Terms to international commerce, a similar analogical comparison with the AAOIFI and its Standards will be provided hereunder; the comparison will cover their similarities in terms of basis, foundations, objectives and contributions. The comparison will aim to establish similar credibility of the AAOIFI with the UNIDROIT and the ICC; it will also aim to establish similar credibility of the Standards to the Principles and the INCOTERMs.

1.10 The Accounting and Auditing Organization for Islamic Financial Institutions

In a legal dispute concerning Islamic financial products, what may be deemed Islamic based and Jurisprudence compliant in Malaysia may not necessarily be agreed upon in the Middle East; “yet, if groups such as the AAOIFI can bring about more clarity to products, then Islamic finance can grow further and, one day, reach its full potential” 184. With major differences between definitions, interpretations, practices, usages of Shari’a commercial and financial disputes needed uniform laws for the same reasons and with similar objectives to its conventional counterparts mentioned above.

As a result of the need for a similar “common language” 185 between members of the Islamic financial and commercial industry, and especially after the 2008 financial meltdown 186, the result was that the AAOIFI 187 took some substantial and positive

183 See the Azhar Fatwa attached in Appendix 1, covering the issue of whether the interest rate can be charged in an Agency Agreement, as opposed to a Loan Agreement.
185 See Footnote 101 above in P.57.
steps in the right direction, and produced its legal Standards. The latter is an Islamic International autonomous non-profit corporate body that prepares common accounting, auditing, governance, ethics and Shari’a standards for Islamic financial industry. Established for the purposes of “Standardization and harmonization of international Islamic finance practices and financial reporting in accordance to sharia” 188, the vision of the AAOIFI is to firstly “guide IF’s markets operation and financial reporting on Shari’a principle and rules”, and to “provide IF markets with a standard that can support growth of the industry” 189.

The AAOIFI is currently “a thought leader in the development of international standards applicable to Islamic financial institutions” 190, it studies the “needs and methods for modernizing, harmonizing and co-ordinating private and in particular commercial law as between states and groups of states and to formulate uniform law instruments, principles and rules to achieve those objectives” 191. Through the several powers given to its Shari’a Standards Board, it:

1- Harmonizes concepts and application of fatwas issued by Islamic financial institutions to avoid contradictions and inconsistencies between them,

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191 The statement is included in the Overview section of the UNIDROIT website, but has been included as that of the AAOIFI to indicate that the AAOIFI carries out an exactly similar role. Visit http://www.unidroit.org/about-unidroit/overview Last seen 26 July 2014.
2- Develops Shari’a approved instruments, empowering Islamic financial institutions to cope with global developments in the field of finance, investments and other banking services,

3- Examines enquiries submitted by Islamic Financial institutions or from their Shari’a supervisory boards, either by providing an opinion, or settling disputes by acting as an arbitrator,

4- Revises the Standards issued by the AAOIFI to ensure their compliance with the rules and principles of Shari’a 192.

In order for their Standards to become the standard reference for the Islamic commercial and financial industry, the AAOIFI studies, issues and reviews its Standards by a roster of experts in the Islamic Financial field, including but not limited to:

1- Shari’a consultants, members of Shari’a supervisory boards, managers of auditing departments, heads of Shari’a compliance departments and Shari’a advisors for a variety of well known Islamic financial institutions,

2- Professors, heads and deans of Islamic jurisprudence departments and Shari’a colleges for universities,

3- Heads of studies and research departments in grand mufti offices,

4- Executive directors for international research academies for Islamic Finance,

5- Economic and legal consultants for consultancy and training institutions,

6- Secretary generals from higher councils for Shari’a supervisory boards 193.


1.11 The Standards vs. the Principles and INCOTERMs

Following the above, it can be initially agreed by use of comparative analogy that the Standards issued by the AAOIFI are also similar to the Principles and the Terms in terms of basis, foundation, developing roster, objectives and contributions. Taken from the Preamble of the 2010 Principles, the Standards similarly act as “general rules for international commercial contracts” 194. By comparative analogy with the Principles and Terms, and referring to the above analysis covering the role of the Principles, the Standards may equally act as:

a) Rules of law governing a contract

The Standards may act as rules of law in international and national contracts, and once expressly and clearly indicated by the parties to an international or national contract. Similar to the Principles and the Terms, the Standards may act as governing contract rules to be applied by domestic courts, and provided that neither mandatory domestic laws nor public policy conflict with this choice of law 195. In an equal manner, the Standards may serve as a neutral applicable law, providing equal bargaining power to contract parties. The Standards can also be a choice of contract law once it is established that “there was both sufficient internal consistency and a substantive content” 196. Private arbitration tribunals are certainly free to apply the Standards.

The Standards may also on an implied basis, serve as applicable rules of law and recognized by the courts. This would be the case when no specific governing law has been expressly chosen by parties to a contract. Furthermore, the Standards may be

195 See Bundesgericht case above.
196 See Handelgericht St. Gallen case above.
chosen as applicable rules of law when a contract includes any terms or acronyms uniquely known and affiliated with the Standards. A good case establishing this argument by analogy is in *St. Paul Guardian Insurance Co., et al. v. Neuromed Medical Systems & Support, et al.* In this case, the plaintiff argued that the Terms were inapplicable to the contract, which included the term “fob”, and since the Terms were not specifically and expressly incorporated into the contract as the applicable laws. The judge in his decision nevertheless decided that since the Terms were widely known and observed in international trade as the standard definitions for delivery terms 197, they would be applicable since the parties "agreed to the detailed oriented [INCOTERMS] in order to enhance the Convention" and included a term very specific to it, being “fob” “ 198. Analogically, the AAOIFI Standards would be applicable in a similar situation, and once reference to very specific and detailed terms affiliated with the Standards become widely known and become part of its usage and practice.

In order to incorporate the Standards in any agreement of which the parties wish to govern by the Standards, we propose a model Governing Law clause, and such as the following one:

“*Without prejudice to any mandatory provisions and to articles……., this contract shall be governed by the AAOIFI Standards 2010 rules, and any dispute(s) shall be resolved by the courts of (X state)*”.

In the event when an SCL based international transaction is to be entered into, parties may agree to incorporate state rules in parallel to the AAOIFI non-state rules. A clause may still be incorporated as follows:


“Without prejudice to any mandatory provision and to article(s)……., this contract shall be governed by the AAOIFI Standards 2010 rules, supplemented when necessary by the rules of (X state), and any dispute(s) shall be governed by the courts of (X state)” 199.

b) A means of interpreting and supplementing international uniform law instruments

The Standards may also “be used to interpret or supplement international uniform law instruments” 200. The Standards may therefore be used to play an interpretative and gap-filling role, and in the event of presence of ambiguities in other uniform law instruments governing Islamic transactions in the future. This may occur when some very specific contract issues arise such as contract formation, performance, interpretation, remedies etc.

c) A means of interpreting and supplementing domestic law

Similar to the above purposes and usages to the Principles and Terms, the Standards “may be used to interpret or supplement domestic law” 201. This is most likely to take place in the case where a State is in the process of developing an Islamic legal framework to accommodate Islamic commercial and financial transactions. Furthermore, reference to the Standards would be very useful even for a state with an already set legal framework accommodating Islamic transactions, but lacking the necessary sophistication, or with sharply divided opinions.


201 See Ibid. Preamble Para. 6.
d) *A model for national and international legislators and as a guide for drafting international contracts*

The Standards can be used in creating whole new legislative codes in the future, reviewing certain existing legislations, providing legislators with unanimously tried and tested model laws and clauses, all designed to accommodate Islamic based transactions. They may also be used for drafting uniform contract laws, also designed to accommodate Islamic based transactions.

1.11.1 *The Mejelle as an ancient uniform law*

On a final point to be made in this section, the Standards are not the first Islamic attempt to codify standard Shari’a laws. In the 1800’s, the *Majallaht Al Ahkam al Adaliya*, better known as the Mejelle, served as an example of an old project to re-instate the law and not to reinvent it. It was an attempt similar to the above U.S project of the Restatements of the Law, as well as the codification attempts in Western Europe in the 18th and 19th centuries, being only European in form, it was the first codification of the Hanafi school of thought Shari’a Contract and obligations law. In 1877 it was promulgated as the Civil Law of the Ottoman State, and remained in force in the successor states, and until it was replaced by separate civil codes States such as Lebanon (1932), Syria (1949) and Iraq (1953) and Turkey itself by the Swiss Civil Code in 1926. In that manner, the Mejelle, being similar to the Standards, was

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created and adopted from laws, principles, maxims and standards to promulgated State rules of law and applicable by courts.

1.11.2 *International State recognition and support for the Standards*

Although the Standards have been constructively criticized as still lacking in detail required to regulate certain transactions 206, its progressive and ongoing development has made it earn the credibility of globally accepted and reliable legal rules, and it has gained implementation support as a result. Some States have made the enforcement of the Standards compulsory by law such as Pakistan and Bahrain 207, where the former imposes penalties in the event the Standards are not applied in regards to specific financial products, and the latter enforcing them fully. Furthermore, some other States have, up to this date, issued their non-compulsory guidelines based on the Standards, including Jordan, Lebanon, Qatar, Sudan and Syria, South Africa, Australia, Malaysia and Saudi Arabia and the Dubai International Financial Centre in the United Arab Emirates 208.

1.11.3 *Independent institutional support for the Standards*

Although the Standards have not yet reached endorsement by the UNCITRAL at this stage, they have however experienced recognition by global international institutions, as will be described below.

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1.11.3.1 Support from independent institutions

The application of the Standards are followed either as part of regulatory requirement or as Islamic Financial Institutions internal guidelines in the Middle East, Asia Pacific, South Asia, Central Asia, Africa, Europe and North America. Furthermore, the AAOIFI has signed several exclusive agreements with some top ranking global institutions, after requesting them to assist in expanding their markets, and by carrying out certification of financial software products or core banking systems for Islamic banking and finance industry. This step will see the AAOIFI’s Standards incorporated into the systems of banking technology service providers. "Regulators are becoming increasingly stringent when it comes to Shari’a compliance. Core banking vendors have to adapt their systems to incorporate the unique features and processes of Islamic products. Such an endorsement should ideally come from a credible organization like AAOIFI. Given the need for a combination of Shari’a, IT, accounting and banking skills and experience, Ernst & Young’s industry credentials are the ideal fit for this joint initiative….”

209 Visit http://www.aaoifi.com/en/about-aaoifi/about-aaoifi.html Last seen 5 November 2013. In relation to France in particular, the jurisdiction of interest in this thesis, a Memorandum of Understanding was signed between the AAOIFI and Paris Europlace in 2009. See the Missions of Paris EuroPlace http://www.paris-europlace.net/goals_and_missions.htm Last seen 6 November 2013. See http://www.paris-europlace.net/files/Press_Release-AAOIFI-Paris_EUROPLACE.pdf. See 26 November 2012. The latter is a Paris Financial Markets Organization, which promotes the Paris Financial Market place and initiates proposals for the collective benefits of the financial center, and by bringing together and representing key players in the financial industry, including investors, issuers, banks insurance companies and financial intermediaries. According to the Memorandum, the latter has translated for the first time 20 Shari’a standards out of 44 existing standards, and which have been validated by the AAOIFI. Such efforts aim to promoting the Islamic financial industry, and specifically Islamic Finance in financial centers in Europe, the Maghreb and Sub-Saharan Africa.

210 An example of global ranking institutions is Ernest and Young, a global leader in assurance, tax transactions and advisory, which entered into an agreement with the AAOIFI in February 2013. See the About Us page for Ernst & Young. Visit http://www.ey.com/UK/en/About-us Last visited 18 November 2013.

Finally, other co-operation events taking place between AAOIFI along with international players signify its growing global recognition, and as the leading institution for issuing Islamic commercial and financial standards. Several public annual conferences have been held annually by the AAOIFI in partnership with the global banks, which discuss in public the most recent developments of the AAOIFI, or develop and promote the Islamic Financial sector 212.

1.11.3.2 Support from global indices

Showing more support and more importantly recognition of credibility, is the fact that some of the most well known global financial indices such as Thomson Reuters 213, FTSE 214, Dow Jones 215 and NASDAQ 216 have established their own Islamic indices; some directly rely on the AAOIFI’s clearances, and some indirectly. On the one hand, and relying directly on the Standards, the Dow Jones indices to include an Islamic bond (Suk), “must pass screens for Shari’ah compliance and meet the standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)” 217. The NASDAQ has also started its NASDAQ OMX Shari’a Index Family, composed of 7 indices, and “Utilizing methodology standards established by the international and independent Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)” 218. On the other hand, some globally known indices such as the

217 See Ibid.
FTSE demonstrate their recognition of the AAOIFI’s credibility indirectly; by way of example, via establishing a joint venture with a well known Shari’a law consultancy to assist them in creating its suite of Shari’a compliant indices. It is the consultancy that is an associate member of the AAOIFI ²¹⁹, and therefore its Standards that will effectively serve as the basis of the creation of the indices.

In addition, some less globally referred to institutions that rely on indices such the Muscat Securities Market in Oman, announced that it had begun internally activating an index that includes joint stock companies, of which business and financial practices are Shari’a compliant in accordance to the AAOIFI Standards ²²⁰.

1.12 Further reasons why the Standards are the most reliable and credible uniform laws for the international Islamic Financial industry

“The existence of law is one thing; its merit or demerit is another” ²²¹. The answer to the question of what makes the Standards credible laws similarly applies to the question of what makes Lex Mercatoria or transnational laws credible laws; in other terms, since the Standards are a form of Lex Mercatoria focusing on the Islamic industry, what characteristics found in Lex Mercatoria render it credible, and therefore the Standards by analogy?

The debate regarding whether Lex Mercatoria represents credible laws or not initially did not seem settled. The debate contained and still contains many arguments stemming from different schools of thought regarding what is considered law to

them, and with no consensus between the schools of thought in sight. Whether considered law or not depends on whether the view is that of a positivist or autonomist one. On the one hand, and from the positivist perspective, Lex Mercatoria will not be a body of laws unless it is expressly adopted by an individual state(s), and will not apply simply because it is a rule or principle of Lex Mercatoria; it would only qualify as a body of laws once it takes the form of “black letter” legislated law, and issued and sanctioned by the state. On the other hand, and from the autonomist perspective, they would see it as a body of laws in substance without any formalization in solid codified legislation.

With the debates regarding the normativeness of Lex Mercatoria still ongoing today, there is a change in the nature of the debates. Firstly, they seem to have shifted towards the direction of whether it is defined by its content or by its sources. Secondly, the debate has been refocused on the means of assessing the content of Lex Mercatoria, and whether it should be restricted to a list or understood as a method. With different opinions surrounding those two questions, players of international commerce have already taken full advantage of their options in all cases, and selected Lex Mercatoria to regulate their transactions.

Since there seems to be no consensus regarding the criteria that must be available for laws rendering Lex Mercatoria as credible laws, this thesis will therefore not engage in this particular discussion, and due to its lengthy and unsettled nature; it will rather only refer to the 2 main and most referred to opinions surrounding this issue. The 2

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main referred to opinions discussing the essential characteristics of a law to be considered credible, are those of Klaus Peter Berger and Peter Nygh.

As for the characteristics suggested by Berger in determining what makes a credible law, he refers to “desirable characteristics”, and such as 1) universal character, 2) flexibility and dynamic ability to grow, 3) informality and speed and 4) reliance on commercial custom and practice. This definition has been said to be vague and ambiguous 224, although in the opinion of this thesis those are supplementary characteristics to allow growth but do not serve as the primary foundations.

As for the primary and main characteristics that should be available are those identified by Peter Nygh, who identifies characteristics of a system being 1) autonomous, 2) providing rules ‘sufficient to decide a dispute’ and 3) a system of law 225. It will be seen that the secondary characteristics suggested by Berger will be naturally found in the primary.

a) “Autonomous”

As it has been previously mentioned, the main reason why Lex Mercatoria was created was to facilitate trade practices between merchants from different regions and / or parts of the usage world, who had different legal and trading backgrounds, and wishing to be governed independently from national laws 226, the Lex Mercatoria was therefore of a harmonious nature, containing substance common to multiple legal

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systems, and providing an alternative to highly bureaucratic and technically annoying nationals laws. “Like the ancient lex mercatoria, the foundation of modern commercial law evolves from commercial practice that can be described by its “far reaching jurisdictional and normative autonomy”.

The Principles are “an autonomous set of rules worked out with a view to their application in a uniform manner to an indefinite number of contracts of different type entered into in various parts of the world; this also applies to the INCOTERMs. Autonomy here does not refer to being fully self-contained, and excluding “all national and international legislation”, however it refers to the fact that the system itself is a creation of an autonomous mercantile community; its comparative laws result “from the comparison of national laws and assent given to a particular proposition at the international level.”

The Standards are also autonomous in their nature, and due to the fact that they emanate from practitioners in the field of the Islamic Commercial and Financial industry, to issue their own non-state laws. Representing best practices, and the opinions of all schools of thought available, the comparative and autonomous nature of the AAOIFI’s standards are also of similar nature. For the same reasons the mercantile community produced Lex Mercatoria, they similarly wished their commercial and financial practices to be independently regulated of any

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inconsistencies and conflict of opinions, and to harmonize all Shari’a laws on a global basis, and to put an end to discrepancies; they similarly set the Standards to circumvent the annoying technical details included in national laws, allowing them to regulate their practices to further global outreach and global application.

b) **Sufficient to decide a dispute**

Lex Mercatoria, or any credible law for that matter, ought to be a body of rules sufficient to decide a dispute, and operating as an alternative to an otherwise applicable national law. Many debates seem to surround this issue, including whether it is possible to identify principles of trade law which are common to all members of the international trade community, as well as whether Lex Mercatoria is comprehensive enough to govern a contract using only trade practice as a source of law. The most important characteristic required of Lex Mercatoria seems to be its “universality,” where the laws should be known to “all parties acting within” the same universe; it should be taken into account that the “universe may be quite different for traders from Islamic countries compared to West European or North American

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233 See Lynch, Katherine. *The Forces of Economic Globalization: Challenges to the Regime of International Commercial Arbitration*. The Hague [u.a.: Kluwer Law Internat, 2003. P.321 quoting Lord Mustill stating “The proponents of lex Mercatoria claim it to be the law of the international business community; which must mean the law unanimously adopted by all countries engaged upon international commerce. Such a claim would have been sustainable two centuries ago. But the international business community is now immeasurably enlarged. What principles of trade law, apart from those that are so general as to be useless, are common to the legal systems of the members of such community? How could the arbitrators ….. amass the necessary materials on the laws of, say, Brazil, China, the Soviet Union, Australia, Nigeria and Iraq?”.


contractors.” 236 It could also be said that two essential main characteristics of a law sufficient to settle disputes must be, that they are sufficiently detailed 237, as well as displaying “consistency and a degree of predictability” 238.

With the Standards today, and similar to the Principles and the INCOTERMs as formal expressions of Lex Mercatoria, they have become detailed and sophisticated to a level where they are sufficient to decide a dispute, and to operate as an alternative to an otherwise applicable national law 239. Furthermore, the Standards enjoy the quality of “universality”, and where they are known to “all parties acting within” the same Islamic Commercial and Financial universe, being all Islamic financial and commercial institutions. To fully enjoy the characteristic of being fit to decide a dispute, the Standards expressed in their current black letter and codified form, are sufficiently detailed, and display “consistency and a degree of predictability”.

c) A system of law

The third and what seems to be the “bottom line” on essential characteristics for Lex Mercatoria to be universally credible, is for it to be a “system of law”, and with “standards no less than that of a state legal system with international standing and authority” 240. To be a distinct system of law or “legal system”, four characteristics are generally

237 ICC Case No. 7110, 10-2 ICC Int’l Ct Arb’n Bulletin 39 (1999) (Unidroit Principles provide a degree of detail often thought to be lacking in the lex mercatoria when considered as an amorphous mass).
238 See Continental Shelf (Libya v. Malta), 1985 I.C.J. 13 (June 3).
239 See Lynch, Katherine. The Forces of Economic Globalization: Challenges to the Regime of International Commercial Arbitration. The Hague [u.a.: Kluwer Law Internat, 2003. P.321 quoting Lord Mustill stating “The proponents of lex Mercatoria claim it to be the law of the international business community; which must mean the law unanimously adopted by all countries engaged upon international commerce. Such a claim would have been sustainable two centuries ago. But the international business community is now immeasurably enlarged. What principles of trade law, apart from those that are so general as to be useless, are common to the legal systems of the members of such community? How could the arbitrators …..amass the necessary materials on the laws of, say, Brazil, China, the Soviet Union, Australia, Nigeria and Iraq?”
found, being its 1) completeness, 2) structured character, 3) ability to evolve and its 4) predictability.

As for the first characteristic, and despite being a debatable term, it is generally accepted that “completeness” is found when an answer to any legal issue may be provided, and within one legal system. This happens even in the case where one has to resort to general principles of that legal system, such as good faith, legality of what is not expressly prohibited, etc…. Although it is difficult to say that general principles of law qualify, and especially since Lex Mercatoria is understood to be a list, using a comparative law approach, arbitrators in private law conflicts will be able to decide on whether a rule is known to a number of legal systems, and whether it is widely accepted 241.

The Standards also well qualify as “complete” at this stage. In their current black letter form, they contain answers to most legal questions. Although some standards regulating certain financial products and transactions are currently in the process of being updated, the current and available versions do already offer complete rules, placed to regulate the transactions and products offered in the market.

As for having the second required characteristic of a legal system, it must have a “structured character”; this is a characteristic any proper legal system must enjoy, as opposed to simply containing “rules of law” in a non-systemic and structured manner. A legal system is an “organized set of rules, with various levels of generality and close ties between rules belonging to those various levels”; this leads to understanding the logic and values of the system as a whole, as well as interpreting any given rule in

that system 242. A system of law does not exist with indeterminate content and purpose, but is structured by particular kinds of and reflects certain types of values and purpose, and therefore providing it with a certain meaning and identity 243.

The third characteristic of a genuine legal system is having an “evolving” character, possessing the mechanisms for its rules and principles to develop and take into account the societal needs. The UNIDROIT Principles and the INCOTERMs as expressions of Lex Mercatoria have actually been updated and “evolved” several times over several different versions, and for the purposes of taking new developments into account.

Similar to the Principles and INCOTERMs, the Standards have also been upgraded and “evolved” several times over several different versions, taking new developments into account. This similarly demonstrates the perfect ability to enjoy the characteristic of being upgradeable, and to offer solutions to the constant changing needs of the Islamic commercial and financial market and industry.

The fourth and final characteristic of a legal system is being a “predictable” system. Predictability ranks high amongst the legal virtues, and is an essential part of “what people mean by the rule of law”. When laws suffer from unpredictability, the autonomy of human beings itself starts suffering, as it is not safe to act not knowing what is allowed and what is prohibited in advance 244. It is imperative for any legal system to allow parties choosing its laws as governing laws, to be able to assess and predict the

242 See Ibid. P.66-68.
likely outcomes of disputes and investments, as well as basic rights, entitlements and obligations. By formalizing the law, predictability then suggests that the law is immobile, independent, pre-established and pre-settled. In an imaginary scenario that the Standards would replace the contents of a national legislation, it would be perfectly detailed, consistent and providing predictable answers to legal questions, and given their current codified form.

Not only is the exponential growth of the Shari’a commercial and financial industry in terms of global asset volume, but the sophistication of its products, and the fact that its positions can no longer go unhedged, have necessitated that a standard agreement come into place. The ISDA produced its Tahawwut Master Agreement 2010 (the “Agreement”), which is especially designed for the Shari’a Commercial and financial industry; the Agreement brings significant contributions to transaction risk management, confirming the industry as even more self sufficient, with even more sophisticated and credible legal framework.

1.13 The ISDA Tahawwut Master Agreement 2010

1.13.1 Master agreements in general

When engaging in complex financial transactions such as those involving financial derivatives, parties have to establish proper terms, settlement procedures and termination provisions. It has also become common practice for parties engaging in such types of transactions to refer to standardized master agreements, as opposed to entering into single agreements specifically newly drafted for each transaction; single agreements usually lead to inefficiency and potential disputes. By entering into Master agreements, standardized set terms apply to all or a particular class of

transactions equally. With all terms pre-agreed, parties would only need to negotiate the fine details such as the notional amounts, strike price and maturity.\(^{248}\)

The advantages of master agreements as applicable to transactions involving financial derivatives include:

1. **Legal safety:** Terms and conditions included in master agreements are very likely to have been thoroughly tried and tested, and are therefore traceable and safe to refer to; it therefore reflects market confidence.

2. **Documentation:** Master agreements provide significant savings on time and expenses in document preparation.

3. **Netting:** Standard master agreements bring more efficiency, since they reflect formal legal opinions from major jurisdictions, and receive approval of regulators.\(^{249}\)

In practice, most master agreements that are referred to are those of the International Swaps and Derivatives Association (the “ISDA”), especially its Master Agreement (1992 and 2002 versions). The latter is the global market standard form for derivative transactions, and especially those of Over The Counter types.\(^{250}\) This Master Agreement is probably the most remarkable standard form ever devised, covering an immense range of transactions; its terms and conditions handle huge transactional amounts traded on the global market.\(^{251}\)


\(^{249}\) See Ibid. P.217.

\(^{250}\) ISDA publishes model arbitration clauses for Master Agreements. 9 September 2013. Article found on the ISDA website and drafted by Allen & Overy law firm. Visit http://www2.isda.org/attachment/NTg0Mg==/ISDA%20publishes%20model%20arbitration%20clauses%20for%20Master%20Agreements.pdf Last seen 8 November 2013.

The ISDA is not the only association to issue master agreements, however other associations have also issued master agreements, with frequent references made to them; a good example of such a master agreement commonly referred to is the FBF Master Agreement, relating to transactions on forward financial instruments. The purpose of this agreement, is to set out general principles and market rules for foreign exchange and derivative transactions, for OTC derivative instruments. The agreement provides French companies and investors a flexible and purpose-built contractual framework for derivative transactions.

1.13.2 The Agreement vs. Conventional ISDA master agreements

The Agreement although resembling to a big extent conventional ISDA agreements in terms of form, it is different in substance due to the fact that it covers transactions based on SCL. As for the main purposes of the Agreement, it is to be strictly used 1) for hedging actual risk purposes 2) with no speculation (actual settlement of assets and payments) 3) permissible (“halal”) assets and 4) exclude chargeable interest, whether directly or indirectly labeled as such. In this way, the Agreement has provided a further stepping stone not only in product development and restructuring, but in allowing parties within financial transactions to protect themselves against market uncertainties; at the same time, it also prohibits them to be realized and materialized in any unethical way. It has also set terms and conditions blocking attempts at any speculative or usurious transactions, under the guise of “Shari’a Compliance”.

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254 See Ibid.
The Agreement also introduces two new transactional categories. Firstly, it introduces actual transactions and referred to as (“Transactions”), and which can be entered into by setting out the relevant terms and conditions, and referred to as “Confirmation”. Secondly, it introduces undertakings to enter into future agreements and arrangements called Designated Future Transactions or (“DFT”) Agreements; the specific agreements to be entered into setting out the relevant terms and conditions are called DFT Terms Confirmation. It will be seen in Chapter 2 of Part 2, that the DFT play a certain role in some transactions comprising of a series of single transactions that when separately and collectively performed, replicate a conventional derivative transaction; it is this transactional structure that provides the added safety brought by Shari’a Jurisprudence. In both cases, the governing law of the Agreement is either English law or New York law.

Overall, the Agreement lays in a very proficient, competent and highly detailed manner the terms and conditions to be respected by any and all Transactions entered into. It addresses very specific issues including general provisions on interpreting the Agreement, payment and delivery conditions, conditions precedent, provisions for set off payments, entering into a Wa’ad (Promissory Note) to enter into Musawama agreements (A general and regular kind of sale in which the price of a good to be traded is bargained between the seller and the buyer) in the events of early termination, basic sets of representations, basic sets of agreements regarding all tax compliance related issues including compliance, default and termination, assignments and transfers, benefits of obligations, payments and currency matters, miscellaneous agreements including those related to interest, expenses, notices,

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governing laws and arbitration as well as further definitions for the avoidance of any doubts 256.

Other certain added elements are included in the Agreement, designed to accommodate the special nature of the Islamic transactions - by way of example, the “Representations”. Each party to a transaction must declare that it is satisfied with the Shari’a compliance of the transaction and is not relying on the other party in terms of compliance. Furthermore, some provisions regarding events of default and termination are amended to include DFT’s 257. Furthermore, and similar to referring to the Master Agreement for all the above mentioned purposes, parties wishing to refer to the terms and conditions of the Agreement to govern their transactions would need to enter into separate and additional agreements, usually referred to as “schedules”; schedules specify which parts of the Agreement shall be applicable to their transaction(s). Although the transactions are separate, they “will be regarded as entered into upon the terms set out in the Master Agreement and covered by the framework created by the Master Agreement” 258.

In this chapter, the detailed nature of Shari’a law and Shari’a Commercial law has been presented. It has been clarified that Shari’a law and its Shari’a Commercial law’s Jurisprudence, that blends the temporal with the spiritual regulate human behavior for the purposes of obtaining the approval of God. It has also been demonstrated that the substance of its Jurisprudence meticulously and comprehensively governs all types of human relationships and transactions, both legal and non-legal, and against abuse, effortless and exploitative profit oriented practices. It has also become clear how it distinguishes itself from modern man made

256 See The ISDA Tahawwut Master Agreement and or memorandum citing agreement.
258 See The ISDA Explanatory Memorandum Relating to the ISDA/IIFM Tahawwut Master Agreement. P.1-2.
laws, by guiding its followers to etiquette and moral driven commerce through its precepts and principles, all which aim at the overall wellbeing of society.

In the process of this introduction, the chapter demonstrated that as much as the Shari’a Commercial industry has grown on an exponential scale, however and till recently, the problems resulting from the unpredictable, arbitrary and inconsistent jurisprudence have been detailed. Furthermore, the chapter then sheds light on the response to this problem, being the birth of the AAOIFI and the production of its Standards, as well as the new legal documentation produced by the ISDA, which further facilitates international commerce. Given that the Standards are relatively new, and in comparison to other international uniform laws responding to the same historical problems in conventional commerce and finance, a comparative analysis between the Standards and the UNIDROIT Principles and the ICC INCOTERMs as codified representations of the New Lex Mercatoria was drawn. The comparative analysis showed firstly that the Standards and the Agreement play an exact similar role of serving as codified expressions of Lex Mercatoria for the Islamic Financial and Commercial industry, and secondly that they are equally credible as the Principles and INCOTERMs by analogy.
Chapter 2

Are Shari’a Commercial laws Proper and Normative Laws?

Or Simply “primitive” and “religious and moral codes”?

Following the above introduction to Shari’a law as well its commercial character, but prior to an extensive analysis regarding its “competence” once its gems and benefits have been understood and reaped by human beings for the purposes of achieving social and economic justice, is Shari’a law normative law first and foremost? Or is it simply centuries old primitive “religious and moral codes” as previously suggested? Neither is this question new nor is the attempt to provide an answer of any novelty; discussions of what constitutes law are probably as old as the term “law” itself, and have been for many decades already addressed by some of the oldest legal theoreticians. The attempt in this chapter is therefore to contribute by adding another way of seeing Shari’a law as normative, and not simply a set of centuries-old and normativeness lacking rules, principles and unrealistic ideologies; once seen as proper normative laws their derivative substance can then be articulated and incorporated into western legal systems, and without the need to assume the form of western contracts and / or positive laws to justify its normativeness, risking the intended social and economic justice.

2.1 The Status Quo: Shari’a law in France

It has been previously claimed by legal theoreticians, that the question of whether religious rules qualify as normative legal rules has been answered in the affirmative; unfortunately not many people share this view, and at the very least, those who do

259 See the Beximco case as an example. The quote has also been heard by the author in person, and in various and different ways amounting to the same meaning, and in a variety debates during the course of developing this thesis.

260 See note 270. Unless Shari’a law is seen as normative law, and not solely from a positivist black letter perspective, any Shari’a law related rules would not be incorporated into any western legal system(s) unless it takes some form of a positive black letter rule(s).
seem to be concentrated in France. The question was first evoked following debates regarding the introduction of Islamic Finance in France. The debates around the normativeness of Shari’a law involved several sectors including the legal, banking as well as the political, and all at a time when many argued in favor of turning its capital Paris into a major Islamic financial centre.

Similar to the UK, several measures have already been introduced to allow Shari’a financing to be offered by banks and financial institutions. The growth and development of the Muslim community in France as well as the metropolitan cities across western countries, progress of microcredit in developing countries, and the skepticism towards international conventional capitalist financing were all in favor of the quick expansion of Islamic Finance. According to an Occasional Paper Series issued by the European Central Bank in June 2013, there are currently 6 Shari’a compliant funds, and with total assets of USD 147.2 million under management.

Despite the introduction of lucrative Islamic financial products in France, this has not resolved the current problem and debate regarding the normativeness of its laws; Islamic Finance can be introduced as a financial tool and product, while still continuing to debate its normative roots, being Shari’a law itself. It is said that if Islamic Finance is to be made available in France, it would have to be provided in the form of an already available French legal contract; failing that, it would constitute a self contained system, with no statutory or legal basis, and would therefore be rejected. Advocates of this approach also mention that lack of acculturation of Islamic Finance

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261 See Notes 1 and 2 above.
263 See P.47, footnotes 108 and 109 in relation to legal reforms in France.
into the French system would also be grounds for refusal of Islamic Finance. This positivist approach inherited from the French revolution continues to mark French law, accepting law as the sole mode of expression of a norm. It is this doctrinal finding in particular that triggered interest in the issue, and subsequently the first part of the thesis question.

2.2 An unsurprising perspective: consistency with older case law

Referring to the case law above, it indicates a long and still ongoing pattern of a single-minded view, as to what counts as law; specifically, it represents law from the Positivist school of thought. It is especially clear in the more recent Beximco case, and where the courts expressly indicated little trust in Shari’a law, owing to an absence of reliable codification; it also indicated little trust that Shari’a law had a normative character. Albeit mentioned obiter dictum, this comes clear when it stated that Shari’a law consisted of principles that “are not simply ‘principles of law’ but are principles which apply to other aspects of life and behaviour……. Shari’a law is the law laid down by the Qur’an and the Sunna (which contain the sayings, teachings and actions of the prophet Mohammed) and the only way to know this is through the collection of Ahadith which consists of reports about the sayings, deeds and reactions of the prophet”.


267 See notes 162-164 above.


269 See [2003] 2 All ER (Comm) 849,. Para. 38.
Furthermore, it comes clearer when it was stated that “it was the evidence of both experts ……… there are indeed areas of considerable controversy and difficulty arising not only from the need to translate into propositions of modern law texts which centuries ago were set out as religious and moral codes…..” 270. In simpler terms, this implies that the court perceived Shari’a law as simply religion, and not as proper normative law 271, or at the very least questioned its normativeness. Any efforts to interpret Shari’a law as a foreign law were therefore dismissed, especially when the English Civil Procedure perfectly allows so, and by reference to the competent experts to carry out the task 272. The judge also had very little trust in the normative character of Shari’a law, and to the extent that he dismissed any efforts to do so, despite the court being “used to disputes about foreign law and, if necessary, it will determine what a judge in a foreign court would decide had he received submission about Islamic law” 273.

As for the cases above, it is difficult to conclusively and assertively decide whether each judge questioned the normative nature of Shari’a law, however their discourse largely resembles that of a positivist approach to law. Since this school of thought sees positive law as the sole expression of a norm, the normativeness of Shari’a law also implicitly comes into question in their view; since they all mentioned that it was not properly codified in modern texts at the time the cases were in process, they were therefore immediately dismissed.

Although admittedly there was a serious shortage of reliable codification at the time, the judges also seriously erred and demonstrated a one sided positivist

270 See [2004] EWCA Civ 19.
271 Sharing a similar view that Shari’a law was seen as religion as opposed to law is Nicholas Foster Senior Lecturer in Commercial Law in the School of Oriental and African Studies in London, United Kingdom. See Nicholas H D Foster. “Encounters between legal systems: recent cases concerning Islamic commercial law in secular courts”. Amicus Curiae. 68 (2006). P.5. For a profile visit http://www.soas.ac.uk/staff/staff30950.php last visited 29 March 2013.
272 See Ibid. P.167.
273 See [2003] 2 All ER (Comm) 849, Para 37.
understanding to the true essence of law, reducing it to a question of form and not substance in the opinion of this thesis. From the many ways they could have seen Shari’a law as normative laws, they had failed to see Shari’a law as the ultimate source of laws in state constitutions, and therefore of normative power regardless of its form; they did not see it as normative in the sense that it regulates people’s behavior, not only towards each other, but also their behavior in and towards the spiritual world via its laws (Al Ahkam).

2.3 Shari’a law as the ultimate normative source of laws: State constitutions, positive law and culture

In this section, an argument will be made in favour of Shari’a laws being normative laws, and from the perspective that they are the highest, ultimate source and substance of positive laws themselves. Shari’a laws to varying degrees, dictate culture and therefore the behavior of its followers in Muslim states; forming those beliefs and values of its followers, they are then in return reflected, incorporated into and protected by state constitutions, and subsequently into all positive laws. The conclusive argument to be made is therefore that state constitutions including all state positive laws, are only a formal expression of Shari’a law, and which is the normative law itself in substance.

2.3.1 What is a constitution?

There are many definitions to the term “constitution”, and it is simply beyond the scope and purpose of this thesis to address all of them. To some, it is “the whole system of government of a country, the collection of rules which establish and regulate or govern the government” 274. To others, a “constitution is not the act of a government, but of a people constituting a government, and a government without a constitution is power without right”

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275. From a more general perspective, and in layman terms, a constitution is a set of rules, which governs an organization, and which defines the powers, rights and duties of its members; it looks at both the internal and external relations of that organization. By analogy, we may consider a state to be an institution with similar structures, where its members, the citizens, abide by its rules 276.

The constitution, being the highest form of law in one state, and according to one legal theory, is the most *basic norm* but highest form of law in any jurisdiction 277. Any and all other laws in any jurisdiction can only be considered valid, invalid, issued, modified or cancelled in accordance to that very highest and most basic norm 278.

2.3.2 *What is culture?*

The term Culture, and similar to the term Law, is neither unanimously agreed upon, nor unanimously interpreted in a narrow or broad fashion. It is a highly subjective term and refers to many different factors for many people, as well as having different connotations in different national frameworks 279. For the purposes of this thesis, sociologically speaking, it “is the sum total of all things we have learned in living together in a group or society” 280, consisting “of the abstract values, beliefs, and the perceptions of the world that lie behind people’s behavior, and which are reflected in their behavior” 281, as well

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as “ideology” “shared interests” “preferences”, “a common set of values” and “shared mental states” 282.

The term Culture has been a subject of academic battles since the mid-eighteenth century. The term “Kultur” has been defined in one instance as the life-blood of a people, and the flow of moral energy that holds society intact; it defines who they are and in terms of identity. This definition was further adopted and interpreted by others to reflect the sense that culture is the defining essence of a nation, a shared spiritual force, and which is manifested in all the customs, beliefs and practices of a people of one nation; it shapes language, art, religion, history and leaves a stamp on every individual event. In another instance, it has been interpreted as cultivation 283.

2.3.3 The relationship between law and culture

As for the relationship between law and culture, and on the one hand, one view suggests that although both the above terms are both not unanimously defined, it is a largely agreed upon fact that law and culture are interrelated, and their intersections form a huge part of both legal sociology and legal anthropology. As the American jurist James Carter stated, “Law, Custom, Conduct, Life—different names for almost the same thing—are so inseparably blended together that one cannot even be thought of without the other”. This view suggests that both law and culture are interconnected but separable.

Another view suggests that in a continuously multi-cultured, interconnected and globalized world, the interrelation of law and culture continues to exist; their relationship with each other has however become questionable. Examples of such challenges are, in highly cosmopolitan states, formed by people from many diverse

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and multi-cultured backgrounds, where law’s recognition of that culture, law’s domination of culture and its ability to define personal identity, social relationships and social institutions become questionable. Furthermore, law being an object of cultural competition, and used as a tool for political support for different communities, the effect of the ever changing popular culture on law, law adhering to those changes, as well as law’s ability to safeguard cultural heritage are always subjects of challenge and continuous change. In short, there is no unanimous agreement between scholars regarding the extent of interaction between law and culture.

On the other hand, some argue that law is culture, or law as culture, and suggests that both are in fact inseparable. According to this view, law is recognized as both constituting and being constituted by social relations and cultural practices; law is discursive and productive, as well as coercive. Law participates in the shaping of meaning of a particular culture, characterized by certain types of behavior, as well as being a product of that culture.

The above views represent two different degrees of the interrelation between law and culture. Whether law is culture and inseparable, or law and culture are separable but strongly interrelated, both arguments will provide credible evidence in regards to the normativeness of Shari’a law, as well as other divine laws in general.

2.3.4 Shari’a law and Muslim culture: Interchangeability and ultimate normativeness

“Not only does a constitution express the broader cultural values of a people – the spiritual powers which live within the nation and rule over it” 

traditional states and societies, the cultural element is explicitly posited for in constitutions. It will appear in the remainder of this chapter that although to varying and different degrees, most Muslim states do not fail to explicitly incorporate Shari’a law in their constitutions, being the source of their culture. Whether separable or inseparable, and in terms of culture dictating laws, and laws reflecting culture, in many Muslim jurisdictions a huge percentage of positive laws, moral laws or customs which regulate people’s behaviour, can be very much cultural in origin, and stem from Shari’a law. By both Muslims and non Muslims abiding by a state constitution and its sub-positive laws, and which are based on Shari’a law culture and its rules, the latter two that are therefore the highest and authoritative source of legal rules in substance; a constitution and sub positive laws are only laws in form. Since they represent the core values of a certain culture, which are in return reflected and secured into state constitutions and their positive laws, the case made is that whether those cultural values are formally expressed in state positive laws or not, they are what ultimately regulate people’s lives in substance, and by sheer existence.

It may be argued that Shari’a law is only normative by substance exclusively to its followers. In this case, if incorporated into state positive laws and irrespective of whether a portion of citizens of that state follow it by belief or not, Shari’a law then goes a step further and regulates their lives, being rules of law by substance but further backed by positive state authority. Followers of all other religions will at this stage be complying with state positive laws, the substance of which comes from Shari’a law. Similarly a Muslim who follows Shari’a law and living in a Jewish state, will be complying with coercive positive state laws, their substance and ultimate normativeness stemming from Jewish law; in this case, Jewish law becomes the

authoritative and normative law, and the Muslim resident’s behavior becomes its subject regardless of his beliefs.

Positive laws reflecting cultural values are then cultural laws themselves; they are only set to back the latter’s normative substance by official state coercion. This is in general similar to any state where its citizens do not necessarily agree to or volunteer to follow some of the state positive laws, however they are still bound by them. To that extent, Shari’a law stops becoming a personal law when backed by state authority and coercion. In short, it is not the state law in its positive and formal form that is normative, but Shari’a law that brought the positive law itself to existence that is normative.

2.3.5 Exceptions to the norm

For the purposes of refraining from presenting a biased argument that state constitutions represent and accurately reflect cultural laws and values at all times, and the source of the latter being the ultimate normative law, in exceptional circumstances, they do not. Constitution drafters at times use state constitutions to reject values otherwise dominant in a state, and for political reasons. At other times, there may be even a simple obstacle, such as difficulty in identifying “a distinct state identity”.

An excellent and recent precedent in state constitutions misrepresenting a state’s culture, and used as a means to a political end, is the case of the 2012 Constitution of Egypt. In this case, the political Islamist group the Muslim Brotherhood represented by the ousted ex president Mohamed Morsi, and with many allegations of exercising gradual and tactical political trickery, set a constitution drafted along with the more religious conservative Salafist groups. The 2012 constitution set had grossly failed to

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reflect the true cultural laws and values of Egyptian society, and brought values largely uncommon to them. During the process of setting the constitution, all other non-Islamist segment representatives from the Egyptian society were excluded. Drafted and completed in an “overnight marathon” and literally speaking overnight and during people’s sleep, and after a walkout by almost all other political factions from the constitutional drafting committee for being marginalized and ignored (replaced by other Islamist members), the constitution was then approved in a referendum vote shrouded with allegations of “massive violations” and electoral rigging in a referendum fraud. The constitution of the Arab Republic of Egypt was a classical precedent of one used as a means to a political end, being a decades long well and commonly known project to establish an Islamic state and empire.

Following the second Egyptian 30 June 2013 revolution, and ousting of the ex Islamist president, the 2012 constitution has been amended to what is now the official 2014 Constitution of the Arab Republic of Egypt, and after a 98.1% approval rate in the 2014 constitutional referendum. The Muslim Brotherhood was later officially

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branded as a terrorist organization in Egypt in 2013 \textsuperscript{295}, and later by Saudi Arabia \textsuperscript{296} and the United Arab Emirates in 2014 \textsuperscript{297}.

To sum up, regardless of some exceptions to the rule, a constitution remains in essence the highest source of laws, and usually representative of a state’s culture. The source of that culture then becomes the ultimate source of normative rules of law, where in the case of predominantly Muslim states, Shari’a law is the ultimate normative law and source.

2.4 Shari’a law’s normativeness from its role in Muslim state legal systems

As previously mentioned, one of the many different ways of seeing Shari’a law as normative laws is its role in state constitutions, and its role as a source of state legislation in a general manner. While Shari’a law is only but one divine law, and solely in constitutions of predominantly Muslim states, reference to other divine laws in non-Muslim state constitutions do similarly exist, and play a similar normative role by analogy. Although many Muslim nations incorporated Shari’a law in their legal system, the role of Shari’a law between Muslim nations greatly varies, and does not have equal legislative roles or powers \textsuperscript{298}. On the one hand, there are some Muslim nations that do not include Islam in their constitutions as a source of legislation at all, such as Turkey. On the other hand, there are Muslim nations that expressly include Shari’a law in their constitutions as the sole source of legislation. In this case, Shari’a


law has full normativeness. In some other states, Shari’a law is “the” or “a” main source of law, or as an important but not sole source of legislation. In this case, it is only partially normative. Being far beyond the scope or objective of this thesis to analyze the position and role played by Shari’a law in all Muslim nations, below are some of the most referred to examples, clarifying the normative role of Shari’a law.

2.4.1 Full normativeness: Shari’a law as the sole source of legislation

There are three Muslim states where Shari’a law is the sole source of legislation, those being Iran, Saudi Arabia and Pakistan; the examples of Iran and Saudi Arabia will be provided.

a) Iran

The place of Shari’a law in the Iranian constitution stands out as “the pinnacle of the normative hierarchy within the constitutional, legal, and political framework of the state. Islamic principles are positioned at the top of the hierarchy, followed by other constitutional provisions and then other sets of laws, namely ordinary legislation and regulations.” Accordingly, Articles 2 and 4 of the Constitution of The Islamic Republic of Iran adopted in 1979 and as amended in 1989, reads as follows:

“Article 2:

The Islamic Republic is a system based on belief in:

1. The One God (as stated in the phrase “There is no deity except God”), His exclusive sovereignty and right to legislate, and the necessity of compliance to His command;

2. Divine revelation as the primary source of law;

3. Resurrection, and the formative role of this belief in the course of man’s ascent towards God;

See Ibid.

*See Ibid. P.44-45.
4. Divine justice, in creation as well as legislation;

5. Perpetual leadership (imāmah) and guidance, and its fundamental role in ensuring the continuity of Islamic revolution;

6. The exalted dignity and worth of the human being and its freedom accompanied with its responsibility before God, which secure equity, justice, and political, economic, social and cultural independence, as well as national solidarity, by recourse to:

   a. Continuous Ijtihad by qualified jurists exercised on the basis of the Qur’an and the Sunnah of the Infallible Ones (Ma‘sūmin), may Peace be upon all of them;............"

Article 4

All laws and regulations pertaining to civil, penal, financial, economic, administrative, cultural, military, political and other spheres must be based on Islamic criteria. This article governs absolutely and generally all articles of the Constitution, as well as all other laws and regulations, and the duty to ascertain this matter devolves on the jurists of the Guardian Council” 301.

b) Saudi Arabia

In Saudi Arabia, the constitution does not take a written form, but is the Holy Quran itself, and as the (“Most High”) and the Sunna of the Prophet 302. In the Basic Regulation of the Kingdom of Saudi Arabia 1992 (Al Nizam Al Asasi lil Hukm), the supremacy of Shari‘a law as the ultimate normative law is mentioned in articles 1, 7 and 48.


“Article 1:

The Kingdom of Saudi Arabia is a sovereign Arab Islamic State. Its religion is Islam. Its constitution is Almighty God’s Book, The Holy Qur’an, and the Sunna (Traditions) of the Prophet (PBUH). Arabic is the language of the Kingdom. The City of Riyadh is the capital.

Article 7:

Government in the Kingdom of Saudi Arabia derives its authority from the Book of God and the Sunna of the Prophet (PBUH), which are the ultimate sources of reference for this Law and the other laws of the State.

Article 48:

The Courts shall apply rules of the Islamic Shari’a in cases that are brought before them, according to the Holy Qur’an and the Sunna, and according to laws which are decreed by the ruler in agreement with the Holy Qur’an and the Sunna” 303.

In the above 3 models, Shari’a law has an exclusive and full normative role. Since all positive legislation will be in compliance and consistent with Shari’a law, it is the latter that directly dictates and influences all positive state rules of law. It is in this manner that Shari’a law is fully normative.

2.4.2 Partial normativeness: Shari’a law as “a” or “the” main source but not sole source of legislation

In some other Muslim States, Shari’a law has been declared as “a” or “the” main source of substantive law, however in varying degrees.

a) **Egypt**

A Muslim nation serving as an example of such a legal system is Egypt, and is a widely referred to example. After facing Islamist movement pressures, Article 2 of the Egyptian constitution was amended from a descriptive “*Islamic Shari’ā is a principal source of Egyptian legislation*” to a more prescriptive article in 1980 to read “*Islamic Shari’ā will be the principle source of Egyptian legislation*”. Years of legal battles between Islamists and the Supreme Constitutional Court of Egypt (the “SCC”) took place over 2 issues. Firstly, to define what the term “Shari’ā” actually meant, and secondly, a comprehensive system of interpreting the Shari’ā rules for the purposes of ensuring that all legislation was in conformity with Article 2 of the Egyptian constitution.

As for the current status of Article 2 of the above-mentioned 2014 Constitution, Article 2 states:

“*Islam is the religion of the State and Arabic is its official language. The principles of Islamic Shari’ā are the main source of legislation*” 304.

b) **The United Arab Emirates**

In the United Arab Emirates, the constitution there reflects a different weight provided to Shari’ā law, and as “*a main source of legislation*”; it is not the sole or principal source of legislation 305. Furthermore, Article 2 of the Civil Code indicates that the principles of Fiqh are to be utilized in the interpretation and understanding of the Civil Code provision. Finally, Article 27 of the same Civil Code provides that


provisions of any governing law cannot contravene Shari’a law if and when applied
306.

c) *Malaysia*

Finally in Malaysia, a country where Islam is the official religion of the Federation 307, the Constitution is the supreme law but not Shari’a law 308; however, the latter still
plays a significant normative role in the country’s legal system. Specifically, Shari’a
law rules regulate personal and family law, succession, betrothal, marriage, divorce,
dower, maintenance, adoption, legitimacy, guardianship, gifts, partitions, trusts,
Zakat, Fitrah, Baitulmal and similar Islamic religious revenue and mosques 309.

Furthermore, some specific acts are considered an offence according to Shari’a law
rules such as drinking liquor, unlawful sexual relations and not fasting the month of
Ramadan. Accordingly, being regulated via the rules of Shari’a law, its rules are
regarded as normative, and are enforced by the state through the Shari’a courts 310.

In the above 3 other examples, although Shari’a law rules are either “a” source of law
or a principal source of law, it still plays a normative role, and to the extent it has
been assigned for. By regulating specific areas of law such as family laws covering
marriage and inheritance laws, all state positive laws in those specific areas will need

308 See Ibid Article 4(1)
to be compliant with and consistent with Shari’a law. To be normative, Shari’a law does not need to be “the” and only principal source of law to be normative law.

On a final note, and contrary to the positivist school of thought, Shari’a law does neither require state coercive power nor authority to maintain its normativeness. On the one hand, many of the Ibadat laws pertaining to worship such as praying obligations, serve as guidance to the followers of the Islamic religion, however neither state nor authority enforce those laws. Ibadat laws form part of Shari’a law, and regulate people’s behavior despite absence of state coerciveness. Some exceptions do exist such as Saudi Arabia, where state sponsored morality police does to an extent patrol and ensure Ibadat rules are enforced.

2.5 Shari’a law and man made constitutions: which is normative?

Since constitutional documents and Basic laws exist, does the normative power therefore come from those final, written, state and positive laws?

Some attempts to answer this question have already been made in the past. It has been said that once the religious normative law is given force by the state, it is this latter positive law that becomes the source of normativeness; Shari’a law therefore no longer becomes the normative law, but instead the state positive law that is 311. This is a typical positivist analysis.

2.5.1 Positivism revisited

First and foremost, and in response to the previous answer provided to this question, a small commentary on positivism is essential; being very similar to the above-mentioned doctrinal finding, positivism is generally one school of thought based on

skepticism. It is a school of thought that unsurprisingly fails to recognize neither any laws of nature generally, nor those tolerance and reason-driven divine laws; they simply take “the other extreme of washing law in the cynical acid of sheer logic and conceptualism”, reducing “the law to a definitional exercise in logic and mathematical formulae”. Essentially, the outlook towards religious divine law as only religious rules and codes, insufficient to be laws themselves, is one that sadly looks at law in terms of form and law-making power. This comes contrary to laws in terms of substance, function and purpose 312.

Whether it is Austin, Hart or Kelsen, and regardless of whether a basic norm, or primary and secondary rules, all the above positivists have lost track of the essentials in terms of the original purpose of law, and therefore its content and spirit; with a short term purpose defeating approach to law, they have even taken great pains to analyze law from an authoritative perspective, in terms of command and rules of recognition. By reducing and restricting what counts as rules of law to formal requirements, and source of descent - a time consuming process - the social needs, essence and substance are ignored, and the issue becomes one of authority and forced compliance backed by threats 313; law then sadly becomes a question of formal exercise 314.

2.5.2 *Positivism from a Shari’a law perspective*

According to “Al Wathiqa” 315, the Islamic state’s first constitution 316, it referred to Shari’a law rules in its Supremacy Clause. Specifically, it stated in Provision VIII Supremacy of Al-Shari’ah:

“VIII (1). Whenever you differ about a matter, it must be referred to God and to Muhammad. None of them shall go out to war save with the permission of Muhammad………

VIII (3). If any dispute or controversy likely to cause trouble should arise, it must be referred to God and to Muhammad, the Apostle of God (may God bless him and grant him peace), God accepts what is nearest to piety and goodness in this document” 317.

Despite the ancient choice of words, the document ultimately refers to the Law of God and Muhammad (Shari’a law) as the ultimate normative laws. Furthermore, Article 52 specifically states that:

“Authority of Allah and the prophet Muhammad (SAW) shall be final and absolute authority in all disputes instigating any quarrel.

And verily if any dispute arises among the parties to this document from which any quarrel may be feared, it shall be referred to God and to Muhammad (SAW), the Messenger of God, for the final and absolute decision. Verily, God is the Guarantee for the faithful observance of the contents of this constitution (which shall be enforced by the state)” 318.

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315 Translated to “The Document”
318 Note that the original copy of this constitution is not in possession of any known scholars, and the above text should be read from a contextual perspective. See Muhammad Tahir-ul-Qadri. *The Constitution of Medina: 63 constitutional articles.* Minhaj-ul-Quran Publications. 2012. Historians such as Ibn Ishaq, Abu Ubayd and Ibn Abi Khathama are said to have provided accurate reproductions on a “word for word” basis to other scholars. See Yetkin, Y. “The Medina Charter: a Historical Case of
It is difficult to verify the exact precise and verbatim text of the above document due to its limited availability. The best and alternative confirmatory and mirror document to Al Wathiqa, that serves as an example reflecting its role, purpose and mechanism, being that the State can serve as a coercive force, but not the ultimate source of normativeness, is in Article 23 of the Basic law of Saudi Arabia. The wording is very similar to the Al Wathiqa, which stipulates

“The State shall protect the Islamic Creed, apply the Shari’a, encourage good and discourage evil, and undertake its duty regarding the Propagation of Islam (Da’wa)” 319.

In the above article, the state’s role is only limited to a coercive and executive role, being a means to an end; the ultimate and normative source of law is the Law of God and his Prophet. The documents have expressly defeated the positivist role of the state as legislative and normative. In both cases, the states are only enforcers.

2.5.3 Normativeness of Shari’a laws after Repealing and Abrogation

Some constitutions such as those of Iran and Pakistan, of which Shari’a law is the sole normative source of law, also include repealing clauses. As an extension to the above question, do the new laws amended by positive human legislation after repealing and abrogation render the latter the final source of normativeness?

Repealing and abrogation between the Quran and the Sunna is provided for by Shari’a law itself, and by virtue of the Doctrine of the Abrogator and the Abrogated

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“Al Nasikh wal Mansoukh” 320. When two texts pose a conflict, the more recent text would override the older texts, ensuring modernization and adaptation of its rules to modernity and continuously changing needs. Repeal and abrogation under Shari’a law is as a matter of fact an essential process ordered by God through His direct words in the Quran “Such of Our Revelation as We abrogate or cause to be forgotten, We bring (in place of it) one better or the like thereof” 321; it “allows jurists to organize the normative complexity of divine texts” 322. In the event that a state provides Shari’a law with coercive force, or even repeals, abrogates and amends Shari’a law itself, the state plays no more than an executive role; the ultimate normativeness rests in Shari’a law and not the state through its coercive powers.

We further find a similar supportive argument in that of L. Ali Khan’s, and who states “Technically, a constitutional provision that declares the Qur’an to be the supreme law can be modified and repealed, unless it is declared unamendable. Article 227 of the Pakistan Constitution, which declares that the Qur’an is the supreme source of law, can be repealed through amendment procedures listed within the Constitution. Because Article 227 can be repealed, one might argue that the Pakistan Constitution, and not the Qur’an, ought to be considered the supreme text. This argument, though technically credible, does not diminish the supremacy of the Qur’an. It is a sociological question whether or not a Muslim nation that constitutionally subscribes to the supremacy of the Qur’an can reverse its normative choices and opt for a secular constitution. Just because a constitutional provision can be amended does

not ipso facto weaken its normative durability” 323. This rather “respects the integrity of
divine texts, retains the jurisprudential heritage of past centuries, but at the same time,
modernizes legal systems to absorb modernity and constantly evolving spatiotemporal
realities” 324.

2.5.4 Normativeness of Shari’a law rules through conflict of laws

The normativeness of Shari’a law can also be seen through its overriding powers, and
specifically in cases of conflict of laws. In cases where Muslim states adopting Shari’a
law as “the” or “a” source of state law, become signatory states to international
conventions, they are then bound by the terms and rules of law emanating from those
conventions 325. Where and when those terms and foreign rules of law pose conflict
with the state laws of the Muslim signatory state(s), Shari’a law demonstrates its
normativeness by superseding and overriding them. During this formal overriding
process, references will usually be made to state positive laws and / or the
constitution. It is reminded that it is not the latter that have the ultimate and final
overriding normative powers, however it is Shari’a law that is in fact the ultimate
source of normativeness in substance in this overriding process. This argument has
been previously made.

To provide a good example, reference is made to the Convention on the Rights of the
Child 1989 (the “Convention”) 326. In this convention, when Muslim states became
signatory members to the Convention, they did so on a conditional “Reservations”
basis; by “Reservation”, it is indicated that the rules of the Convention would not be
applicable in their jurisdictions, and in the case they were inconsistent with Shari’a

324 See Ibid.
17 January 2012.
law rules, incorporated in their constitutions. All states such as Saudi Arabia, Iran, Iraq, Kuwait, Qatar, United Arab Emirates, have expressly undertaken to abide by the rules of the Convention, however with the exception to any rules that pose a conflict with Shari’a law rules.

Similarly, and to use another precedent as an example, reference is made to the Convention on the Elimination of All Forms of Discrimination against Women 1979 327. Similar to the case of the above Convention, “A number of States enter reservations to particular articles on the ground that national law, tradition, religion or culture are not congruent with Convention principles, and purport to justify the reservation on that basis”; this is however valid as long as the reservations are not “incompatible with the object and purpose of the present Convention” 328. Specifically speaking, Muslim states including but not limited to Bahrain, Egypt, Kuwait and Iraq have all ratified the convention, and have undertaken to abide by its normative and applicable rules on their state territories; the rules of the convention would however be overridden by Shari’a laws, and in cases of conflict.

2.6 Normativeness of religious laws in general

The normativeness of laws of religious origins are not only limited to Shari’a law, however other religious laws are normative in non-Muslim states. Similarly, religious and ethical based rules of law, principles and precepts derived from Christian religious law, had in fact played a significant role in the English legal system centuries ago. During the early stages of forming the English legal system, when people felt that they did not receive just decisions from the Common law courts, they appealed to the King, who would render his decisions based on Equity and not

327 Visit http://www.un.org/womenwatch/daw/cedaw/cedaw.htm for full text of convention
Common law; Equity reflected “conscience”, what was morally and ethically right and just 329.

Following the high volume of first instance and appeal requests submitted to the King’s Equity based justice, the practice was then officially institutionalized, and delegated to the King’s Lord Chancellor, who was always a bishop and the “keeper of the king’s conscience”. He established and supervised the Court of Chancery, and which administered Equity 330. Similar to Shari’a law as conserved today in form, context and objective, the Chancellor rendered his decisions according to Christian religious rules, and which were based on religious principles and maxims, and not arbitrarily. This notion of resorting to rules, principles and maxims based on moral and ethical Equity, is the same notion of resorting to Shari’a religious law, seeking more just solutions and reforms, and other than conventional means.

Similarly, Roman law that lies at the basis of almost all-European law could not have been completed without the influence of the Bible. The reformers of Roman law sought guidance and possibly the direction of the Christian bishops, who were described as ones with a lot of wisdom and authority. The Bible heavily inspires constitutional laws such as those of England, and citations to the biblical Scriptures were made as references to ultimate authority 331. Although up to 1200 A.D, when reference to and influence of the Bible on legal systems started diminishing, and being replaced with pure legal science, it was still not excluded in later developments. Texts of the Bible and the Scriptures provided juridical norms that were used for the purposes of evaluating legislation, as well as serving as guidance for positive law; it

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was rarely used as enacted law. Having much more profound effect on the legal systems prior to 1200 A.D, the switch to pure legal science is a matter of cultural change.

2.6.1 *The normativeness of Jewish law: an analogy*

This coming analogy intends to draw on the similarities between Shari’a law and Jewish law in terms of being normative laws, and not merely being religious rules and principles lacking normativeness, from a positivist perspective.

The above analysis focused on the different extents of Shari’a law’s normativeness, and from the perspective of its regulatory powers in Muslim state legal systems; in non-Muslim states however, the situation is different in form but similar in substance. In non-Muslim states, religious law is a source of law regarding certain and specific areas.

Firstly, and regarding nations that do not directly include religious law as a source of law in their constitutions and / or Basic laws, but do consent to religious law being a source of law in certain areas, the State of Israel becomes a good example; Jewish Law is a source of law and is normative law. Similar to the classic debate between positivists and non-positivists, religious law in Israel represents an internal ideological conflict of the classical debate of normativeness of religious law. On the one hand, specifically those who take the secular constitutional system, their religious courts derive their legal powers from the statutes enacted by the Knesset (Israel’s Parliament). On the other hand, and from the point of view of the religious courts, they view their authority as emanating from a religious normative system. From a substance perspective, the latter, further view that the authority they have has

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historical precedence, and when it had always preceded the state, and is intrinsically valid; this is regardless of whether it is recognized by the secular law of the land 333. Israeli law recognizes the self-normative character of “Jewish Law”, irrespective of whether it receives coercive backing by Rabbinical courts 334. The term “Jewish Law” is included in the definition of “law” (hok) in the Israel Interpretation Ordinance 1945, and which states “religious law, whether written or unwritten” 335, and referring to as “law”. The term “Jewish law” in Israel has also been mentioned in Section 2 of the Rabbinical Courts Jurisdiction (Marriages and Divorces) Law of 1953, and which states “marriages and divorces of Jews shall be performed in Israel according to the Din Torah”; it has been undisputedly agreed to encompass the whole of Jewish Law. Rabbinical courts had jurisdiction over matters of personal status, and were governed by the religious law of the community, to which the person in question belonged. In regards to Jews in particular, marriages and divorces were to be conducted exclusively in accordance to the “Din Torah” (Jewish religious law) and not state law 336.

2.6.2 Jewish law normativeness seen through conflict of laws

In cases of rules of international conventions conflicting with internal state laws, the situation in Israel is similar. Although the scope of application of Jewish Law is not as broad as Shari'a law is in Muslim states, the normative overriding powers are similar, and within the specified scope; the normativeness, binding force of Jewish Law and similar to Shari'a law can override foreign rules of law in cases of conflict of laws.

Within the same Convention, the State of Israel has also expressed its “reservations”. Israel has expressed its reservation to Article 7(b) of the Convention concerning the appointment of women to serve as judges of religious courts in Israel. It states:

“1. The State of Israel hereby expresses its reservation with regard to article 7 (b) of the Convention concerning the appointment of women to serve as judges of religious courts where this is prohibited by the laws of any of the religious communities in Israel”.

It has also expressed that “The State of Israel hereby expresses its reservation with regard to article 16 of the Convention, to the extent that the laws on personal status which are binding on the various religious communities in Israel do not conform with the provisions of that article”. It confirmed that "3. In accordance with paragraph 2 of article 29 of the Convention, the State of Israel hereby declares that it does not consider itself bound by paragraph 1 of that article.”

In short, despite the fact that the role of Jewish law in Israel is not expressly and openly provided for in a state where no constitution exists, Jewish religious law is normative “law” by virtue of its definition, application in specific areas, as well as state courts enforcing its laws.

In this chapter, the question of whether normative Shari’a law can be further seen as normative from a lens other than that of a positivist lens has been carried out. This follows a twofold motivation, firstly to protect the intended social and economical justice it aims to achieve when incorporated into western legal systems. Secondly the motivation also stems following certain doctrinal individual and institutional findings made in France indicating a certain trend in the west which reflects law being the sole mode of expression of a norm, being a classical positivist approach, and refusing to recognize Shari’a law as proper normative law.

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Firstly, Shari’a law is normative law from a cultural law perspective, and not solely from its codification in the form of positive black letter laws, however being the highest ultimate source and substance of state positive laws. Forming the beliefs and values of its followers, those beliefs and values are then in return reflected, incorporated into and protected by state constitutions, and subsequently into all constitutional sub–positive laws. Secondly, Shari’a law’s normativeness can be seen from its role in state constitutions and its role as a source of state legislation in a general manner. Shari’a law can either be fully and exclusively normative as the sole source of legislation, or partially normative by standing as “the” or “a” main source of legislation, where it only regulates specific areas of law.

Thirdly, being the ultimate source of normativeness, any law enforcement to Shari’a law is carried out by the State itself; the state and positive laws serve no more than a coercive and executive roles in which they and are only a means to an end. This deeper view of positivism is that of Shari’a law itself, and which is expressly stated in the Constitution of Mecca. Finally, Shari’a law normativeness can be seen in cases of conflict of laws, where in cases Muslim states are signatory states to international foreign conventions and do so on a “Reservations” basis. In the case the convention’s rules conflict with Shari’a laws, the latter then overrides the convention rules.

Following the introductory Chapter 1, and the issue of normativeness addressed in Chapter 2, the next coming Part 2 addresses the second part of the thesis question, being the question of competence. Chapter 1 addresses the issue of general competence, and the issue of specific and technical competence is addressed in Chapter 2.
Part 2

On Shari’a Commercial Law’s Competence in Regulating Modern Commercial Transactions: General Encompassive Capacity and Specific Proficiency

After establishing from a different perspective that Shari’a law is normative law and for the previously mentioned purposes, and once they have been understood and their benefits reaped, to what extent are they competent to govern modern day commercial and financial transactions? To provide an answer to this second part of the thesis question, and prior to indulging into any technical analysis, it will appear in Chapter 1 that SCL when competently studied and successfully reaped of its benefits, it certainly brings substantial added value to modern day commerce, as reflected through its Jurisprudence and which is of dual nature. It encompasses ethical based Jurisprudence that firstly aim to reform the human mind and spirit, which are then subsequently integrated into its laws governing commercial and financial transactions, and which will be discussed in Chapter 2; both go hand in hand. In Chapter 2, it will be seen how although centuries old, SCL is specifically competent to govern modern day complex commercial and financial transactions through its legal contracts, which separately and combined, and along with the Standards and Agreement, are perfectly capable of reproducing conventional complex commercial and financial transactions into more just and fair alternatives.
Chapter 1

Competence by Encompassing

Shari’a Commercial law’s competence does not only stem from setting rules of law to regulate commercial transactions in a quantitative and technical sense, however it has another preceding priority focus that renders it flawless and ideal; in a deep manner, it aims to utilize its divine Jurisprudence to firstly reform the human mentality and conduct. Subsequently after digesting the content, wisdom and intention behind all Jurisprudence, the trader then hopefully embarks on the trade, and genuinely with neither the will nor the need to bend any of its ethical rules for the sake of greed driven profit. When all traders within the same commercial and financial domain share the same divine values and put them in practice, this would form an ideal society driven by equality and justice. It is this incorporation of human nature and needs into detailed and specific Jurisprudence results in genuine change of behavior, and reflected into commercial practice, is what constitutes the dual and general competence of Shari’a law, as will be argued. For the avoidance of any doubt, by reference to SCL, reference is made to Shari’a law Jurisprudence by default.

Before indulging the issue of competence, a famous quote by Count Leon Ostrorog regarding Shari’a law’s level of competence serves as a good introduction. He stated that “considered from the point of view of its logical structure, the system (Islamic Law) is one of rare perfection, and to this day it commands the admiration of the student. Once the dogma of the revelation to the Prophet is admitted as postulate, it is difficult to find a flaw in the long series of deductions, so impeachable do they appear from the point of view of formal logic and of the rules of Arabic grammar. If the contents of that logical fabric are examined, some theories command not only admiration but surprise. Those Eastern thinkers of the ninth century laid down, on the basis of their theology, the principle of the Rights of Man, in those very terms, comprehending the rights of individual liberty, and of inviolability of person and property; described the supreme power in Islam, or Califate, as based on a contract, implying
conditions of capacity and performance, and subject to cancelation if the conditions under the contract were not fulfilled; elaborated a Law of War of which the humane, chivalrous prescriptions would have to put to the blush certain belligerents in the Great War; expounded a doctrine of toleration of non-Moslem creeds so liberal that our West had to wait a thousand years before seeing equivalent principles adopted" 338.

Shari’a law achieves and maintains a dual function. It sets its ethical Jurisprudence in a manner that regulates man’s behavior, and secures his rights individually on the one hand, while at the same time ensuring that he respects his legal and ethical obligations towards his community, on the other hand. The ultimate objectives of Shari’a law are then essentially to “preserve the social order of the community and insure its healthy progress by promoting the well-being and righteousness (salah) of that which prevails in it, namely, the human species. The well-being and virtue of human beings consist of the soundness of their intellect, the righteousness of their deeds as well as the goodness of the things of the world where they live that are put at their disposal”339. To understand those ultimate objectives, one must at the very least briefly understand the intentions of Shari’a law, and therefore understand the blend.

1.1 Maqasid Al Shari’a

Whilst this chapter is not intended to serve as a descriptive text, in order to understand the reasoning and objectives behind Shari’a law’s Jurisprudence in general, the structure of all Shari’a commercial and financial products and instruments in Chapter 2 of Part 2, as well as all precepts and principles, understanding Shari’a law’s Maqasid (underlying intentions and objectives) is then imperative. Furthermore, the above-mentioned dual function of Shari’a law will then be understood.


1.1.1 Definition of Maqasid

Maqasid linguistically refers to purposes, objectives or the intent of a speaker in his speech, or a doer from his actions. From the jurist’s perspective, it refers to his intentions of which he strives to achieve by virtue of what he includes in a law; this is what we may call the intent and spirit of the law, and which is at times referred to as “ideology” 341.

In a more specific definition, and one that perfectly and comprehensively defines the term Maqasid Al Shari’a as “the meanings as well as obvious objectives of legislations as seen through all or part of its rulings, or it is the objective behind the Shari’a. They are the secrets behind each and every rule and as set by the legislator, where their knowledge by people becomes an immediate necessity, including the knowledge of a Mujtahid in the process of analyzing legal rules and in rendering them. If a Mujtahid is need of reaching a judgment regarding a specific event, he would be required to understand the relevant articles for the purposes of applying them to the facts. If he is in need of bringing harmony between contradicting pieces of evidence when reaching a legal judgment, he would need to refer to the Maqasid in due process. If he is in need to reach God’s judgment in a new matter through the process of Qiyas or Istislah or Istihsan, he would be required to diligently investigate all purposes of Shari’a” 342.

The main objective of SCL is essentially to establish and preserve both public and private interest in commercial and financial transactions, and similar to modern man made law, or at least in theory; this is summarized in the term Maslaha. Stemming

340 Free translation.
from the term *Salah* \(^{343}\), it linguistically refers to “an effect of *Istislah*”, which in simple terms refers to a cause or source of something good or beneficial. It is known to be the principle of *public interest*, *public welfare* or “*social good*” \(^{344}\). In the many attempted definitions of the term *Maslaha*, most referred to is that of the prominent scholar Al Imam Al Ghazali, and who has defined it as “the safeguarding and preservation of the intentions of the Shari’a (referring to Al Maqasid) and which are five, their religion, spirit, mind, offspring and wealth. All what preserves those five Usul is a Maslaha, and all what compromises them is a Mafsada” \(^{345}\). Imam Al-Shatibi defines Maslaha as “all concerns that promote the subsistence of human life, the completion of man’s livelihood and the acquisition of all his physical and intellectual qualities which are required for him” \(^{346}\).

To the Islamic jurists, when in the process of considering a new law to meet new realities, or revisiting and updating an already existing law to meet new realities, the requirement of preserving *Maslaha* (public interest) must be satisfied; if public interest is not preserved in any commercial or financial transaction, that serves as the underlying reason that any restrictions, partial or total on any transaction maybe

\(^{343}\) See Muhammad al-tāhir Ibn Āshūr. *Ibn Ashur, Treatise on Maqasid Al-Shariah*. The International Institute of Islamic Thought. 2006. P.96. See website for Islamic Banks and Financial Institutions Information.


imposed by SCL. *Maqasid* are then the greater and more general objectives, and *Masaliḥ* are those more private and specific concepts and principles that forward and safeguard Maqasid.

In SCL, and similar to modern man-made law, one has to differentiate between the Maslaha in regards to private transactions, and public Maslaha; the latter is known as *Maslaha Amma* \(^{347}\), while the former means *Maslaha Khasa* \(^{348}\). *Maslaha Amma* refers to “what is beneficial and useful for the whole or most of the community, and does not concern individuals only in so far as they are members of the whole”. This type of Maslaha on the one hand, refers to the subject matter of most of the Quranic legislation. On the other hand, the *Maslaha Khasa* consists of anything that benefits private individuals \(^{349}\).

In both the general and specific Quranic verses, *Maslaha Amma* comes as a primary objective \(^{350}\) and not the *Maslaha Khasa*. In private commercial and financial transactions, many traders could enter into transactions that are only beneficial to the parties involved, and without necessarily taking into consideration any potential harm to the public. In simpler terms, Shari’a based commercial and financial transactions are structured to factor in and promote *Maslaha* and profit on an *inter se* level, but provided that it does not violate the *Maslaha* on the public level, and on an *outrre se* basis. People may not necessarily have evil intentions, however they would differ in their ability to evaluate and balance their private *Maslaha* versus that of the public, if able at all \(^{351}\).

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\(^{347}\) Literally translated as public benefit.

\(^{348}\) Literally translated as private benefit.


When modernists such as Sanhoury formed modern legal legislations based on western legislation, it was the attitude of Shari’a towards Masalih that made the process possible. In short, the Maqasid are the good ends and public interest that Shari’a laws aim to achieve, either by blocking or opening certain means.

1.1.2 **Maqasid al Shari’ā compatible with universal ideas of social and economic justice**

Although a subjective matter, no one universal social and / or economic justice model can be said to exist; they are however two naturally sought essentials by all human beings, in all societies, and on a universal level. Shari’a law’s main objectives equate universally agreed definitions of social and economic justice; firstly the term “justice” maybe defined as “fairness” or “equity”. Despite any potential different subjective cultural understandings of the term, it generally guides people to organize social institutions; when the latter is “justly” organized, it provides access to what counts as “good” for people, both individually and collectively.

Individuals are also theoretically responsible to others, and must respect their obligations towards and co-operate with each other, and with a view to improve and perfect those institutions to allow people to develop. From an economical standpoint, the individual as well as the groups are guided by moral principles in designing those economic institutions. Institutions are “a complex of positions, roles, norms and values lodged in particular types of social structures and organising relatively stable patterns of human activity with respect to fundamental problems in producing life-sustaining resources, in reproducing individuals, and in sustaining viable societal structures within a

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Institutions come in several forms, including political, legal and economic institutions, all of which are dedicated to the overall “good” of society.

From the above definitions and general concepts of Social Justice, it is easy to see how they are similar in principle to Maqasid al Shari’a, which aims for the same notion of social and economic justice. They equally evolve around the most commonly referred to notion of “Common Good” 357, “General Welfare” 358 or “Common Safety” 359. From what has been included above, the “Common Good”, “General Welfare” or “Common Safety”, have been specifically referred and detailed in the term “Masalih”, all aiming to achieve an ideal society; this also effectively means that any rules of law cannot contradict principles of social justice. In that respect, there is certain equivalency between the Masalih, and what we can claim are universal conceptual elements of justice, both economic and social.

Furthermore, since the common good is taken to be an institution of the highest level, it is therefore wholly constituted from individual component goods on a lower sub level. Similarly, Maqasid Al Shari’a reflecting the common good by virtue of the Masalih al Mursala and Masalih Amma constitute the highest level of social institution. It is also comprised of smaller component unit institutions (Masalih Khasa) on lower sub levels; all actions taken by individual institutions may not violate the ultimate common good, being the Masalih Amma. No Shari’a based legislations may therefore be set to contradict or to serve as an obstacle to Masalih, and since they establish an ideal society, based on principles of equality and justice that lead to social and economic justice.

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1.2 Maqasid al Shari‘a: Transcendental and practical justice

Shari‘a law aims to promote ethical and equitable commerce and financing leading to financial and social justice through its wholesome ethical principles 360; the latter target the human wellbeing overall through social justice, prevention of inequality, and equal distribution of wealth amongst society and for the overall wellbeing of society. “The true laws of God are the laws of our own well-being. And well being of humanity, in its individual or collective form, remains the ultimate objective of all religions. To prevent injustice, deliberate or otherwise, religion identifies and separates the lawful from the prohibited. This concept has been known to all mankind since ancient times. However, people have differed, in relation to superstition and myths, in the definition of the scope, variety and causes of taboos and prohibitions” 361.

From the voluminous literature available, the most inspiring theories regarding the notion of justice are those of Amartya Sen 362. His notions, ideas and findings of justice, as well as the manner of practically putting them to realization are very wholesome. More interestingly, they are almost identical in the theoretical and practical aspects to Maqasid Al Shari‘a. The similarity does not appear from the perspective of securing the individual materially as a goal of social and economic justice, but in allowing the acquisition of necessities as well as luxuries, all which lead to allowing self-development, and the feeling of success in achieving what is personally valuable 363; both theories and models precisely aim for the same.

According to Sen, there are two types of theories on how to effectively introduce and implement the notion of justice; the first theory is that of the Transcendental Justice. This theory does not only limit itself to which institutions are required to implement justice in a given society, it also discusses behavioral expectations of people collectively in a given society; he labels this notion of justice as Arrangement Focused View of justice. A criticism of this approach is that it is generally very theoretical, and does not provide sufficient steps on how to implement justice in a society. Those types of theories have been developed by some of the most outstanding thinkers, such as Thomas Hobbes and Jean Jacques Rousseau \(^{364}\).

The second type of theory of justice and approach, different to the first Transcendental Institutionalism, is called Realization Focused Comparison. The proponents of this theory are Adam Smith, Jeremy Bentham, Marquis Condorcet, Mary Wollstonecraft, Karl Marx and John Stewart. They all collectively have very different ways of reaching, realizing and concluding how society’s institutions should work for achieving justice \(^{365}\).

Both theories of Sen are not different to the Maqasid. Shari’a law’s Jurisprudence has precisely and accurately realized the Maqasid’s theoretical objectives and intentions through practical means. By encompassing theory and practicality, the outcome of the divine Maqasid do not differ from some of the world’s greatest thinkers.

1.2.1 Two distinguishing and founding notions

Similar to all global models that aim to establish and maintain social and economic justice, each model has its own different main and founding concepts. Certainly the justice is a shared objective of SCL, however the founding concepts it uses to achieve


\(^{365}\)See Ibid.
social and economic justice are founded on the same ethical principles and concepts that regulate all other aspects of the human life; those are the same principles that regulate both worship and work.  

Justice according to Shari’a law is based on two founding notions, which serve as the base to Shari’a law’s Jurisprudence. The first founding notion is that human beings are only part and component of the entire universe, of which the latter is there to aid and assist them. Human beings are neither to be brought into this world to endure hardship, nor to exist without being given the necessary care and help. From the general Quranic verses, reference has been made to sending the Prophet Muhammad PBUH “we have not sent you except for mercy for everyone”. Furthermore, it mentions “God does not want to make religion a liability on you, but wants to purify you, and to conclude his grace upon you”.  

The second founding notion is that the duration of human kind cannot be realized except if human beings all unite, and co-operate to exist alongside within their communities and societies. This coexistence of human beings together would naturally arouse the concept of obligations; in simpler terms, the universe is there to assist and aid human kind to exist, however human beings should also co-exist together, and respect their obligations to co-exist with that universe. It is therefore the “absolute, just, and coherent unity of existence, and the general mutual responsibility of individuals and societies. On these two facts Islam bases its realization of social justice”.  

368 See Ibid. P.1018.  
It is therefore the reason Shari’a law ensures self-growth of human beings on the one hand, and ensures the growth towards society at the same time, as factored in its main objectives in its Jurisprudence.

Following the above description and discussion of Fiqh al Mu’amalaat, as well as the founding notions of Shari’a law and SCL, a further explanation of the essential rules that serve as the basis of Fiqh al Mu’amalaat themselves becomes essential. Those essential rules simply put Maqasid al Shari’a and the two founding concepts into practical perspective; they also serve as the basis on which all commercial and financial transactions are structured.

1.3 The essential rules governing Fiqh al Mu’amalaat based on Maqasid al Shari’a

While the rules governing Fiqh al Mu’amlaat target social welfare, charity and poverty alleviation being essential pillars of the Quran and Sunnah370, the “significance of the study of Islamic economics lies in its balanced focus on the production of goods and services as well as other determinants of the ‘quality of life’ for which value judgment may be needed within the Islamic value framework. Accordingly, Islamic economics being an integrated body of knowledge does overlap with other disciplines such as religion, sociology, political science in a much more significant way than secular economics. The fact is that Islamic economics cannot remain neutral between different ends. It is concerned with what is and what ought to be, in the light of the Shar’i’ah. Therefore, it involves the study of social, political, ethical and moral issues affecting the economic problems directly or indirectly” 371.

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370 The term charity and Islamic tax Zakat used for charitable purposes have been mentioned numerous times in the Quran and by the Prophet Muhammad. “So give to the kinsman his due, and to the needy and to the wayfarer. That is best for those who seek the favor of Allah, and it is they who will prosper. Whatever you lay out as interest that it may increase the wealth of the people, it does not increase, in the sight of Allah; but whatever you give in Zakat, seeking the pleasure of Allah—it is these who will increase their wealth manifold”. (Ch 30:38-39).

Understanding the essential rules that govern Fiqh al Mu‘amalaat, of which all SCL Jurisprudence is founded on, is important. It is important to the underlying logic and rational of those rules, in order to avoid diverting away from the main purposes of Shari’a law in general, being the attraction of people’s financial, material, spiritual, individual, communal, present and future related Masalih. When conducting commercial and financial transactions, it is not only rules that must be respected, but people are expected to demonstrate genuine heart-driven etiquette in conducting commerce (Aadaab al Mu’amalaat). “For whoever contemplates the Islamic Shari’a, would find that He (God) the ultimate legislator has set his rules very wisely, all which have been based on honesty, justice, forgiveness as well as treating others with ease. People are allowed to and further encouraged to exchange goods between each other via many types of transactions such as sale and purchase, al wakala, al sulh, al silm or al hiwala. However, “Allah has permitted sale and prohibited riba” the promotion and circulation of wealth cannot be done except if done by ethical and non-abusive means.

Etiquette reflected in the legal precepts of Shari’a law is firstly and mainly focused on generating income with class, manners, ethics, merciful commercial practices, and focusing on ease in treatment of debtors in difficult financial situations, and in default. Creditors are asked to exercise ease, and to delay repayment deadlines until a debtor is ideally able to repay; creditors are asked to take into account the debtors difficult financial situations in repayments with a kind heart, and not to play part in worsening the already troubled situation. The definition of an individual in default

here, is the one who has been hit with visible poverty. An individual not hit with poverty is one who in possession of an asset eligible for sale, and for repaying the debt. With the exception of life’s necessities, the creditor is allowed to foreclose on other assets, and to resell them to recover the amount owed. The second most important element in etiquette is the pursuit of permissible profits, which prevents the accumulation of impermissible profits while conducting commercial and financial transactions.

As for the remainder of Shari’a law’s etiquette, they include but are not limited to refraining from unnecessarily disposing of profits, curiosity in engaging in fruitful labor including commerce, agriculture and industry, respecting obligations without delay, building transactions on mutuality, granting others choice’s and notarizing all commercial transactions with clarity and transparency to increase social confidence.

a) The principle of Ibaha

Translated to the principle of permissibility, it refers to the principle and rule that it is permissible to enter into any and all transactions and contracts, provided there has been no express and unequivocal rule prohibiting it and declaring them “haram”. This comes as the opposite to Ibadat, where all forms of spiritual worship are prohibited, unless expressly permitted. The notion behind this principle is that when people enter into commercial transactions together, and enter into different legal

375 See Ibid. P.81-87.
relationships, the legislator (God) only interferes to reform behavior, clarify the
Maqasid behind the reforms and details all rules realizing them.

According to this rule, “all sale transactions are permissible”, as well as “all contracts and
conditions are permissible”. As for permissibility of sale, and stressing on the sale
contract in particular since it serves as the model contract as previously explained, it
was expressly mentioned in the Quran “and God has permitted sale”; a sale includes
exchange of commodities, exchange of cash or free sale. In terms of Freedom of
contract, which has always been a subject of prolonged debates between the different
schools of thought, the most agreed to and shared opinion is that it is fully
permissible to create new contracts and transactions, and provided no Shari’a laws,
principles or general rules have been violated. All schools of thought have agreed
to this principle, and following the express Quranic verse “O you who have faith! Do
not eat up your wealth among yourselves unrightfully, but it should be trade by mutual
consent. And do not kill yourselves. Indeed Allah is not merciful to you”.

Freedom of contract is a principle that operates in accordance to two essential points.
Firstly, that a contract is undertaken by a command from God and the Sunna of his

377 See Qaradawi, Youssef. Al Qawa’id al Hakima li Fiqh al Mu’amalaat (Governing Rules of Fiqh al
Al Baqqara 275.

378 The debates over the true meaning of the term Ibaha (Permissibility) of Freedom of Contract took
place between the “restrictive” scholars who see that the creativity of contracting is by default
prohibited till evidence to permissibility is found, and all other scholars known to be the “flexible”
scholars, who see that the opposite is true; creativity and freedom of contracting is the rule by default,
and till a prohibition arises. Scholars agree that the Freedom of Contract includes the freedom to a) the
consensus to create a contract and b) the freedom to set its terms and conditions, effects and
compulsory character to a contract(s). See Al Zohaily, Wahba. Al Fiqh Al Islami wa Adillatahoo (Islamic
“Freedom of Contract, the Doctrine of Frustration, and Sanctity of Contracts in Sudan Law and Islamic
Law”. Arab Law Quarterly. 1.1 (1985). P.54. See differences of opinions between schools of thought
regarding freedom of contract in Qaradawi, Youssef. Al Qawa’id al Hakima li Fiqh al Mu’amalaat

Prophet, and secondly, it is against any form of usury (Riba), uncertainty (Gharar) and gambling (Maysir). Those elements will be analyzed extensively.

Finally, it is very important to note that the legislative direction taken in line with this principle is actually to narrow down the scope of impermissible activities, and to expand the scope of permissible activities; this direction is taken for the purposes of easing duties to be carried out by people, and to avoid any element of harshness.

Specifically, the Quran stipulates, “O you who have faith, do not ask about things which, if they are disclosed to you, will upset you. Yet if you ask about them while the Qur’an is being sent down, they will be disclosed to you. Allah has excused it, and Allah is all-forgiving, all-forbearing.”

b) Substance and not form is the ultimate measuring criteria

This rule of “matters are evaluated in accordance with their Maqasid” ranks as the most important rule amongst the top five rules of Fiqh al Mu’amalaat, and next to the other four being “doubts do not discard certainties”, “harm is lifted”, “norms are affirmed” and “ordeals beget ease”. This rule also referred to as “contracts are governed in accordance to Maqasid and meanings, and not by formal terminology”. This rule stems from the Prophet’s Hadith "The reward of deeds depends upon the intentions and every person will get the reward according to what he has intended" as well as “a believer’s intention is better than his deeds”. This rule basically refers to the fact that when contracts are

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385 Free translation from Al Tabrani (6/185).
concluded, it is not the terminology used by the parties entering into the contract that matter, but rather the real intentions and real Maqasid at the time of their conversations; terminology alone is not sufficient since it can serve to confuse the real intentions and meanings behind those discussions.

The ultimate objective of this rule is to avoid circumventing the real essence and substance of laws called “Al Hiyla”, and by using different terminology representing false transactional pretences. An act of Hiyla takes place when one labels something in a manner different to its original intended name, only by changing the form when its substance remain the same. By way of example, when one party purchases a commodity from another party, and leaves him his watch “in trust” until the outstanding sale price due is paid. Despite the fact that “trust” was the terminology used, in reality and according to the real intentions and Maqasid behind this transaction, the watch was left in the first party’s possession as a “collateral”. The party in possession of the collateral is now under an obligation to keep the collateral, and till the outstanding amounts payable in return for the commodity sold are paid off. In the case the buyer returns to reclaim his watch, he would not be able to as it was left with the intention of serving as a collateral until he pays the outstanding amount, and not truly “in trust” 386.

This rule in fact is consistent with the very true spirit and nature of Shari’a law in general, being genuinely concerned with substance and not form, and the deeds truly found in the heart of the person. This has also been confirmed in one of the Prophet’s Sunnah’s “Verily Allah does not look to your faces and your wealth but He looks to your heart and to your deeds” 387.

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c) **Eating people’s wealth in vanity is prohibited**

The basis of this rule is found in the Quran, specifically ““O you who have faith! Do not eat up your wealth among yourselves unrightfully, but it should be trade by mutual consent. And do not kill yourselves. Indeed Allah is not merciful to you” 388. This verse combines the necessity of preserving wealth and self, indicating that they both go together hand in hand; each cannot be looked at separately. It must also be noted that the preservation of wealth precedes the preservation of self. Furthermore, the term “kill” has been used in this verse, to equate it with the notion of eating other’s funds in vanity, and indicating the gravity of the issue 389.

This rule has several meanings, and applies equally to several different situations. By eating other’s wealth in vanity, it also applies to hiring the services of a person without sufficient and just compensation. The opposite is also true; being remunerated for a service without actually carrying out duties is equally eating the person paying the compensation’s wealth in vain. In short, every person conducting a transaction relying on the other person’s delusion, and had the other person been aware of this delusion would have retraced from executing the transaction, is eating other’s wealth in vanity; this is also applicable in the event the transaction was that of a gift or of charitable nature 390.

Finally, it is also one of the biggest sins according to Shari’a law to eat the funds and wealth of the poor in vanity, or those in inferior and weak financial positions, and who are incapable of defending their belongings. This has been stipulated in the

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390 See Ibid. P. 51-56.
Quran as “Indeed, those who consume the property of orphans wrongfully, only injest fire
into their bellies, and soon they will enter the Blaze” 391. Furthermore, a Prophet’s Hadith
confirms the gravity of eating people’s wealth in vain including the poor, and which
states “There was a man who looked after the family and the belongings of the Prophet and he
was called Karkara. The man died and Allah’s Messenger said, “He is in the ‘(Hell) Fire.’ The
people then went to look at him and found in his place, a cloak he had stolen from the war
booty” 392.

More on eating people’s wealth in vain will be elaborated on in the section
discussing the precepts of Shari’a law.

d) “No harm nor reciprocating harm”

This is one of the important rules governing Fiqh al Mu’amalaat, the juridical basis of
which stems from the Prophet’s Sunnah “there is no injury nor return of injury”, or
“there should be neither no harm nor reciprocating harm” 393. It is considered one of the
most important rules since its substance has been mentioned on a number of
occasions in the Quran, and to the extent that some jurists went as far as saying that it
may replace all other rules governing Fiqh al Mu’amalaat. Causing harm is expressly
and equivocally prohibited, where people are obligated to prevent the damaging
event from taking place and / or to take all necessary measures to reverse its effects;
this includes but is not limited to easing any financial burdens resulting from the
damage(s) 394. Equally prohibited and grave, are acts of revenge intended to return the

392 See Sahih al-Bukhari 3074 in the book of Fighting for the Cause of Allah (Jihaad)
393 Narrated by Muwatta Malik in the Book of Judgements, and Sunnan ibn Majah in the Chapter on Rulings. Visit http://sunnah.com/search/%D9%84%D8%A7-%D8%B6%D8%B1%D8%B1-
%D9%88%D9%84%D8%A7-%D8%B6%D8%B1%D8%A7%D8%B1 last visited 15 May 2014.
394 See Qaradawi, Youssef. Al Qawa’id al Hakima li Fiqh al Mu’amalaat (Governing Rules of Fiqh al Mu’amalaat). Dar el Shorouk. 2010. P.69 and
damage, and causing even more harm. It is only accepted that the person causing the damage remunerates the person who suffered the damage in Fiqh al Mu’amalaat.

This rule is equally applicable to sale transactions as well as inheritance. In the context of inheritance, and although it may not be a typical exchange transaction, it is a great sin if one person leaves a will and dedicates to an inheritor an excess of what he is entitled, according to Shari’a inheritance rules; the result of one inheritor receiving more than what he is entitled to, is that the remainder of the inheritors will then be forced to divide their share of inheritance even more amongst themselves, resulting in less of an inheritance share for each, and in order to compensate from the inheritor that received more than what he was entitled to.\(^\text{395}\). Causing damage to others is a very grave sin in Fiqh al Mu’amalaat not just in commercial transactions, but to the extent that a simple act of digging a well in one’s property and causing damage to his neighbor by allowing less water flow to his neighbor’s property, is considered a grave sin.\(^\text{396}\).

Furthermore, and in sale transactions, damage to others is a very grave sin. It is not only selling over-priced commodities or providing services with excess rates that is prohibited, but even more grave is selling to needy people at prices either above their means, or even at relatively extortionate rates; this kind of transactional behavior in Shari’a law is called Riba, and is prohibited by the precept of the prohibition of Riba. This will be covered in much more detail in the next coming section below.

This main rule has allowed jurists to create other essential sub-rules applicable to both Ibadat and Mu’amalaat, including “Damages are to be prevented if possible and

\(^\text{395}\) See Sunnan Abi Dawud in the Book of Wills. Narrated by Abi Hurayra. Visit http://sunnah.com/search/%D9%84%D8%A7-%D9%88%D8%B5%D9%8A%D9%87-%D9%84%D9%88%D8%A7%D8%B1%D8%AB Last visited 15 May 2014.

\(^\text{396}\) See Gami’e al oloom wal hokm (2/212-218).
within capacity” 397, “Damages are to be eliminated” 398, “Damages are not to be eliminated by other damages” 399, “private damage is allowed if it avoids public damage”, “severe damage is to be eliminated by mild damage” and “preventing evil prevails over attracting benefit”.

This rule also applies to the preservation of the environment; Shari’a law has set its Fiqh al Mu’amalaat and ethical guidance for the purposes of preserving the environment including all its components. The term environment does not only refer to nature, animals, human beings, air and water, but generally speaking all what triggers imbalances in human’s conduct. This has been mentioned in the Quran as “He raised the sky and set up the balance, (7) declaring, ‘Do not infringe the balance! (8) Maintain the weights with justice, and do not shorten the balance!” 400.

e) Mitigation and easing and not severity and hardship

This rule has many juridical bases stemming directly from the Quran. The most referred to Quranic verse is “Allah desires ease for you, and He does not desire hardship for
you” 401. Furthermore, many Prophet’s Sunnah also do exist as juridical basis for this rule. The most commonly referred to one is “Facilitate things to people (concerning religious matters), and do not make it hard for them and give them good tidings and do not make them run away (from Islam)” 402, as well as “You have been sent to make things easy and not to make them difficult” 403.

There are several ways of behavior that one can demonstrate ease and avoiding hardship

- **Accepting easing requests and providing facilities:** People are expected to provide permission and make exceptions for those in need, and to provide any means possible considered facilitations in a needy situation 404. The Prophet has been said to have stated “It is charity that Allah has bestowed upon you, so accept His charity” 405, and “it is not righteousness to fast while traveling” 406. This confirms permission to eat while traveling during the holy month of Ramadan is means of demonstrating ease.

- **Waiving necessities:** Every rule has an exception, and exceptions do permit enjoying what is normally prohibited. It has been stipulated in the Quran “He has forbidden you only carrion, blood, the flesh of the swine, and that which has been offered to other than Allah. But should someone be compelled, without being rebellious or aggressive, there shall be no sin

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404 See note 412.


406 See Sahih Al Bukhari in the Book of Commentary on the Quran. Visit http://sunnah.com/search/%D9%84%D9%8A%D8%B3-%D9%85%D9%86-%D8%A7%D9%84%D8%A8%D8%B1 Last seen 17 May 2014.
upon him. Indeed Allah is all-forgiving, all-merciful” 407, and permits eating pork in cases of necessity.

- Narrowing the scope of obligation and prohibitions: In the event that there is no unequivocal expressly stated rule in Shari’a law prohibiting something, or making it an obligation, people must therefore not be unnecessarily burdened with obligations.

- Allowing diversity of opinions: Whenever scholars are in the process of studying matters related to Fiqh al Mu’amalaat, it is natural to find several opinions regarding one specific matter, and stemming from several different schools of thought. Accepting the fact that there is a diversity of opinions and leaving certain matters open is a demonstration of providing ease and avoiding hardship 408.

1.4 The distinctive precepts of Shari’a Contract law: The prohibition of Riba,

Gharar, Maysir

In this next coming section of the chapter, the 3 distinctive precepts will be thoroughly elaborated on. Although the analysis is descriptive in nature, it intends to provide in depth background information, but by referring to some of the most reliable sources of Islamic literature. It intends to rectify any misunderstandings or misconceptions surrounding the terms; the analysis is essentially corrective in nature. It is this latter corrective description and explanation that serves as a contribution in itself. Finally, with no sufficient explanation to the precepts, the entirety of next coming chapter 2 may not be understood.

1.5 The precept of the prohibition of Riba

“No two people in their sane minds would differ that Riba is one of the greatest sins prohibited by divine legislations”. Their prohibition is as clear as the prohibition of alcohol, and


both are banned practices since they were some of the most widespread violations that took place 409.

1.5.1 Definition of the highly debatable term

This is the first and most widely known and quoted element in literature covering Islamic Finance, and commercial transactions in general; it is this precept that lies at the root of the debates regarding the previously discussed principle of freedom of contract. Riba is not one that is only specific to Shari’a law, it had also been mentioned in the Torah, and specifically under “Ribbit Ketzuzah” and “agar nattar”, and meaning rented money, as well as “Sechar hamtana” as a reward for waiting 410.

The definition of the term Riba linguistically stems from the verb “yarbu”, being “increase”, “excess” or “growth”. As for its legal definition, it can be defined as “the increase of money but for no specific return for something else, and in case where exchange of money for money takes place” 411, or “an increase in capital for no legitimate return” 412.

When referred to in the Quran, and in addition to the article “al” (“the”), it is referred to in such a manner that entails the act of lending money with a specific increase 413. It is not the act of increase only per se that is prohibited, however a second element must be found in the transaction; being the act of increase causing a “monetary advantage without a counter value which has been stipulated in favor of one of the two contracting parties in an exchange of two monetary values” 414; it is therefore the increase amounting to usury and exploitation that is banned. There is generally a classical confusion in western literature between Riba and interest rates in commercial

409 See Ibid. P.89.
transactions. Over the centuries, the definition of the term generally caused a divide between those of a conservative outlook, and those that are more liberal with a forward looking vision.

A reason why this precept is highly debatable is that although it is mentioned in the Quran, its precise definition and relevant jurisprudence was not fully elaborated on by the Prophet Muhammad; he had passed away before he had the time to do so. 415 In a famous statement, the Prophet’s companion Omar ibn Al Khattab stated “I wish that the Prophet had not been taken from us until he had given us a satisfactory explanation of riba... We have forsworn things nine tenths of which were permissible, for fear of riba”. When assessing the constitutive elements of Riba in a commercial transaction, utmost importance must be given to the surrounding circumstances in terms of time and actual practice of people when assessing what amounts to Riba 416.

1.5.2 A vehemently condemned practice

Riba has been vehemently condemned and prohibited in both the Quran and the Sunna. In positive law form, Quranic verses that ban Riba and with a strong tone, are “While Allah has allowed trade and forbidden usury.....they shall be the inmates of the Fire and they shall remain in it” 417. It then imposes a punishment by stating “O you who have faith! Be wary of Allah, and abandon what remains of usury, should you be faithful. And if you do not, be informed of a war from Allah and His apostle” 418. Several other Quranic


418 See Ibid. Surat 3, verse 278-279.
verses prohibit and warn of severe punishment against ignoring the prohibition of Riba.

Riba is also harshly condemned and banned by the Prophet Muhammad himself, where he stated in a Hadith “Sell not gold for gold except in equal quantity, none should give the other excess. Sell not silver for silver except in equal quantity, none should give the other in excess, nor exchange what is absent with what is present” 419. It has been narrated that the Prophet himself stopped Bilal (a companion of the Prophet) one day, with dates of superior quality. After being asked by the Prophet regarding the source of those dates, he replied “We had with us dates of inferior quality out of which were purchased the dates of superior quality at the rate of two Sa’s for one”. The prophet then resented the response and stated “It is nothing but riba don’t repeat it again, but if you wish to purchase the dates for money and with that purchase the dates of superior quality” 420. The practice of Riba as seen through the most common example of usurious loans, has been banned for social, civil and economical reasons. As for the social and civil reasons, it abolishes the spirit of co-operation and co-existence, as well as generates communal animosity and envy, and as a result of the usury practiced onto the needy and hopeless by those with no conscious. If one is generating income through effortless means, this naturally leads to the creation of extreme greed; it is this practice of usury and taking profit for granted that has lead to many of poor nations being colonized by others 421. By allowing usurious practices, individuals no longer only rely on such effortless highly lucrative practices, however the practice also slowly eliminates the instinct and spirit of human aide and co-operation; members of a community are therefore willing to provide help to others knowing that help can

always be lucrative via usurious practices. Individuals in a society are all obliged to co-operate, however allowing usurious practices spreads the notion of extreme individualism, and providing help only in cases where help would be in return for profit.422.

In quoting the prominent scholar Ibn Qayyim (d.751/1356) 423, he mentions:

“In the pre-Islamic period, riba was practiced by giving extra time to repay a debt and adding a charge against this extension (thus, increasing the amount of the debt) until one hundred became thousands. In most of the cases, only a needy individual would keep doing so as he would have no choice but to defer the payment of the debt. The creditor agreed to defer his demand for repayment of the debt, and waited so that he might gain more profit on the principal. On the other hand, the debtor was forced to pay the increased amount to ward off the pressing demands of the creditor and the risk of the hardships of prison. Thus, as time passed and the loss of the debtor went on increasing, his troubles multiplied and his debt accumulated until all his possessions and belongings were lost to the creditor”424. Ibn Qayyim then continues to mention that if the debtor were still not able to pay, the amount would keep increasing till at times when it was impossible to repay the debt, the creditor would take the debtor as a slave 425.

The banning of Riba as most commonly found in usurious loans does not only stem from naïve theoretical religious ideals. By way of example, historically, after signing the Bretton Woods Agreement post World War II, where the United Kingdom had asked the United States for financial aid, and after the significant lives and financial

423 Considered one of the most prolific scholars, as well as one of the most influential theologicians and jurists. See Mustafa, Abdul R, and Qayyim -J. M. A. B. Ibn. On Taqlid: Ibn Al Qayyim’s Critique of Authority in Islamic Law. Oxford: Oxford University Press, 2013. P.2.
losses that it incurred fighting alongside with the United States, the latter insisted that financial help would only be provided on an interest based loan. Lord Justice John Maynard Keynes as the representative of England at the time mentioned “I cannot forget at the time the extreme sadness and pain that I suffered from the treatment of the United States to us by this agreement, refusing to lend us anything without usury”.

Furthermore, even Sir Winston Churchill himself also mentioned “I …… Such strange behavior built on accumulation of and love of money of which the United States had treated us. This agreement has left very negative effects on our relationship with the United States”. Finally, the Minister of Finance Dr. Dalton when presenting the agreement to the UK parliament for its approval, he was forced to accept it although he mentioned “This legacy, a wholly disagreeable one, consists essentially of the debt which we find ourselves owing to our Allies and associates in the war, not to speak of certain neutrals. These debts we have accumulated during the war, entirely for war purposes. This great load of debt, which we are bringing out of the war, is, indeed, a strange reward for all we, in this land, did and suffered for the common cause, to which all parties and sections of this community were totally devoted. It is a strange and ironical reward, on which historians will make their comment. But, pending that comment, we must deal with the situation” 426.

1.5.3 Constitutive elements

Riba would be best understood in light of an example of a proper sale transaction. In a conventional sale transaction, the seller presents a commodity to the purchaser, where the latter agrees to the price. The seller either manufactures the product then sells it to the purchaser, or he purchases it from a third party to sell it to the purchaser; in both cases the seller receives remuneration as a reward for the efforts he has exerted, being deserved and earned profit.

In the case of a Loan (Qard) transaction, and according to the linguistic definition, “it is what you give to another person from wealth, provided that he returns this wealth to you” 427. As for its legal definition, “it is the sum given by the loaner to the loanee, for the latter to return it in the same like if identifiable, or for the same value if he is incapable of returning its like”; the term “identifiable” refers to what can be measured or determined by weight.

Further to all the above reasons, Riba has been prohibited over loans (Qard) in particular, as the Quran and Sunna referred to Qard in a meaning entailing kindness to the needful, and in a charity oriented manner; it has been mentioned in such manner to bring people together and to ensure their co-existence built on kindness. As a matter of fact, it has been referred to as Qard Hassan, as in “good loan” or “kind loan” 428. High rewards are promised to those who provide hassan-driven qards for the needy 429. From the many confirmed Prophetic Sunnah covering this matter, one states “he who helps a Muslim ventilate a difficulty from life’s difficulties, God shall ventilate a difficulty for him in judgment day, and he who exercised ease on someone in a difficult situation, God will exercise ease on him in judgment day”. He furthermore clearly and undisputedly mentioned, “Every loan is a Sadaqa (charity)” 430.

In the case of a conventional loan transaction, one person lends another a specific amount of money, with the intent of generating profit from repayment of the principal amount in addition to a surplus. In the case of delay in repayment, more surplus is charged based on the delay in time. In this second transaction, and contrary to the above sale transaction, no effort had been exerted by the loan provider and therefore the profit generated is undeserved and unjustified. Riba being the excess money amount of which one person pays the other in return for a certain period of

427 See Al Qamoos Al Moheet. P.354.
428 Free translation
430 See Ibid. P.112.
time, therefore has three specific characteristics. Firstly, excess on the principal amount, secondly, excess is determined on the basis of time, and thirdly that it is a condition for the transaction to take place and be finalized. Economically, the purchaser repaid the loan with profit only in return for an increase in time, and with no value in return what so ever; this increase in time maybe or may not be to his advantage.

The result of a typical Riba-based transaction such as the above loan transaction is the following:

1- The debtor is more in debt; the excess owed by the debtor to the creditor in return for more time, could have afforded the debtor’s necessities.

2- In a sale transaction, the vendor makes profit from the purchaser only once; as opposed to Riba based transactions, the creditor makes profit over the same loan repeatedly, and at the expense of the debtor’s expense. This reasoning has also been shared by some of the greatest philosophers of all such as Plato and Aristotle, where the latter had indicated that interest, being excess, is money born from money. He also stated that lending money is the most unnatural way to earning money, and since it betrays the true mission for which it was created: to facilitate trade 431.

3- In the cases of sales transactions, the subject matter of the contract is transferred to the purchaser, and once payment has been made or pending payment to be made in the future. The relationship between both parties to a contract would then have ended by the conclusion of a contract, and by receiving the counter value. In the case of Riba, the relationship does not terminate once the extension has been granted, and the purchaser has received no counter value.

4- In labour-based transactions, the person who exerts effort is rewarded in proportion to his efforts at most times. In the case of Riba, the debtor in fact helps the vendor making profit, without the latter having exerted any effort; furthermore, a creditor does not share any losses with the debtor 432.

1.5.4 *An exception to the rule*

In some particular cases, clients to Islamic banks are charged an extra fee as a surplus over the principal amount; this extra fee does not constitute a Riba-based transaction, and for one simple reason. When clients are being charged with fees linked to their loans, those charges are simply fees paid to the lawyers or people employed drafting the agreements. This comes as respecting the requirement to pay those who provide services, promptly and without delay, and as compensation for their efforts 433.

1.6 *The precept of the prohibition of Gharar*

The second precept of which governs all commercial transactions is the precept of the prohibition of *Gharar*; transactions that do not conform to it are rendered null and void.

1.6.1 *Definition*

Similar to Riba, many attempts have been made to provide a precise and unanimous definition of the term, but unfortunately with no success 434. Different definitions vary from conservative to liberal, and result in either highly restrictive contract conditions, or more liberal, flexible and forward thinking ones.

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433 See Ibid. P.105.

Linguistically, Gharar stems from the term “khatar” (danger), and in the context of unconsciously exposing one’s self and / or wealth to risk. It refers to “trickery” which results in lack of satisfaction at the moment of its realization, and which leads to “eating people’s wealth in vanity” 436. According to a widely accepted definition by Islamic scholars is that of Al Sarakhsi, which states, “It is everything of hidden consequences” 437. In a more detailed reference to commercial transactions, “Gharar is what cannot be delivered, whether present or absent, such as selling wild camels, the scope of sales is delivery of the sold items nevertheless seller is unable to deliver to the buyer, where the buyer purchases the items out of risk and gambling, if he was able to take receive the items then we would have gambled with the seller, and if he was not able to receive the item, then the seller would have gambled with the purchaser” 438.

1.6.2 Speculation: a condemned transactional uncertainty

The direct condemnation of Gharar is not found directly in the Quran as is the case of Riba, but can be found in the Prophet’s Hadiths as well as in Ijma. The condemnation mentioned in the Quran does however directly and strongly prohibit Maysir (Gambling) 439. the constitutive elements of the Maysir are equally applicable to Gharar by analogy; this is also confirmed by Ibn Taymiyah and Ibn Al-Qayyim. Ibn Taymiyyah states that “Gharar obtains where consequences are concealed, selling with excessive Gharar is Maysir which is gambling: that if camel or horse lost, its owner can sell it with a very high risk and very low price, so if buyer finds it, the seller will

438 See Majmoo’at Fatawy l’Ibn Taymiyah (20/296) found on the Azhar website, visit http://www.elazhar.com/mafaheemux/20/3.asp
tell him, you deceived me and bought it with very low price, but if he could not find it, the buyer would complain that he paid and got nothing in exchange. This will result in enmity and hatred between them”. Exorbitant Gharar sale is vanity and injustice, and causes enmity and hatred in society. According to the Sahih Al-Bukhari, the Prophet’s Hadiths condemning Gharar are several. Some of the most known are “Do not buy fish in the sea, for it is gharar”, another states “Whoever buys foodstuff, let him not sell it until he has possession of them”; Muwatta in his Hadiths confirms that the prophet mentioned “Selling fruit before it has begun to ripen is an uncertain transaction (gharar)”.

Commercial transactions shrouded with Gharar are prohibited on a good Hikma (reason). The reason for the prohibition is that the transaction would include ignorance of detail, risk akin to gambling leading to Darar (damage), and of which would lead to conflict, dispute and turbulence in people’s benefits. Furthermore, another point of wisdom behind the prohibition of contracts involving uncertainty is namely “the protection of the parties against exploitation, imbalance of their reciprocal rights and obligations and lack of fair and objective criteria according to which their rights and obligations can be determined with an acceptable degree of exactitude and certainty. This will help settle the conditions for validating certain forms of insurance and speculative or aleatory contracts such as futures trading, and certain forms of agreement containing an undertaking

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441 Being one of the most referred to and trusted sources of the Prophet’s hadith.
443 Muwattah is also a highly credible source of Hadith, and similar to Al Bukhari. Visit http://sunnah.com/search/gharar.
to pay a sum certain (determined in figures or at a certain rate) as guaranteed profit or earning of investment of money or property” 445.

1.6.3 The constitutive elements

While risk is inevitable in any transaction, the precept only prohibits risk or uncertainty that is unnecessary, or simply the type of which a transaction would be successful even in its absence. Another Hadith states “The prohibition of Gharar ridden sales is a great ruling, and is one of the rules of Shari’a law that treats an endless range of issues such as the sale of…… the unknown, and what is incapable of being delivered and such sales are invalid, and since that this is considered gharar that is simply not necessary” 446.

Shari’a law jurists have ruled that there are two types of Gharar, the first having an effect on the validity of a transaction, and the second having no effect on a transaction. For Gharar to have an effect on the validity of a sales transaction, it must be considerable; however if the Gharar is minimal or its presence in the contract comes out of necessity, it therefore does not have any annulling effect on the contract 447.

In short “a sale transaction where the sale of a probable item of which their existence and determination are not definite, and due to the danger (taghreer) and adventure elements render it similar to Qimar (gambling). The type of Gharar that renders a sale invalid is that of evident nature, that is everything in the sale item is probable in terms of existence and non existence. As for Gharar in description, it is then (mufid) to the sale transaction” 448. In more

446 See Sharh A Nawawi ala Sahih Muslim 10/156 found on the Al Azhar website, visit http://www.elazhar.com/mafaheemux/20/3.asp.
447 See Bidayt al Mujahid 2/118 found on the Al Azhar website, visit http://www.elazhar.com/mafaheemux/20/3.asp.
practical terms, Gharar will mean uncertainty, risk and speculation \textsuperscript{449}, when the full implications pending the main elements of exchange contracts are unknown \textsuperscript{450} as a result of \textit{Jahl} (ignorance) of the subject matter. The majority of scholars thus void sales of non-existent and uncertain objects.

To summarize the necessary conditions to invalidate a contract on grounds of Gharar, they are exactly four:

1- The Gharar must be major.

2- The contract subject of the Gharar must be that involving financial compensation (contracts such as those of gift and other contracts not involving financial remuneration would naturally not fall under the scope of Gharar as there would be risk)

3- The Gharar must affect the principal components of the financial contract (i.e. price, object of the sale, language of the contract etc...)

4- That there would be no need met by the contract containing the Gharar, and which could not be met otherwise \textsuperscript{451}.

1.6.4 \textit{Exceptions to the rule}

Similar to any other legal rule, exceptions do exist. Firstly, when a sale transaction has been entered into, and where the object of the transaction is one that naturally comes with an attachment, this attachment would not be subject to specification and determination. An example would be the sale of a building, when the natural foundation is an integral part thereof; providing specific information regarding the foundation of a building is not necessary, and since they are attached to them by


default. Similarly, in the case a specific price were separately charged for the foundations, the transaction would also be rendered null and void; firstly, a building foundation naturally comes as the object of sale, and secondly, the foundation is impossible to quantify and / or identify separately.

Secondly, if the object of a transaction was difficult to quantify or identify by nature, the transaction would not be null and void. By way of example, when entering a bathroom, it would be very difficult to quantify the amount of water to be used and charged \(^{452}\). Another opinion summarizing the opinions of earlier jurists regarding what counts as commercial transactions legally valid although inclusive of an element of uncertainty, is that generally \("the criterion for invalidity of the contract based on Gharar or its validity despite the existence of Gharar is thus:\)

\[\text{"if necessity dictates committing Gharar which cannot be avoided without incurring an excessive cost, or if the Gharar is trivial (haqır), the sale is rendered valid, otherwise it is rendered invalid.... Thus, the differences among scholars is based on this general principle, where some of them render a particular form of Gharar minor (yasır) and inconsequential, while others render the same form consequential, and Allah knows best"}\(^{453}\).

Whilst the subject of Gharar is far too vast to explain in this thesis, a list of several cases that constitute Gharar by Ibn Juzay can be found to provide a better understanding of the precept:

1. Difficulty in delivering the subject matter of a commercial transaction
2. The existence of \(Jahl\) (ignorance) towards the type, price and / or the subject matter of the commercial transaction;
3. The existence of \(Jahl\) towards the characteristics of the subject matter of the commercial transaction and its price;


\(^{453}\) See Ibid.
4- The existence of jahl towards the quantum of the price, or the quantity of the subject matter of the commercial transaction;

5- The existence of jahl towards the future performance and / or delivery of the subject matter of the commercial transaction;

6- Two sales in one transaction (bay’atan fi bay’atin) 454.

As a concluding remark, the prohibition of Gharar ensures in an uncompromising manner leaving the subject matter of a contract (the “ayn”) open to indetermination and chance. To the most possible extent, it avoids leaving any victims of unforeseen mischance, which may result in more obligations unaccounted for. In short, the nature, quantity (mikdar) and quality of the ayn must be properly and explicitly defined, and excluding all doubt 455.

1.7 The precept of the prohibition of Maysir

This principle is usually evoked along with the precept of prohibition of Gharar, however a difference must be drawn. While Gharar refers to risk and uncertainty as previously explained, the precept of prohibition of Maysir literally refers to “gambling”; in legal terms, it refers to “games of chance” 456 or “games of hazard” 457. Maysir occurs when there is a chance of one party to a contract to suffer from total loss, and hence the term gambling and / or games of chance is used; it is important to point out that although Maysir does have elements of Gharar, not all Gharar is Maysir 458.

454 See Ibn Juzay, al-Qawain al-Fiqhiyyah. P.169-170. An example such as this one should not be taken literally given the timeframe when this list was compiled, however its application should be done by analogy to modern day examples.


1.8 Is Shari’a law’s Jurisprudence alien to non-Muslim states and unrealistic to implement? Riba, Gharar and Maysir in French law: A comparative analysis

Following the above descriptive analysis of the precepts of Shari’a law’s Jurisprudence, as well a corrective analysis of the usual misconceptions surrounding them, are those concepts truly alien to non-Muslim state laws? Are they only unique to Shari’a law and therefore difficult to implement in western legal systems?

Being partially the triggering reason for this thesis 459, and from a country with enormous potential for becoming the biggest Shari’a financial centre in Europe, French law is then the best case study for this coming comparative analysis, and for the purposes of providing an answer to the above question. The attempt will focus on the fact that the objectives and values of Shari’a law precepts were almost identical in French law, and during the era when Canonical laws were normative and backed by state coercion. Despite changes to the relevant articles in the French Civil Code today providing for standards different to their original ones, those standards have changed gradually due to external political and economical factors over many years, but only in terms of form and not in substance; the original objectives and values behind the relevant civil code articles are nevertheless similar to Shari’a law precepts in essence and origin. A historical analysis will therefore be carried out for all 3 precepts.

1.8.1 The precept of the prohibition of Riba in French law

In the current French legal system, the equivalent of the precept of the prohibition of Riba is le prohibition d’Usure (the prohibition of Usury); despite the current differences in definition between both terms, they are both similar in essence and origin. At this stage, and according to the latest version of the Civil Code, Usury is regulated by articles L 313-1 to L 313-6 of the French Code of Consumption. Art. 313-5 (Act No. 2005-882 of 2 August 2005 Art. 7 (V) Official Journal of 3 August 2005) stipulates:

459 See 2.1 The Status Quo: Shari’a law in France in Chapter 2 of Part 1.
“The usury rate is defined in Article L. 313-3 of the Consumer Code, reproduced hereunder:

"Art. L. 313-3. - Any contractual loan granted at an annual percentage rate which, at the time of its granting, is more than one third higher than the average percentage rate applied by credit institutions during the previous quarter for loans of the same type presenting a similar risk factor, as specified by the administrative authority after consultation with the Conseil national du crédit, is a usurious loan.

Loans granted in connection with hire-purchase agreements are, for application of the present section, treated as contractual loans and considered to be usurious on the same basis as cash loans having the same object.

The procedures for calculating and publishing the average effective rates referred to in the first paragraph are determined by the regulations.

The provisions of the present article and those of Articles L. 313-4 to L. 313-6 are not applicable to loans granted to a natural person for his business requirements or to a legal entity engaged in an industrial, commercial, craft-trade, agricultural or non-commercial business activity" 460.

Usury in the above article is not referred to in a manner that describes certain practices in concept as in Shari’ a law, however it is only considered usury when it exceeds the ceiling set by the law, and in specific transactions; unlike Shari’ a law, Usury today equates “excess” only when interest charged exceeds the rate determined by a state authority. Are Le prohibition d’Usure and Riba therefore two different principles?

1.8.2 *Le prohibition d’Usure: A change in form over time but not in substance*

Although the definitions of each term may be different in their current form today, they represent the same objectives and values *in essence and origin*. This change of standards can be seen through the pattern of changes to the definition of the term *Usure* in France, as well as the relevant legislations of which reflect a diversion from its origins.

Firstly, the term “Usure” has been defined in several different ways in the *Dictionnaire de L’Academie Francaise* over the years, reflecting the changes in standards. The definitions of the term had changed as follows:

*First edition (1694): “Illegitimate interest that requires a money or commodity that had been set to work”* 461.

*Fourth edition (1762): “Illegitimate interest of which we require over a money or commodity that we lent”*.

*Fifth edition (1798): “In Jurisprudence, it refers to the interest on money; in ordinary usage it has been limited to the illegal interest and to illegitimate profit required over a money or commodity that was lent”* 462.

*Sixth edition (1832-5): “Interest, profit required over a money or a loaned merchandise, above the rate set by law or established by custom of trade”* 463.

Although the above differences in definition are those of linguistic nature, it reflects a change of general perception, and reflected by a change of legal culture and

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461 Free translation from “Intérêt, profit illégitime qu’on exige d’un argent ou d’une marchandise qu’on a prêtée”.
462 Free translation from “En Jurisprudence, il signifie l’intérêt de l’argent; dans l’usage ordinaire on l’a restreint à l’intérêt illégal et au profit illégitime qu’on exige d’un argent ou d’une marchandise qu’on a prêtée”.
463 Free translation from “Intérêt, profit qu’on exige d’un argent ou d’une marchandise prêtée, au-dessus du taux fixé par la loi ou établi par l’usage en matière de commerce”.

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standards. Looking from the first to the last definition, there is firstly a notable difference changing from a pure concept of “illegitimacy” and gradually to “illegal”; secondly, the prohibition starts from a practice by pure concept, to that of a specified rate dictated by the law and state authority.

1.8.3 The first orders

Historically, the provisions prohibiting Usury have been kept by the French kings and reproduced in a big number of orders, reflecting many changes in standards over the years. The very first known order that declared practicing usury as a legal offense, dates back to well before the period of separation of church and state, and to the 800’s A.D. During this period, it seems that the church adopting canonical laws, had prohibited the repayment of loans with interest in any shape or form, with the exception of any loan repayments taking place in the form of annuity; even this form of repayment with interest could not even be paid within a specific pre-determined period. Usury prohibited at the time was when a creditor asked a debtor to repay an interest on a loan within a specific period; those were the canonical laws that prohibited such transactions. In civil law, and only applicable in Rome, all forms of interest were also banned.  

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After a widespread public sentiment expressing how unnatural Usury was, and in the year 850 under the rule of Charles-le-Chauve, an order was granted to retain all sums taken above principal amounts lent to people from loan transactions; half the excess amounts were returned to people’s heirs in cases of death of the debtors, and another half was given to the poor. An order was also issued to dismiss those who committed usury out of the church.  

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At later stages, several decrees were also issued reflecting

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a similar approach to what constitutes Usury, being a matter of principal and abstract practice, and reflecting the canonical laws that were identical to Shari’a law today.

In the year 1211, a decree in Melun was issued prohibiting the taking of interest on loans, clearly stipulating “we hear, where it is said, by usury all what is over the capital” 466. Similarly, in the year 1254, King Saint-Louis renewed the decree by another one, and for the purposes of deterring the usurious practices intensely conducted by certain Jews and Christians at the time. He issued them an injunction threatening to abandon them in case they continued their usurious practices. This decree had also been renewed in the year 1274.

With growing usurious lending practices nationwide, legislations set against Usury had at later stages started to use even more assertive and punishing tones; decrees issued from the years 1311-1349 started to see punishments introduced, such as confiscation of bodies and goods (confiscation des corps et des biens), and prosecution of Usury as a serious offence. In the year 1318, Usury had become such a widespread practice, till a new decree with a much more broad scope of application had been issued; the decree did not only allow the search of those who received any form of excess payments due from interest rates, but broadened its scope to include those who receive any financial commissions or any other forms of repayment extraordinary in nature 467.

1.8.4 Remarkable changes to legislation

The first remarkable change in French legislation concerning the Usury offence was in the year 1423, which represented a diversion from the definition of Usury as defined by the canonical laws in its purest form at the time; its definition in the canonical laws was closest to Riba in Shari’a law as still conserved today. The notion of generating

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466 Ibid P.9. Free translation from “Nous entendons, y est-il dit, par usure tout ce qui est au-dessus du capital”.
467 See Ibid. P.9-11.
profit out of profit had become very publicly and widely known, where Pope Martin V officially confirmed the practice legitimate; he had lifted any doubts over its legitimacy, and confirmed by the Concile de Constance. In 1477, Calixte III further renewed this change, when the threshold of usury was then raised and fixed at an interest rate of 10%. Historians attribute this increase in interest rates to the 15th century, and as a result of the big distress that France had suffered during the war with England, from Phillips de Valois to Charles VIII. It is therefore the hypothesis of this thesis that the shift away from the definition of Usury in its original and purest form, was a result of forced circumstances, and not in concept.

The most remarkable changes that took place in the French legal system concerning the Usury offence was in 1789, when it was for the first time declared by the Assembly that money can be lent for a fixed term, at the interest rate fixed by the law. This was further confirmed by another law issued in 1796, which confirmed that lending at interest was left to the complete freedom of contract, and when the law no longer set a threshold for usury; it is known that the year 1796 is when Usury had become openly legal. After the civil code had been promulgated in 1804, and when no regulations on interest rates had been set, interest rates reached up to 60%, forcing many people to declare bankruptcy. When the situation had reached a point beyond control, the famous Law of 1807 was then introduced. This law was the first to reset a threshold once again, and against the complete freedom of contract.

From this point in time and onwards, many changes to laws repealing and resetting government defined interest rate caps had been passed; law No. 19 of 1850 had added more severe penalties to the Law of 1807, and declared Usury as a serious offence (“delit d’habitude”). Finally, after repealing any ceilings on interest rates in 1918, and following many public scandals, the issue was finally settled by Law No. 28 of 1966

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468 See Ibid. P.11.
469 Ibid. P.27.
Today, and as previously mentioned, Usury is regulated by the provision set above. Penalties are set by art. L 313-5, of which an imprisonment penalty may be imposed for up to two years, as well as a 45,000 Euro fine. When looking at the definition of the term “Usure” as traced back and up to the year 1423, lending at interest rates was completely prohibited till then. Not before the year 1789 was the first official legislation of lending at an interest rate and for a fixed term passed by the Assembly; we also note that this is the same year of the outbreak of the 1789 French revolution. It is the significance of this year in particular that leads to the inclination that several different possible scenarios are responsible for the sudden changing of Usury laws, and caused it to drift away from its canonical origins.

1.8.5 Separation of church and state

The first possible scenario, and being the more likely reason, is the start of the process of the separation of church and state, at the outbreak of the French revolution. Although the separation between church and state did not officially take place before 1905, the process had started at that time. The noble class as well as the church clergy owned more than half the land in France, which peasants occupied and could barely survive off. The revolutionaries confiscated and sold their lands and assets, as well as started the process of attempting to bring the church under the control of the

state. It is possible that during this process of attempting to bring the church under state control, that usury laws based on canonical laws were targeted as part of the revolution against the church.

1.8.6 A widening of social gaps

The second scenario is related to the drifting away from religious matters on a social level, a political drive towards secularism and the rise of capitalism. During the second half of the eighteenth century, there was a notable drift away from religious influence over social values within the young generation of the French society, and which had become very evident at the beginning of the 19th century. The origins of this drift could be traced back to the era of the ancien régime (the old regime), which was overthrown by the revolution. French society had always been one with a class-based nature, and where belonging to the people’s class or the noble class did make matters different. By way of example, belonging to the noble class usually implied being less concerned with religion and adopting a skeptical attitude towards it, as well as having a political taste more driven towards secularism. By the second half of the 18th century, the elite, professional and commercial bourgeoisies had all drifted away from religion and towards secularism and skepticism. It is possible that this drift may have played a role in changing usury laws to a different direction.

With the growth of capitalism, its “incompatibility” with religious commercial principles and models had started becoming clear and evident in the eyes and opinion of the French society. There was a great deal of difficulty of accepting the optimism of the rising bourgeois on the one hand, and the pessimistic manner of

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stressing on sins by the church on the other hand; the philosophies of the two ends of society had no common ground to co-exist together. By way of example, with the rising capitalism at the time, the bourgeois had the mentality that if one was poor, it was only that person to blame, which contradicted the church’s teachings that preached giving money for charity and to the poor. Finally, the bourgeois at the time were very famous for their money lending with interest businesses, and which were very lucrative. With the church’s teachings advocating against their primary source of income, the bourgeois had continued to challenge the teachings of the church. The church did not discourage profit, in fact it had encouraged constant business and pursuit of worldly goods, however without the need to revert to usurious practices; to the church, commerce should be abandoned if one cannot trade without lending money at interest 475.

1.8.7 Les Assignats

A third and possible scenario, and also analogically and strongly linked to the second scenario, is for capital market reasons. Usury laws and limitations on interest rates were seen as restricting factors on a developed banking system, the Assignats therefore played a role in repealing the interest rates in 1789 after the revolution took place 476.

1.9 The precept of the prohibition of Gharar in French law

This precept, and similar to the above precept, is not one alien to French law, and as a matter of fact to the contrary. Not withstanding small terminology and application differences, French law in the opinion of this thesis contains articles and provisions

that when read collectively, provide for values and objectives almost identical to Gharar.

1.9.1 *A resemblance in values*

Both French law and SCL require certainty regarding transactional subject matter, and do not allow uncertainty. The relevant articles of the current French Civil Code, which cover the same subject as Gharar, are articles 1126-1130. Article 1126 states “*Any contract has for its object a thing which one party binds himself to transfer, or which one party binds himself to do or not to do*” 477. Any contract firstly therefore needs to have an *object* as its subject of obligation, and which secondly, by default would mean that its sufficient definition and determination must be satisfactory.

Furthermore, Article 1129 stipulates, “*An obligation must have for its object a thing determined at least as to its kind. The quantity of the thing may be uncertain, provided it can be determined*” 478. By “determined”, it has historically been interpreted to, and is still interpreted to refer to the fact that the object must be defined in terms of kind, quality and quantity “*quis, quale, quantum sit*” 479.

The quality of the object must also be guaranteed to avoid transactional Gharar. Similar to SCL, and depending on the type of transaction, the quality of goods subject to delivery must meet standard market expectations, and not necessarily the purchaser’s expectations; the latter may be higher than the average or unreasonably high at times. This is a global principal according to professional experience. If the

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477 Original text states “*Tout contrat a pour objet une chose qu’une partie s’oblige à donner, ou qu’une partie s’oblige à faire ou à ne pas faire*”.


subject matter of the transaction is not specifically detailed in a contract, standard market specifications are then to be delivered by default.

Accordingly, Article 1246 of the French Civil Code stipulates that “Where a debt is of a thing determined only as to its kind, a debtor is not obliged to give it in the best of its kind; but he may not offer it in its worst” 480. By way of example, if a subject of sale contract where a horse is the object of sale, while the vendor is not permitted to deliver a horse in bad health or with visible defects on the hand, however, it is not an obligation to deliver the most beautiful horse that he has 481. The vendor is obliged to deliver the object of the contract of at least medium quality 482.

Both French law and Shari’a law are similar in terms of aiming to promote benefit and repelling harm. An interesting fact is noted, being that in explanatory works over Article 1126 as well as most commentaries on the French Civil Code, the French term “chose” referring to “object” or “thing” being the subject matter of contracts, refers to “all what offers meaningful advantages”, equally applicable to facts as well as acts 483. In the context of SCL, the term “Manfa’a” is used, which refers to “benefits” 484 as the “meaningful advantages”. Both laws generally look for the establishment and

480 Original text states “Si la dette est d’une chose qui ne soit déterminée que par son espèce, le débiteur ne sera pas tenu, pour être libéré, de la donner de la meilleure espèce ; mais il ne pourra l’offrir de la plus mauvaise”.
482 See Edouard Mechelynck et Paul-Alzire Belvaux. Le code civil expliqué: donnant sous chaque article l’interprétation du texte légal par ses motifs, avec des exemples qui en facilitent la compréhension, la définition des termes de droit, ainsi que les sommaires des arrêts des Cours de cassation de Belgique et de France qui complètent la disposition légale. Bruxelles: E. Bruylant 1929. P.411. See commentary on article 1022.
483 “Il comprend tout ce qui peut offrir quelque avantage aux hommes; il s’applique aux faits de l’homme et meme aux actes qu’il peut s’imposer de ne pas faire”. See Edouard Mechelynck et Paul-Alzire Belvaux. Le code civil expliqué: donnant sous chaque article l’interprétation du texte légal par ses motifs, avec des exemples qui en facilitent la compréhension, la définition des termes de droit, ainsi que les sommaires des arrêts des Cours de cassation de Belgique et de France qui complètent la disposition légale. Bruxelles: E. Bruylant 1929. P.448. See commentary on article 1126.
484 Free translation from Arabic.
preservation of “Maslaha”. Although not a direct translation, the choice of terms potentially reflects common objectives.

1.9.2 A historical change in pattern

The requirement of presence of a sufficient degree of certainty and respecting public morality in commercial transactions are further evident in French law historically; a good example we may refer to is the case of introduction of life insurance schemes in France. During the 1800’s when life insurance schemes sales were on the rise, and generating huge profits, “France was the only civilized country in which life insurance has not been fully understood…..it seems to be rather tolerated than decidedly adopted, when it ought to be, as it is in neighboring countries” 485; it was considered “repugnant to French sensitivity” 486.

Refusals to subscribe to life insurance in France during the time were not on any economic grounds. As a matter of fact, knowledge of the products was well developed and sophisticated; mortality tables and numbers had been much more developed in France than neighboring England. Although the French were more sophisticated and advanced in this market, the refusal to capitalize on the market was simply a matter of morality and principle; by way of example, refusal to engage in transactions that were conditional people’s death, was considered “contrary to good morals”, and that “a human life cannot be the object of commerce and it is disgraceful that death should become the source of commercial speculation”. Based on the same ethical grounds of Shari’a law, critics of life insurance and all similarly unethical transactions in nature rejected such transactions, and on grounds that they focus on the “service of money and undermines the sense of compassion which should form the basis of society”. All

contracts where profit was conditional a person’s death were unreservedly refused. The immorality of the insurance scheme was further denounced by a court judge in France, in a court case where the death of a person was so tempting on lucrative grounds, a man was accused of killing a woman to collect her life insurance.

Life insurance was not introduced till 1850, and was limited to a tax scheme after the French revolution. Furthermore, the gradual shift of standards tolerating uncertainty in commercial transactions away from its canonical origins was limited; however and for the purposes of fairness, standards of tolerance did not reach the point of allowing transactions that crossed the line of morality. It is the finding of this thesis that the political and commercial reasons responsible for the gradual shift away from zero tolerance of the Usury offence to limited tolerance are generally but not specifically, the same reasons for the same shift away from zero tolerance for uncertainty in commercial transactions, to limited tolerance.

1.10 The precept of the prohibition of Maysir in French law

This precept and its equivalent articles in French law can be found in the Aleatory Contracts section, articles 1964-1983.

Aleatory contracts are defined in Article 1104 of the French civil code as “It is commutative where each party binds himself to transfer or do a thing which is considered as the equivalent of what is transferred to him or of what is done for him.

Where the equivalent consists in a chance of gain or of loss for each party, depending upon an uncertain event, a contract is Aleatory.”


1.10.1 *A shared objective to promote individual and communal growth*

The commentaries of some of the most prominent French jurists 491 regarding Aleatory contracts in the French Civil Code, made it clear that the intentions and objectives of those contracts largely resemble SCL rules as still preserved today. According to Pothier, the prohibition of *Jeu* et *Pari*, as well as the prohibition of Aleatory contracts which did not balance the interests of the parties, were more closely prohibited on grounds of violating natural law, as well as divine order and interest 492.

The notion of banning transactions of such type are similar to the *Maqasid*, and in the sense that they waste the individual’s time, put his life’s wellness at risk, and fail to allow him focus his efforts and talents in building a healthy life on an *inter se* level. Furthermore, when each individual engages in such types of transactions, and depriving society from benefiting from his efforts and talents, this subsequently spreads in effect on an *outre se* level. Close in wordings to SCL, those types of *gross jeu* are against “*L’ordre de dieu*” (God’s natural order) 493.

Once again and according to Pothier, there are two types of games of chance where fate and chance are the determining factors of gain and loss; one is the *jeu honnette* (honest game), and the other is *jeu pas honnette* (dishonest game). Concerning the former, it is the type of game of chance where the objective is for charity purposes, and for pure recreation; when gains and losses are insignificant, it becomes a *jeu*.

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490 Original article stipulates “Il est commutatif lorsque chacune des parties s’engage à donner ou à faire une chose qui est regardée comme l’équivalent de ce qu’on lui donne, ou de ce qu’on fait pour elle. Lorsque l’équivalent consiste dans la chance de gain ou de perte pour chacune des parties, d’après un événement incertain, le contrat est aléatoire”.

491 See Robert Joseph Pothier was one of the most influential French scholars who had a profound influence over the English Contract of Sale (Traité d'Obligations (1761). See J Baker, John H. *An Introduction to English Legal History*. London: Butterworths, 1979. P.352-53


493 See Ibid. P.306.
disinterrese. As for the latter, it is the gross jeu type, which is significant to take most of the players’ time in a very destructive manner that leads to many confrontations 494.

French law also aims for the protection of individuals from the effects of earning profit out of effortless commerce, on an inter se level; the concern is that this further generates a sense of creativity for transactions structured out of greed and addiction for the love of profit generation. On an outre se level, the magnitude of the economical damage may be far greater if such methods of generating profit are tolerated. Jeu et Pari, although recently being permitted on exceptionally limited grounds, are still largely prohibited in France today, and on grounds of public order as well as social order. On grounds of the former, protection is sought against fraud and money laundering practices, for the safety of players in gambling environments, as well as protection from addiction and overall public health concerns 495.

1.10.2 A gradual distancing from origins

Generally speaking, there has been an overall partial distancing from rules and regulations from their original strict canonical form, to a more tolerant approach due to change of circumstances by time; this has certainly been the approach taken towards jeu et pari. Although a move dictated by desperation for economic recovery, the result is that the legal culture is what has changed, however the origins and reasons behind all prohibitions discussed remain the same, in essence and origin.

Gambling and lottery in France were first tolerated on pure economic grounds. The speculative nature of gambling leading to economic distress of the poor, had always been the principle that saw lottery abolished in France. King Francis I first permitted lottery and gambling in public space in France, when he only did so as a result of

their huge profit generation potential; it was further used to finance the Parisian church of Saint-Sulpice as well as the military school of Paris. Furthermore, it became a very important fiscal instrument, and especially for compensating for those who evaded taxes at the time. He managed to increase the treasury’s revenues and compensating for France’s 37 million livres budget deficit at the time.

Following the French revolution, lotteries were abolished by the revolutionary government in the year 1793 on grounds of exploiting the poor, and was then once again revived in 1799 as a result of economic revenue losses; it was completely abolished in 1836. Although lotteries for the above mentioned raisons honnettes such as those conducted for charitable purposes were declared legal, savings banks for the poor who lost wealth to gambling were established as a result. In the explanation (“presentation”) for the law establishing the savings banks, it was stated that “the creation of savings banks and the insurance contributions was the same as establishing the necessary spirit of order and economy to nations and to families; it is the same as encouraging individual work driven by the social interest to become owners, and non the less the interest of guaranteeing the maintenance of the ownership. To abolishing lottery amounts to slowly terminating the vice of speculation and bad passions that require hazardous luck, and as opposed what work can guarantee. And considering those considerations of highest importance the government has decided the sacrifice of one branch of treasury revenues: the lottery has been abolished.”

Gambling, games of chance and Aleatory


497 See Ibid.

contracts only experienced legalization after the renaissance, and when the latter were legally required to be fair 499.

1.10.3 Modern legislation: Economic “reforms”

The move towards more tolerance of Jeu et Pari is also present in modern legislation; this is expressly based on external factors. It is clearly stated in the newly introduced Code de la Securite Interieure (Ord. no 2012-351 du 12 mars 2012, en vigueur le 1er mai 2012) 500, that while public and social order remain the same concern, nevertheless the dangers to both the former and the latter are not as serious as before. Furthermore, due to economic circumstances and urgent financial needs, it was in the interest of France to make amendments to the laws regulating Jeu et Pari, for the purposes of benefiting the economy.

Furthermore, Art. 1965 of the Civil Code stipulates “Legislation does not grant any action for a gaming debt or for the payment of a bet” 501, the article asserts that although such immoral games may be tolerated in exceptional circumstances, it will not provide state intervention in the collection of profits. It seems from the article that it is unnatural to grant transactions of such immoral nature a legal framework providing legal support. In simpler terms, the parties may agree to their terms, but the law will not interfere and provide support.

Following EU reforms and expansion of international financial investments, many of which rely on high-risk financial products, French law sought to restore confidence of

501 “La loi n’accorde aucune action pour une dette du jeu ou pour le paiement d’un pari”. 

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concerned foreign investors. Till recently, parties to commercial and financial transactions invoked Art. 1965 on many occasions, where they made losses due to taking risks akin to gambling. It is only on 8 January 2009 that an executive order was issued, when Article L211-35 created by Ordinance No. 2009-15 of January 8, 2009 - art. 1 of the French Monetary and Financial law stated “No person shall avail himself of Article 1965 of the Civil Code in order to elude the obligations resulting from financial contracts, even if those contracts could be cancelled upon payment of a simple difference” 502. Judges in French courts usually rendered financial transactions of speculative nature as “outside the law”, and who usually qualified such transactions as games and betting, and usually accepted claims invoking Article 1965 to them. Due to this “uncertainty” posed by the judges, French legislation decided to restore the confidence of the international investors in the market 503. Art. 1965 therefore rests the same in substance and unchanged, despite supplementary changes to law in form dictated by economic desperations.

Secondly and regarding Art.1967 of the same French Civil Code, it further demonstrates that the principle is still rejected on moral grounds, not only in form but in substance. Art. 1967 stipulates “In no case may the loser recover what he has voluntarily paid, unless there was, on the part of the winner, deception, fraud or swindling” 504. When read in combination with Art. 1965, the principle behind the maxim Nemo auditur propriam turpitudinem allegans then comes to light; this latter maxim means nobody

502 “Les instruments financiers à terme mentionnés au 4 du I de l’article L. 211-1 sont valides, alors même qu’ils feraient l’objet de dispositions législatives spéciales, pour autant que leur cause et leur objet sont licites. Nul ne peut, pour se soustraire aux obligations qui résultent d’opérations à terme, se prévaloir de l’article 1965 du code civil, lors même que ces opérations se résoudraient par le paiement d’une simple différence”. Visit http://www.legifrance.gouv.fr/affichCodeArticle.do?cidTexte=LEGITEXT000006072026&idArticle=LEGIA RTI000006653613&dateTexte=&categorieLien=cid”.
504 “Dans aucun cas le perdant ne peut répéter ce qu’il a volontairement payé, à moins qu’il n’y ait eu, de la part du gagnant, dol, supercherie ou escroquerie”.

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can base a claim on their immoral conduct \(^{505}\), except when suffering harm as a result of another party’s immoral conduct. The combination of the two articles reflecting the maxim is largely similar to SCL’s rejection of uncertainty and chance in transactions, with a serious concern to public safety and morality.

**Responding to the second part of the thesis question, this chapter stressed how Shari’a law possesses the quality of general competence.** It stressed that it possesses the quality of dual competence, by encompassing human nature in its Jurisprudence. Utilizing its ethics oriented and mind and spirit reforming divine Jurisprudence, it firstly reforms human conduct and thought process prior to regulating his conduct through its Jurisprudence; it is this encompassing of the needs of human nature into detailed and specific Jurisprudence, resulting in genuine change of behavior, and reflected into commercial practice that constitutes the dual competence of Shari’a law.

To successfully achieve its dual competence, Shari’a law utilizes its two distinguishing concepts that human should not endure hardship, and cannot coexist unless all human beings unite; consequently, when setting its laws, Shari’a law ensures the self-growth of human beings on the one hand, as well as growth towards society at the same time.

To understand the true spirit and fundamentals of Shari’a law and SCL, and to comprehend any restrictions or restructuring exigencies imposed on any of its financial tools and instruments in Chapter 2 of Part 2, the chapter discussed the Maqasid and Masalih of Shari’a law. Through that process, it also became clear how Shari’a law becomes compatible with universal ideas of social and economic justice, and share similar objectives of “Common Good”, “General Welfare” or “Common Safety”. Both allow for necessities as well as luxuries,

\(^{505}\) See Mattila, Heikki E. S. **Comparative Legal Linguistics: Language of Law, Latin and Modern Lingua Francas.** Farnham, Surrey, England: Ashgate, 2013. This is a view subscribed to and agreed to be many authors such as Joseph Pothier.
and for the purposes of self-development, as well as the feeling of success in achieving what is personally valuable.

To further understand the noble ends and intentions of Shari’a law, the chapter further elaborated on the basic rules governing Fiqh al Mu’amalaat; those rules ensure that all transactions are exemplified with fairness and justice, and refrain from containing any elements of abuse, speculation and gambling, which may result in harm and damage to the concerned parties. To further the understanding of its noble ends and intentions, the 3 precepts of the prohibition of Riba, Gharar and Maysir have been thoroughly discussed.

Another important question is posed, and whether SCL precepts are truly alien to non-Muslim state laws? The objectives and values of the 3 precepts are compared to the objectives and values of French law as a case study of western secular law, as well being the primary trigger of this thesis. The chapter then establishes that despite changes to the articles of the French Civil Code, those changes are only in terms of form, but not in substance; those standards have changed in form on a gradual basis, and due to external political and economical factors over the course of many years. The 3 precepts in both Shari’a law and French law are therefore identical in essence and origin, and are therefore not alien to non-Muslim states. Conducting commerce and finance according to the precepts is therefore realistic, as only private and public interest are their ultimate objective. The equivalent of the precept of prohibition of Riba is le prohibition d’Usure, the equivalent of the term Gharar can be found in French law when certain articles and provisions that when read collectively, provide for values and objectives almost identical to Gharar. Finally the equivalent of the precept of the prohibition of Maysir can also be found in French law, and specifically in the section regarding Aleatory Contracts in the French Civil Code.

After the dual competence and the ability of Shari’a law to reform human mind and spirit followed by incorporating their wellness into its Jurisprudence has been discussed, the next coming chapter will discuss the specific and technical competence of Shari’a law. Specifically, the discussion will revolve around whether and how Shari’a law can restructure current
modern complex financial products into more ethical just ones, using its ethics oriented and focused Jurisprudence. This upcoming analysis in Chapter 2 will aim to, collectively with Chapter 1, provide a fully comprehensive answer to the second part of the thesis question.
Chapter 2

Does Shari’a Commercial law have the Specific Competence to Govern Modern Complex Commercial and Financial Transactions?

Is Shari’a law’s Jurisprudence and its Jurisprudence-based contracts capable of effectively restructuring modern day complex commercial and financial products, and to more ethical and just alternatives? In the previous chapter, we have extensively highlighted the distinct dual natured and general competence of SCL, and by its ability to integrate human nature and its wellness into its regulatory framework. In this chapter, the objective is to focus on the specific competence of SCL, and by carrying out an examination of SCL from a proficiency perspective. Specifically, whether Shari’a law’s Jurisprudence embedded into its contracts are realistically capable of offering restructured alternatives to the modern conventional complex commercial and financial products; equally important, whether restructuring and financial engineering can be done on a continuous basis. Examinations will be carried out on financial derivatives as case studies of complex financial products.

The objective of SCL is solely dedicated towards the promotion of the real economy, and being “the part of the economy that is concerned with actually producing goods and services, as opposed to the part of the economy that is concerned with buying and selling on the financial markets” 506; SCL does not promote paper economies. Islamic financial institutions are usually dismissed by western “sophisticated” banking professionals as backwards and remaining in the dark ages, and due to their strict religious rules; it has however been suggested in 2012 that the opposite is true, where it is the western bankers who have much to learn from the Islamic Financial institutions 507.

507 See generally Fraser, Ian. “The West has much to learn from Islamic Finance”. Published on www.qfinance.com on 2 May 2012.
2.1 Shari’a law “is of considerable controversy” and is not suitable for modern transactions: An erroneous perception

In reference to the above mentioned case law pertaining to the lack of reliable uniform global codified Shari’a legal standards, as well as a religion lacking normative legal powers, also bring another point to surface; an erroneous perception exists, and at the very least from court and doctrinal findings, that Shari’a law is not competent to regulate modern commercial transactions.

In the Beximco case, the judge also mentioned that the “fact there may be general consensus upon the proscription of Riba and the essentials of a valid Morabaha agreement does no more than indicate that, if the Shari’a law proviso were sufficient to incorporate the principles of Shari’a law into the parties’ agreements, the defendants would have been likely to succeed”.

In Petroleum Development Ltd v Sheik Abu Dhabi, a dispute arose over an oil concession, granted by the Sheikh of Abu Dhabi to Petroleum Development (Trucial Coast) for a period of 75 years, granting the right to drill and win mineral oil within a specific area of Abu Dhabi. Over the question of the governing law of the contract, Lord Asquith of Bishopstone had decided that be prima facie that of Abu Dhabi’, and which was grounded on Koranic law; however “no such law can be said to exist”.

He had actually dismissed Shari’a law from the case on grounds that “The Sheikh...

510 See 18 ILR (1951).
administers a purely discretionary justice with the assistance of the Koran” 513. Dismissing it as “primitive at best” 514, he stated that “it would be fanciful to suggest that in this primitive region there is any settled body of legal principles applicable to the construction of modern commercial instruments”. He therefore applied “principles rooted in the good sense and common practice of the generality of civilized nations” 515.

In another court case called the Affin case 516 and which was held in Malaysia, and quite shockingly coming from a Muslim country, it gave a different weight to the problem of lack of unified and standardized legal standards. In this case, Affin Bank Berhad (the “Claimant”) being an Islamic bank, entered into an Islamic financing agreement with its customer Mr. Zulkifli Abdullah (“the Defendant”), and who was also an employee of the Claimant at the time of entering into the agreement. Following the terms of the Bai Bithaman Ajil agreement 517, the Claimant purchased a house from a vendor, and immediately resold it back to the Defendant, where the latter was to make deferred payments for the purchase price the bank incurred plus a profit.

After several payments were made, the Defendant had defaulted. Starting legal proceedings, the Claimant demanded an amount of RM 958,909.21, being the original price plus all sums payable by the defendant over full duration of the contract. In examining the case, the judge decided according to his Common law standards of fairness, held and evoked Section 75 of the Malaysian Contracts Act, drafted in a common law form. Accordingly, he decided that only an amount of RM 582,626.80 from the total amount was due, on grounds that “it would be inconsistent with his right to the full tenure if he could be denied the tenure and yet be required to pay the bank’s profit

513 See 18 ILR (1951).
514 See Ibid.
515 See Ibid.
517 Those types of “deferred payment sale agreements” refer to Islamic home mortgages
margin for the full tenure”, and that claiming profit on the already paid amount and therefore generating profit on the same amount twice was unacceptable 518.

In relation to the question of dismissal of Shari’a law, the judge referred to the Bank Kerjasama Rakyat Malaysia Bhd v Emcee Corporation Sdn Bhd 519 where the judge stated” As was mentioned at the beginning of this judgment, the facility is an Islamic facility. But that does not mean that the law applicable in this application is different from the law that is applicable if the facility were given under conventional banking. The charge is a charge under the NLC. The remedy available and sought is a remedy provided by the NLC. The procedure is provided by the Code and the Rules of the High Court 1980. The court adjudicating it is the High Court. So, it is the same law that is applicable, the same order that would be, if made, and the same principles that should be applied in deciding the application”. Consequently, his decision was that “it is not a question of Syariah law” 520. It is clear from the judge’s quote that he did not see that using rules and principles from the classical era were suitable for modern day cases 521.

After demonstrating the above case law as evidence to how Shari’a law is viewed as primitive and incompetent, this chapter will focus on the how those court perceptions and analysis are erroneous.

518 See Ibid P.67-68.
519 See [2003] 2 MLJ 408
520 See Ibid. P.75.
2.2 Complex Financial Transactions and Derivatives

2.2.1 Complex Financial Transactions

Although there is no one universal definition of a complex transaction, they are commonly included under the term Structured Finance, which is a term that refers to “highly complex financial transactions offered by many large financial institutions for companies with very unique financing needs. These financing needs usually don’t match conventional financial products such as a loan” 522; it is basically a transaction “involving the transfer of assets to raise cash, frequently, with the additional goal of achieving certain accounting, regulatory, and/or tax treatment. Such a transaction may or may not involve a securities offering” 523.

Despite their possible toxic spillover effects when negligently handled, and at times leading to global financial meltdowns such as the 2008 meltdown, the benefits of Structured Finance are many, in theory. Benefits include but are not limited to financing unique asset classes neither structurable nor financed through traditional methods, contributing to more complete capital markets, minimizing transactional cost, reducing borrowing costs, providing funding and liquidity by converting illiquid assets into cash, and sheltering corporations from potential operating liabilities 524; ultimately they offer financial hedging.

2.2.2 Financial Derivatives as Complex Transactions

It has been previously mentioned in this thesis that the growth levels of the Shari’a based commercial and financial industry have reached a point where hedging their positions cannot go ignored any longer; it is therefore imperative that Shari’a based financial and commercial products are hedging compatible. It goes without saying that this must be realized without violating its ethical based Jurisprudence, which provides it with its edge over secular conventional hedging products; Financial Derivatives are those financial products which are used for hedging financial positions, and employed as a strategy aimed at minimizing or eliminating risk. They protect the investor against change in the spot value of an underlying asset or currency \(^{525}\).

One of the many definitions to the term Financial Derivative is set by the international financial reporting standards (IFRS) by the London-based International Accounting Standards Board (IASB), which defines it as “a financial instrument whose value changes in response to a change in the price of an underlying, such as an interest rate, commodity, security price, or index” \(^{526}\); in simpler terms, their financial performance depends on the performance of and is derived from other financial instruments \(^{527}\).


\(^{526}\) See Chorafas, Dimitris N. Introduction to Derivative Financial Instruments: Options, Futures, Forwards, Swaps, and Hedging. New York: McGraw-Hill Pub, 2008. P.33. Another definition for a derivative is a “security whose price is dependent upon or derived from one or more underlying assets. The derivative itself is merely a contract between two or more parties. Its value is determined by fluctuations in the underlying asset”. Visit http://www.investopedia.com/terms/d/derivative.asp#axzz2CE9zyMjm

\(^{527}\) See Roberts, Brooks, and Don M. Chance. An Introduction to Derivatives and Risk Management. Eighth Edition. 2009. P.1. In general, there have been many definitions along the same lines, some critics of the above definitions say that while not necessarily inaccurate, can be incomplete, ambiguous, over-inclusive, and typically fail to capture the nature and scope of derivative transactions. See Timothy E. Lynch. “Derivatives: A Twenty-First Century Understanding”. Loyola University Chicago Law Journal. 43 (2011). P.15-16.
2.3 Functions of Derivatives and general problems

When conducting commerce, there are generally two types of risks, firstly business risks, and secondly financial risks; they revolve around uncertainties related to interest rates, exchange rates, stock prices and commodity prices. Derivatives are then used for Risk Management, Price Discovery, Operational Advantages and Market Efficiency. Notwithstanding their own operational risks, and their criticisms, financial derivatives in theory can come in handy and allow for better financial management.

2.3.1 Derivatives in conventional Risk Management and Price Discovery

In terms of Risk Management, this usually takes place either by hedging and / or speculating. Using hedging as “insurance”, businesses are then insured against losses when negative events occur; insurance against any losses are either total or partial. It should also be noted that with derivative products, hedging does come at a price, so although the losses arising from risks are either abolished or minimized in theory, it does not necessarily mean that the cost of hedging itself is justified; incurring unjustified expenses for the hedging process may be accounted for losses themselves, and since no counter value is gained.

In terms of Price Discovery, entering into derivative contracts can allow for inclination to participate in the markets, and allows one to determine a price on a spot basis; for business management, one is able to avoid the uncertainty that markets hold for the future, and where and when price changes may negatively affect

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529 Visit http://www.investopedia.com/articles/basics/03/080103.asp#axzz2CgkJ6CSx

business management and performance. Furthermore, it allows for certain operational benefits such as lowering transaction costs for businesses 531.

2.4 Aleatory Contracts: A false sense of security

Derivatives are not without their dangers. Without entering into a lengthy analysis as to the reasons for derivatives being risky products, as well as outcomes of debatable nature, the middle approach and stance taken in this thesis, and which will be that derivatives when mishandled can produce risky and potentially dangerous outcomes.

Derivatives are described by some as contributing to “the development of a far more flexible, efficient, and resilient financial system that existed just a quarter-century ago”, 532 however, others have mentioned them as “financial weapons of mass destruction” 533.

When derivatives are purchased for the purposes of hedging by parties wishing to insure their transactions, parties selling the derivatives speculate on the risk factor(s) and the probability of triggering events taking place to generate their profits; derivatives therefore contain a strong gambling nature, and landing them in the category of Aleatory contracts. The latter is defined as being a “contract in which at


least one party’s performance depends on some uncertain event that is beyond the control of the parties involved”

Given the aleatory nature of derivative contracts, they therefore provide a false sense security to parties looking to hedge their investments, and due to 2 reasons:

Firstly, when parties who intend on hedging their investments and businesses, they may be incurring heavy expenses in fear of an event that may very well not take place; this outcome can be considered as a new type of risk independently. Hedging parties take out derivative contracts on the basis that the latter will be covering their losses in the case a triggering event takes place; in the case the event does not take place however, the purchasing party would have then incurred expenses that could have been saved, and more constructively used for further expanding its business.

Secondly, derivatives do not necessarily provide investors the guarantee they will receive insurance payments. In the 2008 financial crisis, many of the derivative-hedging product providers were not in possession of the amounts due payment when the triggering events occurred, and resulting in the insured parties assuming even more losses. It is this aleatory nature of conventional derivatives that render them akin to gambling, and providing a false sense of security.

To conclude on this section, financial derivatives can be double-edged swords. They are “like electricity-dangerous if mishandled, but also capable of doing enormous good”


535 See general criticisms and comparisons between Islamic insurance (Takaful) vs. conventional financing.

2.5 The general incompatibility of conventional derivatives with SCL

As opposed to the aleatory nature of today’s conventional Derivatives, and where usually one party ends reaping all the benefits, derivatives can be restructured where both parties can benefit. This is certainly well achievable if restructured according to the divine principles of commerce, combined with a progressive and forward-thinking view.

Not all Derivatives are problematic in the eyes of SCL by default, or as a matter of principle according to the SCL’s principle of Freedom of Contract as previously mentioned in this thesis. Only Derivatives that are not structured in accordance to the essential rules governing Fiqh al Mu’amalaat, or that include prohibited subject matter, are the ones that become prohibited by SCL. Structures or any of the prohibited elements of Riba, Gharar and Maysir are the ones that are prohibited. This, by default, would mean that they do not promote the intentions and objectives of Maqasid and Masalih al Shari’a.

2.5.1 Prohibition on grounds of Riba

Some Derivative products are prohibited on grounds of Riba. We have seen before that the subject matter of a contract must be religiously legitimate and permissible; an example of contract subject matter prohibited on grounds of Riba, is one that includes interest rate(s), and is therefore haram. Being a contract element that individually constitutes unjustified excess, it is therefore not the Derivative product as a whole that is unacceptable in principle, however it is only this specific interest rate element that renders the Derivative contract overall null and void.

2.5.2 Prohibition on grounds of Gharar and Maysir

Derivatives are also prohibited on grounds of Gharar and Maysir. Many of the Derivatives and other complex financial transactions are highly speculative in nature,
and are therefore Aleatory contracts; they promote a gambling spirit and gambling activities, and it is this element of speculation that leads to sharp price variations in the markets 537.

Derivatives structured on speculation causing high uncertainty in price determination, and wild asset price fluctuations 538 are several; Forex (Currency Exchange) and Stocks Trading can be representative examples. Similar to Riba, it is this uncertainty that renders the above type of contracts null and void.

Furthermore, while there may be certainty in pricing for some Derivative products, delivery of the contract objects is not guaranteed. As previously explained, in order for a transaction not to be annulled on grounds of Gharar and ignorance (Jahl), contract subject matters must exist at the time a transaction is concluded, as well as being instantaneously capable of being delivered. For this reason, according to SCL, no contract with an object not in possession, or at least in the constructive possession of a seller may be permitted, with certain exceptions such as agricultural products; existence of the object of the contract also guarantees collateral in case of non-performance of the contract. Once again, it is not certain Derivative products that are unacceptable in principle, however only in the case when one or more of the prohibited elements are included, and that would render them null and void.

2.6 Incompatible conventional Derivatives with SCL and proposed restructures

In this section, the compatibility of some of the most well known conventional financial Derivatives used for hedging transactions will be examined, and against Shari’a law’s Jurisprudence, represented by the Standards and Agreement. In the case a Derivative product is not compatible with SCL, restructuring and compatibility proposals will be made, and in

538 See Ibid. P.17
accordance to the Standards and Agreement. This process will aim to demonstrate how SCL contracts although implement religious Jurisprudence, are nevertheless highly detailed, proficient and possess the quality of specific competence to restructure and govern modern complex transactions.

To narrow down Derivatives to specific groups, regardless of the many classifications available, and “no matter what anyone tells you”, they are four types: Futures, Forwards, Options and SWAPS 539. So how are they structured and what are their primary functions? Do SCL rules and contracts have more secure and ethical alternatives to propose?

First and foremost, given the principle of Freedom of Contract, none of the above Derivatives have been automatically excluded by the Standards for being conventional Derivatives; only in the event when a constitutive element(s) in the Derivative(s) product conflicting with Shari’a law’s Jurisprudence has been found, is it then excluded 540. According to the currently known Derivative structures, they are not compatible with and therefore prohibited by SCL in terms of contract form. The general prohibition for Derivatives by SCL in terms of basic legal form, is that they are considered binding promises, and which “are converted to a sales contract pertaining to the future without an offer and acceptance” 541. SCL therefore does not permit a contract that fails the basic form requirements.

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540 See AAOIFI Shari’a Standard No. 20. P.371.
541 See Ibid. P. 372 citing Resolutions of the International Islamic Fiqh Academy, Resolution No. 63 (1/7).
2.6.1 *Forwards*

According to the conventional Forward contract, it is a “*cash market transaction in which delivery of the commodity is deferred until after the contract has been made. Although the delivery is made in the future, the price is determined on the initial trade date*”\(^542\). This type of Derivative is relatively simple, and is a type of contract binding two parties to an agreement to sell / purchase an asset at a specific future date, and for a specific price \(^543\); it is a type of arrangement that can be contrasted with spot contracts, where an asset is sold / purchased on a spot basis and immediately. This type of contract is found to be very valuable when trading in Foreign Currency Exchange for example, and where it is used to hedge and protect against future foreign currency risk \(^544\); they are also however used to “*speculate on the price movement of the underlying asset*”.

This type of a contract is one entered into for peace of mind, and when uncertainty prevails over the market price; by locking prices for “*forward delivery*”, price changes for both parties do not become a subject of concern, and either guarantees the delivery of the product at the maturity date of the contract, or a law suit in the case of failure to deliver \(^545\).

2.6.2 *Futures*

This type of contract is similar to the Forward contract. It is a “*financial contract obligating the buyer to purchase an asset (or the seller to sell an asset), such as a physical commodity or a financial instrument, at a predetermined future date and price. Futures*”\(^543\).

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\(^{544}\) See Ibid. P.4.

\(^{545}\) Visit http://www.moneyweek.com/investment-advice/glossary/c/commodity-forwards..
contracts detail the quality and quantity of the underlying asset; they are standardized to facilitate trading on a futures exchange. Some futures contracts may call for physical delivery of the asset, while others are settled in cash. The futures markets are characterized by the ability to use very high leverage relative to stock markets" 546. It is a contract often undertaken by parties who do not know each other, and when traded on exchange, provides a mechanism for honoring the contract 547.

Despite the fact that the main difference between Futures and Forwards is their place of exchange, the former as opposed to the latter is conducted on organized markets standardizing their terms; both are binding contracts, and where all rules applicable to Forwards are similarly and equally applicable to Futures 548. In both types of contracts, they are equally used for hedging against price uncertainties, and provide peace of mind to the parties of a transaction. Furthermore, both Forwards and Futures are designed to be an overall effective tool for general and short-term risk management 549.

Forwards and Futures in their current conventional forms and structures conflict with SCL. According to the Standards, it specifically states, “it is not permitted to undertake futures transactions according to the Shari’a, either through their formation or by trading in them”. Identified as contracts in which legal effects take place at a determined future date, either through cash settlement or counter-contracts, one main reason which likely prohibits their conclusion, is due to the fact that they “rarely end in actual

delivery and possession”, and therefore are not allowed 550. It is therefore prohibited to undertake Futures contracts “either through their formation or trading” 551.

Forwards are included in the Standards as contracts with “both counter-values delayed” 552, and under two types of contracts, both containing subject matter on a deferred basis. As for the first contract, it is when a commodity becomes a liability through description with a deferred price; this type of contract is not permitted, since payment “is not done promptly”. The second contract is when the commodity is ascertained, however both a delay in delivery and payment are stipulated in the contract; this is equally not permitted 553. It will be seen that delay in delivery may only be acceptable, provided the full payment of the price is made in advance 554.

Since the intent of purchase, delivery and expressing seriousness of conducting commerce are all compulsory in SCL based transactions 555, and since structuring transactions must be done with a view to eliminating unjustified increase, uncertainty and gambling, the Salam contract is a SCL viable replacement to Forwards and Futures.

2.6.3 The alternative: The Salam Contract

A Salam contract is the equivalent of the conventional Prepaid Forward Sale; historically, merchants of Madina (formerly known as the city of Yathrib) engaged in

551 See Ibid. P.363-367, (2/2/3), (3/3) and (5/1/2). See also AAOIFI Shari’a Standard No. 10 (3/1/3) P.166.
552 See Ibid. P.364.
553 See Ibid. P.364.
555 See debates and views from different schools of thought as well as regarding engaging in forward contracts for purely financial purposes See El-Gamal, Mahmoud A. Islamic Finance: Law, Economics, and Practice. Cambridge (UK: Cambridge University Press, 2006). P.82-89.
1 to 3 year fruits forward-sale contracts 556. It is typically a short-term contract, but could be entered into for longer periods. The structure of the Salam contract in its simplest form, is when both the buyer and seller enter into and conclude a Salam contract, for which payment of the full transaction amount takes place in one day, with the Al Muslim Fihi (goods subject matter of the contract in a Salam contract) to be delivered in the future 557.

The Al Muslim Fihi can only be specified on the basis of their attributes such as type, quality and quantity; they cannot be attributed to an individual supplier, factory, batch or field. Following the approval of the Prophet Muhammad of this type of contract, jurists concluded that the Salam contract constitutes an exception to the general prohibition of sale of non existent properties, as well as ones that are not in the possession of the seller at the time of sale. Jurists generally allowed this type of contract due to the fact that it allowed farmers access to capital in order to buy seeds, fertilizer and other material to aid in growing their crops 558.

A Salam contract has several advantages. Primarily it makes financing available for people in need of it and on an immediate basis. Parties to Salam transactions benefit in the sense that they are allowed to raise capital immediately to cover their expenses, and till their products to be sold in the future become available, ripe or mature. This is particularly useful for small and medium size businesses in agriculture, as well as all trades and other industries who are in similar need for immediate working capital, and for as long as they are able to deliver the products at the agreed future date(s). Ample time is given to utilize the raised funds to ensure the commodity is delivered

Furthermore, purchasing parties also benefit from below market prices, marked at the time the contract was concluded, as opposed to the price that would have been fixed at time delivery was to take place.

2.6.3.1 Salam Contract conditions

To avoid the potential abuse of Salam contracts in a manner where structuring them may lead to transactions shrouded by Riba and Gharar, there are certain conditions that must be met, and for the transaction to be truly different to conventional Forwards and Future contracts. Firstly, and in terms of form, the contract maybe labeled as a Salam, Salaf or even sale contract; regardless of the formal labeling, the principle notion of the contract would be an agreement over deferred delivery of the *Al Muslam Fihi* in return for spot payment.

Secondly, there are two further sets of capital related conditions that must be respected, as well as those of *Muslam Fihi* related conditions. Firstly, as for capital related conditions, capital may be permitted in the form of fungible goods, material value and of usufruct nature to be used by the purchasing party, and as a counter value. As expected, the parties must know the capital at no uncertain terms, and in order to avoid any potential disputes; the capital may be in the form of cash, fungibles or usufruct. Most importantly, and being the rule that adds value and eliminates uncertainty in this contract, is the requirement that payment be made immediately, and on a spot basis. This is in fact where the term Salam comes from, meaning “peace” or “safety”; the primary objective and structure of the Salam contract is the avoidance of any uncertainty and disputes. A spot payment made with

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560 See AAOIFI Shari’a Standard No. 10. P.165.
561 See Ibid. P.174.
a delay in payment to a maximum of 2-3 days is accepted, and provided that it is not on the same day or after the date of delivery itself. Furthermore, the capital may not be a Salam loan and / or a repayment of a debt by the seller 563. The reasoning behind this rule is that according to SCL rules, sale of debt is not allowed 564.

Thirdly, there are also compulsory conditions related to the Al Muslim Fīhi; it must be of fungible nature, with specifications capable of identification by weight or count, and articles of which do not differ between each other in any significant manner. This equally applies to manufactured and traded products, of which are manufactured according to standardized specifications, and under a specific trademark. This type of standardized commodity should also be expected to be available under normal conditions at the time and place of delivery, and not in special circumstances. The reasoning behind the above requirements is simple, being that if the parties were to conclude a transaction the subject matter of which is a car with special specifications, and the result of that delivery was specifications other than those agreed on, the contract would then be annulled on grounds of Gharar; the objective of flexibility would have been lost to rigid rules, and the purpose of the contract defeated.

Removing the single product is there to ensure that the commodity would be available in normal circumstances, and to remove the element of Gharar, ensuring that the seller will be able to deliver on the due delivery date. Although the specification need not be specific to a single item, it is required that the commodity be clearly known to the parties in terms of quality, and by reference to common and standard practice. This would be deemed sufficient, and would not annul the contract on any Gharar grounds. In terms of quantity, it would need to be known by reference to weight, measurement, volume and number. Availability should also take place in

563 See AAOIFI Standard No. 10. Rule No. 3 (3/1).
564 See Ibid. P.174.
normal circumstances on a specified date and place of delivery, and to eliminate any uncertainty or ambiguity, which may lead to a dispute 565.

From the above, this thesis concludes that the Salam contract is a far more cost effective risk-hedging contract, and as compared to those of their conventional forwards and futures contracts. Firstly, in the case where sellers are in need for immediate cash, entering into a Salam contract is far more cost effective than taking a loan from a bank or another financial institution; the purchaser would not have to suffer from paying back the loan principal in addition to the interest rates. As a result of the immediate availability of financing, it prepares the seller to make the commodity available. Secondly, the Salam contract acts as an excellent means for hedging against price fluctuation.

As opposed to a conventional futures or a forward contract, the payment of the contract amount in full eliminates the possibility of disputes between the seller and the purchaser over price changes, and as a result of any change to supply and demand, or any seasonally dictated price variation. Finally, it also protects one of either party from amending terms and conditions in an attempt to benefit from speculative behavior, or lack of seriousness of commercial exchange; it provides protection against one party attempting to gain at the expense of the other party’s financial well being.

In a Salam contract, since the full amount has already been paid, a party intending to amend terms to a contract in order to take advantage of price variation simply cannot do so.

565 See Ibid. P.175
2.6.4 Options

This type of derivative represents a “contract that allows the holder to buy or sell an underlying security at a given price, known as the strike price. The two most common types of options contracts are put and call options, which give the holder-buyer the right to sell or buy respectively, the underlying at the strike if the price of the underlying crosses the strike. Typically each options contract is written on 100 shares of the underlying” 566.

Serving as a security, an Option contract when bought by a party gives the right and / or option but not the obligation, to either buy or sell an underlying asset for a Strike Price; an Option to be bought is called a Call Option, and an Option to be sold is called a Put Option 567. Every Option has a maturity date, and is either to be called or put anytime before the maturity date; this is the case in the United States, or only on the maturity date itself, as is the case in Europe 568.

Option contracts are used for two different purposes: speculating and hedging. In terms of speculation, one may anticipate or bet on either the appreciation of the market, or even make profit by the depreciation of the market because of its versatile nature 569. In terms of hedging, and when considered from an insurance perspective, an Option contract can be thought of as an insurance policy against the downturn of investments; the purchaser limits the downturns and can only enjoy the upside of investments and in a cost effective manner 570. Offering the same advantages as

Forwards and Futures, it bears a payable premium to offer the hedging option, similar to an insurance policy 571.

According to their current form, the only obligation arising out of an options contract is when a purchasing party orders the seller to deliver the purchased item; Options as per their current structure are not permitted by SCL 572. The reasoning is that they “do not come under any one of the Shari’a nominate contracts”, and “since the object of the contract is neither a sum of money nor a utility or a financial right which may be waived, then the contract is not permissible in Shari’a” 573.

2.6.4.1 The alternative: The Arboun Contract

The Arboun contract, which derives its title from the Arabic term “Down Payment” 574, is a contract that is not entered into singularly; the contract would be paid as a partial down payment of a contract price, and tied to an ascertained asset(s). In practical terms, when entering into a transaction over an asset, a purchaser would forward a down payment to a seller to hold the asset, and where the latter would deduct the amount of the down payment from the full price of the asset. He would also have the right to retain the amount in the case the purchaser revokes the contract; this is very similar to a conventional Call Option. Despite the similarities in structure, the difference to a conventional Option contract is that the right to which the down payment is tied to, is the asset subject matter of the Option, and not the right to trade in itself 575.

572 See AAOIFI Shari’a Standard No. 20 (5/2/2) P.367.
574 Free translation.
575 See AAOIFI Shari’a Standard No. 20 Rule 5 (5/2/3/1). P.367.
The above proposed contract although may seem identical to its conventional alternative, is not. Firstly, and in a conventional Option contract, there can be a great element of uncertainty. In the case where a purchaser pays a premium on a Call Option and “calls” on the Option before its maturity date, the seller then has the obligation to deliver the commodity; it cannot always be guaranteed that the seller will be in possession of the commodity. Unless a condition has been stipulated in the Option contract that the seller must be in possession of the Option’s asset for the duration of the contract as a condition precedent, as well as a schedule with the exact specification and delivery details, the contract would be shrouded with Gharar as well as Maysir, and therefore rendering it null and void; this would inevitably lead to disputes. In short, the advantage of an Arboun over a Call Option is the guaranteed availability of the asset, and which ensures the avoidance of disputes.

Secondly, in an Arboun contract, and as opposed to a Call Option, it is true that in both cases the purchaser would have lost his down payment or premium, however a difference does exist. In a conventional Call Option, if the purchaser does not call on the option before its maturity date, he would have as a consequence lost his financial investment, and in addition to the seller increasing his capital by trading in a simple right; the purchaser would have not received any counter value whatsoever. In the case of the Arboun contract, although the purchaser would seem like he had similarly lost his financial investment, the purchaser’s capital would not have increased over a simple right. In the view of this thesis, since the payment of the Arboun was to hold an asset, the temporary holding of the asset can be considered as renting the asset, or can be considered as temporary ownership; the financial remuneration of the seller would have therefore been justified, albeit temporary.

Furthermore, in relation to the seller, since he had put the asset on hold, whether for a temporary rent or purchase for the benefit of the purchaser, the seller was not able to
sell the asset to a third party, potentially losing profit. Since the purchaser did not call the Option, the seller would have been remunerated for the loss of potential profit that he could have generated, in the case he could not sell the asset to a third party. While similar in form to a conventional Option, the difference lies in the substance of the Arboun contract, being the simple availability of the asset, and which allows both parties to the transaction to benefit, and potentially on a temporary basis.

2.6.5 Swaps

Occupyng a position of central importance in the Over The Counter Derivatives market, it is an agreement where its subject is an exchange of cash flows at one point in future time 576. In a conventional Swaps contract, its subject is “the exchange of one security for another to change the maturity (bonds), quality of issues (stocks or bonds), or because investment objectives have changed. Recently, swaps have grown to include currency swaps and interest rate swaps” 577; generally, they include an exchange over interest rate, foreign exchange rate, equity price or commodity price 578.

Swaps gained their popularity as a result of the flexibility they provide investors. They allow subscribers to “swap” their capital raising loans with another, in case the initial terms and conditions did not work to their favor; usually this arrangement would be executed through a mediating bank that executes the Swap transaction 579, and which makes a profit for arranging it. Swaps can be categorized into Interest Rate and Non-Interest Rate Swaps, although most commonly they are used in the interest

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rate and currency markets. In those cases, they help limit or manage exposure to fluctuations in interest rates, or to acquire lower interest rates compared to ones that companies were able to obtain. They allow hedging against interest rate exposure, and to lower amounts needed to service debts. They are designed to be an overall effective tool for long-term risk management.

It is impossible to examine each and every type of Swap in this thesis, a few examples are used for the purposes of demonstrating their incompatibility with SCL, and that the latter does have alternatives; due to the wide variety of swaps, analysis will be slightly more extensive than the above Derivatives.

2.6.5.1 Commodity Swaps

The simplest example to use would be Commodity Swaps, which are most commonly used with oil products. Parties to a Swap can either exchange fixed and floating payments based on a commodity index, or exchange payments when based on an

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An excellent example to be used is one illustrated on the U.S Energy information Administration. In this example, one oil refinery in one country shorts (buys) crude oil and longs (sells) its refined products. It would enter into a SWAP agreement to cover this exposure, and to guarantee a risk in future price hike; in such a case, it would speculate through the use of floating/fixed-priced swaps. To manage risk, a refiner and a producer would enter into a SWAP agreement, where for the term of its duration the refiner would agree to purchase oil from the producer for $25 per barrel in monthly cash payments, and where the producer agrees to pay the refiner the

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settlement price of a futures contract based on a contract market price; the Swap contract notional amount is 10,000 barrels. The party owing the bigger amount depending on the NYMEX market price will pay to the other party owing less on the day payment is due by the end of the month. If the market price is for example $23 and less than the agreed $25, then the producer will not suffer any losses and the refiner will pay the $2 difference x 10,000 barrels = $20,000. In the opposite situation, if the market price is $28 and more than the $25 agreed price, the refiner is protected from such price increase and producer will then pay $3 difference x 10,000 barrels = $30,000.

2.6.5.2 Individual Salam Contracts as an alternative to Commodity Swaps

The above example of a SWAP contract is not compatible with SCL. When examining its structure, effectively each payment may have been made as a price for a separate individual forward contract. For the purposes of hedging, a nominate amount was capped, and would not exceed a specific limit every month, and for the duration of the agreement. Since the parties entered into a SWAP agreement, it can be considered as a portfolio of future contracts for a specific duration serving the needs of its parties. Similarly, one can enter into individual Salam contracts every month for the duration of the agreement.

2.6.5.3 The Istisna’a Contract as an alternative to Commodity Swaps

Since the requirement of spot payment may be limiting for the hedging options of parties against price exposure of a commodity, and who are not capable of making immediate payment, the Istisna’a contract maybe proposed as another alternative for hedging against price fluctuations. An Istisna’a contract is defined as “a contract of sale

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585 i.e NYMEX which is a Designated Contract Market Visit for example http://www.cmegroup.com/company/nymex.html Last seen 10 December 2012.

586 See Ibid.
of specified items to be manufactured or constructed, with an obligation on the part of the manufacturer or builder (contractor) to deliver them to the customer upon completion” 587.

Concerning the manufactured contract subject matter, and labelled as al-Masnoo (the manufactured), an Istisna’a contract is a contract designated for manufacturing processes, aimed at transforming a commodity from its original raw form, through manufacturing or construction labor. It is not permissible however for this type of contract to be concluded for existing commodities, and since commodities can only be specified and not designated.588

Istisna’a contracts offer excellent hedging against price exposures for both parties. All pricing regulations come as a result of SCL’s controls against Gharar and uncertainty, as well as to avoid parties taking advantage of the transaction(s) for the purposes of speculation. According to the Istisna’a contract pricing rules, it is a requirement that the price be known and fixed at the time of concluding a contract; payment can be made in either cash settlements, or to allow for the usufruct of the asset itself, or any other related asset. Most importantly, and as distinct from forward Salam contract, the price to be paid in this type of contract can in fact be deferred, or paid within a specific period of time. If the subject of the contract is one produced in several stages, a portion of the price may be paid in installments, and according to undisputed and specified stages of delivery. In the event that prices are paid in different stages, it is also permitted that prices vary with varying delivery dates. For ensuring certainty leading to informed business decisions, neither party is permitted to demand the other party for price reconsideration at any point during the contract performance, even if production costs differed589.

587 See AAOIFI Shari’a Standard No.11. P.197.
589 See Ibid P.183-184. For the full and detailed set of laws, see Ibid.
2.6.5.4 FOREX Swaps

In a conventional Forex transaction, one currency is exchanged for another either on a spot basis, or via a futures transaction. The exchange can be either done immediately after a contract is concluded, or on a forward basis where the same day’s exchange rate would be applied, however actual delivery to be made at a future date. Typically, a Forex Swap would take place when by way of example, US Dollars would be exchanged for UK sterling pound on a spot or future basis in the first part of a transaction. In the second part of the transaction, the UK Sterling pound would be then re-exchanged back to US Dollars at a later date and on a future basis.

Conventional Forex Swaps are not permitted by SCL according to their current structures. They are based on conventional future contracts conflicting with Salam contracts, as well as the possible absence of the intention of delivery according to actual practices \(^590\); they do also conflict with SCL’s “trading in currencies” rules. Generally for Forex transactions to be valid, parties must be in constructive possession of the values to be exchanged, as well as ensuring they do not default in delivery \(^591\). In the event that the currencies are of the same kind, the amount exchanged must be equal \(^592\). Finally, the exchange cannot aim at establishing any monopolistic positions and / or with any “evil” consequences to individuals and societies \(^593\).

2.6.5.5 The alternative: Wa’ad Currency Swaps

To avoid the risks in exchange that may be found in conventional FOREX Swaps, the Wa’ad (Promise) based Swaps are a SCL alternative. In the opinion of this thesis, a

\(^{590}\) See Shari’a Standards No’s 10 and 20.

\(^{591}\) See Ibid Standard No.1.

\(^{592}\) See AAOIFI Shari’a Standard No. 1. Rule No. 2. The actual methods amounting to constructive possession have been specified in a decision of the International Islamic Fiqh Academy No. 53 (3/6); Majallah al-Majma’. 6.2 / 786 and Al Baraka seminar No. 9 (9/5).

\(^{593}\) See AAOIFI Shari’a Standard No. 1. P.5.
Wa’ad (Promissory) contract is a “unilateral expression of obligation to perform an act, transfer a right or refrain from something. A promise is one party’s commitment, for which that party may suffer specific consequences including being obliged to pay compensation to the promisee”. A promissory note can be a replacement for a Forward contract in the case of Forex Swaps designed for hedging purposes. Due to its unilateral nature, the enforcement of the promissory note by law depends on the jurisdiction in question.594

In a SCL Wa’ad Forex Swap contract, a party may purchase from another party US Dollars on a spot basis and for a spot rate. Instead of entering into another transaction on a Forward basis, where the elements of uncertainty shroud the transaction, the same purchasing party may enter into a Wa’ad to enter into a Sarf (exchange) contract, and to buy the USD back from that party at a specific future date; the advantage of the Wa’ad contract over the Forward contract is the elimination of uncertainty, by avoiding entering into a contract over vague rates. Additionally, this transaction is not a pure transfer of risk. The Wa’ad agreement to repurchase the currency at a later stage gives ample time for the seller who raised his funds to reinvest it elsewhere, and generate more income before then. The transaction is not only limited to immediate cash raising and hedging against market risks, however it provides an opportunity to increase wealth in parallel, and away from the dangers of speculation.

The full status of a unilateral and bilateral Wa’ad contract in the Standards is currently in the process of development595, however to the extent Standards are developed, two rulings concerning promises in currency exchange contracts have been made. According to those, in the case a promise is legally binding in one

jurisdiction, only those unilateral promises can be made and given legal force; a bilateral promise may not be permissible, and even for the purposes of hedging against devaluation of risk. A bilateral Wa’ad defeats the purpose of any proposal, since it replaces a conventional contract by committing its parties to its bilateral terms, which contradicts the flexibility of a promissory note.

2.6.5.6 The Mubadalatul Arbaah “Profit Rate Swaps” (PRS)

Following the development of the Agreement, the Islamic Financial industry now enjoys more global confidence, and owing to the fact that its Jurisprudence is now certainly reliable and able to regulate complex transactions. In March 2012, SCL based SWAP products also experienced further developments, and following the introduction of the new (Profit Rate Swap) Mubadalatul Arbah standards, and “as part of its own on-going efforts and commitment to building safe and efficient OTC hedging markets, across both global and Islamic financial markets”. The structure of the SWAP transactions is modeled and based on the Agreement, and which represents a major step forward in managing cash flow risks for various Islamic Capital Market instruments, such as the Sukuk; the latter enjoys an expanding market that naturally needs more structured hedging products.

This type of PRS transaction is very similar in structure to Interest Rate SWAPs. Two parties secure loans from a financial institution, where one party is to make the loan repayments to the lending institution according to a fixed interest rate, and where the other party is to make repayments according to a floating interest rate; accordingly,

596 See Shari’a Standard No. 1 Rule No. 2 / 11. P. 8 & 15.
one party may “swap” their fixed interest rate with the other party’s floating interest rate, and vice versa.

This type of conventional SWAP agreement does not in itself contradict SCL in terms of structure, however since the very subject matter of the transaction is interest rates, which are prohibited subject matter, the transaction overall becomes null and void. Once again, the exchange of floating repayment conditions with fixed repayment conditions as a transaction structure is in itself permissible. In the case of the PRS transaction, and for it to be fully permissible, the subject matter is not prohibited interest rates, but asset backed interest free bonds, known as Investment Sukuks.

As for the transaction subject matter, the Islamic Investment Sukuks are defined by the Standards as “certificates off equal value representing undivided shares in ownership of tangible assets, usufruct and services or (in the ownership of) the assets of particular projects all special investment activity”. They allow ownerships in leased assets, usufructs, services, Murabaha, Salam, Istisna’a, Mudaraba, Musharaka, investment agency and sharecropping, irrigation and agricultural partnerships. An individual “Suk” is then a debt instrument that comes as a replacement to the conventional debt securitization instruments; being asset-backed, purchasers of Sukuks effectively purchase rights in their underlying assets, such as real estate or any movable asset.

An example of a transaction of this type would be when 2 parties wish to hedge their investments against market fluctuations. Specifically, Party A being a company on the one hand, issues Islamic Bonds (“Sukuk”) dated 1 February 2013 for an amount of 10,000,000 USD (Ten Million U.S Dollars), to be repaid on a 12 month period and on a monthly basis; repayment to the investors purchasing the bond will be made on a floating rate basis, and according to the LIBOR benchmark rate. For risk management

purposes, it would like protection against exposure to any rate fluctuations that might negatively affect it, and make its repayments on a fixed rate instead. Party B being an Islamic bank on the other hand, a financial institution with a fixed profit rate portfolio, would like to take advantage of market floating rates, and instead make some of its fixed repayments on a floating rate basis, as opposed to all repayments made for fixed rate.  

By entering into a PRS Agreement dated 25 January 2013 (the “Trade Date”), both parties would be able to “swap” their repayment rates. Party A will therefore be paying Party B fixed profit rates, and where Party B will be paying Party A profit rates on a floating basis. After both parties enter into the Agreement, they will then have 2 choices to govern the PRS; either by way of a two Sales Structure PRS, or a Single Sale Structure PRS.

a) The Two Sales Structure

Firstly, in entering into a two Sales Structure PRS, both parties will then enter into 2 DFT Terms confirmations, one relating to the Fixed Profit Rate leg of the PRS, and another relating to the Floating Profit Rate leg of the PRS; both contain Wa’ad agreements and an undertaking to enter into further DFT Terms confirmations, only when the first Wa’ad is exercised then expired; the date of which Party A will be issuing its Sukuk will be 1 February 2013, is called the Effective Date.

According to the terms and conditions of the PRS, Party A undertakes in its Wa’ad (Undertaker) to purchase assets from party B if required by the latter, and to be executed according to a Murabaha sale (cost-plus sale); this Murabaha sale executed

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by a Murabaha Asset Sale Confirmation would constitute a transaction under the TMA. Party B will also be exercising its Wa’ad (Exerciser) to purchase assets from Party A in a Murabaha sale if required by the latter. As for the timing of entry into a Murabaha sale, it must be determined by the parties, and would naturally take place either at the start or at the end of the Calculation Period, provided that all Conditions Precedent are satisfied by that Effective Date; every month during the 1 year duration of the period is a Calculation Period. All DFT Terms Confirmations must include the SCL required information, such as all product description and conditions precedent including but not limited to the Effective Date, Business Day, Purchase Dates, Payment Dates, Buyer and Seller details. All such details must be clearly set for the avoidance of any ambiguity and any potential related disputes.

b) *The Single Sales Structure*

Secondly, the parties may enter into a Single Sales Structure. According to this structure, both parties will still enter into two DFT Term Confirmations, however only one will be executable, and for one reason. For the Murabaha Sale to be executable, one Exercise Condition must be satisfied, and as a Condition Precedent, that being the profit generated in one calculation period be greater than zero. Naturally in such a fixed / floating arrangement, when the profits are calculated by a Calculation Agent and in reference to a calculation formula, if one of the rates is positive, the other rate would be negative and therefore only one Wa’ad with a positive rate is executable, and therefore only one Murabaha Sale. As a result, and contrary to the two Sales Structure PRS, only one asset flow and one cash flow will take place. All the above-mentioned DFT Confirmation details are equally applicable to this Single Sale Structure, and equally in high detail.

By combining the appropriate contracts together, the result was a well structured and successful hedging transaction, based on and compliant with SCL rules. Several
points are to be made. Firstly, unlike other conventional hedging transactions, the transaction did not simply transfer risks, but also allowed the parties to generate profits away from exploitation of the financial conditions by one party. Furthermore, it allowed parties to generate their profits against a legitimate contract object; this comes contrary to other transactions that hide illegitimate contract subject matters behind others that are legitimate.

Second, with the recent availability of the TMA as well as the DFT Confirmation, uncertainty and gambling are prevented. With the utilization of simple contracts combined together, and complying with the rules of contract combinations, the above transaction sets an example to the fact that combining contracts together can achieve progressive effective results in Shari’a commercial and financial products development. It has been reported that PRS serving as hedging products, have now been used by financial institutions for risk management, and for notional amounts in excess of $US 2 billion 602.

Finally, it is in the opinion of this thesis that the Wa’ad contract used in PRS agreements is an excellent flexible contract which has a strong potential in playing a role in future SCL product development. By entering into a Wa’ad agreement, and taking into account the governing laws and binding legal force of a given jurisdiction, parties are able to enter into a first transaction, but withdraw from a second financial transaction if compelled to; this is very similar to an Option contract, however without suffering financial losses caused by a premium. In the case of a conventional contractual obligation, where two obligations set for two parties are pre-agreed and irrevocable in one contract, a second obligation must be fulfilled, even if it comes at

602 See Islamic Derivatives” on the Clifford Chance website summarizing Islamic derivative area overview and transactions advised on by the law firm as a result of the availability of the TMA. Visit http://www.cliffordchance.com/expertise/practice_area/finance/islamic_finance/islamic_derivatives.html. Last seen 26 December 2012.
the financial expense of one of the parties and after a change of circumstance. This is explained in a little more detail below.

2.7 Unilateral and Bilateral Wa’ad Contract: The multipurpose instrument

Since a Wa’ad is a promise to enter into a subsequent commercial contract, note that the commercial contract would only be effective once the undertaken Wa’ad has been executed; the concept of one contract coming into force and becoming effective conditional another contract is prohibited. It is a principle that aims to stop one party from setting abusive terms and conditions on another party. By way of example, one party to a contract may set a contract price knowing that there will be a second contract he can benefit from. For this reason, in the above PRS agreement, the second contract to be entered into is separate from the first, and to avoid any abusive intentions.

From the above, and in the two-sale structure, although the first contract may have been successfully executed, the second contract was to become effective and entered into force only via a Wa’ad, the second party may however choose not to enter into the second contract; this may take place when new overriding circumstances arise in the period between the first and second contract, and which may potentially lead to the financial detriment of one of the parties. In this situation, since both contracts were separate, the second party would not suffer financial losses, as well as a guarantee that the first party will not set abusive terms and conditions inconsiderate of his deteriorating financial situation. Furthermore, another reason for the prohibition is that while two parties may enter into a contract, they may not necessarily be in possession of the counter-values at the time they enter into a contract 603; the rules therefore prevent abuse as well as uncertainty.

A Wa’ad provides flexibility to both parties, not only to the promising party. After a documented promise has been made by the promissor, but prior to the execution of the promised transaction, both parties are mutually allowed to amend the terms and conditions of the promise. 

From the above, Unilateral Wa’ad notes should not be viewed as non-binding notes that demonstrate lack of seriousness in commerce. In guarantees used in purchase transactions, using a unilateral binding promise, an institution may accept a security deposit called Hamish Al Jiddiyah (Margin of Seriousness) as a security for a promise to purchase. If no sale contract has been entered into, the deposit cannot be kept on down payment, but can only be retained solely on trust. In case the customer does not finalize his purchase, the institution may not retain the amount, except if the institution suffers financial damages.

2.7.1 The Wa’ad Contract and product development

The SCL industry today has demonstrated a large potential for more growth and product development, for both hedging and non-hedging purposes; up to the year 2012, and in Malaysia alone, a wide range of hedging products based on the Wa’ad promissory note have been put on market. Examples of products recently developed and modeled on the two unilateral undertakings structure include the Islamic Profit Rate Swap (IPRS), Islamic Cross Currency Swap (ICCS), Islamic Forward Rate Agreement (IFRA), FX Forward-I and the Islamic Train-I of the Promissory FX contract-I of Ijarah Rental Swap of Islamic Promissory Forward Currency contract,
Cross Currency Profit Rate Swap (CCPRS-i), Wiqā’ Forward Rate Agreement, Wiqā’ Profit Rate Swap, Wiqā’ Cross Currency Swap as well as Islamic Options.

2.8 Contract Combinations: A promising future

The process of Contract combinations is “a process that takes place between two parties or more, and entails the simultaneous conclusion of more than one contract” 610; it aims at both structuring new and restructuring already existing commercial and financial products. Further to the principle of Freedom of Contract, and subject to the Standards, it has been already demonstrated that modern day complex Derivatives can be restructured to more secure alternatives. It is in the opinion of this thesis that by understanding and utilizing contract combinations, there can be no limit to SCL based financial engineering.

2.8.1 The rules

Firstly, the specific principles and rules of each contract independently within a combination of contracts have to be respected; parties cannot enter into contracts that include any prohibited subject matter and / or structure. Each contract must be permissible individually and before it is blended into a set of contracts 611.

Secondly, the general principles and rules of a combination of contracts have to be respected; once every individual contract within a combination of contracts becomes

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609 For example visit http://kfh.com.my/kfhmb/v2/searchCntView.do?micrositeId=&contentTypeId=3000&displayPage=%2Fver2%2Fcontent%2Fstandard.jsp&contentId=8085&displayPhaseId=-1&phaseId=&pageTypeId=12875

610 See Shari’a Standards No. 25. P.445.

611 See Ibid. P.446.
permissible and valid, the combination of all contracts then blended together may be collectively permissible 612, and provided the combination rules are respected.

Not in an exact systemic order, the first general rule of contract combinations according to the Standards, is that no transactions expressly prohibited by SCL can be entered into. An example can be one such as combining sale with lending, combining two sales in one deal or two transactions in one transaction 613.

Secondly, Contract combinations may take any of the following forms:

“Combining more than one contract without imposing any of them as a condition in the other, and without prior agreement (muata’ah) to do so.

Combining more than one contract while imposing some of them as conditions in the others, without prior agreement to do so.

Combining more than one contract subject to prior agreement (muata’ah), but without imposing any of them as a condition in the others.

Agreement to conclude the deal through any of different contractual forms as will be finally decided in the future” 614.

Thirdly, it is possible to combine more than one contract in one set, however “without imposing one contract as a condition in the other, and provided that each contract is permissible on its own” 615. As previously mentioned, this rule aims to stop the combination from generating any SCL restriction(s), which would not have been generated by an individual contract(s) otherwise.

612 See Ibid. P.452 citing legal opinions of several scholars including but limited to those of Ibn Taymiyah 29/132.
613 See Ibid. P.452.
615 Ibid. P.446.
Fourthly, contract combinations cannot be used in anyway to circumvent any and all SCL general and specific rules, which are set to provide protection against the vices of Riba, Gharar and Maysir. By way of example, in multiple transactions involving multiple sales and purchases, a series of contracts can be concluded and executed consecutively, however only once every contract has been independently fully executed by way of honoring its obligations; the reasoning behind this is to avoid *Riba al Fadhl* and *Bai’ul Eina* 616. The Standard’s description of the latter term is when one party, for instance, sells the commodity to another for one hundred dollars, on a deferred payment basis, and repurchases it from the other for eighty dollars payable on spot; in this transaction, the sale of the commodity in that manner is used for no purpose other than a means to a usurious end.

Contract combinations cannot also be used to practice Riba, in terms of demanding excessive compensation, whether in terms of excessive repayments or demanding extra services 617. This is mostly true of loan agreements that stipulate conditions of repayment 618.

Concessions are made and in exceptional circumstances. Although Riba, Gharar and Maysir are strictly prohibited, whether separate or combined, they can only be allowed in implied and subsidiary contracts; by implied and subsidiary contracts, reference is made to those contracts that were not explicitly included in the original contracts. Since progress is one of the pillars of Shari’a law, all concessions are therefore dictated by the need to achieve an overall greater Shari’a-permitted interest 619; this has been previously mentioned as looking to achieve transactions realizing the bigger Maqasid of its laws.

616 See Ibid. P.446.
617 See Ibid. P.446.
618 See Ibid. P.453.
619 See Ibid. P.446-447.
Finally, when contracts are combined, there must be no conflict of underlying objectives. Contracts are instruments that are simply means to ends, and for the purposes of achieving specific objectives; it is therefore not possible to combine different contracts, which have different rulings and effects. If the legal rulings for each contract within a combination of contracts do not contradict each other separately, then the combination becomes acceptable and valid.

2.9 The progressive proficiency of Shari’a law

Is Shari’a law reform responsive and open to changes? We have demonstrated in an extensive manner above how Shari’a law’s contracts and Jurisprudence can still structure new financial and commercial products, as well as restructure current conventional products to more ethical and safer alternatives. However, what is the specific tool that allows for reinterpreting and placing the old wine in new bottles? In this coming section, it will be argued that it is Ijtihad that is responsible for and allows for such reform responsiveness.

2.9.1 Reform Responsiveness: Ijtihad

Reforms are implemented through the contributory tool of Ijtihad. Ijtihad means “endeavor” or “exertion of mental energy in the search of legal opinion to the extent that the faculties of jurists become incapable of further effort.” In a legal context, it refers to a legal jurist who formulates a rule of law on the basis of a Dalil (evidence), and which

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620 See Ibid. P.446
621 See Ibid. P.453.
is found in an official source. It is the opposite of Taqlid or “imitation”, which refers to the acceptance of a rule, not on the basis of evidence drawn directly from a source(s), but by virtue of authority of other jurists. For the most part, the activities of Ijtihad resemble western “interpretation”, although they cannot be considered similar due to different lexical meanings 624.

2.9.1.1 What is Ijtihad?

Ijtihad as a tool allows reforming Shari’a law rules to meet constantly changing needs, and as opposed to imposing permanent rigidity on people; this flexibility is one of the most essential pillars of Shari’a law. According to the Imam Al Shafie’s classic theory, he states “From the tenth century onwards the juristic consensus was that a rule of law must be derived either from the Qur’an or the Sunna or by analogical deduction there from. But by way of a postscript, classical legal theory recognized that in some cases strict analogical reasoning might entail injustice and that it was then permissible to use a more liberal form of reasoning………… ”Equity” and ”the public interest” were now seen as the purposes of Allah which it was the task of jurisprudence to implement in the absence of any more specific indication in the Qur’an or the Sunna” 625. Furthermore, other legal sources and tools such as Istihsan also allow Shari’a law’s constant development and updating, and which “came to signify a breach of strict analogy for reasons of public interest, convenience, or similar considerations” 626.

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Several techniques in the process of Ijtihad exist, which aim to create and modify existing laws; they are adopted by highly qualified and selected professionals, who follow a rigorous process regulated by highly detailed and proficient rules and standards. By following a valid methodology(s), it provides the juristic authority to derive legal rules from textual sources of Sharia law, as well as credibility to the jurists. The process ensures that the outcomes do not conflict Shari’a principles and objectives.

2.9.1.2 The “Fit for Purpose” approach: The spirit of the Maqasid

Since Ijtihad is a main tool and source of law responsible for legal reforms, it follows a Purposive / Contextual Interpretation, which in fact has been initiated by Imam Al-Ghazali. It is this method that preserves and enshrines the true spirit of Shari’a law, and ensures that all laws are fit for purpose. This comes as the opposite of the Literalist / Strict manner of interpretation, which in fact was started by the Imam Al Shafi’e, with the intention of deviating as little as possible from the original texts, and before its expansion to more flexible approaches. In order to reach purposive / contextual legal reforms, certain techniques are to be applied when exercising Ijtihad; those techniques ensure that the Maqasid of Shari’a law are reflected in each and every law. It is this that represents the proficient, purposive spirit of Shari’a law. For a Mujtahid (a person exercising Ijtihad) to qualify for Ijtihad, he must have a “perfect


628 See Fiqh al Mu’amalaat Rule No. 2 P.158-160.

understanding of the purpose(s) of the law”, as well as having a “command in the skill of deduction on the basis of this understanding” 630.

In the process of Ijtihad, a Mujtahid is to firstly “examine the case in light of Shari’ah”. If the case in hand is acceptable in light of Shari’a, he “then considers its consequences in the context of the condition of its time and its people”. Provided that no evil or harm would result from the case in hand, it must then be “submitted to reason”. By reason, reference is made to one’s feeling “that it will be accepted by reasonable people, then [they should] give [their] opinion in general terms if the case concerns a matter that is generally acceptable”. If the case in hand cannot be resolved by generality, a specific and more specialized opinion should be given 631.

It is essential to note that the use of Ijtihad is not only limited to matters that have not been previously addressed, but also used to provide solutions for specific problems that have been generally covered by the Quran and Sunna, with no specific solutions. Umar the second Caliph appointed after the death of the Prophet, and one of the leading Companions to the Prophet, had exercised Ijtihad himself over matters that had their rules clearly stated in both the Quran and Sunna 632. Ijtihad was known to be the method par excellence for arriving at a truth about a certain matter, developing the intellect and broadening the understanding of the objectives of the Shari’a 633.

631 See Ibid. P. 1455-1456 citing ibid.
Through Ijtihad, flexibility and fluidity of Shari’a law is guaranteed, contrary to its flawed image over centuries being anything but flexible and fluid. This negative connotation stems not from the rigidity of Shari’a law itself, but generally speaking out of a large number of Muslim’s literalist approach and intolerance to legal reasoning, or out of inexplicable blind belief as opposed reasoning in general. A logical and supportive quote used by a judge stating that “Reading and understanding the Qur’an implies the interpretation of it and the interpretation in its turn includes the application of it which must be in the light of the existing circumstance and the changing needs of the world”. He then continues to mention that, had the prophet’s words been final and binding centuries ago, and without further expanding and interpretation to fit modern needs, then Islam would have no role in today’s modern world.

2.9.2 Is Ijtihad still a valid source of law?

This next coming part of the chapter dedicates itself to the reasons why Ijtihad and Shari’a law reforms were long delayed: not for the reason that Shari’a religious laws are centuries old and not open to reforms, however as a result of the influence of backwards political Islamist forces. An argument will also be made in favor of the need to openly admit Ijtihad, which challenges the current status quo.

2.9.2.1 The debate

First and foremost, a validated prophetic Hadith proves the continuing validity of Ijtihad as a source of law, as well as its continuing vital importance. Once the Prophet had asked one of his companions named Mu'adh ibn Jabal, at a time when he had appointed him as a judge to Yemen, as to what would be his source of law in deciding cases. Mu’ddh replied: "I will judge with what is the book of God (Qur’an)". The Prophet then asked: "And if you do not find a clue in the book of God?" Mu’ddh answered:

”Then with the Sunnah of the Messenger of God.” The Prophet asked again: ”And if you do not find a clue in that?” Mu’ddh replied: “I will exercise my own legal reasoning”. The Prophet was reported as being perfectly satisfied with these answers by Mu’ddh, which signified an approval by the Prophet” 635. As a result, “It is obvious and more than obvious that Ijtihad is still and will continuously remain as a valid source of law” 636.

The permanent application of Ijtihad for the purposes of continued, progressive and eternal universality of the Shari’a resulted in the outbreak of debates, lasting ten centuries between the conservative and progressive opinions 637. For the larger portion of scholars, they are of the opinion that the doors of Ijtihad had been closed centuries ago. The controversy over the validity and authority of Ijtihad in terms of its permitted continuation, in the informed opinion of this thesis, is an issue of a political and sociological nature; it represents a classical example of a traditional clash between conservative and progressive jurists.

Two principle theories regarding its validity can be discussed. The first theory claims that the doors of Ijtihad had been permanently closed, and known as insadda babu al-ijtihadi 638; it further argues that while the source had not died in theory, it did in fact in practice. This idea of what we may call “exhaustion” on grounds that no one was qualified to reinterpret rules, was responsible for bringing out the misconception that Shari’a law had reached its maximum potential, and was no longer capable of reforming its laws, nor accepting any proposals for reforms.


636 Translation from “Il est évident, et même plus qu’évident, que l’Ijtihad constitue toujours une source valable de jurisprudence de la Charia. Cela n’a jamais cessé”.


During the Abbasid era, which not only saw the rise of Islamic schools of law, but also the end of the formative period, Shari’a law had been elaborated to a very high level of detail. Further doctrines had put progress including Ijtihad as independent reasoning to a halt; the freedom to exercise individual reasoning of the sacred law had progressively been under stricter scrutiny and allowed very little opportunity for progress. By the beginning of the fourth century, there was a general feeling shared between all the Shari’a law scholars of all schools that laws had been finally settled. The general consensus was that “all future activity would have to be confined to the explanation, application, and, at the most, interpretation of the doctrine as it had been laid down once and for all. This ‘closing of the door of Ijtihad, as it was called, amounted to the demand for taklid ………which now came to mean the unquestioning acceptance of the doctrines of established schools and authorities” 639. Although this opinion claims that the door was closed, being only a false perception, the fact that “in later generations also there were scholars who held that there would always be a mujtahidin existence“ 640.

The second opinion argues that the doors of Ijtihad have never been closed, but rather have been in continued use through history 641; it finds that the first theory seems rather outdated or missing in facts. It also argues that the controversy over the validity of Ijtihad had in fact only emerged in the 12th century Hijry. Many of the developments in positive law, legal theory and the judiciary can be traced back to the continuity of Ijtihad. During the fourth century Hijry (about 900 A.D) to the tenth century Hijry, the vast bulk of fatwas (legal opinions) had only brought their importance and their contribution as legal decisions and precedents to realization. Ijtihad continued by the Mujtahiddin up to the 12th century Hijri had experienced a

640 See Ibid. P.72.
very high level of legal sophistication using highly sophisticated techniques, and therefore had not been put to a halt 642.

2.9.3 Al Azhar Fatwa as a classical case of progressive Ijtihad

Reference is made to the Al Azhar fatwa regarding the question of whether interest rates as part of investment certificates issued by the Arab banking Corp were permissible, and whether it amounted to Riba 643. Receiving a request from the International Arab Banking Corporation, Al Azhar was to clarify whether customers receiving profit used to invest in permissible activities by the banks was permitted, and especially when the profits were pre-determined through interest rates 644.

After careful examination by the Islamic Research Institute, the latter confirmed that it was perfectly permissible to predetermine profits. It had been decided that the relationship between the depositors and the bank was that of an agency relationship, where the bank who had the know-how invests on behalf of the customers; the subject matter covered by the funds deposited in bank accounts were those of investments and not loans, and therefore were perfectly permissible. It was not impermissible for the bank to predetermine profits and guarantee losses for two reasons. Firstly, in order for customers to make an informed decision and organize their lives accordingly, predetermination of the profits was simply just and logical. Secondly, while according to the SCL parties are to enter into a Profit Loss Share agreement where it was permissible for the bank to guarantee profits for the investors, and since the investors are not equal in terms of finances. Furthermore, since the banks usually engage in large-scale economic activities, their losses are then most likely covered.

643 See Appendix 1 for a copy of the Azhar fatwa.
Furthermore, in resort to a moral hazard argument, and with very widespread corruption, it was only fair that those customers would have their investments and promised profits being guaranteed. Since the ultimate objective of banning Riba is to prevent harm being inflicted on the debtor who is in a vulnerable position, interest is banned on loans that are likely to involve a debtor in need; interest is then not banned on investments since the element of exploitation of the needful is not there. In short, every situation should be evaluated according to its own merits. It was stated in the Fatwa “Thus, we say that the bank investing money for a pre-specified profit becomes a hired worker for the investors, who thus accept the amount the bank gives them as their profits, and any excess profits (whatever they may be) are deemed the bank’s wages. Therefore, this dealing is devoid of Riba. In summary: we do not find any Canonical Text, or convincing analogy, that forbids pre-specification of profits, as long as there is mutual consent” 645.

Similarly, and in relation to other similar disputes regarding the same matter, the Azhar consistently declared that Government Investment Certificates and similar financial instruments such as those of Postal Savings Accounts containing interest were also permissible. The fatwa had been issued in request by the government who were losing millions of dollars to Islamic banks. Preset profits were perfectly legitimate provided mutual consent between both parties took place. It is also conditional the legal relationship stays as that of an Agency relationship and not that of a loan transaction.

Finally, and from the viewpoint of this thesis, this decision is not only contextual in the sense that it takes the overall spirit of the law into account, it is also a responsibly progressive Fatwa, as opposed to irresponsibly conservative. To elaborate, focus was made on the same moral hazard argument made by Al Azhar; since the depositors were not in a vulnerable position, no exploitation was therefore found. Assuming the

Azhar Fatwa had in fact banned the certificates on literalist irresponsibly conservative grounds, nothing but Darar (harm) come strongly into light. In an imaginary scenario where someone had earned his profits through his individual efforts, and at a later stage in life became forced to discontinue work for any health related reason, investing in such certificates would certainly guarantee flow of income and maintain his household and family. The combination of discontinued labour as well as deprivation of income potentially emanating from investment certificates as a result of irresponsible conservatism would have certainly destroyed households. Furthermore, many individuals who were never given the opportunity to receive education and gain profits through their labour would also be incapable of establishing and maintaining households, and once again as a result of irresponsible conservatism.

The Azhar decision being a progressive and purposive / contextually oriented one, as a demonstration sample of Ijtihad, was also very similar to common law reasoning in the opinion of this thesis. In the process of reaching a decision, it consulted and analyzed various decisions of previous Azhar jurists, all made within the 20th century 646. In reaching his decision in the manner similar to common law, the Azhar mufti quoted a previously made opinion / precedent, which stated:

“When one gives his money to another for investment and payment of a known profit, this does not constitute the definitively forbidden riba, regardless of the pre-specified rate. This follows from the fact that disagreeing with the juristic rule that forbids pre-specification of profits does not constitute the clear type of riba which ruins households. This type of transaction is beneficial both to the investor and the entrepreneur. In contract, riba harms one for no fault other than being in need, and benefits another for no reason except greed and

hardness of heart. The two types of dealings cannot possibly have the same legal status (hukm)” 647.

It can be clearly seen how in this fatwa, the focus is made on morals, and whether predetermined profits were those that truly destroyed the households of those in need; the opinion focused on the overall spirit of the law, and as opposed to the literary interpretation of a term(s).

As expected, the fatwa had not been met without criticism, and was considered defiant to literalist schools of thought in other countries regarding the same matter; by way of example, it contradicted the decision rendered by the Shari’a Appellate Bench of the Supreme Court of Pakistan 648. Other Shari’a law jurists in other jurisdictions, and especially those of the Hanbali ultra-conservative school of thought in GCC countries, unsurprisingly completely denounced such a decision.

This case is a classical example of what it means to reinterpret rules in a progressive manner, but within the legal boundaries of SCL, and showing how Ijtihad can be exercised in a manner that attracts public Maslaha in a contextual / purposive approach, focusing primarily on the people’s wellbeing. It does not violate any of SCL rules on the one hand, and implements both Maqasid al Shari’a on the other hand.

2.9.4 The Standards as progressive and ongoing Ijtihad

Another example representing progressive and ongoing Ijtihad, in the opinion of this thesis, is the creation and ongoing development of the Standards, as well as the Agreement themselves. The progressive and continuous updating of the Standards is an active and ongoing process of “exertion of mental energy in the search of legal opinion

to the extent that the faculties of jurists become incapable of further effort’; furthermore, all Standards go through a process of exertion to attain the objective of Jalb al Maslaha.

2.9.5 Why was Ijtihad not exercised to reform Shari’a law and consequently SCL for centuries? Possible scenarios

The first person to openly admit that Shari’a law rules needed reform and fresh reinterpretation in line with its divine principles, and to adjust to modern day circumstances was the Imam Mohammed Abduh in 1898; this was well before any of the reforms we have discussed in this thesis took place. He was an influential Islamic reformer, author, editor, a chief Maliki juriconsult, and a professor in Al-Azhar, a judge and chancellor in the National Court of Appeals of Egypt. Other scholars such as Iqbal in India who pursued the same theme, also argued for Ijtihad as well as independent judgment, as it “was not only the right, but also the duty, of present generations if Islam was to adapt itself successfully to the modern world”.

a) “Irresponsible Conservatism” and “Literalism”

We attribute to a large degree the delay for those long due reforms to Shari’a law to what we have previously labelled as “Irresponsible Conservatism”; this term refers to conservative and ultra conservative political Islamist forces. We refer to the decades long and rising literalist thinking and medieval-oriented political Islamist forces in the Middle East. The opposing opinions towards the above Azhar Fatwa serve as a good example of reform intolerance and obsession with literalist interpretation.

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649 For biography, see website for the Centre for Islam and Science. Visit http://cis-ca.org/voices/a/abduh.htm Last seen 25 March 2013.
In the Middle East, Muslim societies tend to be conservative and excessively God-fearing by nature, leading to little logic and little scientific religious thinking. In many Muslim societies, where there is a mix of both conservative and progressive Muslims, where due to the official role of religion in state and political structure, conservatives historically usually had the upper hand 652. Views of the ultra orthodox Muslims have been the most prevalent in recent years 653. Referring to the Imam Mohammed Abdu and his call to reform Shari’a law, he had similarly stated that while Shari’a law must progress constructively while preserving its principles, he called for “creative legal thinking” by the “independent and objective” and for freedom from taqlid (imitation) in order that “God’s wise plan for the consolidation of the order of the human world may be realized”. He further said that only scientific and objectively disciplined use of reason would prepare the Muslim world for the present and the future, and with a radical reconstruction of the Muslim personality 654.

In terms of the commercial and financial world, and in an increasingly globalized and capitalist modern world, if Ijtihad does not become officially allowed, and in order to allow societies to adapt to global factual changes of which they cannot afford to ignore, the result would be that the Maqasid would become pure fiction at best. By being selfishly, irresponsibly conservative and literalist, and deciding that Ijtihad is no longer allowed, people’s welfare and wellbeing become endangered.

Relevant to SCL and this thesis by analogy, yet a recent and explanatory case concerning the prevailing literalist approach taken by the majority of Islamic “scholars” is the debate over whether the Islamic veil is compulsory. In 2012, a thesis

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defended in Al Azhar in Cairo, Egypt confirming that the Islamic veil was not compulsory was published. The thesis in reaching its conclusions, analyzed the term Hijab from a purposive and contextual approach; it found that the Hijab rather referred to a “curtain”, “partition” or “separation”, and not the head cover. By focusing on the meaning of the term in the context of the time when it originated, the literalist approach had deviated from the purposes of the Islamic law and “Sahih Atafsir” and Maqasid al Shari’a. The verse to which all the literalist scholars gave all their attention had a very limited scope of application; solely the Prophet Muhammad’s wives.

The thesis also stated that interpreting the Quran and its terms only from a linguistic perspective was not a correct approach, and that taking the culture at the time the terms originated is the correct way to preserve the Maqasid and in their precise context. The literalist interpretation regarding the compulsory nature of the veil rejected any reasoning and relied only on literal text, and “as if Ijtihad is not to play a role”. It was also argued that they “interpreted the verses in their general sense, overlooking the reasons behind their revelation, whether they had a specific intention or simply had good intentions however incapable of exercising their intellectual capacity beyond a certain level due to any mental or emotional disorder, and this is not only with the so called veil, however they approached hundreds of important issues in the same manner”655. It is this manner of literalist interpretation to Shari’a law terms such as Riba in SCL that lead to endless debates regarding its meaning and scope of application.

b) **Sadd al Dhari’a**

Another reason why reformist Ijtihad has not been openly implemented is due to the exaggeration of what is known as *Sadd al Dhari’a*, literally meaning *blocking evil* 656 or “closing off the means that can lead to evil”; this is based on the previously mentioned *Dar’ al Mafasid* (repelling harm), and opposite to *Fath al- Dhari’a* (attracting harm). In a 100 page extensive research written by Sheikh Ibrahim Zaki El Din Badawy a Shari’a law professor in Faculty of Law, Cairo University, and discussing *Sadd al Dhari’a* in relation to the issue of Riba, he mentions that the Prophet’s companion Omar Ibn Al Khattab out of fear of evading the law “left aside nine tenths what is halal out of fear of Riba”. He further states that all companions, their followers as well as the grand imams have prohibited all what is subject to doubt in Mu’amalaat. Moreover, they had prohibited everything and anything related to Riba as opposed to prohibiting the main causes of Riba, out of *Sadd al Dhari’a*.

Regarding the method of exercising Ijtihad, the Professor openly and clearly stated that “this way of conducting Ijtihad is unacceptable in Mu’amalaat, of which originally all is permissible, and since it relates to the Masalih Al Maliyya (Financial Maslaha) and since their needs are dependent on it” 657. Although the research exclusively refers to and covers the subject of Riba, his view regarding the manner in which Ijtihad is generally exercised as unacceptable, refers to the Irresponsible Conservatism noted in this thesis by means of analogical scrutiny.

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656 Free translation.
c) Identity preservation

Although potentially an arguable contribution, Ijtihad may have been put to halt, and on what may be an unobjective struggle for identity preservation. This comes from witnessing a consistent pattern of a struggle for one nation(s) to preserve its identity, and in cases where a culture and / or laws of another nation(s) are imposed on them. Analogically similar to the case of Quebec and Canada, the Quebec government issues language usage and education-related legislation for preservation of their French- speaking identity 658. Very similar to Quebec, France also similarly adopts legislation aimed at cultural preservation, and amends trade rules to preserve their French culture. Examples are the limits on foreign advertising as well as television programs and films conducted in languages other than French 659.

Although the above examples in Quebec and France are not similar in nature to the case of Ijtihad, it is the argument of this thesis that the fundamental point of resisting imposition of foreign laws or laws of foreign origins is similar and by analogy. By denying Ijtihad, it is a reactive rejection towards what may seem as imposed imperialist rules; although illogical, it may be primarily aimed at preserving culture.

In this final chapter, focus was made on the specific competence of Shari’a law, and from a proficiency perspective; specifically, an examination was carried out on complex financial Derivatives as a case study, and whether Shari’a law was capable of restructuring them in the event they contained prohibited contract subject matter, and / or prohibited subject matter.

Forwards and Futures in their current forms and structures conflict with SCL, and where the alternative proposed by SCL was the Salam Contract, being the equivalent of the conventional

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Prepaid Forward Sale. As for the Options derivative contract, it is not permitted by SCL, and the alternative proposed by SCL is the Arboun Contract, which translates from Arabic to “Down Payment”. Finally the multiple forms of the Swaps derivative product are also not allowed in their current form. Commodity Swaps are replaced by a portfolio of a series of individual Salam contracts, as well as the alternative option of the Istisna’a contract is also offered. As for Forex Swap transactions, they are also not permitted in their current form, and are replaced by Wa’ad Currency Swaps.

As part of demonstrating the developments of the Shari’a Commercial industry, and modeled on the Agreement, the chapter introduces and demonstrates that the Islamic Financial industry now enjoys more global confidence in its ability to regulate complex transactions, and via the introduction of the new (Profit Rate Swap) Mubadalatul Arbah standards. Utilizing the Wa’ad contract, the structure of the transaction as modeled on Interest Rate SWAPs was thoroughly demonstrated; replacing Interest Rates by Sukuk, both the single and double sale structure were detailed.

As the financial industry continuous to grow and innovate more and more complex products over time, and not necessarily just and ethical in nature, Shari’a law also is well capable of indefinitely growing to structure and restructure ethical and just alternatives to those products, and by utilizing contract combinations; there can therefore be no limit to SCL financial engineering. To achieve SCL based financial restructuring, rules of each contract independently within a combination of contracts, as well as the rules of contract combination itself must be respected, and which are all designed to prohibit any potential abuse of parties. It is therefore reform responsive. This quality of reform responsiveness is afforded by Ijtihad, which is a tool allowing for reforming law using a Purposive / Contextual Interpretation, affording its “fit for purpose” quality Jurisprudence, based on its Maqasid and Masalih.

Despite the many disagreements and controversies over Ijtihad as an ongoing and valid source of law, the conclusion of this thesis is that Ijtihad is certainly a valid and continuously
ongoing source of law responsible for accommodating reforms. To make such a statement, reference is made to the Al Azhar fatwa authorizing interest rates as part of investment certificates, and after all the facts of the case were measured against the Maqasid and Masalih of Shari’a law. Furthermore, the creation and ongoing development of the Standards is a classical case of ongoing Ijtihad. The thesis also further concludes that the controversy over the validity of Ijtihad is not related to Shari’a law itself, but rather is that of a political and sociological nature, representing a clash between conservative and progressive jurists.

Finally, as to the reason why was Ijtihad was not exercised to reform Shari’a law and SCL for centuries is posed, and a few possible scenarios are provided. The conclusions of the chapter is that firstly, and to a large degree, the delay for those long due reforms to Shari’a law is a result of what we label as “Irresponsible Conservatism” and “Literalism”; in this specific context, reference is made to the intolerant conservative political Islamist forces who lack the ability of objective “creative legal thinking”, and instead focusing on literalist interpretation of Shari’a law, which unfortunately been the practice of the majority of Islamic “scholars”. Secondly, another reason why reformist Ijtihad has not been openly implemented is due to the exaggeration of what is known as Sadd al Dhari’a, literally meaning blocking evil or “closing off the means that can lead to evil”; this comes out of fear of tolerating any prohibitions and therefore amounting to Shari’a law evasion. Finally and admittedly arguable, Ijtihad may have been put to a halt, and in an unobjective struggle for preserving identity; this comes as a result of many of the Muslim states having their laws changed through western imperialism, and have been struggling to preserve their identity as a result.
Conclusion

The question of whether Shari’a law constitutes normative law is one responsible for stirring years of controversies between the various schools of thought over its legal nature, and especially with those of the Positivist school. In Chapter 1 of Part 1, Shari’a law has been clarified to be a legal science, being a unique blend of positive laws, legal doctrines and legal concepts that blend the temporal with the spiritual, all of which ultimately aim at man obtaining the approval of God. It is an immutable framework with ever changing and adaptable laws of special nature, with its highest primary sources being divine and of flawless supreme character and authority. With its casuistic nature, it allows for human reason to indesparably develop and reform those supreme laws over time, and for the purposes of accommodating constantly changing needs, however within its legal framework, and on a non-conflicting basis. All Jurisprudence set in different categories, they meticulously and comprehensively govern all types of legal and non legal human relationships.

Being non-codified laws in essence, Shari’a Commercial law applies Shari’a law’s ethics oriented Jurisprudence - which equally governs legal and non-legal matters- to commercial and financial transactions. Its Jurisprudence mainly focuses on regulating commercial and financial transactions against commercial abusive, effortless and exploitative profit oriented practices; it distinguishes itself from modern man made laws by guiding its followers to etiquette and morals driven commerce, and through its precepts and principles of “Contractual Fairness and Social Justice” and “permissibility”, all which aim at the overall wellbeing of society.

As much as the Shari’a Commercial industry has grown on an exponential scale, until recently, its legal standards were not unified on an international scale, resulting in great hinderance to the scale of growth of Islamic international commerce; Shari’a law’s Jurisprudence therefore needed major reforms in general, and ultimately for
facilitating international commerce. Focus is made on Shari’a law’s historical problems of suffering from arbitrary, disperse decisions and rulings, lacking consistency, objectivity, predictability, codification and reliability, as well as lacking international uniformity; naturally, its Jurisprudence was not reliable in terms of dispute resolution.

With the availability of several Islamic Schools of thought contributing on a major level to all of the above problems of Shari’a law’s Jurisprudence, light is shed on the differences between the Hanafi, Maliki, Shafi’i and Hanbali schools and the Shi’a schools. As a response to this dispersibility of schools of thought, the AAOIFI was established and its Standards were born, as well as the ISDA producing its first Agreement - all designed to facilitate and international commerce. Given that the Standards are relatively new, and in comparison to other international uniform laws responding to the same historical problems in conventional commerce and finance, a comparative analysis of the UNIDROIT Principles and the ICC INCOTERMs was drawn, concerning their capacity as representations of codified expressions of Lex Mercatoria. The objective of this comparative analysis is two fold. Firstly, to establish that the Standards and the Agreement play a similar role of serving as codified expressions of Lex Mercatoria, and secondly to provide them with similar credibility as the Principles and INCOTERMs by analogy. Following the comparative analogy, that the Standards play an exact role to the Principles and the Terms, specifically serving a) As rules of law governing a contract, b) As a means of interpreting and supplementing international uniform law instruments, c) As a means of interpreting and supplementing domestic law and d) A model for national and international legislators and e) as a guide for drafting international contracts.

Furthermore, the Standards are now considered the most reliable and credible uniform laws for regulating transactions of the international Islamic Financial
industry; this is due to its universal character, being flexible with the ability to grow, informality and speed, and its reliance on commercial custom and practice. Furthermore, it also possesses an autonomous character, sufficient to decide a dispute, as well as being a system of law; the latter quality refers to completeness, having a structured character, as well as the ability to evolve and being predictable. Support for the AAOIFI and its Standards has also tremendously increased, receiving international state recognition, and support from independent institutions and global Indices.

As for the other second major step towards the unification of legal standards and along the same lines as the Standards, the Agreement is designed to facilitate Islamic international transactions. It offers the advantages of conventional master agreements such as legal safety, significant savings on time and expenses in document preparation, as well as more netting. Despite being similar in structure to conventional master agreements, it does however factor in the limited purposes and scope of application in light of the permissible transactions under SCL.

In Chapter 2 of Part 1, and prior to an extensive analysis regarding the competence of SCL, an examination is carried out as to whether Shari’a law is normative law. The motivation to answer this question follows the publication of certain individual and institutional findings made in France, indicating a certain trend in the west, which reflects black letter law as being the sole mode of expression of a norm, and being a classical positivist approach; this school of thought refuses to recognize Shari’a law as proper normative law. Away from addressing the question of “what is law?” in general, firstly, Shari’a law is seen as normative law, not from the perspective that it becomes so once put in the form of positive black letter laws, however being the highest ultimate source and substance of state positive laws themselves. This is seen from its role in state constitutions from a cultural law dimension. From the
relationship of both terms “constitution” and “culture”, and in Muslim states, Shari’a law is then normative since to varying degrees, it dictates their culture, and therefore the behavior of its followers in those states. Forming the beliefs and values of its followers, those beliefs and values are then in return reflected, incorporated into and protected by state constitutions, and subsequently into all constitutional sub–positive laws.

Secondly, Shari’a law’s normativeness can be seen from its role in state constitutions and its role as a source of state legislation in a general manner. Shari’a law can either be fully and exclusively normative as the sole source of legislation, such as the case in Iran, Pakistan, and Saudi Arabia. It can also be partially normative, and serve as the main source but not sole source of legislation, such as the case in Egypt, the United Arab Emirates and Malaysia, where it only regulates specific areas of law.

Thirdly, being the ultimate source of normativeness, any law enforcement to Shari’a law is carried out by the State itself; the state and positive laws serve no more than coercive and executive roles, being solely a means to an end. This deeper view of positivism is that of Shari’a law itself, and which is expressly stated in the Constitution of Mecca; it is also seen in Saudi Arabia’s Basic Law. Shari’a law’s normativeness in relation to state positivism can be further seen via Repealing and Abrogation of laws, where two laws pose a conflict, and for the purposes of adapting to continuously changing needs, old laws are repealed and abrogated and replaced by more recent ones. Although this process of Repealing and Abrogation of laws is actually carried out by the state, the fact that the process itself is a requirement imposed by Shari’a law, and since the state and its coercive powers serve no more than a means to an end, the ultimate normativeness still comes from Shari’a law.

Finally, Shari’a law normativeness can be seen in cases of conflict of laws, where in cases Muslim states are signatory states to international foreign conventions, and do
so on a “Reservations” basis. In the case the convention’s rules conflict with Shari’a laws implemented as State laws, the latter then overrides the convention rules; it is this overriding power that demonstrates Shari’a law’s normativeness. This overriding power on a “Reservations” basis is of course valid and legitimate, and for as long as they are not “incompatible with the object and purpose” of the conventions.

Similarly, and for the purposes of strengthening the arguments made in this chapter regarding the normativeness of Shari’a law, an analogy is drawn with Jewish law as normative law in Israel, and simply as an example of a non Muslim State where religious law similarly plays a normative role. Jewish law is partially normative, and acts as a source of law regarding certain and specific areas. Recognized by Israeli legislation, “Jewish Law” is “religion law, whether written or unwritten”; this express wording precisely states that its normativeness is not a derivative of state positive law, but rather from its own autonomous normative power, and similar to Shari’a law in the same role. Being a signatory state to foreign conventions and similarly on a “Reservations” basis, Jewish law’s normativeness is also seen through its overriding powers in cases of conflict of law, despite its narrow scope of application. Following the above analysis covering how Shari’a law can be seen as normative law, their derivative substance can then be articulated and incorporated into western legal systems, and without the need to assume the form of western contracts and /or positive law to justify its normativeness; this would risk achieving the intended social and economic justice derived from its substance.

To respond to the second part of the thesis question, and to those who understand the full benefits of its fully comprehensive Jurisprudence, the question then becomes: To what extent is it sophisticated and competent to govern modern commercial and financial transactions? Chapter 1 of Part 2 demonstrates how Shari’a law possesses the quality of general competence, and in the sense that it possesses the quality of
dual competence by encompassing the facts about human nature in its laws. Shari’a law utilizes its ethics oriented divine Jurisprudence to firstly reform human conduct and thought process; subsequently after digesting the content, wisdom and intention behind all Jurisprudence, the trader then hopefully embarks on the trade, and genuinely with neither the will nor the need to bend any of its ethical rules for the sake of greed-driven profit. When all traders within the same commercial and financial domain share the same divine values, and put them in practice, this would form an ideal society driven by equality and justice. It is this encompassing of human nature and needs into detailed and specific Jurisprudence resulting in genuine change of behavior, reflected into commercial practice, that constitutes the dual competence of Shari’a law.

Shari’a law has two distinguishing concepts of which all its laws and Jurisprudence are based on. Firstly, that human beings are only part and component of the entire universe, of which the latter is there to aid and assist them; human beings are neither to be brought into this world to endure hardship, nor to exist without being given the necessary care and help. The second concept is that the duration of human kind cannot be realized except if human beings all unite, and co-operate to exist alongside within their communities and societies; this naturally arouses the concept of obligations. Consequently, when setting its laws, Shari’a law ensures the self-growth of human beings on the one hand, as well as the growth towards society at the same time.

To understand the true spirit and fundamentals of Shari’a law and SCL, and to comprehend any restrictions or restructuring exigencies imposed on any of its financial tools and instruments in Chapter 2 of Part 2, this specific chapter defines and discusses the Maqasid (intentions and objectives) and Masalih (interest) of Shari’a law; Shari’a law preserves both the Masalih Aama (Public interest) and Masalih Khasa
(Private Interest). Shari’a law and SCL are compatible with universal ideas of social and economic justice, and share similar objectives of “Common Good”, “General Welfare” or “Common Safety”.

The theoretical notions, ideas and findings of justice in Shari’a law are also wholesomely complimented with practical details, allowing their practical realization. More interestingly, the outcome of the divine Maqasid is essentially similar to some of the world’s greatest thinkers, such as Amartya Sen, and his Idea of Justice; his notions equally aim for securing an individual materially as a goal of social and economic justice, however allowing for necessities as well as luxuries, for the purposes of self-development, and the feeling of success in achieving what is personally valuable.

All transactions, legal and non-legal, are governed by basic rules governing Fiqh al Mu’amalaat; those rules ensure that all transactions are exemplified with fairness and justice, and refrain from containing any abusive, speculative or gambling elements, which result in certain harm and damage to the parties of the transaction. Those Shari’a law rules advocate the Principle of Ibaha (freedom of contract and transaction) - that substance and not form is the ultimate measuring criteria when evaluating which transactions are permissible and which are not – which warns not to eat people’s wealth in vanity, warn not to cause harm nor reciprocate harm, to encourage mitigation, to encourage ease on others and not to impose severity and hardship. Those are the rules all commercial and non-commercial transactions are based upon. Furthermore, transactions must not include any contract subject matter(s) or elements prohibited by Shari’a law, and must not violate any of the three precepts, being the prohibition of Riba, Gharar and Maysir.

Firstly, and in regards to the precept of the prohibition of Riba, a term very frequently misunderstood in western literature, it contains two main elements, being “the
increase of money”, and secondly “for no specific return for something else”; essentially, it is usury that amounts to exploitation. Being a vehemently condemned practice, it is a social and economic evil that produces extreme individualism, communal animosity and envy. Secondly, and further to the precept of the prohibition of Gharar, speculation in commercial transactions is prohibited, since it leads to uncertainty, and at times may lead to dire life threatening situations; generally speaking, when found to be considerable or major, and subject to other specific conditions, it can lead to the annulment of commercial transactions. Thirdly, and according to the precept of the prohibition of Maysir, no transactions with a “gambling” nature are allowed, and since the high risks involved make them “games of chance” or “games of hazard”; parties to such types of transactions, may suffer from total financial loss.

Another important question is posed, are SCL precepts truly alien to non-Muslim state laws? When the objectives and values of the 3 precepts are compared to the objectives and values of French law as a case study of western secular law, being the primary trigger of this thesis, it is established that despite changes to the articles of the French Civil Code, those changes are only in terms of form, however not in substance; those standards have changed in form on a gradual basis, and due to external political and economical factors over the course of many years. The 3 precepts in both Shari’a law and French law are therefore identical in essence and origin, and are therefore not alien to non-Muslim states. Conducting commerce and finance according to those precepts is therefore realistic, as only private and public interest are their ultimate objective.

According to the comparative analysis made in the chapter, the equivalent of the precept of prohibition of Riba in French law is le prohibition d’Usure. Historically, the provisions prohibiting Usury have been kept by the French kings and reproduced in a big number of orders, reflecting many changes in standards over many years, and dating back to well before the period of separation of church and state to the 800’s A.D; during that period, canonical laws had prohibited repaying loans with interest
in any shape or form. After many changes in social perception, the notion of generating profit out of profit started becoming publicly and widely known, and where the threshold of what constituted a usurious loan became defined by the state. For many years, the threshold faced many changes, and due to several possible scenarios, being firstly the separation of church and state, secondly the widening of social gaps and finally special economic interests.

The term Gharar, and similar to Riba, is not a precept alien to French law, and as a matter of fact to the contrary. French law contains articles and provisions that when read collectively, provide for values and objectives almost identical to Gharar. Both French law and SCL require certainty regarding transactional subject matter, in terms of quantity and quality. Both French law and Shari’a law are similar in terms of aiming to promote benefit and repelling harm. Despite a gradual distancing from the Canonical origins, and similar to the case of Riba, a gradual shift of legal threshold was realized by the state, and for the purposes of attracting foreign investors concerned by specific application of articles in the French Civil Codes. Over the course of time lasting for centuries, and starting from the era of King Francis I, laws regulating lotteries experienced many changes, all on grounds of benefiting the French economy, and especially at times of crisis, compensating for revenues lost from tax evasion. Up till the year 2012, lotteries and games of chance were tolerated to a certain extent, as they were not considered a public safety concern as before. All those change are only in terms of form and not in substance.

Finally, the equivalent of the precept of the prohibition of Maysir can also be found in French law, and specifically in the section regarding Aleatory Contracts in the French Civil Code. Both laws, ultimately in essence and origin, have a common objective to promote individual and communal growth; this is proven in the old explanatory works covering the elements of Jeu et Pari in French law, where the works stress in a
canonical tone similar to Shari’a law, that those games that did not balance the interests of the parties, are against natural law, as well as “L’ordre de dieu”.

As historically proven in explanatory works, French law banned certain types of jeu et pari, since such games waste the individual’s time and in a harmful manner; the individual fails to focus his efforts and talents in building a healthy life on an inter se level. By a large proportion of the population engaging in similar transactions, the concern is that those games would, on a large scale, result in a society leading destructive lives, and where individuals can no longer benefit from the talents and potential contributions of other individual citizens on an outré se level. Furthermore, jeu et pari further generates an individual destructive sense of creativity, aimed at generating profit out of greed on inter se level, naturally leading to the same result on an outre se level; those grounds of banning jeu et pari in French law are identical on grounds of banning gambling in Maqasid al Shari’a and its Masalih.

In Chapter 2 of Part 2, the final chapter, focus is shifted from the general competence to the specific competence of Shari’a law, and from a proficiency perspective; specifically, an examination is carried out on financial Derivatives as a case study, and specifically against Forwards, Futures, Options and Swaps. Derivatives offer risk management and price discovery solutions, however they are not without their risks and dangers. Being Aleatory contracts, conventional Derivatives provide a false sense of security; firstly heavy expenses are incurred in fear of covering an event that may not take place and which is a risk in itself. Secondly, they do not provide investors guarantee they will receive insurance payments. Given the principle of Freedom of Contract, not all Derivatives are problematic in the eyes of Shari’a law as a matter of principle, however only the ones that include prohibited subject matter and / or structuring that may potentially lead to unjust or unfair transactional outcome. In the case they are prohibited, this by default would mean that they do not contain both
commercial equality on an *inter se* level, and do not promote public Maslaha on an *outre se* level. Derivatives would only be compatible with SCL in the case their contract structure and / or subject matter does not contain Riba, Gharar or Maysir, rendering them null and void.

Due to the lack of intent in actual exchange and delivery, and since the intent of purchase and delivery and expressing seriousness of commerce is an essential commercial element according to SCL based transactions, and since structuring transactions must be done with a view to eliminating unjustified increase, uncertainty and gambling, conventional Forwards and Futures, in their current forms and structures, conflict with SCL; the alternative proposed by SCL is therefore the Salam Contract, meaning “*peace*” or “*safety*, and being the equivalent of the conventional Prepaid Forward Sale.

As for the Options Derivative contract, it is used for two different purposes, being speculation and hedging. According to their current form, the only obligation arising out of an options contract is the one upon a purchasing party ordering the seller to deliver the purchased item. Options as per their current structure are not permitted by SCL, since they “do not come under any one of the Shari’a nominate contracts”, and “*since the object of the contract is neither a sum of money nor a utility or a financial right which may be waived*”. The alternative proposed by SCL is the Arboun Contract, which translates from Arabic to “Down Payment”. It is a contract that is not entered into singularly, and its subject payments are only made as down payments to an ascertained asset(s).

The final type of Derivative products is Swaps, which is an agreement for the exchange of cash flows at one point in future. Using several types of Swaps as examples to demonstrate SCL’s ability to provide alternatives, Commodity Swaps and Forex Swaps are analyzed, and provided with SCL alternatives. Following the
structure of Commodity Swaps, which is a series of executed portfolio of contracts, a solution of a similar structure using a portfolio of contracts is a portfolio of a series of individual Salam contracts. Furthermore, SCL also offers the Istisna’ contract as an alternative to Commodity Swaps, and which defined as “a contract of sale of specified items to be manufactured or constructed, with an obligation on the part of the manufacturer or builder (contractor) to deliver them to the customer upon completion”.

In terms of Forex Swap transactions, one currency is exchanged for another either on a spot basis, or on a future basis. Conventional Forex Swaps are not permitted by SCL, and since they are firstly based on conventional future contracts conflicting with Salam contracts, and secondly that there is a possible absence or lack of genuine intention of delivery according to actual practices; thirdly they do pose conflict with SCL’s “trading in currencies” rules included in the Standards. As an alternative, SCL then proposes Wa’ad Currency Swaps. The Wa’ad is a unilateral Promissory note to perform or refrain from an act or to transfer a right. A promissory note can be a replacement for a Forward contract in the case of Forex Swaps designed for hedging purposes, and constitutes a promise to enter into a Sarf (exchange) contract, being the SCL based for currency exchange.

As part of the developments of the Shari’a Commercial industry, and modeled on the Agreement, the Islamic Financial industry now enjoys more global confidence in its ability to regulate complex transactions, and via the introduction of the new (Profit Rate Swap) Mubadalatul Arbah standards; the Agreement represents a major step forward in managing cash flow risks for various Islamic Capital Market instruments, such as Sukuk. Utilizing the Wa’ad contract, the transaction is structured and modeled on Interest Rate SWAPs, however interest rates are replaced with Sukuk, since they are not permitted by SCL.
A Wa’ad contract provides flexibility to both parties, and not only to the promising party. After a documented promise has been granted by the promissor, but before the execution of the promised transaction, both parties are collectively allowed to amend the terms and conditions of the promise mutually. In Malaysia alone, a wide range of hedging products based on the Wa’ad promissory note have been put on market.

Modern day complex Derivatives can be restructured with more secure alternatives, and by understanding and utilizing contract combinations, there can be no limit to SCL financial engineering. It is a process that aims at structuring an unlimited number of commercial and financial products, or at restructuring already existing commercial and financial products. To achieve SCL based financial restructuring, rules of each contract independently within a combination of contracts must be respected, as well as the rules of the overall combination of contracts itself; the structure of contract combinations is further regulated by separate and specific principles, designed to prohibit any potential abuse of parties.

Finally, since Shari’a law contracts and Jurisprudence are able to continuously structure new financial and commercial products, as well as restructure current conventional products to more ethical and safer alternatives on a continuous basis, it is therefore reform responsive. This latter quality is affordable due to the availability of the tool of Ijtihad, being one of the most essential pillars of Shari’a law in itself. Following a rigorous process regulated by highly detailed and proficient rules and standards, it must follow a Purposive / Contextual Interpretation, and ensure that all reforms are “fit for purpose”, by including the spirit of the Maqasid and Masalih. Despite the disagreements, Ijtihad is still an ongoing valid source of law responsible for accommodating reforms, and effectively so; Shari’a law reforms were long delayed, as a result of the influence of literalism oriented political Islamist forces. For the majority of the scholars, most are of the opinion that the doors of Ijtihad had been
closed centuries ago. The controversy over the validity and authority of Ijtihad in terms of its permitted continuation is that of a political and sociological nature; it represents a classical example of a traditional clash between conservative and progressive jurists.

As proof for unofficial but continuous Ijtihad, reference is made to the Al Azhar fatwa regarding the question of whether interest rates as part of investment certificates were permissible, and whether it amounted to Riba. Defying the common understanding of interest rates in commercial and financial transactions constituting Riba, and deciding that it did not, the Fatwa presented a purposive / contextual case analysis demonstrating a classical case of what truly constitutes Ijtihad. Furthermore, it demonstrates that the process of Ijtihad is continuous, being an essential pillar of Shari’a law and SCL. On a final note regarding whether Ijtihad is an ongoing source of law, the creation and continuous updating of the Standards themselves is a case of ongoing Ijtihad.

Finally, the question of why was Ijtihad not exercised to reform Shari’a law and SCL for centuries is posed, and a few possible scenarios are provided. Firstly, the thesis finds to a large degree that the delay for those long due reforms to Shari’a law, due to what we label as “Irresponsible Conservatism” and “Literalism”; it refers to reform intolerant, conservative, political Islamist forces, lacking the ability of objective “creative legal thinking”, as well referring to the literalist interpretation of Shari’a law by the majority of Islamic “scholars”. Secondly, another reason why reformist Ijtihad has not yet been openly admitted in public and officially implemented is due to the exaggeration of what is known as Sadd al Dhari’a, literally meaning “blocking evil” or “closing off the means that can lead to evil”; this comes out of fear of tolerating any prohibitions and therefore leading to circumvention of Shari’a law Jurisprudence. Although an arguable contribution, Ijtihad may have been put to a halt, and in an
unobjective struggle for preserving identity. Many of the Muslim states have had their laws changed through western imperialism.
Arabic Terms Glossary

Aadaab al Mu’amalaat: Literally referring to etiquette and / or decency in dealings and conduct with others, whether in a commercial or non – commercial context.

AAOIFI: The Accounting and Auditing Organization for Islamic Financial Institutions.

Adala: Justice.

Al Ghish fil Mizan: The act of cheating in the weight balance.

Al Muslam Fihi: Goods subject matter of the contract in a Salam contract.

Al Nizam Al Asasi lil Hukm: The Basic Law of the Kingdom of Saudi Arabia.

Aqd: Contract.

Asbab al-Q Nuzul: The occasion and reason for the revelation of the Holy Quran.

Athna Asharis: Shi’a Muslims who believe in only 12 imams.

Ayat: Quranic Verses.

Ayn: Contract subject matter.

Bab al Tijara: The Chapter of Commerce in Shari’a Commercial law.

Bay’atan fi bay’atin: Two sales in one.

Da’wa: The propagation of Islam.

Dalil: Referring to Evidence.

Dar’ al Mafasid: Repelling harm, evil, abuse.

Darar: Damage.
Dar’ al Mafasid: Repelling harm, evil, abuse.

Darul Qudah: A Muslim judicial tribunal.

Fath al- Dhari’a: Attracting harm.

Fatwa: An Islamic legal opinion.

Fiqh: Referring to jurisprudence.

Fiqh al Ibadat: Jurisprudence covering matters related to worship.

Fiqh al Mu’amalaat: Jurisprudence covering dealings and transactions, both in a commercial and non-commercial context, including but not limited to legislation, marriage and inheritance. It does not cover worship.

Furuk: Meaning differences.

Gharar: Literarily meaning Danger, and referring to trickery and excessive risk taking.

Habl al-habalah: the unborn offspring of a fetus.

Hadith: The sayings of the Prophet Muhammad.

Halal: An Islamic term referring to permissible.

Hamish Al Jiddiyah: Margin of Seriousness.

Haram: Not permissible, and the opposite of Halal.

Hikma: Wisdom, sapience.

Hukm: Ruling, judgment, verdict, decision regarding a matter.

Husn: Beauty and suitability.

Ibaha: Permissibility.
**Ijara:** Literally meaning rental, and referring to Rental agreements in a Shari’ah law context.

**Ijtihad:** Literally referring to Endeavour, and referring to the exertion of mental energy in the search of a legal opinion, and to the extent where jurists are no longer capable of exerting any mental effort to reach that legal opinion.

**Imam:** An Islamic temporal and spiritual leader.

**Ismaili:** Shi’a Muslims who believe in only 7 imams.

**Isnaad:** Literally meaning justification. In the context of Shari’ah law, it refers to something reported by a trusted, verified and credible source.

**Jahl:** Ignorance.

**Khatar:** Danger.

**Lex Mercatoria:** Law Merchant.

**Masalih:** The plural of the term Maslaha, and literally referring to interest.

**Masalih Aama:** Public interest.

**Masalih Khasa:** Private interest.

**Masalih Maliyya:** Financial Masalih.

**Masnoo:** Manufactured.

**Ma’sum:** An infallible one.

**Maqasid al Shari‘a:** Literally referring to Intentions. In the context of Shari’ah law, it refers to the logic and rational behind all laws and rules.

**Maysir:** Gambling.
Miqdar: Quantity, measure amount.

Muata’ah: Prior agreement.

Mubadalatul Arbaah: Profit Rate Swaps agreements.

Mufid: Beneficial.

Mujtahid: Literally meaning a diligent, thorough and hard working person. In the specific context of the thesis refers to a person qualified to conduct Ijtihad.

Murabaha: Cost-plus sale.

Musawamah: A general and regular kind of sale in which the price of a good to be traded is bargained between the seller and the buyer, and with no reference to the cost incurred by the seller.

Qard: Referring to Loan.

Qimar: Gambling.

Qubh: Ugliness and unsuitability.

Riba: Usury.

Sadaqah: Charity.

Salah: Well-being and righteousness.

Sarf: Exchange.

Shari’a Commercial law: A specific branch of Shari’a law that focuses on and regulates commercial transactions.

Sukuk: The plural of Sak and referring to Islamic bonds.
Sunna: Provides the details and detailed practice of the Holy Quran, which provides a general Shari’a law framework, as well as the Prophet Muhammad’s Hadiths.

Taghreer: Danger.

Taqlid: Referring to Imitation of others.

Usul: Being the plural of Asl, it is a term that literally refers to the origins or roots of a matter or an object. In legal terms, it refers to the rules governing a specific matter(s).

Wa’ad: Literarily meaning a promise, and referring to a Promissory Note in a legal context.

Zakat: The Islamic Alms tax. It is a tax paid by Muslims over their income, given to other Muslims in need.

Zaydis: Shi’a Muslims who believe in only 5 imams.
Appendix

Al Azhar Fatwa

(استثمار الأموال في البنوك التي تحدد الربح مقدما)

أرسل الأستاذ الدكتور / حسن عباس زكي رئيس مجلس إدارة بنك الشركة المصرية للبنك العربي الدولي كتاباً بتاريخ 22/6/2003 إلى فضيلة الإمام الأكبر الدكتور / محمد سيد طنطاوي شيخ الأزهر وهذا نصه:

حضرت صاحب الفضيلة الدكتور / محمد سيد طنطاوي

شيخ الجامع الأزهر

سلام عليكم ورحمة الله وبركاته:

فإن عملاء بنك الشركة المصرية للبنك العربي الدولي يقدمون أموالهم ومدخراتهم للبنك الذي يستثمرها ويستثمرها في عملاياته المشروعة مقابل ربح يصرف لهم ويحدد مقدماً في مدة يتفق مع العملاء عليها.

وتوجه الأفادة عن الحكم الشرعي لهذه العمالة.

رئيس مجلس الإدارة

توقيع:

(دكتور / حسن عباس زكي)

وقد أرافق سماحته مع الخطاب نموذجاً لمستند التعامل الذي يتم بين المستثمر والبنك - ونص هذا النموذج كالآتي:
وقد أحلت فضيلة الإمام الأكبر الكتاب ومرفقه للعرض على مجلس جميع
البحوث الإسلامية في جلسته القادمة.
وعقد المجلس جلسته في يوم الخميس 31 من أكتوبر سنة 1443
 الموافق 2022 وعرض عليه الموضوع المذكور.
وبعد مناقشات الأعضاء ودراستهم قرر المجلس: الموافقة على أن
استثمار الأموال في البنوك التي تحدد الربح مقدما خلال شرعا ولا يس
به.
ولما لهذا الموضوع من أهمية خاصة لدى المواطنين الذين يريدون
معرفة الحكم الشرعي في استثمار أموالهم لدى البنوك التي تحدد الربح

(37)
بسم الله الرحمن الرحيم

فقد كثرت استفساراتهم عن ذلك فقد رأت الأمانة العامة لمجمع
البحوث الإسلامية أن تعد الفتوى بالأدلة الشرعية وخلاصة أقوال أعضاء
المجمع حتى تقدم للمواطنين صورة واضحة كاملة تتعلق إليها نفسها

وقد قامت الأمانة بعرض نص الفتوى بصيغتها الكاملة على مجلس
مجمع البحوث الإسلامية في جلسته المنعقدة في يوم الخميس 23 من
رمضان 1421 ه الموافق 4-11-2000م وبعد قراءتها
ومداخلات الأعضاء في صياغتها تمت موافقتهم عليها

وهذا نص الفتوى

الذين يتعاملون مع بنك الشركة المصرفية العربية الدولية - أو مع غيره
من البنوك - ويقومون بتقديم مالهم ومدخراتهم إلى البنك ليكون وفولا
عنهم في استثمارها في مشاريعهم المشروعة، مقابل ربح يصرف لهم

ويمكنهم في مدى يتفق مع المتعاملين معهم عليها

هذه المعاملة بنفس الصورة حالولاً شبهها فيها لأنه لم يرد نص في
كتاب الله أو من السنة النبوية يمنع هذه المعاملة التي يتم فيها تحديد
الربح أو العائد مقدماً، ما دام الطرفان يرضيان هذا النوع من المعاملة.

قال الله تعالى: "يا أيها الذين آمنوا لا تأكلوا أموالكم بينكم بالباطل
لا أن تكون تجارة عن تراض منكم..." (سورة النصراء: الآية 29)
بسم الله الرحمن الرحيم

أي يا من أمتتم بالله حق الإيمان لا بحل لكم ولا بليغ بكم أن أكل بعضكم مال غيره بالطرق الباطلة التي جرهم الله تعالى كما سرقة أو الغصب أو الربا أو غير ذلك مما حرمه الله تعالى. لكن يباح لكم أن تتبادلوا المنافع فيما بينكم عن طريق المعاملات الناشئة عن التراضي الذي لا يحل حراما ولا يحرم حالا سواء أكان هذا التراضي فيما بينكم عن طريق التنظيم أم الكتابة أم الإشارة أم غير ذلك مما يدل على الموافقة والقبول بين الطرفين.

ومما لا شك فيه أن تراضي الطرفين على تحديد الربح مقدما من الأمور المقبولة شرعا وعلاوة حتى يعرف كل طرف حقه.

ومن المعروف أن البنوك عندما تحدد للمتعاملين معها هذه الأرباح أو العوائد مقدما إما تحتددها بعد دراسة دقيقة لأحوال الأسواق العالمية ومحلية والأوضاع الاقتصادية في المجتمع، ولظروف كل معاملة ولنوعها والمتوسط أرباحها.

ومن المعروف كذلك أن هذا التحديد قابل للزيادة والتقلص، بدلاً أن شهادات الاستثمار بدأت بتحديد العائد 4% ثم ارتفع هذا العائد إلى أكثر من 10% ثم انخفض الآن إلى ما يقرب من 10%.

والذي يقوم بهذا التحديد القابل للزيادة أو التقلص، هو المسؤول عن هذا الشأن طبقاً للتعليمات التي تصدرها الجهة المختصة في الدولة. ومن فرائد هذا التحديد لا سيما في ظلها هذا الذي كثر فيها الإحراق عن الحق والصدق. أن في هذا التحديد منفعة لصاحب المال ومنفعة أيضاً للقارئين على إدارة هذه البنوك المستثمرة للأموال.

(4)
فهي منفعة لصاحب المال، لأنه يعرف حقه معرفة خالية عن الجهلة، ويغتتسي هذه المعرفة ينظم حياته. وفيه منفعة للقائمين على إدارة هذا البنوك، لأن هذا التحديد يجعلهم يجتهدون في عملهم وفي نشاطهم حتى يحققوا ما يزيد على الربح الذي حددهه لصاحب المال، وحتى يكون الفائض بعد صرفهم لأصحاب الأموال حقوقهم، حقا خالصا لهم في مقابل جهد ونشاطهم.

وقد يقال: إن البنوك قد تخسر فكيف تحدد هذه البنوك للمستثمرين أموالهم عندما الأرباح مقدما؟

والجواب: إذا خسرت البنوك في صفقة ما فإنها تربح في صفقات أخرى، وبذلك تغطى الأرباح الخسارة.

ومع ذلك فإنه في حالة حدوث خسارة فإن الأمر مرده إلى القضاء والخلاصة أن تحديد الربح مقدما لذين يستمرون أموالهم عن طريق الوكالة الاستثمارية في البنوك أو غيروا حلال ولا شبيه في هذه المعاملة فهي من قبل المصالح المرسلة وليس من العقائد أو العبادات التي لا يجوز التغيير أو التبديل فيها.

وبناه على ما سبق فإن استثمار الأموال لدى البنوك التي تحدد الربح أو العائد مقدما حلال شرعا ولا يأس به، والله أعلم.
AUTHOR'S TRANSLATION

Office of the Grand Imam, Rector of Al-Azhar
Investing Funds with Banks that Pre-specify Profits

Dr. Hasan Abbas Zaki, Chairman of the Board of Directors of the Arab Banking Corporation, sent a letter dated 22/10/2002 to H.E. the Grand Imam Dr. Muhammad Sayyid Tantawi, Rector of Al-Azhar. Its text follows:

H.E. Dr. Muhammad Sayyid Tantawi, Rector of Al-Azhar:
Greetings and prayers for peace, mercy, and blessings of Allah,

Customers of the International Arab Banking Corporation forward their funds and savings to the bank to use and invest them in its permissible dealings, in exchange for profit distributions that are pre-determined, and the distribution times are likewise agreed-upon with the customer. We respectfully ask you for the [Islamic] legal status of this dealing.

[Signature]

He has also attached a sample documentation of the dealing between an investor and the bank. The sample reads as follows:

<table>
<thead>
<tr>
<th>The International Arab Banking Corp. Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date / / 2000 A.D.</td>
</tr>
<tr>
<td>Mr/________ Account number _________</td>
</tr>
<tr>
<td>Kind Greetings</td>
</tr>
</tbody>
</table>

This is to inform you that your account with us, in the amount of L.E. 100,000 (only one hundred thousand Egyptian Pounds) has been renewed. For the period 1/1/2002 until 31/12/2002 A.D.

Rate of return 10% resulting in a return of
L.E. 10,000
Total of deposit + return on distribution date
L.E. 110,000

New amount, including return as of 31/12/2002
L.E. 110,000
His Excellency, the Grand Imam, has forwarded the letter and its attachment for consideration by the Council of the Islamic Research Institute in its subsequent session. The Council met on Thursday, 25 Sha’ban, 1423 A.H., corresponding to October 31, 2002 A.D., at which time the above mentioned subject was presented. After the members’ discussions and analysis, the Council determined that investing funds in banks that pre-specify profits is permissible under Islamic law, and there is no harm therein. Due to the special importance of this topic for the public, who wish to know the Islamic legal ruling regarding investing their funds with banks that pre-specify profits (as shown by their numerous questions in this matter), the Secretariat General of the Islamic Research Institute decided to prepare an official fatwa, supported by the Islamic legal proofs and a summary of the Institute members’ statements. This should give the public a clear understanding of the issue, thus giving them confidence in the opinion.

The General Secretariat presented the full fatwa text to the Islamic Research Institute Council during its session on Thursday, 23 Ramadan 1423, corresponding to November 28, 2002 A.D. Following the reading of the fatwa, and noting members’ comments on its text, they approved it.

**Text of the Fatwa**

Those who deal with the International Arab Banking Corporation Bank – or any other bank – forward their funds and savings to the bank as an agent who invests the funds on their behalf in its permissible dealings, in exchange for a profit distribution that is pre-determined, and at distribution times that are mutually agreed-upon . . .

This dealing, in this form, is permissible, without any doubt of impermissibility. This follows from the fact that no canonical text in the Book of Allah or the prophetic Sunnah forbids this type of transaction within which profits or returns are pre-specified, as long as the transaction is concluded with mutual consent.

Allah, transcendent is He, said: “Oh people of faith, do not devour your properties among yourselves unjustly, the exception being trade conducted by mutual consent . . .” (Al-Nisā: 29)

The verse means: Oh people with true faith, it is not permissible
for you, and unseemly, that any of you devour the wealth of another in impermissible ways (e.g., theft, usurpation, or usury, and other forbidden means). In contrast, you are permitted to exchange benefits through dealings conducted by mutual consent, provided that no forbidden transaction is thus made permissible or vice versa. This applies regardless of whether the mutual consent is established verbally, in written form, or in any other form that indicates mutual agreement and acceptance. There is no doubt that mutual agreement on pre-specified profits is legally and logically permissible, so that each party will know his rights.

It is well known that banks only pre-specify profits or returns based on precise studies of international and domestic markets, and economic conditions in the society. In addition, returns are customized for each specific transaction type, given its average profitability.

Moreover, it is well known that pre-specified profits vary from one time period to another. For instance, investment certificates initially specified a return of 4%, which increased subsequently to more than 15% and is now returning to near 10%.

The parties that specify those changing rates of returns are required to obey the regulations issued by the relevant government agencies.

This pre-specification of profits is beneficial, especially in this age, when deviations from truth and fair dealing have become rampant. Thus, pre-specification of profits provides benefits both to the providers of funds, as well as to the banks that invest those funds.

It is beneficial to the provider of funds since it allows him to know his rights without any uncertainty. Thus, he may arrange the affairs of his life accordingly.

It is also beneficial to those who manage those banks, since the pre-specification of profits gives them the incentive for working hard, since they keep all excess profits above what they promised the provider of funds. This excess profit compensation is justified by their hard work.

It may be said that banks may lose, thus wondering how they can pre-specify profits for the investors.

In reply, we say that if banks lose on one transaction, they win on many others, thus profits can cover losses.
In addition, if losses are indeed incurred, the dispute will have to be resolved in court.

In summary, pre-specification of profits to those who forward their funds to banks and similar institutions through an investment agency is legally permissible. There is no doubt regarding the Islamic legality of this transaction, since it belongs to the general area judged according to benefits, i.e., wherein there are no explicit texts. In addition, this type of transaction does not belong to the areas of creed and ritual acts of worship, wherein changes and other innovations are not permitted.

Based on the preceding, investing funds with banks that pre-specify profits or returns is Islamically legal, and there is no harm therein, and Allah knows best,

[signed]
Rector of Al-Azhar
Dr. Muhammad Sayyid Tantawi
27 Ramadan 1423 A.H.
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